

**AICPA INTERNATIONAL PRACTICES TASK FORCE**  
**AICPA Washington Office**  
**July 26, 2005**  
**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)  
John Abbott (PricewaterhouseCoopers)  
Wayne Carnall (PricewaterhouseCoopers)  
Paul Curth (Ernst & Young)  
Jon Fehleison (KPMG)  
Tim Martin (McGladrey & Pullen)  
Peter Nurczynski (Ernst & Young)  
Joel Osness (Deloitte & Touche)  
Eric Phipps (Deloitte & Touche)  
Carol Riehl (Grant Thornton)  
Reva Steinberg (BDO)  
Michael Walters (KPMG)

Observers

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

**The meeting commenced at 10:00 am.**

**AGENDA ITEMS**

**1. Inflationary status of certain countries**

**Background**

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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. 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.

**Conclusion**

The Task Force discussed the inflationary status of countries currently considered highly inflationary through May 31, 2005, as well as countries on the "watch list".

The Task Force noted that of the countries currently considered highly inflationary, the three-year cumulative inflation rates for Belarus, Myanmar, Turkey and Uzbekistan were all below 100% through May 31, 2005 (with the inflation rate for Myanmar dropping below 100% during 2Q 2005, the rates for Belarus and Turkey dropping below 100% during 1Q 2005, and the rate for Uzbekistan dropping below 100% during 2Q 2004). The Task Force discussed the current economic environment for these countries 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 these countries should continue to be considered highly inflationary. The Task Force will revisit inflation trends at its next meeting.

See the Appendix for a list of countries that are considered highly inflationary as of May 31, 2005 and those being monitored by the Task Force.

**2. Reporting Issues**

**(a) SOX 404 reports on foreign private issuers**

**Background**

PCAOB Auditing Standard No. 2 ("AS 2") requires that management assess and report on internal controls over financial reporting as a whole. AS 2 also requires that the auditor evaluate control deficiencies and determine whether the deficiencies, individually or in combination, are significant deficiencies or material weaknesses. The evaluation of deficiencies in the audit of internal control over financial reporting (ICFR) includes deficiencies relating to procedures used by the registrant to draft footnote disclosures.

Items 17/18 of Form 20-F require foreign private issuers that prepare their financial statements in accordance with either their home country GAAP or International Financial Reporting Standards (collectively "foreign GAAP") to include a reconciliation between the foreign GAAP used to prepare the primary financial statements and U.S. GAAP. This reconciling information is included in the notes to the primary financial statements.

SEC Release 33-7119 (December 1994) indicates that while the audit report required by Rule 2-02 of Regulation S-X on the issuer's audited financial statements need not refer specifically to the note containing the reconciliation, the reconciliation must be considered by the auditor when expressing an opinion on the financial statements taken as a whole.

The Task Force was provided a memorandum that discussed an approach to reporting on internal controls over financial reporting with respect to a foreign private issuer that reconciles to U.S. GAAP.

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**Issues**

Is AS 2 applicable to the U.S. GAAP reconciliation information? If so, what impact would deficiencies in internal control over the preparation of the U.S. GAAP reconciling information have on the reporting on internal controls over financial reporting under AS 2?

**Discussion**

The Task Force noted that “financial reporting” in the context of AS 2 would include the totality of the financial reporting by a registrant. Consequently, U.S. GAAP reconciling information included in the financial statements would be subject to internal controls over financial reporting.

With respect to the impact of a deficiency in internal control over the preparation of the U.S. GAAP reconciling information on the auditor’s AS 2 report, several views were discussed by Task Force members.

The Task Force noted that if the U.S. GAAP reconciliation contains a material error or omission, then the financial statements taken as a whole would be presumed to be materially misleading and an exception should be cited in the auditor’s report. In general, the Task Force noted that a material weakness in internal control over the preparation of the U.S. GAAP reconciling information would result in an adverse opinion under AS 2.

One alternative view discussed involved reporting a “qualification” for such a material weakness if internal control over “primary GAAP financial reporting” otherwise was effective. Supporters of this view noted that it would be possible to issue an unqualified AS 2 opinion on internal controls over primary GAAP financial reporting in financial statements that excluded the U.S. GAAP note issued in the home country. Other Task Force members expressed reservations as to whether consideration of this type of reporting by the independent auditor would be appropriate under AS 2, without some form of amendment or interpretation being issued by the PCAOB. These Task Force members also questioned whether it would be appropriate for management to report its own assessment in this manner.

The Task Force agreed to further discuss this issue with representatives on the Internal Controls Task Force. Based on the outcome of those discussions, the Task Force will consider the need for discussion at a future meeting.

The SEC staff noted the discussion and indicated that it would also consider the issue further with the PCAOB.

**(b) Interim information and SOX 404**

**Background**

AS 2 includes numerous references to quarterly and interim financial reporting. For example, the definitions of “significant deficiency” and “material weakness” in paragraphs 9 and 10 of the standard address the likelihood and magnitude of misstatements to both annual and interim financial statements. In addition, the discussion of the “period-end financial reporting process” in paragraphs 40 and 76 of the standard refers to the preparation of both annual and quarterly financial statements.

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PCAOB FAQ 32 clarified that AS 2 requires the auditor to evaluate the possible effects of identified control deficiencies on both annual and interim financial statements to determine whether the control deficiencies, individually or in combination, represent significant deficiencies or material weaknesses. The FAQ notes that paragraph E92 of AS 2 points out that an evaluation of internal control over financial reporting as of year end encompasses controls over the annual financial reporting and quarterly financial reporting as such controls exist at that point in time.

Unlike domestic issuers, foreign private issuers are not required to file quarterly financial reports. Instead, the SEC's integrated disclosure system allows foreign private issuers to provide interim reporting on the basis of home country and stock exchange practice. The frequency and level of detail of interim information that is furnished - not filed - on Form 6-K varies between countries and between companies within the country. Many foreign jurisdictions do not have quarterly or interim reporting requirements. In these jurisdictions, issuers may release earnings data on an interim basis, but the release is often not followed by the release of interim financial statements. In addition, there is no statutory requirement in the U.S. for foreign private issuers to obtain a SAS 100 review of interim financial information, notwithstanding the form, content, location or timing of its distribution.

**Issue**

Given the difference in statutory reporting and practice between foreign and domestic issuers, are the provisions of AS 2 applicable to quarterly and interim reporting published by foreign private issuers?

**Discussion**

The Task Force discussed the applicability of AS 2 to interim information published by a foreign private issuer and agreed to further discuss this issue with representatives on the Internal Controls Task Force. Based on the outcome of those discussions, the Task Force will consider the need for consideration at a future meeting.

**3. Non-GAAP measures**

**(a) OFR in UK annual reports**

**Discussion**

The Task Force continued its discussion from its May 2005 meeting that the UK requirements for inclusion of voluntary Operating and Financial Review ("OFR") in the UK Annual Report introduce a potential conflict between practice in the UK and the Commission's release on non-GAAP measures. The UK standard encourages companies to include certain performance measures in their OFR which are based on GAAP measures but as adjusted for one-off items that generally would not be permitted under the SEC's rules.

The Task Force noted at its May 2005 meeting that non-GAAP measures would be permitted in SEC filings if expressly permitted under local GAAP. It also was noted that the SEC staff has permitted UK companies to use certain measures that are measures of operating profit before goodwill and intangible amortization and exceptional items based, in part, on the long-standing practice under UK financial reporting, provided that the measure is accompanied by appropriate additional disclosures.

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The SEC staff said they were continuing to consider this issue and would do so in the context of the issue discussed further below

(b) **Non-GAAP measures and IFRS**

**Discussion**

As noted in the November 2003 Task Force highlights, companies in the UK and other countries are allowed to present their home country financial statements in a manner that would not be allowed for a U.S. company, provided certain specified disclosures are provided. At the September 2004 Task Force meeting, the SEC Staff indicated that foreign private issuers should not assume that a similar accommodation would be applicable for IFRS.

It appears that a number of practitioners in Europe (in particular, those in the United Kingdom) believe that their historical or similar presentation under home country GAAP would be acceptable under IFRS. That is, they do not intend to change their presentation formats.

Companies will start reporting IFRS amounts in the very near future. While an agreement among regulators on the format of IFRS financial statements would be most helpful, it is not clear whether this is a reasonable expectation in the near term.

At its May 2005 meeting the Task Force noted certain difficult aspects of applying the Commission's rules to the financial statements of a foreign private issuer using non-U.S. GAAP. The Task Force noted that because a particular presentation is not "expressly permitted" does not necessarily mean that it is considered to be non-GAAP in a particular country.

Under the assumption that the regulators around the world will not reach an agreement on IFRS presentation requirements in the near future, the Task Force discussed the applicability of the approach that was developed for UK GAAP. While no conclusions were reached on the approach discussed, the SEC Staff acknowledged the need to address the issue and asked the Task Force to develop a proposal for consideration at the next meeting.

**4. Classification of French SICAV**

Discussion deferred to a later meeting

**5. Mexico - Statement 112 and D-3**

**Background**

Under Mexican Labor Law, Mexican employees are entitled to receive a severance payment equal to 90 days of salary, plus 20 days salary for every year of services rendered in prior years when they are terminated without a justified reason (i.e., rights accumulate). Should an employee leave on his own, the employer is not required to pay any severance (i.e., rights are non vesting). In practice, many companies negotiate settlements with employees in return for "voluntary resignations".

Mexican Bulletin D-3, "Labor Obligations" ("Bulletin D-3") was recently revised and provides guidance on how to account for post-employment benefits, including severance payments,

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defining them as the benefits paid after employment but before retirement. Bulletin D-3 paragraphs 20-28 indicates that severance payments should be accounted for in the same manner as other retirement benefits and should use actuarial calculations. This provision of Bulletin D-3 goes into effect January 1, 2005. Prior to the revised guidance, severance payments were charged to expense as incurred under Mexican GAAP.

**Discussion**

At its May 2005 meeting the Task Force discussed whether there was any difference between Mexican and U.S. GAAP in the application of the "probability" concept for the purpose of recognizing a liability.

The Task Force noted that practice was mixed in applying U.S. GAAP. Some companies accrued for the liability under Statement 112 while others recognized the expense as incurred (similar to that under Mexican GAAP).

Task Force members agreed to follow up with their respective Mexican firms to better understand practice in applying the revised Mexican standard. The Task Force also agreed to consider the issue further at its next meeting.

**6. SEC Staff issues**

**(a) Canadian 10-K filers**

The staff has a historical practice of allowing certain Canadian companies who are not eligible to file Form 20-F to report under Canadian GAAP in their Form 10-K. This was based upon rules in Canada that would prohibit these companies from reporting under US GAAP. Given that the majority of Canadian provinces (excluding Ontario) have now revised their laws and regulations such that it would be permissible for these Canadian companies to report in US GAAP, the staff questioned whether it would be possible to eliminate the use of Canadian GAAP in Form 10-K.

The Task Force noted the possibility of implementing any changes beginning with filings for FY 2007, and agreed to discuss with their counterparts in Canada.

**(b) Canadian audit reports**

The staff noted that they had seen some Canadian audit reports (for audits conducted in accordance with PCAOB standards) that do not include language that states "We believe that our audit provides a reasonable basis for our opinion". It was noted that this language is part of the standard report required by the PCAOB (similar language is also included in the IAASB's proposed standard report).

Task Force members noted that the Canadian Auditing Standards Board had considered this matter when it adopted its (otherwise identical) standard audit report language under Canadian GAAP, and concluded that this sentence should not be included. Task Force members suggested that the difference in the reports should be viewed as an acceptable "style variation" consistent with the Commission's Sept. 1999 Release 33-7745 adopting revisions to Form 20-F. The staff did not object to that view.

**DATE OF NEXT MEETING**

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The Task Force agreed to meet on November 22, 2005.

**The meeting adjourned at 4:00 pm.**

## APPENDIX

The following countries are considered highly inflationary through May 31, 2005:

Angola
Belarus
Democratic Republic of Congo *
Dominican Republic
Myanmar
Serbia and Montenegro *
Suriname *
Turkey
Uzbekistan
Zimbabwe

\* These countries will come off highly inflationary status. The Task Force agreed that registrants may change status as of the first period beginning after June 15, 2005, if practicable, but no later than the first period beginning after December 15, 2005.

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

<i>Cumulative inflation greater than 70%</i>	<i>Significant inflation in current or prior year</i>
Eritrea	Ghana
Haiti	Guinea
Venezuela	Zambia