



INTERNET

## New SEC Rules Governing Foreign Private Issuers' Financial Statements

### SEC Accepts Financial Statements from Foreign Private Issuers Prepared in Accordance with International Financial Reporting Standards without Reconciliation to U.S. GAAP

*The Securities and Exchange Commission ("SEC") issued final rules on December 21, 2007 under which foreign private issuers<sup>1</sup> may file financial statements prepared in accordance with the English language version of International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB") without reconciliation to generally accepted accounting principles ("U.S. GAAP").<sup>2</sup> The new rules became effective March 4, 2008 and are applicable to financial statements for financial years ending after November 15, 2007 and for interim periods within those years that are included in filings submitted after March 4, 2008.*

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The new rules reduce differences between accounting and disclosure practices of issuers in the United States and those in other countries, thereby reducing the administrative and transactional costs of foreign private issuers accessing U.S. capital markets. Additionally, the new rules may provide U.S. investors with improved financial information concerning U.S.-registered foreign companies in which they have invested.

#### **ELIGIBILITY**

Under the SEC's final rules, an issuer who is a foreign private issuer will not be required to reconcile its financial statements to U.S. GAAP if the issuer (i) files reports on Form 20-F; (ii) files financial statements in compliance with IFRS as issued by the IASB and states unreservedly and explicitly that its financial statements are in compliance with IFRS as issued by the IASB; and (iii) compels its independent auditor to opine that the issuer's financial statements comply with IFRS as issued by IASB.

# CLIENT ALERT

Any foreign private issuer that files financial statements that reflect any deviation from IFRS as issued by the IASB will be required to reconcile to U.S. GAAP. A foreign private issuer that uses a jurisdictional variation of IFRS instead of IFRS as issued by the IASB may still benefit from the new rules if the issuer and its independent auditor both issue statements declaring that the financial statements are in compliance with IFRS as issued by the IASB.

The new rules also permit foreign private issuers to file required financial statements for interim periods without a reconciliation to U.S. GAAP and without providing disclosures under Article 10 of Regulation S-X, as long as the interim financial statements filed are in accordance with International Accounting Standard 34, which provides accounting standards for interim period financial statements.

## **FORM 20-F**

Historically, foreign private issuers filing reports on Form 20-F were required to prepare financial statements in compliance with U.S. GAAP or in compliance with the accounting principles of another jurisdiction along with a reconciliation to U.S. GAAP in the footnotes.

In light of the new rules permitting the filing of financial statements in accordance with IFRS as issued by the IASB without reconciliation, a conforming amendment has been made to Item 3A of Form 20-F indicating that reconciliation of selected financial data to U.S. GAAP is no longer required unless the issuer prepares its primary financial statements using a basis of accounting other than IFRS as issued by the IASB.

Form 20-F also contains various disclosure requirements with reference to specific items of U.S. GAAP. Please note that under the new rules, when preparing Form 20-F, issuers preparing financial statements in accordance with IFRS as issued by the IASB should provide disclosures that respond to the underlying objective of the line item disclosure requirements in Form 20-F instead of using specific pronouncements of U.S. GAAP.

Where the information requested on the non-financial statements of Form 20-F is duplicative of information already provided in the IFRS financial statements, the issuer may make a cross-reference to the appropriate footnote in the financial statement without repeating such information.

## **TRANSITION RELIEF - INTERNATIONAL ACCOUNTING STANDARD 39**

Prior to the adoption of the new rules, the European Commission implemented regulations which permitted certain U.S. listed companies to eschew specific provisions of International Accounting Standard 39 (the "IAS 39 carve-out") pertaining to the use of hedge accounting for certain financial instruments.

The new rules provide issuers who have already taken advantage of the IAS 39 carve-out with temporary relief whereby, for the first two financial years ending after November 15, 2007, the SEC will accept financial statements that do not include a reconciliation to U.S. GAAP provided that those statements are otherwise in compliance with IFRS as issued by the IASB and contain a reconciliation to IFRS as issued by the IASB.

Financial statements issued after the first two financial years must either be prepared in accordance with IFRS as issued by the IASB or provide reconciliation to U.S. GAAP.

The new rules also extend the current accommodation of first-time adopters of IFRS as issued by the IASB, whereby these issuers can provide two years of audited financial statements (instead of three years) indefinitely.

## REGULATION S-X

Regulation S-X will continue to apply to all foreign private issuers, including those who file financial statements prepared using IFRS as issued by the IASB without reconciliation to U.S. GAAP. However, the new rules do affect the application of Regulation S-X.

For example, a foreign private issuer using IFRS as issued by the IASB as its basis of accounting will not be required to reconcile its pro forma financial information to U.S. GAAP. Instead, the issuer will prepare the pro forma financial information by presenting its IFRS results and converting the financial statements of the business acquired into IFRS as issued by the IASB.

Under Rule 3-10 of Regulation S-X, the issuer of a guaranteed security and the guarantor must follow the financial statement requirements of a registrant. Accordingly, if both entities are reporting foreign private issuers filing reports on Form 20-F, the SEC will accept financial statements prepared in accordance with IFRS as issued by the IASB without reconciliation.

Further, because under Rule 3-10 the determination as to whether reconciliation is required will be based on

the consolidated financial statements of the parent company, a parent issuer or guarantor that presents consolidated financial statements in accordance with IFRS as issued by the IASB may also present condensed consolidating financial information on the basis of IFRS as issued by the IASB, without reconciliation to U.S. GAAP.

## CONCLUSION

The SEC, while noting that complete convergence of IFRS and U.S. GAAP will require ongoing efforts, characterizes the new rules as an important first step in reducing disparities between accounting and disclosure practices of the U.S. and other countries. We should anticipate continuing efforts by the SEC to support the development and implementation of globally accepted accounting standards, improved shareholder access to issuers' financial information and reduced costs of accessing global capital markets.

**1** A "foreign private issuer" means, under Rule 405 of the Securities Act of 1933, any foreign issuer, other than a foreign government, except an issuer that meets the following conditions: (i) more than 50 percent of its outstanding voting securities are directly or indirectly owned or record by residents of the United States and (ii) any of the following: (a) the majority of the executive officers or directors are United States citizens or residents; (b) more than 50 percent of the assets of the issuer are located in the United States; or (c) the business of the issuer is administered principally in the United States.

**2** Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards Without Reconciliation to U.S. GAAP. SEC Release No. 33-8879 (December 21, 2007).

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