

AICPA International Practices Task Force Meeting Highlights

August 15, 1996

Location: AICPA Washington Office

NOTICE: *The AICPA SEC Regulations Committee meets periodically with the staff of the SEC to discuss emerging technical accounting and reporting issues relating to SEC rules and regulations. The purpose of the following highlights is to summarize the issues discussed at the meetings. These highlights have not been considered and acted on by senior technical committees of the AICPA, or by the Financial Accounting Standards Board, and do not represent an official position of either organization.*

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I. ATTENDANCE

Richard Dieter, Chairman (Arthur Andersen LLP)
Taiwo Danmola (Arthur Andersen LLP)
Larry Leva (KPMG Peat Marwick LLP)
Brian Hegarty (KPMG Peat Marwick LLP)
Larry Evans (KPMG Peat Marwick LLP)
Bill Decker (Coopers & Lybrand L.L.P.)
Joel Osnoss (Coopers & Lybrand L.L.P.)
Lewis M. Gill Jr. (Price Waterhouse LLP)
Cathy S. Leonhardt (Price Waterhouse LLP)
A. Conrad Johnson (Price Waterhouse LLP)
Dick Miller (Ernst & Young LLP)
Vincent Longuet (Ernst & Young LLP)
Ken Allen (Deloitte & Touche LLP)
Wayne Carnall (SEC Observer)
Lisa Vanjoske (SEC Observer)

The draft minutes of the meeting of April 19, 1996, were reviewed. Several changes were proposed and made. A revised draft of the minutes will be sent to Task Force members before finalization.

II. USE OF APPROPRIATE INDEX FOR PRICE LEVEL FINANCIAL STATEMENTS-BRAZIL

Larry Leva presented the results of a recent meeting by representatives from the Brazilian Big 6, which reviewed the issue of the appropriate index to be used for preparing price level adjusted financial statements of Brazilian companies filing with the SEC. As stated in the attached [Exhibit 1](#), the Brazilian task force had recommended the use of the IGP-M or IGP-DI (both indexes were noted to be identical) on a prospective basis for filings with the SEC. The Task Force discussed this issue and the related issue concerning the manner in which those statements

should be presented, reaching the following consensus:

- A. The Task Force recommended the use of one index (the IGP) for preparing price level adjusted financial statements by Brazilian companies filing with the SEC. Wayne Carnall indicated that the SEC strongly supports the use by all Brazilian registrants of one index.

With respect to the transition to this index, the Task Force also agreed that companies that are registered with the SEC should use this index, prospectively, in financial statements of periods beginning with January 1, 1996. Brazilian companies that file with the Commission for the first time and include audited financial statements for periods subsequent to January 1, 1996 should use the IGP for each period that US GAAP information is presented. To illustrate, if a Brazilian company files a registration statement with audited financial statements that are reconciled to US GAAP for 1998 and 1999, the company should use the IGP at a minimum for these two years. For periods prior to 1998, any comprehensive index that reflects actual inflation during the applicable period which the company represents is most appropriate in their circumstances would be acceptable.

- B. The Task Force discussed the fact that Brazilian GAAP as of January 1, 1996, will no longer allow price level adjusted financial statements. The Task Force believed that most companies filing with the SEC would elect to continue to prepare price level adjusted financial statements even though this would represent a departure from Brazilian GAAP. Accordingly, the related auditors' report would be qualified. As Brazil is a hyperinflationary economy, Wayne Carnall indicated that the staff would, generally, be expected to grant a waiver of the requirement that the auditors report be unqualified. These Brazilian companies should submit a written request. He also indicated that while the SEC supports the Task Force members recommendation, registrants would still be allowed, under Rule 3-20 of Regulation S-X, to present their local statutory GAAP financial statements with price level financial information presented supplementally. Brazilian companies would be expected to prepare such supplemental information using the IGP index for periods after 1996.

III. **MEXICAN ISSUES DISCUSSED AT THE INFORMAL MEETING IN MEXICO CITY ON JULY 16, 1996**

Wayne Carnall informed the Task Force that certain representatives of the Mexican accounting profession recently advised him that the Mexican Accounting Principles Commission (MAPC) was considering delaying the implementation of the Fifth Amendment to Bulletin B-10. The Fifth Amendment would eliminate the use of replacement cost for property, plant and equipment and inventories. They indicated that the MAPC may request a letter regarding the staff's experience with the use of replacement cost accounting.

On July 16, 1996 an informal meeting was held in Mexico City by members of the Mexican accounting profession, members of the Mexican Accounting Principles Commission and Wayne Carnall. Members of the AICPA International Task Force were also invited to attend. The purpose of the meeting was to resolve, to the extent possible, those issues that were previously addressed at the meeting between representatives of the Task Force and MAPC in Houston earlier this year. The matters addressed primarily related to the application of US GAAP when the primary financial

statements are price level adjusted for inflation. At this meeting certain tentative recommendations were made. At the August 15, 1996 meeting of the AICPA International Task Force the following actions were taken on the Mexican Accounting issues as summarized below (a description of the issues - as prepared by Wayne Carnall - are attached as [Exhibit 2](#)).

- A. Consolidation of foreign subsidiaries
 - i. Prior year amounts -- The alternative method appears to be the preferred method in Mexico. The Staff was advised that certain Mexican companies are using the alternative method. The MAPC is considering issuance of an exposure draft to revise Bulletin B-10. Wayne Carnall expressed the SEC Staffs view that the alternative method would appear to violate Rule 3-20 of Regulation S-X that requires the financial statements to be prepared using the same currency for all periods. Mexican companies are defining their reporting currency as pesos of equivalent purchasing power as of a given date. The alternative method effectively results in changing amounts that were previously reported and thus are not presented in the same reporting currency. Accordingly, the "regular method" should be used for translating prior year financial statements. The AICPA Task Force agreed with the SEC staff view that the alternative method was at variance with Rule 3-20. This consensus can be applied prospectively.
 - ii. Current year amounts - Wayne Carnall expressed his view that the IAS method appeared more logical, but that either method would appear to be acceptable for purposes of reconciling to US GAAP. The Task Force agreed not to address this issue, but rather let the Mexican accounting profession conclude on the appropriate method under Mexican GAAP. As there continues to be diverse practice, Mr. Carnall indicated that the disclosures regarding consolidation of foreign subsidiaries that were discussed at the April meeting should be considered for inclusion in the financial statements and/or MD&A as applicable.
- B. Hedge of investments in a US subsidiary

The Task Force reached a consensus that prospectively from January 1, 1996, the monetary gain on debt that is used to hedge the investment in a foreign subsidiary should be recorded directly to equity if it is based on the rate of inflation in Mexico. If a company recorded the monetary gain in the income statement in prior years, pro forma information should be presented that removes the gain from the income statement. Inclusion of the monetary gain in the income statement is acceptable if it is based on inflation in the country whose investment is being hedged. For example, if the Mexican parent is hedging an investment in the US, it would be acceptable to include the monetary gain in the income statement if it is based on inflation in the US. The amount of the monetary gain included in the income statement would be the same as if the debt were recorded on the books of the US subsidiary and the US operations were price level adjusted for inflation in the US.

- C. Employee profit sharing

Wayne Carnall observed that with the exception of KPMG Peat Marwick, the

Task Force believed that the balance sheet (SFAS 109) methodology should be used to determine the liability for the Mexican employee profit sharing plans. Representatives from KPMG Peat Marwick continued to disagree that the balance sheet methodology was appropriate because the employee profit sharing is not an income tax; rather, they believed that the liability should be determined using an accrual methodology. Wayne Carnall indicated that he did not believe that alternative accounting was desirable and strongly encouraged that all companies use the same methodology. Representatives of KPMG indicated that they would discuss the issue internally and make a decision if the issue should be recommended for EITF consideration.

Wayne Carnall noted that under the proposed new standard in Mexico, the liability for employee profit sharing would be determined using a balance sheet methodology, except differences would be ignored that are attributable to property, plant and equipment. The logic for this exception is that if there are significant differences attributable to fixed assets, companies will, to the extent possible, transfer assets to an entity within the consolidated group before disposal that have no employees to avoid paying a large amount for employee profit sharing. The Task Force concluded that this methodology would not be appropriate under US GAAP.

D. Accounting for long-lived assets

Wayne Carnall reiterated the conclusion reached at the last meeting that the impairment on long-lived assets should be measured based upon replacement cost at the date the evaluation is made. The Task Force reaffirmed this conclusion.

The Task Force members expressed concern with respect to possible abuses in practice, whereby the write down of assets held for sale based upon appraisals may be recorded to equity instead of income under replacement cost accounting. It was agreed that this issue would be tabled pending MAPCs decision to repeal replacement cost accounting.

E. Accounting for pension plans under US GAAP

Wayne Carnall stated the MAPCs decision to consider a new standard requiring the use of real rates and accounting for pension plan obligations as non-monetary items, represented excellent progress to reduce diverse practice. The Task Force concluded that prior to final adoption of such a Mexican standard, for US GAAP purposes, Mexican registrants can either (a) use real rates for pension accounting purposes and treat pension plan obligations as non-monetary or (b) use nominal rates for the pension calculations and defer and disclose the amount of any monetary gain on the pension liability to the extent that the rate of inflation exceeds the discount rate.

F. Applying SFAS 109 (allocating a portion of deferred tax provision to RETANM)

The Task Force decided to defer action on this matter until the December meeting and appointed a sub-committee consisting of Steve Derrick, Larry

Evans and Cathy Leonhardt to work with Wayne Carnall and the MAPC representatives on this item. The sub-committee would report on the matter at the December meeting.

G. Status of Hyperinflation - Mexico

As a follow up to the discussion at the April 19, 1996 meeting, the Task Force discussed when Mexico would be considered hyperinflationary as defined by SFAS 52. Wayne Carnall indicated that he had received information on the projected rates of inflation in Mexico for the years ended December 31, 1996 and 1997. These projections were made by approximately 20 different groups (banks, investment bankers, etc.). The projected three year cumulative rate of inflation at December 31, 1996 ranged from 103% to 111% with an average of 107%. The projected three year cumulative rate of inflation at December 31, 1997 ranged from 118% to 150% with an average of 129%.

Mr. Carnall addressed the fact that paragraph 109 of SFAS 52 states that the definition of a highly inflationary economy should be applied with judgement. He had been informally advised by a member of the FASB staff that this statement was included in the standard so that the determination was not simply a mechanical application of inflation over a three year period, but could consider other factors to prevent companies from changing hyperinflationary status on a too frequent basis. Mr. Carnall indicated, however, given the same information about historic and future inflation, different companies should generally not have different conclusions regarding the status of an economy - i.e., highly inflationary or not highly inflationary. Mr. Carnall indicated that based on the rates of inflation as described above, the staff would challenge any calendar year end company that did not account for Mexico as a highly inflationary economy for purposes of applying SFAS 52 beginning on January 1, 1997. The Task Force further reached a unanimous consensus that if Mexico's three-year cumulative inflation exceeds 100% at December 31, 1996, the Mexican economy would be deemed hyperinflationary and registrants with December 31 year ends would be required to follow SFAS 52 accounting for a hyperinflationary economy beginning on January 1, 1997. For companies with fiscal years ending prior to December 31, the three year cumulative inflation should be measured through their year ends and the consensus applied accordingly.

IV. **ISRAELI ISSUES**

A. Paragraph 9f of SFAS 109

Richard Dieter led a discussion regarding Israeli companies compliance with paragraph 9f of SFAS 109, which prohibits recognition of deferred taxes for differences related to assets and liabilities that are remeasured from local currency to the functional currency. The Task Force members agreed, based upon inquiries of their Israeli counterparts, that companies are complying with this standard. Wayne Carnall stated that if the US dollar is the functional currency, the staff expects the methodology of paragraph 9f to be specifically addressed in the notes to the financial statements. Mr. Carnall noted that many of the Israeli companies indicated that they are using a balance sheet methodology which is not consistent with paragraph 9f. If an Israeli registrant elects to pay taxes on a US dollar basis, as allowed under Israeli tax law,

paragraph 9f is not applicable.

B. Pension plans

The Task Force members reported on the results of their inquiries regarding Israeli retirement plans and how they are accounted for. With Richard Dieter leading the discussion, the Task Force agreed that their understanding of the Israeli retirement arrangements is as follows:

A typical Israeli retirement arrangement is comprised of 72% defined contribution and 28% deferred vested benefit. The deferred vested benefit appears also to be a supplement to primary benefits provided by the Government. While companies are not obligated to pre-fund the liability, many are pre-funding it through managers insurance and/ or mutual funds. There is no legal defeasance, since the sponsor typically is the beneficiary of the funding arrangement.

The Task Force also agreed that while Israeli companies have properly not followed SFAS 87 in accounting for the deferred vested portion of the arrangement, they believe that EITF 88-1 would apply to this arrangement. Under EITF 88-1, companies not using SFAS 87 for deferred vested benefits should record the obligation as if it was payable at each balance sheet date (the so called "shut-down method"). The Task Force understands that Israeli registrants are fully accruing the liability on an undiscounted basis as contemplated by EITF 88-1.

Wayne Carnall indicated that the SEC Staff would require Israeli registrants to disclose their accounting method for the deferred vested benefit arrangement, the amount of the related liability accrued and the related assets, if funded (for Israeli purposes the balance sheet amounts are shown net). Registrants would also be required to disclose the components of the net expense (income), vis-a-vis the amount of the gross expense and income from the funding arrangement.

V. **FIRM BEST PRACTICES RE: FOREIGN FILINGS**

Richard Dieter conducted a survey of the represented firms regarding their quality control practices as they relate to foreign registrants. The purpose of the survey was to determine best practices to be included in the report of the AICPA Best Practices Task Force regarding Communications with the SEC Staff. Based upon the results of the discussion, the following paragraphs were developed to be considered for inclusion in the paper entitled "Summary of Best Practices Communication with the SEC Staff"

In addition to the normal quality control procedures adopted by CPA firms for filing reports in registration statements with the SEC, in the case of a non US registrant, a US expert partner or equivalent should be assigned to the engagement. The US expert partner or equivalent would discuss with the local engagement team the process used to determine the registrants compliance with US GAAP and to determine the local firms compliance with US GAAS and US independence rules. The extent of involvement by the US expert partner will vary significantly depending

upon the experience of the local firm and the registrants staff with these matters.

Consistent with the procedures for domestic filing, registrants should take the lead in discussions with the SEC staff. However, often times in non US filings, CPAs play a broader role as a facilitator, due to language and cultural differences, in helping to resolve issues raised by the SEC staff or in pre clearing other issues.

VI. ACCOUNTING FOR SENIORITY PREMIUMS AND SEVERANCE INDEMNITIES IN MEXICO

Cathy Leonhardt summarized the results of her survey of Mexican companies SEC filings to determine their accounting for seniority premiums and severance indemnities. Details of the survey are included on the attached Exhibit 3. Upon further discussion, it was agreed that firms would ask their Mexican counterparts to confirm the accounting for these arrangements. The matter was tabled for discussion at the December meeting.

VII. CHILEAN INFLATION ACCOUNTING METHOD

Mr. Carnall was asked to comment on the need to address differences between Chilean GAAP (Technical Bulletin No. 45) and US GAAP (SFAS S2) with respect to consolidating foreign subsidiaries. Under Chilean GAAP, financial statements are comprehensively adjusted for inflation and presented in constant pesos. In summary, pursuant to Technical Bulletin No. 45, local currency financial statements of a foreign subsidiary are first remeasured into US dollars and then translated into Chilean pesos using the period end exchange rates. The difference between inflation in Chile and the change in the exchange rate between the peso and the US dollar as applied to beginning of the year equity is recorded in the income statement. The staff concluded that this method was part of the comprehensive basis of preparing price level adjusted financial statements as required by Chilean GAAP. Therefore, pursuant to Item 17/18 of Form 20--F, the effect does not need to be quantified in the reconciliation to US GAAP.

VIII. SEC OBSERVATIONS FROM RECENT FOREIGN FILINGS

Wayne Carnall briefly discussed the following matters, some of which were observations of potential departure from US GAAP in recent registration statements filed by foreign companies.

- A. Chilean Minimum Dividends-- Chilean companies are required by law to distribute 30% of their net income to shareholders. An approval of the majority of shareholders is required in order for a company not to pay such dividend. The SEC Staff would require registrants to identify as temporary equity, in the reconciliation to US GAAP, the amount of retained earnings applicable to the dividend to be distributed, as the amount is not permanent equity.
- B. United Kingdom True and Fair Override - The UK Companies Act of 1985 states that if following the provisions of the Act, including applying the specific accounting standards, is inconsistent with the requirement to give a true and fair view of the state of affairs and profit and loss, the directors shall depart from the particular standards to the extent necessary to give a true

and fair view. Urgent Issues Task Force Abstract No. 7 requires specific disclosures if this provision is invoked. The staff will inquire with the UK Financial Reporting Review Panel or the UK Accounting Standards Board about the appropriateness of invoking the True and Fair override provisions whenever such disclosures are noted during a review.

- C. Canadian MJDS Filings-- Wayne Carnall reported on the status of the proposed arrangement that would allow the SEC Staff to participate in the review of Canadian MJDS filings for compliance with US GAAP.
- D. Predecessor Financial Statements - The financial statements of an acquired foreign business by a domestic issuer may be prepared on a basis other than US GAAP but must be reconciled to US GAAP in compliance with Item 17 of Form 20-F. However, this accommodation does not apply if the financial statements are those of a predecessor, as such statements are not being provided pursuant to Rule 3-05 of Regulation S-X. Accordingly, these financial statements must be prepared under US GAAP.
- E. Financial statements of acquired foreign business - In situations in which three years of audited financial statements of an acquired foreign business would be required based on the size test, a company can elect to present only two years if the statements are prepared on a US GAAP basis. In applying this accommodation, the primary financial statements of the registrant must also be prepared in accordance with US GAAP if the company is considering post acquisition periods in determining the years presented.
- F. Foreign Registrants with Significant Subsidiaries-- Foreign registrants with significant subsidiaries that are consolidated in the local GAAP financial statements but use the equity method for US GAAP purposes should consult with the SEC staff to determine what information should be presented under Rule 3-09. In the situation described above, the staff would expect, at a minimum, the following information in the US GAAP reconciliation note: 1) condensed information on the equity investee required by Rule 4-08(g) and 2) a sufficiently detailed reconciliation so that an investor could reconstruct financial statements prepared in accordance with US GAAP and Regulation S-X. Based on the specific facts and circumstances, the staff may require additional disclosure either in the financial statements or management's discussion and analysis.
- G. Item 1. (4) of Form 20-F-- requires a breakdown of total sales and revenues during the registrants past three fiscal years by category of activities and into geographical markets. Wayne Carnall indicated that foreign registrants who present two years of US GAAP primary financial statements would only be required to comply with the requirements of this Item 1 for two years.
- H. France, 10% Surtax-- In 1996, France passed a law imposing a 10% income surtax, and indicated, if subsequently approved by parliament, would be eliminated in 1998 or 1999. Since the law has yet to be repealed, the Staff would expect that deferred taxes under SFAS 109 would be computed using rates that include the 10% surtax. The SEC staff indicated that all firms on the Task Force had concurred with this accounting.
- I. Canadian- Non Foreign Private Issuers-- For Canadian companies that do not meet the definition of Foreign Private Issuer, the SEC would not object to presenting Canadian GAAP financial statements provided that a reconciliation required by Item 18 of 20-F is presented.

IX. **NEXT MEETING**

The next meeting is scheduled for December 12, 1996.

EXHIBITS

[View Exhibit 1](#) - Brazilian Registrant Issues

[View Exhibit 2](#) - Mexico - Consolidation of Foreign Subsidiaries