

## CORPORATE & SECURITIES UPDATE

### SEC Allows Foreign Private Issuers to File Financial Statements Without U.S. GAAP Reconciliation

*April 2, 2008*

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The U.S. Securities and Exchange Commission (the “SEC”) has adopted rules that allow foreign private issuers to include in their SEC filings financial statements that are prepared in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB), without reconciliation to U.S. generally accepted accounting principles (U.S. GAAP). The new rules amend Form 20-F and make conforming changes to Regulation S-X and other regulations, forms and rules under the Securities Act of 1933 (the “Securities Act”) and the Securities Exchange Act of 1934 (the “Exchange Act”). Previously, foreign private issuers were required to reconcile their financial statements to U.S. GAAP if they were prepared using a basis of accounting other than U.S. GAAP. However, foreign private issuers using IFRS other than as issued by the IASB, or using another non-U.S. GAAP standard, continue to be subject to the U.S. GAAP reconciliation requirement. The new rules took effect on March 4, 2008, and apply to financial statements for financial years ending after November 15, 2007, and interim periods within those years contained in filings made after the effective date of

the amendments. Amendments relating to issuers that are adopting IFRS for the first time will apply to their filings made after the effective date.

#### Introduction

The recently adopted amendments permit foreign private issuers to file financial statements (including for interim periods) under IFRS as issued by the IASB without reconciliation to U.S. GAAP and make conforming amendments to Rules 1-02, 3-10 and 4-01 of Regulation S-X, Securities Act Forms F-4 and S-4 and Securities Act Rule 701. The amendments reflect the SEC’s efforts to reduce the disparity between U.S. accounting and disclosure practices and those of other countries, by balancing investor protection considerations and promoting the efficiency of global capital markets. The SEC believes that the availability of uniform, globally-recognized accounting standards should help U.S. investors to better understand investment opportunities than having to evaluate financial information under various national accounting standards.

Prior to the adopted changes, foreign private issuers essentially had to meet U.S. issuer

disclosure standards, which requirement was thought to discourage some non-U.S. companies from publicly offering securities in the United States and from registering with the SEC. The new rules are expected to reduce U.S. listing and SEC-registration costs for non-U.S. companies whose financial statements are prepared in accordance with IFRS as issued by the IASB. Although supportive of the efforts by the IASB and the Financial Standards Accounting Board to converge their accounting standards, the SEC has indicated that, despite substantial similarity, convergence between IFRS and U.S. GAAP is not complete and that differences can occur depending on which standard is used for reporting purposes.

## Summary of Amendments

### ELIGIBILITY AND IMPLEMENTATION

The new rules apply only to foreign private issuers that file Form 20-F with the SEC, although the SEC is considering whether IFRS SEC reporting could be made more broadly available to companies that are not classified as foreign private issuers.<sup>1</sup>

To be eligible to forego the need for U.S. GAAP reconciliation, a foreign private issuer must state explicitly and unreservedly in a footnote to its financial statements that it complies with IFRS as issued by the IASB. The report of the issuer's independent auditor must also confirm this compliance. The auditor's report may also state that the presentation complies with another version of IFRS. The use of a non-English version of IFRS, even if the non-English version does not substantively change IFRS as adopted by the IASB, would not satisfy the requirement

that the issuer's financial statements be prepared in accordance with IFRS as issued by the IASB. An issuer's motivation for using IFRS as issued by the IASB is irrelevant to the consideration.

The new rules apply to annual financial statements for financial years ending after November 15, 2007, and to interim periods within those years that are contained in filings made after the effective date of the amendments. A limited accommodation has been made for SEC-registered European Union foreign private issuers that have historically prepared financial statements by applying the European Union's "carve out" from IAS 39 with respect to hedge accounting for certain financial instruments. For those issuers' first two financial years that end after November 15, 2007, the SEC will accept financial statements that do not include a reconciliation to U.S. GAAP if those financial statements otherwise comply with and include a reconciliation to IFRS as issued by the IASB.

### MAIN AMENDMENTS

#### *Generally*

The basic financial statement requirements for foreign private issuers are described in Items 17 and 18 of Form 20-F. Item 17 applies to companies filing their financial statements in an Exchange Act registration statement or an annual report filed on Form 20-F, or as part of a Securities Act registration statement for investment-grade, non-convertible securities or certain rights offerings. Item 18 compliance is required when filing financial statements in a Securities Act registration statement for

offerings of equity, convertible and certain other securities. Under Item 17, financial statements and schedules must be prepared either in accordance with U.S. GAAP or include a reconciliation to U.S. GAAP. The reconciliation must include a discussion of reconciling differences and a reconciliation of net income, major balance sheet captions and cash flows. A reconciliation under Item 18 requires an issuer to provide all information required by U.S. GAAP and Regulation S-X, in addition to the line item reconciling information.

The amendments revise Item 17(c) and Item 18(b) so that the Item 17 reconciliation and the Item 18 U.S. GAAP and Regulation S-X disclosures will not be required when the issuer files financial statements using IFRS as issued by the IASB.

#### *Interim Period Financial Statements*

A foreign private issuer eligible to omit U.S. GAAP reconciliation from its audited annual financial statements may also omit the reconciliation from its unaudited interim period financial statements if those statements are prepared in accordance with IFRS as issued by the IASB. In registration statements and prospectuses under the Securities Act and initial registration statements under the Exchange Act, if the document is dated less than nine months after the end of the last audited financial year, foreign private issuers are not required to include interim period financial information unless they publish that information. If the document is dated more than nine months after the end of the last audited financial year, foreign private issuers must provide consolidated interim period financial statements covering at least the first six months of the current and prior

financial years, prepared using the same basis of accounting as the audited financial statements, and include a reconciliation to U.S. GAAP.

The amendments adopt an instruction to Item 8.A.5 of Form 20-F to clarify that interim period financial information that is made public or interim financial statements that are prepared by a foreign private issuer need not be reconciled to U.S. GAAP if IFRS as issued by the IASB is used. Such a foreign private issuer will not have to comply with Article 10 of Regulation S-X for interim period financial statements required to be provided pursuant to Item 8.A.5 of Form 20-F if it complies (and states compliance) with IAS 34 (Interim Financial Reporting). Foreign private issuers may omit the U.S. GAAP reconciliation from their unaudited interim period financial statements only if the audited annual financial statements for all required periods are prepared in accordance with IFRS as issued by the IASB.

#### CERTAIN ACCOUNTING AND DISCLOSURE MATTERS

##### *Inclusion of Selected Financial Data*

Foreign private issuers are required to provide five years of selected financial information in their Form 20-F filing. Item 3.A of Form 20-F has been revised to clarify that such selected financial information will not require U.S. GAAP reconciliation if the primary financial statements are prepared using IFRS as issued by the IASB.

##### *Certain U.S. GAAP Pronouncements*

Form 20-F contains several non-financial statement disclosure items that refer to

specific U.S. GAAP pronouncements. An IFRS filer not required to provide a U.S. GAAP reconciliation will continue to be required to respond to such Form 20-F items referencing U.S. GAAP pronouncements, but would apply appropriate corresponding IFRS pronouncements to the extent they incorporate the principles of the referenced U.S. GAAP pronouncement. Issuers may cross-reference footnotes in the audited financial statements that are responsive to such information.

#### *FAS 69 Disclosure from Oil and Gas Companies*

Foreign private issuers with significant oil and gas activities that provide reserves and other disclosure under FAS 69 (Disclosures about Oil and Gas Producing Activities) must continue to provide that disclosure even if preparing financial statements in accordance with IFRS as issued by the IASB without reconciliation to U.S. GAAP. FAS 69 disclosure is viewed by the SEC as supplementary information (and not a U.S. GAAP reconciliation) that can be provided as an unaudited financial statement footnote and such information would not otherwise be required under IFRS. Item 18 of Form 20-F has been amended to reflect this change.

#### *IFRS Market Risk Disclosure and the Safe Harbor*

Some IFRS filers have expressed concern that the safe harbor for forward-looking statements provided under Section 27A of the Securities Act and Section 21E of the Exchange Act, which excludes information included in GAAP financial statements, does not cover forward-looking market risk

disclosure required by IFRS 7 (Financial Instruments: Disclosure) which appears in the footnotes to audited IFRS financial statements. While not addressing the issue in the amendments, the SEC has acknowledged that the point may warrant further review and a possible separate rulemaking initiative.

#### *IFRS Treatment of Certain Areas*

While the SEC views IFRS as issued by the IASB as a comprehensive basis of accounting that may be used by foreign private issuers, it acknowledges there are areas where the IASB has yet to develop standards or where IFRS permits different options. For example, IFRS does not have a specific standard or interpretation on accounting treatment for common control mergers, recapitalization transactions, reorganizations or acquisitions of minority shares not resulting in a change of control, or for accountings for insurance contracts and extractive activities. Pursuant to IAS 8 (Accounting Policies, Changes in Accounting Estimates and Errors), where gaps might exist in IFRS, issuers may look to accounting guidance issued by other standards, such as U.S. GAAP. Issuers may also look for guidance from SEC sources such as rules and regulations, Accounting Series Releases and Financial Reporting Releases, Staff Accounting Bulletins, and Industry Guides.

#### *Issuers Adopting IFRS for the First Time*

Form 20-F provides an accommodation so that a foreign private issuer in its first year of reporting under IFRS as published by the IASB may file financial statements for two rather than three prior years. General Instruction G of the form has been amended

to be consistent with the new changes. The first-time IFRS adopters accommodation was scheduled to expire after the first financial year on or after January 1, 2007 (which related to the European Union's IFRS transition timeline), but, as many other countries are likely to adopt IFRS, the accommodation has been extended for an indefinite period.

#### ***Form 20-F Check Boxes on Cover Page***

The amendments add check boxes to the Form 20-F cover page to indicate whether included financial statements have been prepared using U.S. GAAP, IFRS as issued by the IASB or another basis of accounting. The Form 20-F cover page has been revised to identify an issuer contact person to whom SEC or staff enquiries may be directed, including the name of an individual at the company or its legal counsel contact information.

#### **REGULATION S-X**

Regulation S-X contains the form and content requirements for financial statements included in SEC filings. It also includes provisions that do not relate to U.S. GAAP, such as requirements for auditor qualifications and reports. Regulation S-X will continue to apply to SEC filings of all foreign private issuers, including those that file financial statements prepared using IFRS as issued by the IASB without reconciliation to U.S. GAAP.

#### ***Rules 3-05, 3-09 and 3-16***

Under Rules 3-05, 3-09 and 3-16 of Regulation S-X, an issuer, under certain circumstances, must include the financial statements of another entity in its filings, depending on the significance of the entity to the issuer. These rules have not been

changed, but the amendments to accept IFRS financial statements without a U.S. GAAP reconciliation apply to them. Requirements for "significance testing" are governed by the issuer's financial statements, which means that a foreign private issuer preparing its own financial statements using IFRS as issued by the IASB is now required to perform significance tests using IFRS as issued by the IASB regardless of the other entity's basis of accounting. If significance thresholds are exceeded, the issuer must separately provide audited annual financial statements of the subject entity. Generally, historical financial statement requirements for a foreign acquired business or investee under Rule 3-05 or 3-09 are governed by the status of that entity, and do not impose a higher presentation burden on a non-issuer entity than on an issuer. If the entity's audited financial statements are in accordance with IFRS as issued by the IASB, no U.S. GAAP reconciliation is required.

#### ***Pro Forma Financial Statements***

Article 11 of Regulation S-X requires issuers to prepare unaudited *pro forma* financial information to give effect to transactions, such as a significant recent or probable business combination, as though the events occurred at the beginning of the financial period covered by the financial statements. Requirements for *pro forma* financial information are governed by the financial statements of the issuer, not the acquiree or other entity. The *pro forma* results must be presented using the issuer's basis of accounting, and do not impose a higher presentation burden for *pro forma* financial information than required by the issuer's historical financial statements. Although

Article 11 is not amended, the new rules affect the application of Article 11 and, accordingly, a foreign private issuer using IFRS as issued by the IASB as its basis of accounting will not be required to reconcile *pro forma* financial information to U.S. GAAP.

#### ***Financial Statements Under Rule 3-10***

Rule 3-10 of Regulation S-X specifies financial statement requirements for issuers and guarantors of guaranteed securities. Generally, under this rule, both the issuer of the guaranteed security and the guarantor must follow the financial statement requirements of a registrant. If both entities are reporting foreign private issuers filing on Form 20-F, the SEC will accept financial statements prepared in accordance with IFRS as issued by the IASB without reconciliation from each one under the adopted rules. Rule 3-10 permits modified reporting by subsidiary issuers of guaranteed securities and subsidiary guarantors. Separate financial statements need not be filed for subsidiaries meeting the applicable conditions contained in Rule 3-10. Instead, condensed consolidating financial information would be presented in the parent company's reports in an additional audited footnote to the financial statements. A parent issuer or guarantor that presents consolidated financial statements in accordance with IFRS as issued by the IASB will present the condensed consolidating financial information on the basis of IFRS as issued by the IASB, without reconciliation to U.S. GAAP.

#### ***Conforming Amendment to Rule 4-01***

Rule 4-01 of Regulation S-X, which sets out general requirements for financial statements in SEC filings and requires

foreign private issuers to include an Item 18 U.S. GAAP reconciliation if they use a basis of accounting other than U.S. GAAP Rule 4-01. The Rule has been revised to clarify that those financial statements may now be prepared using IFRS as issued by the IASB without needing U.S. GAAP reconciliation.

#### **OTHER CONFORMING AMENDMENTS**

##### ***Securities Act Forms F-4 and S-4***

Certain conforming amendments were made to references to the U.S. GAAP reconciliation contained in Securities Act Forms F-4 and S-4 to make them consistent with the amendments to Items 17(c) and 18(b) of Form 20-F so that the U.S. GAAP reconciliation would only be required for financial statements prepared using a basis of accounting other than U.S. GAAP or IFRS as issued by the IASB.

##### ***Rule 701***

Rule 701 under the Securities Act provides an exemption from registration for offers and sales made under certain compensatory benefit plans. A foreign private issuer conducting an offering under Rule 701 is required to deliver certain information to investors, including financial statements, if more than \$5 million in securities are sold over a 12-month period. Rule 701 has been revised to make clear that a foreign private issuer conducting a Rule 701 offering and preparing its financial statements using IFRS as issued by the IASB should not be required to present a U.S. GAAP reconciliation.

### ***Schedule TO and Schedule 13E-3***

The amendments adopted to Form 20-F to implement acceptance of IFRS financial statements without reconciliation to U.S. GAAP are intended to apply to all Securities Act and Exchange Act filings that reference the U.S. GAAP reconciliation requirement contained in Item 17 or Item 18 of Form 20-F. These include Schedule TO, the tender offer statement under the Exchange Act, and Schedule 13E-3, the transaction statement under Section 13(e) of the Exchange Act, both of which contain a reference to U.S. GAAP reconciliation in accordance with Item 17 of Form 20-F.

### **Endnote**

<sup>1</sup> A “foreign private issuer” is a non-U.S. company in which U.S. residents hold less than a majority of the shares or, if they do hold a majority, in which a majority of its directors and officers are not U.S. citizens or residents, its business is administered from outside the United States and a majority of its assets are located outside the United States.

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