

IFRS Briefing Sheet

Publication of U.S. Securities and Exchange Commission's (SEC's) Final Rule for First-time Adopters of IFRSs

April 2005, **Issue 22**

This *IFRS Briefing Sheet* discusses the U.S. SEC's recent publication of a final rule to provide a one-time accommodation relating to financial statements prepared under IFRSs.

The final rule will exempt first-time adopters of IFRSs from the normal SEC requirement to present three years of certain primary financial statements prepared on a consistent basis of accounting. Instead, in the year in which an entity adopts IFRSs, it may provide only two years of financial information on the basis of IFRSs. The rule does not change the existing requirement for reconciliation to U.S. GAAP. It also introduces disclosure requirements that apply whether or not the exemption is used.

A copy of the rule is available at <http://www.sec.gov/rules/final/33-8567.pdf>.

Highlights of the Final Rule

- One-time relief from providing three years of financial information for first-time adopters of IFRSs.
- Relief also will be available to entities applying international accounting standards as adopted for use in the E.U. (referred to in the

final rule as E.U. GAAP), provided other conditions have been met.

- Additional guidance is provided to companies subject to Industry Guide 3 *Statistical disclosure by bank holding companies* or Industry Guide 6 *Disclosures concerning unpaid claims and claim adjustment expenses of property-casualty insurance underwriters*.
- A specified format is not required for an entity's reconciliation from Previous GAAP to IFRSs. Quantitative numerical information on the financial significance of any exceptions applied is not required.
- Unlike the proposal, the final rule offers flexibility around the basis of preparation for interim financial statements when they are required for registration statements in the year of adoption.
- The proposed additional requirement to include condensed U.S. GAAP information for three years has not been included in the final rule.

Eligibility Requirements and Scope

The relief is applicable to entities that adopt IFRSs prior to or for the first financial year starting on or after 1 January 2007. This means that entities that are not required to apply the E.U. IAS Regulation (see *IFRS Briefing Sheet IFRSs and the E.U. Endorsement process – Issue 18*) until

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2007 will be eligible for the relief from presenting three years of financial information. Generally, in order to qualify for the exemption the financial statements must contain an unreserved explicit statement of compliance with IFRSs and not be subject to any qualification relating to the application of IFRSs. However, the final rule also extends this accommodation to entities using E.U. GAAP (see below).

The rule clarifies that the relief is available only to entities that meet the definition of a first-time adopter under IFRS 1 *First-time Adoption of IFRSs*.

Entities using national GAAP from a country that has a convergence programme with IFRSs appear to be eligible for the one-time accommodation under the final rule. The final rule specifically refers to Australian entities and notes that in order to qualify for the relief, dual compliance (i.e., compliance with both IFRSs and Australian GAAP) must be stated explicitly. The final rule does not preclude relief for entities using other “converged” national GAAPs so long as their statement of compliance qualifies them as a first-time adopter of IFRSs.

If an entity publishes three years of financial information under IFRSs, then the entity is not eligible for the relief under this rule.

The SEC clarified that the relief from providing three years of financial information also would extend to financial statements provided under Rule 3-05 *Financial Statements of Businesses Acquired or to Be Acquired*, Rule 3-09 *Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons*, Rule 3-10 *Financial Statements of Guarantors and Affiliates Whose Securities*

Collateralise an Issue Registered or Being Registered and Rule 3-16 *Financial Statements of Affiliates Whose Securities Collateralise an Issue Registered or Being Registered* of Regulation S-X, provided that the entities meet the definition of a foreign business in Rule 1-02(1) *Definition of Terms Used in Regulation S-X*.

The final rule does not alter current requirements for reconciliation of non-U.S. GAAP financial statements. As required by item 17 or 18 of Form 20-F, entities must reconcile at least net income and shareholders’ equity to amounts determined under U.S. GAAP.

Entities using E.U. GAAP

Unlike the proposal, the final rule permits entities using E.U. GAAP to use the one-time relief from presenting three years of financial information in the year of transition to IFRSs. However, to qualify for the relief, these entities also must provide an audited reconciliation to IFRSs as published by the IASB for the two years presented. This reconciliation must be provided for the two years of financial statements provided and it must contain information relating to financial statement line items and footnote disclosures equivalent to that required under IFRSs.

The reconciliation to “full” IFRSs does not replace the required reconciliation to U.S. GAAP. The rule permits entities to use net income and shareholders’ equity as reported either under E.U. GAAP or IFRSs as the starting point for the reconciliation to U.S. GAAP.

The final rule clarifies that the reconciled IFRS amounts would provide the basis for the selected financial data and that the E.U. GAAP numbers should be used as the basis for the operating and financial review (Management Discussion and

Analysis). However, the operating and financial review also should include a discussion of any differences between E.U. GAAP and IFRSs that otherwise are not discussed in the reconciliation and that the issuer believes are necessary for an understanding of the financial statements taken as a whole.

Selected Financial Data

The SEC clarified that first-time adopters of IFRSs relying on this accommodation can build up to a five-year history of selected financial data under IFRSs in years subsequent to their transition year.

Industry Guides

The final rule does not include amendments to the current requirements of Industry Guide 3 or Industry Guide 6 for banks and insurance companies. However, it does note that an entity will be in compliance with Industry Guide requirements if it provides two years of Industry Guide data based on information prepared under IFRSs, and provides information for earlier years based on information prepared under U.S. GAAP or Previous GAAP (the basis of accounting before the entity adopts IFRSs). No relief is provided for other Industry Guides. However, entities encountering compliance issues in connection with other industry guides may wish to consult with the SEC staff.

New Disclosure Requirements

The rule requires entities to disclose each exception used under IFRS 1 regardless of whether use of the exception is optional or mandatory. It also clarifies that entities need not provide quantitative disclosures of the financial impact of each exception. However, the example disclosure included in the rule suggests that the level of explanation required is extensive. The SEC emphasises that disclosure is intended to give investors some

information as to the magnitude of the effect of an exception on an issuer's financial statements. This disclosure is required for all first-time adopters whether or not they elect to present only two years of financial statements on an IFRS basis.

These disclosures are expected to be presented in the operating and financial review and not in the financial statements.

The rule does not prescribe a format for the reconciliation from Previous GAAP to IFRSs required by IFRS 1, but notes that a reconciliation following example 11 under IFRS 1.IG 63 would meet its requirements.

Requirements Regarding Presentation of Interim Financial Statements

Presentation of interim financial statements by foreign private issuers continues to be a complex area. The final rule does not make any changes to the requirements for presentation of interim financial statements and reconciliation to U.S. GAAP in limited circumstances. However, it does provide some alternatives for those entities that are required to file interim financial statements in a registration statement declared effective more than nine months after the most recent audited annual financial statements. The SEC will allow three alternatives in these situations: Previous GAAP, IFRS, and the U.S. GAAP Condensed Information Option.

Previous GAAP Option

Under this option, a foreign private issuer would present three years of audited Previous GAAP financial statements as well as Previous GAAP interim financial statements for the current year and comparable prior year period, all reconciled to U.S. GAAP. This would be consistent with what would be presented absent transition to IFRSs.

IFRS Option

This option would allow a foreign private issuer to present two years of audited financial statements as well as interim financial statements for the current year and comparable prior year period, all prepared in accordance with IFRSs and reconciled with U.S. GAAP. For a first-time adopter in 2005 this would require annual financial statements prepared under IFRSs for not only 2004 but also 2003. This would have the effect of pushing back the entity's date of transition to IFRSs to 1 January 2003.

The U.S. GAAP Condensed Information Option

This option would allow a foreign private issuer to present (i) audited Previous GAAP financial statements for the prior three years, reconciled to U.S. GAAP; (ii) unaudited IFRS financial statements for the current and prior year comparable interim periods, reconciled to U.S. GAAP; and (iii) unaudited condensed U.S. GAAP balance sheets and income statements for the most recent prior financial year and the current and prior year comparable interim periods. The condensed U.S. GAAP information should provide a level of detail consistent with that required by Article 10 of Regulation S-X for interim financial statements.

Other Options

As a fourth option, the SEC states that if companies are unable to comply fully with any of these options, then they shall contact the SEC staff for further guidance.

Other Observations

The rule does not preclude entities that adopt IFRSs from including, incorporating by reference, or referring to Previous GAAP financial information; however, it does prohibit presentation of Previous GAAP information in a side-by-side format with IFRS information.

The SEC clarified that information provided about the entity, as well as amounts included in the operating and financial review and derivatives and market risk disclosures, should be provided on an IFRS basis.

The SEC decided, based on comments received, not to require presentation of condensed balance sheets and income statements under U.S. GAAP. This had been proposed to facilitate trend analysis.

The rule release confirms that the SEC will consider use of E.U. GAAP to be a comprehensive body of accounting standards that would be accepted in SEC filings as a basis of preparation of primary financial statements. The rule release notes that the SEC would accept the use of E.U. GAAP in SEC filings by E.U. entities. In our view, if a non-E.U. issuer wishes to use E.U. GAAP, then it should consult in advance with the SEC staff.

[If you would like further information on any of the matters discussed in this issue of *IFRS Briefing Sheet*, please talk to your usual local KPMG contact or call any of our member firms' offices.](#)

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Publication name: *IFRS Briefing Sheet*

Publication number: Issue 22

Publication date: April 2005