U.S. Securities and Exchange Commission

Speech by SEC Staff: International Reporting Issues

Remarks by

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Introduction

2000 was another record-setting year for the foreign private issuer program. During the fiscal year ended September 30, 2000, the staff declared effective over 200 initial registration statements filed by new registrants from 34 countries. These include registrants from 3 new countries - Austria, Turkey, and the Slovak Republic. These also include some of the largest industrial companies and financial institutions in Europe, and telecommunications and technology companies from all over the world.

The New International Outline

A significant initiative of the staff during the past year has been the publication of "International Financial Reporting and Disclosure Issues in the Division of Corporation Finance" (the Outline). A copy of this publication is included in your conference materials. It's also available on the SEC website. We believe the Outline will benefit foreign registrants, their advisors and the staff. In addition to discussing current developments, it also pulls together many of the significant staff interpretations and practices affecting foreign registrants that were previously not readily retrievable. We believe that the Outline will promote more consistent application of the reporting requirements and improve the transparency of the filing and review process. We plan to update the Outline periodically to reflect new issues and rule-

making developments.

New 20-F Implementation Issues

Last year I spoke about the Commission's adoption of revisions to Form 20-F, and outlined the key provisions affecting financial reporting. Revised Form 20-F is now in effect. Several implementation issues have arisen since last year's conference.

US GAAS Audit Reports - Comparative Periods

Last year I spoke about the rules that require auditors to conduct audits in conformity with US GAAS and to state their compliance in the audit report. In the past, many audit reports have stated that the audit was conducted in conformity with home-country GAAS which is "substantially similar" to US GAAS. Because that practice is no longer acceptable, an issue has arisen regarding how the auditor should report on comparative prior financial statement periods when the current year's US GAAS report is issued.

Except in two limited transitional situations, the audit report should state that the audit was conducted in conformity with US GAAS for all periods presented. The first exception relates to existing registrants that changed auditors in prior periods. Because full compliance would require the former auditor to issue a report different than the report originally filed with the SEC, the staff would not object if the former auditor re-issues its original report that includes the "substantially similar" language. This exception would not apply to initial filings.

The second exception relates to Canadian registrants. Under the special Canadian Multi-Jurisdictional Disclosure System (MJDS) rules, Canadian GAAS audits continue to be acceptable. In the past, Canadian registrants not under MJDS have also been permitted to file Canadian GAAS audit reports that did not assert substantial similarity to US GAAS. Canadian registrants not under MJDS must now comply with the US GAAS audit requirement. The staff strongly encourages Canadian registrants not under MJDS to file audit reports that state the audit was conducted in conformity with US GAAS for all periods presented, but will not insist that they do so for the comparative prior periods. In any event, a Canadian auditor's report should clearly state which GAAS has been followed each period. Also, consistent with Article 2 of Regulation S-X, an auditor should not assert compliance with US GAAS for any period unless it is true.

Incidentally, the requirement for US GAAS audits applies to any required financial statements, including those of foreign businesses, foreign investees, and foreign guarantors under Rules 3-05, 3-09 and 3-10 of Regulation S-X.

Interim Audits under Instruction 1 to Item 8.A.4

We've received a number of questions about the age of financial statement requirements in Item 8.A of revised Form 20-F. Item 8.A.4 requires the most

recent audit of an annual period to be no more than 15 months old at the time of the offering (the 15-month rule). Instruction 1 to Item 8.A.4 was added to clarify what "time of the offering" means in the US for purposes of applying the 15-month rule. Instruction 1 also includes a sentence that states "you may satisfy this requirement by providing audited financial statements covering a period of less than a full year". Quite frankly, that sentence doesn't make much sense - a registrant cannot satisfy its obligation to file *annual* audited statements by filing *interim* statements. The new rule requires a foreign registrant to update a registration statement with audited *annual* financial statements three months after its fiscal year-end. That updating is required regardless of whether the registration statement already included audited *interim* financial statements. The staff is currently evaluating how best to address that particular sentence from a technical standpoint.

15 Month Rule Still Applies even if Interim Audit Provided under 12 Month IPO Rule

A similar question has arisen with respect to the age of financial statements in an IPO registration statement. Item 8.A.4 requires that audited financial statements in initial public offerings be no more than 12 months old *at the time of filing*. The Item states that this requirement may be satisfied with an audit as of an interim date. This requirement is *in addition to* the requirement that the audited *annual* financial statements be no more than 15 months old *at the time of effectiveness* of a registration statement.

However, an instruction to the Item clarifies that the 12-month rule applies only where the registrant is not public in any jurisdiction. Further, the instruction indicates that the staff will waive the 12-month requirement where it is not applicable in the registrant's other filing jurisdictions and is impracticable or involves undue hardship. As a result, we expect that the vast majority of IPOs will be subject only to the 15-month rule. The only times that we anticipate audited financial statements will be filed under the 12-month rule are when the registrant must comply with the rule in another jurisdiction, or when those audited financial statements are otherwise readily available.

2 Year US GAAP Financial Statements in IPO

When the Commission last revised the US GAAP reconciliation requirement in 1994, it permitted initial registrants to reconcile to US GAAP for two years rather than three years. It also adopted an accommodation to permit initial registrants that present US GAAP financial statements as their primary statements to file two years of audited statements rather than three years. This accommodation is found in footnote 37 to Release 33-7053. Revised Form 20-F did not override this accommodation. The reasons for the accommodation are still relevant today, and initial registrants using revised Form 20-F may continue to rely on it.

Selected Financial Data

Under Item 3.A of revised Form 20-F, selected data for the earliest two years of the required five years may be omitted if the registrant represents that the information cannot be provided without unreasonable effort or expense, and states the reasons for the omission in the filing. If only some of the required data, such as revenues, is available for the two earliest years, that data usually should be provided. The Instruction to Item 3.A requires that the document disclose any omission as well as the reasons supporting the omission. If a registrant meets the criteria, pre-filing waiver by the staff is no longer required. As with any disclosure, a registrant's explanation of the reasons for omission is subject to staff review and comment.

Impact on MJDS

Canadian registrants that use the MJDS are not required to follow revised Form 20-F and are generally not affected by those rule revisions. However, there is one area where they could be affected. Under MJDS, Form F-10 requires *any* financial statements included in the registration statement to be reconciled to US GAAP using Item 18 of Form 20-F. A literal application of that requirement would result in MJDS registrants reconciling interim information more currently than any other foreign private issuers. Historically, the staff has not objected if a MJDS registrant reconciled to US GAAP only those periods that would be required if the filing had been made on a regular foreign form. That is, the registrant could apply the age of financial statement requirements in Rule 3-19 of Regulation S-X. However, as of October 1, 2000, Item 8 of revised Form 20-F superceded Rule 3-19. An MJDS registrant may still rely on this age of financial statement accommodation, but it must now follow the more stringent age requirements in new Form 20-F.

Processing Matters

Completeness of Draft Registration Statements and Audit Reports

When a foreign private issuer seeks to offer or list its securities in the US for the first time, the staff is generally willing to review the initial registration statement in confidential draft form. The time period required for the staff to review, comment on, and ultimately declare effective a registration statement depends upon the completeness of the draft registration statement and degree of compliance with the disclosure requirements. Draft registration statements must be complete in all material respects at the time of first submission, unless special arrangements have been agreed in advance with the Office of International Corporation Finance. Common examples of incompleteness include missing or partial US GAAP reconciliations, missing or partial US GAAP disclosures under Item 18, missing interim periods, missing Industry Guide data, and missing financial statements of acquirees and investees. The staff will also expect the auditor's report to be signed and dated at the time the draft registration statement is first submitted, unless special arrangements have been agreed in advance with the Office of International Corporation Finance.

During the past year the staff has deferred the review of a number of incomplete or seriously deficient draft registration statements. Of course, we recognize that some registrants have extenuating circumstances that may warrant processing accommodations. As always, we encourage consultation on these matters well in advance of the intended submission date.

Effectiveness of Filing Reviewer Procedures

Last year I spoke about the new AICPA SEC Practice Section rules regarding the extension of member firm quality control procedures to foreign audit affiliates. Briefly, the rules require the involvement of the filing reviewer - a designated expert in US financial reporting and SEC compliance matters - in SEC filings by foreign private issuers. The staff also informally confirms that draft registration statements submitted for review have been subjected to the member firm's filing reviewer procedures.

The staff's experience with these procedures has been reasonably encouraging. We believe the procedures have been reasonably effective in permitting auditors and the staff to identify draft registration statements that were submitted prematurely, enabling the staff to defer the review of documents that contained serious deficiencies. We believe the ultimate result will be better disclosure documents for US investors, and we thank the profession for their assistance in this effort.

However, we have seen circumstances where incomplete or seriously deficient draft registration statements have been submitted, despite representations from registrant's counsel confirming the filing reviewer's association with the document. In these circumstances the staff will likely contact the filing reviewer directly regarding the filing reviewer's awareness of the submission and completion of the review procedures. I urge registrants and their counsel to provide meaningful responses to the staff's initial confirmation requests. We seek not merely a list of the auditor's contact persons, but rather a confirmation that the filing reviewer procedures have been completed prior to submission of the draft registration statement.

Also, during the past two year period there have been at least 40 restatements of primary financial statements or significant revisions to US GAAP reconciliations as a result of staff reviews of foreign registrants. I strongly encourage all parties involved in the process to ensure that disclosure documents comply in all material respects when they are submitted.

Business Combinations

Trading in a Registrant's Own Shares - Tainted Treasury Stock

Financial institution registrants may have subsidiaries or divisions that trade, make markets in, write derivative contracts on, or otherwise transact in the registrant's own common shares. Under US GAAP, these transactions are usually considered to be treasury share transactions. A registrant

contemplating a business combination to be accounted for as a pooling of interests under US GAAP must evaluate whether these transactions violate paragraphs 47b or 47d of APB Opinion 16[1]. Tainted shares related to these activities must be aggregated with all other tainted shares in applying the 10% limitation. Generally, it would be extremely difficult to demonstrate that these activities represent a systematic pattern of repurchases to be issued for reasons unrelated to the business combination. Similarly, it would be extremely difficult to demonstrate that the purchases are required to fulfill contractual obligations pre-dating the two-year period before initiation of the business combination.

These transactions must also be evaluated under the requirements of paragraph 48a of APB 16 and Staff Accounting Bulletin 96[2]. That guidance prohibits agreements or plans to directly or indirectly reacquire shares issued in the business combination. Transactional activity occurring between the dates of initiation and consummation, or after consummation, are considered to be evidence of agreements or plans to reacquire shares issued in the business combination. Planned reacquisitions of shares related to these activities for a period of two years from the date of consummation would be aggregated with all other tainted shares in applying the 10% limitation. The staff believes SAB 96 should be applied on a gross basis in the post-consummation period. Measurement of the number of shares *intended* to be reacquired in these instances is problematic, and it would be difficult to support an assertion that the number of shares to be reacquired will be limited to an amount that results in an aggregate tainted share amount less than 10%.

Date of Consummation under US GAAP

Paragraph 93 of APB Opinion 16 specifies the date that a purchase business combination should be recognized in the financial statements under US GAAP. Ordinarily that is the date assets of the acquired business are received in exchange for consideration from the acquirer. As noted in an earlier session of the Conference, a purchase business combination should not be recognized as of an earlier date except in the rare instance where a written agreement provides that effective control is transferred to the acquirer at an earlier date without restrictions except those required to protect the stockholders of the acquired company.

Some merger agreements in various countries may include designation of a retroactive effective date, such as the beginning of the fiscal year. In most of these cases, the rare conditions in paragraph 93 of APB Opinion 16 are not met prior to the exchange of consideration, and the business combination should not be recognized for any period before consummation.

APB 16 and FASB Statement 94[3] require consolidation of a business acquired in a purchase beginning with the date of acquisition. Some registrants have a practice of applying the equity method or cost method to newly acquired businesses for the period from the consummation date through the end of the fiscal year in which the acquisition occurred. US GAAP does not permit

that practice.

The staff has also seen situations where a pooling of interests transaction has been reflected in the financial statements before the merger consideration has been exchanged. Because the exchange of shares is one of the fundamental conditions that must be met to qualify for pooling treatment, the consummation of a pooling of interests can *never* occur before the date of that exchange.

Miscellaneous Filing Issues

Changing to US GAAP - Periodic Reports versus Registration Statements

A registrant that loses its foreign private issuer status becomes subject to the reporting requirements for a domestic company on that date. While previous Exchange Act reports do not need to be amended upon the loss of foreign private issuer status, all future filings are required to fully comply with the requirements for a domestic company. The financial statements and selected financial data should be recast into US GAAP and US dollar reporting currency for all periods presented. The first filing containing US GAAP financial statements should set out in full the accounting policies under US GAAP that the registrant has adopted.

Similarly, when a registrant *voluntarily* changes from home-country GAAP to US GAAP all periods must be restated. The timing of the restatement will depend on whether the registrant has also voluntarily elected to file on domestic forms. If so, the change is ordinarily made in the first quarter of a new fiscal year. The first Form 10-Q and each subsequent Form 10-Q should reflect US GAAP in all current and comparative interim periods presented. The annual comparative periods are then recast when the next annual report is filed.

However, the timing of the restatement will be accelerated in the event of a registration statement. Interim financial statements included in a registration statement must be prepared on the same basis of accounting and reporting currency as the annual financial statements, so all comparative interim and annual periods must be restated at that time. This is true even if a registrant is eligible to incorporate previously filed documents by reference.

Applicability of Audit Committee Disclosures to Foreign Private Issuers

In December 1999, the Commission adopted new rules to improve public disclosure about the functioning of corporate audit committees and to enhance the reliability and credibility of financial statements of public companies. The Commission originally proposed to generally exclude foreign private issuers from the new requirements, but include those that voluntarily file on domestic forms. The Commission reconsidered that view based on public comments. Accordingly, the final rules are not applicable to any foreign private issuers, including those that elect to file on domestic forms.

Italian Fairness Reports

In previous conferences, I've talked about the impact of certain types of reports on an auditor's independence. If an auditor renders an opinion on the value of a company, the adequacy of consideration, or the fairness of a transaction that the auditor subsequently will audit (fairness opinion), the staff considers the auditor's independence to be impaired.

The staff would consider the auditors' independence to be impaired whether the engagement of the auditor for that service was voluntary or *required* by law. For example, in Italy the law requires certain opinions about the consideration to be exchanged in certain business combinations, share issuances and non-monetary transactions to be delivered by the company's auditor. The staff ordinarily would not be in a position to declare effective registration statements that include audit reports where the auditors have also issued this type of report. However, representatives of the Italian accounting profession, working with regulators in Italy and the US, have developed an alternative form of reporting on these types of transactions when the auditor is subject to US independence rules. The staff will view the alternative report as not impairing the auditor's independence, provided that the auditor represents in writing that the report is not an opinion on the value of the company, the adequacy of the consideration to shareholders, or the fairness of the transaction. This written representation should be furnished to the staff at the time that the audit report is filed.

Registrants should also be aware that Form F-4 requires extensive disclosures about the Board of Director's consideration of a proposed merger or exchange. Where the Board in approving the transaction considers the report of an accountant or other expert, the report and consent of the expert must be included in the registration statement. In that circumstance the auditor's written representation described above must also be included in the registration statement.

Recently, the staff has become aware that other countries have similar laws requiring the auditor to render these types of reports. In several of those countries, the staff is currently working with the accounting profession and regulators to resolve this issue.

Oil and Gas Properties

Some governments do not permit private parties to own oil & gas properties. Instead, the governments grant leases or concession rights to explore, develop and produce the underlying oil & gas reserves. Those rights are usually granted for a fixed term, which may be shorter than the estimated period required to extract the underlying reserves.

For purposes of determining proved reserves under FASB Statements 19[4] and 69[5] and Rule 4-10 of Regulation S-X, a registrant's estimate of oil & gas reserves should be limited to quantities expected to be produced during the

term of its leases or concessions. Renewals should not be assumed unless the registrant has a demonstrated history of obtaining renewals.

Conclusion

That concludes my prepared remarks. I look forward to working with registrants and their advisors during the upcoming year, and I'd be happy to take questions at the end of the session.

[1] APB Opinion No. 16, *Business Combinations*

[2] Staff Accounting Bulletin No. 96, *Treasury Stock Acquisition Following a Consummation of a Business Combination Accounted for as a Pooling-of-Interests*

[3] FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*

[4] FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*

[5] FASB Statement No. 69, *Disclosures about Oil and Gas Producing Activities*

http://www.sec.gov/news/speech/spch440.htm
