

SECURITIES UPDATE

SEC Adopts Mandatory Use of Interactive Data for Financial Reporting

February 24, 2009

The US Securities and Exchange Commission (SEC) has published its final rules on “Interactive Data to Improve Financial Reporting,” available at <http://www.sec.gov/rules/final/2009/33-9002.pdf> (the “Final Release”). These rules require companies to provide their financial statements in interactive data format using the eXtensible Business Reporting Language (XBRL) in specified filings with the SEC, as well as on their corporate web sites. This mandatory rule will be phased in over three years.

We have summarized the new rule in a question-and-answer format, which can serve as a continuing reference for companies preparing to comply with the new requirements.

What financial information must be presented in interactive form?

Companies that become subject to the SEC’s interactive financial data reporting requirements will need to tag financial statements, including the accompanying footnotes and any required financial statement schedules, that are included in specified registration statements or reports filed with the SEC. However, companies

will not need to tag any financial statements required by Rules 3-05, 3-09, 3-14 and 3-16 or Article 11 of Regulation S-X. Interactive data will be required for all periods that are included in the company’s financial statements. Rule 405 of Regulation S-T sets forth the content, format, submission and web site posting requirements for the interactive financial data file.

How is the interactive data presented?

In addition to presenting financial statements in a traditional format, companies required to provide interactive financial data must prepare an additional exhibit for their SEC filings, with financial statement data tagged in XBRL. The financial data in this exhibit will be identical to the financial statements provided in the traditional format filing, but the exhibit will contain machine-readable tags, which operate in a manner similar to bar codes. By individually labeling each number, this format allows for financial statement items to be searched on the Internet, downloaded into spreadsheets, reorganized in databases and otherwise used in analytical software.

Companies that report in U.S. generally accepted accounting principles (GAAP) will be required to tag their financial statements using the most recent list of tags for U.S. financial statement reporting, as released by XBRL U.S. This standard list of tags contains descriptive labels, definitions, U.S. GAAP references, SEC regulation references and other elements. Similarly, filers using International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB), will be required to tag their financial statements using the most recent list of tags for international financial reporting, as released by the International Accounting Standards Committee Foundation (IASCF). If a company wishes to use a non-standard financial statement line item, it can create a company-specific extension.

The interactive data is intended to be processed by software applications. As a result, the unprocessed data is not readable by the human eye, but viewers are available, including on the SEC web site, to render the interactive data file into a human-readable form.

How is the interactive financial data different from the financial data in traditional format?

The elements of the financial data presented in interactive form must be identical to the corresponding traditional format elements. There can be no changes to, deletions or summarizing of the financial data in the interactive file. The only difference between the interactive exhibit and the traditional formatted financial data will be the machine-readable interactive tags and the inability to read the interactive exhibit without using a reader.

How are financial statement footnotes and schedules tagged?

In a company's first year of filing an interactive financial data exhibit, it will be required to tag financial statement footnotes and financial schedules individually as blocks of text. Starting in the company's second year of tagging, it will also be required to tag the detailed quantitative disclosures within the footnotes and schedules. This will require tagging with three additional levels of detail:

- Each significant accounting policy within the significant accounting policies footnote tagged as a single block of text,
- Each table within each footnote tagged as a separate block of text, and
- Within each footnote, each amount (i.e., monetary value, percentage and number) separately tagged.

A company may, but is not required to, tag each narrative disclosure in the footnotes and schedules.

What is the phase-in schedule?

The SEC is phasing in its interactive financial data requirements over three years. There is a grace period for the first interactive financial data exhibit filing, as discussed below.

The first group of companies required to file interactive financial data is composed of domestic and foreign large accelerated filers using U.S. GAAP with worldwide public common equity float above \$5 billion as of the end of the second fiscal quarter of their most recently completed fiscal year. These companies must submit their initial tagged

financial data in their first quarterly report on Form 10-Q or annual report on Form 20-F or Form 40-F containing financial statements for a fiscal period ending on or after June 15, 2009. For example, U.S. public companies falling in this category that have a calendar year-end will file this exhibit as part of their quarterly report on Form 10-Q for the quarter ending June 30, 2009, which report is due August 10, 2009. The interactive financial data will be due with each quarterly or annual report thereafter filed.

All other large accelerated filers using U.S. GAAP must file their initial interactive financial data exhibit with their first quarterly report on Form 10-Q or annual report on Form 20-F or Form 40-F containing financial statements for each fiscal period ending on or after June 15, 2010.

Remaining filers using U.S. GAAP must file their initial interactive financial data exhibit with their first quarterly report on Form 10-Q or annual report on Form 20-F or Form 40-F containing financial statements for each fiscal period ending on or after June 15, 2011.

Foreign private issuers with financial statements prepared in accordance with IFRS as issued by the IASB will be required to file their initial interactive financial data exhibit with their first annual reports on Form 20-F or Form 40-F for fiscal periods ending on or after June 15, 2011.

Is there a grace period?

Generally, the interactive data exhibit must be filed simultaneously with the rest of the SEC filing of which it is a part. However, the SEC has established two grace periods.

The new rules permit the initial interactive financial data exhibit to be filed within 30 days after the earlier of the due date or the filing date of the related filing.

As discussed above, during the first year that a company is required to provide an interactive financial data exhibit, the footnotes and schedules that accompany the financial statements may be solely block-text tagged. In the second year of interactive financial data reporting, the first interactive financial data exhibit that is required to have detailed tagging of financial statement footnotes and schedules, as opposed to block-text tagging, is due within 30 days after the earlier of the due date or the filing date of the related report or registration statement.

What types of companies must prepare interactive financial data?

All domestic and foreign public companies that prepare their financial statements in accordance with U.S. GAAP, and foreign private issuers that prepare their financial statements using IFRS, as issued by the IASB, will be required to provide the interactive financial data exhibit. Non-U.S. issuers that do not report in U.S. GAAP or IFRS, as issued by the IASB, even if they include a reconciliation to U.S. GAAP, are not subject to these requirements.

Investment companies registered under the Investment Company Act of 1940, business development companies and other entities that report under the Exchange Act and prepare their financial statements in accordance with Article 6 of Regulation S-X are not subject to the new rules described

in the Final Release. However, the SEC has issued separate rules that require open-end management investment companies (mutual funds) to provide their risk/return summary information in interactive data format, beginning with initial registration statements, and post-effective amendments that are annual updates to effective registration statements that become effective after January 1, 2011. The mutual fund rules on interactive data are outside the scope of this Securities Update. For more information on those rules, see <http://www.sec.gov/rules/final/2009/33-9006.pdf>.

What SEC filings require interactive tagging?

The interactive financial data requirement applies to:

- Quarterly reports on Form 10-Q;
- Annual reports on Form 10-K;
- Annual reports on Form 20-F;
- Annual reports on Form 40-F;
- Forms 8-K and 6-K that contain revised or updated financial statements;
- Transition reports on Forms 10-Q, 10-K, or 20-F; and
- Registration statements under the Securities Act of 1933 (the “Securities Act”) that include financial statements (rather than incorporate them by reference), but that are not being used in connection with an initial public offering.

Interactive data is not required for registration statements under the Securities Exchange Act of 1934 (the “Exchange Act”) on Forms 10, 20-F and 40-F.

When is the interactive financial data exhibit required for a Securities Act registration statement?

The interactive data exhibit needs to be filed with a Securities Act registration statement filing only after a price, or price range, has been determined, and any later time when the financial statements are changed.

Because the rules provide that a company’s first filing subject to the interactive data requirement would be a quarterly report, or an annual report for a foreign private issuer not required to file quarterly reports, interactive data exhibits will not be required for initial public offerings.

When must the interactive financial data exhibit be posted on the company’s web site?

In addition to filing the interactive financial data with the SEC, the rules require that companies also post the interactive financial data on their web sites. The data must be posted no later than the end of the calendar day on which the company either submitted or was required to submit the interactive data exhibit to the SEC, whichever is earlier. The posting of the data on the web site is as much a requirement of the new rules as the filing of that data with the SEC. The interactive financial data must remain posted on the web site for at least 12 months.

Is auditor attestation required?

The SEC is *not* requiring that auditors, or any other consultants, provide an attestation as to a company’s interactive financial data exhibit. Companies are permitted to request third-party assurance under the Public

Company Accounting Oversight Board's Interim Attestation Standard — AT sec. 101, "Attest Engagements" on interactive data — but there is no requirement to do so. Companies can start and stop obtaining such assurance whenever they choose. Because the rules do not prohibit issuers from indicating in the financial statements the degree of auditor involvement in the tagging process, companies, if they feel it is appropriate to do so, may include a financial statement footnote that makes clear the level, or absence, of auditor involvement in the creation of the interactive financial data exhibit.

Do the CEO and CFO have to certify the interactive financial data exhibit?

No. The interactive financial data exhibit is expressly carved out of the certifications that the chief executive officer and chief financial officer are required to provide in connection with SEC filings.

What is the consequence of failure to comply?

If a company fails either to file its interactive data or to post this data on its web site when required, it will not be deemed current with its reporting obligations under the Exchange Act, subject to the applicable grace periods and exemptions. Therefore, such a company would not be eligible to use short form registration statements such as Forms S-3, F-3 and S-8, or be able to elect to provide Form S-4 or F-4 information at a level prescribed by Form S-3 or F-3.

In addition, a company that fails to file and post the required interactive data will not be deemed to have available adequate current public information for the purposes of Rule 144 resales.

In contrast to a late filing of a traditional format Exchange Act report, once the missing filing or posting of interactive data is made a delinquent company will be restored to current and timely status, assuming that there is no other reason for the loss of such status.

What federal securities law liability applies to interactive financial data exhibits?

The new rules include a temporary rule, Rule 406T of Regulation S-T, which provides a limited grace period for certain liabilities under the federal securities laws for interactive financial data. Each company only gets the benefit of Rule 406T for two years and the protections of this rule extend only through October 31, 2014.

During the time that Rule 406T is applicable to a company, the interactive financial data file will be exempt from the anti-fraud provisions of Section 17(a)(1) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 206(1) of the Investment Advisers Act of 1940 for a failure to comply with the new requirements for tagging interactive financial data file for SEC submission and related web site posting if the company:

- Has made a good faith attempt to comply with these requirements, and

- Corrects any such failure promptly after becoming aware of it.

Rule 406T defines “promptly” to mean as soon as reasonably practicable under the facts and circumstances at the time.

Rule 406T provides a safe harbor so that technical tagging corrections that are filed by the later of 24 hours or 9:30 a.m. ET on the next business day after a mistake is discovered will be deemed to have been corrected promptly.

Under Rule 406T, the interactive financial data file is not deemed filed for the purposes of Section 11 or 12 of the Securities Act, Section 18 of the Exchange Act or Section 34(b) of the Investment Company Act of 1940, and is not otherwise subject to liability under these sections. The interactive data file is deemed filed, and therefore gets the benefit of Rule 103 under Regulation S-T, so that there is no liability for electronic transmissions beyond the issuer’s control, if it corrects the problem through amendment as soon as reasonably practicable after becoming aware of the problem.

It is critical for companies to promptly correct this type of technical error in order to receive the benefit of the temporary exemption from liability afforded by Rule 406T. The SEC specifically noted in the Final Release that it “could bring an action against a filer under Section 13(a) of the Exchange Act if the filer submits an interactive data file with a periodic report and the interactive data file fails to comply with the tagging requirements despite a good faith attempt, where the filer fails to correct the interactive data file promptly after it discovers the failure.”

A company remains liable under the federal securities laws for the substantive content of its financial statements, whether in traditional or interactive format. And, after the two-year grace period provided by Rule 406T is no longer available, a company will be liable under the federal securities laws with respect to its interactive financial data file to the same extent it is liable under federal securities laws with respect to any other element of an SEC filing.

Is there any exception for hardships?

Rule 201 of Regulation S-T provides a temporary hardship exemption from electronic submission of information when a filer experiences unanticipated technical difficulties that prevent timely preparation and submission of an electronic filing. This exemption is self-executing—no SEC staff action is needed. In this situation, a company would submit the information in paper, with a confirming electronic copy of the information filed and posted within six business days of filing the information in paper.

Rule 202 of Regulation S-T provides for a continuing hardship exemption if information otherwise required to be submitted in electronic format cannot be so filed without undue burden or expense. This exemption must be applied for in writing. If the SEC grants the request, the filer would have to file the information in paper by the applicable due date, with a confirming electronic copy if and when specified in the grant of the request. If a Rule 202 request is granted, the filer will be deemed current until the end of the period for which the exemption is granted.

What tools are available to accomplish the tagging?

Companies may tag their financial data themselves by using commercially available software or they may outsource the tagging process to financial printers, consultants and software companies. However, as noted in the Final Release, even if the tagging process is outsourced, companies retain ultimate responsibility and liability for both their financial statements and the tagging of their financial data.

When is it appropriate to use a customized tag?

The new rules contemplate use of extensions, which are customized additions to the standard list of tags by a company, to accommodate unique circumstances in its public disclosures. The rules limit the use of extensions to circumstances where the appropriate financial statement element does not exist in the standard list of tags. If an appropriate element exists in a standard list of tags, that element must be used. If the standard element is appropriate, but the standard label is not, the label should be changed rather than creating a new customized tag.

Does any financial information outside the financial statements and associated footnotes and schedules need to be tagged?

No. Only the financial statements, financial statement footnotes and financial statement schedules are subject to interactive tagging requirements. Financial information contained in executive compensation disclosures, management's discussion and

analysis or other portions of a company's SEC filings are not required to be tagged in XBRL.

What should companies be doing to prepare for interactive financial data?

Companies, particularly those in the first group of companies required to provide interactive financial data, should decide whether they will tag their financial data themselves. If so, they should investigate software options and designate and train appropriate employees to implement this task. If a company prefers to outsource the tagging process, it should select the vendor it will use, satisfy itself that the vendor is adequately prepared for this task and designate the company employees who will oversee this process.

Even if a company is not in the first group that will be required to present financial data in interactive format, it is prudent to commence the preparations for the ultimate use of interactive financial data. Making use of the extra lead time, by beginning consideration as to how best to accomplish the process of tagging data, should make ultimate compliance easier. It will be helpful to monitor the first wave of filings subject to the interactive financial data requirements to fully benefit from the experience and precedents of these filings.

It is important to identify early in the process whether the company will need to create new tags for any non-standard financial statement line items that are not included in the standard list of tags. It is also important to determine if any labeling changes with regard to standard tags are needed.

If a company chooses to outsource tagging, the company should identify and train persons within the organization to review what is produced. The SEC has made clear that the interactive financial data exhibit is the reporting company's responsibility. Although there is a temporary exemption, the prospect of liability exists. There should be employees of the company who are responsible for the interactive financial data exhibits, whether or not the company does the entire filing in-house or outsources it. These employees will need to work with the vendor to confirm that they are comfortable with the tags that the vendor assigns. Time needs to be built into the process to allow these company employees to review drafts of the interactive exhibit produced by the vendor.

Although the interactive financial data exhibit is expressly excluded from the officer certification requirements under Rules 13a-14 and 15d-14 under the Exchange Act, the interactive data nevertheless is subject to the internal control over financial reporting and disclosure controls and procedures requirements contained in Rules 13a-15 and 15d-15 under the Exchange Act. Reporting companies should consider whether any adjustments need to be made to their internal control over financial reporting or to the composition or procedures of their disclosure committee to reflect the new rules. Reporting companies should determine how they are going to satisfy themselves from an internal control and disclosure control standpoint if they plan to retain a third party for data tagging. Also, the disclosure committee should be aware of how the company plans to implement the interactive financial data requirements and what steps are being taken to make sure that the company is prepared.

Companies should be advising those responsible for their web sites that there will be a requirement to post the interactive data on the company's web site on the same day that filings are made with the SEC, making clear that these companies face serious ramifications if there is a failure, or a delay, in compliance.

While there is no need to obtain third-party assurance for interactive data, companies should determine the extent, if any, to which they wish to involve their outside auditors in the tagging process and whether they feel it is appropriate to develop any financial statement footnote to clarify what role auditors or other consultants play in this process.

On an ongoing basis, companies will need to stay current with changes made to standard tags made by XBRL U.S. or IASCF to determine if updated tags are needed on future filings.

If you have any questions regarding interactive financial data requirements, please contact the author of this Securities Update, Laura D. Richman, at +1 312 701 7304 or any of the lawyers listed below or any other member of our Corporate & Securities group.

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