AICPA International Practices Task Force Meeting Highlights

April 28, 1999

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)
Steven Derrick (PricewaterhouseCoopers)
Carol Riehl (Grant Thornton)
Lee Graul (BDO Seidman)
Roger Jahncke (Ernst & Young)
Michael Reilly (Deloitte &Touche)
Wayne Carnall (PricewaterhouseCoopers)
Enrique M. Tejerina (KPMG Peat Marwick)
Joseph M. Langmead (KPMG Peat Marwick)
Lisa Paules (Ernst & Young)
Craig Olinger (SEC Observer)
Lisa Vanjoske (SEC Observer)
Paul Dudek (SEC Observer)
Herb Finkston (AICPA)
Annette Schumacher Barr (AICPA)

II. UPDATE ON SECPS PROPOSED RULE REGARDING INTERNATIONAL AFFILIATES

The SECPS has formed the International Task Force (ITF) to address SEC staff concerns regarding quality control for foreign affiliates that audit foreign registrants. This working group has representatives from each of the firms that have foreign affiliates. Lee Graul, a member of the ITF, provided a status update of its progress. He stated that the ITF discussed a proposed rule amendment with the SEC staff on April 13. Although the SEC staff raised certain questions, they generally appeared to be satisfied with what was proposed. The proposed rule amendment has been revised to reflect the staff's comments and will be considered again at a meeting of the ITF on April 30.

Describing the proposed rule amendment, Lee said that the US firm would effectively

become the gatekeeper to ensure foreign affiliates were knowledgeable with regard to US GAAP and US GAAS including auditor independence. There would need to be a review by a designated reviewer of each filing although the review would not extend to workpapers. Arrangements would be subject to scrutiny as part of the peer review process of the US Firm.

An implementation date has not yet been designated.

III. COMFORT LETTER ISSUES ON CROSS BORDER FINANCINGS

At the November 24, 1998 meeting of the Task Force it had been agreed that members would exchange and compare information about their firm's SAS 72 policies for Rule 144a offerings. The ultimate objective of this exercise is to develop a "best practices" document that will help ensure that all firms are handling requests for comfort letters consistently. As an initial step, Roger Jahncke circulated a questionnaire to Task Force representatives regarding their firms' SAS 72 policies. He then aggregated the responses and provided a summary for the Task Force to review.

After discussing the various similarities and differences highlighted by the survey responses, the Task Force agreed to review the survey summary and ensure that their initial responses were truly indicative of their firm practices. This review should be completed by May 28 and any amendments/clarifications should be sent to Roger.

Roger, Joe Langmead and Eric Phipps will then meet to highlight issues where policy differences exist among the firms and to identify areas where a common position may be reached. The results of this comparison and analysis will be reported at the next Task Force Meeting.

IV. UPDATE ON SECPS PROPOSED RULE re INTERNATIONAL AFFILIATES

Dick Dieter briefly described the response of IOSCO to an IAPC ED on external confirmations that would remove the presumption that external confirmations would be performed as part of the audit process. Instead, the ED reflected a risk-based model in which the assessment of risk determines the nature and extent of procedures that the auditor deems necessary. IOSCO's response was to express concerns about the effectiveness of audits generally and the strengths and weaknesses of risk-based audit approaches. They referred to the current Public Oversight Board audit effectiveness panel and encouraged IAPC to consider these concerns with their counterparts in national standard setting bodies.

V. DEFERRAL OF FOREIGN EXCHANGE LOSSES IN BRAZIL

Dick Dieter stated that the Brazilian Securities Commission has issued a paper giving companies the option of deferring exchange losses incurred in 1999, and amortizing them over the following five years. IBRACON (the Brazilian accounting principles body) has stated that the audit opinions must be qualified if those losses are deferred. Craig Olinger stated that the SEC staff would most likely object to such qualifications.

VI. SEC DEVELOPMENTS

Craig Olinger made observations relating to the following recent developments:

A. Euro as Reporting Currency

The staff recently considered a situation in which a registrant is required to prepare statutory financial statements for 1998 in the legacy currency of its home country, but is permitted (by stock exchange regulations or otherwise) to also prepare financial statements in euros for distribution to shareholders. The staff will not object if the financial statements included in the 1998 Form 20-F are presented in euros, provided that a registrant is permitted to, and does, distribute to its shareholders financial statements prepared in the same manner.

B. Consolidation / Proportionate Consolidation under IAS

The staff has recently addressed several situations involving the use of proportionate consolidation under IAS. The staff has objected to the proportionate consolidation of majority owned, controlled investees. These investees were appropriately characterized as subsidiaries in the notes to the financial statements, and did not meet the definition of a joint venture in IAS 31. In these circumstances consolidation is required by IAS 27. The staff has also objected to the inappropriate characterization of a controlled subsidiary as a joint venture.

In these situations, the registrants had certain large joint venture investments that qualified for proportionate consolidation as well as numerous smaller subsidiaries that did not. The registrants asserted that proportionate consolidation was used for all investments as a matter of accounting policy because the effects were immaterial. The staff was unable to concur with this conclusion. Full consolidation could not be demonstrated to require unreasonable cost and effort, because the same investee information was necessary to apply proportionate consolidation. Further, the investees were fully consolidated in the US GAAP reconciliation."

C. Dual Proformas: Purchase and Pooling

The staff recently considered situations in which a registrant had sought to present US GAAP pro forma information on both the basis that (a) an acquisition would be accounted for as a purchase and (b) that it would be accounted for as a pooling.

Article 11 of Regulation S-X requires alternative pro forma presentations in circumstances where the terms of a business combination may result in a range of outcomes. For example, the level of shareholder acceptance of an exchange offer may not be known at the time of filing. Pro formas on a pooling basis may be necessary to reflect acceptance of 90 percent or greater, with alternative pro formas on a purchase basis to reflect lower acceptance.

However, alternative pooling and purchase pro forma presentations should not be used as a substitute for the timely identification and resolution of accounting issues related to the business combination. Purchase versus pooling issues should be resolved prior to effectiveness. The staff encourages pre-filing consultations on difficult business combination issues.

D. Auditor Independence – Fairness Opinions

Statutes or regulations in various countries (particularly in Europe) require companies to obtain a report from a chartered accountant regarding the consideration to be exchanged in stock-for-stock mergers, non-monetary exchange transactions or other capital transactions. The staff understands that in most countries, management is permitted to engage any duly licensed accountant to perform this service. At the November 24, 1998 meeting, the staff had commented that if an auditor renders an opinion on the value of a company, the adequacy of consideration, or the fairness of a transaction that the auditor will subsequently audit, the auditor's independence will be considered impaired.

However, the staff would also consider the auditors' independence impaired where a country required the service to be performed by the company's auditor. In Italy the law (Article 158) has recently been changed to require certain opinions to be delivered by the company's auditor. The staff is discussing the matter with CONSOB to see whether Italian law or practice could be amended to address the difficulties that would arise for Italian companies that are SEC registrants. Pending resolution of this matter, the staff does not expect to be in a position to declare effective registration statements that include audit reports where the auditors have also issued the type of report required under Article 158.

E. US Contacts in Confidential Filings

Mr. Olinger stated that the staff is considering certain procedures upon receipt of confidential filings received from foreign companies audited by foreign affiliates of US firms. A form letter would ask for the name of the US contact that the staff should address inquiries concerning the application of the US firm's policies and procedures to the draft registration statement.

In discussion, there was general agreement that such a step would be helpful in ensuring that foreign affiliates made sure that they involved their US firm in such filings. A draft of the proposed form letter is attached as *Attachment A*.

VII. USE OF FOREIGN AUDITORS TO AUDIT DOMESTIC REGISTRANTS

Mr. Carnall explained that the staff of the SEC had traditionally believed that registrants that are not foreign private issuers as defined by Rule 405 of the Securities Act of 1933 and Section 3b-4 of the Securities Exchange Act of 1934 should be audited by a US accounting firm – i.e., licensed in one of the several states or DC and not a foreign accounting firm. The reasons for this policy include the

following:

1. More knowledgeable about US GAAP and US GAAS.
2. Easier for SEC to obtain workpapers.
3. Easier for shareholders to bring litigation.

Historically, the staff has normally not required the use of a US accounting firm if the majority of the registrant's operations are located outside of the United States. These situations involved the conflicting policy to have a US accounting firm with the policy to have the principal auditor audit over 50% of the operations. Originally, this accommodation primarily involved registrants from Israel that were incorporated in the US but had substantially all of their operations in Israel. The following scenarios illustrate the increasing complexity of this area:

4. Should there be a distinction in policy if the registrant is incorporated in the US compared to a registrant incorporated in a foreign country but does not meet the definition of a foreign private issuer?

5. A company has the majority of its operations outside of the US and in a particular country, but the country is not English speaking – e.g., Chile.
6. A company has the majority of its operations outside of the US, but less than 50% in any particular country – 40% France, 40% Germany and 20% Switzerland – could the accounting firm be from any of the three countries – assume Corporate headquarters is in Switzerland.
7. Same fact pattern as in 3) except that instead of 40% of the operations being conducted in France, 40% is conducted in the US.
8. 55% of the operations are in the US, but the company is headquartered in Germany where 45% of the operations are conducted – could a German auditor be used?

The staff has historically indicated that it will not object, and pre-clearance is not necessary, for the use of a foreign accounting firm to audit a registrant that is not a foreign private issuer provided the following three criteria are met:

The majority of the operations are conducted in a particular country.
The accounting firm is licensed in that country.
The accounting firm is from an English speaking country – e.g., Canada, England, Ireland, Australia, and New Zealand.

In other circumstances, pre-clearance is required.

There were a number of questions concerning the application of this policy and the need to pre-clear. Moreover, knowledge as to the staff's expectations were not widespread and there were a number of domestic registrants where, because of a back door listing, the audit was signed by non-US firm without pre-clearance.

Craig Olinger stated that the staff will consider all observations regarding this issue. The staff begins with the presumption that registrants other than foreign private issuers should be audited by a U.S. firm. Given the increasing frequency and complexity of these situations, however, the staff recognizes that some of the historical distinctions may be impractical to apply. The staff encourages registrants and auditors with unusual situations to consult with the staff. Pending the

development of further guidance, the staff will generally not object to a reporting company's continued use of a foreign auditor that is otherwise acceptable.

VIII. SFAS 130 AND FOREIGN FILERS

At the November 24, 1998 meeting the staff had stated that the requirements of SFAS 130 would apply to both Item 17 and 18 filers and that the statement could be provided under either local GAAP or US GAAP. In practice, however, it was difficult to determine what represented "other comprehensive income" for the purpose of local GAAP since Statement 130 only required that *changes in balances of items under Statements 52, 80, 87 and 115 that are reported directly as a separate component of equity* be reported in a statement of other comprehensive income. Other items were not to be reported as components of comprehensive income.

With respect to the practical applications of SFAS 130 to foreign filers, the Task Force and staff agreed that:

- A Statement of Total Recognized Gains and Losses prepared by a UK entity in accordance with the UK standard, FRS 3., should be regarded as being consistent with Statement 130.
- If a registrant recognizes **revaluations** of assets in conformity with home country GAAP, the statement of other comprehensive income should include such changes.

IX. CHILEAN TRANSLATION PROCEDURES

Under the new Chilean foreign currency standard, BT N 64, investments that are considered to be an extension of the Chilean parent's operations continue to be remeasured in Chilean pesos and price-level restated for the effects of inflation in Chile. Investments in stable countries, which are not considered to be an extension of the Chilean parent's operations, continue to use the local currency as the currency of measurement.

The primary difference between BT N 51, its predecessor, and BT N 64 relates to foreign investments made in unstable environments. Under BT N 64, effective January 1, 1998, such investments are required to adopt the US dollar as the "functional currency", as the Chilean peso itself is not considered to be a stable currency.

Issues have arisen regarding the practical application of this new standard. Although the profession in Chile has reached a common view, the issues involved are complex. Wayne Carnall agreed to prepare numerical examples to illustrate the issues and facilitate discussion at the next meeting.

X. AICPA RESPONSE - INTERNATIONAL DISCLOSURE STANDARDS

Mike Reilly summarized the Commission's proposals to adopt the international disclosure standards endorsed by IOSCO in September 1998 (Release No 33-7637). Mike agreed to draft a comment letter to be signed by the SEC Regulations Committee. The Task Force agreed that the comment letter should include the

following points:

- Auditor consents - would consent be required when auditors were mentioned under Item 1?
- MD&A - Item 5 referred to "prospects" which appeared to be more forward looking than would be required in relation to the disclosure of known trends.
- Item 4 (b) and 5 both touched on the issue of segmental disclosures - it was not clear whether segments would be as determined on the basis of local GAAP or Statement 131.
- Regarding amendments to Rule 3-19, timings should be brought into line with those proposed in the Aircraft Carrier Proposal (see below). Generally, 33 and 34 Act timings should be consistent. This suggested that the 15-month period proposed was too tight.
- A glossary would be useful.
- It is not clear what happened to the Ratio of Fixed Charges to Earnings.

The proposed 20-F simply referred to the need for audits to be conducted in accordance with US GAAS. The Task Force asked whether it was safe to assume that the staff will continue to accept reports that attested to the fact that local GAAS was substantially consistent with US GAAS. Craig Olinger confirmed that the rule proposal is not intended to change present practice at this time.

The Task Force is in the process of finalizing its comment letter on the proposal and expects to issue it shortly.

XI. AIRCRAFT CARRIER PROPOSAL

Wayne Carnall led a discussion of the international reporting aspects of the SEC's "Aircraft Carrier" Proposal. The following observations were made:

- A five-month reporting deadline for annual reports was probably achievable although it should be noted that the current six-month deadline had been a factor in bringing foreign registrants to US markets.
- There should be no fundamental change in the present 6-K regime and the distinction between it and the 8-K regime. There should be no further specificity in the items to be reported on a Form 6-K.

Wayne Carnall agreed to prepare a list of bullet points that reflects the Task Force discussion for inclusion in the SEC Regulations Committee's comment letter on the proposal.

XII. IMPLEMENTATION OF SFAS 131

Mr. Dieter noted that at the November 24, 1998 meeting it had been agreed that representatives would bring back to the Task Force any implementation issues that arose from differences between Statement 131 and segmental reporting under local GAAP.

The following question arose: Assuming that the application of Statement 131 produced a different segment "cut" from that under local GAAP, would it be possible

in MD&A to discuss the business based on the local GAAP segment cut?

Item 9 of Form 20-F permits the MD&A discussion to be based on the primary financial statements. However, Instruction 11 to Item 9 and Staff Accounting Bulletin 88 require discussion of matters relating to differences between home country GAAP and US GAAP that impact an understanding of the financial statements taken as a whole. The staff noted that if the Statement 131 segmental information provides new and additional information as to how management views the business, or indicates material trends or relationships not apparent from the local GAAP segmental disclosures, it would be necessary and appropriate for that to be discussed within MD&A.

XIII. IMPLEMENTATION OF SFAS 133 AND FOREIGN FILERS

The FASB staff, as part of the FASB's Derivatives Implementation Group (DIG) process, has reminded companies that desire Statement 133 hedge accounting that they must complete their hedge designation and documentation no later than the date the company initially applies Statement 133. The issue is whether the FASB staff guidance should be applied to a foreign registrant that initially files after the effective date of SFAS 133.

There was general agreement by the Task Force and SEC staff that Paragraph 48 of Statement 133 requires hedge-accounting designation as ***at the beginning*** of the fiscal year in which Statement 133 is initially applied. If a registrant does not meet the requirements *as of that date* it cannot apply hedge accounting.

It was also noted that the FASB staff is considering taking the issue of initial application of Statement 133 by an entity that is initially applying U.S. GAAP to the EITF Agenda Committee or the Board for discussion of the broader issue of whether and how an entity initially applying U.S. GAAP should consider the transition provisions of specific Statements of Financial Accounting Standards, especially those involving intent-based accounting. For example, an entity with a calendar-year fiscal year initially adopts U.S. GAAP in the year 2004. Should it consider the transition provisions in Statement 133 (for example, as though it were initially adopting Statement 133 as of January 1, 2004) in applying Statement 133's hedge accounting provisions or must it have met all Statement 133 hedge criteria without regard to its transition to U.S. GAAP?

XIV. NEXT MEETING

The Task Force scheduled its next meeting for Tuesday, November 4, 1999.