

March 31, 2004

## SEC Proposes Accommodations to Address First-Time Application of IFRS for Foreign Issuers

On March 11, 2004, the SEC proposed certain changes to the disclosure requirements applicable to foreign private issuers registered with the SEC in order to provide one-time accommodations relating to financial statements prepared in accordance with International Financial Reporting Standards ("IFRS").

The SEC's proposed changes are prompted primarily by a new European Union ("EU") regulation requiring publicly traded EU companies to prepare their consolidated financial statements in accordance with IFRS for each financial year starting on or after January 1, 2005. It has been estimated that the new EU requirements will affect approximately 7,000 companies in the EU. Other countries, including Australia, also have adopted similar requirements. In addition, a number of countries elsewhere in the world allow and in certain instances encourage companies to adopt IFRS. The SEC has estimated that approximately 417 foreign private issuers, one-third of all foreign private issuers registered with the SEC, will be able to avail themselves of the proposed accommodations.

The SEC has stated that the proposed changes are intended to facilitate the transition of companies to IFRS. However, the proposed changes will not eliminate current SEC requirements relating to reconciliation of financial statement items to generally accepted accounting principles ("GAAP") as used in the United States ("U.S. GAAP").

The following memorandum briefly summarizes the proposed amendments. The SEC has requested comments on the proposed rules to be submitted no later than April 19, 2004.

### *Eligibility requirements*

The proposed accommodations would apply to a foreign private issuer:

- that adopts (either voluntarily or by mandate) IFRS for the first time for a financial year that begins no later than January 1, 2007;
- that is able to state unreservedly and explicitly that its general purpose financial statements comply with IFRS; and
- whose audited financial statements are not subject to any qualification relating to the application of IFRS.

The proposed rules would not apply to a foreign private issuer that:

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- previously published audited financial statements prepared in accordance with IFRS (either voluntarily or by mandate); or
- adopts a set of accounting standards that includes deviations from the standards promulgated by the International Accounting Standards Board (“IASB”) and the International Accounting Standards Committee (“IASC”).

#### *Primary IFRS financial statements*

##### *Current requirements*

Under current SEC rules, foreign private issuers are required to provide three years of audited statements of income, changes in shareholders’ equity and cash flows, and two years of audited balance sheets, prepared on a consistent basis of accounting. In addition, companies that change their basis of accounting to another GAAP are required to present audited financial statements for the past three years prepared in accordance with the new GAAP. Accordingly, current rules would require that a calendar year-end company adopting IFRS in 2005 (voluntarily or by mandate) include in its 2005 annual report on Form 20-F audited statements of income, changes in shareholders’ equity and cash flows for each of 2003, 2004 and 2005, together with audited balance sheets for 2004 and 2005, all prepared in accordance with IFRS.

However, IFRS 1, the standard applicable to first-time adopters of IFRS, requires companies adopting IFRS to present only one year of comparative financial information for the year IFRS is adopted. (IFRS 1 allows presentation of additional comparative periods, either voluntarily or by mandate.) Accordingly, IFRS would require companies adopting IFRS in 2005 to present audited financial statements for 2004 and 2005 only.

The SEC has noted in the proposing release that, at the beginning of 2003, the IASB had not finalized a number of elements of IFRS that companies will be required to apply retroactively upon adoption of IFRS in 2005. The SEC has also noted its concern that companies in this situation may have difficulty recasting results accurately under IFRS for year 2003, and may find that such efforts would involve undue cost and effort for an uncertain benefit. Accordingly, the SEC proposed the accommodations set forth below.

The SEC has stated that the proposed accommodations would be available to first-time adopters of IFRS for financial years beginning no later than January 1, 2007 because IFRS may continue to be developed in a manner that may affect these companies in future years.

##### *Accommodations*

The accommodations would permit eligible foreign private issuers for 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 prepared in accordance with IFRS. For example, an eligible foreign private issuer with a calendar year-end that adopts IFRS in 2005 would include in its 2005 annual report on Form 20-F audited balance sheets for 2004 and 2005 and audited statements of income, shareholders’ equity and cash flows also for 2004 and 2005 (but not for 2003). The current

SEC requirements relating to primary financial statements, including those relating to audits to be conducted in accordance with U.S. generally accepted auditing standards, would continue to apply in all other respects.

#### *U.S. GAAP financial information*

As discussed above, the proposed amendments would retain current requirements regarding U.S. GAAP reconciliation, but modify the form in which the reconciliations are presented in the first filing that includes IFRS financial statements. Reconciliation to U.S. GAAP for the two financial years covered by the primary IFRS financial statements will continue to be required. As before, that reconciliation must be audited and included as a note to the primary financial statements.

In addition, as part of the U.S. GAAP reconciliation footnote, condensed U.S. GAAP financial information for the three most recent financial years would be required under the SEC's proposal. As proposed, the condensed U.S. GAAP financial information would be presented in a level of detail consistent with that for interim financial statements required by Article 10 of Regulation S-X, and would include three years of condensed income statements and two years of balance sheets. Statements of changes to shareholders' equity and cash flows and notes to the condensed financial information would not be required.

#### *Previous GAAP financial statements*

As proposed, eligible foreign private issuers relying on the accommodations would not be required to include any financial statements, textual discussion or other financial information prepared on the basis of the accounting standards that an issuer used immediately before adopting IFRS ("Previous GAAP"). However, the proposed amendments would not prohibit companies from including, incorporating by reference or referring to Previous GAAP financial statements in their SEC filings.

If Previous GAAP financial information is included or incorporated by reference in an SEC filing, that filing must also include or incorporate by reference the company's operating and financial review and prospects under Item 5 of Form 20-F for the reporting periods covered by Previous GAAP financial information. The SEC has stated specifically that it is not proposing specific legends or language to accompany this disclosure because the language may vary depending on the use made of Previous GAAP information.

If Previous GAAP financial information is included, incorporated by reference or referred to in an SEC filing, that filing must also include appropriate cautionary language disclosing, at an appropriate prominent location, that the filing contains Previous GAAP financial information, which is not comparable to the IFRS financial information.

#### *Selected financial data*

The proposed amendments would require selected historical financial data to be presented in accordance with IFRS for the two most recent years. In addition, as before, selected historical

financial data prepared in accordance with U.S. GAAP are required for the five most recent financial years, unless an exemption exists.

As with Previous GAAP full financial statements, the proposed amendments neither require nor prohibit companies from including, incorporating by reference or referring to Previous GAAP selected historical financial data in SEC filings. If Previous GAAP selected financial data or financial information is included in an SEC filing, that filing must also include appropriate cautionary language with respect to that data. However, the SEC has specifically stated that it does not believe that Previous GAAP selected financial data should be presented in “side-by-side” format with IFRS selected financial data as this may lead to comparison between periods for which financial data are presented on a different basis.

#### *Operating and financial review and prospects*

The proposed amendments clarify that eligible foreign private issuers relying on the accommodations should, in disclosing their operating and financial review and prospects under Item 5 of Form 20-F, focus on the IFRS financial statements from the past two financial years, as well as the U.S. GAAP reconciliation for the same two financial years. Management should not include in this section any discussion relating to Previous GAAP financial information, unless it has otherwise elected to include or incorporate by reference Previous GAAP financial information, which, as discussed above under “Previous GAAP financial information,” must be accompanied by a separate discussion of operating and financial review and prospects on the basis of such Previous GAAP financial information.

#### *Other disclosures*

As with Item 5 disclosure, the proposed amendments clarify that eligible foreign private issuers relying on the accommodations should, in providing information about their business under Item 4 of Form 20-F and about their use of derivatives under Item 11 of Form 20-F, provide such information based on IFRS.

The SEC has specifically stated that it is not proposing any amendments to the current rules with respect to information required to be disclosed pursuant to Industry Guides 3 and 6 by a foreign private issuer that changes its basis of accounting to IFRS.

#### *Interim financial statements and information for the transition year*

While in its proposing release the SEC has acknowledged that appropriate presentation of financial statements during a Transition Year raise unique issues, the SEC has not proposed any accommodating amendments to the current requirements. (“Transition Year” is the financial year in which an issuer first changes its basis of accounting from Previous GAAP to IFRS. For example, the Transition Year for a foreign private issuer with a calendar year-end that is subject to the new EU regulation would be the financial year ended December 31, 2005.) However, the SEC has invited public comment on three alternative proposals to the current requirements.

#### *Current requirements*

If a registration statement or prospectus is dated more than nine months after the end of the last audited financial year, consolidated interim financial statements covering at least the first six months of the financial year and the comparative period for the prior financial year must be provided. The unaudited interim financial statements must comply with Article 10 of Regulation S-X, be prepared using the same basis of accounting as the audited financial statements contained in the document and include or incorporate by reference a reconciliation to U.S. GAAP.

If the document is dated less than nine months after the last financial year, it must include any published financial information that is more current than what is required. When this type of information is presented, any material variation from U.S. GAAP must be described and to the extent not present in the most recent financial year must be also quantified. Generally, a full reconciliation to U.S. GAAP is not required for this type of interim non-U.S. GAAP financial information.

Under current rules (absent accommodation), a foreign private issuer that is switching to IFRS and is required to present interim financial statements during the Transition Year will present three years of audited financial statements and two years of unaudited interim period financial statements, all prepared in accordance with Previous GAAP. (For example, a calendar year-end company that is required to switch to IFRS for year 2005 would include or incorporate by reference in a registration statement or prospectus filed during 2005 audited financial statements for 2002, 2003 and 2004 and (when required) unaudited financial statements for the six months ended June 30, 2004 and 2005, all prepared in accordance with Previous GAAP, and (when required) containing a reconciliation to U.S. GAAP.)

In addition, if a foreign private issuer has also published IFRS financial statements covering the interim periods for which Previous GAAP interim financial statements are provided, the issuer must also include this IFRS information in its SEC filings with appropriate and prominent cautionary disclosure that the IFRS financial statements are not comparable to Previous GAAP financial statements.

#### *Alternative 1*

The SEC has invited comment on an alternative proposal, whereby if both Previous GAAP and IFRS interim financial statements are available, a foreign private issuer would have the choice to include one or the other.

#### *Alternative 2*

An alternative approach would be that, when the Transition Year is 2004 or 2005, instead of requiring both Previous GAAP and available IFRS interim financial statements for two years, the SEC would require audited IFRS financial statements for the last full financial year only, with unaudited IFRS financial statements for interim periods in both years. (For example, for a calendar year-end company that adopts IFRS in 2005, this would mean audited IFRS financial statements for 2004 only and unaudited IFRS financial statements for interim periods in 2004 and 2005.) The SEC has recognized that this approach would not be in technical compliance with IFRS 1, which requires that first-time adopters include one year of comparative information under IFRS. (Based on the fact

pattern of the previous example, IFRS 1 would require audited comparable financial statements for 2003.) Accordingly, the SEC has invited comment if it should permit audit reports that are qualified as to this provision of IFRS 1.

*Alternative 3*

As a third alternative, the SEC has solicited comment on a proposal whereby, if the Transition Year is 2004 or 2005, three years of audited Previous GAAP financial statements and two years of unaudited IFRS financial statements would be required, the latter with the same level of disclosure as in annual financial statements. (For example, for a calendar year-end company that adopts IFRS in 2005, this would mean audited Previous GAAP financial statements for 2002, 2003 and 2004 with unaudited IFRS financial statements for interim periods in 2004 and 2005.)

***Disclosure about exceptions to IFRS***

IFRS 1 establishes both elective and mandatory exceptions to the principle that a first-time adopter must comply with each element of IFRS effective at the reporting date for its first IFRS financial statements. The SEC has proposed to add an instruction to Item 5 of Form 20-F requiring any issuer relying on any of the elective or mandatory exceptions from IFRS to include detailed discussion of each exception used and the circumstances that gave rise to its use. In particular, an issuer should:

- identify the items or class of items to which the exception was applied (for example, specific business combination, asset or category of asset, pension plan, financial instrument, etc.); and
- describe what accounting principle was used and how it was applied (for example, if a business combination was treated as a pooling based on Previous GAAP that would have been treated as a purchase under IAS 22).

The issuer would be required to provide an explanation of the significance of each exception to the company's financial condition and to the changes in its financial condition and results of operations. Where material, the company also would have to identify the line items in the financial statements that were affected by the exceptions from IFRS. The discussion of each elective exception used would include, where material, qualitative disclosure of the impact on financial condition and changes in the company's financial condition and results of operation that the alternatives would have had. When relying on a mandatory exception, the issuer would have to describe the exception and state that it complied. Under the SEC's proposal, exceptions (whether elective or mandatory) would have to be identified in the notes to the audited financial statements.

*Reconciliation from Previous GAAP to IFRS*

IFRS 1 requires first-time adopters to include in the notes to audited financial statements a reconciliation from Previous GAAP to IFRS that gives "sufficient data to enable users to understand the material adjustments to the balance sheet and income statement," and if presented under Previous GAAP, the cash flow statement. The SEC's proposal includes a new instruction to Item 8 of Form 20-F requiring a similar level of information in the reconciliation of Previous GAAP to IFRS to be included in SEC filings. This reconciliation is to be included as a note to the audited financial statements with respect to the first financial year for which the issuer adopts IFRS.

The SEC has not proposed specific form or content requirements with respect to the reconciliation disclosure. The SEC has stated however that a reconciliation following Example 11 provided in paragraph IG63 of the Implementation Guidance to IFRS 1 ("IG63"), which quantifies balance sheet and income statement captions at a level of detail comparable to that required by Article 10 of Regulation S-X, would meet the required level of information under the proposed amendment to Item 8. Recognizing that IG63 is not mandatory, the SEC has also stated that following IG63 would assure that first-time adopters registered with the SEC provide a comparable level of information with respect to the reconciliation, but that companies may comply with the proposed instruction to Item 8 in other ways. For example, a reconciliation that satisfies the requirements of Item 17 of Form 20-F may be provided. The SEC has also stated that there may be other acceptable alternative formats of reconciliation.

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This memorandum provides only a general overview of certain provisions of the Act and is not intended to provide or constitute legal advice, and no legal or business decision should be based on its contents.

Any questions concerning the foregoing should be addressed to members of the Paul Weiss Securities Group (see below). In addition, memoranda on related topics may be accessed under Securities Group publications on our web site ([www.paulweiss.com](http://www.paulweiss.com)).

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