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SEC Publishes Final Rules for Financial Disclosures of U.S.-Registered Foreign Companies

On December 21, 2007, the Securities and Exchange Commission (“the Commission”) published various rule amendments adopted on November 15, 2007 (the “Final Rules”) that permit foreign private issuers to file financial statements with the Commission in accordance with International Financial Reporting Standards (“IFRS”) as promulgated by the International Accounting Standards Board (the “IASB”)¹ without the need to reconcile such statements with U.S. Generally Accepted Accounting Principles (“GAAP”).² Specifically, the Commission amended Form 20-F, Regulation S-X, Forms F-4 and S-4, and Securities Act Rule 701.

Previously, U.S.-registered foreign companies using *any* non-GAAP accounting method, including IFRS,³ were required to reconcile resulting financial statements with GAAP. This exception for IFRS will encourage its use to the exclusion of smaller, national standards, which will thereby permit investors to better compare the financial situations of foreign companies registered in the U.S. The Final Rules take effect 60 days from publication in the Federal Register and apply to all financial statements for years ending after November 15, 2007. They are the result of proposed rule amendments issued on July 2, 2007 (the “Proposed Rules”).⁴

¹ The IASB, based in London but owned by the International Accounting Standards Committee Foundation, a Delaware corporation, “is committed to developing, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements.” See IASB, About the IASB, available at <http://www.iasb.org/About+Us/About+IASB/About++the+IASB.htm>

² Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP, Release Nos. 33-8879, 34-57026, File No. S7-13-07 (Dec. 21, 2007) [hereinafter Final Rules], available at <http://www.sec.gov/rules/final/2007/33-8879.pdf> (the “Adopting Release”).

³ Although it is possible to file statements in accordance with IFRS in a manner *not* promulgated by the IASB, in this Memorandum when discussing whether an issuer has complied with IFRS, compliance with the IASB’s interpretations is assumed.

⁴ Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP, Rel. Nos. 33-8818, 34-57026,

I. Background

The Commission views reducing disparities in accounting and disclosure practices among the United States and the rest of the world as an important goal.⁵ A single set of standards, the Commission believes, will both permit issuers to obtain capital at a lower cost and allow investors to compare financial data with greater ease.⁶ To further this goal, the Commission has previously supported the use of IFRS and encouraged the IASB and the Financial Accounting Standards Board (the “FASB”)⁷ to converge their standards.⁸ The Final Rules are another step in the Commission’s efforts to encourage a single set of globally accepted accounting standards.

II. Summary

In order to achieve its purpose, the key provisions⁹ of the Final Rules affect:

- Items 17 and 18 of Form 20-F. When preparing these financial statement requirements for foreign issuers, if the financial statements comply with IFRS, such compliance must be explicitly stated without reservation in the notes to the financial statements. Furthermore, issuers wishing to avoid reconciliation with GAAP must include an auditor’s report containing an opinion on whether the financial statements comply with IFRS. Failing that, reconciliation with GAAP must occur.
- Item 8.A.5 of Form 20-F. If a foreign issuer is permitted to file audited annual financial reports without GAAP reconciliation, it may also file unreconciled unaudited interim financial statements if those statements are prepared in accordance with IFRS. Furthermore, no material variations between GAAP and IFRS need be reported, distinguishing IFRS from other standards. If the is-

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File No. S7-13-07, at 19-24 (July 2, 2007 (the “Proposing Release”), *available at* <http://www.sec.gov/rules/proposed/2007/33-8818.pdf>.

⁵ For a discussion and summary of past consideration of a single set of globally accepted accounting standards, see *id.* at 19-24.

⁶ Adopting Release at 6.

⁷ The FASB is a private organization that establishes GAAP. See Facts About FASB, <http://www.fasb.org/facts/> (last visited Dec. 21, 2007). The FASB’s decisions are recognized as authoritative by the Commission. Commission Statement of Policy Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter, Release Nos. 33-8221, 34-47743 (Apr. 25, 2003), *available at* <http://www.sec.gov/rules/policy/33-8221.htm>.

⁸ Proposing Release at 26.

⁹ The Amendments affect other sections and subsections as well. See Adopting Release at 94-111.

suer cannot file its audited annual financial reports without GAAP reconciliation, it must also reconcile its unaudited interim financial statements with GAAP.

- Item 3.A of Form 20-F, which requires issuers to provide five years of selected financial data. To the extent that this Item requires GAAP reconciliation, issuers that file statements in accordance with IFRS need not comply.
- General Instruction G to Form 20-F. This instruction previously required first time IFRS filers to file three years of select financial statements, while repeat IFRS filers only needed such information from the last two years. The Final Rules eliminate this difference: all issuers complying with IFRS need file two years of such statements.
- Regulation S-X. Although the Commission did not originally propose changes to Regulation S-X, it amended some provisions based on comments. The changes eliminate the mandatory nature of reconciliation with GAAP for issuers who comply with IFRS. These changes are not substantive.
- Forms F-4 and S-4. The Final Rules only make conforming changes to these forms.
- Securities Act Rule 701. The Final Rules only make conforming changes to Rule 701. Rule 701 provides an exemption from registration for offers and sales made under certain compensatory benefit plans. This exemption is not available to issuers that must file with the Commission, but it does require foreign issuers to reconcile their statements with GAAP. The Final Rules carve out an exception to issuers who comply with IFRS.

While the Final Rules increase the prominence of IFRS, which the Commission hopes will one day become a uniform global standard of accounting¹⁰ and which over 100 countries already permit or mandate¹¹, domestic companies must still comply with GAAP¹². Furthermore, U.S.-registered foreign companies may continue to use other accounting standards so long as they continue to reconcile resulting financial statements with GAAP.

III. Criticism

Although the creation of a universal global accounting system is an admirable goal, some raised concerns about the efficacy of excluding IFRS-compliant statements from reconciliation with GAAP. For example, in a comment¹³ to the Proposed Rules, the American Bankers Association stated that, while the

¹⁰ See, e.g., SEC, Press Release: SEC Takes Action to Improve Consistency of Disclosure to U.S. Investors in Foreign Companies, available at <http://www.sec.gov/news/press/2007/2007-235.htm>.

¹¹ See, e.g., Deloitte Touche Tohmatsu. IAS Plus, Use of IFRSs by Jurisdiction, available at <http://www.iasplus.com/country/useias.htm> (noting 108 jurisdictions that either permit or require IFRS).

¹² See, e.g., *id.* (noting that IFRS is not permitted in the U.S.). Permitting domestic companies to comply with IFRS, rather than GAAP, is a separate issue that the Commission plans to address. SEC, Press Release: SEC Takes Action to Improve Consistency of Disclosure to U.S. Investors in Foreign Companies, available at <http://www.sec.gov/news/press/2007/2007-235.htm>.

¹³ For a complete list of comments to the Proposed Rules, see Comments on Proposed Rule: Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP, available at

two sets of accounting have currently converged to the point where they are “close enough” to eliminate the need for reconciliation, nothing prevents divergence in the future.¹⁴ The American Bankers association also voiced its concern over a lack of a coherent list of differences between IFRS and GAAP, which it argues would be helpful to investors comparing IFRS and GAAP statements.¹⁵ In another comment to the Proposed Rules, Senator Christopher Dodd, Chairman of the Senate Committee on Banking, Housing, and Urban Affairs, and Senator Jack Reed, stated that the Commission’s decision was “premature and being unduly rushed.”¹⁶

These criticisms notwithstanding, the Commission approved the Proposed Rules almost in their entirety, furthering the creation of a global set of accounting standards.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Jon Mark at (212) 701-3100 or jmark@cahill.com.

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<http://www.sec.gov/comments/s7-13-07/s71307.shtml> (last visited Dec. 21, 2007).

¹⁴ Letter from Donna J. Fisher, Director, Tax and Accounting, American Bankers Association, to Nancy M. Morris, Secretary, Securities and Exchange Commission, at 1 (Sept. 21, 2007), *available at* <http://www.sec.gov/comments/s7-13-07/s71307-35.pdf>.

¹⁵ *Id.* at 2.

¹⁶ Letter from Sen. Jack Reed and Sen. Christopher C. Dodd, Members of Congress, to Christopher Cox, Chairman, Securities and Exchange Commission, at 1 (Nov. 14, 2007), *available at* <http://www.sec.gov/comments/s7-13-07/s71307-145.pdf>.