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**COMMISSION STAFF WORKING DOCUMENT**

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**FIRST REPORT TO THE EUROPEAN SECURITIES COMMITTEE AND TO THE  
EUROPEAN PARLIAMENT**

**on convergence between International Financial Reporting Standards (IFRS) and third  
country national Generally Accepted Accounting Principles (GAAPs)**

{COM(2007) 405 final}

**SIGNIFICANT ISSUES ACCORDING TO CESR ADVICE**

Theme	Issues according to CESR advice (June 2005)	FASB		IASB	
		Current status as of 12/06 on FASB agenda	Prospects 2007/2008	Current status as of 12/06 on IASB agenda	Prospects 2007/2008
Share-based payments (IFRS 2)	N/A anymore with the application of FAS 123R				
Business Combination (IFRS 3)	<p><b>Acquisition date</b> - Under US GAAP, the acquisition date is ordinarily the date on which consideration passes and the acquired (net) assets are received. That is, the date on which the transaction closes. However, if the parties agree in writing that effective control passes to the acquirer at an earlier date then that earlier date is the acquisition date. Under IFRS3 the acquisition date is the date on which the acquirer effectively obtains control of the acquiree. Under US GAAP shares issued as consideration are measured at their market price over a reasonable period of time (a few days) before and after the parties reach an agreement on the purchase price and the transaction is announced. Under IFRS 3 shares issued as consideration are measured at their fair value on the date of the exchange transaction.</p> <p><b>In process R&amp;D</b> - In process R&amp;D is capitalised under IFRS but usually expensed under US GAAP</p> <p><b>Negative Goodwill</b> - Under IFRS 3 negative goodwill is recognized immediately as a gain. Under US GAAP it is initially allocated on a pro rata basis against the carrying amounts of certain acquired non-financial assets, with any excess recognized as an extraordinary gain.</p> <p><b>Minority interest</b> - Minority interest under IFRS is measured at fair value but under US GAAP it is at historical cost.</p> <p><b>Step acquisitions</b> - Step acquisitions under IFRS 3 require revaluation of previous interests at fair value at each acquisition date. Under US GAAP previous interests are not revalued, resulting in an accumulation of fair values at different dates</p> <p><b>Contingent consideration</b> - Under US GAAP, contingent consideration is part of the purchase price when additional consideration is issued or becomes issuable whereas under IFRS 3 it is part of the purchase price at the date of acquisition if payment is probable and can be measured reliably.</p>	On agenda – deliberations in process	A final document should be issued in the second quarter of 2007.	On agenda – deliberations in process	An IFRS should be issued in the third quarter of 2007.

Property, plant & equipment (IAS 16)	<b>Costs of replacing component parts</b> - Costs of replacing component parts of an asset and planned major maintenance activities may be capitalized or expensed. The deferral method which is specified under IFRS is one of four possible methods under US GAAP.	Nothing specific			
Employee benefits (IAS 19)	US GAAP and IAS 19 have the same objectives and follow the same principles. While there are differences, the fact that there are four broad options for defined benefit schemes available under IAS make it difficult to determine which version would be used as the basis for reconciliation, and against that background a reconciliation would not help investors' decisions. The key point is to have adequate disclosures to enable investors to make decisions	On agenda – deliberations underway on the first phase of multi-phase project	A final document should be issued in the first quarter of 2007.	On agenda – no publication yet	A Discussion Paper should be issued in the third quarter of 2007.
Consolidated & separate financial statements (IAS 27)	<b>Scope of Consolidation.</b> Under IAS 27 and SIC 12, the scope of consolidation is determined by reference to the principle of control defined in general terms as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities (IAS 27.4). The issue of consolidation of Special Purpose Entities (SPE) in the US is very complex, being based on principles combined with additional guidance that altogether make the third country framework close to IFRS in most cases. The status of Qualifying SPEs (QSPEs) is slightly different as being essentially addressed in connection with provisions on derecognition of assets.	On agenda – currently inactive	None	On agenda – no publication yet	A Discussion Paper should be issued in the second quarter of 2007. An Exposure draft should be issued in the second semester of 2008.
Investments in associates (IAS 28)	No requirement to <b>conform accounting policies</b> where associate's policies are different	Nothing specific			
Impairments of assets (IAS 36)	<b>Impairment test</b> - Impairments under US GAAP are based firstly on a comparison of carrying amount to the expected future cash flows to be derived from an asset (or asset group) on an undiscounted basis. If the carrying amount is lower the asset (or asset group) is not impaired, if higher then impairment is measured by comparing the carrying amount to the fair value of the asset (or asset group).	"Impairment" is a topic for short term convergence according to the Roadmap but is not on the agenda of IASB or FASB			
	<b>Subsequent reversal of an impairment loss</b> is prohibited under US GAAP				
Provisions (IAS 37)	Measurement of <b>decommissioning provisions</b> – discount rates are not adjusted under US GAAP	Nothing specific		On the Agenda (ED was issued in June 2005) but the project is not part of the MoU.	An IFRS should be issued in the first semester of 2008.

Intangibles Assets (IAS 38)	<b>Capitalisation of development costs.</b> Development costs and purchased IPR&D are expensed under US GAAP (with some exceptions)	This potential short-term convergence project is currently in the staff research phase.	N/C	On research agenda (led by a national standard-setter)	An Agenda Decisions should be made in the fourth quarter of 2007.
Financial instruments (IAS 39)	Key differences that could affect investors decisions are: <ul style="list-style-type: none"> <li>• Derecognition of securitizations</li> <li>• Split accounting on convertible bonds</li> <li>• Reversal of impairments on debt securities</li> </ul>	At joint meetings held in April 2005 and October 2005, the FASB and the IASB agreed to long-term objectives to improve, simplify, and converge financial reporting requirements for financial instruments. The Boards are addressing some of those impediments in various active projects: <b>Fair Value Measurement, Fair Value Option</b> and <b>Financial Instruments: Liabilities and Equity</b> . These projects are described in the next table.			
Investment Property (IAS 40)	US GAAP does not permit property to be measured at <b>fair value</b> . A cost based method of accounting is generally required	To be considered by the FASB as part of the fair value option project	See Fair value option project		
Agriculture (IAS 41)	Differences in fair value of specific agriculture items	Nothing specific			

**OTHER ISSUES WHICH WERE NOT SIGNIFICANT OR NOT IDENTIFIED IN CESR ADVICE BUT ON WHICH THERE IS A CONVERGENCE PROJECT**

Theme	Issues according to CESR advice (June 2005)	FASB		IASB	
		Current status as of 12/06 on FASB agenda	Prospects 2007/2008	Current status as of 12/06 on IASB agenda	Prospects 2007/2008
Subsequent events (IAS 10)	Not in the advice	To be examined	The Board expects to begin deliberation of issues in this project in late 2006 or early 2007.	Nothing specific	
Income tax (IAS 12)	Not significant - Various differences in detail exist between US GAAP and IFRS. Nevertheless, basics and objectives of the standards are the same in both standards.	On the agenda - no publication yet	The Board plans to issue an Exposure Draft for public comment in the second quarter of 2007.	To be examined (jointly with the FSAB)	An ED should be issued in the second quarter of 2007. An IFRS should be issued in the second semester of 2008.
Segment reporting (IAS 14)	Not significant	Nothing specific yet		IFRS 8 was issued in Nov 2006 with an application on 1 Jan 2009.	N/A
Leases (IAS 17)	Not significant - IAS 17 and US GAAP have the same objective – to require leases that effectively transfer ownership of assets (usually called finance leases) to be capitalised. Differences of detail, between the standards may give rise to different treatment of the same leases under the two GAAPs, but a reasonably knowledgeable investor could be expected to understand that the lease terms will be different if the standards changed.	A joint international working group was formed in 2006 and will provide input on the issues to be considered in a lease project.	The Board will begin deliberations of those issues in 2007; those deliberations will result in issuing for public comment a discussion paper that explores lease accounting issues and describes the preliminary views of both Boards. That discussion paper is expected to be published in 2008.	On the agenda since July 2006 - no publication yet	A working group meeting held in Feb 2007. A Discussion Paper should be issued in the second semester of 2008.
Revenue recognition (IAS 18)	Not significant - General principles are consistent between the two GAAPs, but there are some differences of detail. Unlikely to affect investors' decision making as long as there is full disclosure of accounting policies and sufficient information provided under US GAAP for investor making decisions.	On agenda – no publication yet	The Board's goal is to issue a Preliminary Views by the end of 2007 covering both concepts- and standards-level revenue recognition guidance.	On agenda – no publication yet	A Discussion Paper should be issued in the fourth quarter of 2007.
Government grants (IAS 20)	Not significant	Nothing specific yet		On agenda – no publication yet	Timing yet to be determined - pending work on other projects

Borrowing costs (IAS 23)	Not significant	Nothing specific yet		On agenda – an ED was issued in May 2006.	An IFRS should be issued in the first quarter of 2007.
Earnings per share (IAS 23)	No significant differences	On agenda – The Board commenced redeliberations and noted that it and the IASB reached different conclusions on the earnings per share treatment of options, warrants, and their equivalents classified as equity, mandatorily convertible instruments, and convertible debt. The Board directed the staff to further analyze those differences for discussion at a future meeting.	An Exposure Draft should be issued in the second quarter of 2007.	On agenda – no publication yet	An Exposure Draft should be issued in the first quarter of 2007. An IFRS should be issued by the end of 2007.
Joint-ventures	No significant differences	Nothing specific yet		On the agenda - no publication yet	An Exposure Draft should be issued in the second quarter of 2007. An IFRS should be issued in the first half of 2008.
Fair Value measurement guidance	Refer to IAS 39 in the previous table	Statement 157 was issued in Sept 06	N/A	On agenda – Discussion Paper was issued in Nov 2006	A roundtable is going to take place in the second quarter of 2007. An ED should be issued in the second semester of 2008.
Fair Value Option		On agenda – On January 25, 2006, the Board issued an FASB Exposure Draft, The Fair Value Option for Financial Assets and Financial Liabilities, for Phase 1.	The Board will continue its discussions on disclosure requirements at a Board meeting in January 2007. A Statement for Phase 1 will be issued in the first quarter of 2007. The Board's activity on Phase 2 will begin after a final Statement has been issued for Phase 1.	On the agenda - no publication yet	N/C
Financial Instruments: Liabilities and Equity		On the agenda - no publication yet	The Preliminary Views are expected to be issued in the second quarter of 2007.	On agenda – deliberations in process	A Discussion Paper should be issued in the second quarter of 2007.
Financial Statements Presentation	Nothing specific	On agenda – no publication yet	The FASB decided that it would not publish a separate Exposure Draft on Phase A of the project. Rather, it will expose its Phase A decisions along with its Phase B decisions. The initial output for Phase B is an initial discussion document (similar to a Preliminary Views or a Discussion Paper) that is expected to be published in the third quarter of 2007.	Exposure draft on phase A	On the first phase, an IFRS should be issued in the second quarter of 2007. On the second phase, a Discussion Paper should be issued in the second quarter of 2007 and an Exposure Draft should be issued in the second semester of 2008.

## ANNEX 2

Issues advised by CESR concerning the equivalence assessment on Japanese Accounting Standards and the ASBJ's approach to those issues

Remedies	No.	Issues	Current status and policy	Prospects at the beginning of 2008
Supplementary statement	1	Business combinations (pooling-of-interest method)	The ASBJ will ascertain the feedback from markets on the accounting standards put into effect from 2006. To this end, a project team will be established by the end of 2006 in order to conduct market research in 2007.  The application of the pooling-of-interest method is very limited only to business combinations where it is impossible to identify an acquiring party.	Deliberations will be made considering the results of market research, feedback from markets after the implementation of IFRS, and the progress in discussions between the IASB and the FASB. A discussion paper will be released as necessary.
	2	Scope of consolidation (qualified special purpose entities)	A technical committee was established for this issue. The committee has picked up the issue of the disclosure of SPE as the first agenda to be discussed and deliberations thereon have been initiated. Further study will be done considering the progress in discussions between the IASB and the FASB in 2007.	As for deliberations of the disclosure, its guidance will be released by March 2007. As for deliberations of the scope of consolidation, a discussion paper will be released taking into consideration the progress in discussions between the IASB and the FASB by the end of 2007.

Remedies	No.	Issues	Current status and policy	Prospects at the beginning of 2008
	3	Uniformity of accounting policies concerning overseas subsidiaries	With the release of Practical Issues Task Force (PITF) (May 2006), accounting policies applicable to foreign subsidiaries will be unified substantially with those applicable to parent companies. (Furthermore, consolidation of financial statements using IFRS or U.S. GAAP is now permitted here subject to certain adjustments.)	PITF will be applied from April 2008 (earlier application encouraged).
<b>Disclosure B</b>	4	Share-based payments (expense recognition)	Accounting standards and guidance were released (December 2005). Requisite disclosure is also defined therein. (See No.13, "Share-based payments - explanatory notes")	Accounting standards and guidance have been implemented since.
	5	Business combinations (date of exchange)	Deliberations will be conducted considering the progress in discussions between the IASB and the FASB also in conjunction with the deliberations of No. 1, "Business combinations (pooling-of-interest method)."	(See No. 1, "Business combinations, pooling-of-interest method")
	6	Business combinations (capitalization of acquired R&D in process)	Deliberations will be conducted by the Intangible Assets Working Group. (See No. 11, "Capitalization of development costs")	(See No. 11, "Capitalization of development costs")
	7	Business combinations (negative goodwill)	Information required to be disclosed as Disclosure B (amounts, causes of occurrence, methods of amortization and amortization periods) are already required under the new accounting standards put into effect from 2006.	Accounting standards and guidance are currently effective.



Remedies	No.	Issues	Current status and policy	Prospects at the beginning of 2008
	8	Inventories (LIFO)	A project team is to be established in 2007 to initiate deliberations. Only a few companies have adopted the LIFO method. Also, this is an issue for which the application of remedies can be avoided by the choice of accounting policies at each entity level.	A decision will be made on the course of action.
		Inventories (lower of cost or market method)	Accounting standards were released (July 2006) stipulating book value should be adjusted downward where any deterioration of earning power thereof exists.	Accounting standards will be applied from April 2008 (earlier application encouraged).
	9	Uniformity of accounting policies of associates	A project team will be established in 2007 to initiate deliberations. Also to include such issues that may arise from the introduction of IFRS in fiscal 2005 in the project team deliberations, it is considered that this issue may be brought up for redeliberation in the course of discussions with the IASB and/or with the FASB. (Under current Japanese accounting standards, uniformity of accounting policies applied to investing companies and their affiliates are considered to be desirable as a general rule, but such uniformity is not forced from practical considerations.)	Based on the deliberations by the project team, an exposure draft will be released as necessary.

Remedies	No.	Issues	Current status and policy	Prospects at the beginning of 2008
	10	Impairment tests	The ASBJ will assess feedback from market on the impairment standards effective from 2005. To this end, a project team will be established in 2007 to conduct market research. Deliberations will be made reflecting the progress in discussions between the IASB and the FASB (short-term convergence project).	A decision will be made regarding the course of action to be taken, based on the results of market research and considering the progress in discussions between the IASB and the FASB. If IFRS are converged to U.S. GAAP, differences between Japanese accounting standards and IFRS will then be eliminated.
	11	Capitalization of development costs	A working group was established to initiate deliberations. Deliberations will be made taking into consideration the progress in discussions with the IASB and the FASB (short-term convergence project).	Discussion papers will be released by the end of 2007 based on the results of market research and taking into consideration the progress in discussions between the IASB and the FASB. If IFRS are converged to U.S. GAAP, differences between Japanese standards and IFRS will then be eliminated.
	12	Agriculture	Very few numbers of publicly listed companies are engaged in agricultural businesses.	—
<u>Disclosure</u> A	13	Share-based payments (explanatory notes)	(See No. 4, "Share-based payments - expense recognition")	(See No. 4, "Share-based payments, expense recognition")

Remedies	No.	Issues	Current status and policy	Prospects at the beginning of 2008
	14	Business combination (minority interests at historical cost)	Deliberations will be made taking into consideration the progress in discussions between the IASB and the FASB in conjunction with No. 1, "Business combinations "Business combinations (pooling-of-interest method)."	(See No. 1, "Business combinations, pooling-of-interest method")
	15	Business combinations (step acquisitions)	Deliberations will be made considering the progress in discussions between the IASB and the FASB in conjunction with No. 1, "Business combinations (pooling-of-interest method)."	(See No. 1, "Business combinations, pooling-of-interest method")
	16	Insurance contracts (catastrophic provisions)	The industry targeted for application is limited to the insurance industry and in the IASB currently the phase II discussion has been conducted.	—
	17	Construction contracts (percentage-of-completion method)	This issue was chosen as the agenda for a short-term joint project with the IASB, and a working group was established to initiate deliberations.	Accounting Standards and guidance will be released by the end of the year 2007.
	18	Non-performing loans	The development of specific measures against this issue is not considered to be necessary because the group of financial institutions already have certain established disclosure rules.	—
	19	Scrapping costs	(Deliberations will be conducted in conjunction with No. 24, "Asset retirement obligations")	(See No. 24, "Asset retirement obligations")

Remedies	No.	Issues	Current status and policy	Prospects at the beginning of 2008
	20	Pensions, Post Retirement Benefits (including the discount rate to be used for calculating retirement benefits obligations)	This issue was chosen as the agenda for the longer-term joint project with the IASB, and a working group will be established in 2007 to initiate deliberations and to convey opinions and comments to the IASB and the FASB.	A decision will be made on the course of action to be taken, based on considering the progress in discussions between the IASB and the FASB.
	21	Business combinations (translation of goodwill)	Deliberations are to be conducted in conjunction with No. 1, "Business combinations (pooling-of-interest method)".	(See No. 1, "Business combinations, pooling-of-interest method")
	22	Disclosure of financial instruments at fair value	This issue was chosen as the agenda for a short-term joint project with the IASB, and a working group was established to initiate deliberations.	Accounting standards and guidance will be issued by the end of the year 2007.
	23	Reversal of impairment loss	Deliberations will be conducted in conjunction with No. 10, "Impairment tests".	(See No. 10, "Impairment tests")
	24	Asset retirement obligations	Working Group was established on this issue which was added to topics for the convergence project with the IASB.	Accounting standards and guidance will be issued by the end of 2007.

Remedies	No.	Issues	Current status and policy	Prospects at the beginning of 2008
	25	Investment property	This is the agenda for the short-term joint project with the IASB. The ASBJ will continue to provide its own comments to the IASB. Deliberations will be made taking into consideration the progress in discussions between the IASB and the FASB (short-term convergence project).	A decision will be reached on the course of action taking into consideration the progress in discussions between the IASB and the FASB. If IFRS are converged to U.S. GAAP, differences between Japanese standards and IFRS will then be eliminated.
Future agenda	26	Financial instruments	Because of the complexity of pertinent Japanese standards, the position of the CESR is to continue reviewing its technical assessments. Therefore no particular actions are scheduled at this stage. Deliberations will be made taking into consideration the progress in discussions between the IASB and the FASB.	—

(Note 1) The ASBJ puts the above "No." for convenience.

(Note 2) Headings in the column "Remedies" means as follows.

Supplementary statement : Pro-forma statements including a limited restatement for taking account of one identified aspects of IFRS requirement that is not present of not fully applied under Japanese GAAP

Disclosure B : Quantitative indication of the impact of an event or transaction under IAS/IFRS provisions (The gross and net of tax effect of the difference on the profit and loss or on the shareholders' equity)

Disclosure A : Additional narrative and/or quantitative disclosures augmenting the disclosures already provided pursuant to Japanese GAAP

Future Agenda : To be reconsidered later

**ANNEX 3:  
Implementation Plan for Incorporating IFRSs into Canadian GAAP  
Calendar of Implementation Goals (As of June 30, 2006)**

- 2006**
- Expose definition of publicly accountable enterprises
  - Initial meetings with Canadian Securities Administrators to initiate dialogue about disclosure requirements for transition to IFRSs
  - Initial discussions with the SEC to determine if it will consider an exemption for comparative year financial information, similar to that provided for countries adopting IFRSs in 2005
  - Determine policy for what, if any, modifications can be made to an IFRS on adoption into Canadian GAAP
  - Consider treatment of Canadian standards that will have no IFRS equivalent at the changeover

**Standards anticipated to be adopted**

Accounting Changes\* (effective January 1, 2007)

Earnings per Share\* (effective 2007)

Financial Instruments — Disclosures\* (effective October 1, 2007)

\* Standards anticipated to be adopted in substantially the same wording as IFRS counterpart

**2007**

- Define criteria for assessment during Progress Review
- Expose disclosures required prior to adoption
- Determine basis for exposing existing IFRS for adoption into Canadian GAAP

**Standards anticipated to be adopted**

Business Combinations\* (effective January 1, 2009)

Going Concern\*

Income Taxes\* (effective 2008)

Inventories\* (effective July 1, 2007)

Joint Ventures\*

Liabilities and Equity\*

\* Standards anticipated to be adopted in substantially the same wording as IFRS counterpart

**2008**

- Complete progress review
- Announce changeover timing
- Finalize disclosures required prior to adoption
- Issue omnibus exposure draft of existing IFRSs

**Standards anticipated to be adopted**

Consolidations\*  
Government Grants\*  
Internally Developed Intangible Assets\*  
Fair Value Measurement\*

\* Standards anticipated to be adopted in substantially the same wording as IFRS counterpart

**2009**

- Determine rules of procedure for the exposure of IFRS after changeover

- Finalize process for translation to both official languages

**Standards anticipated to be adopted beyond 2008**

Financial Statement Presentation\*  
Impairment\*  
Insurance Contracts\*  
Research and Development Costs\*  
Revenue Recognition\*

\* Standards anticipated to be adopted in substantially the same wording as IFRS counterpart

Source: Accounting Standard Board of Canada