# AICPA International Practices Task Force Meeting Highlights

**May 28, 1998**

*Location:* AICPA Washington Office

**NOTICE:** The AICPA SEC Regulations Committee's International Practices Task Force 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.

In addition, these highlights are not authoritative positions or interpretations issued by the SEC or its staff. The highlights were not transcribed by the SEC and have not been considered or acted upon by the SEC or its staff. Accordingly, these highlights do not constitute an official statement of the views of the Commission or of the staff of the Commission.

## I. ATTENDANCE

Richard Dieter, Chairman (Arthur Andersen)
Eric Phipps (Arthur Andersen)
William E. Decker (Coopers & Lybrand)
Tania Chebli (Coopers & Lybrand)
Carol Riehl (Grant Thornton)
Lee Graul (BDO Seidman)
Roger Jahncke (Ernst & Young)
Larry Bradley (KPMG Peat Marwick)
Dick Goligoski (Deloitte & Touche)
Michael Reilly (Deloitte & Touche)
Wayne Carnall (Price Waterhouse)
Craig Olinger (SEC Observer)
Mary Tokar (SEC Observer)
D.J. Gannon (SEC Observer)
Annette Schumacher Barr (AICPA)

## II. COMFORT ON COMPLIANCE WITH S-X IN NON-SEC FILINGS

The Task Force discussed the need for additional guidance in applying the provisions of paragraph 22 of SAS 72 in situations involving non-SEC filings. All Task Force members acknowledged that although it was their firm policy not to give comfort in relation to compliance with Regulation S-X where the offeror was not an SEC registrant, the prohibitive guidance in SAS 72 is not absolutely clear for all situations. Dick Dieter agreed to present the issue to the Audit Issues Task Force of the Auditing Standards Board and ask them to issue formal interpretive guidance with clear prohibitions. In the interim, firms will continue to adhere to their internal policies.

## III. UPDATE ON NASDAQ REQUIREMENT FOR PEER REVIEW

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, by organizations such as the American Institute of Certified Public Accountants (AICPA), SEC Practice Section, or comparable review organization." Under the rule, auditors in foreign countries that do not have a formal peer review system in place are not subject to peer review requirements.

## IV. RUSSIAN 144A OFFERINGS AND ASSURANCE

A number of Task Force members reported that auditors were coming under pressure to issue compilation reports on financial statements of Russian offerors in offering documents. Each Task Force member reported that it was their firm policy not to issue compilation reports in connection with 144A offerings. It was agreed that each member would follow up with their individual practice offices to make sure that they are adhering to firm policy.

## V. STATUS OF PRICE LEVEL ACCOUNTING IN BRAZIL

Wayne Carnall reported that for the purpose of corporate law reporting in Brazil, adjustments for inflation had not been made since 1995, thus creating a difference between Brazilian corporate law and Brazilian GAAP. He noted that the Brazilian Institute of Accountants (IBRACON) has issued a draft accounting standard that proposes to eliminate the requirement to prepare price level adjusted financial statements under Brazilian GAAP. However, until such time as the new standard becomes effective, Brazilian GAAP requires companies to continue to price-level restate their financial statements (on the constant currency method) despite Brazilian Corporation Law no longer permitting the effects of such indication for taxation or dividend determination purposes. He will report at the next meeting if there are any new developments.

## VI. FAS 131 IMPLEMENTATION ISSUES

A number of Task Force members expressed concern regarding the implementation of FAS 131 by foreign registrants in countries that follow IAS 14 (or a standard similar to IAS 14). It was noted that FAS 131 and IAS 14 provided differing guidance in terms of both segment identification and measurement of segment results. As such, foreign registrants are concerned they may be required to perform two segmental analyses. The staff has been advised that differences in segment identification between FAS 131 and IAS 14 are expected to be infrequent. If registrants are encountering differences, the staff would be interested in learning about how they arose. Task Force members agreed to keep the staff advised of problems as registrants consider the requirements of FAS 131.

The staff stated that formal rulemaking would be required before the staff could accept IASC 14 disclosures in lieu of FAS 131 for filings under Item 18.

The Task Force will address this issue again at its November meeting.

## VII. MEXICO'S HYPER INFLATIONARY STATUS

The Task Force and staff discussed whether it would be appropriate to consider

Mexico as non-hyper inflationary and concluded that, based on Mexico's historical chronic inflation patterns, it would NOT be appropriate to cease hyper inflationary accounting before December 31, 1998. Craig Olinger noted that D-55 requires a change in inflationary status to be "other than temporary" before hyper inflationary accounting can be ceased; the group agreed that there was not sufficient evidence that Mexico's decline in inflation was "other than temporary" at this time. The group agreed to revisit the issue at the Task Force's November meeting to discuss whether it would be appropriate to consider Mexico non-hyper inflationary beginning January 1, 1999. Larry Leva will lead the discussion in November.

## VIII. THE EURO

### A. Reporting Currency

At the Task Force's December 12, 1997 meeting, Larry Leva discussed the use of the Euro as a reporting currency and the related implications of presenting comparative financial statements in Euros for periods before the January 1, 1999 introduction date. 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.

At that time, Craig Olinger stated that the Commission would not allow Option 1 and that Option 2 appeared workable. Mr. Olinger stated that the staff has since reconsidered the position made at the December meeting. After further studying the issue, the staff believes Option 1 is acceptable. Option 2 would also be acceptable but is not expected to be widely adopted by registrants. The staff believes that Rule 3-20 of Regulation S-X did not contemplate this situation. The normal prohibition on a retroactive convenience translation approach would not apply because the Euro did not exist in prior periods.

The staff will not object if a registrant presents comparative financial statements for periods prior to January 1, 1999 by recasting previously reported financial statements into Euros using the exchange rate between the Euro and the prior reporting currency as of January 1, 1999. This is consistent with the recommendations of the European Commission.

When financial statements are stated in a currency different from the one used in previous filings with the SEC, SEC Regulation S-X, Rule 3-20(e), *Currency for Financial Statements of Foreign Private Issuers*, requires a registrant to recast its financial statements as if the newly adopted currency had been used since at least the earliest period presented. The staff has interpreted this provision to require a methodology consistent with FASB

Statement No. 52, *Foreign Currency Translation*. That is, the income statement and statement of cash flows should be translated into the new reporting currency using weighted-average exchange rates for the applicable periods, and assets and liabilities should be translated using exchange rates at the end of the applicable periods.

However, Rule 3-20(e) did not contemplate the introduction of a new, cross-border currency that would replace multiple existing currencies. Because the Euro did not exist prior to January 1, 1999, the retroactive application of the January 1, 1999 exchange rate to previously reported financial statements would not result in the remeasurement of previously reported results and would not alter previously reported trends and relationships.

The financial statements of multinational registrants that report in different currencies generally are not comparable. Financial statements reported in Euros by recasting based on the January 1, 1999 exchange rate will depict the same trends and relationships among a registrant's accounts as those previously reported prior to the introduction of the Euro. However, investors could inappropriately assume that the financial statements of various registrants that report in Euros are directly comparable. To highlight the potential lack of comparability in periods prior to January 1, 1999, the staff would expect the following disclosures:

- Each page of the basic financial statements (balance sheet, income statement, statement of cash flows) should indicate that prior-year balances were restated from [the applicable prior reporting currency] into Euros using the exchange rate as of January 1, 1999.
- The notes to the financial statements should disclose the following:

    - the reporting currency that was previously used;
    - the methodology used to restate prior year balancesCretroactive application of the exchange rate as of January 1, 1999;
    - the exchange rate as of January 1, 1999;
    - a statement that the comparative financial statements reported in Euros depict the same trends as would have been presented if the company had continued to present financial statements in the currency that was previously used;
    - a statement that the financial statements for periods prior to January 1, 1999 will not be comparable to the financial statements of other companies that report in Euros and that restated amounts from a different currency than the one previously used by the company.

- Selected financial data should indicate that balances prior to January 1, 1999 were restated from [the applicable prior reporting currency) into Euros using the exchange rate as of January 1, 1999. A cross-reference to the related financial statement disclosure should be provided.
- Management's Discussion and Analysis should include a headnote that describes the introduction of the Euro, explains that the comparative

financial statements reported in Euros depict the same trends as would have been presented if the company had continued to present financial statements in the currency that was previously used, and discusses the lack of comparability to other companies reporting in Euros that restated amounts from a different currency than the one previously used by the company. A cross-reference to the related financial statement disclosure should be provided.

For registrants with financial statement periods not coinciding with the calender year, the introduction of the Euro will occur during the financial statement period. The staff understands that most countries in the EMU have or are in the process of enacting laws or regulations to prohibit such companies from adopting the Euro in financial statement periods ending prior to January 1, 1999. It is unlikely that a registrant in these countries would request adoption of the Euro in financial statements filed in the United States for those periods.

In cases where a registrant wishes to adopt the Euro as its reporting currency for financial statement periods ending prior to January 1, 1999, the staff would expect to be consulted.

Wayne Carnall will advise the Task Force at the next meeting if there are any countries that would permit reporting in Euros for the year ended December 31, 1998.

### B. Euro Disclosures

Craig Olinger noted that registrants that expect to be materially impacted by the introduction of the Euro should consider the disclosure requirements of Regulation S-K, particularly MD&A. The staff has issued Staff Legal Bulletin 6 to provide interpretive guidance regarding disclosures about the Euro.

## IX. CURRENT COMMENTS ON MEXICAN B-15 ISSUE

At its December 2, 1997 meeting, the Task Force discussed consolidation of foreign subsidiaries by Mexican registrants. The specific issue addressed was whether the method that is required by recently issued Mexican Bulletin B-15 should be acceptable for purposes of filing with the SEC. At the meeting, Craig Olinger stated that the staff was concerned that the requirements of Bulletin B-15 are in conflict with constant currency reporting under Rule 3-20. Subsequent to the meeting, Wayne Carnall presented the staff with a memorandum providing guidance for Mexican companies that apply Bulletin B-15. The staff has agreed that the guidance adequately addresses the staff's concerns. See Attachment A for the memorandum and the related correspondence with the staff.

## X. TREATMENT OF CAPITAL TRANSACTIONS OF LATIN AMERICAN COMPANIES UNDER FASB NO. 128

The Task Force and staff discussed the following three transactions and their related treatment:

A. **Shares issued in connection with transfers of amounts from various equity accounts to capital stock.**

In most of Latin America, within the equity accounts is a "Restatement" account which represents the effect of restating capital stock to constant currency. There may also be designated reserve accounts and other accounts, such as "Results of Holding Non-Monetary Assets" in Mexico, which represent differences in appraisal values and indexation for inflation. It is not uncommon to transfer these reserves to capital stock and issue new shares to existing holders on a pro rata basis. The Task Force and the staff agreed that these transactions are most similar to a stock split or stock dividend, since each holder's pro rata ownership and total shareholders' equity remains unchanged. Therefore, these issuances should be treated as if they were outstanding for all periods presented for basic and diluted earnings per share, as required under FASB 128, paragraph 54.

B. **Capital contributions made (non-withdrawable) but shares not yet issued.**

This is a transaction not uncommon in Brazil and certain other Latin American countries. The contribution may be in cash or from other sources, such as capitalization of debt due to shareholders, particularly in government owned companies. Legally, until the shares are issued, the contributors do not have the right to receive dividends. However, there is an obligation by the Company to issue the shares; therefore these contributors have rights to the equity of the Company. The number of shares to be issued may or may not be defined at the time of contribution.

The Task Force and staff recognized that whether or not the contribution was returnable was a significant fact in the accounting analysis and it was difficult to believe that funds would be advanced if there was any uncertainty as to whether the shares would be allotted. The staff noted that zero cost options might provide an appropriate analogy.

The Task Force did not reach a conclusion and decided to consider the issue further after additional inquiries were made.

C. **Inclusion of preferred shares in EPS computations.**

Under Brazilian Corporation Law, one-half of net income is required to be distributed to shareholders each year if the statutes are silent as to distribution; a public-listed company may stipulate a minimum mandatory distribution of not less than 25%; a non-listed company may establish a lower minimum dividend. Brazilian Corporation Law requires management to propose a dividend distribution at the year end, the liability for which is provided for at such date despite the distribution being subject to approval and declaration by the shareholders at the Annual General Meeting up to four months after year-end.

Wayne Carnall stated that Law 9457 (May 1997) amended Brazilian Corporation Law to require payment of a 10% premium to preferred shareholders over and above the distribution to common shareholders, unless the preferred shares are entitled to a minimum dividend fixed in monetary-per-share terms or as a percentage of capital. A number of legal interpretations have yet to be tested by the courts, including: effective date of the Law, whether the Law applies to existing equity instruments or new shares only, and if the premium is payable over and above the minimum mandatory dividend, among others.

The Task Force and staff discussed how earnings per share would be calculated. Craig Olinger stated that the staff has a number of questions regarding this issue. The Task Force agreed to do additional research to verify current Brazilian law and discuss the staff's questions. The issue will be discussed again at the Task Force's November meeting.

## XI. AUDIT REPORT QUALIFICATIONS IN FILINGS BY FOREIGN PRIVATE ISSUERS

Craig Olinger distributed the staff's position regarding audit report qualifications (see Attachment B). Mr. Olinger added that in certain unusual circumstances the staff has accepted a qualification in respect of a departure from home country GAAP to comply with US GAAP."

The staff encourages practitioners to discuss unusual circumstances with the staff prior to filing a qualified auditor's report.

## XII. TREATMENT OF FAS 130 BY FOREIGN REGISTRANTS FILING UNDER ITEM 17 & 18

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. After reviewing the issue, the staff agrees that a statement of comprehensive income is a financial statement requirement and not merely a disclosure item and as such, would be required for both Item 17 and Item 18 filers. He stated that the statement could be provided in either US or home country GAAP. The staff will encourage (but not require) a reconciliation if the statement is provided in home country GAAP.

## XIII. CONVENIENCE TRANSLATIONS

Craig Olinger discussed the staff's views regarding US dollar convenience translations of financial statements prepared in a foreign currency. SEC rules permit, but do not require or encourage, presentation of a convenience translation. If a convenience translation is presented, Rule 3-20(b) of Regulation S-X specifies that the translation should be presented using the exchange rate as of the most recent balance sheet included in the filing, except that a rate as of the most recent practicable date shall be used if materially different.

Various Asian currencies declined significantly in value subsequent to December 31, 1997. The staff has received questions regarding the applicability of the guidance in Rule 3-20(b) to registrants that report in a currency with a significant decline after the balance sheet date. Some believe that literal application of the rule using the more recent rate could result in a potentially misleading presentation. For example, if a registrant's debt is denominated in US dollars or other major currencies, the convenience translation would depict the debt at a much lower US dollar amount than the registrant's actual debt service requirements.

The staff will not object if a registrant uses the exchange rate at the date of the most recent balance sheet in preparing a convenience translation for inclusion in an annual report on Form 20-F or a registration statement, or if it omits a convenience translation. The staff also will not object if a registrant uses a more current exchange rate. However, all amounts presented for a given period must be translated using the same exchange rate. If convenience translations are presented in a registration statement that includes all required financial statements, such as Form F-1, the same exchange rate should be used for the most recent fiscal year presented and any subsequent interim period. If a registrant files a registration statement that incorporates by reference financial statements previously filed on Form 20-F, the staff will not require amendment of the previously filed financial statements to reflect a convenience translation based on a more current exchange rate.

In any event, registrants should highlight the currency devaluation and provide full, balanced disclosures regarding its effects on the registrant's results of operations, liquidity, and cash flows in MD&A. Also, paragraph 32 of FAS 52 requires disclosure of significant changes in currency exchange rates occurring after the balance sheet date and the effects on unsettled balances pertaining to foreign currency transactions.

## XIV. IAS 22 BUSINESS COMBINATIONS/SIC D-9

D.J. Gannon provided the Task Force with an update of recent staff applications of IAS 22, *Business Combinations* (IAS 22). Mr. Gannon also indicated that the IASC's Standing Interpretation Committee (SIC) has issued for comment a draft interpretation, SIC D-9, *Classification of Business Combinations as either Acquisitions or Unitings of Interests* (SIC D-9), which provides guidance on how to apply the various provisions in IAS 22, when accounting for a business combination.

Mr. Gannon indicated that both the staff and the International Organization of Securities Commissions (IOSCO) have voiced concern over SIC D-9, as currently proposed. He indicated the staff and IOSCO believe SIC D-9 does not give proper consideration to all the factors in IAS 22 that characterize a uniting of interests; in particular, joint or combined control over the net assets and operations of the combined entity (i.e., the apparent absence of control by any of the combining enterprises) and a continuing "mutual sharing in the risks and benefits" in the combined entity.

Mr. Gannon indicated the staff believes that, in addition to demonstrating joint or combined control over the combined entity, all of the criteria in paragraph 16 of IAS 22 must be met in order for a uniting of interests to exist.

Regarding the application of the relative size test in paragraph 16(b) of IAS 22, Mr. Gannon indicated that the staff has objected to the U.K. interpretation that an enterprise is presumed to dominate if it is more that 50 percent larger than each of the other enterprises party to a business combination (i.e., in a two party transaction, a relative split of 60%-40%).

Task Force members asked if the staff has addressed the issue of planned dispositions of assets made in contemplation of a business combination and whether such dispositions would preclude a uniting of interests. Mr. Gannon indicated that the staff has not been asked to address this issue, however, he did indicate that the SIC is expected to address this issue, along with many others relating to the application of IAS 22.

Finally, Mr. Gannon discussed the staff's concerns regarding two of the IASC's proposed amendments to IAS 22 -- the proposal to eliminate the current requirement that goodwill be amortized over a period not to exceed twenty years and the accounting for negative goodwill.

## XV. HYPERINFLATION IN RUSSIA

The Task Force and staff agreed that it was appropriate to continue to regard Russia as hyperinflationary throughout 1998. The Task Force will revisit the issue at its November meeting to discuss whether it should still be considered hyperinflationary beginning January 1, 1999.

## XVI. CANADIAN MINING COMPANIES

At the Task Force's December 2, 1997 meeting, Craig Olinger noted that Canadian mining companies typically capitalize all costs until either the mine is producing revenues or until it is abandoned. At that time, Mr. Olinger 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.

Mr. Olinger stated that the staff is currently considering various issues related to exploration activities by mining companies including capitalization and impairment policies. The Task Force noted that there is diversity in practice among U.S. mining companies relating to these issues. The Task Force and staff agreed that it would be beneficial to request assistance from AcSEC in developing guidance for these unique issues relating to mining companies. Wayne Carnall will investigate the feasibility of obtaining assistance from AcSEC.

## XVII. NON-FINANCIAL STATEMENT PROSPECTUS REQUIREMENTS

Mary Tokar noted that IOSCO has completed work on a project to harmonize non-financial statement disclosures (i.e., International Disclosure Standards). Ms. Tokar indicated that these standards will be presented to the full membership of IOSCO for endorsement at its upcoming annual conference in September. Ms. Tokar stated the adoption of these standards in the United States will require a change in the Commission's rules to replace current Form 20-F with the IOSCO disclosure standards and amend the requirements of Forms F-1, F-2, F-3, and F-4. Ms. Tokar indicated that, assuming the standards are recommended for endorsement in September, the staff would expect to issue a rule proposal in 1999.

## XVIII. CASH FLOW STATEMENT -- PRICE LEVEL ADJUSTED FINANCIAL

**STATEMENTS**

At the December 2, 1997 meeting, the Task Force indicated that it would continue to investigate the preparation of a cash flow statement when financial statements are price level adjusted for inflation. Wayne Carnall distributed an example of a cash flow statement that he prepared. This example presents a fourth caption in addition to operating, financing and investing -- effect of inflation on cash flow. This is similar to the concept of the effects of exchange rate changes on cash described in SFAS No. 95, *Statement of Cash Flows*. Mr. Carnall noted that the example appears to be conceptually consistent with Bulletin 50 issued by the Chilean Accounting Principles Commission. It was further noted that the Mexican Accounting Principles Commission is considering adding an item to its agenda to revise Bulletin B-12 that currently requires the presentation of a statement of changes in financial position as opposed to a cash flow statement. The SEC staff is considering requiring companies that prepare price level adjusted financial statements to prepare a "true" cash flow statement that would be conceptually similar to Mr. Carnall's example. The SEC staff and the Task Force will continue to investigate this issue, and it will be further discussed at the next meeting.

## XIX. NEXT MEETING

The Task Force's next meeting was scheduled for Tuesday, November 24.