

IASBriefing

This special issue of *IASBriefing* summarises the key points of the US Securities and Exchange Commission's (SEC) recently published rule proposal regarding requirements in SEC filings for foreign private issuers that are first-time adopters of IFRSs.

On 12 March 2004, the SEC published a rule proposal (release 33-8397) regarding requirements in SEC filings for foreign private issuers that are first-time adopters of IFRSs. The rule proposal is intended to relieve foreign private issuers of the burden related to restating financial statements for a prior financial year using IFRSs. The rule proposal, if approved, would, for a limited time, permit qualifying foreign private issuers filing with the SEC to provide only two years of financial information on an IFRSs basis for filings for the first year of reporting under IFRSs.

Background

The SEC has indicated that it wishes to provide relief to entities adopting IFRSs that were not finalised during the period to which such standards would have to be applied. The SEC noted that a large number of foreign private issuers would be adopting IFRSs shortly, in part because of the European Union (EU) regulation that requires all EU incorporated entities with an EU listing to adopt IFRSs, generally from 2005 (the EU IAS regulation). The Australian government also has committed to requiring reporting entities to adopt IFRSs from 2005.

Overview

The SEC proposes to permit, in the year of adoption of IFRSs, presentation of two years rather than three years of certain primary financial statements. The proposed accommodation will apply to registration statements as well as annual reports filed with the SEC.

The rule proposal also would permit the following items to focus only on the two years covered in the primary financial statements:

- operating and performance review;
- certain business and market risk disclosures; and
- selected financial data.

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However, the rule as proposed would require presentation of certain condensed US GAAP financial information for three years. It also would require disclosure of any exemptions from restatement used under IFRS 1 *First-time Adoption of IFRSs*. Disclosure of the exemptions used would be a *continuing* requirement for any foreign private issuer that changes its basis of accounting to IFRSs.

The release also addresses possible approaches when an entity conducts an offering or registration of securities (e.g., an initial listing, or a secondary offer of shares) at a time when it would be required to file interim information for the year when it first adopts IFRSs.

Discussion of the SEC rule proposal

The main points addressed in the rule proposal are requirements in respect of:

- primary financial statements
- presentation of condensed US GAAP financial information
- operating and performance review (management's discussion and analysis)
- certain business and market risk disclosures
- selected financial data
- presentation of supplemental non-IFRSs financial statements
- information required by SEC industry guides
- interim information in 1933 Act filings

The release makes specific proposals in each of the above areas, but also asks a number of questions about possible alternative approaches. The release notes that it is *not* proposing any relief from the current requirement to reconcile financial statements prepared using IFRSs with US GAAP.

Primary financial statements

The rule would permit foreign private issuers reporting for the first time under IFRSs to present as their primary financial statements two years, rather than three years, of statements of income, changes in shareholders' equity and cash flows.

The rule proposal would permit this relief to be available only for those entities that adopt IFRSs for financial years beginning on or *before* 1 January 2007. The EU IAS regulation generally requires entities covered by that regulation to adopt IFRSs for financial years beginning on or after 1 January 2005. However, the EU IAS regulation permits member states to defer the required effective date for certain entities up to financial years beginning on or *after* 1 January 2007. It appears that entities eligible for deferral under

the EU IAS regulation that do not have a calendar year end would be excluded from the relief proposed by the SEC.

The relief would be available only to those entities that have not previously published audited financial statements prepared in accordance with IFRSs; it is not linked explicitly to being a first-time adopter under IFRS 1. In some cases an entity that previously claimed compliance with IAS (International Accounting Standards) may be a first-time adopter of IFRSs under IFRS 1 (See IASB *Briefing* Issue 17, February 2004 for a further discussion of this issue). Only entities that comply with IFRSs as approved by the International Accounting Standards Board, and its predecessor the International Accounting Standards Committee, and whose audited financial statements are not subject to any qualification regarding compliance with IFRSs will be eligible for the relief.

IFRS 1 establishes both elective and mandatory exemptions to the principle that a first-time adopter must retrospectively comply with each standard effective at the reporting date for its first IFRSs financial statements. The release proposes requiring an entity to discuss each exemption used, the circumstances that gave rise to its use and the significance of the exemption to the entity's balance sheet and income statement. The release indicates this would be a qualitative rather than quantitative disclosure, despite proposing a discussion of its *significance*. Also note that this requirement would apply to all first-time adopters whether or not they take advantage of the proposed relief (presentation of two years of certain primary financial statements), and would apply in subsequent years.

IFRS 1 requires entities to present a reconciliation from previous GAAP to IFRSs. Implementation guidance (IG) in IFRS 1 presents an example in paragraph 63 (Example 11) of how this reconciliation may be presented. The release proposes requiring certain disclosures relating to this reconciliation and recommends using the format of Example 11 to comply with these disclosure requirements.

Presentation of condensed US GAAP financial information

The release proposes that if an entity presents only two years of primary financial statements under the first-time adoption relief then the entity also must include summary condensed US GAAP balance sheet and income statement information for the periods for which primary financial statements normally are required (i.e., income statements for the three most recent financial years and balance sheets for the two most recent financial years). Neither US GAAP footnotes nor condensed statements of changes in shareholders' equity or of cash flows prepared in accordance with US GAAP would be required. The SEC states its belief that most of the information required is collected in order to prepare the US GAAP reconciliations required in the Form 20-F and that this should not be a significant burden.

Entities filing an initial registration statement would not be required to present the additional condensed US GAAP financial information.

Operating and performance review, and certain business and market risk disclosures

The release would permit the management's discussion and analysis to focus on the financial statements prepared using IFRSs when discussing their operating and performance results (i.e., a two-year analysis). Similarly, disclosures about business operations, products, services, derivatives and market risk would be required only with respect to information covered by the primary financial statements (i.e., the two years prepared using IFRSs).

Selected financial data

Generally, issuers must provide five years of selected financial data, showing information both on the basis of the primary financial statements and, if those were not prepared using US GAAP, certain US GAAP amounts. The release proposes that, while five years of US GAAP information will continue to be required, only two years of information prepared on an IFRSs basis would be required in the year of adoption of IFRSs.

Presentation of supplemental non-IFRSs financial statements

The SEC's rule proposal permits, but does not require, inclusion of financial statements prepared using a basis other than IFRSs. In some cases, national regulators are expected to require presentation of "bridging" financial statements – e.g., 2003 and 2004 on a "previous GAAP" basis, and 2004 and 2005 on an IFRSs basis, in order to provide some additional information for trend analysis. The SEC made clear that it is not proposing such a requirement, and asks if such a presentation should be prohibited, or if there should be any limits on presentation of such information (e.g., not permitted to be presented on a "side by side" basis with IFRSs-based information). In addition, if such information is included or incorporated by reference, the release proposes requiring an entity to include or incorporate narrative discussion of the operating and financial review and prospects for the period covered by previous GAAP. Further, the rule proposal would in this situation require the inclusion of cautionary language regarding the lack of comparability with financial information included under IFRSs.

Information required by SEC industry guides

The release notes that some SEC industry guides (e.g., Guide 3 for bank holding companies) require statistical data for periods from three years up to ten years. The release does not propose any relief for the information required by these guides, noting that the guides require statistical information that should not be impacted by the basis of accounting used in an entity's primary financial statements.

Interim information in 1933 Act filings

When an entity registers securities under the 1933 Act, for example as part of an initial registration or offering, or in connection with issuing shares in a secondary offering, it may be required under SEC rules to supplement annual financial statements with interim financial statements. Supplemental interim financial statements are required if the annual financial statements presented are for a period that ended more than nine months prior to the effective date of the registration statement. In the release, the SEC notes that, in the "transition year" (e.g., 2005 for a calendar year company that is a first-time adopter of IFRSs for its financial year beginning 1 January 2005), this might create problems if an entity prepares interim information on an IFRSs basis but only has available annual financial statements on a previous GAAP basis. The SEC notes that compliance with current SEC requirements would involve preparing interim information for 2005, in this case, on a previous GAAP basis, even if the entity planned to report 2005 interim information on an IFRSs basis in another jurisdiction (i.e., interim financial statements under previous GAAP and IFRSs would be required). The SEC does not propose any relief but asks if it should, and if so, what.

Comment period

The SEC has requested comments on a number of different aspects of the rule proposal. Many of the SEC's requests for comments centre around the difficulties and costs of preparing and presenting certain information, whether investors will receive adequate information based on the proposals, and whether alternatives to the proposal should be considered. We encourage entities that have, or are considering, a US listing to comment on the rule proposal and provide the SEC with valuable insight on the implementation issues relative to the proposed rules, including where clarification would be helpful. The comment period closes on **19 April 2004**.

A copy of the rule proposal is available on the SEC's Web site at <http://www.sec.gov/rules/proposed/33-8397.htm>.

If you would like further information on any of the matters discussed in this IASBriefing, please talk to your usual contact at KPMG or call any of our offices.

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