AICPA INTERNATIONAL PRACTICES TASK FORCE
AICPA Washington Office
March 4, 2003
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)
Paul Curth (Ernst & Young)
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)
Susan Koski-Grafer (SEC Observer)
Craig Olinger (SEC Observer)
Annette Schumacher Barr (AICPA)
Alison Spivey (SEC Observer)
Sondra Stokes (SEC Observer)

ROGER JAHNCKE RETIREMENT

This was Roger's last Task Force meeting before his retirement from Ernst & Young. The Task Force wished to record their appreciation of Roger's time as a member of the Task Force. Roger was one of the early members of the Task Force. The Task Force joined in thanking Roger for all the time, professionalism and expertise he has devoted to the Task Force and its mission.

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AGENDA ITEMS

1. Monitoring inflation in certain countries

Background

At the last meeting of the Task Force in November 2002, 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.

Proposed approach

Mr. Gannon proposed that the Task Force should regularly consider the inflationary status of a number of countries for the purpose of determining whether they were highly inflationary as defined in FASB Statement 52. It was proposed that inflation rates be monitored regularly (monthly to the extent possible) in order to identify cases where the Task Force could discuss a country's inflationary status. Based on the cumulative inflation information, countries would be categorized as follows:

1. Countries that are clearly highly inflationary (i.e., that have cumulative inflation approaching or exceeding 100%).
2. Countries with increasing cumulative inflation rates that should be monitored.
3. Countries that are clearly not highly inflationary (i.e., with sufficiently low cumulative inflation).

Assumptions

The following assumptions were developed as a means of screening countries in order to determine whether the Task Force should discuss their inflationary status:

- Inflation rates used would be based on a consumer price index, unless otherwise noted. Where an index other than the CPI is used, the Task Force would need to discuss the appropriateness of the index.
- Inflation information would be derived from the "International Financial Statistics" on the IMF website. In cases where information is not provided to the IMF, local sources would be used (e.g., country central bank data).
- Countries with cumulative inflation rates not exceeding a certain level, say 70%, generally would not be considered highly inflationary based on quantitative factors alone. However, qualitative factors ultimately would be considered pursuant to EITF Topic D-55, as deemed necessary by the Task Force.
- Countries with cumulative inflation rates between 70% and 100% would be assessed for highly inflationary status given recent trends, based on the guidance in EITF Topic D-55. For example, in cases where the cumulative rate has declined below 100%, is that decline "other than

temporary"? Or, in cases where the inflation rate has been increasing, is the cumulative rate at a level that "approximates" 100%? In addition, countries with a significant increase in inflation during the current period would be monitored.

In certain cases inflation information is not updated regularly. In such cases the following was proposed:

- Where a country was previously considered highly inflationary (i.e., the last known cumulative inflation rate previously exceeded or approached 100%), presume that still highly inflationary.

- Where a country was previously not considered highly inflationary (i.e., the last known cumulative inflation rate did not previously exceed or approach 100%), deduce the current inflation rate necessary in order to exceed 100% (the "deduced rate"). The deduced rate would be calculated solely for the purpose of determining whether or not the Task should analyze a particular country's inflationary status. The ultimate determination of that status would depend on all relevant facts and circumstances.

    - If deduced inflation rate for the current period(s) exceeds a certain level, say 30%, then presume that not highly inflationary unless the deduced rate is consistent with the trend in recent known periods.

    - If deduced inflation rate does not exceed a certain level, say 30%, then presume highly inflationary unless the deduced rate is not consistent with the trend in recent known periods.

The Task Force generally agreed with the approach as proposed and added that qualitative factors should also be considered. The Task Force noted that the existence of objective and verifiable evidence would be necessary for a country to no longer be considered highly inflationary.

Depending on the limited nature and significance of the business conducted in a particular country, it may not be necessary to track that country's inflationary status. It also was noted that the categorization of those countries considered highly inflationary would be made available generally on the AICPA website.

Based on information presented, it was noted that the inflationary status of Argentina and Venezuela should continue to be monitored. Depending on future developments, consideration will be given to a conference call to discuss the situation prior to June 30, 2003.

The SEC Staff noted that registrants should consider the need for disclosure in description of business, risk factors, and MD&A regarding operations that either are or trending toward highly inflationary status.

Mr. Gannon agreed to circulate to the Task Force updated inflation data.

2. Income tax issues from previous meeting

(a) Taiwan tax

Background

At the meeting of the Task Force in November 2002, issues related to the tax regime in Taiwan were discussed. In Taiwan, companies are subject to a 25% income tax on taxable income but, under a revised Taiwan tax rule effective on January 1, 1998, an additional 10% corporate income tax is assessed on taxable income but only to the extent such taxable income is not distributed before the end of following year.

The Task Force had concluded that provided there was no available means whereby an entity could mitigate the effect of the additional tax, the appropriate guidance in accounting for this tax was contained in EITF 95-10. Under EITF 95-10, tax is provided at the undistributed rate (i.e., 35%), in the period the income is earned and the reduction in the liability that arises when the income is distributed is not anticipated.

The Task Force understood that it was possible for a Taiwanese company to avoid the additional tax by paying dividends in the form of stock and that a number of Taiwanese companies did follow this route. It was agreed that further information would be obtained regarding the extent to which such a tax mitigation strategy was feasible.

Conclusion

Mr. Jahncke confirmed that shareholder approval was required for the payment of stock dividends. Consequently, the Task Force confirmed its earlier view that such a strategy was not in the control of the company and it should not be anticipated.

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

Background

At is meeting in November 2002, the Task Force discussed issues related to the tax regime in South Africa. Resident companies of the Republic of South Africa are subject to corporate income taxes at a rate of 30% based on the taxable income during the current tax year. However, resident companies of the Republic of South Africa are subject to a Secondary Tax on Companies (STC) upon distribution of accumulated earnings of 12.5% based on the dividends, net of the STC tax liability, declared by a company during any dividend cycle. 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 the liability for both the 12.5% STC and the 30% corporate income tax, determined separately. The South African tax scheme provides an exception from the STC for mining companies.

There was general agreement within the Task Force that providing for taxes at the distributed rate (an effective rate of 37.78%) was preferable to only providing for taxes at the rate of 30% and accounting for STC as and when the actual liability to the taxing authority arose. However, it was noted that the existing literature was not conclusive and, as a result, the Task Force suggested that this issue be considered by the EITF. The SEC Staff had noted they would not object to either approach subject to appropriate disclosure, and consideration by the EITF. It also was noted that the highlights of the November 2002 Task Force meeting outline the disclosures that would be necessary in these circumstances.

Conclusion

Mr. Gannon noted that a paper had been submitted to the EITF Agenda Committee for its consideration. It was noted that given the differences between U.S. GAAP and IAS, the FASB Staff suggested that this

issue be referred to the FASB and IASB as part of their convergence efforts on accounting for income taxes.

The Task Force noted that until a final decision is taken on this issue, the disclosures identified in the November 2002 Task Force highlights would still be applicable.

3. Meaning of "expressly permits" under the non-GAAP financial measures release

Background

In Release 33-8176, the SEC adopted new rules relating to the use of non-GAAP financial measures in filings with the Commission. New Item 10 of Regulation S-K placed certain restrictions on the use of non-GAAP financial measures in filings and, where the non-GAAP financial measure was permitted to be disclosed, required certain additional disclosures. Amongst other things, the new Item 10 (e) (ii) provides:

> *(ii) A registrant must not:*
>
> *(A) Exclude charges or liabilities that required, or will require, cash settlement, or would have required cash settlement absent an ability to settle in another manner, from non-GAAP liquidity measures, other than the measures earnings before interest and taxes (EBIT) and earnings before interest, taxes, depreciation, and amortization (EBITDA);*
>
> *(B) Adjust a non-GAAP performance measure to eliminate or smooth items identified as non-recurring, infrequent or unusual, when the nature of the charge or gain is such that it is reasonably likely to recur within two years or there was a similar charge or gain within the prior two years;*
>
> *(C) Present non-GAAP financial measures on the face of the registrant's financial statements prepared in accordance with GAAP or in the accompanying notes;*
>
> *(D) Present non-GAAP financial measures on the face of any pro forma financial information required to be disclosed by Article 11 of Regulation S-X (17 CFR 210.11-01 through 210.11-03); or*
>
> *(E) Use titles or descriptions of non-GAAP financial measures that are the same as, or confusingly similar to, titles or descriptions used for GAAP measures; and….*

However, a Note to paragraph (E) states:

> *"A non-GAAP financial measure that would otherwise be prohibited by paragraph (e)(1)(ii) of this section is permitted in a filing of a foreign private issuer if:*
>
> *1. The non-GAAP financial measure relates to the GAAP used in the registrant's primary financial statements included in its filing with the Commission;*
>
> *2. The non-GAAP financial measure is required or expressly permitted by the standard-setter that is responsible for establishing the GAAP used in such financial statements; and*
>
> *3. The non-GAAP financial measure is included in the annual report prepared by the registrant for use in the jurisdiction in which it is domiciled, incorporated or organized or for distribution to its security holders."*

(a) UK GAAP example

At it's meeting in May 2002, the Task Force had discussed the use of alternative per share amounts in SEC filings by foreign registrants. At that meeting, it was noted that paragraph 25 of UK standard FRS 3 states, in part:

> "If an additional [i.e. other than basic earnings] per share amount calculated at any other level of profit is presented it should be…reconciled to the amount required by the FRS."

The SEC Staff had concluded that provided the registrants fully complied with the requirements of home country GAAP in presenting such alternative per share amounts, such measures could be presented in SEC filings. However, in light of the new release on non-GAAP measures, the issue was whether the wording in the UK standard was such that it "expressly permits" alternative per share amounts.

(b) French GAAP example

In France, the following French extract from CRC 99-02 on consolidation rules addresses non-GAAP financial measures:

> "[Model financial statements] are presented…indication purposes, however the existing line items are considered as minimal requirements, if deemed significant. Other items, than those presented in the attached tables, can be chosen by companies only if their definition is provided in the notes to the financial statements."

Discussion

It was noted that practice in a number of jurisdictions, including the UK, was to have various forms of presentation intended to highlight what a particular item would have been had it not included a specified amount. While such practices are considered to be acceptable in the home jurisdiction, the resulting amounts may not be "expressly permitted", as the SEC Staff applies the new rules.

The Task Force noted that one likely consequence would be that the home-country GAAP financial statements released in the home jurisdiction (and likely furnished under cover of a 6-K) would continue to include the accepted forms of presentation but that when the company came to file its Form 20-F it would delete those items that the Staff would determine objectionable.

It was further noted that investors may find confusing two different sets of financial statements. In many instances individual investors may read an entity's annual report more frequently than the Form 20-F. The fact that there is different information in an entity's Form 20-F may not be known to a large number of investors.

Conclusion

The SEC Staff indicated that it would further consider the issues noted by the Task Force. The Staff did note that discussions within IOSCO had indicated that regulators in other jurisdictions were becoming increasingly concerned over non-GAAP measures. As a result, IOSCO issued a "Cautionary Statement" regarding non-GAAP measures in 2002 (see the IOSCO web site at www.iosco.org).

Subsequent to the Task Force meeting, the SEC Staff issued Frequently Asked Questions Regarding the Use of Non-GAAP Financial Measures. Question 28 addresses the meaning of "expressly permits".

4. FIN 46 issues

In January 2003, the FASB released Interpretation 46 "Consolidation of Variable Interest entities" (FIN 46). FIN 46 requires that an entity meeting the definition of a variable interest entity (VIE) be consolidated by any entity that meets the definition of being the primary beneficiary. The primary beneficiary is the entity that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns or both. In order to make that determination, an entity needs to consider the rights and obligations conveyed by its variable interests and their relationship to the variable interests held by other parties.

(a) Impact of secrecy laws

Background

VIEs might be structured so that other investors or holders of variable interests were incorporated in jurisdictions where "secrecy" laws made it illegal for them to respond to queries that would allow a registrant to determine its relative interest in the VIE and thus make it impossible to conclude whether they or some other party was the primary beneficiary.

Discussion

In practice, Task Force members had not yet come across this as an issue. The Task Force noted that it would be more difficult to get information in certain jurisdictions than others, but if the investor in a VIE was preparing U.S. GAAP financial statements or financial statements that were reconciled to U.S. GAAP, it would need to ensure it, and its auditors, had access to appropriate information. Otherwise, the auditors would likely need to consider a scope limitation.

(b) Transition provisions of FIN 46 relating to foreign private issuers

Background

Paragraph 27 of FIN 46 states that

> "A public entity with a variable interest in a variable interest entity created before February 1, 2003, shall apply the provisions of the Interpretation (other than the transition disclosure provisions in paragraph 26) to that entity no later than the beginning of the first interim or annual reporting period beginning after June 15, 2003".

Issue

How do the transition provisions of FIN 46 affect Foreign Private Issuers (FPIs)?

Conclusion

Previously, the Task Force had considered how the transitional provisions of Statement 142 applied to foreign private issuers and noted that EITF Topic D-86 contained the Staff's views as to when financial statements should be regarded as "issued".

The Task Force believed that the matter raised in EITF Topic D-86 was not relevant to this issue. If the entity prepared information (including reconciliations) that was intended to present fairly under U.S. GAAP it needed to apply FIN 46 in the preparation of that information to the extent FIN 46 was already effective. Consequently, assuming in each of the following scenarios that the company has a calendar year end:

- If the FPI only reports U.S. GAAP information annually, it would not have to report under FIN 46 until December 31, 2004, although it should apply FIN 46 from the beginning of that year.
- If the FPI reports U.S. GAAP information every quarter but each quarter the only information presented is cumulative from the beginning of the year as opposed to reporting information for each quarter, it would not need to apply FIN 46 until the first quarter in the year ended December 31, 2004.
- If the FPI reports U.S. GAAP information quarterly and reports both cumulative and quarterly, it would begin to report under FIN 46 as of and for the three months ended September 30, 2003 and should begin to apply FIN 46 from July 1, 2003.

The Task Force noted that for purposes of applying FIN 46, the reporting periods beginning after June 15, 2003 are those reporting periods presented in accordance with U.S. GAAP. It was irrelevant as to whether a company discloses U.S. GAAP information that is less detailed than that required by Article 10 of Regulation S-X.

5. References to GAAP reconciliations in audit reports

Introduction

For information purposes, the Firms represented on the Task Force responded to a short series of questions regarding their policies on references to reconciliations in audit reports.

Issues and summary of responses

Firm's policies as to whether or not they include an additional paragraph.

- Two firms do not include an additional paragraph.
- Two firms have a policy is that it is optional but is generally preferred.
- Two firms require the use of an additional paragraph.
- Generally, the additional paragraph language is similar.

Where Firms do use an additional paragraph, does it draw any distinction between a complete reconciliation and a reconciliation that takes advantage of certain exemptions in Form 20-F?

- Only one firm's policies recognize this in the additional paragraph in the audit report.

While the auditors' report already makes clear that management is responsible for the financial statements, is it clear from the language that management has responsibility for the GAAP reconciliation footnote?

- No Firm appears to have any additional language in this respect.

Is the paragraph in the audit report regarded as an additional explanatory paragraph, which should be referred to as such in our consent language?

- Only one firm regards it as such.

The Task Force agreed to consider further whether or not to include language in the additional paragraph making clear management's responsibility. It was proposed that each Task Force member consider whether their firm could accept language along the following lines:

> "Accounting principles generally accepted in [registrant's country] vary in certain significant respects from accounting principles generally accepted in the United States of America. Management has disclosed the effect of the application of accounting principles generally accepted in the United States of America on results of operations for each of the years in the three-year period ended December 31, 20X2 and stockholders' equity as of December 31, 20X2 and 20X1, in Note X to the (consolidated) financial statements."

The Task Force agreed to further discuss this issue at its next meeting.

6. Dormant accounts in European banks

Background

Although written in the context of UK banking institutions, the following issue arises more generally.

In the U.S., dormant bank accounts are turned over to the State. The AICPA Accounting and Auditing Guide on Banks relating to the escheat laws states, in part:

> "**11.12** Institutions generally have a policy on classifying accounts as dormant. The required period of inactivity before savings accounts are classified as dormant normally exceeds that for checking accounts because savings accounts are normally less active. After a specific period of inactivity, as determined by the state in which the institution is located, the accounts may no longer be deposits of the institution and may be required to be turned over to (escheat to) the state".

In some countries, such as the UK, where there are no escheat laws, the customer has a legal right to claim deposit with interest in perpetuity.

Under UK GAAP, banks release the liability into income over a period of time based on expectations that the customer will not reclaim the amount held on deposit. If a claim is subsequently made, the liability is re-established and charged as an expense.

Issue

Is this a reconciling difference between U.S. GAAP and home-country GAAP where such amounts were released into income?

Discussion

In the U.S. banking environment, state "escheat laws" apply to unclaimed property, which includes stock certificates and securities, dividend checks, bank accounts, insurance benefits, trust fund distributions, uncashed and unclaimed money orders, traveler's checks, payroll or vendor checks, and credit balances. Such unclaimed property that has not been paid to the rightful owner within a specified period of time, usually between one and five years, must be transferred to the state of the owner's last known address. If the owner's address is unknown, the funds must be remitted to the company's state of incorporation. The Task Force was not aware of similar escheat laws in the UK.

Therefore, in the U.S., dormant account liabilities are removed when the dormant bank account balances are handed over to the states (i.e., debit liability and credit cash rather than crediting income).

Conclusion

As noted at the December 2002 AICPA Annual National Conference on Current SEC Developments (the "2002 Conference"), the SEC believes that companies should look to paragraph 16 of SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (a replacement of FASB Statement 125)* ("SFAS 140") for guidance when it is possible that a liability could remain on the books for an indefinite period of time if the customer does not require performance. Paragraph 16 of SFAS 140 states:

> "A debtor shall derecognize a liability if and only if it has been extinguished. A liability has been extinguished if either of the following conditions is met:
>
> a. The debtor pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes delivery of cash, other financial assets, goods, or services or reacquisition by the debtor of its outstanding debt securities whether the securities are canceled or held as so-called treasury bonds.
>
> b. The debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor."

The Task Force did not believe that the dormant accounts have met either criteria (a) or (b) above. Consequently, where such amounts are being released to income, the Task Force believed this was at variance with Statement 140. As a result, there should be a UK/U.S. GAAP reconciling item.

The SEC Staff noted that it discussed at the 2002 Conference the accounting for unfulfilled performance obligations such as those related to gift certificates. The Staff noted that unredeemed gift certificate receipts could be recognized as revenue if the amount is non-refundable and the company concludes,

based on extensive evidence, that the likelihood of the customer requiring the company to fulfill its performance obligation is remote. The Staff further noted that it would not analogize dormant bank accounts to gift certificates, because gift certificates involve a revenue generating activity governed by SAB 101. Dormant bank accounts do not involve a revenue-generating activity and should be accounted for as unextinguished liabilities under Statement 140.

Registrants that have unique situations in which they believe that a liability should be eliminated despite not satisfying the derecognition criteria in Statement 140 are encouraged to discuss them with the SEC Staff.

7. UK audit reports

Background

The auditor's duty of care under the UK Companies Act is to the shareholders as a group who appoints and pays for their service. Consequently, they can bring an action against the auditors to recover loss suffered by the company that was caused by the auditors' negligence.

An extension of a duty of care to third parties can arise through the law of tort under which third parties may bring a claim on the basis that a duty is owed to them by the auditor as a result of particular circumstances. Case law in the UK has historically required some act of contact with the third party in order for sufficient proximity to arise for a claim in tort to be successful. This proximity would require the auditor to have knowledge that a particular third party would be relying on the audited financial statements for a particular purpose.

In a recent case in Scotland, Royal Bank of Scotland v Bannerman Johnstone Maclay and others *("Bannerman"),* the Court interpreted the tests of proximity such that no contact between the third party and the auditors is required. Instead, the auditor merely has to come across information in the ordinary course of their audit that indicates that a third party is likely to rely on the audited financial statements for a particular purpose and the auditor has not disclaimed any duty or liability to that third party.

In this case, Royal Bank of Scotland (RBS) lent money to APC Limited (APC) that was audited by Bannerman – Chartered Accountants. The Court ruled that Bannerman should have known that RBS was relying on its opinion on the financial statements because they would have reviewed the loan agreements that contained the provision about providing the audited financial statements to RBS. The court further ruled that based on this knowledge, Bannerman had a duty of care to RBS unless they (Bannerman) expressly disclaimed such responsibility in the auditor's opinion.

The UK accounting profession does not believe it has a duty of care to third parties in situations such as Bannerman case. As the Court ruled that, absent a disclaimer of responsibility, the auditor has a responsibility to third parties, the UK profession had concluded it was appropriate to include such a disclaimer of responsibility to those third parties in the auditor's report. The Institute of Chartered Accountants in England and Wales ("The Institute") issued a technical release in January 2003 entitled *The Audit Report and Auditors' Duty of Care to Third Parties* to specifically address the implications of this case. It recommended auditors provide specific language regarding a disclaimer of responsibility in their report and suggested the following wording:

> *This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's*

> *members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.*

Issue

Can such language or a modification thereof be included in audit reports filed with the Commission?

Discussion

The Task Force understood that one Firm, PricewaterhouseCoopers, concluded that the opinion presented above would not be acceptable for filings with the Securities and Exchange Commission. PwC had developed for the purpose of U.S. filings a modification to the recommended language above as follows:

> ***This report is intended solely for the information and use of the company's members and for such other persons as are entitled to rely on it under United States Federal and State securities laws and regulations and is not intended to be and should not be used by anyone other than these specified parties. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.***

Conclusion

The SEC Staff noted that on February 28, 2003, the Director of the Division of the Corporation Finance and the Acting Chief Accountant of the Commission had written to Mr. Peter Wyman, President of the Institute of Chartered Accountants in England and Wales relating to this matter and had stated that the Bannerman language or variants thereof would not be acceptable in SEC filings.

8. Inclusion of post-acquisition results of joint ventures under Rule 3-05

Background

The SEC Staff are willing to consider the inclusion of post-acquisition audited results of acquirees in determining a registrant's compliance with Rule 3-05, on the basis that the results of the acquiree are included in the consolidated results of the registrant post-acquisition. If a registrant wishes to include the post-acquisition period in meeting the requirements for Rule 3-05 financial statements by a combination of pre and post acquisition periods, the Staff will require that the pre-acquisition period be audited up to the date of acquisition such that there is no discontinuity in audited periods. Also, while the SEC Staff has required that this relief only be available when specifically pre-cleared with the Staff, they have not generally objected to the proposal.

Issue

Does this "accommodation" apply to recently acquired joint ventures that are accounted for, post-acquisition, by proportional consolidation under home-country GAAP (i.e., when the registrant does not have to reconcile-out the effects of proportional consolidation)?

Discussion

The Staff does not require Rule 3-09 financials for proportionally consolidated entities that would be accounted for under the equity method under U.S. GAAP that meet the conditions for the accommodation specified in Form 20-F. The Task Force, therefore, believed that logic also should be applied in the context of financial statements provided under Rule 3-05. As a result, it would appear that the "accommodation" also should apply to entities using proportionate consolidation.

The SEC Staff noted they would likely not object to the Rule 3-05 financial statements provided in respect of an acquired entity accounted for under proportional consolidation in compliance with home country GAAP taking in to account the post-acquisition periods for which the acquired entity was included in consolidated financial statements (subject to pre-clearance as for any situation where the registrant wished to take advantage of this accommodation).

9. Updating financial statements under Item 8.A. 5 of Form 20-F

Background

A foreign private issuer has a year-end of December 31. It wishes to go effective with an IPO before March 31, 2003. It proposes to include in its Form F-1 the following annual statements:

- Audited financial statements for years ended December 31, 1999, 2000 and 2001.
- Unaudited interim financial statements for 6 months ended June 30, 2002 and June 30, 2001.

The above are in local GAAP with a reconciliation to U.S. GAAP (except 1999). The company has received a waiver of the 12-month requirement and thus intends to comply with the 15-month requirement of Item 8.A.4 of Form 20-F. However, before going effective it will release in its local jurisdiction audited (in accordance with local GAAS) financial statements for the year ended December 31, 2002.

Issue

What information would need to be presented in the filing in respect of the year ending December 31, 2002?

Discussion

There are at least three options in respect of the information to be included in the filing:

(1) Supplemental summarized data: Provide supplemental summarized data related to the year ended December 31, 2002 that is consistent with the information released locally. This information would be included in the recent developments section of the prospectus.

(2) Supplemental audited financial statements: Provide the audited financial statements for the registrant prepared in compliance with local GAAP and audited in compliance with local GAAS.

(3) Update the financial statements: Update the financial statements included in the Form 20-F to the most recently audited period (as of and for the year ended December 31, 2002) including a

reconciliation of the financial statements to U.S. GAAP and an audit in accordance with US GAAS.

If either option (2) or (3) above is applied, the following questions exist:

- What impact does this have on selected financial data?
- What impact does this have on MD&A?
- Where within the document are these financial statements included?

The financial statements proposed to be included in the filing appear to comply with the age requirements of Item 8.A.5 of Form 20-F.

The guidance in Regulation S-X, Rule 3-12(c) states that if a filing is made near the end of a fiscal year and audited financial statements for the year are not included in the filing, then the filing shall be updated with such audited financial statements if they become available prior to the anticipated effective date.

However, Regulation S-X, Rule 3-12(f) allows that if a foreign private issuer's fiscal year end audited financial statements are not included in the filing, then the filing shall be updated with such audited financial statements if they become available prior to the anticipated effective date. Regulation S-X, Rule 3-12(f) allows foreign private issuers to file financial statements whose age is specified in Item 8.A. of Form 20-F. That item requires that the audited financial statements may be up to 15 months after year end and that the most recent financial data, which does not need to be audited, may be up to 9 months after year end. Item 8.A.5 (and Instruction 3 thereto) also states that if interim financial information is published by the Company that is for a period more recent than that included in the document it must be included in the filing. This item, however, does not specifically address the situation in which there are financial statements available that have been audited under local GAAS.

Conclusion

The Task Force believed that Instruction 3 to Item 8.A.5 is applicable to both interim periods and subsequent audited periods. The information that has been provided in the local jurisdiction should be included in the filing. This would be consistent with Option 2 above.

The Task Force noted that, in addition to the approaches above, an issuer may include unaudited financial statements (i.e., financial statements with no local or U.S. GAAS audit report included). The Task Force also noted that if an issuer used an Option 3 approach, then the updating requirement would be applicable for all items.

The SEC Staff noted that they would not object to an Option 2 approach and in particular noted that:

- This information does not require reconciliation to U.S. GAAP. There would be disclosure of the fact there are differences between local and U.S. GAAP and a reference to the footnotes provided elsewhere in the filing. In addition, to the extent that additional GAAP differences had arisen since the last reconciliation included in the filing they should be described and quantified.

- The financial statements do not need to be audited in accordance with U.S. GAAS. If the audit report is included along with the supplemental information it is simply because the audit report forms part of the information that has been published locally.

- The rest of the registration statement document (including MD&A, industry guide, and selected financial data) does not require updating for this information. Naturally, because a registration statement does speak through the date of effectiveness, if that information were to reveal important things about the company's operations or liquidity or capital resources, then those underlying matters would need to be addressed in MD&A. For example, if there were to be deterioration in performance or liquidity, this would need to be disclosed in MD&A (but that would be true regardless of whether the most recent financials were included in the filing or not).

- The information cannot be filed as an Exhibit but must be in the body of the prospectus.

- An issuer's obligation to file a Form 20-F annual report the year ended December 31, 2002, containing U.S. GAAS audited financial statements that are reconciled to U.S. GAAP as required by Rule 13a-1.

10. Currency exchange restrictions in Venezuela

Background

The Task Force noted that in February the Government of Venezuela introduced restrictions on the exchange of Venezuelan currency for U.S. dollars and made exchanges deriving from particular or "non-qualifying" transactions subject to Government approval.

Subsequent to the Task Force meeting, additional restrictions have been put in place. On March 26, 2003, Venezuela began to release the specifics of its new exchange-control regime. The government published lists itemizing approximately 6,000 imported products that will enjoy priority in the allocation of foreign currency. The broad categories granted priority treatments are foodstuffs, medicines and agro-industry products. Companies interested in purchasing foreign currency will also be required to obtain certifications from the corresponding ministries that the goods they wish to import are unavailable locally.

Issue

These events have raised a practical issue as to the appropriate foreign exchange rate(s) that could be used for remeasurement purposes and translation of financial statements. This would be particularly the case for entities that are required to file financial statements for periods ending after January 22, 2003 (i.e., the last date of market activity for the Bolivar).

Discussion

The Task Force believed that U.S. GAAP does not permit the use of a black market exchange rate since such a rate was not objectively determinable. Instead, transactions should be translated at the official

exchange rate and if there was more than one official exchange rate depending on the type of transaction (e.g., dividend remittances), then the appropriate exchange rate should be used.[1]

In addition, the Task Force noted that issues may exist as to whether or not consolidation by an overseas parent of a Venezuelan entity continues to be appropriate. However, it was noted that at this time it would not be appropriate to deconsolidate Venezuelan operations absent any other control considerations as the lack of exchangeability does not appear to meet the "other than temporary" threshold in paragraph 26 of Statement 52.

The need to continue consolidation of Venezuelan entities, coupled with the fact that no transactions have occurred at the official rate raises a practical issue as to the appropriate foreign exchange rate(s) that could be used for remeasurement purposes and translation of financial statements. There would appear to be two appropriate rates that could be used in the current circumstances in Venezuela where lack of exchangeability exists.

The stated governmental rate of 1,600 VEB

This rate was established by the Venezuelan government as the legal rate to be used for converting Bolivar into US Dollars from February 6, 2003 until further notice. While no transactions have occurred yet at that rate as a result of the imposed Venezuelan government currency restrictions, this is the rate at which transactions would be exchanged under the current situation.

The most recent market rate as of January 22, 2003, of approximately 1,900 VEB

This rate represents the last rate at which transactions took place prior to the currency restrictions. While transactions may not be exchanged at this rate, it may represent better evidence of the current exchange rate in the absence of any subsequent transactions.

Disclosure considerations

Given the current situation, whatever rate is used for remeasurement purposes or translation of financial statements may not be reflective of economic reality. Accordingly, additional disclosure may be necessary. Potential disclosures that would be relevant include the following:

- Summarized financial information (level of detail required by 1-02(bb) of Regulation S-X) on the Venezuelan operations in a note to the financial information in dollars with the exchange rate that was used. This information would have to reflect the parent company's basis (e.g., push down goodwill recorded in consolidation).
- Disclosure of the exchange rate that is used.
- Disclosure of the net monetary assets and liabilities by currency - (e.g., bolivars, dollars, etc.)

In addition, it may be helpful to include in MD&A disclosure of the impact of a change of 100 VEB in the exchange rate - income statement, equity and balance sheet implications. For example, if the rate changes from 1,600 to 1,700 VEB, what is the impact?

[1] This discussion was predicated on the fact that transactions could occur at that rate.

The SEC Staff indicated that it would not object to the above.

11. SEC staff issues

(a) Reviews of foreign filers

The Staff noted that following the Fortune 500 Review, the Division of Corporation Finance would be adopting the same review approach to approximately 30 of the largest foreign registrants based on their December 30, 2001 20-Fs (assuming calendar year ends).

(b) Extractive industry issues

The SEC Staff discussed a number of issues that have arisen in recent reviews of entities in the extractive industries. A detailed discussion of these topics is included in the Appendix to the Task Force highlights.

(c) Land Use Rights in the PRC

Background

As discussed at prior meetings of the Task Force, a number of Chinese state-owned enterprises (SOE's) were reorganized and registered with the SEC. As part of the reorganization, the SOE's would establish a wholly owned joint stock company (a shell company) as the listing vehicle (Listco) and the SOE's would contribute business assets and liabilities into the Listco as capital contributions in return for the issuance of shares. Independent appraisers valued the assets and liabilities contributed to the Listco, including land use rights and tangible property, plant and equipment, just prior to the IPO, pursuant to PRC government regulations. This appraisal value formed the carrying value of the contributed assets in the accounts of Listco. This is acceptable under PRC GAAP for local reporting purposes. Many of these companies that filed with the SEC used IAS in their primary financial statements.

While there was diversity under IAS, property plant and equipment and land use rights contributed by the PRC government were, in many cases, carried at the appraisal value and amortized over their estimated useful lives. In the PRC there is no private ownership of land and companies will effectively rent the land for a period of time. For U.S. GAAP reconciliation purposes, the increase in the carrying value and the related deprecation expense was reversed. This was necessary because U.S. GAAP requires use of historical cost carry-over basis on transactions between entities under common control.

Conclusion

The Staff indicated that it now believes that land use rights are more akin to operating leases and not tangible assets. Therefore, since such rights are not considered tangible assets, they should not be carried at revalued amounts under IAS 16.

The Task Force noted that in some instances land use rights 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.

Given the diversity in practice noted, the Task Force suggested that it would be necessary to discuss transitioning to the Staff's view where entities accounted for land use rights as tangible assets. Mr. Gannon and Mr. Carnall agreed to further discuss this issue with the Staff.

DATE OF NEXT MEETING

The Task Force agreed to meet on July 15, 2003.

Issues in the Extractives Industry

Reserve determination

A contract or a binding letter of intent is required to be in place to establish proven and probable reserves when there is no spot market for a mineral.

Industrial minerals

There are no spot markets for industrial minerals. As a result, the staff has traditionally required a sales contract or binding letter of intent to buy the industrial mineral to provide evidence that the company has the ability to sell the industrial mineral, before the staff would accept proven and probable reserve designation.

The amount of industrial mineral quantities covered by a contract is commonly less than the total reserves available to mine. Proven and probable reserve quantities can exceed the quantities covered under the contract, assuming that company expects that it will continue to be able to economically sell the industrial mineral in quantities that equal or exceed total proven and probable reserve quantities.

For situations when a contract is not in place, those minerals may be designated as an industrial *non-reserve material* (e.g., salt material, gravel material) with related quantities reported in the appropriate measure. To disclose a quantity of non-reserve material, a company must be able to demonstrate that the reported quantities exist by sufficient drilling and/or sampling to provide evidence that continuity exits between drill holes or sampling points before the staff would accept the disclosure of an industrial material quantity.

Background on industrial minerals

Industrial minerals are rocks and minerals not produced as sources of metal and exclude mineral fuels, such as coal, tar sands and oil shale. Common industrial minerals include sand and gravel, various clays, salt and gypsum. Less common industrial minerals include garnet and industrial diamonds used for abrasives. There is no spot market for industrial minerals and suppliers are required to actively market their product directly to customers.

Characteristics of industrial minerals:

- Most sales of industrial minerals are made by using independently negotiated contracts.
- Industrial minerals are commonly available compared to the market size.
- The common variety or bulk industrial minerals, such as sand and gravel, are very heavy compared to their value.
- The use and composition of the industrial mineral is often highly specific to a customer's needs.

Characteristics of industrial minerals producers:

- Several suppliers will commonly compete in any market or area.
- Access to the industrial sale market may be limited by the relationships in place and the buyer's ability to assess or evaluate the credit and performance risk of a new industry participant.
- The marketing staff is significantly larger, compared with the production staff, than a precious or base metals producer.
- Geographical scope of operations is often limited by the cost to transport the industrial mineral.

Inventory costing

All direct costs and certain indirect costs of producing a product are required to be included in the cost of inventory, including but not limited to the depreciation of mine development cost and mining production equipment. In other words, like other companies, mining companies should use full absorption inventory costing for U.S. GAAP.

Heap leach "inventory" accounting

Background

Heap leach refers to a "coffee filter like" production process where broken rock is placed onto a lined pit (leach pad). Cyanide is poured onto the heap of broken rock and drains through it and then flows through tubes to collect the "metal laden chemicals" at the bottom of the leach pad. The metal laden chemicals are then processed to separate the metals from the chemicals, etc.

Determination of a current asset

The determination of a current vs. long-term asset must only include production from materials on the leach pad as of the balance sheet date. The staff has noted companies that consider production from materials placed on the leach pad after the balance sheet date in their calculation of current inventory. For U.S. GAAP, the staff will object to the use of that approach to determine the amount of current assets contained in the leach pad.

Financial statement and other disclosure

As indicated below, where material, the staff expects companies with current assets contained in the leach pad to report these as separate balance sheet items and to refer to them as materials contained in the leach pad. There should be specific accounting policy disclosure of how the estimates are made, as well as critical accounting policy disclosure. These heap leach-related disclosures should be separate and apart from accounting policy disclosures concerning underground mining, or the mining of materials from stockpiles where non-heap leaching processes are employed, such as mill stockpiles. Suggested presentation and disclosure are noted below.

Balance sheet presentation

(a) Report the cost of materials currently contained on the leach pad as a separate line item apart from inventory if material. The line item caption should not be referred to as inventory, but rather one such as "*materials on the leach pad*" or "*broken ore on the leach pad*". The cost of materials currently contained on the leach pad that are not material should be classified as a component of other assets.

Financial statement footnote disclosure

(b) Expand the accounting policy note to disclose how the amount of *materials on the leach pad* classified as current or long term is determined.

Disclosures outside the financial statements (*Critical accounting policy disclosure)*

(c) Explain how costs relating to *materials on the leach pad* are captured and classified from the time materials are extracted from the mine to the final sale. This description should identify key stages in this conversion process.

(d) Provide a description of the heap leaching process. Without limitation, this description should explain the extent to which additional processing is required to bring the metal contained in the leach pad to a salable form and how additional processing costs are considered in the valuation of the materials on the leach pad.

(e) Disclose the length of time it takes for gold, silver, copper, and/or other metal to be recovered from the leach pad.

(f) Highlight to investors that the estimation of the quantity of metal contained in the leach pad is inherently imprecise and explain why.

(g) Explain how management assesses the effectiveness of its assumptions used to estimate metal quantity and recovery.

(h) Identify the assumptions used by management to measure metal content during each stage of the materials on the leach pad conversion process.

(i) Describe the techniques used to develop these assumptions, including, but not limited to: quantities, grade and recovery.

(j) Identify circumstances that may change assumptions and how changes in those assumptions impact financial position and results of operations.

(k) Provide a sensitivity analysis that presents the dollar impact of changes in key assumptions used to measure quantity and metal content on the balance of materials on the leach pad and net income, for each key assumption used. Without limitation, provide like disclosure for recovery and your quantity estimates.

(l) Explain that the ultimate recovery is unknown until leaching is completed at the end of the leach pad's life.

(m) Disclose when current leaching operations are scheduled to cease.

Current asset UK vs. U.S. GAAP difference

The current asset concept under UK GAAP differs from the "consumed in the operating cycle" concept that U.S. GAAP has under ARB 43, CH 3A, paragraph 4.

Assets that will not be converted to cash or consumed during the operating cycle may include: restricted cash or current investments, long-term accounts receivable and long-term inventory. Balance sheet classification differences related to differences between U.S. and UK GAAP should be identified in the U.S. GAAP reconciliation footnote.

Management's discussion and analysis, liquidity discussion should identify UK GAAP current assets that will not be used or converted to cash in the next 12 months, which generally represents the operating cycle.