

US GAAP vs. IFRS

The basics: Oil and gas

May 2009



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Introduction



While the convergence of US GAAP and IFRS continues to be a high priority on the agendas of both the US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB), there are still significant differences between the two GAAPs.

Understanding the similarities and differences between US GAAP and IFRS on an industry basis can be challenging because while the principles and conceptual frameworks for US GAAP and IFRS are generally similar, US GAAP has more detailed, industry-based guidance than IFRS.

In this guide, “US GAAP v. IFRS – The basics: Oil and gas,” we take a top level look at the accounting and reporting issues most relevant to reporting entities in the oil and gas industry and provide an overview, by accounting area, of where the standards are similar, where they diverge, and any current convergence projects. The following areas contain the most significant similarities and differences that are relevant to oil and gas:

- ▶ Exploration and production activities
- ▶ Risk sharing arrangements
- ▶ Join venture accounting
- ▶ Production sharing contracts or agreements
- ▶ Decommissioning liabilities
- ▶ Regulated assets
- ▶ Reserves disclosures

Following these sections, we have included similar analyses for other accounting areas that will affect oil and gas enterprises but are not specific to the industry.

No publication that compares two broad sets of accounting standards can include all differences that could arise in accounting for the myriad of potential business transactions. The existence of any differences – and their materiality to an entity’s financial statements – depends on a variety of specific factors including: the nature of the entity, the detailed transactions it enters into, its interpretation of the more general IFRS principles, its industry practices, and its accounting policy elections where US GAAP and IFRS offer a choice.

In planning a possible move to IFRS, it is important that reporting entities in the oil and gas industry monitor progress on the Boards’ convergence agenda to avoid spending time now analyzing differences that most likely will be eliminated in the near future. At present, it is not possible to know the exact extent of convergence that will exist at the time US public companies may be required to adopt the international standards. However, that should not stop preparers, users and auditors from gaining a general understanding of the similarities and key differences between US GAAP and IFRS, as well as the areas presently expected to converge. We hope you find this guide a useful tool for that purpose.

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May 2009



Exploration and production activities

Under US GAAP, companies follow either the full cost or successful efforts method of accounting for exploration and production activities. The successful efforts method is governed by FAS 19 *Financial Accounting and Reporting by Oil and Gas Producing Companies* and the full cost method is governed by SEC Regulation S-X Rule 4-10 *Financial Accounting and Reporting for Oil and Gas Producing Activities Pursuant to the Federal Securities Laws and the Energy Policy and Conservation Act of 1975* and various SEC Staff views.



IFRS 6 *Exploration and Evaluation of Mineral Resources* governs the accounting for Exploration and Evaluation (E&E) assets under IFRS. The accounting for costs incurred before the exploration for and evaluation of mineral interests and after technical feasibility and commercial viability of production are demonstrable is outside the scope of IFRS 6.

Importantly, IFRS 6 does not require an entity to look to the IFRS framework before looking to pronouncements promulgated by other standard setters and suspends the requirement in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* that accounting policies set forth by such pronouncements should not conflict with the IFRS framework. As such, IFRS 6 suggests that entities could continue to use their existing practices of accounting for E&E assets upon adoption of IFRS, provided that the requirements of paragraph 10 of IAS 8 are satisfied. However, IFRS 6 also stipulates the following:

- ▶ An entity must specify which expenditures are recognized as E&E assets and apply that accounting policy consistently
- ▶ Expenditures related to the development of mineral resources should not be recognized as E&E assets
- ▶ IAS 16 *Property, Plant and Equipment*, IAS 38 *Intangible Assets* and IAS 36 *Impairment of Assets* must be applied after the E&E phase (which may affect the choice of accounting policies during the E&E phase)

IFRS 6 requires an entity to determine an accounting policy specifying which expenditures are recognized as E&E assets and apply the policy consistently. That accounting policy should take into account the degree to which the expenditure can be associated with finding specific mineral resources. The standard requires that upon initial recognition, E&E assets should be measured at cost. It also provides a nonexhaustive list of examples of types of expenditures that may be included in cost at initial recognition:

- (a) Acquisition of rights to explore
- (b) Topographical, geological, geochemical and geophysical studies
- (c) Exploratory drilling
- (d) Sampling
- (e) Activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource

IFRS 6 allows either of two alternatives to be chosen as the accounting policy for E&E assets after initial recognition. Under the cost model, the item is carried at cost less impairment. Entities that apply the cost model should develop an accounting policy within the constraints of IFRS 6 and either (1) write off E&E costs as incurred or (2) capitalize E&E costs pending evaluation. Under the revaluation model, E&E assets are classified as intangible or tangible assets and revalued based on IAS 38 or IAS 16, respectively. That is, the deferred costs of an undeveloped mineral right may be amortized over some determinable period, subject to an impairment test each period with the amount of impairment charged to expense, or remain deferred until it is determined whether the property contains mineral reserves.

E&E assets should no longer be classified as such when the technical feasibility and commercial viability of production are demonstrable. At such time, the assets should be tested for impairment under IAS 36, reclassified and accounted for under IAS 16 or IAS 38. If a company elected an accounting policy outside of the IFRS framework for its assets in the E&E phase in accordance with IFRS 6, the policy would not be allowed to be applied to those assets outside the E&E phase (both before and after); instead IAS 16 or IAS 38 must be followed. If it is determined that no commercial reserves are present, the E&E costs capitalized should be expensed.

Similarities

Full cost method

Under US GAAP, the full cost method requires that all costs incurred in prospecting, acquiring mineral interests, exploration, appraisal, development and construction be capitalized in cost centers. The application of IFRS 6 may be comparable to the full cost method as it allows an entity to group cash generating units (CGUs) when assessing impairment, which is not allowed outside of IFRS 6. Therefore, IFRS 6 would permit accounting comparable to full cost accounting during the E&E phase.

Successful Efforts

IFRS 6 requires only relatively minor modifications to the successful efforts method under FAS 19, and the essence of the approach—that costs are capitalized pending evaluation—is consistent with IFRS 6.

Significant differences

	US GAAP – Full cost	US GAAP – Successful efforts	IFRS
Unit of account	Full cost centers (or pools) established on a country-by-country basis.	Individual mineral lease, field, concession or production sharing contract as a cost center.	No specific guidance on determining the unit of account. Current industry practice is generally similar to the successful efforts method.
Costs incurred prior to lease acquisition	Costs are capitalizable, typically at a lease or well level.	Costs are expensed as incurred.	No specific accounting standard addresses the accounting for costs prior to the E&E phase. IAS 16 and IAS 38 should be followed, and costs that are expected to provide future economic benefit are capitalized. Typically, prospecting costs are expensed as incurred.
Exploration and evaluation (E&E)	<p>Property acquisition costs, such as leasehold costs, are capitalized.</p> <p>E&E costs are initially capitalized at a lease or well level.</p> <p>Costs of drilling exploratory wells are capitalized.</p> <p>Dry holes and dry hole contributions are transferred to the full cost center (or pool) and are amortized.</p> <p>The costs of commercially viable wells are transferred to the full cost center (or pool) and amortized.</p>	<p>Property acquisition costs, such as leasehold costs, are capitalized.</p> <p>E&E costs are initially capitalized, typically at a lease or well level, with the exception of geological and geophysical (G&G) costs, which are expensed as incurred.</p> <p>Costs of drilling exploratory wells are capitalized. If no proved reserves are found, the costs are charged to expense at the time that the determination is made.</p> <p>Dry holes and dry hole contributions are charged to expense as incurred.</p> <p>The costs of commercially viable wells are transferred to wells and equipment and amortized.</p>	<p>E&E costs are capitalizable, including G&G costs, or may be expensed subject to the accounting policy elected. Property acquisition costs, such as leasehold costs, are capitalized.</p> <p>Once technical feasibility and commercial viability of production are demonstrable, E&E assets are tested for impairment and reclassified to property, plant and equipment or intangible assets.</p> <p>The treatment of exploratory wells, dry holes and dry hole contributions depends on the unit of account and how impairment is assessed.</p>
Development and production	All development costs are capitalized at the full cost center (or pool) level. All costs related to production activities, those solely to maintain or increase levels of production, are expensed as incurred.	All development costs are capitalized, typically at a field level. All costs related to production activities, those solely to maintain or increase levels of production, are expensed as incurred.	No specific accounting standard addresses the accounting for costs subsequent to the E&E phase. IAS 16 and IAS 38 should be followed and costs should be capitalized if they are expected to provide future economic benefit.
Impairment (see additional discussion in the "Impairment of long-lived assets and goodwill" section)	<p>Capitalized costs cannot exceed the full cost center ceiling, which is assessed each reporting period at the full cost center (or pool) level.</p> <p>If costs related to unproved properties are excluded from the costs to be amortized, those properties are assessed at least annually to ascertain whether impairment has occurred.</p> <p>Unevaluated properties whose costs are individually significant are assessed individually, if practicable.</p>	<p>Capitalized costs are subject to the impairment provisions of FAS 144 <i>Accounting for the Impairment or Disposal of Long-Lived Assets</i>.</p> <p>Unproved properties are assessed periodically to determine whether they have been impaired under the guidance in FAS 19.</p>	<p>Under IFRS 6, CGUs may be aggregated in evaluating E&E costs for impairment testing.</p> <p>All assets outside the E&E phase are tested at the CGU level in accordance with IAS 36.</p> <p>Impairment loss must be reversed up to the newly estimated recoverable amount (including dry holes).</p>

	US GAAP – Full cost	US GAAP – Successful efforts	IFRS
Depreciation, depletion and amortization (DD&A)	<p>Capitalized costs within a full cost center are amortized on a unit of production basis over total proved oil and gas reserves.</p> <p>The capitalized costs in the calculation include costs of future expenditures for developing proved reserves and costs related to asset retirement obligations (AROs).</p> <p>The capitalized costs exclude costs of unevaluated properties and costs incurred related to major development projects that are expected to involve significant costs to determine the quantities of proved reserves.</p>	<p>DD&A is computed on a unit of production basis either for each individual property or properties may be aggregated by common geological structure or stratigraphic condition (for example, at a field level). Proved property acquisition costs are depreciated over total proved reserves. Costs of wells and equipment are depreciated over proved developed reserves.</p> <p>The capitalized costs in the calculation include costs related to AROs.</p>	<p>Under IAS 16, each part of an item of property, plant and equipment must be depreciated separately and if a part fails it must be derecognized.</p> <p>It may be appropriate to aggregate individually insignificant items.</p> <p>A variety of depreciation methods can be used, including the units of production method.</p> <p>IFRS does not provide any guidance on the selection of an appropriate reserves base or unit of account for the application of the unit-of-production method. It is important that, whatever reserves base is chosen, the costs applicable to that category of reserves are included in the depreciable amount to achieve a proper matching of costs and production.</p>
Reserves estimates for DD&A and disclosures	<p>Rule 4-10 prescribes the use of total proved oil and gas reserves in computing DD&A and also defines proved developed and proved undeveloped oil and gas reserves for the purpose of the DD&A calculation and disclosures.</p>	<p>FAS 19 prescribes the use of total proved oil and gas reserves in the DD&A calculation for property acquisition costs and proved developed reserves in the DD&A calculation for costs of wells and equipment. Rule 4-10 defines proved developed and proved undeveloped oil and gas reserves for the purpose of the DD&A calculation and disclosures.</p>	<p>IFRS does not prescribe the method of computing DD&A nor does it define proved, probable or possible reserves for the purpose of computing DD&A or presenting disclosures.</p>

Example of capitalization of exploration and development costs (unsuccessful wells)

Under the successful efforts method of US GAAP, costs relating to drilling an exploratory or exploratory-type stratigraphic well may be capitalized pending determination of whether the well has found proved reserves. If the well has found proved reserves, the capitalized costs become part of the company's wells, equipment and facilities. If it is determined that the well has not found proved reserves, the capitalized costs of drilling the well are expensed, net of any salvage value. All costs to drill and equip development type stratigraphic test wells and service wells are development costs and may be capitalized regardless of whether the well is successful or unsuccessful.

This situation highlights where IFRS could result in different accounting treatments. Under IFRS, expensing the costs of unsuccessful development wells is permitted, but depending on the unit of account selected, these same costs could be capitalized as part of the field costs.

Convergence

The current research project on extractive activities, which has been on the IASB's agenda since 2004, is expected to result in the publication of a Discussion Paper in 2009. While this is not a convergence project, the SEC is a member of the IASB's advisory panel for the extractive activities project.

Risk sharing arrangements

Entities enter into risk sharing arrangements of mineral interests in properties for a variety of reasons, including the desire to spread risks, obtain financing, improve operating efficiency and achieve tax benefits. Risk sharing arrangements of those mineral interests may involve the transfer of all or a part of the rights and responsibilities of operating a property (operating interest). The transferor may or may not retain an interest in the oil and gas produced that is free of the responsibilities and costs of operating the property (for example, an overriding royalty interest). A transaction may, on the other hand, involve the transfer of a nonoperating interest to another party and retention of the operating interest. Certain transactions are in substance borrowings repayable in cash or its equivalent. FAS 19 and Rule 4-10 (for specific issues related to the full cost method) govern the accounting for these risk sharing arrangements, referred to as property conveyances, and other pooling of capital and exchanges of assets under US GAAP. Under IFRS, the substance of the transaction and the stage of development of the property determine which literature to follow. The guidance in IFRS 6 should be followed for transactions that are determined to occur in the E&E phase. Outside of the E&E phase, entities should look to IAS 16.



Types of risk sharing arrangements commonly seen in the oil and gas industry are described below.

- (1) Carried interests generally refer to the situation when one or more parties (the “carrying party”) agree to bear the costs of another (the “carried party”), typically in the exploration and/or development phase of a project, in the hope of recovering costs incurred from a share of future production that is given up by the carrying party.
- (2) A farm-in typically involves the transfer of part of an oil and gas interest in consideration for an agreement by the transferee to bear certain expenditures that would otherwise have to be undertaken or shared by the owner.
- (3) In a unitization, the holders of oil and gas properties in an area pool their individual interests in return for an interest in the combined venture with the intention to develop the interests as one oil and gas property rather than a collection of smaller properties.
- (4) A redetermination typically occurs following the initial unitization whereby the respective shares of the venture are adjusted some period later as better information becomes available.
- (5) Companies sometimes exchange or swap assets as part of their portfolio and risk management activities. Such exchanges may involve the full range of assets in the oil and gas industry (for example, E&E assets, unproved prospects, assets under development or producing assets).

Generally, no gain or loss related to property conveyances is recognized under US GAAP, with the exception of an asset swap. An asset swap is accounted for in accordance with APB 29 *Accounting for Nonmonetary Transactions*.

Similarities

Under both US GAAP and IFRS, transactions that are in substance financings will not result in gain recognition and will be accounted for as borrowings.

Significant differences

Under IFRS, companies must first determine if the assets involved in the transaction are in the E&E phase. If they are, IFRS 6 allows companies to elect an accounting policy that does not have to be consistent with the IFRS framework. Therefore, a company can either elect a policy that follows

their past practices or elect an accounting policy that is consistent with the IFRS framework (for example, IAS 16). If the assets are outside the E&E phase, IAS 16 requires exchanges of non-monetary assets to be recorded at fair value unless the exchange lacks commercial substance or the fair values of the asset(s) exchanged are not reliably determinable.

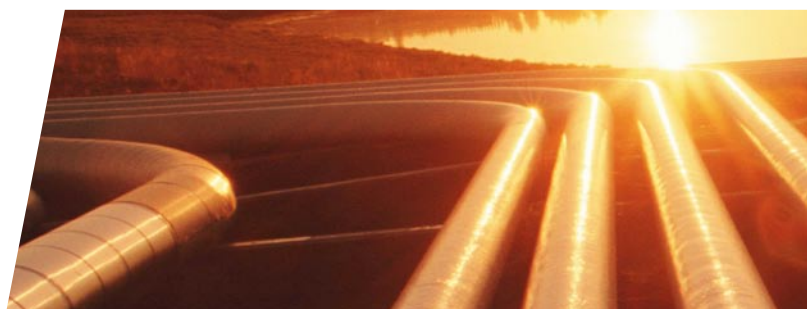
	US GAAP	IFRS
Risk sharing arrangements	<p>FAS 19 contains scope provisions such that gain or loss on property conveyances are generally not recognized even if otherwise required under other GAAP, such as FAS 153 <i>Exchange of Nonmonetary Assets</i> (with the exception of asset swaps).</p> <p>Under the successful efforts method, the sale of an interest may result in a gain. FAS 19 provides the accounting for sales of unproven and proven property interests.</p> <p>Under the full cost method, a gain or loss on a partial or full sale of an interest is treated as an adjustment to the capitalized costs in the full cost center, unless such adjustments would significantly alter the relationship between capitalized costs and proved reserves.</p>	<p>There is no specific guidance for risk sharing arrangements. Each transaction should be evaluated under the IFRS framework. Gain or loss is generally recognized on the portion of the interest given up unless the asset is in the E&E phase and the policy is to measure at carryover cost or if the asset is outside the E&E phase and fair value cannot be reliably measured.</p>
Carried interests in the E&E phase	<p>No gain or loss is recognized. The carried party makes no accounting entries for costs and revenue until after recoupment (payout) of the carried costs by the carrying party. Subsequent to payout the carried party accounts for its share of revenue, operating expenses and (if the agreement provides for subsequent sharing of costs rather than a carried interest) subsequent development costs. Amortization of the carried party's property cost does not commence prior to payout. During the payout period the carrying party records all costs and revenue from the property including that applicable to the recovery of costs carried.</p>	<p>Purchase/sale type arrangements generally will represent a disposal by the carried party and an acquisition of an oil and gas property by the carrying party. When the asset is in the E&E phase, the accounting may be viewed in the scope of IFRS 6. Because IFRS 6 does not specifically address the accounting for carried interests, an entity may develop an accounting policy or apply the IFRS framework. Once the assets are outside the E&E phase, the accounting is governed by the IFRS framework (for example, IAS 16).</p> <p>Financing type arrangements for assets in the E&E phase follow the same thought pattern as discussed above, except that if the IFRS framework is applied and IAS 37 <i>Provisions, Contingent Liabilities and Contingent Assets</i> or IAS 39 <i>Financial Instruments: Recognition and Measurement</i> would generally be considered.</p>
Carried interests in the development phase	<p>No gain or loss is recognized. The carried party makes no accounting entries for any costs and revenue until after recoupment (payout) of the carried costs by the carrying party. Subsequent to payout the carried party accounts for its share of revenue, operating expenses and (if the agreement provides for subsequent sharing of costs rather than a carried interest) subsequent development costs. Amortization of the carried party's property cost does not commence prior to payout. During the payout period the carrying party records all costs and revenue from the property including that applicable to the recovery of costs carried.</p>	<p>For purchase/sale type carried interests, gain or loss is recognized based on the difference between the net disposal proceeds and the carrying amount of the asset disposed of.</p> <p>For financing-type carried interests, no gain or loss is recognized. The carried party recognizes an investment and a corresponding liability for the expected reimbursement. The carrying party records an asset related to reimbursement.</p>

	US GAAP	IFRS
Farm-ins and farm-outs in the E&E phase	No gain or loss is recognized. Farmor records the cost of the interest retained. Farmee accounts for costs as property acquisition costs.	IFRS 6 allows a company to develop an accounting policy in the E&E phase, as discussed above under carried interests.
Farm-ins and farm-outs in the development phase	No gain or loss is recognized. Farmor records the cost of the interest retained. Farmee accounts for costs as property acquisition costs.	Farmee records the underlying interest as an asset and recognizes a liability for the future obligation to fund development from which the farmee does not derive future economic benefits. Farmor reduces the proportion of the asset sold and recognizes a receivable. In addition, a gain or loss is recorded as the difference between the net disposal proceeds and the carrying amount of the asset disposed of.
Asset swaps	In accordance with APB 29, a gain or loss is recognized based on the difference between the book value and fair value of the asset relinquished, unless the transaction lacks commercial substance or the fair values are not reliably measurable.	For assets in the E&E phase, IFRS 6 allows a company to develop an accounting policy, as discussed above under carried interests. For assets outside the E&E phase, an asset swap results in a gain or loss unless the transaction lacks commercial substance or the fair values are not reliably measurable.
Unitization	No gain or loss is recognized. Any payments represent additional oil and gas properties to payer and recovery of costs by the receiver.	For assets in the E&E phase, IFRS 6 allows a company to develop an accounting policy, as discussed above under carried interests. For assets outside the E&E phase, if the unitization arrangement results in joint control over an underlying entity then SIC 13 <i>Jointly Controlled Entities, Non-monetary Contributions by Venturers</i> is applicable. If the arrangement gives rise to jointly controlled assets or results in a swap of assets that are not jointly controlled, the arrangement is accounted for as an asset swap. Consideration should be made regarding whether mineral reserves have actually been unitized if they are subject to redetermination. Although the reserves are unitized in the physical sense, in volume terms the parties remain entitled to a quantity of reserves that is equal to that which they contributed.
Unitization redeterminations	No gain or loss is recognized. Amounts paid are credited to oil and gas properties and DD&A is adjusted prospectively.	Adjustments to interest are treated prospectively as a change in accounting estimate.

Convergence

It is unclear whether the accounting for risk sharing arrangements will be within the scope of the IASB's extractive activities project.

Joint venture accounting



The principal guidance for joint venture accounting under US GAAP is APB 18 *The Equity Method of Accounting for Investments in Common Stock*. IAS 31 *Interests in Joint Ventures* provides the related guidance under IFRS.

Joint ventures are common in the oil and gas industry. However, not all arrangements that are casually described as “joint ventures” meet the definition of a joint venture under IFRS. In the absence of a contractual arrangement to establish joint control, an investment cannot be a joint venture and should be accounted for either as an investment in an associate under IAS 28 *Investments in Associates* or as a financial asset under IAS 39.

Similarities

The accounting for jointly controlled entities is similar to the accounting that oil and gas companies may use for investments in unincorporated legal entities involved in oil and gas exploration and production activities under US GAAP, pursuant to EITF 00-1 *Investor Balance Sheet and Income Statement Display under the Equity Method for Investments in Certain Partnerships and Other Ventures*.

Significant differences

	US GAAP	IFRS
Definition - joint venture	APB 18 defines a corporate joint venture as a corporation owned and operated by a small group of businesses as a separate specific business or project for the mutual benefit of the members of the group.	A contractual arrangement in which two or more parties undertake an economic activity that is subject to joint control. The definition of a joint venture under IFRS is more restrictive than that under US GAAP due to the joint control requirement.
Jointly controlled assets	Equity method if the arrangement is carried out as a separate legal entity. If the legal entity is unincorporated, it may be proportionately consolidated under EITF 00-1.	Recognize share of the jointly controlled assets (classified according to their nature), liabilities, income from the sale or use of the share of the output of the joint venture and expenses.
Jointly controlled operations (not conducted through a legal entity)	Recognize costs incurred and revenue generated from transactions with third-parties under EITF 07-1 <i>Accounting for Collaborative Arrangements</i> . The classification of profit-sharing payments between collaborators is an accounting policy election.	Recognize controlled assets and liabilities incurred and expenses incurred through the process of pursuing the joint operation and its the share of income.
Jointly controlled entities	Equity method if the arrangement is carried out as a separate legal entity. If the legal entity is unincorporated, it may be proportionately consolidated under EITF 00-1.	Equity method or proportionate consolidation.



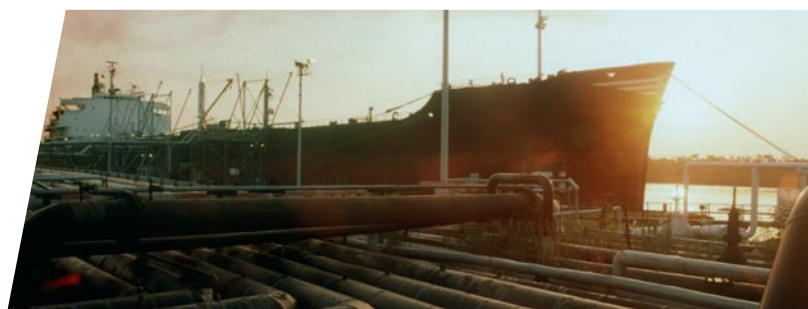
	US GAAP	IFRS
Undivided interests	In practice, proportionate consolidation pursuant to EITF 00-1.	If subject to joint control, undivided interests are accounted for as jointly controlled assets. If not subject to joint control, therefore cannot be accounted for as jointly controlled assets, undivided interests are accounted for as follows: <ol style="list-style-type: none"> (1) If the investor is entitled to use the underlying asset the arrangement should be accounted for as a tangible or intangible asset under IAS 16 or IAS 38, respectively. The investor's proportionate share of the operating costs of the asset (e.g. repairs and maintenance) should be accounted for in the same way as the operating costs of wholly-owned assets. (2) If the investor is entitled only to a proportion of the cash flows generated by the asset then its investment will generally meet the definition of a financial asset under IAS 39.
Accounting policies	No requirement to conform investees accounting policies to investor's policies.	IAS 28 requires adjustments to conform the joint venture's accounting policies to that of the venturer's.
Gain on formation of joint ventures	Under FAS 160 <i>Noncontrolling Interests in Consolidated Financial Statements</i> a gain or loss is recognized if a subsidiary is contributed and loss of control occurs. If an asset is contributed, partial gain may be recognized if cash or near-cash consideration is received and there is no commitment to support future operations or return the cash received.	Under SIC 13 a partial gain or loss may be recognized.

Convergence

In September 2007 the IASB issued Exposure Draft 9 *Joint Arrangements*, which would amend IAS 31 so that proportionate consolidation of jointly controlled entities will no longer be allowed. Proportionate consolidation would still be allowed for jointly control operations and assets. The IASB is expected to publish the final standard in 2009.

The FASB recently added a project to its agenda regarding the scope of FAS 160 to in part address its application when a subsidiary is transferred to a joint venture. Future developments should be monitored.

Production sharing contracts or agreements



Production sharing contracts or agreements (PSCs) are often the legal form by which governments allow outside companies to participate in the oil and gas industry within that country. A PSC is generally a contract between a National Oil Company (NOC) of a host country and a contracting enterprise (the oil and gas company) to carry out certain activities. The oil and gas company generally bears all of the risks during exploration and will generally be responsible for extracting the NOC's share of production from a field. The oil and gas company typically pays 100% of exploration costs and some or all of development and production costs and can recoup these costs only from future production. PSCs can take many different forms and the allocation of profits is generally different for each contract.

Other agreements prevalent in the industry are pure and risk service contracts. In a pure service contract, the oil and gas company performs exploration, development and production activities in exchange for a fee to cover all incurred costs plus a profit; the host country bears the risk of exploration and production. The oil and gas company in a pure service contract is not deemed to be engaged in oil and gas producing activities.

In a risk service contract, the oil and gas company performs exploration, development and production activities and, if production is achieved, will receive a fee representing its costs plus a profit (fee is typically capped at a certain price per barrel produced).

Similarities

Under US GAAP, the costs paid by the oil and gas company under a PSC are recorded using the full cost or successful efforts method of accounting. The PSC contract will specify which costs are recoverable and in what order (commonly called cost oil). The proceeds from the sale of cost oil are recorded as oil revenue, not a recovery of capitalized costs. After costs are recovered based on the production limit in the contract, the remaining production represents profit and is split according to the contract (commonly called profit oil). The proceeds of the profit oil to the oil and gas company are also recorded as oil revenues under US GAAP. The accounting under IFRS is similar in practice. Under both IFRS and US GAAP, the oil and gas company should not recognize revenue for the share of production passed to the NOC.

As the oil and gas company bears much of the risk under a PSC, they generally disclose the reserves as their own (displayed separately in their reserves disclosures) even though they never legally own the hydrocarbons until they are produced.

Risk service contracts are similar to PSCs in a number of respects. The accounting under US GAAP and IFRS is similar in practice.

Under US GAAP, an oil and gas company in a pure service contract will expense all costs as incurred as the contract is not deemed to be an oil and gas producing activity and will record the service fee into revenue as services are performed. The accounting under IFRS is similar in practice.

Decommissioning liabilities



Similarities

Both US GAAP and IFRS require that the costs of dismantling an asset and restoring its site (that is, the costs of asset retirement under FAS 143 *Accounting for Asset Retirement Obligations* or IAS 37) be included in the cost of the asset. Both models require a provision for asset retirement costs to be recorded when there is a legal obligation, although IFRS requires a provision in other circumstances as well. Uncertainty around the timing and/or method of settling an ARO (often referred to as a conditional ARO) does not preclude recognition of an ARO under both models, although US GAAP has a standard (FIN 47 *Accounting for Conditional Asset Retirement Obligations*) that explicitly addresses conditional AROs. When an ARO is remeasured due to changes in assumptions, both GAAPs (FAS 143 and IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*) require that the depreciation on the related asset be adjusted prospectively over the remaining useful life.

Significant differences

	US GAAP	IFRS
Identification of AROs	Only legal obligations give rise to AROs. Under FAS 143, a legal obligation can result from a law, statute, ordinance, an agreement between entities (written or oral) or a promise that imposes a reasonable expectation that becomes an enforceable promise.	Both legal and constructive obligations give rise to decommissioning liabilities under IAS 37. A constructive obligation arises when an entity has created a valid expectation, based on past practice or published policies, that it will discharge the obligation and may or may not be enforceable.
Initial measurement	AROs and the related capitalized costs are measured at fair value in accordance with FAS 157 <i>Fair Value Measurements</i> , such that the estimated costs should reflect marketplace participant assumptions. ARO liabilities are discounted using a risk-free interest rate adjusted for the effects of an entity's own credit standing.	Decommissioning liabilities and the related capitalized costs are measured at the best estimate of the costs required to settle the decommissioning liability or to transfer it to a third party. Decommissioning liability provisions are discounted using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.
Subsequent recognition and measurement - change in estimates	AROs may be remeasured due to revisions in the amounts or timing of the original estimated cash flows. An upward revision to the original estimated cash flows gives rise to a new obligation measured using current market assumptions and is recognized as an additional "layer" to the ARO asset and liability. A downward revision to the original estimated cash flows is measured using the original assumptions and recognized as a reduction to the ARO asset and liability.	Decommissioning liabilities may be remeasured due to revisions in the amounts or timing of the original estimated cash flows and due to changes in the current market-based discount rate, if applicable. If the related amount is measured at cost, changes in the decommissioning liability, whether due to revised cash flow estimates or discount rates, are added to or deducted from the cost of the related asset, with any reductions in excess of the carrying amount of the asset recognized as a gain in the current period.
Subsequent recognition and measurement - accretion of obligation	Changes to the liability, as a result of the passage of time, are recorded as accretion expense. FAS 143 requires that accretion expense be classified as an operating item in the statement of income.	Changes to the liability, as a result of the passage of time, are recorded as interest expense.

	US GAAP	IFRS
Deferred income taxes	Deferred taxes are recognized upon initial recognition of the ARO asset and liability and consist of a deferred tax asset (timing difference in expense recognition) and a deferred tax liability (the book-to-tax basis difference on the ARO asset). Similar to the ARO asset and liability, the deferred tax asset and liability are equal at initial measurement.	No deferred taxes are recognized at initial recognition of the decommissioning liability because there is no profit and loss effect. See the "Income taxes" section for further details.
Treatment of exchange differences	Generally, exchange gains or losses are recorded in income for the period.	In most cases it will be appropriate for the exchange differences arising on provisions to be taken to profit or loss in the period they arise under IAS 21 <i>The Effects of Changes in Foreign Exchange Rates</i> . However, IFRIC 1 provides guidance for accounting for decommissioning liabilities and it requires any adjustments to cash flows to be recorded as an adjustment to the cost of the asset. Because we believe IFRIC 1 is the more relevant pronouncement, exchange differences arising relating to decommissioning liabilities should be taken to profit or loss.

Convergence

No convergence activities are underway or planned for decommissioning liability matters.

Regulatory assets and liabilities



A company operating in a regulated environment is often allowed by the regulator to make a fixed return on its investment or recoup its investment by increasing prices over a defined period. Consequently, the future price that the regulated entity is allowed to charge its customer may be influenced by past cost levels and investment levels. The regulated entity may also be required to decrease future prices to reflect the current recovery of costs expected to be incurred in the future. The anticipated recovery of current costs and incurral of future costs in a regulated environment are accounted for as regulatory assets and liabilities under FAS 71 *Accounting for the Effects of Certain Types of Regulation*. These regulatory assets and liabilities are classified as intangible asset under US GAAP.

Regulatory assets do not meet the definition of an intangible asset under IFRS because they are not a resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity. In addition, under IFRS, the right to charge a higher price to customers can result in economic benefits only in connection with future sales to those customers. The economic benefits from sales to customers should be recognized in accordance with IAS 18 *Revenue*, which requires delivery of the goods or services to the customers.

Under FAS 71, a liability arises when the regulator requires an entity to decrease prices in a subsequent period. This regulatory liability, in most circumstances, would not be a provision under IAS 37 as it is not a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits. Instead, the entity will charge less and receive less from the individual customers in the subsequent period to address the fact that the entity has recovered future costs in the current period. This is because the regulatory requirement to reduce future prices constitutes a decrease in the price charged to customers for future supplies and not a refund to particular customers based on the amounts by which they were individually “overcharged.” In other words, new customers that had not previously been “overcharged” would nevertheless benefit from the lower prices, while former customers who had been “overcharged” in the past but were no longer customers would neither get a refund nor benefit from the future lower prices. However, certain regulatory liabilities may need to be recognized.

Convergence

IFRIC specifically addressed the topic of regulatory assets in an August 2005 rejection notice. In summary, it concluded that the recognition criteria in FAS 71 are not fully consistent with the recognition criteria under IFRS. Therefore, the special regulatory asset and liability model of FAS 71 cannot be used under IFRS without modification and regulatory assets and liabilities arising from performing price-regulated activities should be recognized in accordance with the applicable standards under IFRS.

The IASB added a project on rate-regulated activities to its agenda in December 2008. The objective of the project is to develop a standard on rate regulated activities that clarifies whether regulated entities could or should recognize an asset or a liability as a result of rate regulation.

The IASB expects to issue an exposure draft in 2009. While this is not a convergence project, the IASB is looking to FAS 71 for guidance but differences may arise.

Reserves disclosures



Reserves and related information are a significant element in communications by oil and gas companies to their stakeholders. However, IFRS does not currently require disclosure of reserves or other related information, though certain national standards and stock exchange regulators do. IFRS requires an entity to provide “additional disclosures when compliance with the specific requirements of IFRS are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity’s financial position and financial performance.” In this regard, disclosures that address reserves and related information generally will be necessary under IFRS to provide users with the information that they need to understand the entity’s financial position and financial performance.

In the absence of specific guidance, companies should develop a method for communicating reserves that is consistent with the overall IFRS framework. Companies use reserve measures for a number of accounting areas. The measures used should be consistent with the definitions within the IFRS framework for asset recognition that is the expectation of future benefits. If management uses proved reserves for investment appraisal and uses the same reserves for depreciation and impairment calculations, these should clearly be identified in the reserves disclosure.

While disclosure of information about mineral reserves is very useful, users of financial statements should be aware that many differences exist between different jurisdictions or even within those jurisdictions. Therefore, comparisons between entities may be difficult. The SEC requires foreign private issuers in the oil and gas industry that are using IFRS to provide the disclosures required by FAS 69 *Disclosures About Oil and Gas Producing Activities*.

On 31 December 2008 the SEC issued Final Rule *Modernization of the Oil and Gas Reporting Requirements*. This rule changes the reporting requirements for both US and foreign private issuers that have oil and gas producing activities. This rule is effective for Forms 10-K and 20-F filed on or after 31 December 2009. The FASB has added a project to its agenda to amend FAS 19 and FAS 69 to conform to the Final Rule.

While IFRS does not require specific disclosures, companies that prepare their financial statements under IFRS typically follow their national regulatory standards for reserves disclosures. The following table summarizes differences between current US GAAP and other national standards.



Significant differences

	US GAAP	Other
Reserves disclosures	FAS 69 requires disclosure of proved reserves and proved developed reserves.	As an example, UK Oil Industry Accounting Committee's Statement of Recommended Practice (OIAC SORP) permits disclosure of either proved and probable or proved developed and undeveloped reserves.
Commodity price	FAS 69 requires the use of year-end prices. ¹	As an example, OIAC SORP allows the use of long-term price path assumptions.
Royalties payable in-kind to the government or legal owner of the mineral rights	Excluded from disclosed reserves estimates.	May or may not be included.
Reserves attributable to noncontrolling interests	Required to disclose the reserves attributable to significant noncontrolling interests.	May or may not be included.
Reserves of associates and other investments	Not included in consolidated reserves, but disclosed separately.	May or may not be included.
Production sharing contracts	May or may not be included in consolidated reserves depending on the terms of the contract. If the enterprise participates in the operation of the properties in which the oil or gas is located or otherwise serves as the "producer" of those reserves, they may be disclosed separately.	Depending on the reserve reporting framework to which the entity is subject, such economic reserves may or may not be included.
Value based disclosures	FAS 69 requires disclosure of a standardized measure of discounted future net cash flows relating to proved oil and gas reserves using a 10% discount rate.	As an example, OIAC SORP does not require value based disclosures.

Convergence

The current research project on extractive activities, which has been on the IASB's agenda since 2004, is expected to result in the publication of a Discussion Paper in 2009. While this is not a convergence project, the SEC is a member of the IASB's advisory panel for the extractive activities project and the panel holds frequent meetings with the staff of the SEC.

¹ Under the final SEC rule, the price used will be a 12-month average price. It is likely that this change will be conformed through the FASB project to amend FAS 69. In addition, the Final Rule will allow, but not require, disclosure of a price sensitivity analysis.

Revenue recognition

Similarities

As a general, conceptual matter, revenue recognition under both US GAAP and IFRS is tied to the completion of the earnings process and the realization of assets from such completion. Under IAS 18 Revenue revenue is defined as “the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity other than increases relating to contributions from equity participants.” Under US GAAP, revenues represent actual or expected cash inflows that have occurred or will result from the entity’s ongoing major operations. Under both GAAPs, revenue is not recognized until it is both realized (or realizable) and earned. Ultimately, both GAAPs base revenue recognition on the transfer of risks and both attempt to determine when the earnings process is complete. Both GAAPs contain revenue recognition criteria that, while not identical, are similar. For example, under IFRS, one recognition criteria is that the amount of revenue can be measured reliably, while US GAAP requires that the consideration to be received from the buyer is fixed or determinable.

Sales and entitlements methods

For oil and gas companies, the volume of oil and gas sold may differ from the volumes to which a company is entitled based on its interest in a property. Revenue recognition related to these imbalances has historically followed one of two different methods. Under the sales method, revenue is recognized based on the amounts actually sold. Under the entitlements method, revenue is recognized based on the amount that it is entitled to based on its interest in the property. Under EITF 90-22 *Accounting for Gas-Balancing Arrangements*, either method is allowed and should be applied consistently. IFRS does not specifically address the accounting, but both methods are used in practice. In addition, while IFRS does not address the accounting for volume differences discussed above, an entity may look to the provisions of EITF 90-22 based on IAS 8. The geography of the income statement and the valuation of the asset and liability resulting from the differences depend on a company’s revenue recognition policy.

Significant differences

Despite the conceptual similarities, differences in oil and gas revenue recognition may exist as a result of differing levels of specificity between the two GAAPs. There is extensive guidance under US GAAP, which can be very prescriptive and often applies only to specific industry transactions. For example, under US GAAP there are specific rules relating to the recognition of software revenue and sales of real estate, while comparable guidance does not exist under IFRS. In addition, the detailed US rules often contain exceptions for particular types of transactions. Further, public companies in the US must follow additional guidance provided by the SEC. Conversely, a single standard (IAS 18) exists under IFRS which contains general principles and illustrative examples of specific transactions. Exclusive of the industry-specific differences between the two GAAPs, following are the major differences in revenue recognition.

	US GAAP	IFRS
Sale of goods	Public companies must follow SAB 104 <i>Revenue Recognition</i> , which requires that delivery has occurred (the risks and rewards of ownership have been transferred), there is persuasive evidence of the sale, the fee is fixed or determinable, and collectability is reasonably assured.	Revenue is recognized pursuant to IAS 18 only when risks and rewards of ownership have been transferred, the buyer has control of the goods, revenues can be measured reliably, and it is probable that the economic benefits will flow to the company.
Rendering of services	Certain types of service revenue, primarily relating to services sold with software, have been addressed separately in US GAAP literature. All other service revenue should follow SAB 104. Application of long-term contract accounting (SOP 81-1 <i>Accounting for Performance of Construction-Type and Certain Production-Type Contracts</i>) is not permitted for non-construction services.	Revenue may be recognized in accordance with long-term contract accounting, including considering the stage of completion, whenever revenues and costs can be measured reliably, and it is probable that economic benefits will flow to the company.
Multiple elements	Specific criteria are required in order for each element to be a separate unit of accounting, including delivered elements that must have standalone value, and undelivered elements that must have reliable and objective evidence of fair value. If those criteria are met, revenue for each element of the transaction can be recognized when the element is complete.	IAS 18 requires recognition of revenue on an element of a transaction if that element has commercial substance on its own; otherwise the separate elements must be linked and accounted for as a single transaction. IAS 18 does not provide specific criteria for making that determination.
Deferred receipt of receivables	Discounting to present value is required only in limited situations.	Considered to be a financing agreement. Value of revenue to be recognized is determined by discounting all future receipts using an imputed rate of interest.
Construction contracts	Construction contracts are accounted for using the percentage-of-completion method if certain criteria are met. Otherwise completed contract method is used. Construction contracts may be, but are not required to be, combined or segmented if certain criteria are met.	Construction contracts are accounted for using the percentage-of-completion method if certain criteria are met. Otherwise, revenue recognition is limited to recoverable costs incurred. The completed contract method is not permitted. Construction contracts are combined or segmented if certain criteria are met. Criteria under IFRS differ from those in US GAAP.

Convergence

The FASB and the IASB are conducting a joint project to develop a standard for revenue recognition. The Boards issued a discussion paper in December 2008 that describes a contract-based revenue recognition approach. This model focuses on the asset or liability that arises from an enforceable arrangement with a customer. The proposed model allocates the customer consideration to the vendor's contractual performance obligations on a relative standalone selling price basis, and revenue is recognized based on the allocated amount as each performance obligation is satisfied.

The EITF is working on a project that is expected to supersede EITF 00-21 *Accounting for Revenue Arrangements with Multiple Deliverables*, resulting in a model that is more consistent with the model discussed by the FASB and IASB in their revenue recognition discussion paper. The EITF reached a consensus-for-exposure on EITF 08-1 *Revenue Arrangements with Multiple Deliverables* at its 13 November 2008 meeting, in which the EITF tentatively concluded that

the selling price threshold in EITF 00-21 for the undelivered item(s) in an arrangement should allow for an entity's use of its best estimate of selling price to a third party in situations where the entity does not have vendor-specific objective evidence (VSOE) or relevant third-party evidence of selling price. An entity could use its estimated selling price only after it determined that neither VSOE nor relevant third-party evidence of selling price exist. Subsequently, at its 19 March 2009 meeting, the EITF tentatively concluded to revise the consensus-for-exposure to require the relative selling price method when allocating arrangement consideration to the elements in an arrangement. The consensus-for-exposure originally required the use of the residual method in certain circumstances. Because of the change to require that arrangement consideration be allocated using the relative selling price method and revised disclosure requirements, the EITF concluded that it will issue another consensus-for-exposure, subject to a comment period. Readers should closely monitor the EITF's activities related to this issue.

Inventory



Similarities

ARB 43 Chapter 4 *Inventory Pricing* and IAS 2 *Inventories*

are both based on the principle that the primary basis of accounting for inventory is cost. Both define inventory as

assets held for sale in the ordinary course of business, in the process of production for such sale, or to be consumed in the

production of goods or services. The permitted techniques for cost measurement, such as standard cost method, are similar

under both US GAAP and IFRS. Further, under both GAAPs

the cost of inventory includes all direct expenditures to ready inventory for sale, including allocable overhead, while selling

costs are excluded from the cost of inventories, as are most

storage costs and general administrative costs.

Significant differences

	US GAAP	IFRS
Costing methods	LIFO is an acceptable method. Consistent cost formula for all inventories similar in nature is not explicitly required.	LIFO is prohibited. Same cost formula must be applied to all inventories similar in nature or use to the entity.
Measurement	Inventory is carried at the lower of cost or market. Market is defined as current replacement cost as long as market is not greater than net realizable value (estimated selling price less reasonable costs of completion and sale) and is not less than net realizable value reduced by a normal sales margin.	Inventory is carried at the lower of cost or net realizable value (best estimate of the net amounts inventories are expected to realize, which may or may not equal fair value).
Trading inventory	There are no separate measurement criteria for trading inventory.	The scope exceptions provided by IAS 2 paragraphs 3(a) relating to minerals and mineral products and 3(b) relating to broker-traders appear to have relevance to oil and gas companies as they produce minerals and mineral products and often have trading operations that are similar to broker-traders. As a result, oil and gas companies may carry trading inventories at fair value less costs to sell.
Reversal of inventory write-downs	Any write-downs of inventory to the lower of cost or market create a new cost basis that subsequently cannot be reversed.	Previously recognized impairment losses are reversed up to the amount of the original impairment loss when the reasons for the impairment no longer exist.

Convergence

In May 2008, the FASB issued for comment proposed FSP ARB 43-a *Amendment of the Inventory Provisions of Chapter 4 of ARB No. 4*. This proposed FSP would have amended ARB 43 to require that inventories included in an entity's trading activities (e.g., crude oil, natural gas) be initially and

subsequently measured at fair value with changes in fair value reported in earnings. Subsequent to adoption, inventory designated as trading would be accounted for at fair value under the provisions of FAS 157. At the 21 January 2009 FASB Board meeting, the project was removed from the Board's agenda.

There are no ongoing convergence efforts at this time.

Impairment of long-lived assets and goodwill



The following are considerations and areas where policy decisions may need to be made regarding impairment that are applicable to oil and gas companies applying IFRS.

For impairment related to E&E assets, see the “Exploration and production activities” section.

Identifying cash generating units (CGUs)

In the oil and gas industry, a well does not generate individual cash flows because the output will generally flow through a gathering system, a processing system and a storage facility before being available for sale and being capable of generating cash flows. In practice, under IFRS the field is typically the unit of account because it is generally the level at which separately identifiable cash flows are available. We believe this is similar to the level at which most companies applying successful efforts accounting in US GAAP test producing properties for impairment.

Prices to apply to future production

Prices should reflect management’s best estimate of the prices to be received from the production and sale of mineral resources over time. Prices that are observable in the market (for example, consideration should be given to the forward and spot prices) are generally used as they are generally more reliable. This concept is reinforced by paragraph AG82 of IAS 39, which suggests that observable market data should be used when calculating fair values. Care must be taken when using illiquid markets for long-term prices. Management should develop an accounting policy regarding inputs to impairment calculations and also which long-term prices should be used. These policies should also be consistent with those used for investment appraisal purposes and will likely be linked to an internal long-term planning assumption.

Foreign exchange rates

Under IFRS, future cash flows are estimated in the currency in which they will be generated and then discounted using a discount rate appropriate for that currency. The present value of the cash flows is translated using the spot exchange rate at the date of the value in use calculation.

Shared infrastructure

Shared infrastructure between fields can be dealt with in two ways consistent with the guidance in IAS 36 regarding corporate assets. Under the first option, the shared infrastructure may be allocated to the fields or CGUs in question and each field or CGU would be tested for impairment individually when indicators of impairment exist. The second option aggregates the CGUs to which the shared infrastructure is dependent and tests the shared infrastructure for impairment at this combined level of CGUs.

Similarities

Both US GAAP and IFRS contain similarly defined impairment indicators for assessing the impairment of long-lived assets. Both standards require goodwill and intangible assets with indefinite lives to be reviewed at least annually for impairment and more frequently if impairment indicators are present. Long-lived assets are not tested annually, but rather when there are indicators of impairment. The impairment indicators

in US GAAP and IFRS are similar. Additionally, both GAAPs require that an asset found to be impaired be written down and an impairment loss recognized. FAS 142 *Goodwill and Other Intangible Assets*, FAS 144 and IAS 36 apply to most long-lived and intangible assets, although some of the scope exceptions listed in the standards differ. Despite the similarity in overall objectives, differences exist in the way in which impairment is reviewed, recognized and measured.

Significant differences

	US GAAP	IFRS
Method of determining impairment – long-lived assets	Two-step approach requires a recoverability test be performed first (carrying amount of the asset is compared to the sum of future undiscounted cash flows generated through use and eventual disposition). If it is determined that the asset is not recoverable, impairment testing must be performed.	One-step approach requires that impairment testing be performed if impairment indicators exist.
Impairment loss calculation – long-lived assets	The amount by which the carrying amount of the asset exceeds its fair value, as calculated in accordance with FAS 157.	The amount by which the carrying amount of the asset exceeds its recoverable amount. Recoverable amount is the higher of: (1) fair value less costs to sell and (2) value in use (the present value of future cash flows in use including disposal value). (Note that the definition of fair value in IFRS has certain differences from the definition in FAS 157.)
Allocation of goodwill	Goodwill is allocated to a reporting unit, which is an operating segment or one level below an operating segment (component).	Goodwill is allocated to a CGU (or group of CGUs) which represents the lowest level within the entity at which the goodwill is monitored for internal management purposes and cannot be larger than an operating segment as defined in IFRS 8, <i>Operating Segments</i> .
Method of determining impairment – goodwill	Two-step approach requires a recoverability test to be performed first at the reporting unit level (carrying amount of the reporting unit is compared to the reporting unit fair value). If the carrying amount of the reporting unit exceeds its fair value, then impairment testing must be performed.	One-step approach requires that an impairment test be performed at the CGU level by comparing the CGUs carrying amount, including goodwill, with its recoverable amount.
Impairment loss calculation – goodwill	The amount by which the carrying amount of goodwill exceeds the implied fair value of the goodwill within its reporting unit.	Impairment loss on the CGU (amount by which the CGUs carrying amount, including goodwill, exceeds its recoverable amount) is allocated first to reduce goodwill to zero, then, subject to certain limitations, the carrying amount of other assets in the CGU are reduced pro rata, based on the carrying amount of each asset.
Impairment loss calculation – indefinite life intangible assets	The amount by which the carrying value of the asset exceeds its fair value.	The amount by which the carrying value of the asset exceeds its recoverable amount.
Reversal of loss	Prohibited for all assets to be held and used.	Prohibited for goodwill. Other long-lived assets must be reviewed annually for reversal indicators. If it is determined that the fair value has recovered, the loss must be reversed up to the newly estimated recoverable amount, not to exceed the initial carrying amount adjusted for depreciation.

Convergence

Impairment is one of the short-term convergence projects agreed to by the FASB and IASB in their 2006 "Memorandum of Understanding." However, as part of their 2008 MOU, the boards agreed to defer work on completing this project until their other convergence projects are complete.

Provisions and contingencies

Similarities

While the sources of guidance under US GAAP and IFRS differ significantly, the general recognition criteria for provisions are similar. For example, IAS 37 provides the overall guidance for recognition and measurement criteria of provisions and contingencies. While there is no equivalent single standard under US GAAP, FAS 5 *Accounting for Contingencies* and a number of other statements deal with specific types of provisions and contingencies (for example, FAS 143 for asset retirement obligations and FAS 146 *Accounting for Costs Associated with Exit or Disposal Activities* for exit and disposal activities). Further, the guidance provided in two Concept Statements in US GAAP (CON 5 *Recognition and*

Measurement in Financial Statements of Business Enterprises and CON 6 *Elements of Financial Statements*) is similar to the specific recognition criteria provided in IAS 37. Both GAAPs require recognition of a loss based on the probability of occurrence, although the definition of probability is different under US GAAP (where probable is interpreted as “likely”) and IFRS (where probable is interpreted as “more likely than not”). Both US GAAP and IFRS prohibit the recognition of provisions for costs associated with future operating activities. Further, both GAAPs require information about a contingent liability, whose occurrence is more than remote but did not meet the recognition criteria, to be disclosed in the notes to the financial statements.

Significant differences

	US GAAP	IFRS
Discounting provisions	Provisions may be discounted only when the amount of the liability and the timing of the payments are fixed or reliably determinable, or when the obligation is a fair value obligation (for example, an asset retirement obligation under FAS 143). Discount rate to be used is dependent upon the nature of the provision, and may vary from that used under IFRS. However, when a provision is measured at fair value, the time value of money and the risks specific to the liability should be considered.	Provisions should be recorded at the estimated amount to settle or transfer the obligation taking into consideration the time value of money. Discount rate to be used should be “a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.”
Measurement of provisions – range of possible outcomes	Most likely outcome within range should be accrued. When no one outcome is more likely than the others, the minimum amount in the range of outcomes should be accrued.	Best estimate of obligation should be accrued. For a large population of items being measured, such as warranty costs, best estimate is typically expected value, although mid-point in the range may also be used when any point in a continuous range is as likely as another. Best estimate for a single obligation may be the most likely outcome, although other possible outcomes should still be considered.
Restructuring costs	Under FAS 146, once management has committed to a detailed exit plan, each type of cost is examined to determine when recognized. Involuntary employee termination costs are recognized over future service period, or immediately if there is none. Other exit costs are expensed when incurred.	Once management has “demonstrably committed” (that is a legal or constructive obligation has been incurred) to a detailed exit plan, the general provisions of IAS 37 apply. Costs typically are recognized earlier than under US GAAP because IAS 37 focuses on exit plan as a whole, rather than the individual cost components of the plan.
Disclosure of contingent liability	No similar provision to that allowed under IFRS for reduced disclosure requirements.	Reduced disclosure permitted if it would be severely prejudicial to an entity’s position in a dispute with other party to a contingent liability.
Environmental remediation costs	SOP 96-1 <i>Environmental Remediation Liabilities</i> requires that a liability for environmental remediation costs be recorded when it is probable that a liability has been incurred and the amount can be reasonably estimated. SOP 96-1 requires the environmental liability to be discounted only if the aggregate amount of the liability and the amount and timing of cash flows related to that liability are fixed or reliably determinable. In practice, environmental remediation liabilities generally are not discounted.	IFRS requires that a provision be recognized when a legal or constructive obligation exists, it is probable that an obligation will be incurred and the amount of the obligation can be reasonably estimated. It should be noted the probable assessment under IFRS is similar to the “more likely than not” notion under US GAAP. As discussed above, provisions recorded under IFRS should be discounted.

Convergence

Both the FASB and the IASB have current agenda items dealing with this topic. An exposure draft proposing amendments to IAS 37 was issued in 2005, with a final standard expected no earlier than 2010. The IASB has indicated its intent to converge with US GAAP in the accounting for restructuring costs as part of this project.

In June 2008, the FASB issued proposed amendments to the disclosure requirements in FAS 5. Many of the proposed changes are consistent with current disclosures under IAS 37. A final standard is expected in 2009.

Financial instruments

Similarities

The US GAAP guidance for financial instruments is contained in several standards. Those standards include, among others, FAS 65 *Accounting for Certain Mortgage Banking Activities*, FAS 107 *Disclosures about Fair Value of Financial Instruments*, FAS 114 *Accounting by Creditors for Impairment of a Loan*, FAS 115 *Accounting for Certain Investments in Debt and Equity Securities*, FAS 133 *Accounting for Derivative Instruments and Hedging Activities*, FAS 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, FAS 150 *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, FAS 155 *Accounting for Certain Hybrid Financial Instruments*, FAS 157 and FAS 159 *The Fair Value Option*

for *Financial Assets and Financial Liabilities*. IFRS guidance for financial instruments, on the other hand, is limited to three standards (IAS 32 *Financial Instruments: Presentation*, IAS 39 and IFRS 7 *Financial Instruments: Disclosures*). Both GAAPs require financial instruments to be classified into specific categories to determine the measurement of those instruments, clarify when financial instruments should be recognized or derecognized in financial statements, and require the recognition of all derivatives on the balance sheet. Hedge accounting and use of a fair value option is permitted under both. Each GAAP also requires detailed disclosures in the notes to financial statements for the financial instruments reported in the balance sheet.

Significant differences

	US GAAP	IFRS
Fair value measurement	<p>One measurement model whenever fair value is used (with limited exceptions). Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.</p> <p>Fair value is an exit price, which may differ from the transaction (entry) price.</p>	<p>Various IFRS standards use slightly varying wording to define fair value. Generally fair value represents the amount that an asset could be exchanged for, or a liability settled between knowledgeable, willing parties in an arm's length transaction.</p> <p>At inception, transaction (entry) price generally is considered fair value.</p>
Day one gains and losses	<p>Entities are not precluded from recognizing day one gains and losses on financial instruments reported at fair value even when all inputs to the measurement model are not observable. For example, a day one gain or loss may occur when the transaction occurs in a market that differs from the reporting entity's exit market.</p>	<p>Day one gains and losses are recognized only when all inputs to the measurement model are observable.</p>
Debt vs. equity classification	<p>US GAAP specifically identifies certain instruments with characteristics of both debt and equity that must be classified as liabilities.</p> <p>Certain other contracts that are indexed to, and potentially settled in, a company's own stock may be classified as equity if they: (1) require physical settlement or net-share settlement or (2) give the issuer a choice of net-cash settlement or settlement in its own shares.</p>	<p>Classification of certain instruments with characteristics of both debt and equity focuses on the contractual obligation to deliver cash, assets or an entity's own shares. Economic compulsion does not constitute a contractual obligation.</p> <p>Contracts that are indexed to, and potentially settled in, a company's own stock are classified as equity when settled by delivering a fixed number of shares for a fixed amount of cash.</p>
Compound (hybrid) financial instruments	<p>Compound (hybrid) financial instruments (for example, convertible bonds) are not split into debt and equity components unless certain specific conditions are met, but they may be bifurcated into debt and derivative components, with the derivative component subjected to fair value accounting.</p>	<p>Compound (hybrid) financial instruments are required to be split into a debt and equity component and, if applicable, a derivative component. The derivative component may be subjected to fair value accounting.</p>

	US GAAP	IFRS
Impairment recognition – Available-for-Sale (AFS) financial instruments	<p>Declines in fair value below cost may result in an impairment loss being recognized in the income statement on an AFS debt security due solely to a change in interest rates (risk-free or otherwise) if the entity has the intent to sell the debt security or it is more likely than not it will be required to sell the debt security before its anticipated recovery. The impairment loss is measured as the difference between the debt security's amortized cost basis and its fair value.</p> <p>When a credit loss exists, but the entity does not intend to sell the debt security and it is not more likely than not that the entity will be required to sell the debt security before the recovery of its remaining amortized cost basis, the impairment is separated into (1) the amount representing the credit loss and (2) the amount related to all other factors. The amount of the total impairment related to the credit loss is recognized in the income statement and the amount related to all other factors is recognized in OCI, net of applicable taxes.</p> <p>For an AFS equity investment, an impairment is recognized in the income statement, measured as the difference between the equity security's cost basis and its fair value, if the equity security's fair value is not expected to recover sufficiently in the near term to allow a full recovery of the entity's cost basis. An entity must have the intent and ability to hold an impaired security until such near-term recovery; otherwise an impairment must be recognized currently in the income statement.</p> <p>When an impairment is recognized in the income statement, a new cost basis in the investment is established equal to the previous cost basis less the impairment amount recognized in earnings. Impairment losses recognized through earnings cannot be reversed for any future recoveries.</p>	<p>Generally, only evidence of credit default results in an impairment being recognized in the income statement of an AFS debt instrument.</p> <p>For an AFS equity investment, an impairment is recognized in the income statement, measured as the difference between the equity security's cost basis and its fair value, when there is objective evidence that the AFS equity investment is impaired, and that the cost of the investment in the equity instrument may not be recovered. A significant or prolonged decline in fair value of an equity investment below its cost is considered objective evidence of an impairment.</p> <p>Impairment losses for AFS debt instruments may be reversed in the income statement if the fair value of the asset increases in a subsequent period and the increase can be objectively related to an event occurring after the impairment loss was recognized. Impairment losses on AFS equity instruments may not be reversed in the income statement.</p>
Impairment recognition – Held-to-Maturity (HTM) financial instruments	<p>The impairment loss of an HTM investment is measured as the difference between its fair value and amortized cost basis. Because of an entity's assertion with an HTM investment to hold it to recovery (i.e., the positive intent and ability to hold those securities to maturity), the amount of the total impairment related to the credit loss is recognized in the income statement and the impairment amount related to all other factors is recognized in equity (other comprehensive income).</p> <p>The new cost basis of the security is the fair value when the impairment is recognized. The impairment recognized in equity is accreted from other comprehensive income to the amortized cost of the HTM security over its remaining life.</p>	<p>The impairment loss of an HTM investment is measured as the difference between the carrying amount of the investment and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the financial asset is reduced either directly or through use of an allowance account. The amount of the impairment (credit) loss is recognized in the income statement.</p>

	US GAAP	IFRS
Normal purchase/normal sale (NPNS)	<p>Normal purchases and normal sales are contracts that provide for the purchase or sale of something other than a financial instrument or derivative instrument that will be physically delivered in quantities expected to be used or sold by the reporting entity over a reasonable period in the normal course of business.</p> <p>The NPNS designation is optional if certain criteria are met and must be documented if elected.</p>	<p>Own use contracts (the IFRS term for what US GAAP calls NPNS contracts) are those to buy or sell non-financial items that can be settled net as long as they were entered into and continue to be held for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements.</p> <p>The own use designation for non-financial items is required if certain criteria are met. If an own use agreement is net settled or volumes purchased are immediately sold, that activity may taint the own use designation for all similar own use contracts as it will be difficult to assert the probability of physical settlement and that the purchases are for own use.</p>
Clearly and closely related criteria for normal purchase/normal sale election	Contracts that have a price based on an underlying that is not clearly and closely related to the asset being sold or purchased are not considered normal purchases and normal sales and are accounted for at fair value.	The component of a contract that is not clearly and closely related to the asset being sold or purchased may represent an embedded derivative that requires bifurcation. The embedded derivative is accounted for under IAS 39. The host contract will need to be evaluated separately to determine if it meets the own use criteria in IAS 39.
Hedge effectiveness – shortcut method for interest rate swaps	Permitted.	Not permitted.
Hedging a component of a risk in a financial instrument	The risk components that may be hedged are specifically defined by the literature, with no additional flexibility.	Allows entities to hedge components (portions) of risk that give rise to changes in fair value.
Measurement – effective interest method	Requires catch-up approach, retrospective method or prospective method of calculating the interest for amortized cost-based assets, depending on the type of instrument.	Requires the original effective interest rate to be used throughout the life of the instrument for all financial assets and liabilities, except for certain reclassified financial assets, in which case the effect of increases in cash flows are recognized as prospective adjustments to the effective interest rate.
Derecognition of financial assets	<p>Derecognition of financial assets (sales treatment) occurs when effective control has been surrendered over the financial assets. Control has been surrendered only if certain specific criteria have been met, including evidence of legal isolation.</p> <p>Special rules apply for transfers involving “qualifying” special-purpose entities.</p>	<p>Derecognition is based on a mixed model that considers both transfer of risks and rewards and control. If the transferor has neither retained nor transferred substantially all of the risks and rewards, there is then an evaluation of the transfer of control. Control is considered to be surrendered if the transferee has the practical ability to unilaterally sell the transferred asset to a third party, without restrictions. There is no legal isolation test</p> <p>The concept of a qualifying special-purpose entity does not exist.</p>
Measurement – loans and receivables	Unless the fair value option is elected, loans and receivables are classified as either (1) held for investment, which are measured at amortized cost, or (2) held for sale, which are measured at the lower of cost or fair value.	Loans and receivables are carried at amortized cost unless classified into the “fair value through profit or loss” category or the “available for sale” category, both of which are carried at fair value on the balance sheet.

Other differences include: (i) application of fair value measurement principles, including use of prices obtained in 'principal' versus 'most advantageous' markets, (ii) definitions of a derivative and embedded derivative, (iii) cash flow hedge – basis adjustment and effectiveness testing, (iv) foreign exchange gain and/or losses on AFS investments, (v) recognition of basis adjustments when hedging future transactions, (vi) macro hedging, (vii) hedging net investments, (viii) impairment criteria for equity investments, (ix) puttable minority interest and (x) netting and offsetting arrangements.

Convergence

In the US, the issuance of FAS 157 established a common framework for measuring fair value for all financial instruments, although it did not expand the use of fair value accounting. The IASB is working on a project to establish a single source of guidance for all fair value measurements required or permitted by existing IFRSs to reduce complexity and improve consistency in their application. The IASB intends to issue an exposure draft of its fair value measurement guidance in Q2 of 2009.

Additionally, at a joint meeting in March 2009, the Boards agreed to work jointly and expeditiously towards common standards that deal with off-balance sheet activity, accounting for financial instruments and loan loss accounting. The Boards have agreed to issue proposals to replace their respective financial instruments standards with a common standard “in a matter of months, not years.”

To also address concerns by constituents about the current worldwide financial crisis and its effects on financial reporting, the Boards have established an advisory group—Financial Crisis Advisory Group (FCAG)—comprised of senior leaders with broad international experience in financial markets to assist in improving financial reporting standards in light of the global financial crisis and potential changes to the global regulatory environment. The FCAG will consider how improvements in financial reporting could help enhance investor confidence in financial markets. The advisory group also will help identify significant accounting issues that require the urgent and immediate attention of the Boards, as well as issues for

long-term consideration. At the date of this publication, the activities of the FCAG are ongoing and the Boards have yet to announce any new joint projects. However, it is anticipated after the FCAG's deliberations and issuance of any recommendations that such projects will be announced in the latter part of 2009.

The following two projects are ongoing, which are expected to result in more converged standards:

- ▶ Derecognition of financial assets and financial liabilities: In September 2008, FASB issued a proposed amendment to FAS 140. The proposed statement would remove (1) the concept of a qualifying SPE from FAS 140, and (2) the exceptions from applying FIN 46 (Revised). In April 2009, the IASB issued an exposure draft (ED) to improve and simplify the requirements as to when financial assets and liabilities are derecognized. The ED proposes a new derecognition model for financial instruments to replace the existing provisions of IAS 39 and the disclosure requirements of IFRS 7. The comment period for the ED ends in July 2009.
- ▶ Derivatives, hedging and financial instruments: The FASB and the IASB have separate, but related, projects on reducing complexity in accounting for derivatives and generally in reporting financial instruments. Additionally, the FASB and the IASB have a joint project to address the accounting for financial instruments with characteristics of equity.

Long-lived assets

Similarities

Although US GAAP does not have a comprehensive standard that addresses long-lived assets, its definition of property, plant and equipment is similar to IAS 16 which addresses tangible assets held for use that are expected to be used for more than one reporting period. Other concepts that are similar include the following:

Cost

Both accounting models have similar recognition criteria, requiring that costs be included in the cost of the asset if future economic benefits are probable and can be reliably measured. Neither model allows the capitalization of start-up costs, general administrative and overhead costs or regular maintenance. However, both US GAAP and IFRS require that the costs of dismantling an asset and restoring its site (that is, the costs of asset retirement under FAS 143 or IAS 37) be included in the cost of the asset. Both models require provisions for asset retirement costs to be recorded when there is a legal obligation, although IFRS requires provisions in other circumstances as well.

Capitalized interest

FAS 34 *Capitalization of Interest* and IAS 23 *Borrowing Costs* address the capitalization of borrowing costs (for example, interest costs) directly attributable to the acquisition, construction or production of a qualifying asset. Qualifying assets are generally defined similarly under both accounting models. However, there are significant differences in the measurement of eligible borrowing costs for capitalization.

Depreciation

Depreciation of long-lived assets is required on a systematic basis under both accounting models. FAS 154 *Accounting Changes and Error Corrections* and IAS 8 both treat changes in depreciation method, residual value and useful economic life as a change in accounting estimate requiring prospective treatment.

Assets held for sale

Assets held for sale are discussed in FAS 144 and IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations*, with both standards having similar held for sale criteria. Under both standards, the asset is measured at the lower of its carrying amount or fair value less costs to sell; the assets are not depreciated and are presented separately on the face of the balance sheet. Exchanges of nonmonetary similar productive assets are also treated similarly under APB 29 as amended by FAS 153 and IAS 16, both of which allow gain/loss recognition if the exchange has commercial substance and the fair values of the amount(s) exchanged can be reliably measured.

Significant differences

	US GAAP	IFRS
Revaluation of assets	Revaluation is not permitted.	Revaluation is a permitted accounting policy election for an entire class of assets, requiring revaluation to fair value on a regular basis.
Depreciation of asset components	Component depreciation permitted but not common.	Component depreciation required if components of an asset are significant and have differing patterns of benefit.
Mass asset accounting	Like assets are grouped and depreciated over the useful life of the group. A composite depreciation rate is developed and applied to the weighted average gross asset balance at the end of the reporting period to calculate depreciation. No gains or losses on disposals are recognized in earnings. Instead, the difference between the sales proceeds and the net book value of the property, plant and equipment is recorded to accumulated depreciation.	There is no method comparable to mass asset accounting under IFRS and would not be permitted. IFRS requires component depreciation.
Measurement of borrowing costs	Eligible borrowing costs do not include exchange rate differences. Interest earned on the investment of borrowed funds generally cannot offset interest costs incurred during the period. For borrowings associated with a specific qualifying asset, borrowing costs equal to the weighted average accumulated expenditures times the borrowing rate are capitalized.	Eligible borrowing costs include exchange rate differences from foreign currency borrowings. Borrowing costs are offset by investment income earned on those borrowings. For borrowings associated with a specific qualifying asset, actual borrowing costs are capitalized.
Costs of a major overhaul	Multiple accounting models have evolved in practice, including: expense costs as incurred, capitalize costs and amortize through the date of the next overhaul, or follow the IFRS approach.	Costs that represent a replacement of a previously identified component of an asset are capitalized if future economic benefits are probable and the costs can be reliably measured.

Other differences include: (i) hedging gains and losses related to the purchase of assets, (ii) constructive obligations to retire assets and (iii) the accounting for changes in the residual value.

Convergence

No further convergence is planned at this time.

Intangible assets

Similarities

The definition of intangible assets as non-monetary assets without physical substance is the same under both US GAAP's FAS 141 (Revised) *Business Combinations* and FAS 142 and the IASB's IFRS 3 (Revised) *Business Combinations* and IAS 38. The recognition criteria for both accounting models require that there be probable future economic benefits and costs that can be reliably measured. However, some costs are never capitalized as intangible assets under both models, such as start-up costs. Goodwill is recognized only in a business combination in accordance with FAS 141 (Revised) and IFRS 3 (Revised). In general, intangible assets that are acquired outside of a business combination are recognized at cost. With the exception of development costs (addressed in the following

table), internally developed intangibles are not recognized as an asset under either FAS 142 or IAS 38. Moreover, internal costs related to the research phase of research and development are expensed as incurred under both accounting models.

Amortization of intangible assets over their estimated useful lives is required under both US GAAP and IFRS, with one minor exception in FAS 86 *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed* related to the amortization of computer software assets. In both sets of GAAP, if there is no foreseeable limit to the period over which an intangible asset is expected to generate net cash inflows to the entity, the useful life is considered to be indefinite and the asset is not amortized. Goodwill is never amortized.

Significant differences

	US GAAP	IFRS
Development costs	Development costs are expensed as incurred unless addressed by a separate standard. Development costs related to computer software developed for external use are capitalized once technological feasibility is established in accordance with specific criteria (FAS 86). In the case of software developed for internal use, only those costs incurred during the application development stage (as defined in SOP 98-1 <i>Accounting for the Costs of Computer Software Developed or Obtained for Internal Use</i>) may be capitalized.	Development costs are capitalized when technical and economic feasibility of a project can be demonstrated in accordance with specific criteria. Some of the stated criteria include: demonstrating technical feasibility, intent to complete the asset, and ability to sell the asset in the future, as well as others. Although application of these principles may be largely consistent with FAS 86 and SOP 98-1, there is no separate guidance addressing computer software development costs.
Advertising costs	Advertising and promotional costs are either expensed as incurred or expensed when the advertising takes place for the first time (policy choice). Direct response advertising may be capitalized if the specific criteria in SOP 93-07 <i>Reporting on Advertising Costs</i> are met.	Advertising and promotional costs are expensed as incurred. A prepayment may be recognized as an asset only when payment for the goods or services is made in advance of the entity's having access to the goods or receiving the services.
Revaluation	Revaluation is not permitted.	Revaluation to fair value of intangible assets other than goodwill is a permitted accounting policy election for a class of intangible assets. Because revaluation requires reference to an active market for the specific type of intangible, this is relatively uncommon in practice.

Convergence

While the convergence of standards on intangible assets was part of the 2006 "Memorandum of Understanding" (MOU) between the FASB and the IASB, both boards agreed in 2007 not to add this project to their agenda. However, in the 2008 MOU, the FASB indicated that it will consider in the future whether to undertake a project to eliminate differences in the accounting for research and development costs by fully adopting IAS 38 at some point in the future.

Leases

Similarities

The overall accounting for leases under US GAAP and IFRS (FAS 13 *Accounting for Leases* and IAS 17 *Leases*, respectively) is similar, although US GAAP has more specific application guidance than IFRS. Both focus on classifying leases as either capital (IAS 17 uses the term “finance”) or operating, and both separately discuss lessee and lessor accounting.

Lessee accounting (excluding real estate)

Both standards require the party that bears substantially all the risks and rewards of ownership of the leased property to recognize a lease asset and corresponding obligation, and specify criteria (FAS 13) or indicators (IAS 17) to make this determination (that is, whether a lease is capital or operating). The criteria or indicators of a capital lease are similar in that both standards include the transfer of ownership to the lessee at the end of the lease term and a purchase option that, at inception, is reasonably expected to be exercised. Further, FAS 13 requires capital lease treatment if the lease term is equal to or greater than 75% of the asset’s economic life, while IAS 17 requires such treatment when the lease term is a “major part” of the asset’s economic life. FAS 13 specifies capital lease treatment if the present value of the minimum lease payments exceeds 90% of the asset’s fair value, while IAS 17 uses the term “substantially all” of the fair value. In practice, while FAS 13 specifies bright lines in certain instances (for example, 75% of economic life), IAS 17’s general principles are interpreted similarly to the bright line tests. As a result, lease classification is often the same under FAS 13 and IAS 17.

Under both GAAPs, a lessee would record a capital (finance) lease by recognizing an asset and a liability, measured at the lower of the present value of the minimum lease payments or fair value of the asset. A lessee would record an operating lease by recognizing expense on a straight-line basis over the lease term. Any incentives under an operating lease are amortized on a straight line basis over the term of the lease.

Lessor accounting (excluding real estate)

Lessor accounting under FAS 13 and IAS 17 is similar and uses the above tests to determine whether a lease is a sales-type/direct financing lease or an operating lease. FAS 13 specifies two additional criteria (that is, collection of lease payments is reasonably expected and no important uncertainties surround the amount of unreimbursable costs to be incurred by the lessor) for a lessor to qualify for sales-type/direct financing lease accounting that IAS 17 does not have. Although not specified in IAS 17, it is reasonable to expect that if these conditions exist, the same conclusion may be reached under both standards. If a lease is a sales-type/direct financing lease, the leased asset is replaced with a lease receivable. If a lease is classified as operating, rental income is recognized on a straight-line basis over the lease term and the leased asset is depreciated by the lessor over its useful life.

Significant differences

	US GAAP	IFRS
Lease of land and building	<p>A lease for land and buildings that transfers ownership to the lessee or contains a bargain purchase option would be classified as a capital lease by the lessee, regardless of the relative value of the land.</p> <p>If the fair value of the land at inception represents 25% or more of the total fair value of the lease, the lessee must consider the land and building components separately for purposes of evaluating other lease classification criteria. (Note: Only the building is subject to the 75% and 90% tests in this case.)</p>	<p>The land and building elements of the lease are considered separately when evaluating all indicators unless the amount that would initially be recognized for the land element is immaterial, in which case they would be treated as a single unit for purposes of lease classification. There is no 25% test to determine whether to consider the land and building separately when evaluating certain indicators.</p>
Recognition of a gain or loss on a sale and leaseback when the leaseback is an operating leaseback	<p>If the seller does not relinquish more than a minor part of the right to use the asset, gain or loss is generally deferred and amortized over the lease term. If the seller relinquishes more than a minor part of the use of the asset, then part or all of a gain may be recognized depending on the amount relinquished. (Note: Does not apply if real estate is involved as the specialized rules are very restrictive with respect to the seller's continuing involvement and they may not allow for recognition of the sale.)</p>	<p>Gain or loss is recognized immediately, subject to adjustment if the sales price differs from fair value.</p>
Recognition of gain or loss on a sale leaseback when the leaseback is a capital leaseback	<p>Generally, same as above for operating leaseback where the seller does not relinquish more than a minor part of the right to use the asset.</p>	<p>Gain or loss deferred and amortized over the lease term.</p>

Other differences include: (i) the treatment of a leveraged lease by a lessor under FAS 13 (IAS 17 does not have such classification), (ii) real estate sale-leasebacks, (iii) real estate sales-type leases and (iv) the rate used to discount minimum lease payments to the present value for purposes of determining lease classification and subsequent recognition of a capital lease, including in the event of a renewal.

Convergence

The Boards are jointly working on a convergence project on lease accounting with an overall objective of creating a common standard on lease accounting to ensure that the assets and liabilities arising from lease contracts are recognized in the statement of financial position. The Boards have published a discussion paper that sets out their preliminary views on accounting for leases by lessees and describes some of the issues that the Boards will need to resolve in developing a new standard on lessor accounting. An exposure draft of a new accounting standard for leases is expected to be published in the first half of 2010.

Consolidation and equity method investees

Similarities

The principal guidance for consolidation of financial statements under US GAAP is ARB 51 *Consolidated Financial Statements* (as amended by FAS 160) and FAS 94 *Consolidation of All Majority-Owned Subsidiaries* while IAS 27 (Amended) *Consolidated and Separate Financial Statements* provides the guidance under IFRS. Variable interest entities and special-purpose entities are addressed in FIN 46 (Revised) *Consolidation of Variable Interest Entities* and SIC 12, *Consolidation – Special Purpose Entities*, in US GAAP and IFRS respectively.

Under both US GAAP and IFRS, the determination of whether or not entities are consolidated by a reporting enterprise is based on control, although differences exist in the definition of control. Generally, under both GAAPs all entities subject to the control of the reporting enterprise must be consolidated (note that there are limited exceptions in US GAAP in certain

specialized industries). While IFRS explicitly requires uniform accounting policies for all of the entities within a consolidated group, US GAAP has exceptions (for example, a subsidiary within a specialized industry may retain the specialized accounting policies in consolidation). Under both GAAPs, the consolidated financial statements of the parent and its subsidiaries may be based on different reporting dates as long as the difference is not greater than three months. However, under IFRS a subsidiary's financial statements should be as of the same date as the financial statements of the parent's unless it is impracticable to do so.

An equity investment that gives an investor significant influence over an investee (referred to as "an associate" in IFRS) is considered an equity method investment under both US GAAP (APB 18) and IFRS (IAS 28), if the investee is not consolidated. Further, the equity method of accounting for such investments, if applicable, generally is consistent under both GAAPs.

Significant differences

	US GAAP	IFRS
Consolidation model	Focus is on controlling financial interests. All entities are first evaluated as potential variable interest entities (VIEs). If a VIE, FIN 46 (Revised) guidance is followed (below). Entities controlled by voting rights are consolidated as subsidiaries, but potential voting rights are not included in this consideration. The concept of "effective control" exists, but is rarely employed in practice.	Focus is on the concept of the power to control, with control being the parent's ability to govern the financial and operating policies of an entity to obtain benefits. Control presumed to exist if parent owns greater than 50% of the votes, and potential voting rights must be considered. Notion of "de facto control" must also be considered.
VIEs / Special-purpose entities (SPEs)	FIN 46 (Revised) requires the primary beneficiary (determined based on the consideration of economic risks and rewards, if any) to consolidate the VIE.	Under SIC 12, SPEs (entities created to accomplish a narrow and well-defined objective) are consolidated when the substance of the relationship indicates that an entity controls the SPE.
Preparation of consolidated financial statements – general	Required, although certain industry-specific exceptions exist (for example, investment companies).	Generally required, but there is a limited exemption from preparing consolidated financial statements for a parent company that is itself a wholly-owned subsidiary, or is a partially-owned subsidiary if certain conditions are met.
Preparation of consolidated financial statements – different reporting dates of parent and subsidiary(ies)	The effects of significant events occurring between the reporting dates when different dates are used are disclosed in the financial statements.	The effects of significant events occurring between the reporting dates when different dates are used are adjusted for in the financial statements.

	US GAAP	IFRS
Equity method investments	<p>FAS 159 gives entities the option to account for their equity method investments at fair value, but the SEC staff believes careful consideration is required to determine whether this option is available. For those equity method investments for which management does not elect to use the fair value option, the equity method of accounting is required.</p> <p>Uniform accounting policies between investor and investee are not required.</p>	<p>IAS 28 requires investors (other than venture capital organizations, mutual funds, unit trusts and similar entities) to use the equity-method of accounting for such investments in consolidated financial statements. If separate financial statements are presented (that is, those presented by a parent or investor), subsidiaries and associates can be accounted for at either cost or fair value.</p> <p>Uniform accounting policies between investor and investee are required.</p>

Convergence

As part of their joint project on business combinations, the FASB issued FAS 160 (effective for fiscal years beginning on or after 15 December 2008) and the IASB amended IAS 27 (effective for fiscal years beginning on or after 1 July 2009, with early adoption permitted), thereby eliminating substantially all of the differences between US GAAP and IFRS pertaining to noncontrolling interests, outside of the initial accounting for the noncontrolling interest in a business combination (see the “Business combinations” section).

The FASB recently added to its agenda a project regarding the scope of FAS 160 to (1) address subsidiaries that are in-substance real estate and an inconsistency with FAS 66’s provisions and (2) address its application when a subsidiary is transferred to an equity method investee or joint venture. Future developments should be monitored.

The FASB has proposed amendments to FIN 46 (Revised). Additionally, the IASB is working on a consolidation project that would replace IAS 27 (Amended) and SIC 12 and is expected to provide for a single consolidation model within IFRS. These projects may ultimately result in some additional convergence. Future developments should be monitored.

Foreign currency matters

Similarities

FAS 52 *Foreign Currency Translation* and IAS 21 are quite similar in their approach to foreign currency translation. While the guidance provided by each for evaluating the functional currency of an entity is different, it generally results in the same determination (that is, the currency of the entity's primary economic environment). Both GAAPs generally consider the same economies to be hyperinflationary, although the accounting for an entity operating in such an environment can be very different.

Both GAAPs require foreign currency transactions of an entity to be remeasured into its functional currency with amounts resulting from changes in exchange rates being reported in income. Once a subsidiary's financial statements

are remeasured into its functional currency, both standards require translation into its parent's functional currency with assets and liabilities being translated at the period-end rate, and income statement amounts generally at the average rate, with the exchange differences reported in equity. Both standards also permit the hedging of that net investment with exchange differences from the hedging instrument offsetting the translation amounts reported in equity. The cumulative translation amounts reported in equity are reflected in income when there is a sale, or complete liquidation or abandonment of the foreign operation, but there are differences between the two standards when the investment in the foreign operation is reduced through dividends or repayment of long-term advances as indicated below.

Significant differences

	US GAAP	IFRS
Translation/functional currency of foreign operations in a hyperinflationary economy	Local functional currency financial statements are remeasured as if the functional currency were the reporting currency (US dollar in the case of a US parent) with resulting exchange differences recognized in income.	Local functional currency financial statements (current and prior period) are indexed using a general price index, and then translated to the reporting currency at the current rate.
Treatment of translation difference in equity when a partial return of a foreign investment is made to the parent	Translation difference in equity is recognized in income only upon sale (full or partial), or complete liquidation or abandonment of the foreign subsidiary. No recognition is made when there is a partial return of investment to the parent.	A return of investment (for example, dividend) is treated as a partial disposal of the foreign investment and a proportionate share of the translation difference is recognized in income.
Consolidation of foreign operations	The "step-by-step" method is used whereby each entity is consolidated into its immediate parent until the ultimate parent has consolidated the financial statements of all the entities below it.	The method of consolidation is not specified and, as a result, either the "direct" or the "step-by-step" method is used. Under the "direct" method, each entity within the consolidated group is directly consolidated into the ultimate parent without regard to any intermediate parent. The choice of method could affect the cumulative translation adjustments deferred within equity at intermediate levels, and therefore the recycling of such exchange rate differences upon disposal of an intermediate foreign operation.

Convergence

No convergence activities are underway or planned for foreign currency matters.

Share-based payments

Similarities

The guidance for share-based payments, FAS 123 (Revised) and IFRS 2 (both entitled *Share-Based Payment*), is largely convergent. Both GAAPs require a fair value-based approach in accounting for share-based payment arrangements whereby an entity (1) acquires goods or services in exchange for issuing share options or other equity instruments (collectively referred to as “shares” in this guide) or (2) incurs liabilities that are based, at least in part, on the price of its shares or that may require settlement in its shares. Under both GAAPs, this guidance applies to transactions with both employees and non-employees, and is applicable to all companies. Both FAS 123 (Revised) and IFRS 2 define the fair value of the transaction

to be the amount at which the asset or liability could be bought or sold in a current transaction between willing parties. Further, both GAAPs require, if applicable, the fair value of the shares to be measured based on market price (if available) or estimated using an option-pricing model. In the rare cases where fair value cannot be determined, both standards allow the use of intrinsic value. Additionally, the treatment of modifications and settlement of share-based payments is similar in many respects under both GAAPs. Finally, both GAAPs require similar disclosures in the financial statements to provide investors sufficient information to understand the types and extent to which the entity is entering into share-based payment transactions.

Significant differences

	US GAAP	IFRS
Transactions with non-employees	<p>Either the fair value of (1) the goods or services received, or (2) the equity instruments is used to value the transaction, whichever is more reliable.</p> <p>If using the fair value of the equity instruments, EITF 96-18 <i>Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services</i> requires measurement at the earlier of (1) the date at which a “commitment for performance” by the counterparty is reached or (2) the date at which the counterparty’s performance is complete.</p>	<p>Fair value of transaction should be based on the value of the goods or services received, and only on the fair value of the equity instruments if the fair value of the goods and services cannot be reliably determined.</p> <p>Measurement date is the date the entity obtains the goods or the counterparty renders the services. No performance commitment concept.</p>
Measurement and recognition of expense – awards with graded vesting features	<p>Entities make an accounting policy election to recognize compensation cost for awards containing only service conditions either on a straight-line basis or on an accelerated basis, regardless of whether the fair value of the award is measured based on the award as a whole or for each individual tranche.</p>	<p>Must recognize compensation cost on an accelerated basis – each individual tranche must be separately measured.</p>
Equity repurchase features at employee’s election	<p>Does not require liability classification if employee bears risks and rewards of equity ownership for at least six months from date equity is issued or vests.</p>	<p>Liability classification is required (no six-month consideration exists).</p>
Deferred taxes	<p>Calculated based on the cumulative GAAP expense recognized and trued up or down upon realization of the tax benefit.</p> <p>If the tax benefit exceeds the deferred tax asset, the excess (“windfall benefit”) is credited directly to shareholder equity. Shortfall of tax benefit below deferred tax asset is charged to shareholder equity to extent of prior windfall benefits, and to tax expense thereafter.</p>	<p>Calculated based on the estimated tax deduction determined at each reporting date (for example, intrinsic value).</p> <p>If the tax deduction exceeds cumulative compensation expense, deferred tax based on the excess is credited to shareholder equity. If the tax deduction is less than or equal to cumulative compensation expense, deferred taxes are recorded in income.</p>

	US GAAP	IFRS
Modification of vesting terms that are improbable of achievement	If an award is modified such that the service or performance condition, which was previously improbable of achievement, is probable of achievement as a result of the modification, the compensation expense is based on the fair value of the modified award at the modification date. Grant date fair value of the original award is not recognized.	Probability of achieving vesting terms before and after modification is not considered. Compensation expense is the grant-date fair value of the award, together with any incremental fair value at the modification date.

Convergence

No significant convergence activities are underway or planned for share-based payments.

Employee benefits other than share-based payments

Similarities

Multiple standards apply under US GAAP, including FAS 87 *Employers' Accounting for Pensions*, FAS 88 *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, FAS 106 *Employers' Accounting for Postretirement Benefits Other than Pensions*, FAS 112 *Employers' Accounting for Postemployment Benefits*, FAS 132 (Revised) *Employers' Disclosures about Pensions and Other Postretirement Benefits* and FAS 158 *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*. Under IFRS, IAS 19 *Employee Benefits* is the principal source of guidance for employee benefits other than share-based payments.

Under both GAAPs, the periodic postretirement benefit cost under defined contribution plans is based on the contribution due from the employer in each period. The accounting for defined benefit plans has many similarities as well. The defined benefit obligation is the present value of benefits that have accrued to employees through services rendered to that date, based on actuarial methods of calculation. Additionally, both US GAAP and IFRS provide for certain smoothing mechanisms in calculating the period pension cost.

Significant differences

	US GAAP	IFRS
Actuarial method used for defined benefit plans	Different methods are required dependent on the characteristics of the benefit calculation of the plan.	Projected unit credit method is required in all cases.
Valuation of defined benefit plan assets	Valued at "market-related" value (which is either fair value or a calculated value that smoothes the effect of short-term market fluctuations over five years) within three months of the balance sheet date. (Note: for fiscal years ending after December 15, 2008, the valuation must be done as of the balance sheet date.)	Valued at fair value as of the balance sheet date.
Treatment of actuarial gains and losses for annual pension cost	May be recognized in income statement as they occur or deferred through either a corridor approach or other rational approach applied consistently from period to period.	May be recognized in the income statement as they occur or deferred through a corridor approach. If immediately recognized, can elect to present in either the income statement or other comprehensive income.
Amortization of deferred actuarial gains and losses	Over the average remaining service period of active employees or over the remaining life expectancy of inactive employees.	Over the average remaining service period (that is, immediately for inactive employees).
Amortization of prior service costs	Over the future service lives of employees or, for inactive employees, over the remaining life expectancy of those participants.	Over the average remaining service period; immediate recognition if already vested.
Recognition of plan asset or liability in the balance sheet	Must recognize in balance sheet the over/under funded status as the difference between the fair value of plan assets and the benefit obligation. Benefit obligation is the PBO for pension plans, and APBO for any other postretirement plans. No portion of a plan asset can be classified as current; current portion of net postretirement liability is the amount expected to be paid in the next 12 months.	Must recognize a liability in the balance sheet equal to the present value of the defined benefit obligation plus or minus any actuarial gains and losses not yet recognized, minus unrecognized prior service costs, minus the fair value of any plan assets. (Note: If this amount is negative, the resulting asset is subject to a "ceiling test.") Balance sheet classification not addressed in IAS 19.

	US GAAP	IFRS
Settlements and curtailments	Settlement gain or loss recognized when obligation is settled. Curtailment losses recognized when curtailment is probable of occurring, while curtailment gains are recognized when the curtailment occurs.	Gain or loss from settlement or curtailment recognized when it occurs.
Multi-employer pension plans	Accounted for similar to a defined contribution plan.	Plan is accounted for as either a defined contribution or defined benefit plan based on the terms (contractual and constructive) of the plan. If a defined benefit plan, must account for the proportionate share of the plan similar to any other defined benefit plan unless insufficient information is available.

Convergence

The FASB and the IASB have agreed to a long-term convergence project that will comprehensively challenge the accounting for postretirement benefits. This project is expected to address many of the common concerns with the current accounting model such as the smoothing and deferral mechanisms in the current model. The IASB issued a discussion paper in March 2008, as the first step of the IASB project, addressing a limited number of topics in this area, and is expecting to issue an exposure draft in 2009.

Income taxes

Similarities

FAS 109 Accounting for Income Taxes and IAS 12 Income Taxes provide the guidance for income tax accounting under US GAAP and IFRS, respectively. Both pronouncements require entities to account for both current tax effects and expected future tax consequences of events that have been recognized (that is, deferred taxes) using an asset and liability approach. Further, deferred taxes for temporary differences arising from non-deductible goodwill are not recorded under either approach, and tax effects of items accounted for directly in equity during the current year also are allocated directly to equity. Finally, neither GAAP permits the discounting of deferred taxes.

Significant differences and convergence

In March 2009 the IASB published an exposure draft to replace IAS 12 that will eliminate certain of the differences that currently exist between US GAAP and IFRS. The table below highlights the significant differences in the current literature, as well as the proposed accounting under the IASB's exposure draft. While initially participating in the deliberations on this proposed standard, the FASB decided to suspend deliberations on this project until the IASB issues its exposure document on the proposed replacement to IAS 12 for public comment. The FASB is expected to solicit input from US constituents regarding the IASB's proposed replacement to IAS 12 and then determine whether to undertake a project to fully eliminate the differences in the accounting for income taxes by adopting the revised IAS 12.

	US GAAP	IFRS	IASB Exposure Draft
Tax basis	Tax basis is a question of fact under the tax law. For most assets and liabilities there is no dispute on this amount; however, when uncertainty exists it is determined in accordance with FIN 48 <i>Accounting for Uncertainty in Income Taxes</i>	Tax basis is generally the amount deductible or taxable for tax purposes. The manner in which management intends to settle or recover the carrying amount affects the determination of tax basis.	The Exposure Draft proposes a new definition for tax basis that will eliminate consideration of management's intent in the determination of the tax basis.
Uncertain tax positions	FIN 48 requires a two-step process, separating recognition from measurement. A benefit is recognized when it is "more likely than not" to be sustained based on the technical merits of the position. The amount of benefit to be recognized is based on the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement. Detection risk is precluded from being considered in the analysis.	Does not include specific guidance. In practice, two approaches have been applied: (1) uncertain tax positions are recorded based on the recognition principles in IAS 37 and the measurement principles in IAS 12 or (2) uncertain tax positions are recorded based on the "expected value" approach.	The Exposure Draft addresses uncertain tax positions, but the approach is different from FIN 48. The Exposure Draft does not include separate recognition criteria; instead it requires, based on the technical merits of the position, measurement of the benefit to be recognized based on the probability weighted average of all possible outcomes. Detection risk is precluded from being considered in the analysis.
Initial recognition exemption	Does not include an exemption like that under IFRS for non-recognition of deferred tax effects for certain assets or liabilities.	Deferred tax effects arising from the initial recognition of an asset or liability are not recognized when (1) the amounts did not arise from a business combination and (2) upon occurrence the transaction affects neither accounting nor taxable profit (for example, acquisition of non-deductible assets).	The Exposure Draft eliminates the initial recognition exemption, but it proposes a new complex model that will create additional differences.

	US GAAP	IFRS	IASB Exposure Draft
Recognition of deferred tax assets	Recognized in full (except for certain outside basis differences), but valuation allowance reduces asset to the amount that is more likely than not to be realized.	Amounts are recognized only to the extent it is probable (similar to "more likely than not" under US GAAP) that they will be realized.	The Exposure Draft proposes to converge IFRS with US GAAP requirements.
Calculation of deferred tax asset or liability	Enacted tax rates must be used.	Enacted or "substantively enacted" tax rates as of the balance sheet date must be used.	The Exposure Draft clarifies the definition of "substantively enacted" and indicates that for US jurisdictions, it equates to when tax laws are enacted.
Classification of deferred tax assets and liabilities in balance sheet	Current or non-current classification, based on the nature of the related asset or liability, is required.	All amounts classified as non-current in the balance sheet.	The Exposure Draft proposes to converge IFRS with US GAAP requirements.
Recognition of deferred tax liabilities from investments in subsidiaries or joint ventures (JVs) (often referred to as outside basis differences)	Recognition not required for investment in foreign subsidiary or corporate JV that is essentially permanent in duration, unless it becomes apparent that the difference will reverse in the foreseeable future.	Recognition required unless the reporting entity has control over the timing of the reversal of the temporary difference and it is probable ("more likely than not") that the difference will not reverse in the foreseeable future.	The Exposure Draft proposes to converge IFRS with US GAAP requirements with respect to foreign subsidiaries and joint ventures. Differences will remain with respect to the recognition of deferred tax assets on basis differences in domestic subsidiaries and domestic joint ventures that are permanent in duration.
Taxes on intercompany transfers of assets that remain within a consolidated group	Requires taxes paid on intercompany profits to be deferred and prohibits the recognition of deferred taxes on differences between the tax bases of assets transferred between entities/tax jurisdictions that remain within the consolidated group.	Requires taxes paid on intercompany profits to be recognized as incurred and permits the recognition of deferred taxes on differences between the tax bases of assets transferred between entities/tax jurisdictions that remain within the consolidated group.	The Exposure Draft does not propose to change current accounting, but it requires additional disclosures. Differences with US GAAP will continue to exist.

Other differences include: (i) the allocation of subsequent changes to deferred taxes to components of income or equity (the Exposure Draft proposes to substantially eliminate this difference), (ii) the calculation of deferred taxes on foreign nonmonetary assets and liabilities when the local currency of an entity is different than its functional currency and (iii) the tax rate applicable to distributed or undistributed profits and (iv) deferred tax effects of intercompany transfers of assets.

Business combinations

Similarities

The issuance of FAS 141 (Revised) and IFRS 3 (Revised) (both entitled *Business Combinations*), represent the culmination of the first major collaborative convergence project between the IASB and the FASB. Pursuant to FAS 141 (Revised) and IFRS 3 (Revised), all business combinations are accounted for using the acquisition method. Under the acquisition method, upon obtaining control of another entity, the underlying transaction should be measured at fair value, and this should be the basis

on which the assets, liabilities and noncontrolling interests of the acquired entity are measured (as described in the table below, IFRS 3 (Revised) provides an alternative to measuring noncontrolling interest at fair value), with limited exceptions. Even though the new standards are substantially converged, certain differences will exist once the new standards become effective. The new standards will be effective for annual periods beginning on or after 15 December 2008, and 1 July 2009, for companies following US GAAP and IFRS, respectively.

Significant differences

	US GAAP	IFRS
Measurement of noncontrolling interest	Noncontrolling interest is measured at fair value, which includes the noncontrolling interest's share of goodwill.	Noncontrolling interest is measured either at fair value including goodwill or its proportionate share of the fair value of the acquiree's identifiable net assets, exclusive of goodwill.
Assets and liabilities arising from contingencies	<p><i>Initial Recognition</i> Certain contingent assets and liabilities are recognized at the acquisition date at fair value if fair value can be determined during the measurement period. If the fair value of a contingent asset or liability cannot be determined during the measurement period, an asset with a liability should be recognized at the acquisition date in accordance with FAS 5 if certain criteria are met.</p> <p>Contingent assets and liabilities not meeting the recognition criteria at the acquisition date are subsequently accounted for pursuant to other literature, including FAS 5. (See "Provisions and contingencies" for differences between FAS 5 and IAS 37.)</p> <p><i>Subsequent Measurement</i> Contingent assets and liabilities recognized at the acquisition date are subsequently measured and accounted for on a systematic and rational basis, depending on their nature.</p>	<p><i>Initial Recognition</i> Contingent liabilities are recognized as of the acquisition date if there is a present obligation that arises from past events and its fair value can be measured reliably. Contingent assets are not recognized.</p> <p><i>Subsequent Measurement</i> Contingent liabilities are subsequently measured at the higher of their acquisition-date fair values less, if appropriate, cumulative amortization recognized in accordance with IAS 18 or the amount that would be recognized if applying IAS 37.</p>
Acquiree operating leases	If the terms of an acquiree operating lease are favorable or unfavorable relative to market terms, the acquirer recognizes an intangible asset or liability, respectively, regardless of whether the acquiree is the lessor or the lessee.	Separate recognition of an intangible asset or liability is required only if the acquiree is a lessee. If the acquiree is the lessor, the terms of the lease are taken into account in estimating the fair value of the asset subject to the lease - separate recognition of an intangible asset or liability is not required.
Combination of entities under common control	Accounted for in a manner similar to a pooling of interests (historical cost).	Outside the scope of IFRS 3 (Revised). In practice, either follow an approach similar to US GAAP or apply the purchase method if there is substance to the transaction.

Other differences may arise due to different accounting requirements of other existing US GAAP-IFRS literature (for example, identifying the acquirer, definition of control, definition of fair value, replacement of share-based payment awards, initial classification and subsequent measurement of

contingent consideration, initial recognition and measurement of income taxes and initial recognition and measurement of employee benefits).

Convergence

No further convergence is planned at this time.

Financial statement presentation

Similarities

There are many similarities between US GAAP and IFRS relating to financial statement presentation. For example, under both frameworks, the components of a complete set of financial statements include: balance sheet, income statement, other comprehensive income for US GAAP or statement of recognized income and expense (SORIE) for IFRS, statement of cash flows, and accompanying notes to the

financial statements. Further, both frameworks require that the financial statements be prepared on the accrual basis of accounting (with the exception of the cash flows statement) except for rare circumstances. Both GAAPs have similar concepts regarding materiality and consistency that entities have to consider in preparing their financial statements. Differences between the two tend to arise in the level of specific guidance.

Significant differences

	US GAAP	IFRS
Financial periods required	Generally, comparative financial statements are presented; however, a single year may be presented in certain circumstances. Public companies must follow SEC rules, which typically require balance sheets for the two most recent years, while all other statements must cover the three-year period ended on the balance sheet date.	Comparative information must be disclosed in respect of the previous period for all amounts reported in the financial statements.
Layout of balance sheet and income statement	No general requirement within US GAAP to prepare the balance sheet and income statement in accordance with a specific layout; however, public companies must follow the detailed requirements in Regulation S-X.	IAS 1 <i>Presentation of Financial Statements</i> does not prescribe a standard layout, but includes a list of minimum items. These minimum items are less prescriptive than the requirements in Regulation S-X.
Presentation of debt as current versus non-current in the balance sheet	Debt for which there has been a covenant violation may be presented as non-current if a lender agreement to waive the right to demand repayment for more than one year exists prior to the issuance of the financial statements. Deferred taxes are presented as current or non-current based on the nature of the related asset or liability.	Debt associated with a covenant violation must be presented as current unless the lender agreement was reached prior to the balance sheet date. Deferred taxes are presented as non-current. (Note: In the joint convergence project on income taxes, IFRS is expected to converge with US GAAP.)
Income statement – classification of expenses	SEC registrants are required to present expenses based on function (for example, cost of sales, administrative).	Entities may present expenses based on either function or nature (for example, salaries, depreciation). However, if function is selected, certain disclosures about the nature of expenses must be included in the notes.
Income statement – extraordinary items	Restricted to items that are both unusual and infrequent.	Prohibited.
Income statement – discontinued operations presentation	Discontinued operations classification is for components held for sale or to be disposed of, provided that there will not be significant continuing cash flows or involvement with the disposed component.	Discontinued operations classification is for components held for sale or to be disposed of that are either a separate major line of business or geographical area or a subsidiary acquired exclusively with an intention to resale.
Changes in equity	Present all changes in each caption of stockholders' equity in either a footnote or a separate statement.	At a minimum, present components related to "recognized income and expense" as part of a separate statement (referred to as the SORIE if it contains no other components). Other changes in equity either disclosed in the notes, or presented as part of a single, combined statement of all changes in equity (in lieu of the SORIE).
Disclosure of performance measures	SEC regulations define certain key measures and require the presentation of certain headings and subtotals. Additionally, public companies are prohibited from disclosing non-GAAP measures in the financial statements and accompanying notes.	Certain traditional concepts such as "operating profit" are not defined; therefore, diversity in practice exists regarding line items, headings and subtotals presented on the income statement that are relevant to an understanding of the entity's financial performance.

Convergence

In April 2004, the FASB and the IASB (the Boards) agreed to undertake a joint project on financial statement presentation. As part of "Phase A" of the project, the IASB issued a revised IAS 1 in September 2007 (with an effective date for annual reporting periods ending after 1 January 2009) modifying the requirements of the SORIE within IAS 1 and bringing it largely in line with the FASB's statement of other comprehensive income. As part of "Phase B," the Boards each issued an initial discussion document in October 2008, with comments due by April 2009. This phase of the project addresses the more fundamental issues for presentation of information on the face of the financial statements, and may ultimately result in significant changes in the current presentation format of the financial statements under both GAAPs.

In September 2008, the Boards issued proposed amendments to FAS 144 and IFRS 5 to converge the definition of discontinued operations. Under the proposals, a discontinued operation would be a component of an entity that is either (1) an operating segment (as defined in FAS 131 *Disclosure About Segments of an Enterprise and Related Information* and IFRS 8 respectively) held for sale or that has been disposed of, or (2) a business (as defined in FAS 141 (Revised) and IFRS 3 (Revised)) that meets the criteria to be classified as held for sale on acquisition.

Segment reporting

Similarities

The requirements for segment reporting under FAS 131 and IFRS 8, are applicable to entities with public reporting requirements and are based on a “management approach” in identifying the reportable segments. These two standards are largely converged, and only limited differences exist between the two GAAPs.

Significant differences

	US GAAP	IFRS
Determination of segments	Entities with a “matrix” form of organization (that is, business components are managed in more than one way and the CODM reviews all of the information provided) must determine segments based on products and services.	All entities determine segments based on the management approach, regardless of form of organization.
Disclosure requirements	Entities are not required to disclose segment liabilities even if reported to the CODM.	If regularly reported to the CODM, segment liabilities are a required disclosure.

Convergence

No further convergence is planned at this time.

Earnings per share

Similarities

Entities whose ordinary shares are publicly traded, or that are in the process of issuing such shares in the public markets, must disclose earnings per share (EPS) information pursuant to FAS 128 and IAS 33 (both entitled *Earnings Per Share*, which are substantially the same). Both require presentation of basic and diluted EPS on the face of the income statement, and both use the treasury stock method for determining the effects of stock options and warrants on the diluted EPS calculation. Both GAAPs use similar methods of calculating EPS, although there are a few detailed application differences.

Significant differences

	US GAAP	IFRS
Contracts that may be settled in shares or cash	Presumption that such contracts will be settled in shares unless evidence is provided to the contrary.	Such contracts are <i>always</i> assumed to be settled in shares.
Calculation of year-to-date diluted EPS for options and warrants using the treasury stock method and for contingently issuable shares	The number of incremental shares is computed using a year-to-date weighted average of the number of incremental shares included in each quarterly calculation.	The number of incremental shares is computed as if the entire year-to-date period were "the period" (that is, do not average the current period with each of the prior periods).
Treatment of contingently convertible debt	Potentially issuable shares are included in diluted EPS using the "if-converted" method if one or more contingencies relate to the entity's share price.	Potentially issuable shares are considered "contingently issuable" and are included in diluted EPS using the if-converted method only if the contingencies are satisfied at the end of the reporting period.

Convergence

Both Boards are jointly working on a short-term convergence project to resolve the differences in the standards, with both Boards issuing exposure drafts in August 2008 and planning to issue a final standard in the second half of 2009. The Boards have tentatively decided to adopt the approaches used by IFRS to eliminate the significant differences noted above, with the exception of the treatment of contingently convertible debt. Additionally, instruments that may be settled in cash or shares are classified as an asset or liability, and are measured at fair value with changes in fair value recognized in earnings, would no longer be included in diluted EPS. Other issues to be converged include the effect of options and warrants with a nominal exercise price on basic EPS (including the two-class method) and modifications of the treasury stock method to (1) require the use of the end-of-period share price in calculating the shares

hypothetically repurchased rather than the average share price for the period and (2) for liabilities that are not remeasured at fair value, including the carrying amount of the liability within the assumed proceeds used to hypothetically repurchase shares under the treasury stock method.

Interim financial reporting

Similarities

APB 28 and IAS 34 (both entitled *Interim Financial Reporting*) are substantially similar with the exception of the treatment of certain costs as described below. Both require an entity to use the same accounting policies that were in effect in the prior year, subject to adoption of new policies that are disclosed. Both standards allow for condensed interim financial

statements (which are similar but not identical) and provide for comparable disclosure requirements. Neither standard mandates which entities are required to present interim financial information, that being the purview of local securities regulators. For example, US public companies must follow the SEC's Regulation S-X for the purpose of preparing interim financial information.

Significant difference

	US GAAP	IFRS
Treatment of certain costs in interim periods	Each interim period is viewed as an integral part of an annual period. As a result, certain costs that benefit more than one interim period may be allocated among those periods, resulting in deferral or accrual of certain costs. For example, certain inventory cost variances may be deferred on the basis that the interim statements are an integral part of an annual period.	Each interim period is viewed as a discrete reporting period. A cost that does not meet the definition of an asset at the end of an interim period is not deferred and a liability recognized at an interim reporting date must represent an existing obligation. For example, inventory cost variances that do not meet the definition of an asset cannot be deferred. However, income taxes are accounted for based on an annual effective tax rate (similar to US GAAP).

Convergence

As part of their joint Financial Statement Presentation project, the FASB will address presentation and display of interim financial information in US GAAP, and the IASB may reconsider the requirements of IAS 34. This phase of the Financial Statement Presentation project has not commenced.

Subsequent events

Similarities

Despite differences in terminology, the accounting for subsequent events under AU Section 560 *Subsequent Events* of the AICPA Codification of Statements on Auditing Standards and IAS 10 *Events after the Balance Sheet Date* is largely similar. An event that during the subsequent events period that provides additional evidence about conditions existing at the balance sheet date usually results in an adjustment to the financial statements. If the event occurring after the balance sheet date but before the financial statements are issued relates to conditions that arose subsequent to the balance sheet date, the financial statements are not adjusted, but disclosure may be necessary in order to keep the financial statements from being misleading.

FASB Interpretation No. 36 *Accounting for Exploratory Wells in Progress at the End of a Period* an interpretation of FASB Statement No. 19 requires that If an exploratory well or exploratory-type stratigraphic test well is in progress at the end of a period and the well is determined not to have found proved reserves before the financial statements for that period are issued, the costs incurred through the end of the period, net of any salvage value, are charged to expense for that period. Under IAS 10, adjusting events are those events for which the receipt of information after the balance sheet date indicates that an asset was impaired at the balance sheet date. For example, the receipt of information after the balance sheet date but before the financial statements are authorized for issue indicating there are no proved reserves for a well generally represents an adjusting event under IFRS.

Significant differences

	US GAAP	IFRS
Date through which subsequent events must be evaluated	Subsequent events are evaluated through the date that the financial statements are issued. For public entities, this is the date that the financial statements are filed with the SEC.	Subsequent events are evaluated through the date that the financial statements are "authorized for issue." Depending on an entity's corporate governance structure and statutory requirements, authorization may come from management or a board of directors.
Stock dividends declared after balance sheet date	Financial statements are adjusted for a stock dividend declared after the balance sheet date.	Financial statements are not adjusted for a stock dividend declared after the balance sheet date.
Short-term loans refinanced with long-term loans after balance sheet date	Short-term loans are classified as long-term if the entity intends to refinance the loan on a long-term basis <i>and</i> , prior to issuing the financial statements, the entity can demonstrate an ability to refinance the loan.	Short-term loans refinanced after the balance sheet date may not be reclassified to long-term liabilities.

Convergence

No convergence activities are planned at this time, although the FASB recently issued an exposure draft with the objective of incorporating into FASB literature the current guidance included in AU 560, with certain modifications.

Related parties

Similarities

Both FAS 57 and IAS 24 (both entitled *Related Party Disclosures*) have a similar reporting objective: to make financial statement users aware of the effect of related party transactions on the financial statements. The related party definitions are broadly similar, and both standards require that the nature of the relationship, a description of the transaction, and the amounts involved (including outstanding balances) be disclosed for related party transactions. Neither standard contains any measurement or recognition requirements for related party transactions. FAS 57 does not require disclosure of compensation of key management personnel as IAS 24 does, but the financial statement disclosure requirements of IAS 24 are similar to those required by the SEC outside the financial statements.

Significant Differences and Convergence

There are no significant differences between the two standards, nor are there any convergence initiatives.

First-time adoption

Companies electing to adopt the financial reporting standards of the IASB are required to retrospectively apply the international standards that exist as of the company's first reporting date under IFRS, to all periods presented as if they had always been in effect. However, in deliberating how to account for transition to IFRS, the IASB recognized there were certain situations in which the cost of a full retrospective application of IFRS would exceed the potential benefit to investors and other users of the financial statements. In other situations, the Board noted that retrospective application would require judgments by management about past conditions after the outcome of a particular transaction is already known. As a result, the IASB issued IFRS 1 *First-time Adoption of International Financial Reporting Standards*, which provides guidance that all companies must follow on their initial adoption of the international standards. IFRS 1 contains a number of voluntary exemptions and mandatory exceptions to the requirement for a full retrospective application of IFRS, which are listed below.

Voluntary exemptions

- ▶ Business combinations
- ▶ The use of fair value or revaluation as deemed cost of property, plant and equipment, investment properties and certain intangible assets
- ▶ Financial instruments:
 - ▶ Designation of previously recognized financial instruments
 - ▶ Compound financial instruments
 - ▶ Fair value measurement of financial assets or financial liabilities at initial recognition
- ▶ Employee benefits
- ▶ Cumulative transition differences
- ▶ Share-based payment transactions
- ▶ Insurance contracts
- ▶ Assets and liabilities of subsidiaries, associates and joint ventures
- ▶ Service concessions
- ▶ Decommissioning liabilities included in the cost of property, plant and equipment
- ▶ Leases
- ▶ Investments in subsidiaries, jointly controlled entities and associates
- ▶ Borrowing costs

Mandatory exemptions

- ▶ Financial instruments:
 - ▶ Derecognition of financial assets and liabilities
 - ▶ Hedge accounting
- ▶ Estimates
- ▶ Some aspects of accounting for non-controlling interests

Refer to our IFRS 1 FRD for further discussion and application of these exemptions (expected to be issued in May 2009).

Proposed amendments to IFRS 1

Oil and gas producing assets

Under the proposed amendment, a first-time adopter using full cost accounting under previous GAAP (i.e., US GAAP) would be able to elect to measure oil and gas assets² at the date of transition to IFRS on the following basis:

- a. exploration and evaluation (E&E) assets at the amount determined under US GAAP; and
- b. assets in the development or production phases at the amount determined under US GAAP, allocated to the underlying assets pro rata using reserve volumes or reserve values as of that date.

After measuring oil and gas assets on this basis, E&E assets and assets in the development and production phases would be required to be tested for impairment at the date of transition to IFRS in accordance with IFRS 6 and IAS 36 respectively.

² The proposed amendment defines oil and gas assets for the purpose of the exemption as only those assets used in the exploration, evaluation, development or production of oil and gas.

Rate regulated fixed assets

A first-time adopter with operations subject to rate regulation³ may elect to use the carrying amount of the asset at the date of transition to IFRS if it is otherwise impracticable (as defined in IAS 8) to meet the requirements of IFRS 1. This exemption is applied individually to each rate regulated asset (e.g., it is not a “blanket” exception).

At the date of transition to IFRS, each item for which the exemption is used must be tested for impairment in accordance with IAS 36 and, if necessary, the carrying amount of the asset must be reduced.

The comment period for the proposed amendment ended 23 January 2009 and a final amendment is expected in 2009.

³ The proposed amendment defines operations subject to rate regulation as those that provide services or products to customers at prices (e.g., rates) established by legislation, an independent regulator or other authorized body that are designed to recover the cost of providing the services or products and allow the entity to earn a determined return on investment.

Appendix –

The evolution of IFRS

This appendix provides a high level overview of key milestones in the evolution of international accounting standards.

Phase I – 2001 and prior

- ▶ **1973: International Accounting Standards Committee (IASC) formed.** The IASC was founded to formulate and publish International Accounting Standards (IAS) that would improve financial reporting and that could be accepted worldwide. In keeping with the original view that the IASC's function was to prohibit undesirable accounting practices, the original IAS permitted several alternative accounting treatments.
- ▶ **1994: IOSCO (International Organization of Securities Commissions) completed its review of then current IASC standards and communicated its findings to the IASC.** The review identified areas that required improvement before IOSCO could consider recommending IAS for use in cross-border listings and offerings.
- ▶ **1994: Formation of IASC Advisory Council approved to provide oversight to the IASC and manage its finances.**
- ▶ **1995: IASC developed its Core Standards Work Program. IOSCO's Technical Committee agreed that the Work Program would result, upon successful completion, in IAS comprising a comprehensive core set of standards.** The European Commission (EC) supported this agreement between IASC and IOSCO and "associated itself" with the work of the IASC towards a broader international harmonization of accounting standards.
- ▶ **1997: Standing Interpretations Committee (SIC) established to provide interpretation of IAS.**
- ▶ **1999: IASC Board approved a restructuring that resulted in the current International Accounting Standards Board (IASB).** The newly constituted IASB structure comprises: (1) the IASC Foundation, an independent organization with 22 trustees who appoint the IASB members, exercise oversight, and raise the funds needed, (2) the IASB (Board) which has 12 full-time, independent board members and two part-time board members with sole responsibility for setting accounting standards, (3) the Standards Advisory Council, and (4) the International Financial Reporting Interpretations Committee (IFRIC) (replacing the SIC) and is mandated with interpreting existing IAS and IFRS standards, and providing timely guidance on matters not addressed by current standards.
- ▶ **2000: IOSCO recommended that multinational issuers be allowed to use IAS in cross-border offerings and listings.**
- ▶ **April 2001: IASB assumed standard-setting responsibility from the IASC.** The IASB met with representatives from eight national standard-setting bodies to begin coordinating agendas and discussing convergence, and adopted the existing IAS standards and SIC Interpretations.
- ▶ **February 2002: IFRIC assumed responsibility for interpretation of IFRS.**

Phase II – 2002 to 2005

- ▶ **July 2002: EC required EU-listed companies to prepare their consolidated financial statements in accordance with IFRS as endorsed by the EC, generally from 2005 onward.** This was a critically important milestone that acted as a primary driver behind the expanded use of IFRS.
- ▶ **September 2002: Norwalk Agreement executed between the FASB and the IASB.** A "best efforts" convergence approach was documented in a Memorandum of Understanding in which the Boards agreed to use best efforts to make their existing financial reporting standards fully compatible as soon as practicable and to coordinate future work programs.
- ▶ **December 2004: EC issued its Transparency Directive.** This directive would require non-EU companies with listings on an EU exchange to use IFRS unless the Committee of European Securities Regulators (CESR) determined that the national GAAP was "equivalent" to IFRS. Although CESR advised in 2005 that US GAAP was "equivalent" subject to certain additional disclosure requirements, the final decision as to US GAAP equivalency, and what additional disclosures, if any, will be required, has not been reached.
- ▶ **April 2005: SEC published the "Roadmap."** An article published by then SEC Chief Accountant discussed the possible elimination of the US GAAP reconciliation for foreign private issuers that use IFRS. The Roadmap laid out a series of milestones, which if achieved, would result in the elimination of the US GAAP reconciliation by 2009, if not sooner.

Phase III – 2006 to present

- ▶ **February 2006: FASB and IASB published a Memorandum of Understanding (MOU).** The MOU reaffirmed the Boards' shared objective to develop high quality, common accounting standards for use in the world's capital markets, and further elaborated on the Norwalk Agreement. The Boards would proceed along two tracks for convergence: (1) a series of short-term standard setting projects designed to eliminate major differences in focused areas, and (2) the development of new common standards when accounting practices under both GAAPs are regarded as candidates for improvement.
- ▶ **August 2006: CESR/SEC published a joint work plan.** The regulators agreed that issuer-specific matters could be shared between the regulators, following set protocols, and that their regular reviews of issuer filings would be used to identify IFRS and US GAAP areas that raise questions in terms of high-quality and consistent application. The plan also provides for the exchange of technological information to promote the modernization of financial reporting and disclosure. Finally, the staff of both regulators agreed to dialogue on risk management practices.
- ▶ **November 2007: the SEC eliminates the US GAAP reconciliation for foreign private issuers.** After hosting a roundtable discussion in March 2007 to discuss the effects the acceptance of IFRS would have on investors, issuers, and capital raising in the US capital markets and issuing a summary of its observations regarding foreign private issuers that adopted IFRS for the first time in 2005, the SEC determined that the milestones on its 2005 Roadmap had been sufficiently met to eliminate the reconciliation requirement.
- ▶ **Mid-2007, continuing into 2009: SEC explores the future use of IFRS by US companies.** Also in August 2007, the SEC issued a Concept Release asking the public to comment on the possible use of IFRS by US domestic registrants. In December 2007 and August 2008, the SEC held three additional roundtables on the topic of IFRS, with the roundtables focusing on the potential use of IFRS for US issuers. Further, in November 2008 the SEC issued for public comment an updated Roadmap which anticipates mandatory reporting under IFRS beginning in 2014, 2015 or 2016, depending on the size of the company. The comment period ended 20 April 2009.
- ▶ **Looking ahead:** The future remains uncertain, but momentum continues to build for a single set of high quality global standards. The possible use of IFRS by US domestic registrants is a topic that remains active on the SEC's agenda. **The updated proposed Roadmap identifies certain milestones to be considered in determining whether reporting under IFRS should be mandated for US companies, and calls for future SEC action in 2011 to make that assessment.**

IFRS resources

Ernst & Young offers a variety of online resources that provide more detail about IFRS as well as things to consider as you research the potential impact of IFRS on your company.

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Ernst & Young's global website contains a variety of free resources, including:

- ▶ Our five-step approach to IFRS conversion—diagnosis, design and planning, solution development, implementation, and post-implementation review
- ▶ A variety of tools and publications:
 - ▶ *IFRS outlook*—access the online version and archived issues of our monthly client newsletter
 - ▶ Technical publications—including a variety of publications focused on specific standards and industries
 - ▶ International GAAP® Illustrative Financial Statements—these publications include the consolidated financial statements for a fictitious manufacturing company, bank and insurance company. The statements are updated annually
 - ▶ Sector-specific guidance, including *Industry 360: IFRS*, an overview of our industry-related IFRS thought leadership
- ▶ From here you can also link to several country-specific IFRS pages, including Canada and the United States, and locate information about free web-based IFRS training and our Thought Center Webcast series

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SCORE No. BB1757

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