# AICPA INTERNATIONAL PRACTICES TASK FORCE
## AICPA Washington Office
## September 27, 2004 (also incorporating the October 14 conference call)
## 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)
Bill Decker (PricewaterhouseCoopers)
Jon Fehleison (KPMG)
Tim Martin (McGladrey & Pullen)
Peter Nurczynski (Ernst & Young)
Joel Osnoss (Deloitte & Touche)
Eric Phipps (Deloitte & Touche)
Mike Santay(Grant Thornton)
Michael Walters (KPMG)

Observers

Jill Davis (SEC Observer)
Paul Dudek (SEC Observer)
Susan Koski-Grafer (SEC Observer)
Craig Olinger (SEC Observer)
Georgene Palacky (SEC Observer)
Annette Schumacher Barr (AICPA)
Sondra Stokes (SEC Observer)

**AGENDA ITEMS**

**1. Inflationary status of certain countries**

**Background**

At the March 2003 meeting of the Task Force, it was agreed that inflation rates be monitored regularly in order to identify cases where the Task Force could discuss a country's inflationary status under Statement 52. Based on the cumulative inflation information, countries would be categorized as follows:

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

See the highlights from the March 2003 meeting for the assumptions developed as a means of screening countries in order to determine whether the Task Force should discuss their inflationary status.

Based on the screening process, only the Dominican Republic had inflation rates above 70% (actually over 100%) since the last Task Force meeting. Of the countries with three-year cumulative inflation rates below 70%, no new countries had annual inflation for 2004 above 30%. In addition, Turkey's three-year cumulative inflation rate has dropped below 100%.

**Issues**

- Have there been any changes in Venezuela that would impact our prior conclusion?
- Should Turkey no longer be considered highly inflationary?

**Conclusion**

The Task Force noted that the three-year cumulative inflation rate in Venezuela is still below 100% (based on data through August 2004). The Task Force noted that if the three-year cumulative inflation rate exceeds 100% by December 31, 2004, then Venezuela would be considered highly inflationary beginning January 1, 2005.

Subsequent to the September 2004 meeting, the Task Force agreed to revisit its prior conclusion that absent any significant changes before the end of 2004, Venezuela should be considered highly inflationary beginning January 1, 2005. The Task Force noted that inflation in September 2004 was .45%, which is well below recent months. The Task Force also noted that forecasted inflation for the remainder of the year is expected to result in three-year cumulative inflation of approximately 94% through December 31, 2004. Given current trends, the cumulative inflation rate in Venezuela is expected to decline in 2005 without ever reaching 100%. In light of these developments, the Task Force concluded that unless the three-year cumulative inflation rate exceeds 100% by December 31, 2004, Venezuela would not be considered highly inflationary beginning January 1, 2005. The Task Force also agreed to continue to monitor inflation developments on a monthly basis.

The Task Force noted that Turkey's three-year cumulative inflation rate dropped below 100% in July 2004. As a result, the Task Force discussed whether Turkey should no longer be considered highly inflationary. The Task Force discussed the current economic environment and noted that at this time there was not sufficient evidence to conclude that the decline in inflation was "other than temporary" as discussed in Example B in EITF Topic D-55. Therefore, the Task Force agreed that Turkey should continue to be considered highly inflationary through December 31, 2004. The Task Force will revisit inflation trends at its next meeting.

The Task Force also agreed to publish a more complete list of those countries it considers to be highly inflationary and those to be monitored (see Appendix A).

**2. PCAOB standard 3 on audit documentation**

The Task Force agreed to defer discussion until a later meeting.

**3. Development Stage Entities and Foreign Private Issuers**

**Background**

The Staff Training Manual indicates that the disclosures required by Statement 7 for development stage companies should be provided since they are part of the primary financial statements. Such disclosures include the following:

- Reference to development stage in heading
- Reference to development stage and cumulative data in auditor's report
- Cumulative columns in the statements of operations and cash flows
- Reference to development stage in equity section of statement of financial position
- Details of equity issuances prior to earliest period presented
- Development stage footnote

The Task Force noted that practice regarding the inclusion of the above disclosures has varied.

**Issue**

Are the disclosures in Statement 7 required to be included in the local GAAP primary financial statements for foreign private issuers filing under Item 17 of Form 20-F?

**Conclusion**

The SEC Staff indicated that Statement 7 disclosures are not required for Item 17 filers. The Staff did note that such disclosures are still required for Item 18 filers, which may be made on the face of the primary financial statements or in the footnotes.

**4. IFRS issues**

**(a) Status of SEC proposed rule on first-time adoption of IFRS**

**Discussion**

In March 2004 the SEC approved Release No. 33-8397, *First-Time Application of International Financial Reporting Standards*. The proposal addresses certain matters relating to the first-time application of IFRS in the context of financial statements filed with the SEC and, in particular, the issue of whether three years of income statements would need to be presented in the year of adoption on the basis of consistent GAAP.

The SEC Staff noted that the responses to the proposed rule change had been broadly supportive, and that they continued to work on developing the final rule for release as soon as possible after due process within the Commission. The Staff also noted that the proposed accommodation to permit two years of IFRS financial statements is intended only for registrants that fully comply with IFRS. Also see item 4(d) below for a discussion of IAS 39 and the European Commission.

**(b) Non-GAAP measures**

**Discussion**

The Task Force noted its prior discussions on non-GAAP measures, particularly with regard to established reporting practices in the United Kingdom. Certain Task Force members noted that questions have arisen as to the appropriateness of such measures in the context of IFRS adoption, and more specifically, whether the approach to such disclosures discussed at the November 2003 Task Force meeting would continue upon a registrant's adoption of IFRS.

The Task Force noted that some practitioners outside the United States believe that the practices under U.K. GAAP are consistent with IFRS. Given its prior discussions on non-GAAP measures, Task Force members noted their expectation that such practices would not continue upon the adoption of IFRS.

The SEC Staff noted that the approach noted in the November 2003 Task Force highlights should not be assumed to be applicable for companies adopting IFRS. FAQ 28 of the June 13, 2003 *Frequently Asked Questions Regarding the Use of Non-GAAP Financial Measures* states that a measure is expressly permitted if the particular measure is clearly and specifically identified as an acceptable measure by the standard setter that is responsible for establishing the GAAP used in the company's primary financial statements included in its filing with the Commission.

The Staff also indicated its intention to discuss with other regulators the evolving practices under IFRS relating to financial statement format.

**(c) Application of IFRS 1 accommodations**

**Background**

Companies adopting IFRS for the first-time may make certain one-time elections under IFRS 1 that may create differences from U.S. GAAP that will continue in perpetuity and result in companies maintaining separate records and information. Such elections relate to the following areas:

- Business combinations;
- Fair value or revaluations as a "deemed cost";
- Cumulative translation difference;
- Employee benefits; and
- Designation of previously recognized financial instruments;

To illustrate, a company may elect to reset their cumulative translation adjustment ("CTA account within shareholders equity to zero as of the beginning of the earliest period presented in accordance with IFRS (e.g., January 1, 2004). Under U.S. GAAP, the CTA account would still exist and be included within stockholders equity. Such a difference would exist until the company disposes the investment in the entity that generated the CTA. A difference also would be created on disposal of the entity, which would result in the release of the CTA through the income statement for U.S. GAAP purposes (but not for IFRS purposes).

**Issue**

Would the SEC allow a one-time adjustment to opening balances under U.S. GAAP to conform to IFRS for such items?

**Discussion**

The SEC Staff noted no precedent for allowing such adjustments to the U.S. GAAP balances. The Staff also noted that it will be monitoring first-time and subsequent application of IFRS, including any differences between IFRS and U.S. GAAP relating to issues addressed in IFRS 1 before making any recommendations on future relief to foreign private issuers using IFRS.

**(d) IAS 39 and the European Commission**

The European Commission is proposing to "carve out" certain provisions in IAS 39 for purposes of acceptance within the European environment. Such provisions relate to the use of the fair value option and certain provisions relating to hedge accounting.

**Issue**

- Would the SEC Staff accept such statements as being in compliance with IFRS?
- How would this impact a company's ability to use the proposed accommodation regarding first time adopters of IFRS?

**Discussion**

Subsequent to the September 2004 Task Force meeting, the SEC Staff indicated that companies electing to follow the IAS 39 "carve out" would not be able to assert compliance with IFRS (at least in regards to the hedging provisions). Therefore, such financial statements would need to be described in some other manner.

The Staff also indicated that IFRS with the IAS 39 carve-out, like many other GAAPs, appears to be a comprehensive basis of accounting and therefore should be acceptable in an SEC filing when reconciled to U.S. GAAP as contemplated by Form 20-F. However, as financial statements on this basis would not be compliant with IFRS, they would not be eligible for any of the relief proposed in the SEC's release on first-time adoption of IFRS.

**5. SEC Staff issues**

**(a) Division of Corporation Finance organizational update**

The SEC staff briefly described the following recent staffing and organizational developments in the Division of Corporation Finance:

- The Division currently employs approximately 500 staff members, 250 of whom are accountants.

- Several candidates for accounting positions are in process of being interviewed.

- Two new Associate Chief Accountants have been hired: Sondra Stokes and Rachel Mincin. In addition, Stephanie Hunsaker has been hired as an Assistant Chief Accountant.

- David Sherman has been selected as an Academic Accounting Fellow in the Division.

- Each of the 11 industry offices has selected 1-3 Accounting Branch Chiefs who will supervise the work of staff accountants and report to the respective Senior Assistant Chief Accountants.

**(b) PCAOB registration**

The SEC staff asked the Task Force whether there were any particular issues relating to registration by foreign audit firms. None were noted.

**(c) Parent-only schedule under Rule 5-04/4-08(e)(3)**

The SEC Staff reiterated the requirement to provide parent-only condensed financial statements where the restricted net assets of consolidated subsidiaries exceed 25% of consolidated net assets at most recent fiscal year end. The Staff noted that a number of foreign private issuers had Chinese subsidiaries that constituted the greater part of group operations but where there were governmental restrictions on the ability to make distributions outside the PRC. It was noted that this will primarily be an issue with respect to those companies incorporated in Bermuda, BVI, and similar countries in which substantially all of the operations are in the PRC. In addition, the SEC Staff indicated that the PRC is not the only country that has restrictions on the ability to make distributions and that all companies, domestic and foreign, with operations outside of their country of incorporation need to evaluate the restrictions on currency movement to comply with this rule.

**(d) Impact of New Canadian Regulations permitting US GAAP Financial Statements on the Staff Accommodation regarding Canadian-incorporated Registrants on Form 10-K that use Canadian GAAP with an Item 18 Reconciliation**

**Background**

Foreign-incorporated registrants that do not meet the foreign private issuer definition must file on domestic forms and follow U.S. GAAP. However, the Staff has a long-standing practice, applicable only to Canadian-incorporated registrants, of accepting Canadian GAAP financial statements with an Item 18 U.S. GAAP reconciliation rather than U.S. GAAP financial statements in filings on Forms 10-K and 10-Q.

Prior to March 30, 2004, this accommodation was based largely on Canadian securities regulations that required Canadian- incorporated companies to use Canadian GAAP in their Canadian filings.

Effective March 30, 2004, Canadian securities regulations have been changed to permit Canadian-incorporated companies that also file with the SEC to use U.S. GAAP as their primary basis of accounting in their Canadian filings. When a registrant elects to report using U.S. GAAP, the Canadian regulations require the registrant to recast all comparative periods.

**Issue**

In light of the recent change in Canadian securities regulations, does the SEC Staff accommodation continue to be necessary?

**Discussion**

The SEC Staff indicated that if Canadian companies were allowed to use U.S. GAAP to comply with their reporting requirements in Canada they did not believe the long-term continuation of the accommodation was necessary or appropriate. It was noted that even though the securities regulations had changed, corporate law in certain jurisdictions (e.g., Ontario, Canada Business Corporations Act) still required the use of Canadian GAAP.

The Task Force agreed that if Canadian companies were not required to use Canadian GAAP, that the accommodation should be eliminated (i.e., all companies regardless of country of incorporation that are legally a domestic issuer should be subject to the same rules). The Task Force agreed an appropriate amount of lead time would be necessary before this change became a requirement. The Task Force agreed to discuss this issue further at a future meeting.

Subsequent to the meeting, the Government of Canada published proposed revisions to the Canada Business Corporations Act (CBCA) that, if adopted, would permit the use of U.S. GAAP financial statements in Canadian filings by CBCA incorporated companies that are SEC registrants.

**(e) Rule 3-10 – 100% test for Mexican subsidiaries**

The SEC Staff noted that it had previously issued "no action" letters in respect of the disclosure requirements of Rule 3-10 on the basis of understanding that in Mexico it was not possible for a subsidiary to be "100%-owned" as the law required two shareholders. It had come to the Staff's attention that certain structures could be put in place in Mexico to ensure that a subsidiary did indeed meet the definition in Rule 3-10 of 100%-owned. The Staff indicated that it would expect registrants to avail themselves of such structures in order to qualify for reporting relief.

**(f) Extractive Industries Update**

See Appendix B for a discussion of recent issues identified by the SEC Staff in regards to the extractive industries.

**6. Reporting issues**

**(a) Canadian compilation reports**

**Background**

Historically, the SEC Staff has accepted the inclusion of a compilation report from Canada on pro forma information provided certain additional disclosures were provided to warn a U.S.

reader of its limitations. The Staff's International Reporting and Disclosure Issues outline indicates the following:

> *"In some countries, compilation reports by independent accountants on pro forma information may be included in registration statements used in cross-border offerings pursuant to requirements in the foreign country. While such reports normally would not be allowed in US filings, the staff will not object to the inclusion of a compilation report provided that the registration statement includes a statement from the independent accountants that addresses the following items:*
>
> - *The opinion is included solely to comply with the requirements of the particular jurisdiction;*
> - *U.S. GAAS does not provide for an expression of an opinion on a compilation of pro forma financial statements;*
> - *To report in conformity with U.S. GAAS, an examination greater in scope than that performed would be required; and*
> - *No opinion is expressed under U.S. GAAS.*
>
> *Presentation of these comments in the manner in which the Canadian Institute of Chartered Accountants recommends for differences between U.S. and Canadian reporting standards would be acceptable. The registration statement should include a letter from the independent accountants acknowledging the use of the report."*

Pursuant to AT201 under U.S. GAAS, an agreed upon procedures report must be a restricted report (i.e., no duty of care to third parties). The revised Canadian report contains certain elements that would ordinarily be found in an agreed upon procedures report under U.S. standards.

Effective November 1, 2003, the CICA changed the compilation report on pro forma information that a Chartered Accountant would issue to comply with the requirements of the various securities regulators in Canada - this report is required to be included in an offering document in Canada. Presented below is a copy of report from the CICA Handbook:

> *To the Directors of X Limited*
>
> *I have read the accompanying unaudited pro forma balance sheet of X Limited (the company) as at March 31, 20X4 and unaudited pro forma income statements for the three months then ended and for the year ended December 31, 20X3, and have performed the following procedures.*
>
> 1. *Compared the figures in the columns captioned "X Limited" to the unaudited financial statements of the company as at March 31, 20X4 and for the three months then ended, and the audited financial statements of the company for the year ended December 31, 20X3, respectively, and found them to be in agreement.*
> 2. *Compared the figures in the columns captioned "Y Limited" to the unaudited financial statements of Y Limited as at March 31, 20X4 and for the three months then ended and the audited financial statements of Y Limited for the year ended December 31, 20X3, respectively, and found them to be in agreement.*

3. *Made enquiries of certain officials of the company who have responsibility for financial and accounting matters about:*

   *(a) the basis for determination of the pro forma adjustments; and*

   *(b) whether the pro forma financial statements comply as to form in all material respects with [identified regulatory requirements].*

   *The officials:*

   *(a) described to me the basis for determination of the pro forma adjustments, and*

   *(b) stated that the pro forma statements comply as to form in all material respects with [identified regulatory requirements].*

4. *Read the notes to the pro forma statements, and found them to be consistent with the basis described to me for determination of the pro forma adjustments.*

5. *Recalculated the application of the pro forma adjustments to the aggregate of the amounts in the columns captioned "X Limited" and "Y Limited" as at March 31, 20X4 and for the three months then ended, and for the year ended December 31, 20X3, and found the amounts in the column captioned "Pro forma consolidated" to be arithmetically correct.*

*A pro forma financial statement is based on management assumptions and adjustments which are inherently subjective. The foregoing procedures are substantially less than either an audit or a review, the objective of which is the expression of assurance with respect to management's assumptions, the pro forma adjustments, and the application of the adjustments to the historical financial information. Accordingly, I express no such assurance. The foregoing procedures would not necessarily reveal matters of significance to the pro forma financial statements, and I therefore make no representation about the sufficiency of the procedures for the purposes of a reader of such statements.*

**Issues**

- Does the revised Canadian report constitute an agreed upon procedures report under U.S. standards?

- As compilation reports are generally not allowed in SEC filings, is the historical accommodation allowing the Canadian compilation report on pro forma information to be included in a SEC filing still appropriate given the changes that were made to the report?

**Discussion**

The Task Force had varying views on whether the revised Canadian report constituted an agreed upon procedures report. Those members of the Task Force that believed the report should be excluded from an SEC filing viewed the revised report as the substantial equivalent of an "agreed upon procedures report" under U.S. standards. One of the conditions for the accommodation is the discussion of how the Canadian report is different from a U.S. report. In that regard, it would be necessary to indicate that the Canadian report would be viewed as an agreed upon procedures report under U.S. standards and that under U.S. standards, an

agreed upon procedures report would be a restricted use report. These Task Force members note that because the SEC Staff has objected to the inclusion of a restricted use report in a SEC filing, the disclosures that would be required by the Staff accommodation effectively prohibit the inclusion of the report.

Other members of the Task Force did not believe that the Canadian compilation report was the equivalent of an agreed upon procedures report and thus the concern expressed above regarding the restrictions on duty of care would not be applicable.

It was understood by certain Task Force members that the Canadian guidance would be changing in the near future and that further investigation was required to understand the developing regime in Canada. In any case, the Task Force noted that the inclusion of such reports should be discouraged. The Task Force also noted that if the SEC Staff has objections to such Canadian reports, as discussed, then they should withdraw in its entirety the concession in the International Reporting Issues Outline.

The SEC Staff indicated that they will follow up on this issue with the appropriate regulators in Canada. The Staff also indicated that based on preliminary discussions with regulators in Canada, such regulators may be willing to consider providing relief from inclusion of such reports in filings in Canada.

**(b) Acquired Businesses and Delayed and Continuous Offerings**

**Background**

At the meeting of the Task Force in March 2004 it was noted in relation to keeping shelf registration statements current that:

> *"The SEC Staff indicated that, in keeping a shelf registration active, it is necessary to update other "financial" information (e.g., MD&A, Quantitative and Qualitative Disclosures of Market Risk, Rule 3-10 disclosures, Selected Financial Data) when the financial statements are updated in order to comply with the age of financial statement requirements. This information typically also would be included in the Form 6-K that includes the interim financial information and which is incorporated by reference into the shelf."*

The Task Force did not specifically discuss the question of what 3-05 financial statements might be required to keep a foreign private issuer shelf registration statement active.

Rule 3-05 says:

> *"Financial statements required for the periods specified in paragraph (b)(2) of this section may be omitted to the extent specified as follows:*
>
> *(i) Registration statements not subject to the provisions of Rule 419 of Regulation C and proxy statements need not include separate financial statements of the acquired or to be acquired business if it does not exceed any of the conditions of significance in the definition of significant subsidiary in Rule 1-02 at the 50 percent level, and either:*
>
> *(A) The consummation of the acquisition has not yet occurred; or*
>
> *(B) The date of the final prospectus or prospectus supplement relating to an offering as filed with the Commission pursuant to Rule 424(b) of Regulation C, or mailing date in the case of a*

*proxy statement, is no more than 74 days after consummation of the business combination, and the financial statements have not previously been filed by the registrant."*

Item 512(a)(1) and (4) of Regulation S-K state:

*"The undersigned registrant hereby undertakes:*

*(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:*

*(i) To include any prospectus required by section 10(a)(3) of the Securities Act of 1933;*

*(ii) To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information in the registration statement. To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) (§230.424(b) of this chapter) if, in the aggregate, the changes in volume and price represent no more than a 20% change in the maximum aggregate offering price set forth in the "Calculation of Registration Fee" table in the effective registration statement;*

*(iii) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement;*

*Provided, however, that paragraphs (a)(1)(i) and (a)(1)(ii) of this section do not apply if the registration statement is on Form S-3 (§239.13 of this chapter) or Form S-8 (§239.16b of this chapter) or Form F-3 (§239.33 of this chapter), and the information required to be included in a post-effective amendment by those paragraphs is contained in periodic reports filed with or furnished to the Commission by the registrant pursuant to section 13 or section 15(d) of the Securities Exchange Act of 1934 that are incorporated by reference in the registration statement.*

*(4) If the registration is a foreign private issuer, to file a post-effective amendment to the registration statement to include any financial statements required by §210.3-19 of this chapter at the start of any delayed offering or throughout a continuous offering. Financial statements and information otherwise required by Section 10(a)(3) of the Act need not be furnished, provided that the registrant includes in the prospectus, by means of a post-effective amendment, financial statements required pursuant to this paragraph (a)(4) and other information necessary to ensure that all other information in the prospectus is at least as current as the date of those financial statements. Notwithstanding the foregoing, with respect to registration statements on Form F-3 (§239.33 of this chapter), a post-effective amendment need not be filed to include financial statements and information required by Section 10(a)(3) of the Act or*

> *§ 210.3-19 of this chapter if such financial statements and information are contained in periodic reports filed with or furnished to the Commission by the registrant pursuant to section 13 or section 15(d) of the Securities Exchange Act of 1934 that are incorporated by reference in the Form F-3."*

The SEC Staff Training Manual says:

> ***"Delayed and continuous offerings:*** *After effectiveness, the registrant has no specific obligation to update the prospectus except as stipulated by 33 Act Rule 10(a)(3) and with respect to any* ***fundamental change.*** *If an acquisition would be significant under Rule 3-05, the staff recommends that management consider whether the probability of consummation of the transaction would represent a fundamental change.*
>
> ***What is a "fundamental change?"***
>
> - *It is the responsibility of management to determine what constitutes a fundamental change and it is based generally on whether additional information is necessary for an investor to make an informed investment decision. (Refer to Item 512(a) of Regulation S-K).*
> - *The registrant should also consider whether individually insignificant acquisitions occurring subsequent to effectiveness, when combined with individually insignificant acquisitions that occurred after the most recent audited balance sheet in the registration statement but prior to effectiveness, may be of such significance in the aggregate that an amendment is necessary. "*

**Issue**

Once a registration statement is declared effective, what obligation does a foreign private issuer have to file financial statements of an acquired business under Rule 3-05 of Regulation S-K in a delayed or continuous offering?

**Discussion**

The Task Force believed there is diversity in practice. Some attorneys have indicated that pursuant to Item 512(a)(4) of Regulation S-K, that a registrant is required to provide the financial statements of an acquired business required by Rule 3-05 of Regulation S-X to keep the registration statement current throughout the delayed or continuous offering. Others believed it was only necessary to file financial statements of acquired business if the acquisition is viewed as a fundamental change under Item 512(a)(1) of Regulation S-K.

**Conclusion**

The SEC Staff indicated that Item 512(a)(4) of Regulation S-K addresses the age of financial statements of entities that were required to be included in the filing at the time the registration statement was declared effective, which would include 3-05 financial statements that were included in the registration statement. The Staff noted that it does not require financial statements of a subsequently acquired business under Rule 3-05 of Regulation S-X that were not required to be included in the registration statement when it was declared effective. The Staff also noted that once the registration statement is effective, financial statements of a subsequently acquired business would only be required in a delayed or continuous offering if the company concludes that the acquisition represents a fundamental

change. If the acquistion represents a fundamental change, pursuant to Rule 512(a)(1)(ii) of Regulation S-K, the financial statements required by Rule 3-05 would need to be filed.

**(c) Filing dates – MJDS**

**Background**

A Form 40-F is required to be filed the same day that information is made public in Canada. In practice, the release of the information that would be included in a Form 40-F is not done all at once – in fact, financial statements, MD&A and the AIF will generally be distributed and filed on Sedar at different times. Many of these companies will file a Form 6-K with this information when it is issued, but will only file the 40-F when all information has been issued and it has completed the additional information required by the Commission.

Form 6-K indicates that it excludes information that is required to be filed on Form 40-F.

**Issues**

- Should a company file multiple Form 40-Fs for the various components as information is made public in Canada or is a 6-K acceptable – Form 40-F would appear to contemplate AIF separate from the financial statements? There is a concern with the filing of multiple 40-Fs including certifications, splitting of documents (not everything in one location, etc.).

- If a Form 6-K is acceptable, must it be filed on the same day as the information is filed in Canada – consistent with the 40-F rule or could they file a 6-K which requires the information to be furnished promptly after it was distributed in the home country.

- If multiple Form 40-Fs should be filed, when is all of the incremental information required by the SEC that is not required by the Canadian regulators due?

- When will the report on Internal Controls be due?

**Discussion**

The SEC Staff agreed to consider these issues further.

**(d) Consents and Audit Reports on Schedule B**

**Background**

Foreign government entities are allowed to file a registration statement on Schedule B. There are no financial statement requirements in a Schedule B and most issuers do not include financial statements. However, in limited situations, the entity will include audited financial statements.

**Issues**

- Is the audit required to be in accordance with U.S. GAAS – there are no rules that address this point?

- If there is an audit report included in the registration statement, is a consent required?

**Conclusion**

The SEC Staff indicated that U.S. GAAS was not required and often the financial information was unaudited. The Staff also indicated that if an auditors report is included, then a consent is required.

**DATE OF NEXT MEETING**

The Task Force agreed to meet on November 23, 2004.

## APPENDIX A

The following countries are considered highly inflationary:

| |
|---|
| Angola |
| Belarus |
| Dominican Republic |
| Myanmar |
| Turkey |
| Zimbabwe |

The following countries have three-year cumulative inflation rates that dropped below 100% during 2004, which the Task Force will assess at its next meeting:

| |
|---|
| Democratic Republic of Congo |
| Ghana |
| Serbia and Montenegro |
| Suriname |
| Uzbekistan |
| |

## APPENDIX A

The following countries are on the Task Force's inflation "watch list":

| *Cumulative inflation greater than 70%* | *Significant inflation in current or prior year* |
|---|---|
| Eritrea | Malawi |
| Haiti | Romania |
| Venezuela | |
| Zambia | |
| | |

## Issues in the Oil and Gas Industry

### Price Used to Determine Proved Oil and Gas Reserve Quantities

The SEC Staff reminds registrants that U.S. GAAP and Regulation S-X require the use of the year-end price to determine reserve quantities. It has come to our attention that certain companies have used an internally developed planning price or other forward looking price information to determine proved oil and gas reserve quantities. Accepted petroleum engineering practice requires that the same prices be used for calculating economic limits and future cash flows and thus we continue to believe that the year-end price is required to be used to determine proved oil and gas reserve quantities. This is consistent with guidance that has been posted on the Commission's website since 2000, which is noted below.

> "(h) Statement of Financial Accounting Standards 69, paragraph 30.a. requires that "Future cash inflows . . . be computed by applying year-end prices of oil and gas relating to the enterprise's proved reserves to the year-end quantities of those reserves. This requires the use of physical pricing determined by the market on the last day of the (fiscal) year. For instance, a west Texas oil producer should determine the posted price of crude (hub spot price for gas) on the last day of the year, apply historical adjustments (transportation, gravity, BS&W, purchaser bonuses, etc.) and use this oil or gas price on an individual property basis for proved reserve estimation and future cash flow calculation (this price is also used in the application of the full cost ceiling test). A monthly average is not the price on the last day of the year, even though that may be the price received for production on the last day of the year. Paragraph 30b) states that future production costs are to be based on year-end figures with the assumption of the continuation of existing economic conditions."

Refer to the *Division of Corporation Finance: Frequently Requested Accounting and Financial Reporting Interpretations and Guidance*, Item II.F.3(h) at http://www.sec.gov/divisions/corpfin/guidance/cfactfaq.htm#P279_57537

### Disclosures about Oil and Gas Producing Activities

Statement 69 requires companies that have significant oil and gas producing activities to disclose certain information to enhance financial statement user understanding of an oil and gas producers' proved reserve portfolio, its ability to continue to generate net cash flows from those proved reserves and to provide comparability to other enterprises in the industry. The standard provides specific guidance on how certain measures are to be calculated and in Appendix A includes summaries and illustrations that provide guidance on how the information should be presented.

We have noted that certain registrants have either omitted required disclosure, and/or expanded the disclosure to include measures not contemplated by the standard. Those instances are noted below and we ask registrants to ensure that their disclosure is complete and complies with the requirements of Statement 69. This information is required to be disclosed by companies that report financial statements under Item 18 of Form 20-F.

Equity Method Accounted Investee Disclosure

- Statement 69 requires separate disclosure about the oil and gas producing activities of investments in entities accounted for under the equity method. This information is required to be disclosed with the like disclosure of the oil and gas producing activities of the consolidated enterprise, but not included in the amounts reported for that entity. We

have noted that certain registrants have reported consolidated and equity method investment data in a combined total. The combined total is not contemplated by Statement 69 and should not be disclosed.

- Statement 69 requires separate disclosure of an amount attributable to equity method investment for the following. With the exception of the second item below (capitalized costs), Statement 69 requires the following information to be disclosed by geographic area:

    - Disclosure of the results of operations for oil and gas producing activities. Refer to paragraph 29 and Illustration 3.

    - Disclosure of capitalized costs related to oil and gas producing activities. Refer to paragraph 20 and Illustration 1.

    - Disclosure of costs incurred in oil and gas producing activities. Refer to paragraph 23 and Illustration 2.

    - Disclosure of proved oil and gas reserve quantities. Refer to paragraphs 12, 14(b) and Illustration 4

    - Standardized measure of future cash flows Refer to paragraphs 32 and Illustration 5.

The SEC Staff has noted that certain companies have omitted the disclosure(s) noted above. The Staff reminds registrants to disclose this information, as required by Statement 69.

Disclosure of Significant Minority Interest

Registrants are reminded to identify by geographic area, to the extent material, each instance for which a significant portion of reserve quantities are attributable to a consolidated subsidiary in which there is a significant minority interest and report the approximate portion of reserves attributable to the minority interest. Refer to paragraph 14(b) and Illustration 4 of Statement 69. This disclosure is also applicable to standardized measure of future cash flows disclosure (refer to paragraph 31 of Statement 69).

**Disclosure of Information by Geographic Area**

Statement 69 requires certain information to be separately disclosed, to the extent there are significant reserves, for both the enterprise's home country and foreign geographic areas. A foreign geographic area can be either an individual country or groups of countries.

The SEC Staff has noted that certain registrants have not separately reported the information required to be disclosed by geographic area for geographic areas that are determined to be individually significant. The Staff reminds registrants that separate reporting of individually significant geographic areas is required by Statement 69, and expect this disclosure to reflect the geographic diversity of their oil and gas operations. Refer to paragraphs 12, 22, 24, 30 and illustrations 2, 3, 4, and 5 of Statement 69.

**Disclosure of Certain Operating Measures**

Entities engaged in oil and gas exploration and production activities frequently disclose certain operating measures in their Management's Discussion and Analysis and/or their business and property disclosures. It is the SEC Staff's understanding that these measures are used in the investment community as a means of evaluating the operational performance and to a greater extent the prospects of entities engaged in the production and sale of depleting

natural resources. These measures are often used as a metric to evaluate an entity's historical track record of replacing the reserves that it produced and its ability to replace those reserves at a favorable cost.

Reserve Replacement Ratio

The reserve replacement ratio is frequently calculated by dividing *reserve replacement* by production in the same period. *Reserve replacement* is calculated by summing the total proved reserves added over a particular period. If a registrant chooses to disclose a reserve replacement ratio its disclosure needs to address each of the following, without limitation.

- Describe how the ratio is calculated. We would expect the information used to calculate this ratio to be derived directly from the line items disclosed in the reconciliation of beginning and ending proved reserve quantities, which is required to be disclosed by paragraph 11 of FAS 69.

- Identify the status of the proved reserves that have been added (e.g., proved developed vs. proved undeveloped). It is not appropriate to calculate this ratio using:

    - non-proved reserve quantities, or,

    - proved reserve additions that include both proved reserve additions attributable to consolidated entities and investments accounted for using the equity method.

- Identify the reasons why proved reserves were added.

    - The reconciliation of beginning and ending proved reserves, referred to above, includes several line items that could be identified as potential sources of proved reserve additions. Explain to investors the nature of the reserve additions, and whether or not the historical sources of reserve additions are expected to continue, and the extent to which external factors outside of managements' control impact the amount of reserve additions from that source from period to period.

- Explain the nature of and the extent to which uncertainties still exist with respect to newly discovered reserves, including, but not limited to regulatory approval, changes in oil and gas prices, the availability of additional development capital and the installation of additional infrastructure.

- Indicate the time horizon of when the reserve additions are expected to be produced to provide investors a better understanding of when these reserve additions could ultimately be converted to cash inflows.

- Disclose how management uses this measure.

- Disclose the limitations of this measure.

Finding Cost Per Unit

Finding cost per unit is a measure that is often used to determine how much it costs a company, on a per unit basis, to find new proved reserves as a result of their exploration and development efforts. This ratio is often calculated by dividing the *sum of costs incurred for exploration and development activities* by *total proved reserve additions*.

The SEC Staff is currently considering whether or not it is appropriate to disclose this measure in Commission filings and have made several observations about how the measure is calculated that we believe warrant further consideration.

The Staff has noted that information used to calculate this measure may not be comparable, which could result in a cost per unit that does not include all of, or includes more than, the costs associated with a particular set of reserve additions. This measure is often calculated using data over a 3 to 5 year period, in attempt to overcome timing differences between when costs are incurred (the numerator) and the proved reserve quantities are added (the denominator). For example:

- Exploration efforts related to a particular set of reserve additions may extend over several years. As a result, the exploration costs incurred in earlier periods are not included in the amount of exploration costs incurred during the period in which that set of proved reserves is added. This results in a unit cost that is lower because it does not include all of the costs of exploring for those reserves. Also, those costs incurred in prior periods are being added to the cost to find a different set of proved reserves, which results in a higher unit cost.

- Likewise, since proved reserves include both proved developed and proved undeveloped reserves, the development costs that are yet to be incurred for a particular set of proved undeveloped reserves will also not be included in the amount of costs incurred during the period the proved undeveloped reserves were added. This also results in a unit cost that is lower because it does not include all of the costs of developing those reserves. Also, those development costs incurred in future periods will be added to the cost to develop a different set of proved reserves, which results in a higher unit cost.

At present, the SEC Staff has noted that, if it is determined that it is appropriate to disclose this measure, the following should be addressed.

- Describe how the ratio is calculated.

  - The information used to calculate this ratio should be derived directly from the line items disclosed in your schedule of costs incurred and the reconciliation of beginning and ending proved reserve quantities, which is required to be disclosed by paragraphs 11 and 21 of Statement 69.

- Identify the status of the proved reserves that have been added (e.g., proved developed vs. proved undeveloped).

  - As with the calculation of the reserve replacement ratio, it is not appropriate to calculate this ratio using non-proved reserves or to use a figure for proved reserve additions that includes both proved reserve additions attributable to consolidated entities and investments accounted for using the equity method.

  - If a significant portion of the proved reserve additions is proved undeveloped, explain that additional development costs will need to be incurred before these proved reserves are ultimately produced, and the impact this has on the use and reliability of the measure.

- Identify the reasons why proved reserves were added.

  - As with the calculation of the reserve replacement ratio, the reconciliation of beginning and ending proved reserves, referred to above, includes several line items that could be identified as potential sources of proved reserve additions. Explain to

investors the nature of the reserve additions, whether or not the historical sources of reserve additions are expected to continue, and the extent to which external factors outside of managements' control impact the amount of reserve additions from that source from period to period.

- Identify all situations that resulted in a reserve addition that did not require the expenditure of additional costs. We note for example that changes in commodity prices and foreign exchange rates routinely has a direct impact on the quantity of proved reserve quantities, but do not have require the expenditure of additional exploration or development costs.

- Disclose how management uses this measure.

- Disclose the limitations of this measure.