CAQ International Practices Task Force Highlights

May 21, 2019 – Joint Meeting with SEC Staff

SEC Offices – Washington, DC

I. Attendance

Task Force Members	Observers	Guests
D.J. Gannon, Chair (Deloitte) Judith Freeman, Vice-Chair (KPMG) Greg Bakeis (PwC) Tim Brown (KPMG) Rich Davisson (RSM-US) Steven Jacobs (EY) Kathleen Malone (Deloitte) Alan Millings (EY) Victor Oliveira (EY) Ignacio Perez Zaldivar (Deloitte) Scott Ruggiero (Grant Thornton) Guilaine Saroul (PwC) Julie Valpey (BDO)	SEC staff from the Division of Corporation Finance and Office of Chief Accountant Annette Schumacher Barr (CAQ staff)	David Oldham (KPMG)

II. Reporting on certain types of financial statements prepared using IFRS, as issued by the IASB

Certain SEC regulations and/or accommodations do not require the presentation of a complete set of financial statements, unlike IFRS as issued by the IASB (herein referred to as "IFRS"). Presented below are examples where a complete set of financial statements are not required by SEC regulations and/or accommodations granted under Rule 3-13 of Regulation S-X ("S-X 3-13"), even though IFRS has a requirement for a complete set of financial statements, along with related Task Force and staff observations about the examples.

A. Omission of Comparative Financial Statements included in an SEC Filing for S-X Rule 3-09 purposes

A foreign private issuer ("FPI") (that does not qualify as an Emerging Growth Company ("EGC")) with a December 31 year-end plans to submit a draft registration statement to conduct an Initial Public Offering ("IPO") in May 2019. The registrant acquired an equity method investment (i.e., a foreign business using IFRS, but not considered a first-time adopter) in mid-April 2018, where the investment met the income significance test under Rule 3-09 of Regulation S-X ("S-X 3-09") (greater than 20%) in 2018. For purposes of this example, the evaluation under Rule 3-05 of Regulation S-X ("S-X 3-05") did not result in any requirement to present the investee's financial statements for any period.

Financial Reporting Manual ("FRM") 2405.4 states that "for purposes of S-X 3-09, the investee's separate annual financial statements should only depict the period of the fiscal year in which it was accounted for by the equity method." As a result, separate audited financial statements of the investee for the period from mid-April 2018 to December 31, 2018 (stub period) are required.

SX Rule 3-09 requires the presentation of the 2018 stub period, and does not permit the presentation of the comparative period prior to the date it was acquired and accounted for under the equity method. The presentation of financial statements without a comparative period would not comply with paragraph 38 of IAS 1. The Task Force asked the staff whether they would object to an audit report containing a qualified opinion with respect to the lack of comparative information similar to that as discussed in Appendix A. An example of the qualification is presented below:

> Reference to IAS 1
>
> As discussed in Note [X], the accompanying [consolidated] financial statements are not presented in accordance with International Accounting Standard 1, Presentation of Financial Statements, as they do not include comparative figures, which constitute a departure from International Financial Reporting Standards as issued by the International Accounting Standards Board

The staff indicated that they would not object to the inclusion of an audit report containing a qualified opinion with respect to the lack of comparative information in the S-X 3-09 financial statements described above.

B. Reporting on a Statement of Assets Acquired and Liabilities Assumed and Revenue and Direct Expenses of a segment of a business or a product line acquired (i.e., abbreviated financial statements)

In certain circumstances abbreviated financial statements may be used to satisfy the requirements of S-X 3-05 in lieu of full carve-out financial statements and are tailored to the informational needs determined by the SEC, based on compliance with SEC requirements or practices. In addition, the basis of presentation note would include:

- A statement describing the regulatory purpose of such financial statements
- A statement that they are not intended to represent a complete presentation of the financial position or results of operations and the related footnotes of the acquired business
- A statement that the financial statements are prepared on a basis that is "in accordance with IFRS as issued by the IASB **relevant to such financial statements"**
- A description of the basis for determining the assets and liabilities to be included
- An explanation as to why a complete set of financial statements is not available and cannot be prepared
- A statement that the financial statements have been derived from the accounting records of the entity from which it was acquired and
- Additional disclosures necessary to understanding the abbreviated financial statements

The Task Force asked the staff if they would object to an audit report that includes the following:

- A statement describing the regulatory purpose of such financial statements
- A statement that they are not intended to represent a complete presentation of the financial position or results of operations of the acquired business
- A statement that the financial statements are prepared on a basis that is "in accordance with IFRS as issued by the IASB **relevant to such financial statements"**

The staff indicated that they would not object to the approach outlined in the bullets above for those circumstances where the staff did not object to the use of abbreviated financial statements prepared using IFRS to satisfy S-X 3-05. Refer to Appendix B for a Report example and related Basis of Presentation Note example.

C. Omission of Balance Sheet of Financial Statements included in an SEC filing for S-X 3-05 purposes

Generally, in an IPO, the SEC has accepted a combination of pre and post-acquisition financial statements of an acquired business to satisfy the requirements under S-X 3-05 provided there are no gaps in audited periods. In such cases, the pre-acquisition financial statements are generally not required to include the balance sheet at the date of acquisition.

> Example:
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> Registrant A acquires Business B on September 1, 20X1. Business B is significant to A at the 20-40% level and therefore, audited financial statements for only the most recent fiscal year are required. Registrant A is required to include audited financial statements for the years ended 20X0 and 20X1 (assume EGC IPO of common equity securities) in its Form F-1.
>
> Registrant A may satisfy the requirement for 1 year of financial statements of B by providing audited financial statements for the 8 months ended August 31, 20X1 along with the 4 months of post-acquisition results of B included in A's financial statements for the year ended December 31, 20X1. Since B's assets and liabilities acquired are included in the audited balance sheet of A as of December 31, 20X1, the balance sheet of B as of August 31 20X1 is not required by SEC Rules.

The Task Force asked the staff whether they would object to an audit report containing a qualified opinion with respect to the omission of a balance sheet, at acquisition date, under IFRS when pre and post-acquisition financial statements of an acquired business are used to satisfy S-X 3-05. An example of the audit report containing the qualified opinion is presented below:

> Reference to IAS 1
>
> As discussed in Note [X], the accompanying [consolidated] financial statements are not presented in accordance with International Accounting Standard 1, Presentation of Financial Statements, as they do not include a balance sheet and related notes, which constitute a departure from International Financial Reporting Standards as issued by the International Accounting Standards Board.

The staff indicated that they would not object to the inclusion of an audit report containing a qualified opinion with respect to the omission of a balance sheet at acquisition date under IFRS when pre and post-acquisition financial statements of an acquired business are used to satisfy S-X 3-05 as described above.

D. Omission of Opening Balance Sheet for a Carve out under IFRS 1 included in an SEC filing for S-X 3-05 purposes

Assume a domestic company acquires a foreign business (“Foreign Business”) and that the financial statements of the Foreign Business will be prepared in accordance with IFRS. Based on the significance tests under S-X 3-05, one year of financial statements will be required by S-X 3-05 for the year ended December 31, 2018.

The financial statements of the Foreign Business will be a carve-out of a parent company that prepares financial statements under IFRS. Financial statements of the Foreign Business, which will have the same basis as its parent, have never been prepared. Accordingly, the Foreign Business would be subject to the disclosure requirements of IFRS 1.

As a first-time adopter of IFRS, the Foreign Business should provide a balance sheet at January 1, 2017, December 31, 2017 and December 31, 2018 and an income statement and cash flow statement for the two years ended December 31, 2018 under IFRS 1. In this fact pattern, S-X 3-05 only required financial statements at and for the year ended December 31, 2018 (i.e. one year).

The Task Force notes that if this company was not a first-time adopter of IFRS it could simply exclude the financial statements at and for the year ended December 31, 2017 and the audit report would have noted the departure from IAS 1 in not providing comparatives financial statements as discussed in Section II.A.

The Task Force asked the staff whether they would object to an audit report containing a qualified opinion for noncompliance with IFRS 1 with respect to the exclusion of the opening and comparative period balance sheet, which in this case is the opening balance sheet at January 1, 2017 and for the year ended December 31, 2017 that would be provided for a first-time adopter of IFRS. Similar to the accommodation discussed in Appendix A. An example of the explanation in the audit report containing the qualified opinion is presented below:

> Reference to IFRS 1
>
> As discussed in Note [X], the accompanying [consolidated] financial statements are not presented in accordance with International Financial Reporting Standard 1, First-time adoption of International Financial Reporting Standards, as they do not include comparative figures, which constitute a departure from International Financial Reporting Standards as issued by the International Accounting Standards Board.

The staff indicated that they would not object to the inclusion of an audit report containing a qualified opinion with respect to the exclusion of the opening balance sheet and comparative balance sheet under IFRS 1 as described above.

III. Issues related to S-X 3-13 relief

A. Reporting requirements under S-X 3-05 for a private U.S. domestic entity ("Domestic Business") that is acquired by a FPI where the application of the rules would indicate the Domestic Business would be required to present more years and periods of financial statements than the registrant

The Task Force and SEC staff discussed S-X 3-05 reporting requirements for a non-EGC FPI that prepares its financial statements for an IPO on Form F-1 in accordance with U.S. GAAP and presents registrant financial statements for only two years as allowed by Instruction 3 to Item 8.A.2 of Form 20-F. The FPI acquired a Domestic Business that is significant at a level in excess of 50% using the tests in S-X 3-05, and as such three years of financial statements would be required for the Domestic Business.

The Task Force noted that it is generally expected that an acquired business should follow the requirements applicable to that type of entity (e.g., a domestic acquiree would follow those of a domestic entity, and a FPI or foreign business would follow those of a FPI regardless of the filer status of the registrant).

The staff noted that the guidance in Section 10220.5 of the FRM, (which indicates that if the registrant is an EGC, only two years of financial statements under S-X 3-05 are required) should not be applied by analogy in this scenario. As such, the staff confirmed that in this fact pattern, absent other specific relief, three years of the Domestic Business's financial statements would be required.

The Task Force and the staff also discussed the reporting requirement if the FPI was a first-time adopter of IFRS such that, similar to the above fact pattern, only two years of registrant financial statements are required, noting that this would not change the requirement for three years of the Domestic Business's financial statements.

The Task Force and the staff also discussed reporting requirements for interim financial statements of the Domestic Business and whether interim financial statements of the Domestic Business would be required if no such interim financials are required for the FPI registrant (e.g., for a registration statement filed more than 135 days after the end of the fiscal year of the Domestic Business such that interim financial statements of the Domestic Business would be required, but before nine months after the end of the fiscal year of the FPI registrant).

Under the same guidance noted above, interim financial statements of the Domestic Business would be required where interim financial statements of the FPI registrant would not.

Registrants may contact the staff to discuss their facts and circumstances if they believe relief should be considered under S-X 3-13.

B. Acceptance of IFRS financial statements without reconciliation for a non-foreign business equity method investee when registrant uses IFRS

The Task Force noted that FPIs often have significant equity method investments in foreign entities that do not qualify as foreign businesses. It was noted that financial statements provided under S-X 3-09 in this scenario would be required to be prepared using U.S.GAAP or contain an Item 18 reconciliation to U.S. GAAP, but that such presentation may be less relevant for investors when the registrant prepares its financial statements using IFRS.

Registrants may contact the staff to discuss their facts and circumstances if they believe relief under S-X 3-13 should be considered to allow the S-X 3-09 financial statements under IFRS instead of U.S. GAAP or with an Item 18 reconciliation to U.S. GAAP.

IV. Requirements for FASB ASC 932 disclosures in financial statements of a foreign target that uses IFRS

U.S. GAAP (FASB ASC 932-235-50) requires supplemental disclosures about oil and gas reserves, changes in such reserves during the reporting period, capitalized costs related to oil and gas producing activities and standardized measures of future net cash flows ("the supplemental U.S. GAAP oil & gas disclosures"). When the SEC eliminated the reconciliation requirement for financial statements prepared in accordance with IFRS, it amended Item 18 of Form 20-F to require the supplemental U.S. GAAP oil & gas disclosures for all "*issuers"* filing financial statements under Item 18 irrespective of the basis of accounting on which they prepare their financial statements filed with the SEC (Instruction 2).

Item 18(b) of Form 20-F specifically exempts IFRS basis financial statements prepared to comply with S-X 3-05 and 3-09 from providing other information required by U.S. GAAP or Regulation S-X. Given that exemption, it is unclear how to apply Instruction 2 in the context of IFRS-basis financial statements of non-issuers such as significant acquirees or equity method investees ("IFRS-basis non-issuers"). Unlike the financial statements of an issuer, such IFRS-basis non-issuer financial statements may have already been prepared and issued outside the U.S. without such disclosures and in the case of S-X 3-05, may be filed by the SEC issuer only once.

FRM 2065.12 and Question 1 of Staff Accounting Bulletin Topic 2.D. *Financial Statements of Oil and Gas Exchange Offers* both require only a portion of the disclosures in ASC 932-235-50 for each full year of operations when they might not have otherwise been required; however, both appear to be written in the context of financial statements for an acquired oil and gas operation prepared under U.S. GAAP.

Considering the discussion above, the Task Force and SEC staff discussed whether financial statements prepared under IFRS provided to satisfy S-X 3-05 would be required to include the disclosures required by ASC 932-235-50 similar to what an FPI would be required to disclose if they use IFRS.

The SEC staff would expect such disclosures to be included. Registrants with acquisitions unable to provide **all** of the disclosures required by ASC 932-235-50 may contact the SEC staff to discuss.

V. Audit reports by a government auditor

Rule 2-03 of Regulation S-X ("S-X 2-03") states that "*Notwithstanding any requirements as to examination by independent accountants, the financial statements of any foreign governmental agency may be examined by the regular and customary auditing staff of the respective government if public financial statements of such governmental agency are customarily examined by such auditing staff.*"

An agency, or business unit, of a foreign government, ("foreign government entity"), where the government auditing staff was the appointed auditor may be acquired by an issuer. The government auditing staff is not an auditor registered with the PCAOB and the audit of the foreign government entity had not been performed in accordance with PCAOB or US GAAS auditing standards. In such a situation, audited financial statements may be required for that foreign government entity either as predecessor financial statements or as required by S-X 3-05.

The Task Force asked the staff for their views on how S-X 2-03 may apply in these instances and whether a registration statement may include financial statements audited by the government auditing staff.

The SEC staff noted that registrants looking to present such financial statements should discuss their specific facts and circumstances with the staff prior to submission.

VI. Monitoring inflation in certain countries

The summary of inflation data collected by the members of the IPTF can be found on the CAQ website at https://www.thecaq.org/resources/publications.

VII. Next meeting

The next meeting of the Task Force has been set for November 19, 2019.

Appendix A – Excerpt from International Reporting and Disclosure Issues in the Division of Corporation Finance

Rule 3-05

Under Rule 3-05 of Regulation S-X, the period for which audited financial statements must be presented for a recently acquired business varies from one to three years depending upon its significance to the registrant. Some systems of GAAP, such as IFRS, specifically require prior year comparative financial statements to be presented when the most recent fiscal year is presented.

In situations where only one year is required by Rule 3-05, the staff would not object if the audit report includes a qualification under IFRS or home-country GAAP solely for the absence of comparative prior year financial statements.

Appendix B – Report Example

Independent Auditor's Report

To the Management of ABC Company

We have audited the accompanying combined financial statements of the Global XXX Business and Certain Other Assets of ABC Company, which comprise the combined statements of net assets acquired as of December 31, 20X7 and 20X6, and the related combined statements of revenues and direct expenses for each of the three years in the period ended December 31, 20X7.

Management's Responsibility for the Special Purpose Combined Financial Statements

Management is responsible for the preparation and fair presentation of the combined financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ***relevant to such financial statements***; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of special purpose combined financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the combined financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the special purpose combined financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the Global XXX Business and Certain Other Assets of ABC Company as of December 31, 20X7 and December 31, 20X6, and the results of their revenues and direct expenses for each of the three years in the period ended December 31, 2017, in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board *relevant to such financial statements*.

Emphasis of Matter

The accompanying combined financial statements were prepared for the purpose of complying with the rules and regulations of the Securities and Exchange Commission for inclusion in the Current Report on Form 8-K of XYZ Industries Ltd. as described in Note 1 and are not intended to be a complete presentation of the financial position or results of operations of the Global XXX Business and Certain Other Assets of ABC Company in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board. Our opinion is not modified with respect to this matter.

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Basis of Presentation Note Example

The accompanying Combined Financial Statements (the “Financial Statements”) are prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (“IFRS”) relevant to such financial statements. These Financial Statements are prepared by management in consideration of the terms and conditions of the Purchase Agreement and the relevant guidance under SEC Rule 3-05, Significant Acquisition Carve-out Financial Statement Reporting Requirements. These combined financial statements are not intended to be a complete presentation of financial position, results of operations, or cash flows of the Global XXX Business in conformity with IFRS. Due to the extent to which the Global XXX Business has been integrated into ABC Company during the periods required to be covered by the Financial Statements, the presentation of full or carve-out financial statements for the Business in accordance with the Securities and Exchange Commission’s Regulation S-X, including a reasonable and appropriate allocation of corporate overhead, interest and taxes, is impracticable. Thus, Statements of Net Assets Acquired and Statements of Revenues and Direct Expenses have been prepared. The Financial Statements have been derived from the accounting records of ABC Company using historical results of operations and financial position and only present the net assets acquired and the associated revenues and direct expenses, including certain allocated expenses, of the Business. The net assets acquired include legal entities transferred and assets specifically identified in the Purchase Agreement. All significant intercompany accounts and transactions within the Business have been eliminated.