AICPA INTERNATIONAL PRACTICES TASK FORCE
AICPA Washington Office
November 25, 2002

HIGHLIGHTS

The AICPA SEC Regulations Committee's International Practices Task Force (the "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.

ATTENDANCE

Task Force Members

D.J. Gannon, Chairman (Deloitte & Touche)
Wayne Carnall (PricewaterhouseCoopers)
William Decker (PricewaterhouseCoopers)
Melanie Dolan (KPMG)
Roger Jahncke (Ernst & Young)
Debra MacLaughlin (BDO Seidman)
Tim Martin (McGladrey & Pullen)
Peter Nurczynski (Ernst & Young)
Joel Osnoss (Deloitte & Touche)
Eric Phipps (Deloitte & Touche)
Carol Riehl (Grant Thornton)
Michael Walters (KPMG)

Observers

Jill Davis (SEC Observer)
Paul Dudek (SEC Observer)
Randy Green (SEC Observer)
Craig Olinger (SEC Observer)
Annette Schumacher Barr (AICPA)
David Smith (SEC Observer)
Alison Spivey (SEC Observer)
Sondra Stokes (SEC Observer)

AGENDA ITEMS

1. Task Force Operations

The Task Force discussed the following issues related to its operations:

(a) Impact of Sarbanes-Oxley

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The Task Force discussed briefly the potential impact of the Sarbanes-Oxley Act of 2002 on its operations. While there will be changes in the oversight of the profession as a result of Sarbanes-Oxley, the Task Force noted that issues will continue to exist that affect foreign private issuers.

In terms of responding to rulemaking initiatives related to Sarbanes-Oxley, it was noted that the Firms represented on the Task Force generally would be writing their own comment letters on SEC proposals arising from Sarbanes-Oxley. However, the Task Force noted that it could make a particular contribution in developing comments on the practical implications of proposed rule changes in so far as they would affect foreign private issuers. The Task Force agreed that, to the extent possible, it would be willing to provide input to the SEC Regulations Committee.

Ms. Schumacher Barr noted that the SEC Regulations Committee has been developing their response to the SEC's proposed rule on the use of non-GAAP financial measures and disclosures about off-balance sheet arrangements, contractual obligations, contingent liabilities and commitments. Ms. Schumacher Barr solicited input from the Task Force on potential issues that may affect foreign private issuers. Mr. Carnall agreed to draft, for review by the Task Force, comments for potential inclusion in the Regulations Committee comment letter.

(b) Frequency of meetings

Mr. Gannon noted that over the past couple of years the Task Force has dealt with an increasing number of issues and as a result suggested that the Task Force consider changing its meeting schedule and potentially adding a third meeting per year.

The Task Force agreed that its present schedule of two meetings a year, which typically are in May and November, was not the most efficient. The Task Force also agreed that it would be more beneficial to meet earlier than May, which would allow for the consideration of issues that could affect that current 20-F reporting season for calendar year companies. In addition, the Task Force agreed that, to the extent necessary, a third meeting could be held in the summer depending on the number of current issues.

2. Reporting issues related to Andersen foreign affiliates

Following the March 14, 2002 indictment against Arthur Andersen LLP, various foreign affiliates of Andersen had concluded transactions with other Firms whereby generally partners and staff would transfer to another Firm. It was noted that in some cases the foreign firm survived as a legal entity albeit that it was now part of another international organization.

In its Release dated March 18, 2002 (Release 33-8070 or "FR 62"), the SEC addressed circumstances where Andersen was unable to issue a consent or reissue an opinion and in those circumstances permitted the registrant to include a copy of the prior Andersen report in the filing and "make prominent disclosure that the report is a copy of the previously issued … report and that the report has not been reissued by Andersen".

Task Force members discussed their firm's experiences in addressing issues related to audit reports and whether or not they were signing audit opinions in the name of their Firm that would cover those periods where the former Andersen affiliate had previously signed the audit report. The Task Force also discussed the ability to consider the guidance in Question 4 of SAB Topic 1L, *Specific Matters Relating to the Bankruptcy of an Accounting Firm which had Public Company Clients*.

The Task Force noted the following:

- Practice varied depending on the circumstances. In some cases, Firms would determine, based on the specific facts and circumstances, the appropriate level of work necessary in order to sign an audit opinion covering all periods covered in the filing. Factors considered in making this determination, included, among other things, the form of the transaction (e.g., acquisition, merger or purchase of resources) and the applicable guidance in AU 315 (when there is a successor auditor relationship) or Interpretation 15 of AU 508 (when the predecessor auditor's operations have ceased). In other cases, Firms would sign the audit opinion only for the current year and take advantage of the relief in FR 62.
- In circumstances where the former Andersen affiliate continued to practice as a separate legal entity and sign audit reports but had now joined another international organization, it was noted that the audit report typically would refer to the change of affiliation.

3. Highly inflationary status under Statement 52 of certain countries' economies

The Task Force discussed the following issues related to high inflation:

(a) Russia

Since its transition to a market based economy in 1991, Russia's economy generally has been considered hyperinflationary. At its May 2002 meeting, the Task Force discussed the issue of whether or not Russia's economy should no longer be considered hyperinflationary given the recent declines in inflation rates. Mr. Carnall noted that the three-year cumulative inflation rate for Russia has declined from over 100% to approximately 64% at the end of September 2002. He also noted that the current annual inflation rate is approximately 14%.

The Task Force noted that EITF Topic D-55 requires a change in inflationary status to be "other than temporary" before hyperinflationary accounting can cease. Given the facts to date, the Task Force agreed that there was now sufficient evidence to suggest that Russia's decline in inflation was "other than temporary". Consequently, the Task Force agreed that, beginning January 1, 2003, Russia should no longer be considered hyperinflationary, assuming no significant intervening change in the facts.

(b) Argentina

The Task Force briefly discussed developments in Argentina (also see the Addendum to the May 23 minutes reflecting the Task Force's view that the appropriate inflation index to use in Argentina was the Consumer Price Index and that on that basis Argentina's economy was not hyperinflationary).

The Task Force noted that while inflation in Argentina has increased it was unlikely that it would increase to a level where Argentina's economy should be regarded as hyperinflationary commencing January 1, 2003. The Task Force agreed to continue to monitor developments in Argentina.

(c) Venezuela

Mr. Carnall noted that the accounting profession in Venezuela has questioned the Task Force's prior consensus that Venezuela was not highly inflationary beginning January 1, 2002 (see the Task Force meeting highlights for May 3, 2001).

The Task Force noted the current political and economic situation in Venezuela and reaffirmed its previous consensus that Venezuela's economy should not be considered highly inflationary.

(d) Future monitoring of inflation

Mr. Gannon noted that the Task Force historically has dealt with issues related to the inflationary status of individual countries' economies on an ad hoc basis and suggested that the Task Force develop a mechanism for proactively monitoring the inflationary status of countries.

The Task Force agreed that it would be helpful to be more proactive in assessing the inflationary status of countries. Mr. Gannon asked Task Force members to provide any information their firms use in monitoring inflation and that based on that input, a specific proposal for monitoring inflation would be discussed at the next meeting.

4. Issues related to first-time application of IFRS

The Task Force discussed the following issues related to the first-time application of International Financial Reporting Standards:

(a) SAB 74 disclosures

The Task Force noted that SAB 74 was written in the context of adopting a new accounting standard rather than a wholesale change in the GAAP used to prepare the financial statements. While the Task Force agreed that SAB 74 disclosures would not be directly applicable for companies transitioning to IFRS, it did note that it may be useful as a guide in developing MD&A disclosure about first-time application of IFRS.

The Task Force also noted that other disclosures may be relevant, and that the inclusion of an emphasis paragraph in the auditor's report should be considered. AU 9410.15 indicates that the auditor should consider the adequacy of disclosure related to impending changes in accounting principles if those changes will require subsequent retroactive restatement of the financial statements currently being reported on. AU 9410.16 notes that, even if the auditor decides that the disclosure in the financial statements is adequate, he "may decide to include an explanatory paragraph in his report if the effects of the change are expected to be unusually material".

The Task Force noted that the above guidance may be relevant to an auditor issuing an opinion under U.S. GAAS on the home-country GAAP financial statements of a registrant who will, in the future, be required to adopt IFRS.

(b) IASB ED on first-time application of IFRS

Mr. Gannon noted that the International Accounting Standards Board—IASB had issued an exposure draft, ED1, *First-time Application of IFRS*. The Task Force noted that with the issuance of ED1, several disclosure issues will need to be addressed by the SEC, including the impact on comparative periods presented, selected financial data requirements, and the disclosures required in industry guides such as Guide 3 and 6.

ED1 would require that all comparative financial periods presented in an entity's first IFRS financial statements be restated. It was noted that foreign private issuers adopting IFRS in 2005 would need to present IFRS compliant financial statements for two comparative periods (e.g., 2003 and 2004) for purposes of its financial statements included in Form 20-F. It was noted that certain regulators in Europe that currently require two years of comparable financial statements are considering relaxing those requirements in the year a company first applies IFRS. It also was noted that the IASB is considering only requiring one year of comparative financial statements for purposes of an entity's first IFRS financial statements.

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In regards to the issue of restatement of comparable periods, the SEC Staff noted that under existing SEC Rules three years of financial statements prepared using the same basis of accounting are required. *Any* changes to the requirement to present three years of financial statements on a consistent GAAP basis would require the Commission to amend its current rules after appropriate due process.

The Task Force noted that a number of companies will be changing to IFRS and that 2003 likely will be the third year back. Given the significance of these changes in reporting, the Task Force encouraged the SEC Staff to address this issue as soon as possible. The Task Force also noted that ED1 provided for certain exceptions from the general requirement of retrospective application. For example, a company would not be required to restate its previous accounting for a business combination occurring before the date of transition to IFRS.

The SEC Staff noted that it would be interested in understanding any practical or implementation issues related to the first-time application of IFRS.

5. Life of intangible assets: UK FRS 10 v Statement 142

Background

GAAP in some countries, such as the UK, generally require the life assigned to goodwill and other intangibles to be less than 40 years (e.g., 20 years). Many registrants in these countries did not want to create a reconciling difference to increase the life of the asset under U.S. GAAP and, therefore, used the same life for U.S. GAAP reconciliation purposes.

Discussion

The Task Force noted that the SEC Staff often challenges the appropriateness of useful lives assigned to goodwill and other intangibles, particularly when those lives are in excess of 20 years.

The Task Force noted the following, based on recent discussions with the SEC Staff:

- The use of a life under U.S. GAAP that was consistent with the guidance in FRS 10, IAS 22 and other standards around the world that had a maximum life of less than 40 years would be a reasonable explanation as to why 40 years was not used under U.S. GAAP in the past. Historically, it was uncommon for the Staff to issue a comment requiring a registrant to increase the life of an intangible asset. Accordingly, it *generally* would have been reasonable for a foreign private issuer to use the same life under U.S. GAAP as that used in the primary financial statements.
- While the Staff may question why a life of less than 40 years was used in the past in situations where an indefinite life is assigned under Statement 142, the primary focus of the Staff's concern is the acceptability of an indefinite life under Statement 142.
- Registrants will need to support their assignment of an indefinite life under Statement 142, regardless of the life used in the past. In addition, registrants will need to evaluate each asset separately versus all assets in the same class. As a result, some assets of the same class (e.g., brands) may have an indefinite life while others may not.
- There may be conceptual differences between the definition of indefinite life under another GAAP and Statement 142. Accordingly, it is possible that under one standard an intangible asset will have an indefinite life but not under the other.

The SEC Staff also noted that ultimately the determination of useful lives is based on an analysis of the specific facts and circumstances.

6. Income Tax Issues

The Task Force discussed the following income tax issues:

(a) Taiwan tax

Background

In Taiwan, companies are subject to a 25% income tax. Under a revised Taiwan tax rule effective on January 1, 1998, an additional 10% corporate income tax is assessed but only to the extent taxable income is not distributed before the end of the subsequent year. Normally this 10% income tax is determined during the subsequent year when the distribution plan becomes final. The tax then will become due in the second subsequent year (i.e., for income earned in 2000 that is not distributed by the end of 2001, an entity will be assessed the additional tax in 2002).

Once the 10% tax is determined, the company will not be entitled to any additional credit or refund, even if the current year's undistributed earnings on which such tax was based is distributed in future years, in which event the shareholders (but not the company) can claim an income tax credit.

Under Taiwan GAAP, the 10% tax on undistributed taxable earnings is recorded as a tax expense for the undistributed portion in the period in which the shareholders resolve the amount of the earnings distribution.

Conclusion

The Task Force noted that, provided there was no available means whereby an entity could mitigate the effect of the additional tax, the appropriate guidance in accounting for the additional 10% tax was contained in EITF 95-10, *Accounting for Tax Credits Related to Dividend Payments in Accordance with FASB Statement No. 109*. Under the guidance in EITF 95-10, tax is provided at the undistributed rate (in this case 35%) in the period the income is earned, and any reduction in the liability that will arise when the income is distributed is not anticipated, but rather would be recognized in the period in which the distribution plan becomes final.

However, it was noted that in certain cases it may be possible for an entity to mitigate the effects of the tax on undistributed income. For example, a Taiwanese company may be able to avoid the additional tax by paying dividends in the form of stock. Mr. Carnall agreed to obtain further information about the extent to which such a tax mitigation strategy was feasible. The Task Force also noted that if the agreement of shareholders was required for the payment of stock dividends, then in any event such a strategy was not in the control of the company and, therefore, should not be anticipated.

(b) South Africa: Secondary Taxation on Companies ("STC")

Background

Resident companies of the Republic of South Africa are subject to corporate income taxes at a rate of 30%. The South African tax law exempts dividends received from domestic entities from taxation under its tax scheme, in part to avoid double taxation of corporate earnings. However, resident companies are subject to a Secondary Tax on Companies—STC upon distribution of accumulated earnings, equal to 12.5% of such dividends net of the STC tax liability, declared by a company during any dividend cycle. Any excess of dividends received by a company in a relevant dividend cycle, excluding those foreign

dividends which are not exempt from South African income tax, over the dividends paid in such cycle are carried forward by the company to the succeeding dividend cycle as an STC credit.

The imposition of STC, together with the corporate income tax discussed above, effectively imposes a dual corporate tax system in the Republic of South Africa, with a liability for both the 12.5% STC and the 30% corporate income tax. Accordingly, a company without a current period corporate income tax liability would nevertheless have a liability for STC if dividends are paid from prior period accumulated earnings. In addition, a company with both current period earnings and distributions from current and/or accumulated earnings would be liable for both the corporate income tax and the STC on distributed earnings. Thus, the STC creates an effective tax rate on companies of 37.38% on distributed earnings.[1]

The South African taxation scheme exempts capitalization shares distributed (i.e., a stock dividend) in lieu of cash dividends from the STC or other income taxes at both the issuer and investor levels. Due to the favorable tax treatment of capitalization shares, a number of listed South African companies pay dividends in the form of stock rather than cash. However, the STC liability will become payable by the company at some point during the life of the company when accumulated earnings are paid to shareholders, for example, through a merger or liquidation of the company or a share buy-back. In addition, mining companies are exempt from the STC.

Issue

What rate should be used to recorded deferred income taxes under U.S. GAAP?

Conclusion

The Task Force discussed the following two views:

- View A – Distributed rate of 37.78%.
- View B – Undistributed Rate of 30%.

The Task Force expressed a preference for View A. However, at least one member of the Task Force did not believe it was possible on the basis of existing authoritative literature to object to the accounting under View B. The Task Force noted that the current literature was not entirely clear and agreed that the issue be raised to the EITF for further consideration.

The Task Force also discussed, regardless of the accounting that was followed, what disclosures should be provided. Task Force members agreed that disclosures generally should include the basis on which tax liabilities had been computed and, to the extent provision for the STC was made, the amount of undistributed earnings on which such provision has been made. The Task Force noted that all entity's subject to the STC should provide a description of the tax concept (i.e., what it is and how it works) and how they are accounting for the tax (i.e., View A or B).

In cases where a registrant is applying View B, the Task Force agreed the following additional disclosures would be appropriate:

Financial statements

[1] Assume income earned during the year = Rand (R) 1,000, undistributed rate = 30%, STC rate = 12.5%. The effective tax rate is computed as follows: Tax on income earned = R1,000 x 30%= R300. Therefore, undistributed income = R700. This amount includes both the future dividend as well as the STC (i.e., R700 = 112.5% of the future dividend). As a result, the future dividend = R622.22. Therefore, the STC = R622.2 x 12.5%= R77.78. This results in an effective tax rate = 37.78% (R300 + R77.78 = R377.78/R1,000).

- A statement that if dividends are distributed that the company will have to pay taxes additional taxes at a rate of X% on all distributions, and that this amount will be recorded as an income tax expense in the period the company declares the dividends;
- A statement of when the additional taxes will be owed to the government;
- The amount of retained earnings that if distributed would be subject to the tax;
- The amount of tax that would be owed if the company distributed all of the retained earnings that would be subject to the tax; and
- If dividends were declared and additional tax provision recorded during the year an income statement is presented, this item would need to be separately presented in the effective rate reconciliation. That is, the materiality criteria in Rule 4-08(h) of Regulation S-X would not be applied to justify combining with other items. If the registrant is not providing an effective rate reconciliation on U.S. GAAP basis (disclosure of the effective rate reconciliation is presented in the primary financial statements) the effect on the income tax provision would need to be separately disclosed.

The Task Force noted that the information above would be best presented in one section of the financial statements to facilitate a readers understanding of the implications, or at a minimum, should include specific cross references.

Operating and Financial Review (MD&A)

In addition to the disclosures in the financial statements, registrants may need to discuss this issue in its critical accounting policies, provided such disclosures are deemed “critical”. The disclosures should include a statement that some companies with operations in South Africa record deferred taxes at the distributed rate of 37.78%. In addition, the company should quantify and disclose the following on a U.S. GAAP basis as if the tax provision was calculated using the distributed rate:

- Increase (decrease) in the tax provision with an explanation of how that number was determined for each year US GAAP information is presented;
- Net income for all years US GAAP information is presented;
- Deferred tax liability at period end; and
- Equity at period end.

The SEC Staff noted that the existing literature appears unclear, and that the Staff would not object to the application of View A and that it would further consider the acceptability of View B. The Staff subsequently advised the Task Force that it would not object to the application of View B pending further clarification by the EITF. However, the Staff also indicated that registrants contemplating a change in accounting should consult the Staff in advance.

7. Item 512(a) of Regulation S-K – applicability to age of financial statements under Rule 3-09 of Regulation S-X

<u>Background</u>

Item 512(a)(4) of Regulation S-K requires a foreign issuer to include any financial statements required by Item 8.A of Form 20-F at the start of a delayed offering or throughout a continuous offering. The term “8.A” in Item 512(a)(4) replaced the term “Rule 3-19 of Regulation S-X”. Item 8.A technically only applies

to the registrant, but the instructions remind preparers that they need to consider the financial statements required by Rule 3-05, 3-09, etc.

Issue

Could a foreign private issuer take down off the shelf assuming it is current with respect to its own financial statements, but the audited financial statements of an equity investee were older than 15 months but less than 18 months (i.e., the financial statements are not due under the Exchange Act)?

Discussion

The Task Force noted that if the concepts of 512(a)(4) were applied to an equity investee that is a foreign business of a foreign private issuer, it would mean that a foreign issuer would need to update on a substantially more current basis than a domestic issuer to take down off the shelf. To illustrate, assume the following:

- All entities have a calendar year end;
- A domestic issuer and a foreign private issuer each have an equity interest in Company X;
- Both account for the investment in Company X using the equity method;
- Company X meets the definition of a foreign business as defined by Regulation S-X;
- The investments are material to both the domestic and foreign issuer at a level in excess of 20% (i.e., 3-09 financial statements are required);
- Both file their own audited financial statements by March 31, 2002; and
- Both the domestic issuer and foreign private issuer have an obligation to file the 3-09 financial statements by June 30, 2002.

In the above example, the Task Force noted that a domestic issuer could take down off the shelf during the period of April 1, 2002 to June 30, 2002, while a foreign private issuer could not. Domestic companies report interim financial information under the 1934 Act, whereas foreign private issuers have no such obligation under the 1934 Act. However, at the time of adoption of Item 512(a)(4), in all situations, the financial statements would have always been more current for the registrant and an equity investee for a domestic issuer compared to a foreign issuer. Under rules adopted as part of the International Disclosure Standards, the updating requirements for audited financial statements could be the same (i.e., 15 months after year-end).

Conclusion

The SEC Staff indicated that Item 512(a)(4) applies to all financial statements included in a registration statement, including those provided under Rule 3-09 of Regulation S-X. However, the Staff noted that it was not their intent to apply the rules such that a foreign private issuer needed to update a shelf registration statement with more current information in respect of Rule 3-09 financial statements than a similarly situated domestic issuer.

8. Disclosures relating to business combinations when differences exist between U.S. and home country GAAP

Background

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In some cases there may be fundamental and pervasive differences between the accounting for business combinations under home-country and U.S. GAAP. For example:

- The combination is accounted for as a merger (or uniting of interests or a pooling) in the primary financial statements but is a purchase business combination under U.S. GAAP.
- The combination is accounted for as a straight acquisition in the primary financial statements but a reverse acquisition under U.S. GAAP or visa versa.

In both of these situations, virtually all of the amounts for pre-acquisition periods in the primary financial statements would be materially different compared to the amounts presented under U.S. GAAP. In effect, the financial statements presented as the primary financial statements are of a different reporting entity than would be required under U.S. GAAP.

Issue

Is it acceptable to present just a "normal" reconciliation of income and equity in these situations, or are additional disclosures necessary?

Conclusion

The Task Force noted that, in these cases, the SEC Staff generally would expect more disclosure than what is provided in the "normal" reconciliation under Items 17/18 of Form 20-F.

The Task Force noted that each situation is unique and the SEC Staff generally expects more disclosure in these circumstances, including in some instances the presentation of condensed U.S. GAAP financial statements. The following generally is the minimum level of disclosure expected by the SEC Staff:

- The reconciliation should be in sufficient detail to allow a user to understand the differences between the amounts reflected in the primary financial statements and the amounts reflected in the US GAAP reconciliation. For example, if the income statement is pooled for all periods under home-country GAAP, then a columnar reconciliation that removes the acquired business and a separate column with "normal" U.S. GAAP adjustments to reconcile to the U.S. GAAP amounts may be appropriate.
- A U.S. GAAP condensed income statement and cash flow statement for all years presented, in a level of detail that would comply with Article 10 of Regulation S-X, generally would be required for as long as the accounting for the combination resulted in materially different amounts.
- For each year that an income statement is presented for periods prior to and including the acquisition (but not after), a condensed statement of comprehensive income and changes in shareholders' equity using U.S. GAAP balances should be provided.
- For each balance sheet presented for year-ends prior to the year of acquisition, the normal reconciliation of differences should be supplemented with a condensed balance sheet that complies with Article 10 of Regulation S-X. Generally, balance sheet differences in the current year can be addressed in the "normal" reconciliation.
- Financial statement notes that support the income statement on a U.S. GAAP basis (e.g., income taxes, pensions) should be provided.
- Condensed Operating and Financial Review and Prospects using U.S. GAAP amounts balances may be necessary.

Deleted: should include disclosures with respect to the condensed financial statements presented on a U.S. GAAP basis consistent with Article 10 of Regulation S-X.

The SEC Staff did not object to the foregoing as a summary of their expectation as to disclosure when a business combination for local GAAP was accounted for in a manner fundamentally different to that required under U.S. GAAP.

9. Revaluations and land use rights in the People's Republic of China

Background

Over the past 10 years, a number of Chinese state-owned enterprises (SOE's) were reorganized. As part of the reorganization, the SOE's established a wholly owned joint stock company (a shell company) as the listing vehicle (Listco), and the SOE's contributed business assets and liabilities to the Listco in return for shares in the IPO.

Just prior to the IPO, independent valuers, pursuant to PRC government regulations, appraised the assets and liabilities contributed to Listco, which typically included land use rights, as well as, property, plant, and equipment. The land use rights in the PRC are usually granted for a period of time ranging from 30 to 50 years and give the grantee the right to use the land, including the right to erect buildings and plant and equipment on that land; however the title to the land remains with the government. The appraisal formed the basis for the carrying value of the contributed assets. Such revaluations are acceptable under PRC GAAP. Many of the companies that filed with the SEC, however, used International Accounting Standards--IAS to prepare their primary financial statements.

For U.S. GAAP reconciliation purposes, the increase in the carrying value and the related depreciation expense was reversed, as U.S. GAAP requires use of historical cost carry-over basis on transactions between entities under common control.

Issues

The Task Force discussed the following issues:

1. The acceptability of carrying property, plant, and equipment, including land use rights, in financial statements prepared in accordance with IAS at an appraised value without performing subsequent revaluations.
2. The acceptability of revaluing land use rights in financial statements prepared in accordance with IAS.

Discussion

The Task Force noted that there appears to be diversity in practice in the application of IAS to the carrying value of property plant and equipment as well as the accounting for land use rights.

Property, plant and equipment

The Task Force noted at its May 2000 meeting, that the SEC Staff indicated that if registrants using IAS revalue property, plant, and equipment at the time of an IPO, then they effectively have adopted a policy of revaluation accounting and, therefore, should follow all the guidance in IAS 16, *Property, Plant and Equipment* with respect to revaluations. The Staff would expect registrants that have not followed this guidance to restate their financial statements.

The Task Force also noted that in certain privatizations the Staff has permitted the use of fair values in the opening balance sheet. However, these situations were limited to cases where there was no reliable historical cost information.

The SEC Staff noted that it would object to a partial revaluation (of property, plant, and equipment only) based on analogy to purchase accounting under IAS 22, *Business Combinations*, for a transfer of a controlled business to a controlled shell holding company.

It was further noted that, under U.S. GAAP, a revaluation of the assets and liabilities (including land use rights) of the SOE at the date of Listco formation would not be appropriate, but rather all assets and liabilities would be initially recorded at predecessor cost (i.e., SOE's carrying value).

Land use rights

IAS 17, *Leases*

Land use rights could be viewed as being, in substance, leases, and therefore should be accounted for under IAS 17. Under this logic, land use rights generally would be considered operating leases, as they are long-term leases of land, which do not transfer title. As such, they should not be classified as property, plant and equipment, and therefore, would not be subject to revaluations under IAS 16.

IAS 38, *Intangible Assets*

It would appear that land use rights have no physical substance and, therefore, could be viewed as intangible assets under IAS 38. Accordingly, such rights could be revalued, but only in cases where an active market, as defined in IAS 38, exists. If an active market for such assets does not exist, the intangible assets should be carried at cost. It was noted that an active market for land use rights generally does not exist in China at this time.

IAS 40, *Investment Properties*

While IAS 40 currently excludes property held as an operating lease from its scope, the IASB has proposed to amend IAS 40 to allow a property interest that is held as an operating lease to be classified as an investment property assuming that the fair value alternative in IAS 40 is selected. As a result, such rights would be capitalized as finance (capital) leases and recognized at their fair value.

Mr. Gannon noted that, in addition to the proposed amendments to IAS 17 and IAS 40, the IASB is developing new standards that may affect the accounting for land use rights. These include ED1, *First-time Application of IFRS*, and ED3, *Business Combinations*. It also was noted that the International Financial Reporting Interpretations Committee is considering a project on rights of use.

The SEC Staff indicated that it would continue to consider issues related to the accounting for land use rights under IAS.

10. Valuation allowances of pension assets under Canadian GAAP

Background

The Task Force previously discussed this issue at its May 2002 meeting.

Canadian GAAP (CICA 3461) requires that any time a surplus (i.e., the excess of the fair value of a plan's assets over the defined benefit obligation) is recognized as an asset, it should be reviewed for impairment. The impairment test consists of three parts:

- The first step is to isolate the portion of the accrued benefit asset that actually relates to the plan surplus. This is done by reducing the accrued benefit asset by (a) the aggregate of unamortized past service costs, unamortized actuarial losses and any unamortized

transitional obligation over (b) the aggregate of unamortized gains and any unamortized transitional asset (the "adjusted benefit asset").

- The second step is to determine the portion of the plan surplus from which the employer can derive benefit (the "expected future benefit").
- The final step is to compare the expected future benefit with the adjusted benefit asset. If the adjusted benefit asset exceeds the expected future benefit, a valuation allowance is necessary. Allowances and changes to allowances are charged fully to earnings in the periods they arise.

The Task Force noted that Canadian registrants typically have not reported a reconciling difference in the U.S. GAAP reconciliation for the effects of recognizing a valuation allowance.

At its May 2002 meeting, the Task Force noted that U.S. GAAP does not provide for valuation allowances against a pension asset and therefore would expect that valuation allowances recognized under Canadian GAAP be presented as a reconciling item for purposes of the U.S. GAAP reconciliation. The Task Force tentatively suggested that in cases where a Canadian SEC registrant historically has not included a reconciling item for the effects of recognizing a valuation allowance, such amounts should be accounted for prospectively.

Conclusion

At the May 2002 meeting the SEC Staff indicated that it would consider this issue further. After further consideration, the Staff noted that Canadian registrants should account for the effects of not including a reconciling item for the effects of recognizing a valuation allowance as a correction of an error, if material, in accordance with paragraphs 36 and 37 of APB Opinion 20. In evaluating whether an error is material and requires prior periods to be restated, or if the error is immaterial and the correction to eliminate the valuation allowance can be recorded in the current period, the staff indicated that companies and their auditors should follow the guidance in paragraph 38 of APB 20 and Staff Accounting Bulletin Topic 5:F.

11. SEC Staff Issues

(a) Sarbanes-Oxley Act issues

Mr. Dudek noted that the SEC would apply both in letter and in spirit the provisions of the Sarbanes–Oxley Act, especially with regard to disclosure. There were certain issues at the edge where the Commission would need to give further thought as to how the rule changes should impact foreign private issuers, regarding those provisions relating to financial experts and the U.S. GAAP knowledge thereof and those provisions relating to conduct-related matters (e.g. audit committees).

In relation to the proposed rule changes regarding non-GAAP measures, Mr. Dudek noted that the proposed Regulation G would not apply to a foreign private issuer if:

(a) The registrant was listed outside the United States,

(b) The non-GAAP measure was not presented in accordance with U.S. GAAP, and

(c) The disclosure is made outside the U.S. or is included in a written communication released outside the U.S.

In relation to the Commission's proposed rule regarding critical accounting policies, Mr. Dudek noted that until the proposed rule was finalized and implemented, registrants should continue to have regard to the Cautionary Release of December 20, 2001.

(b) Application of new Interpretation of SAS 58 (AU 508)

Mr. Olinger asked Task Force members how their Firms were applying the provisions of the Interpretation of SAS 58 when restatement of the U.S. GAAP reconciliation footnote, but not the primary financial statements, is required.

The Task Force noted that the restatement of such a footnote would require a re-audit of the primary financial statements.

(c) Extractive Industry Issues

The SEC Staff discussed a number of issues related to the extractive industries. A detailed discussion of these topics is included in the Appendix to the Task Force highlights.

(d) Practices and processes for achieving and maintaining consistent interpretation of IFRS

The SEC Staff requested that Task Force members describe briefly their global firm structures and processes for addressing IFRS issues. Task Force members noted their firm's structures and processes, including how they were developing training and competency in IFRS, as well as procedures to encourage the consistent interpretation of IFRS throughout their international practices.

12. Update on impairment of investments under U.S. GAAP and IFRS

The Task Force noted that some have considered there to be a difference in accounting for the impairment of investments under U.S. GAAP and IFRS. U.S. GAAP requires that for individual securities classified as either available-for-sale or held-to-maturity, an entity should determine whether a decline in fair value below amortized cost is "other than temporary" (having regard to the additional guidance in SAB Topic 5 M). While the related IFRS guidance is similar, it does not refer to the notion of "other than temporary" declines in value (see paragraphs 109 and 110 of IAS 39).

The Task Force also noted that the SEC Staff's position appears to be that, in practice, it is unlikely that a difference would exist and that, in cases where a registrant believes that, based on their specific facts and circumstances, a GAAP difference exists; the Staff expects to be consulted.

Mr. Gannon noted that, as part of the IASB's proposed amendments to IAS 39, the language in regards impairment of assets would be amended to be more consistent with the terminology in U.S. GAAP.

13. Actuarial assumptions used by pension plans in Brazil

Background

At its May 2002 meeting the Task Force discussed several issues related to the use of actuarial assumptions in respect of pension arrangements in Brazil. At that meeting, the Task Force tentatively concluded that:

- The Brazilian government security should be considered a variable rather than a fixed rate security as it is linked to inflation. Consequently, that security could not be used as a basis for the discount rate.
- In general, foreign registrants should have regard for the local rating scheme in making the determination of whether or not a security is considered "high quality".

HIGHLIGHTS

- The rate of return on high quality zero-coupon bonds, as well as other actuarial assumptions, should be expressed in nominal terms.
- The rates of return on assets should be determined separately from the discount rate.

Discussion

It was noted that the accounting profession in Brazil had been discussing these matters following the Task Force's May discussion, but that no additional views or considerations in Brazil had surfaced and that discussions are continuing.

14. Update on the analysis of IPTF issues by country

Mr. Carnall noted that certain revisions had been made to the analysis of Task Force issues by country and that a marked draft had been circulated to Task Force members for review. Mr. Carnall requested that comments on the revised summary be provided so that Ms. Schumacher-Barr could arrange for its publication on the AICPA website early next year. *[**Note:** Subsequent to the meeting, the analysis was finalized. See* http://www.aicpa.org/download/belt/iptf2003_01.pdf

DATE OF NEXT MEETING

The Task Force agreed to meet on March 4, 2003.

SEC Staff Comments Regarding Extractive Industries

I. Asset retirement obligations under Statement 19 and SAB 92

The SEC Staff noted the following regarding the calculation and disclosure of depreciation, depletion and accumulated retirement obligations.

- Estimated future costs should not be used in the calculation of depreciation, depletion and accumulated retirement obligation rates.
- When site restoration costs, post-closure and monitoring costs, or other environmental exit costs are expected to be incurred at the end of the useful life of the asset, these exit costs should be accrued over the useful life of the asset. Refer to Question 8 of SAB 92, *Accounting and Disclosures Relating to Loss Contingencies: Site restoration costs, post-closure and monitoring costs, or other environmental exit costs.*

In addition, certain asset retirement obligations may now be within the scope of Statement 143, *Accounting for Asset Retirement Obligations*.

II. Issues related to the extractive industries – mining activities

The SEC Staff indicated that the Commission's Mining Engineering Staff are available to discuss Industry Guide 7 reserve determination and disclosure items prior to filing a registration statement or other disclosure document with the Commission.

Costs and prices used in determining depreciation, depletion and accumulated retirement obligation provision rates

The SEC Staff noted the following in regards the costs and prices used in determining depreciation, depletion and accumulated retirement obligation provision rates:

Reserve quantities used to calculate depreciation, depletion and accumulated retirement obligation provision rates should be derived from Industry Guide 7 reserves, calculated using consistent price and cost assumptions (refer to paragraph (a)(1) of Industry Guide 7).

Disclosure of other than proven and probable reserves

The SEC Staff stated that, as indicated in Industry Guide 7, companies are not allowed to disclose possible reserves, unless the registrant is a foreign private issuer and it is required by law or statute, not just *permitted* by law or its stock exchange, to disclose that information in its home country.

Consistency between reserve quantities used under Industry Guide 7 and reserve quantities used in determining depletion, depreciation and amortization rates and asset retirement obligation provision rates

Background

The determination of proven and probable reserves, as defined by Industry Guide 7, is required prior to the capitalization of mine development costs. Accordingly, the reserve quantities used to measure the financial results of a mining operation are also limited to proven and probable reserves.

Typically a mining company will amortize its capitalized mine and production equipment and its asset retirement obligations using the units of production method and the amount of proven and probable reserves is a key variable of the units of production amortization calculation. Proven and probable reserve quantities are also used to assess and measure long-lived mine asset impairment.

Generally, the proven and probable reserve quantities are either located under ground (un-mined) or contained in unprocessed materials that have been removed from the mine.

The mineral content of the material included in the unprocessed materials, which are frequently accumulated in stockpiles, generally determines whether and when the materials will be processed and the related accounting treatment for the associated costs. For stockpiled material that the company determines it will process, usually based on internally developed mineral quantity and grade content criteria, the associated costs are capitalized as either current or long-term inventory and commonly referred to as stockpiled inventory or in process inventory.

Reserve quantities used in financial statement measurements

The SEC Staff noted that, unless management has reasonable certainty that these reserve quantities will actually be processed, proven and probable reserve quantities contained in stockpiled inventory should not be recognized and used for financial accounting and reporting purposes. This is the case, even though it is possible that these reserve quantities may meet the Industry Guide 7 criteria to be classified as proven and probable reserves if it is expected they will be economic to process.

The Staff also noted that the proven and probable reserve quantities attributable to stockpiled inventory should be classified as inventory and accounted for as processed when they are removed from the mine. These reserve quantities should not be included in the total proven and probable reserve quantities used in the units of production depreciation, depletion and amortization calculations.

The Staff stated that it expects companies to disclose its accounting policy for stockpiled inventory and how it uses the proven and probable reserve quantities attributable to stockpiled or other inventory in its financial accounting.

The Staff also stated that the Industry Guide 7 reserve quantity disclosures should specifically disclose the following related stockpiled and other inventories for each mine:

- The amount of proven and probable reserve quantities attributable to them;
- The time period over which the proven and probability reserve quantities are expected to be processed; and
- Whether or not costs have been capitalized as inventory in the balance sheet, and, if so, whether any inventory write-downs have been recognized.

Exploration stage property acquisition costs

The SEC Staff stated that the acquisition cost for an exploration stage mining property should generally be viewed as an exploration expense and expensed as incurred. The Staff acknowledged that acquired exploration properties are often unique and encourage registrants to contact the Staff to discuss their specific facts and circumstances.

Deferral of post-production stripping costs

Background

The SEC Staff noted that, in the mining industry, companies that use open pit mining methods are required to remove overburden and other waste materials to access mineral deposits. The costs of removing waste materials are referred to as 'stripping costs.' During the development of a mine, before production commences, it is generally accepted that stripping costs are capitalized as part of the depreciable cost of building and constructing the mine. The mining company must continue to remove waste materials as it mines the mineral deposits during the production stage of the mine.

In practice, some companies expense these post-production stripping costs as incurred, while others defer these stripping costs using a life-of-mine based accounting model, which is commonly referred to as "deferred stripping".

Under the deferred stripping accounting model, a company estimates what the total post-production stripping costs will be throughout the mine's production life, and then develops a "life-of-mine stripping ratio", calculated as estimated total post-production stripping costs divided by the estimated total proven and probable reserves. This ratio is then used to calculate the current period production cost charged against earnings by multiplying the stripping ratio times the reserves mined during the period.

Because the concentration of the mineral deposits is not evenly distributed throughout the mine, there are periods during the life of the mine where the company is mining more (or better quality) reserves as the waste is removed. Of course, there are also periods during the life of the mine where the company is mining lesser (or lower quality) reserves as the waste is removed. As a result, the amount that is charged against earnings in the current period (based on the stripping ratio) will not, necessarily, equate to the actual production costs during the period. The company records a deferred stripping cost asset (when the actual costs incurred to date exceed the normalized costs to date) or a deferred stripping cost liability (when the normalized costs to date exceed the actual costs incurred to date).

Disclosure and financial statement classification

The Staff indicated that it is currently evaluating the accounting for postproduction stripping costs and expects companies engaged in mining activities to include the following disclosures in its financial statements and operating and financial review (MD&A).

Financial statements

Balance sheet:

Deferred charges and credits should be reported as separate line items apart from the property, plant and equipment and long-lived assets.

Statement of cash flows:

The cash activity associated with deferred stripping should be classified as a component of operating cash flows rather than investing cash flows.

Disclosure of significant accounting policies:

- Disclose the accounting methods used to measure and recognize production stage deferred stripping costs and credits. We expect this accounting policy to be disclosed in its own discrete section in your accounting policy footnote.
- Clarify when and under which circumstances mining costs associated with waste rock removal are deferred.
- Disclose the method used to defer and amortize post-production stripping costs.
- Define the term waste-to-ore ratio.
- Define the reserve quantities used to develop the waste-to-ore ratio.
- Disclose how deferred stripping costs or credits are evaluated for loss in value.
- Explicitly state that the accounting for stripping costs smoothes the cost of waste-rock removal over the life of the mine rather than expensing the actual waste removal cost incurred in each period.
- Disclose that there is mixed accounting practice in this area and that some mining companies expense waste removal costs as incurred, which policy, if followed, may result in the reporting of greater volatility in period to period results of operations.
- Disclose where deferred amounts are reported in the balance sheet and where amortized amounts are reported in the statement of operations.

Other footnote disclosures:

- Indicate whether the deferred stripping accounting resulted in an increase or a decrease to production costs as compared to actual costs incurred for each period presented.
- Disclose that the full amount of postproduction stripping costs incurred will not be expensed until the end of the mine life.
- Disclose the year that the deferred costs and credits are expected to be fully amortized.
- Disclose the balance of deferred stripping costs or credits as of each balance sheet and the related amount amortized for each period an income statement is presented.

Operating and Financial Review (MD&A) and/or disclosure of critical accounting policies

- Disclose the waste ore ratio used by each mine for each income statement period presented. Explain significant changes from period to period. To the extent the changes result in a material change in estimate, include all disclosure required by paragraph 35 of APB Opinion 20.
- Identify changes in this ratio from period to period; explain why the changes occurred and how these changes will impact your financial results.
- Disclose the extent to which the life of mine waste-to-ore ratio differs from the actual waste-to-ore ratio encountered during the period.
- Indicate whether the deferred stripping accounting resulted in an increase or a decrease to the reported ore grade extracted as compared to the actual ore grade extracted for each period presented.