

SEC Eliminates U.S. GAAP Reconciliation Requirement for IFRS Financial Statements of Foreign Private Issuers

February 20, 2008

On December 21, 2007, the U.S. Securities and Exchange Commission issued final rules eliminating the long-standing requirement that foreign private issuers¹ reconcile financial statements in their SEC filings to U.S. generally accepted accounting principles², as long as those financial statements have been prepared using International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board. The new rules, which will become effective on March 4, 2008, are intended to facilitate access to the U.S. capital markets by non-U.S. companies and improve the consistency and readability of financial reporting for U.S. investors who own foreign securities³.

The new rules apply to financial statements for fiscal years ending after November 15, 2007 and for interim periods within those financial years, included in SEC filings made after March 4, 2008.

ELIGIBILITY

To be entitled to omit the U.S. GAAP reconciliation under the new rules, a foreign private issuer must satisfy the following conditions:

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- ¹ A "foreign private issuer" is defined in Rule 405 of the Securities Act of 1933 to mean 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 of record by residents of the United States and (ii) any of the following: (a) the majority of the executive officers or directors are U.S. 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", Release No. 33-8879 (Dec. 21, 2007), 17 CFR Parts 210, 230, 239 and 249: <http://www.sec.gov/rules/final/2007/33-8879.pdf>. For related SEC releases, see SEC Release No. 33-8818 (Jul. 2, 2007) : <http://www.sec.gov/rules/proposed/2007/33-8818.pdf> and SEC Release No. 33-8818 (Jul. 2, 2007) : <http://www.sec.gov/news/press/2007/2007-235.pdf>.
 - ³ The SEC has also issued a concept release on use by U.S. issuers of IFRS. See "Concept Release On Allowing U.S. Issuers To Prepare Financial Statements In Accordance With International Financial Reporting Standards", Release No. 33-8831 (Aug. 7, 2007): <http://www.sec.gov/rules/concept/2007/33-8831.pdf>

- the financial statements must be prepared in accordance with the English language version of IFRS as published by the International Accounting Standards Board (the "IASB");
- the foreign private issuer must state in the notes to the financial statements that those financial statements are in compliance with IFRS as issued by the IASB; and
- the foreign private issuer must provide an unqualified auditor's report stating that the financial statements are in compliance with IFRS as issued by the IASB.

The elimination of the U.S. GAAP reconciliation requirement does not change the applicability of other filing requirements, including auditor qualification requirements under the SEC rules. The financial statements of foreign private issuers filed with the SEC will continue to be required to be audited under the rules of the U.S. Public Company Accounting Oversight Board and U.S. generally accepted auditing standards.

The amendments eliminate the U.S. GAAP reconciliation requirement only for financial statements prepared using the English language version of IFRS as published by the IASB, and are thus not applicable to jurisdictional variations and other deviations from that version of IFRS. In these other situations, a foreign private issuer may either (1) continue to reconcile its financial statements to U.S. GAAP or (2) include in its IFRS financial statements such additional information as may be necessary so that those statements comply with the IASB-issued IFRS, thus in effect complying with both the IASB-issued IFRS and the jurisdictional version of IFRS.

TRANSITIONAL PROVISION FOR IAS 39 "EU CARVE-OUT"

The SEC has allowed a transitional provision for certain foreign private issuers based in the European Union. An issuer incorporated in an EU member state that has complied with the "EU carve-out" from International Accounting Standard 39⁴ (*Financial Instruments: Recognition and Measurement*) in financial statements previously filed may file financial statements for its first two financial years that end after November 15, 2007 without a reconciliation to U.S. GAAP, if that issuer's financial statements otherwise comply with the IASB-issued IFRS and the issuer provides an audited reconciliation to the IASB-issued IFRS. At the end of the two-year transition period, however, companies continuing to use the EU carve-out will have to revert back to providing a reconciliation of their financial statements to U.S. GAAP. Financial statements for years ending prior to November 15, 2007 that use the IAS 39 carve-out must be reconciled to U.S. GAAP.

OTHER IMPLICATIONS OF AMENDMENTS

The new rules have certain other implications for the financial disclosure requirements under SEC rules applicable to foreign private issuers:

⁴ IAS 39 deals with fair value and hedge accounting for certain financial instruments.

- Foreign private issuers using IFRS financial statements for required interim periods need not provide disclosure under Article 10 of Regulation S-X (which sets out certain requirements for interim financial statements) if the interim financial statements fully comply with IAS 34, which prescribes corresponding interim reporting requirements.
- The rules extend indefinitely the accommodation, contained in General Instruction G of Form 20-F, that allows foreign private issuers in their first year of reporting under IFRS to file two years rather than three years of statements of income, changes in shareholders' equity and cash flows. That accommodation had been scheduled to expire for years beginning on or after January 1, 2007.
- The rules clarify that the elimination of the reconciliation requirement extends to certain financial information in addition to the primary financial statements, including:
 - selected financial data required by Item 3.A of Form 20-F;
 - financial statements of an entity acquired or about to be acquired;
 - financial statements of a foreign private issuer used in an offering under Rule 701⁵.

Although the SEC was initially considering shortening the current six-month deadline for annual reports on Form 20-F if a reconciliation were not required, the SEC announced that it decided not to modify the deadline.

In adopting the new rules, the SEC noted that, while more progress needs to be made on the convergence of IFRS and U.S. GAAP, as well as matters relating to the consistent application of IFRS, the SEC's acceptance of IFRS will encourage the use of IFRS and support its development as a globally accepted set of high-quality accounting standards. The SEC staff will also continue to review whether or not to permit the use of IFRS by public U.S. companies in the future.

This memorandum is for general information purposes and should not be regarded as legal advice. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all of our partners, as well as memoranda regarding recent corporate reporting and governance developments, can be obtained from our website, www.simpsonthacher.com.

⁵ Rule 701 under the U.S. Securities Act of 1933 provides an exemption from registration for offers and sales of securities made under certain compensatory benefit plans and contracts relating to compensation.