AICPA International Practices Task Force Meeting Highlights

November 4, 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)
Amy Ripepi (Arthur Andersen)
Roger Jahncke (Ernst & Young)
Victor Olivera (Ernst & Young)
Michael Reilly (Deloitte & Touche)
Wayne Carnall (PricewaterhouseCoopers)
William Decker (PricewaterhouseCoopers)
Michael Moran (KPMG)
Joseph M. Langmead (KPMG)
Craig Olinger (SEC Observer)
D. J. Gannon (SEC Observer)
Paul Dudek (SEC Observer)

II. COMFORT LETTER ISSUES ON CROSS BORDER FINANCINGS

At the April 28, 1999 meeting the Task Force considered a summary prepared by Roger Jahncke of the members' responses to a questionnaire about their firm's SAS 72 policies for Rule 144a offerings. Following that meeting, Roger, Joe Langmead and Eric Phipps had met 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 were presented at the meeting.

Significant progress was made in developing consensus on best practices in many areas. It was noted that these best practices have now been adopted by all of the firms that are represented on the Task Force. A draft of the best practices will be circulated to the Task Force for comments and will be finalized at the next meeting.

There remain a number of issues that require further follow-up, including a number that are unique to the London market. The subgroup agreed to continue working on

these areas and report back at the next meeting.

III. CHARTER AND ROLE OF TASK FORCE

Dick Dieter briefly described the development of the Task Force and gave a summary of the issues it had considered over the last few years. Its role as a Task Force of the AICPA SEC Regulations Committee had been set out in a 1991 paper ("the charter"). The issue was to what extent that "charter" should now be revised.

In discussion, the following points were made:

1. As the number of foreign registrants who used IAS in their primary financial statements increased, one issue was whether the Task Force should have an enhanced role in considering IAS issues. It was noted that both IOSCO and the SEC had expressed interest in improving the identification of issues to be considered by the Standing Interpretations Committee of the IASC. The Task Force might be a useful mechanism to assist in identifying areas which the SIC should address. Dick Dieter agreed to consider how this might best be achieved and coordination with the US representatives on the SIC should be developed including inviting the US representative to be a permanent member of the Task Force.
2. The present Charter focused on the issues raised by foreign registrants. As the discussion about comfort letters and Rule 144a offerings had shown, significant issues were also raised by unregistered cross-border offerings in the US and the charter should reflect that.
3. Firms had increasingly recognized some of the risk management issues that arose outside the US. There were already mechanisms whereby the Firms could co-ordinate their policies on these international risk management issues and the Task Force should not attempt to duplicate that role.
4. At present there was no member of the Task Force who was also a member of the Regulations Committee. It was not necessary that there should be but periodically it would be useful for the Chairman of the Task Force to update the Regulations Committee on the work of the Task Force and the projects that it had underway.
5. Independence issues often arose in the context of foreign registrants. Independence was a complex area and while the Task Force had a useful role in making sure that the current views of the staff were understood and disseminated it should not become involved in trying to take the lead on independence issues.
6. There should more emphasis in the charter on the two-way nature of the communication between the profession and the SEC and vice-versa.

A proposed revised charter that has been approved by the Task Force is set out in Attachment A. This will be forwarded to the SEC Regulations Committee for final approval.

Finally it was suggested that the AICPA staff undertake a project to prepare an index and summary of the issues discussed in the official minutes in the past to assist users in retrieving information regarding the topics discussed. A goal was established of having this completed by the next meeting.

IV. SECPS PROPOSED RULE REGARDING INTERNATIONAL AFFILIATES

The SECPS had recently adopted a new membership requirement to enhance the quality of SEC filings by foreign SEC registrants whose financial statements are audited by member firms affiliated with a US member firm. In summary, each US member firm is required to:

- Seek adoption by its affiliated member firms of policies and procedures that address (a) review of SEC filings by an expert partner, (b) practice reviews must now include selected audit engagements performed by such member firms for clients that are SEC registrants and (c) how disagreements, if any, between an expert partner and the audit engagement partner are resolved;
- Report annually to the SECPS, the name and country of each member firm that has advised the US Firm by written representation, that the policies and procedures referred to above were established.

Dick Dieter suggested that it would be useful if a comparison of the various firms' policies to implement the new SECPS requirements could be prepared. The comparison would focus on the nature of the expert review and any specific guidance that would be provided. This could then be considered at the next meeting of the Task Force so that members could consider whether there were any "best practices" that might be shared with the profession. Each member of the Task Force should submit a copy of their policies in this area to Eric Phipps with a copy to Annette by March 1, 2000. Together they would prepare a summary for the next meeting.

V. US CONTACTS IN CONFIDENTIAL FILINGS

At the April 28, 1999 meeting the staff had explained that they were considering certain procedures upon receipt of confidential filings from foreign companies audited by foreign affiliates of US firms and a form letter would ask for the name of the contact that the staff should address inquiries concerning the application of the US firm's policies and procedures to the draft registration statement.

The form letter now being sent out asked for "the name of the representative of [US firm] who the staff may contact with any questions regarding the application of that firm's policies and procedures to this draft registration statement".

It was noted that in some cases, consistent with the new SECPS requirements and existing practices, the responsible person for the staff to contact might be a partner or employee in an overseas Firm rather than a partner or employee in the US firm. However, company/underwriter counsel had sometimes understood the request of the staff to require that a member of the US firm be specified.

The staff confirmed that it was their intention to identify that person who had reviewed the confidential filing who was knowledgeable in accounting, auditing, and independence standards generally accepted in the US, independence requirements of the SEC and ISB, and SEC rules and regulations, i.e. the person specified in the new SECPS rules as the "filing reviewer". The staff has redrafted the form letter to make that more explicit.

VI. MJDS

Mr. Dudek explained that the staff was giving serious thought to recommending that the Commission eliminate the MJDS for Canadian filers. There are a number of perceived shortcomings with the MJDS:

0. The Commission's international strategy has moved away from mutual recognition with other securities regulators towards international harmonization. Consequently, the MJDS model had not been adopted in respect of any other country.
1. Since the MJDS was introduced, there have been various rule changes in the US intended to enhance investor protection, particularly the Plain English and market risk disclosure rules, that do not have counterparts in Canada. Because the MJDS is a separate regime, MJDS filers are not required to comply with these US rules.
2. Few US companies have used the MJDS in Canada, and many of the Canadian companies using the MJDS have done so for US-only offerings rather than joint US-Canada offerings.

VII. CANADIAN FLOW THROUGH SHARES

Wayne Carnall explained that "flow through shares" were typically issued by small Canadian exploration stage companies. The shares permitted the investor to claim deductions for tax purposes related to expenditures incurred by the issuer. The issuer explicitly renounces the right to claim these deductions. The investor's tax basis is reduced by the amount of deductions taken.

The Canadian Institute of Chartered Accountants recently issued a new standard on income taxes (Section 3465 of the Handbook). Under the new standard when the shares are issued they are recorded at their face value. When the entity acquires assets the carrying value may exceed the tax basis as a result of the enterprise renouncing the deductions to the investors. The tax effect of the temporary difference is recorded as a cost of issuing the shares. This standard is consistent with the accounting previously adopted for US GAAP purposes by issuers of flow through shares.

However, the FASB staff has taken the view that under Statement 109 when the shares are issued the proceeds should be allocated between the offering of shares and the sale of tax benefits. The allocation is made based on the difference between the quoted price of the existing shares and the amount the investor pays for the flow through shares (given no other differences between the securities). A liability is recognized for this difference. The liability is reversed when tax benefits are renounced and a deferred tax liability recognized at that time. Income tax expense is the difference between the amount of the deferred tax liability and the liability recognized on issuance.

Attachment B illustrates the differences between the Canadian GAAP model and the FASB staff model. The SEC staff would expect registrants to follow the FASB staff model for US GAAP purposes.

VIII. EFFECT OF ADOPTING CHILEAN BT No. 64 on US GAAP FINANCIAL

STATEMENTS

Under the new Chilean foreign currency standard, BT No. 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 its predecessor and BT No. 64 relates to foreign investments made in unstable environments. Under BT No. 64, effective January 1, 1999 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.

Mr. Carnall had prepared a paper discussing the differences between BT No. 64 and previous Chilean pronouncements as Attachment C. He had also prepared some numerical examples to illustrate the differences.

Mr. Carnall stated that the profession in Chile has reached a common view that the adjustments made in respect of investments in unstable countries were part of a comprehensive basis of adjusting for inflation, and accordingly, differences compared to US GAAP did not need to be eliminated in the reconciliation to US GAAP. The staff indicated it will not object to that conclusion. While not objecting to the conclusion that the application of BT 64 is part of the comprehensive basis of accounting, the staff did express its concern that the standard setters in Chile have changed the accounting model for the consolidation of foreign companies three times in recent years.

The staff would expect Chilean filers to include the following disclosures in the financial statements:

- Description of methodology used to translate foreign operations
- Indication of which countries are considered to be stable vs. unstable
- The amount of the foreign exchange gain/loss included in income that is attributable to operations in unstable countries – i.e., the effect of remeasuring transactions into US dollars.

In addition, MD&A should discuss the effects of the application of BT No. 64 on the registrant's results of operations and explain how the results are affected by changes in currency exchange rates and inflation rates.

Where material and necessary to an understanding of the registrant's results of operations, MD&A should also disclose the following:

- Year-end and average exchange rates. This will allow an investor to estimate the effect of using the year end exchange rates.
- verage rates of inflation for the period. This will allow investors, with the information in the point above, to estimate what the results would have been had the amounts been presented in pesos of equivalent purchasing power.

IX. SEC DEVELOPMENTS

The staff made observations relating to the following recent developments:

. International Disclosure Rules

The staff highlighted certain provisions of the recently issued international disclosure rules. In September the Commission adopted rule changes intended to bring SEC non-financial disclosure requirements for foreign private issuers in line with the international disclosure standards endorsed by IOSCO in 1998. The rule changes incorporate the international disclosure standards into revised Form 20-F. While the IOSCO standards were specifically developed for equity offerings, the Commission has extended their applicability to other registered offerings, listings, and annual reports. The rule changes are effective for reports filed with respect to fiscal years ending on or after September 30, 2000.

Revised Form 20-F includes new Item 8 that specifies the form, content and age of financial statements of the registrant. New Item 8 supercedes Rule 3-19 of Regulation S-X. Items 17 and 18 of Form 20-F have been retained without substantive change. In general, the financial reporting requirements for foreign registrants will not change, except for the age of financial statements in a registration statement.

1. Age of Financial Statements

Item 8.A.4 of revised Form 20-F reduces the period before audited financial statements of the most recent fiscal year are required in a registration statement from 18 months old (6 months after fiscal year end) to 15 months old (3 months after fiscal year end). However, an instruction to Item retains the 18 month period (6 months after fiscal year end) for specified types of continuous offerings where the "blackout" period would be disruptive - outstanding warrants, dividend reinvestment plans, and outstanding convertible securities.

Also, Item 8.A.4 requires that audited financial statements in initial public offerings be no more than 12 months old at the time of filing. However, an instruction clarifies that this applies only where the registrant is not public in any jurisdiction. Further, the instruction indicates that the staff will waive the 12-month requirement where it is impracticable or involves undue hardship. These requirements do not change the due date for filing an annual report on Form 20-F, which continues to be 6 months after fiscal year end.

New Item 8.A.5 effectively reduces the updating period for interim financial statements from 10 months after fiscal year end to 9 months after fiscal year end. If interim financial statements are required, they must cover a period of at least six months.

New Item 8.A.5 also requires financial information more current than the required interim period to be included in a registration statement if

that information has been published. Instructions to this item essentially retain the disclosure provisions of Rule 3-19(f).

2. References to US GAAS in audit reports

New Item 8 requires the annual financial statements to be audited "in accordance with a comprehensive body of auditing standards." An instruction clarifies that in SEC filings and reports the financial statements must be audited in accordance with US generally accepted auditing standards (US GAAS). Public commentaries asked whether this clarification was intended to change the staff's practice of accepting audit reports that state the audit was conducted in accordance with local auditing standards that are "substantially similar" or "similar in all material respects" to US GAAS. As one commenter noted, that practice was adopted to accommodate audit report styles in different jurisdictions that differ from the audit report wording specified by US GAAS. The practice was not intended to relieve the auditor of the responsibility to perform all auditing procedures necessary under US GAAS. The staff does not intend to change our practice of accepting wording variations in audit reports to comply with local reporting formats. In all other respects, however, in order to avoid ambiguity, the report must say that the audit was performed in accordance with US GAAS. This guidance is intended to apply to all foreign private issuers other than those reporting under the Canadian Multi-Jurisdictional Disclosure System (MJDS).

A. UK GAAP and Item 9A of Form 20-F

The U.K. Financial Reporting Standard No.13 Derivatives and other financial instruments: disclosures (FRS 13) requires certain quantitative and qualitative information about market risk to be included in, or incorporated into, the audited financial statements. Similar information is required to be presented under the SEC's market risk disclosure rules (Item 9A of Form 20-F) but General Instruction 6 of that Item states that such information must be presented outside of, and not incorporated into, the financial statements.

The staff has determined that it will waive the requirement of General Instruction 6 to Items 9A(a) and 9A(b) of Form 20-F that the quantitative and qualitative information about market risk be presented outside of, and not incorporated into, the financial statements. This waiver is limited solely to those disclosures under Items 9A(a) and 9A(b) whose inclusion or incorporation in the financial statements is necessary for compliance with FRS 13.

B. True and Fair View Overrides

The staff had recently considered situations in which a registrant had applied the use of the "true and fair override" in UK GAAP to override the specific requirements of a UK accounting pronouncement in their primary financial statements on the grounds that the adopted treatment resulted in a more

true and fair view in the context of the particular facts and circumstances.

In some cases, the override was necessary to address a conflict between the particular requirements of UK GAAP and the Companies Act. For example, Financial Reporting Standard 6 requires certain "group reconstruction" transactions (similar to reorganizations of entities under common control in the US GAAP literature) to be recognized at historical cost. But under the Companies Act, all business combination transactions must be characterized as either acquisitions (purchases) or mergers (pooling of interests). Since a group reconstruction will ordinarily not meet the conditions for merger accounting, an override from the Companies Act is necessary to comply with UK GAAP. The staff may inquire about such a matter to ensure that it is adequately explained to US investors, but would not object to this type of override.

However, in other situations registrants have overridden specific requirements of UK GAAP itself. Generally, the accounting treatments adopted instead of the prescribed treatment have been highly unusual. In some cases, the registrant's adopted treatment appeared to be unique and not identifiable as an accepted accounting practice in any system of GAAP with which the staff is familiar. The staff noted that they would question rigorously the basis on which such an override had been used and the basis on which the auditors had given an unqualified report.

Further the staff has noted situations where a US GAAP reconciling item was provided, even though there was no identifiable difference between the US GAAP pronouncement and the treatment specified by UK GAAP. The practical effect was to reconcile the adopted treatment back to the treatment that management concluded would not provide a true and fair view. The staff will challenge such reporting.

The staff has also challenged the adequacy of disclosure of true and fair overrides. Both UK GAAP and IAS have specific disclosure requirements that include identification of the required treatment from which the enterprise has departed, the nature of the departure, including the treatment that would be required, the reason why that treatment would not give a true and fair view, the treatment adopted and the financial impact of the departure on the enterprise's financial statements. Certain additional disclosures are required under IAS. The staff will expect full compliance with those requirements. In particular the staff has noted poor disclosure about the adopted treatment and its effects. The adopted accounting treatments were unique to the registrant, and a US investor would have no framework to understand or evaluate them. Yet the disclosures were minimal. We would expect full and clear disclosure that not only discusses why an override is necessary, but also clearly describes the adopted treatment, explains how and when it is applied, discloses the key assumptions or estimates inherent in the method, and quantifies its effects on the financial statements.

The staff has noted similar issues with true and fair overrides under IAS.

C. **Auditor Independence - Fairness Opinions in Italy**

The staff position was 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. 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 (Articles 158 and 2501) requires certain opinions about the consideration to be exchanged in certain business combinations, share issuances and non-monetary transactions to be delivered by the company's auditor. The staff would not expect to be in a position to declare effective registration statements that include audit reports where the auditors have also issued this type of report. However, representatives of the accounting profession in Italy have developed an alternative form of reporting for use on these types of transactions when the auditor is subject to US independence rules. The staff will view the alternative report as not impairing the auditor's independence, provided that the auditor represents in writing (and discloses in the filing, where applicable) that the report is not an opinion on the value of the company, the adequacy of the consideration to shareholders, or the fairness of the transaction.

D. **SAB 74**

The staff noted that a number of significant IAS standards with extended transition dates have been issued in recent years. Certain other countries such as the UK also have substantial recent standard-setting activity.

SAB 74 requires that when a new accounting standard has been released but has not yet been adopted, the registrant should discuss the effect that the new standard will have on the registrant's financial statements when adopted. If alternative adoption methods and dates are permitted, the registrant should indicate the anticipated method and adoption date.

The staff wished to remind foreign registrants that the SAB 74 disclosure requirement applied not only to the US GAAP information presented by foreign registrants but also applied to the local GAAP used to prepare the primary financial statements included in SEC filings. Any new accounting standard released but not yet adopted in the primary GAAP should be disclosed in the manner required by SAB 74 in the MD&A.

E. **MD&A**

Recently, the staff encountered several situations where it concluded that the unusual nature or highly material amount of a particular US GAAP reconciling item warranted further MD&A disclosure based on the guidance in SAB 88. In these situations, the following factors indicated the need for additional MD&A disclosure:

- Significant differences in key financial indicators not ordinarily required

to be reconciled, such as revenues or operating income.

- Differences resulting in a significant divergence of trends between home-country GAAP and US GAAP amounts.
- Differences that are likely to grow significantly in future periods because they relate to outstanding long-term contracts with fixed terms.
- Differences related to specialized industry accounting that may be unfamiliar to US investors, particularly where home-country GAAP would not ordinarily be expected to produce significant differences.
- Significant differences reflected in the separate financial statements of a recently acquired business that are not yet fully reflected in the registrant's financial statements.
- Differences reflected in the separate financial statements of an equity method investee, whose effects are not fully apparent in the registrant's financial statements.

The staff believes that an expanded presentation of selected financial data on a US GAAP basis may also be necessary in these circumstances to highlight unusual or highly material matters that might not otherwise be disclosed with sufficient prominence.

X. NEXT MEETING

The Task Force scheduled its next meeting for Thursday, May 11, 2000.