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Client Alert

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SEC PROPOSES ROADMAP FOR CONSIDERING ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

On November 14, 2008, the United States Securities and Exchange Commission, or SEC, issued a proposing release outlining a “roadmap” for considering whether to require U.S. public companies to adopt International Financial Reporting Standards, or IFRS, beginning in 2014. The SEC also proposed allowing certain eligible issuers to voluntarily adopt IFRS beginning in 2010. The proposal is the latest step in a series of SEC initiatives to promote the adoption of a single set of high-quality, globally accepted accounting standards, which, if consistently applied, the SEC believes will enhance the ability of investors to compare the financial information of U.S. and non-U.S. companies.

Background

IFRS are issued by the International Accounting Standards Board, or IASB, in London. Approximately 113 countries currently require or permit the use of IFRS

for domestic, listed companies. For several years the IASB and the US Financial Accounting Standards Board have been working to converge IFRS and generally accepted accounting principles in the United States, or U.S. GAAP. In recognition of these efforts toward convergence, as well as the increasingly global nature of the capital markets, the SEC believes that a single, uniform set of accounting standards will protect investors and improve the efficiency and effectiveness of capital formation and allocation. The SEC believes that IFRS have the greatest potential to provide this common platform.

Prior to November 2007, the SEC permitted foreign private issuers to prepare their financial statements in accordance with either local generally accepted accounting principles or IFRS, but required a reconciliation of net income and net assets to U.S. GAAP. In January 2008, the SEC eliminated this reconciliation requirement for foreign private issuers

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that prepare financial statements in accordance with IFRS without any reconciliation to U.S. GAAP. The current proposal would allow certain eligible U.S. companies to use IFRS beginning in 2010 and could result in the mandatory use of IFRS for all U.S. registrants beginning in 2014.

SEC Roadmap to Evaluate the Mandatory Adoption of IFRS

The roadmap sets forth several milestones that the SEC proposes to use to determine whether to mandate the use of IFRS by U.S. reporting companies, including the following:

- **Improvements in Accounting Standards.** The SEC will evaluate the ongoing development of IFRS to determine if the substantive standards and interpretive guidance are sufficiently comprehensive. IFRS are not as well-developed as U.S. GAAP in certain areas and, furthermore, there is less authoritative guidance due to the smaller amount of IFRS literature available. The SEC will also review the IASB's standard-setting practices to ensure that it will be able to maintain and update IFRS to reflect emerging issues and changing business practices.
- **Accountability and Funding of the IASC Foundation.** IASB operations are largely funded through voluntary contributions by accounting firms, companies, international organizations, central banks and governments. The SEC is concerned about any perceived or potential connection between the availability of funding and the outcome of the standard-setting process. The IASC Foundation, which oversees the IASB, is currently modifying its funding practices and the SEC will evaluate the stability and independence of the reformed funding mechanism as it deliberates the adoption of

IFRS. The SEC is also working with other national securities authorities to establish a monitoring group to participate in and approve nominations for IASC Foundation trustees and provide oversight.

- **Improvement in the Ability to Use Interactive Data for IFRS Reporting.** In May 2008, the SEC proposed rules that will require registrants to provide financial statements in interactive data format. Additional technical development will be required in order to allow companies to provide IFRS financial data in the format required.
- **Education and Training in the United States.** There are significant differences between U.S. GAAP and IFRS. The timely and accurate preparation and filing of financial information will require all parties involved in the financial reporting process to become familiar with IFRS, including auditors, accounting personnel, executive officers, boards of directors, audit committees and other affected parties. The SEC will consider the overall readiness of the corporate, auditing and investing communities to transition to IFRS.

In addition to the roadmap milestones, the proposing release outlines a variety of other factors that the SEC may consider, including the following:

- the extent to which IFRS are adopted and applied globally;
- whether such standards are consistently applied across jurisdictions, industries and companies;
- the impact of different national accounting standards, and, in particular, the degree of judgment customarily used, on the application of IFRS in different countries;

- the impact of transitioning to IFRS on the use of financial statements for regulatory purposes, tax purposes, financial covenants, market and listing requirements;
- the ability of firms to make necessary changes to accounting systems, policies and internal controls;
- the ability of auditing firms, especially smaller auditing firms, to adapt to IFRS reporting, train personnel and establish necessary policies and procedures;
- the decreased influence of U.S. capital markets participants, including the SEC, over the standard-setting process; and
- the increased influence over the standard-setting process of a broad, world-wide spectrum of investors, issuers and regulators, reflecting varying economic, social and political perspectives, some of which may have different financial reporting objectives than U.S. regulators and market participants.

If the proposed rules are adopted, an eligible issuer will need to submit a letter to the SEC describing the analysis used to determine its eligibility and obtain a letter of no objection before using IFRS to prepare its financial statements.

The SEC proposes to consider the adoption of mandatory IFRS for U.S. reporting companies through 2011. Comments on the proposals are requested by February 19, 2009.

Optional Use of IFRS for Certain Eligible U.S. Companies

The SEC has also proposed rule changes to allow certain large U.S. reporting companies to use IFRS for fiscal years ending after December 15, 2009. Eligible issuers must satisfy the following two criteria:

- the issuer must be one of the 20 largest listed companies worldwide within its industry, measured by market capitalization; and
- IFRS must be used more than any other basis of financial reporting by the 20 largest listed companies worldwide within the issuer's industry.

Please feel free to discuss any aspect of this Client Alert with your regular Milbank contacts or with any of the members of our Global Securities Group, whose names and contact information are provided below.

Beijing

Units 05-06, 15th Floor, Tower 2, China Central Place
79 Jianguo Road, Chaoyang District
Beijing 100025, China
+86-10-5969-2700

Anthony Root	+86-10-5969-2777	aroot@milbank.com
Edward Sun	+86-10-5969-2772	esun@milbank.com

Frankfurt

Taunusanlage 15
60325 Frankfurt am Main, Germany
+49-69-71914-3400

Thomas Inghoven	+49-69-71914-3436	tingenhoven@milbank.com
Peter Memminger	+49-69-71914-3436	pmemminger@milbank.com

Hong Kong

3007 Alexandra House, 18 Chater Road
Central, Hong Kong
+852-2971-4888

Anthony Root	+852-2971-4842	aroot@milbank.com
Joshua Zimmerman	+852-2971-4811	jzimmerman@milbank.com

London

10 Gresham Street
London EC2V 7JD, England
+44-20-7615-3000

Kevin Muzilla	+44-20-7615-3008	kmuzilla@milbank.com
Tom Siebens	+44-20-7615-3034	tsiebens@milbank.com

Los Angeles

601 South Figueroa Street
Los Angeles, CA 90017
+1-213-892-4000

Ken Baronsky	+1-213-892-4333	kbaronsky@milbank.com
Deborah Ruosch	+1-213-892-4671	druosch@milbank.com
Neil Wertlieb	+1-213-892-4410	nwertlieb@milbank.com

Munich

Maximilianstrasse 15 (Maximilianhoefer)
80539 Munich, Germany
+49-89-25559-3600

Peter Nussbaum	+49-89-25559-3636	pnussbaum@milbank.com
Christoph Rothenfusser	+49-89-25559-3636	crothenfusser@milbank.com

New York

One Chase Manhattan Plaza
New York, NY 10005
+1-212-530-5000

James Ball	+1-212-530-5515	jball@milbank.com
Paul Denaro	+1-212-530-5431	pdenaro@milbank.com
Joy Gallup	+1-212-530-5211	ygallup@milbank.com
Michael Fitzgerald	+1-212-530-5224	mfitzgerald@milbank.com
Taisa Markus	+1-212-530-5165	tmarkus@milbank.com
Marcelo Mottes	+1-212-530-5602	mmottes@milbank.com
Robert Mullen	+1-212-530-5150	rmullen@milbank.com
Arnold Peinado	+1-212-530-5546	apeinado@milbank.com
Douglas Tanner	+1-212-530-5505	dtanner@milbank.com
Robert Williams	+1-212-530-5516	rwilliams@milbank.com

Singapore

30 Raffles Place
#14-00 Chevron House
Singapore 048622
+65-6428-2400

Naomi Ishikawa	+65-6428-2525	nishikawa@milbank.com
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Tokyo

21F Midtown Tower, 9-7-1 Akasaka
Minato-ku, Tokyo 107-6221
+813-5410-2801

Darrel Holstein	+813-5410-2841	dholstein@milbank.com
Bradley Edmister	+813-5410-2843	edmister@milbank.com