

AICPA International Practices Task Force Meeting Highlights

December 2, 1997

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)
Taiwo Danmola (Arthur Andersen)
Steven J. Derrick (Coopers & Lybrand)
Lee Gaul (BDO Seidman)
Roger Jahncke (Ernst & Young)
Larry Leva (KPMG Peat Marwick)
Enrique Tejerina (KPMG Peat Marwick)
Victor Oliveira (Ernst & Young)
Ken Allen (Deloitte & Touche)
Wayne Carnall (Price Waterhouse)
Craig Olinger (SEC Observer)
Lisa Vanjoske (SEC Observer)
D.J. Gannon (SEC Observer)
Annette Schumacher Barr (AICPA)

II. SECTION 144 PRACTICE ISSUES

The Task Force discussed various Section 144 practice issues encountered with foreign registrants. It was agreed that the Task Force members would verify their firms' formal policy with respect to comfort letters not involving an SEC registrant offering and to circulate their policy among the Task Force. Task Force members also agreed to inform each other if they become aware of deviations from formal policy.

III. APPLICATION OF SFAS NO. 52 IN BRAZIL

The Task Force discussed the application of EITF Topic D-55 in determining whether Brazil has ceased to be a highly inflationary economy as defined by FASB Statement No. 52. The Task Force presented the following proposed guidance based on earlier conversations with the SEC staff:

Entities should evaluate the historical inflation rate trends and other pertinent factors on a quarterly basis to determine the status of Brazil as a highly inflationary economy. Upon concluding that the economy is no longer highly inflationary, entities will need to measure the financial statements of the Brazilian entity using that entity's functional currency. It is not appropriate to delay making the change in functional currency once the determination by management has been made that Brazil is no longer a highly inflationary economy.

Entities could weigh the "other pertinent factors" referred to in D-55 differently resulting in different conclusions as to when Brazil ceases to be a highly inflationary economy. However, the longer the period and the greater the amount by which the three year cumulative rate of inflation is below 100%, the more difficult it will be for the other pertinent factors to outweigh a conclusion that an economy is no longer highly inflationary. Absent significant changes in the rate of inflation or other economic events in Brazil, it will be difficult for entities to be able to justify treating Brazil as a highly inflationary economy for quarters beginning after December 31, 1997.

For a short period of time, entities may have different conclusions regarding the status of Brazil as a highly inflationary economy. Acknowledging these possible differences, entities should disclose the following, as appropriate, regarding significant Brazilian operations:

- o Status of Brazil as either a highly or non highly inflationary economy;
- o Date Brazil ceased or is expected to cease being considered a highly inflationary economy;
- o Functional currency used by the Brazilian operations;
- o Effects on the financial statements of changing functional currency, if practicable.

Craig Olinger indicated that the staff will not object to the above guidance and added that, absent major changes, the staff would expect that Brazil will no longer be deemed hyperinflationary beginning January 1, 1998. The Task Force noted that it does not foresee any significant obstacles to achieving consistent treatment beginning January 1, 1998.

The Task Force also noted that Attachment A to the highlights of the June 4, 1996 meeting of the International Practices Task Force should be corrected to note that Brazilian generally accepted accounting principles continues to *require* the use of inflation accounting.

IV. CONSOLIDATION OF FOREIGN SUBSIDIARIES — MEXICO

The Task Force discussed Bulletin B-15 recently issued by the Mexican Accounting Principles Commission. A summary of the background and practice issues raised by Bulletin B-15 is included as [Attachment A](#) to these highlights. Craig Olinger stated that the staff is concerned that the requirements of Bulletin B-15 are in conflict with constant currency reporting under Rule 3-20. The Task Force noted that the reason for the amendment was diversity in Mexican practice, which has now been eliminated and has become part of the Mexican price level system. Many believe that this rationale should be used as a basis to conclude that no US GAAP adjustment is

necessary. Others, including the leaning of the SEC staff, believe that this method is in conflict with Rule 3-20. The Task Force and the SEC staff agreed to continue working on this issue and possibly require additional disclosure in lieu of a US GAAP difference. (Note: A US GAAP difference would impact all numbers in the financial statements.) A resolution is expected shortly.

V. **ACCOUNTING FOR THE INTRODUCTION OF THE EURO**

Larry Leva discussed the establishment of a common European currency (the "Euro") and the related accounting implications. A summary of the Mr. Leva's discussion is included as [Attachment B](#) to these highlights. The Task Force discussed the following possible solutions:

1. Allow prior year financial statements to be restated using the fixed exchange rate and address changes in reported trends in MD&A.
2. Require foreign registrants participating in the Euro to continue to present their financials in the Home currency until 2001 to ensure three year audited comparability and avoid changes in reported trends. (Five year SFD would also need to be addressed.) Euro financials could also be presented beginning in 1999 to be consistent with the reporting currency used in the Home country. For example, the income statement for Company X would have four columns with 1997, 1998 and 1999 in Lira and a fourth column presenting 1999 also in Euros.

Craig Olinger stated that the Commission would not allow Option 1 and that Option 2 appears workable. The Task Force agreed that Option 1 would conflict with Rule 3-20 and that Option 2 would better report the trends of the company.

The Task Force will continue to monitor the progress of the Euro and the related accounting implications.

VI. **NASDAQ REQUIREMENTS FOR FOREIGN REGISTRANTS**

The Task Force discussed the new Nasdaq listing requirements recently issued which contain peer review requirement for all auditors of Nasdaq-listed companies. Nasdaq will require auditors "to be subject to peer review of their accounting and audit practices every three years, by organizations such as the American Institute of Certified Public Accountants (AICPA), SEC Practice Section, or comparable review organization." The new entry requirements will apply retroactively to issuers that list after March 3, 1997, although there is conflicting language in the release suggesting an 18-month delayed effectiveness. It was noted that the Auditing Standards Board is monitoring this development and the related issues it raises, such as whether or not it applies to foreign issuers. NASD's General Counsel (citing Rule 4460) has stated that the rule was not intended to apply to foreign issuers other than Canadian issuers.

VII. **APPLICATION OF SFAS NO. 130 TO ITEM 17 FILERS**

The Task Force discussed the application of SFAS No. 130 to foreign registrants using Item 17 of Form 20-F. The issue is whether the information required by SFAS No. 130 should be deemed a "statement" or a disclosure. The Task Force believes that SFAS No. 130 defines the required disclosures as a new basic statement, although

many US companies present the comprehensive income within the shareholders equity statement, more akin to a disclosure. Craig Olinger will study the issue further and advise the Task Force of his conclusion.

VIII. **SFAS NO. 131 ISSUES FOR FOREIGN REGISTRANTS**

The Task Force addressed certain implementation questions regarding presentation of segment information by foreign registrants. The following is a summary of the issues discussed and conclusions reached.

Q1. SFAS No. 131 requires reported segment information to conform to the information reported to management (even if that information is not US GAAP). What information does a foreign registrant report for US GAAP segment purposes?

A1. The foreign registrant should present financial information using whatever basis of accounting is used internally, even if that information is on a local GAAP basis. No US GAAP reconciliation of this data is required. The measurement basis for the data would be disclosed.

Q2. For purposes of measuring materiality using the 10% criterion in SFAS No. 131, should the registrant use its internal basis of accounting?

A2. Yes, materiality would be based on the internal basis of accounting. The Task Force noted that, as required by SFAS No. 131, all reported segments must comprise at least 75% of consolidated revenues.

Q3. In reconciling segment data to the consolidated financial statements, should that consolidated data be US GAAP or local GAAP? If so, should the effects of the adjustments be isolated?

A3. The final column in the reconciliation should be to the consolidated financial statements presented under local GAAP. The reconciling items should be isolated in a separate column and described.

Q4. If the foreign registrant's financial statements are presented in local GAAP but in US\$ and the internal financial statements are presented in the currency of the parent, what currency should be used to present segment data?

A4. All financial information should be reported in the same currency. Accordingly, if the foreign registrant chooses to present its financial statements in US\$, then the segment data must be presented in US\$.

IX. **OTHER COMMENTS BY THE SEC STAFF** **Auditor Indemnification**

Craig Olinger distributed an excerpt from the 1985 Companies Act which permits companies to indemnify auditors "against any liability incurred by him in defending any proceedings (whether civil or criminal) in which judgement is given in his favor or he is acquitted". The excerpt is included as [Attachment C](#) to these highlights. Mr. Olinger noted that the staff views *any* indemnification to public accountants as contrary to public policy. He added that such

indemnifications would, in the staff's view impair auditor independence. As a result, the staff would object to any indemnification received by an auditor.

A. Mining Companies

Craig Olinger noted that Canadian mining companies typically capitalize all costs until either the mine is producing revenues or until it is abandoned. Craig added that this practice is inconsistent with that of U.S. mining companies that are in the development stage and that the staff would expect this to be shown as a US GAAP difference.

B. Privatizations

Craig Olinger stated that the SEC staff has seen examples of foreign governments that issue stock to employees, often at steep discounts. The staff is considering whether such issuances should be viewed as compensatory grants. In their deliberations, the staff is looking to APB 25, which provides specific criteria in determining whether an issuance of stock is compensation. For example, APB 25 states that unless shares are offered to all employees and the discount is relatively small, compensation should be charged.

C. Hong Kong Stock Exchange Requirements

Craig Olinger distributed an example disclosure included in a recent prospectus of a Hong Kong offering as required by the Hong Kong Stock Exchange. The disclosure contained pro forma financial information that normally would have been prohibited by the SEC staff since it covered a three year period. (SEC rules limit pro forma disclosures to the latest year and any interim to date.) The disclosure is included as [Attachment D](#) to these highlights. Mr. Olinger noted that there have been limited instances in which certain information, such as more than one year pro forma information, have been allowed by the staff. Such allowances, however, were granted in pre-clearance meetings with the staff and, as noted in the example, were sufficiently different than a typical pro forma that the staff concluded investors would not be misled. He recommended that any issuer wishing to present such information should pre-clear the proposed disclosures with the staff.

D. Stock Compensations Plans

Craig Olinger discussed what appears to be an increasing use of variable-type stock option awards by foreign registrants which are not accounted for as variable plan awards under APB 25. He indicated that the staff would look to guidance under APB 25 in determining whether such awards are variable plans and would require that they be accounted for properly in the US GAAP reconciliation.

X. REPLACEMENT COSTS — MEXICO

The Task Force discussed the Fifth Amendment to Bulletin B-10 under Mexican GAAP that retained the use of replacement costs for inventories, which are valued at last

purchase price, and cost of sales and abolished the use of replacement cost for fixed assets (see [Attachment E](#)). The amendment divides fixed assets into two classes as follows:

—For fixed assets of foreign origin, they would be restated on the basis of the devaluation of the peso against the currency of origin and applying a factor for inflation in such foreign country.

—For fixed assets of Mexican origin, they would be restated applying factors derived from NCPI.

The Task Force noted that the methodology stated above for restating fixed assets does not appear to comply with Rule 3-20 for presenting price level financial statements. Craig Olinger stated his agreement with the Task Force's conclusion and indicated that the staff would require a disclosure of the effect, if material, in the US GAAP reconciliation.

XI. **FREE CASH FLOW — UK GAAP**

A number of UK companies disclose (see examples in [Attachment F](#)) in the financial statements an amount that is referred to as "Free Cash Flow" or similar term. In presenting this amount, companies will include a reconciliation of the amount in the statement of cash flows to free cash flow. Craig Olinger stated that such disclosures in the financial statements violates ASR 142. The Task Force agreed with Mr. Olinger's position.

XII. **CASH FLOW STATEMENT — PRICE LEVEL ADJUSTED FINANCIAL STATEMENTS**

The Task Force discussed the preparation of cash flow statements when the Mexican financial statements are price level adjusted and are presented as a statement of changes in working capital. (Background information relating to this issue is included as [Attachment G](#) to these highlights.) The Task Force concluded that the financial statements for entities that present price level adjusted financial statements should, at a minimum, reconcile (based on local numbers) and present major captions of a cash flow statement (i.e., operating, investing and financing). The Task Force, however, did not agree on the specific format of this reconciliation and whether a complete cash flow statement should be presented. Steve Derrick and Wayne Carnall agreed to draft an illustrative reconciliation for consideration by the SEC staff and the Task Force.