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SEC Eliminates Need For Non-US Issuers To Provide Reconciliation Of Financial Statements To US GAAP

On December 21, 2007, the Securities and Exchange Commission, or SEC, adopted new rules that will for the first time remove the requirement for non-US companies[1] to reconcile their financial statements to US generally accepted accounting principles, or US GAAP. This change affects the financial statements that non-US companies must include in registration statements to issue new securities and in periodic filings, such as Form 20-F, filed with the SEC. In order to take advantage of this new provision, a non-US company will need to file financial statements that comply with the English language version of International Financial Reporting Standards, or IFRS, as issued by the International Accounting Standards Board, or IASB.

This rule change signals a new approach by the SEC in regulating access to US capital markets, and reflects a global trend among regulators towards more convergence in the use of accounting standards. The SEC hopes to reduce the disparity between the accounting and disclosure practices of the US and other countries by fostering the use of IFRS, as issued by the IASB. The IASB is an independent, privately funded accounting standard-setter based in London. It is committed to developing "a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements." Nearly one hundred countries currently require or permit the use of, or are replacing their national standards with, IFRS. The SEC also is considering whether to permit US issuers to file financial statements prepared in accordance with IFRS as published by the IASB.

Summary of the key changes

Historically, the SEC required non US-companies preparing registration statements to issue new securities or periodic filings to file financial statements that complied with either (a) US GAAP, or (b) local GAAP, provided they contained a reconciliation to US GAAP. The preparation of this reconciliation was

[1] The new rules are applicable to non-US issuers who qualify as foreign private issuers under Rule 405 of the Securities Act and Rule 3b-4(c) of the Securities Exchange Act.

burdensome. The SEC required the reconciliation to include a narrative discussion of reconciling differences, and a reconciliation of net income and shareholders' equity for each year and any interim periods presented.

The SEC now will permit non-US issuers to file financial statements prepared in accordance with IFRS as issued by the IASB, without any reconciliation to US GAAP. To take advantage of this option, the issuers will need to meet certain conditions:

1. Their financial statements will need to comply with the English language version of IFRS as issued by the IASB, as opposed to any jurisdictional adaptations of IFRS. The SEC has explicitly refused to accept financial statements prepared using jurisdictional variants of IFRS without a US GAAP reconciliation, even if the local variants are reconciled to IFRS as issued by IASB. Companies relying on a translation of the English language version of IFRS should ensure that the translation they use does not depart from the original English version;

2. They will need to continue to comply with the auditing standards of the Public Company Accounting Oversight Board;

3. They will need to state explicitly and unreservedly in the notes to their financial statements that such financial statements are in compliance with the English language version of IFRS as issued by the IASB; and

4. They will need to provide an auditor's unqualified report that opines on that compliance.

To encourage the adoption of IFRS, the SEC has decided to extend indefinitely the possibility for all first-time adopters of IFRS as issued by the IASB to provide two years rather than three years of audited financial statements in their first year of IFRS reporting.

The new rules will be applicable 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 March 4, 2008. Companies wishing to take advantage of the new rules should contact us as their application may raise certain transition issues.

Other key changes

- Non-US companies taking advantage of the new rule will be able to file financial statements for required interim periods without reconciliation to US GAAP, and without providing disclosure under Article 10 of Regulation S-X, provided the interim financial statements fully comply, and explicitly state compliance, with IAS 34.

- The SEC has specified that the US GAAP and Regulation S-X disclosures required to be furnished with a US GAAP reconciliation will not be required for non-US issuers preparing their financial statements using IFRS as issued by the IASB.

- Non-US issuers preparing their own financial statements using IFRS as issued by the IASB will be able to compute the significance tests deciding whether they should provide the financial statements of a foreign-acquired business or investee using IFRS as issued by the IASB.

- If the financial statements of a foreign-acquired business or investee's financial statements must be provided, these financial statements will not be required to be reconciled to US GAAP if they are in accordance with IFRS as issued by the IASB, regardless of the significance of the entity.

- The Securities Act requires companies to deliver to investors certain information, including financial statements, when they sell, pursuant to certain compensatory benefit plans, more than $5 million in securities over a 12-month period. A non-US issuer that conducts offerings of this type and prepares its financial statements using IFRS as issued by the IASB will not be required to present a US GAAP reconciliation. This will facilitate stock ownership for US employees of non-US issuers.

Over the past few years, the SEC has gained an increasing understanding of IFRS through its review of the filings of publicly registered companies. With the advent of the new rules, we expect the SEC to step up its review of IFRS financial statements. The SEC has expressed its intention to cooperate with other national regulators in order to ensure that it does not substantially depart from the majority interpretation of IFRS.

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