

## SEC Eliminates U.S. GAAP Reconciliation Requirement for Foreign Private Issuers that Adopt International Financial Reporting Standards

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### Client Advisory

February 7, 2008 by Guy P. Lander and G. Christina Gray-Trefry

The SEC recently adopted rules to permit foreign private issuers that file a Form 20-F to file financial statements using International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") without a reconciliation to U.S. generally accepted accounting principles ("GAAP"). The SEC's rules apply to foreign private issuers that file their annual reports on Form 20-F.

### Statement in Notes to Financial Statements

Foreign private issuers that elect to provide IFRS financial statements must state explicitly and unreservedly in the notes to their financial statements that their financial statements are in compliance with IFRS as issued by IASB. Also, the foreign private issuer's independent auditor must provide an unqualified report that opines that the issuer's financial statements comply with IFRS as issued by IASB. Where there is no discrepancy between IFRS as issued by IASB and a jurisdictional variation, issuers may state, and their auditor's report opine, that the financial statements comply with both IFRS as issued by IASB and the jurisdictional variation. However, the statements concerning compliance with IFRS as issued by the IASB must be unreserved.

### Interim Period Financial Statements

Foreign private issuers may file financial statements for required interim periods without reconciliation to U.S. GAAP if they also prepare their interim financial statements using IFRS as issued by the IASB. These issuers need not provide any disclosure under Article 10 of Regulation S-X (describing the minimum content of financial statements for an interim period) if the interim financial statements fully comply with International Accounting Standard 34, "Interim Financial Reporting" (prescribing the minimum content of an interim financial report and the principles for recognition and measurement in interim period financial statements).

The requirement for interim period financial statements is often triggered by the filing of a registration statement under the Securities Act of 1933. Generally, foreign private issuers must provide unaudited consolidated interim period financial statements if the registration statement is dated more than nine months after the end of the last audited financial year. These interim period financial statements must cover at least the first six months of the financial year and the comparative period for the prior financial year. Foreign private issuers may omit the U.S. GAAP reconciliation from their unaudited interim financial statements only if the annual audited financial statements included or incorporated by reference into the registration statement for all required periods are prepared in accordance with IFRS as issued by IASB. However, the issuer must comply with and explicitly state compliance with IAS 34 for the interim periods.

### Selected Financial Data

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The SEC revised the instruction to Item 3.A. of Form 20-F to clarify that selected financial data based on the U.S. GAAP reconciliation is required only if the issuer prepares its primary financial statements using a basis of accounting other than IFRS as issued by IASB.

### **First Time Adopters**

During their first year of reporting under IFRS as issued by IASB, foreign private issuers may file two years rather than three years of income statements, changes in shareholders' equity, cash flows and balance sheets.

### **Multijurisdictional Disclosure System**

The Multijurisdictional Disclosure System ("MJDS") permits eligible Canadian issuers to use their disclosure documents prepared in accordance with Canadian requirements in filings with the SEC. While not all filings under the MJDS must contain a U.S. GAAP reconciliation, registration statements and annual reports on Form 40-F and registration statements on Form F-10 generally require a U.S. GAAP reconciliation. Canadian foreign private issuers eligible for MJDS may file financial statements prepared in accordance with IFRS as issued by IASB without a U.S. GAAP reconciliation. However, Canadian accounting standards are not expected to allow the use IFRS as issued by the IASB as the basis of accounting for Canadian public issuers until 2011.

### **European Union – IAS 39 – Two Year Transition Period**

Issuers listed in the European Union (the "EU") are already required to prepare their financial statements using IFRS as adopted by the EU. Currently, the only difference between IASB IFRS and EU IFRS relates to International Accounting Standard 39, "Financial Instruments: Recognition and Measurement" ("IAS 39"). EU IFRS offers greater flexibility concerning hedge accounting for certain financial instruments than does IASB IFRS. The SEC provided an accommodation to existing SEC issuers from the EU that have already used the IAS 39 "carve out" in financial statements previously filed with the SEC. For the first two financial years that end after November 15, 2007, the SEC will accept these issuers' financial statements (without a U.S. GAAP reconciliation) provided their financial statements otherwise comply with IASB IFRS and contain a reconciliation to IASB IFRS.

### **Disclosure from Oil and Gas Companies**

The SEC amended Item 18 of Form 20-F to expressly require that any issuer that provides disclosure under Financial Accounting Standards Board Statement No. 69, "Disclosures about Oil and Gas Producing Activities," continue to provide that disclosure even if the issuer is preparing financial statements in accordance with IFRS as issued by IASB without a reconciliation to U.S. GAAP.

### **Regulation S-X**

Regulation S-X contains the form and content requirements for financial statements in SEC filings, along with many provisions that do not relate to U.S. GAAP, such as requirements for auditor qualifications and independence. Regulation S-X will continue to apply to the filings of all foreign private issuers, but foreign private issuers that file financial statements prepared under IFRS as issued by the IASB should comply with IASB requirements for form and content within the financial statements. This effectively strips out the GAAP requirements but leaves in the other requirements, including those for auditing issuers.

Form 20-F was amended to clarify that if the financial statements of a foreign acquired business or investee under Rule 3-05 or 3-09 of Regulation S-X are prepared under IFRS as issued by the IASB, they do not need a U.S. GAAP reconciliation regardless of the significance of the entity. The SEC will accept the condensed consolidating financial information of guaranteed securities and guarantors under Rule 3-10 of Regulation S-X without a U.S. GAAP reconciliation if the financial information is prepared under IFRS as issued by the IASB.

Article 11 of Regulation S-X requires issuers to prepare unaudited pro forma financial information that is intended to give effect as if a particular transaction had occurred at the beginning of the financial period. Article 11 will continue to apply. Pro forma financial information continues to be governed by the financial statements of the issuer, as the pro forma information must be presented using the same basis of accounting as the issuer. A foreign private issuer using IFRS as issued by IASB as its basis of accounting need not reconcile its pro forma financial information to U.S. GAAP.

#### **Areas Not Addressed by IFRS**

In areas not addressed by IFRS, consistent with IAS 1 and IAS 8, the SEC expects issuers to provide full and transparent disclosure in their financial statements and related disclosure about accounting policies selected and the effects of those policies on the IFRS financial statements. Under IAS 8, issuers using IFRS may also look for guidance from the SEC, including Accounting Series Releases, Financial Reporting Releases, Staff Accounting Bulletins and Industry Guides.

#### **Implications of the SEC's New Rules**

The use of IFRS by foreign private issuers removes a significant regulatory impediment for foreign private issuers, facilitating their ability to access the U.S. capital markets. These rules are intended as a major step toward the goal of creating a single set of globally accepted accounting standards and the convergence of IFRS and U.S. GAAP. The SEC has issued a separate concept release, which considers whether U.S. domestic issuers should also be allowed to use IFRS, and it may allow U.S. domestic issuers to use IFRS in the near future.

#### **Effective Dates**

The SEC's rules apply to annual financial statements for fiscal years ending after November 15, 2007, and to interim periods within those years that are contained in SEC filings made after March 4, 2008.

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