AICPA INTERNATIONAL PRACTICES TASK FORCE
AICPA Washington Office
November 21, 2006

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.

I. Attendance

Task Force Members

D.J. Gannon, Chairman (Deloitte & Touche)
John Abbott (PricewaterhouseCoopers)
Wayne Carnall (PricewaterhouseCoopers)
Paul Curth (Ernst & Young)
Jon Fehleison (KPMG)
Steven Krohn (KPMG)
Debra MacLaughlin (BDO)
Tim Martin (McGladrey & Pullen)
Peter Nurczynski (Ernst & Young)
Joel Osnoss (Deloitte & Touche)
Eric Phipps (Deloitte & Touche)
Carol Riehl (Grant Thornton)

Observers

Jill Davis (SEC Staff Observer)
Paul Dudek (SEC Staff Observer)
Chris Holmes (SEC Regulations Committee Observer)
Len Jui (SEC Staff Observer)
Susan Koski-Grafer (SEC Staff Observer)
Mark Mahar (SEC Staff Observer)
Thomas Noland (SEC Staff Observer)
Craig Olinger (SEC Staff Observer)
Annette Schumacher Barr (AICPA Staff Observer)
Sondra Stokes (SEC Staff Observer)

II. Inflationary status of certain countries

Discussion

A summary of the countries considered to be highly inflationary as well as those on the "watch list" is in Appendix A.

III. Current Practice Issues Addressed in Discussion Documents

TOPIC	DISCUSSION DOCUMENT
SAB 108 and FPIs	A
Reg AB and First-Time Adoption of IFRS	B
Scope of Management's SOA 404 Assessment and Proportionately Consolidated Entities	C
Approved Enterprise Zones in Israel – Change in Tax Law	D
Update on Currency Restrictions in Venezuela	E
Accounting for Minimum Dividends in Various Countries	F

IV. Date of Next Meeting

The Task Force agreed to meet on April 24, 2007.

Discussion Document A

Topic: SAB 108 and FPIs

Background:

On September 13, 2006, the SEC staff published Staff Accounting Bulletin (SAB) No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB 108 (SAB Topic 1.N) addresses quantifying the financial statement effects of misstatements, specifically, how the effects of prior year uncorrected errors must be considered in quantifying misstatements in the current year financial statements. SAB 108 does not change the SEC staff's previous positions in SAB 99 (SAB Topic 1.M) regarding qualitative considerations in assessing the materiality of misstatements.

A number of implementation questions related to SAB 108 and foreign private issuers have arisen as discussed below.

Issue 1:

Does SAB 108 apply to the US GAAP information prepared by a foreign private issuer?

Staff Response:

SAB 108 applies to the US GAAP information in the same manner as it would to a US domestic entity.

Issue 2:

Does SAB 108 apply to the primary financial statements prepared using IFRS or home-country GAAP? If so, could the application of SAB 108 to the primary financial statements prepared using IFRS or home-country GAAP result in a reconciling item to US GAAP?

Staff Response:

SAB 108 is an interpretation of US GAAP. Accordingly, it does not apply to IFRS or home country GAAP. The Staff understands that presenting a reconciling item between the primary financial statements and US GAAP for uncorrected errors existing in the IFRS or home country financial statements may be an unusual disclosure and viewed skeptically by users of the financial statements. Therefore, the staff encourages foreign private issuers to apply the guidance in SAB 108 to their primary financial statements.

The SEC staff will not object to foreign private issuers presenting the initial application of SAB 108 in a manner similar to a voluntary change in accounting principle and retrospectively applying it to prior periods (provided it is acceptable under the GAAP used in the primary financial statements). If this option is elected, the SEC staff would

still expect foreign private issuers to include disclosure consistent with the disclosure described in SAB 108.

Since SAB 108 is an interpretation of US GAAP, if the SAB 108 approach is not applied in the preparation of the IFRS or home country primary financial statements, it would need to be applied in connection with the US GAAP information provided pursuant to Item 17 or 18 of Form 20-F. If a foreign private issuer is contemplating having a reconciling difference for errors not corrected in the IFRS or home country primary financial statements but corrected in the US GAAP reconciliation, the foreign private issuer should consider discussing their fact pattern with the SEC staff. In any case, if a reconciling difference is presented, the foreign private issuer will need to have explicit and transparent disclosure about the reconciling item, consistent with the disclosures required in SAB 108.

The Task Force understands that the SEC staff believes that a reconciling item may be appropriate if there is a difference in how the "dual approach" is adopted in the primary financial statements. For example, a registrant may adopt SAB 108 in its US GAAP financial information using a cumulative effect adjustment in the year of adoption but adopts the dual approach in its primary GAAP financial statements using retrospective application. The SEC staff agreed that a timing difference reconciling item related solely to transition may be appropriate. Companies also have the option of adopting the impact on US GAAP information retroactively in a manner consistent with the primary financial statements.

Issue 3:

How should the change to the SAB 108 approach in the primary non US GAAP financial statements be characterized (for example, should the change be characterized as a "change in accounting principle" or a restatement for immaterial error)?

Staff Response:

The cumulative effect method of initially applying the guidance in SAB 108 would generally be inconsistent with accounting standards in most countries and IFRS. The Task Force understands that the SEC staff has indicated a willingness to be flexible about how the change is characterized. Accordingly, the SEC staff will not object to foreign private issuers presenting the initial application of SAB 108 in a manner similar to a voluntary change in accounting principle and restating prior periods (assuming it is acceptable under the GAAP used in the primary financial statements). If this option is elected, the SEC staff would still expect foreign private issuers to provide disclosures consistent with those included in SAB 108, such as the nature and amount of each individual error that is being adjusted.

<u>Discussion Document B</u>

Topic: Regulation AB and first-time adoption of IFRS

Background:

Item 1115 of Regulation AB requires that entities within its scope provide certain financial information. Item 1115 (b) states, in part:

> …(b)*Financial information.*
>
> (1) If the aggregate significance percentage related to any entity or group of affiliated entities providing derivative instruments contemplated by this section is 10% or more, but less than 20%, provide financial data required by Item 301 of Regulation S-K (§ 229.301) for such entity or group of affiliated entities.
>
> (2) If the aggregate significance percentage related to any entity or group of affiliated entities providing derivative instruments contemplated by this section is 20% or more, provide financial statements meeting the requirements of Regulation S-X (§§ 210.1-01 through 210.12-29 of this chapter), except § 210.3-05 of this chapter and Article 11 of Regulation S-X (§§ 210.11-01 through 210.11-03 of this chapter), of such entity or group of affiliated entities. Financial statements of such entity and its subsidiaries consolidated (as required by § 240.14a-3(b) of this chapter) shall be filed under this item.

The instructions to Item 1115 state, in part:

> …Instructions 2, 3 and 5 to Item 1114 of this Regulation AB apply to the information contemplated by paragraph (b) of this item…

Instruction 5 of Item 1114 states:

> …5. If the enhancement provider is a foreign business (as defined §210.1-02 of this chapter):
>
> a. Paragraph (b)(2)(i) of this section may be complied with by providing the information required by Item 3.A. of Form 20-F (§249.220f of this chapter). If a reconciliation to U.S. generally accepted accounting principles called for by Instruction 2. to Item 3.A. of Form 20-F is unavailable or not obtainable without unreasonable cost or expense, at a minimum provide a narrative description of all material variations in accounting principles, practices and methods used in preparing the non-US GAAP financial statements used as a basis for the selected financial data from those accepted in the U.S.
>
> b. Paragraph (b)(2)(ii) of this section may be complied with by providing financial statements meeting the requirements of Item 17 of Form 20-F for the periods specified by Item 8.A. of Form 20-F.

The SEC's rule *First-time Application of International Financial Reporting Standards* (FTA Rule) amended Form 20-F to allow foreign private issuers adopting IFRS for the first-time certain relief from the Commission's financial statement/information requirements. In particular, relief is provided from the number of periods financial statements/information are required in the first year of reporting under IFRS.

Issue:

Can an entity that is required to provide financial information under Item 1115 of Regulation AB take advantage of the FTA Rule?

Task Force Recommendation:

Yes.

Staff Response:

The Staff agrees with the Task Force recommendation.

Discussion Document C

Topic: Scope of Management's SOA 404 Assessment and Proportionately Consolidated Entities

Background:

Section 404 of the Sarbanes-Oxley Act becomes effective for large accelerated foreign private issuers ("FPIs") in fiscal years ending on or after July 15, 2006. Under a recently adopted change by the SEC, accelerated foreign private issuers are required to furnish a management assessment only in their filings for the same fiscal year, while full adoption is delayed until fiscal years ending on or after July 15, 2007. Many of these FPIs prepare their primary financial statements using International Financial Reporting Standards ("IFRS") or other local standards that permit proportionate consolidation of certain affiliates. While proportionately consolidated on a line-by-line basis, the investor usually does not exercise unilateral control over the affairs of the affiliate. Accordingly, management of these entities must decide whether the accounts of these affiliates must be included within the scope of Section 404 internal controls assessment.

In 2003, the SEC staff stated in "Management's Report on Internal Control over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports Frequently Asked Questions" (SEC Section 404 FAQs) its views on the scope of management's assessment as it relates to consolidated entities (e.g., variable interest entities). The SEC staff indicated that management's report on internal control over financial reporting typically should include controls at all consolidated entities, irrespective of the basis for consolidation. For instance, the SEC staff indicated that the internal controls of an entity consolidated by virtue of "FASB Interpretation No. 46(R) (revised December 2003), Consolidation of Variable Interest Entities" (FIN 46), should be covered in management's report on internal control over financial reporting if the registrant's initial involvement with the variable interest entity occurred after December 15, 2003. However, in a situation where the entity was in existence prior to December 15, 2003 and is consolidated by virtue of FIN 46 (i.e., would not have been consolidated in the absence of application of that guidance) and where the registrant does not have the right or authority to assess the internal controls of the consolidated entity and also lacks the ability, in practice, to make that assessment, the SEC staff believes management's report on internal control over financial reporting should provide disclosure regarding such entities. Finally, the SEC staff further indicated that the disclosure should note that the financial statements include the accounts of certain entities consolidated pursuant to FIN 46 or accounted for via proportionate consolidation in accordance with EITF 00-1, but that management has been unable to assess the effectiveness of internal control at those entities due to the fact that the registrant does not have the ability to dictate or modify the controls of the entities and does not have the ability, in practice, to assess those controls. (See Appendix for the text of Section 404 FAQs 1.)

Issue:

Considering the above-mentioned guidance in the SEC Section 404 FAQs, would managements of FPIs that proportionately consolidate entities in their primary GAAP financial statements include these entities within the scope of their Section 404 assessments?

Task Force Discussion:

The Task Force understands that the SEC Staff believes that FPI management should look to the primary GAAP (e.g., IFRS) used to prepare their financial statements when making their scope assessments under Section 404. Consequently, the presumption is that the scope of Section 404 should include all entities that are consolidated line-by-line, whether proportionately or otherwise in the primary financial statements. The Task Force also understands that there may be instances that prevent management from assessing the controls of a proportionately consolidated entity, because management may not have the right or authority to dictate or modify the controls at the affiliate and does not have the ability, in practice, to assess those controls.

In this situation, management's report on internal control over financial reporting should provide disclosure in the body of its Form 20-F regarding such entities. For example, an FPI could refer readers to a discussion of the scope of management's report on internal control over financial reporting in a section of the annual report entitled "Scope of Management's Report on Internal Control Over Financial Reporting." The FPI should disclose in the body of the Form 20-F that it has not evaluated the internal controls of the entity and should also note that the FPI's conclusion regarding the effectiveness of its internal control over financial reporting does not extend to the internal controls of the entity. The FPI should also disclose any key sub-totals, such as total and net assets, revenues and net income that result from consolidation of entities whose internal controls have not been assessed. The disclosure should note that the financial statements include the accounts of certain entities accounted for via proportionate consolidation in accordance with primary GAAP but that management has been unable to assess the effectiveness of internal control at those entities due to the fact that the FPI does not have the ability to dictate or modify the controls of the entities and does not have the ability, in practice, to assess those controls.

Finally, the Task Force noted that in order to overcome the presumption (i.e., all entities that are consolidated in the primary financial statements are within scope of Section 404) it believes that management would need to assert and have persuasive documented evidence regarding it's inability to obtain a controls evaluation for the proportionately consolidated entity based on the facts and circumstances (e.g., contracts, joint venture agreements, and/or legal opinions).

Staff Response:

The Staff agrees with the Task Force discussion.

Appendix:

In their FAQs on Internal Controls Reporting, the SEC staff addressed in 2003 the following question in a related topic:

Question 1

Financial Accounting Standards Board (FASB) Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities – An Interpretation of ARB No. 51, requires that registrants apply that guidance and, if applicable, consolidate entities based on characteristics other than voting control no later than the period ending March 15, 2004, or December 15, 2004 for small business issuers. In instances where the registrant lacks the ability to dictate or modify the internal controls of an entity consolidated pursuant to Interpretation No. 46, it may not have legal or contractual rights or authority to assess the internal controls of the consolidated entity even though that entity's financial information is included in the registrant's financial statements. Similarly, for entities accounted for via proportionate consolidation in accordance with Emerging Issues Task Force Issue No. 00-1 (EITF 00-1), management may not have the ability to assess the internal controls. How should management's report on internal control over financial reporting address these situations?

Answer

We would typically expect management's report on internal control over financial reporting to include controls at all consolidated entities, irrespective of the basis for consolidation. However, in a situation where the entity was in existence prior to December 15, 2003 and is consolidated by virtue of Interpretation No. 46 (i.e., would not have been consolidated in the absence of application of that guidance) and where the registrant does not have the right or authority to assess the internal controls of the consolidated entity and also lacks the ability, in practice, to make that assessment, we believe management's report on internal control over financial reporting should provide disclosure in the body of its Form 10-K or 10-KSB regarding such entities. For example, a registrant could refer readers to a discussion of the scope of management's report on internal control over financial reporting in a section of the annual report entitled "Scope of Management's Report on Internal Control Over Financial Reporting." The registrant should disclose in the body of the Form 10-K or 10-KSB that it has not evaluated the internal controls of the entity and should also note that the registrant's conclusion regarding the effectiveness of its internal control over financial reporting does not extend to the internal controls of the entity. The registrant should also disclose any key sub-totals, such as total and net assets, revenues and net income that result from consolidation of entities whose internal controls have not been assessed. The disclosure should note that the financial statements include the accounts of certain entities consolidated pursuant to FIN 46 or accounted for via proportionate consolidation in accordance with EITF 00-1 but that management has been unable to assess the effectiveness of internal control at those entities due to the fact that the registrant does not have the ability to dictate or

modify the controls of the entities and does not have the ability, in practice, to assess those controls.

Discussion Document D

Topic: Approved Enterprise Zones in Israel - Change in Tax Law

Background:

In Israel, the tax law was amended and introduced certain tax reforms. In general, the amendment to the tax law limits the scope of enterprises which may be approved to qualify for tax benefits and establishes that it is the company's responsibility to pay taxes upon liquidation of a new enterprise zone approved as of 2005.

The Law for Encouragement of Capital Investments (the "Law"), specifically Section 51, provides that companies can elect the "Alternative Benefits Route" in order to be entitled to tax benefits with respect to taxable income derived from an approved enterprise depending on its geographical location (that is, "approved enterprise zones"). For example, if the approved enterprise zone is located in development area A, then the company has tax exemption for a period of 10 years from the commencement of the benefit period or until the tax exempt profits are distributed. It is important to note that Section 51 does not provide a complete exemption, but rather, a tax deferral until the time when the tax exempt profits are distributed. Therefore, a company has a tax holiday for a specified period provided the profits generated during the exempt period are retained.

Until April 1, 2005, according to Israeli tax law and based on numerous legal opinions, a company could be liquidated and profits distributed with no tax liability to the company; rather, the shareholders would incur the tax liability.

The SEC staff's views, as to the accounting for the approved enterprise zones under US GAAP, are outlined in SEC's "International Financial Reporting and Disclosure Issues" in The Division of Corporate Finance. The SEC staff has taken the position that under FASB Statement No. 109 "Accounting for Income Taxes" (SFAS 109), a deferred tax liability normally would be recorded relating to taxes that would be owed on the distribution of profits even if management does not intend currently to declare dividends. (See Appendix 1 International Financial Reporting and Disclosure Issues in the Division of Corporation Finance - APPENDIX A — COUNTRY SPECIFIC ISSUES) However, under Israeli tax law, a company could be liquidated and profits distributed with no tax liability to the company; rather, the shareholders would incur the tax liability. If the registrant can represent that profits could be distributed tax free in liquidation, and the undistributed earnings are essentially permanent in duration, a deferred tax liability does not need to be recorded. If deferred taxes are not provided for amounts that would be owed on distribution of profits, the company would have to provide appropriate disclosures.

On April 1, 2005, an amendment to the Investment Law became effective ("the Amendment") and has significantly changed the provisions of the Investment Law. The Amendment limits the scope of enterprises which may be approved by the Investment Center by setting criteria for the approval of a facility as an Approved Enterprise, such as provisions generally requiring that at least 25% of the Approved Enterprise's income will

be derived from export. Additionally, the Amendment enacted major changes in the manner in which tax benefits are awarded under the Investment Law so that companies no longer require Investment Center approval in order to qualify for tax benefits. In addition for new enterprise zone approved as of 2005, the liability to pay taxes upon liquidation is specifically, the responsibility of the company.

However, the Investment Law provides that terms and benefits included in any certificate of approval already granted will remain subject to the provisions of the law as they were on the date of such approval. Therefore, a Company's existing approved enterprise zones will generally not be subject to the provisions of the Amendment.

The objective of this paper is to analyze the accounting consequence as a result of amendment to the tax law when the tax is paid by the company at the company level. The accounting consequences for the consolidated financial statements or at the parent level is in accordance with APB 23 “Accounting for Income Taxes – Special Areas”.

Accounting Literature and Recent Developments

As part of its Short-Term Convergence Project on Income Tax, the FASB staff has provided that SFAS 109 is silent on whether the distributed or undistributed tax rate should be used in measuring deferred taxes (January 19, 2005 FASB meeting minutes). However, certain fact patterns were addressed by the Emerging Issues Task Force (EITF) in EITF Issues No. 95-10 “Accounting for Tax Credit Related to Dividend Payments in accordance with FASB Statement No. 109” (EITF No. 95-10) and No. 95-20 “Measurement in the Consolidated Financial Statements of a Parent of the Tax Effects Related to the Operations of a Foreign Subsidiary That Receives Tax Credits Related to Dividend Payments.” In EITF No. 95-10, the issue is whether a deferred tax asset should be recognized for the tax benefits of future tax credits that will be realized when income previously taxed at the undistributed rate is subsequently distributed. The Task Force reached a consensus that a deferred tax asset should not be recognized for the tax benefits of future tax credits that will be realized when the previously taxed income is distributed; rather, those tax benefits should be recognized as a reduction of income tax expense in the period that the tax credits are included in the enterprise's tax return. Based on the consensus, the enterprise would measure the tax effects of temporary differences using the undistributed rate.As part of its Short Term Convergence Project on Income Tax deliberations, the FASB considered certain differences between the provisions of SFAS 109 and IAS 12, Income Taxes. At its January 19, 2005 meeting, the FASB decided that if corporate income is taxed at different rates depending on whether that income is distributed to shareholders, it would require measurement of deferred tax assets and liabilities using the distributed rate. However, at the March 30, 2005 meeting, the FASB **revisited** that previous decision and decided that if income is taxed at different rates depending on whether that income is distributed to shareholders, then:

(a) Deferred tax assets or liabilities should be measured based on the undistributed rate.

(b) To the extent that there is an obligation to distribute a portion of that income, any deferred tax assets or liabilities related to that portion should be re-measured using the distributed rate.

At the October 24, 2005 Joint IASB/FASB Board Meeting, the most recent FASB decisions on this project were as follows:

On the effect of the use of the undistributed rate to measure tax assets and liabilities on entities that regard themselves as tax exempt, the Boards expressed concern over the results presented by the staff. They asked the staff to explore the following options:

1. Keep the proposed requirements, noting that entities that did commit themselves to making a distribution would recognize the distributions and the available deductions.

2. Create a definition of an 'in substance tax exempt entity' that would cover entities whose tax structure is set up to avoid shareholders suffering double taxation and that involves tax deductions being available if the entity distributes all or almost all of its total income.

3. Require a point-in-time analysis of whether an entity has the ability to be effectively tax exempt, in which case it would be treated as tax exempt. Disclosure would be required of why it qualifies and what it has to do in the future to continue to qualify.

4. Allow the effects of a distribution outside the entity to be included as a tax-planning strategy in determining whether or not the recovery of an asset or settlement of a liability has taxable consequences and, hence, whether a temporary difference exists.

The FASB's Exposure Draft was expected to be posted in Q3 2006 for comments.

At its November 2002 and March 2003 meetings, the AICPA's International Practice Task Force (IPTF) discussed a similar issue regarding the rate to be used to record deferred income taxes for resident companies of the Republic of South Africa. (See Appendix 2 for relevant IPTF highlight excerpts related to this issue). 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 in a tax rate of 12.5%.

There was general agreement within the Task Force that providing for taxes at the distributed rate was preferable to only providing for corporate income 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.

Issue:

What are the consequences of the tax law amendment on the accounting for deferred income taxes under US GAAP?

Task Force Discussion:

The tax law amendment has US GAAP deferred tax accounting consequences. In that regard, there are the following three views:

1. Record a deferred tax liability based on the distributed tax rate in the 2006 financial statements.

   Under SFAS 109, a deferred tax liability normally would be recorded relating to taxes that would be owed on the distribution of profits even if management does not intend currently to declare dividends.

2. Record a deferred tax liability based on the undistributed tax rate in the 2006 financial statements (which is 0% in this situation) and disclose the effect that if dividends are distributed, the company will have to pay additional taxes at a rate of X% on all distributions and that this amount will be recorded as an income tax expense in the period the company declares the dividends.

   Deferred taxes should be recorded based on the undistributed tax rate, when earned considering that (a) SFAS 109 is unclear, (b) the expected amendment to SFAS 109, and (c) the SEC Staff's views on the South African matter discussed at the IPTF. When the registrant recognizes a liability to pay dividend, then the tax consequence is recorded based on the distributed rate.

3. The preference would be to record a deferred tax liability based on the distributed tax rate; however, it is acceptable to record a deferred tax liability based on the undistributed tax rate with appropriate disclosures.

   Supporters of View 3 expressed a preference for View 1. However, they did not believe it was possible on the basis of existing authoritative literature to object to the accounting under View 2 similar to the Task Force views on the South African matter previously discussed at the IPTF.

   View 3 supporters also agree, regardless of the accounting that is followed, that all entities subject to the Approved Enterprise Zones should provide a description of the tax concept (i.e., what it is and how it works) and how they are accounting for the tax (i.e., View 1 or 2). In cases where a registrant is applying View 2, View 3 proponents agreed additional disclosures similar to those that were outlined in the South African matter would be appropriate.

Proposed Task Force Recommendation:

View 3

Staff Response:

The Staff is considering this issue.

Appendix:

International Financial Reporting and Disclosure Issues in the Division of Corporation Finance APPENDIX A — COUNTRY SPECIFIC ISSUES

5. ISRAEL

Approved Enterprise Zones

Israel has a tax incentive program for "approved enterprise zones". Under the alternative system of tax benefits, a company has a tax holiday for a specified period provided the profits generated during the exempt period are retained. If those profits subsequently are distributed, the company generally would owe taxes at the applicable rate.

Under FAS 109, a deferred tax liability normally would be recorded relating to taxes that would be owed on the distribution of profits even if management does not intend currently to declare dividends. However, under Israeli tax law, a company could be liquidated and profits distributed with no tax liability to the company; rather, the shareholders would incur the tax liability. If the registrant can represent that profits could be distributed tax free in a liquidation, and the undistributed earnings are essentially permanent in duration, a deferred tax liability does not need to be recorded.

If the approved enterprise benefit relates to a domestic (Israeli) subsidiary, the parent company would be liable for the taxes upon distribution. Accordingly, a deferred tax liability should be recorded unless the subsidiary could be merged with the parent in a tax free merger or if there is some other manner in which the earnings could be distributed tax free.

If deferred taxes are not provided for amounts that would be owed on distribution of profits, the following disclosures may be appropriate:

- a description of the approved enterprise zone program indicating if the benefit relates to the parent company or a subsidiary;
- the amount of retained earnings for which taxes have not been provided;
- a statement that such undistributed earnings are essentially permanent in duration;

- a statement that such earnings could be distributed to shareholders tax free in a liquidation, or if applicable, in some other manner;

- the tax rate to the company if the profits were distributed; and

- the amount of tax that would be owed if the profits were distributed.

March 4, 2003 IPTF Highlights Excerpt:

(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 US 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.

November 25, 2002 IPTF Highlights Excerpt:

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

Background

Resident companies of the Republic of South Africa are subject to corporate income taxes at a rate of 30%. The South African tax law exempts dividends received from domestic entities from taxation under its tax scheme, in part to avoid double taxation of corporate earnings. However, resident companies are subject to a Secondary Tax on Companies—STC upon distribution of accumulated earnings, equal to 12.5% of such dividends net of the STC tax liability, declared by a company during any dividend cycle. Any excess of dividends received by a company in a relevant dividend cycle, excluding those foreign dividends which are not exempt from South African income tax, over the dividends paid in such cycle are carried forward by the company to the succeeding dividend cycle as an STC credit.

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

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

Issue

What rate should be used to record deferred income taxes under US GAAP?

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

Conclusion

The Task Force discussed the following two views:

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

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

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

Financial statements

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

understanding of the implications, or at a minimum, should include specific cross references.

Operating and Financial Review (MD&A)

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

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

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

Discussion Document E

Topic: Update on Currency Restrictions in Venezuela

Background:

Since February 5, 2003, an exchange control has been in force in Venezuela. According to the Exchange Control regulations issued to date (the "Exchange Regulations"), the Central Bank of Venezuela ("BCV") centralizes the purchase and sale of foreign currency within the country, which is made at the official rate of exchange that is fixed from time to time by the Executive Branch and BCV (the "Official Rate"), and which currently is Bs. 2,150.00 per United States Dollar ("Dollar"). In addition to providing for exchange controls, the Exchange Regulations require sale to the BCV, at the Official Rate, of all foreign currency received by virtue of exportation of goods, services or technology from Venezuela, and of all foreign currency that enters the country for any reason except as follows:

- Oil and gas companies engaged in certain qualifying activities (e.g., exploration) may retain 100% of the foreign currency collected from exportation.

- All other exporters may retain up to 10% of foreign currency collected from exportation activities to cover export costs.

- Companies selling goods or services in Venezuela, but receiving payment in foreign currency outside of Venezuela, may retain the foreign currency outside of Venezuela. However, if such currency is brought into Venezuela or exchanged for Bolivars, it must be sold to the Foreign Exchange Administration Board (CADIVI) at the official rate or through a parallel market (as discussed below) for certain qualifying activities..

As a result of the foregoing, there has been no free market for the purchase and sale of foreign currency in Venezuela since February 2003. Although approvals for foreign currency exchanges exist they are limited. Specifically:

- Effective April 1, 2005 exports must be expressed in the currency of the destination country or in US dollars (not Bolivars) and foreign currency obtained from export operations (other than the exceptions noted above) must be sold to the BCV within 180 days.

- After proper submission and approval by the CADIVI US dollars may be acquired for imports (currently approximating US $90 million a day) and for payment of dividends, capital gains, interest or private external debt.

In October 2005, the Venezuelan government enacted the Criminal Exchange Law that imposes strict sanctions, criminal and economic, for the exchange of Venezuelan currency with other foreign currency through other than officially designated methods, or for obtaining foreign currency under false pretenses. The law quantifies fines and cites

circumstances in which prison time would be required. However, the Criminal Exchange Law provides an exemption for the purchase/sale of securities, defined as (a) National Public Debt bonds (DPNs) denominated in Bolivars, (b) American Depository Receipts (ADRs), (c) other securities issued by Venezuela, and (d) bonds issued by Venezuela and denominated in US dollars.

The exemption for transactions in certain securities results in an indirect "parallel" market of foreign currency exchange, through which companies may obtain foreign currency "legally" without resorting to or requesting it from CADIVI. The average rate of exchange in the parallel market is variable, and fluctuates between 25% and 40% above the Official Rate. Publicly available quotes do not exist for the foreign exchange rates but such rates may be obtained from brokers. In this market, the purchase of foreign currency is performed through a series of transactions made by a broker. For example, a company would purchase a DPN, swap it for a US$ denominated security, sell the US security on the international securities market, and obtain US dollars. The swap and the subsequent sale of the US security would be performed outside of Venezuela. As such, these parallel market transactions are used to settle foreign currency obligations and to move currency in and out of Venezuela.

ARB 51, Consolidated Financial Statements, paragraph 2, provides the following guidance:

> "A majority-owned subsidiary shall not be consolidated if control does not rest with the majority owner (as, for instance, if the subsidiary is in legal reorganization or in bankruptcy or operates under foreign exchange restrictions, controls, or other governmentally imposed uncertainties so severe that they cast significant doubt on the parent's ability to control the subsidiary)."

FAS 52, Foreign Currency Translation, paragraph 26, provides the following guidance:

> "If the lack of exchangeability is other than temporary, the propriety of consolidating, combining, or accounting for the foreign operation by the equity method in the financial statements of the enterprise shall be carefully considered."

The Task Force has previously discussed Venezuela exchange controls at its meetings on March 4 and November 25, 2003, and March 9 and July 27, 2004. A recap of certain decisions made in those meetings includes the following:

- Use of the official rate would be appropriate to re-measure transactions and translate Venezuelan financial statements (July 27, 2004 meeting).

- US GAAP does not permit the use of a black market exchange rate since such a rate is not objective or determinable. Instead, transactions should be translated at the official exchange rate, and if there are more than one official exchange rate depending on the transaction (e.g., dividend remittances), then the appropriate exchange rate should be used (March 4, 2003).

- It would not be appropriate to deconsolidate Venezuelan operations absent any other control considerations, as the lack of exchangeability by itself does not appear to meet the "other than temporary" threshold in paragraph 26 of Statement 52 (July 27, 2004 meeting).

- Use of the US dollar as the functional currency would not be precluded as a result of the currency restrictions in place (July 27, 2004 meeting). The Task Force noted that this may become more of an issue in the upcoming year if the currency restrictions continue (November 25, 2003 meeting).

- The rate used for re-measurement purposes or translation of financial statements may not be reflective of economic reality and additional disclosure may be necessary (e.g., summarized financial information of Venezuelan operations in a footnote; disclosure of exchange rate used; disclosure of the net monetary assets and liabilities by currency; discussion of potential impact of a change in exchange rate on financial statements in MD&A) (March 4, 2003). Disclosure considerations continue to be applicable and the Task Force agreed that it would revisit issues related to Venezuela at its next meeting (July 27, 2004 meeting).

Due to the continuing nature of the exchange controls in place, the previously discussed matters should be readdressed by the Task force.

Issue 1:

Since restrictions regarding exchangeability have remained in place for almost four years and there is no indication that the restrictions will be removed, should companies continue to consolidate Venezuelan subsidiaries at December 31, 2006?

Task Force Recommendation:

The exchangeability restrictions in Venezuela are not so severe as to represent a "lack of exchangeability" under Statement 52. Nor do they meet the criteria for deconsolidation as set forth in ARB 51. Control under ARB 51 is not predicated on an ability to remit dividends. Locally denominated funds would continue to be available to a parent company to fund operations and future investments.

However, additional restrictions on a parent company's ability to control the subsidiary entity should be carefully considered. In circumstances where exchange controls exist, other regulations or conditions could be present that impact the parent company's control over the operations of the subsidiary. If other conditions are present, they should be evaluated on a facts and circumstances basis, together with the exchange controls, to determine whether sufficient control exists to support consolidation.

Staff Response:

The Staff agrees with the Task Force recommendation.

Issue 2:

Assuming consolidation is appropriate, and taking into account the existence of a parallel market with observable market exchange rates, what rates should be used to re-measure transactions and translate financial statements of Venezuelan companies?

Task Force Recommendation:

The translation of financial statements into the reporting currency should be made at the rate that will be available for dividend remittance. **Paragraph 27a of SFAS 52 requires the applicable rate at which a particular transaction could settle and the date shall be used to translate and record the transaction.** Since dividends can only be remitted using the official rate, the official rate should be used.

However, the rate used for re-measurement of foreign currency denominated transactions into the functional currency depends on the type of transaction being re-measured. Since the Criminal Exchange Law, by virtue of exemption, provides for a parallel exchange mechanism and since there is an observable market rate of exchange for securities traded in this market, based on facts and circumstances this market rate may be appropriate for the re-measurement of foreign currency denominated transactions that could be settled through the parallel market mechanism. All other foreign currency transactions should be re-measured at the official rate.

Whatever rate is used for re-measurement purposes or translation of financial statements may not be reflective of economic reality and additional disclosure may be necessary. Potential relevant disclosures would include summarized financial information of Venezuelan operations; disclosure of exchange rate used; disclosure of the net monetary assets and liabilities by currency (e.g., Bolivars, US dollars, etc.); and discussion in MD&A of potential impact of a change in exchange rates on financial statements

Staff Response:

The Staff agrees with the Task Force recommendation.

Issue 3:

Does the fact that companies are continuing to be required to exchange US dollars for local currency, and require approval to exchange back to US dollars, impact the ability of a company to conclude that the US dollar is the functional currency?

Task Force Recommendation:

The functional currency should be determined based on the specific facts and circumstances and the criteria in Statement 52. The nature of the exchange controls in place, including the requirement to exchange foreign currency receipts into local currency for certain companies, should be included in this evaluation **but does not in of itself result in a conclusion that the US dollar cannot be the functional currency.**

Staff Response:

The Staff agrees with the Task Force recommendation.

Discussion Document F

Topic: Accounting for Minimum Dividends in Various Countries

Background:

At its last meeting, the Task Force agreed to follow up on the accounting for minimum dividends in various countries, particularly Chile.

Issue:

How should minimum dividends be accounted for?

Task Force Discussion:

The Task Force continued to discuss whether or not its prior discussion in the context of Chile would be applicable to Brazil and Greece. It was noted that while the specific circumstances varied slightly in each of these countries, the overall observation was that the circumstances relating to the minimum dividend requirements were similar enough to warrant consistent accounting. Chile, Brazil and Greece were all similar in that in order to defer or permanently postpone the payment of minimum dividends, the matter had to be subjected to a shareholder vote.

Task Force Recommendation:

The Task Force agreed that consistent with its past discussion in regards to Chile, minimum dividends in Brazil and Greece also should be presented outside permanent equity. The Task Force noted that as the outcome of a shareholder vote typically will not be within the control of the company (wholly-owned subsidiaries being one possible exception), the amount should be reflected as either temporary equity or a liability.

Staff Response: The SEC Staff indicated that they believed the preferred answer was to treat the minimum dividends as a liability, but indicated that they would not object to a temporary equity classification.

Appendix A

Topic: Monitoring Inflation in Certain Countries

Background:

At the March 2003 meeting of the Task Force, it was noted that it would be helpful to be more proactive in assessing the inflationary status of countries. As a result, it was agreed that a mechanism be developed for proactively monitoring the inflationary status of countries. That approach and the related assumptions used by the Task Force are described below:

Approach

The Task Force agreed to 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 agreed 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 agreed:

- 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 agreed that qualitative factors also should 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.

Current inflationary status of certain countries

Countries considered highly inflationary

The Task Force concluded that the following countries should be considered highly inflationary through December 31, 2006:

Angola	Myanmar
Dominican Republic	Zimbabwe

Countries on the highly inflationary "watch list"

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

Eritrea	Guinea
Haiti	Venezuela
Iran	Zambia