INTERNATIONAL PRACTICES TASK FORCE
Center for Audit Quality Washington Office
November 20, 2012
HIGHLIGHTS

I. Attendance

<u>Task Force Members</u>
Jonathan Guthart, Chair (KPMG)
Cathy Samsel, Vice-Chair (PwC)
Randall Anstine, (Ernst & Young)
Rich Davisson (McGladrey & Pullen)
Jon Fehleison (KPMG)
Steven Jacobs (Ernst & Young)
Debra MacLaughlin (BDO)
Victor Oliveira (Ernst & Young)
Scott Ruggiero (Grant Thornton)
Sondra Stokes (Deloitte & Touche)

<u>Observers</u>
Jill Davis (SEC Staff)
Paul Dudek (SEC Staff)
Craig Olinger (SEC Staff)
Annette Schumacher Barr (Center for Audit Quality Staff)

II. Current Practice Issues

A. Re-application of IFRS 1 – *First-Time Adoption of International Financial Reporting Standards*

General Instruction G to Form 20-F provides a "one-time accommodation"[1] to foreign private issuers and foreign businesses (as defined in Rule 1.02 (l) of Regulation S-X) upon their initial adoption of International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) (collectively, IFRS-IASB). Under the accommodation, an eligible foreign private issuer or foreign business may file two years, rather than three years, of audited financial statements in the year of IFRS-IASB adoption. The accommodation also reduces the periods required for MD&A and selected financial information.

In summary, to qualify for the accommodation, pursuant to General Instruction G to Form 20-F, the following is required to be met: [2]

- The company adopts IFRS-IASB for the first time by making an explicit and unreserved statement of compliance with IFRS-IASB; and
- The financial statements are prepared in accordance with IFRS-IASB

The definition of a "first-time adopter" in Form 20-F was consistent with that in IFRS 1 in existence at the time of the final rule.

In May 2012 the IASB issued the *Annual Improvements to IFRSs 2009 – 2011 Cycle*, which contains amendments to IFRS 1. Under the amendments, an entity that has applied IFRS in a previous reporting period, but whose most recent previous annual financial statements were not prepared in accordance with IFRS, may re-adopt IFRS by choosing to either:[3]

(i) Re-apply IFRS 1, even if the entity applied IFRS 1 in a previous reporting period; or
(ii) Apply IFRS retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (i.e., as if it had never stopped applying IFRS) in order to resume reporting under IFRS.

The effective date for the amendments is for annual periods beginning on or after January 1, 2013. Earlier application is permitted.

[1] Securities and Exchange Commission, First-Time Application of International Reporting Standards, Release NOS. 33-8567, 34-51535, April 12, 2005, Summary (page 1).
[2] General Instruction G to Form 20-F, G(a)(1) and (G(a)(2).
[3] IFRS 1 (2012), paragraph 4A.

The Task Force and the SEC staff noted the differences between the definitions of first-time adopter included in General Instruction G to Form 20-F and IFRS 1, as amended. This may result in new registrants and foreign businesses (as defined) having to select a much earlier date of transition to IFRS than what IFRS permits in order to meet SEC filing requirements. The SEC staff indicated that it is generally receptive to permitting, and is willing to consider, the application of the accommodation provided in General Instruction G where an entity qualifies as a repeat first-time adopter based upon the amended definition and elects to reapply the transition provisions of IFRS 1 rather than apply IFRS retrospectively as if it had never stopped applying IFRS in order to resume reporting under IFRS. The ultimate determination will depend on the specific facts and circumstances. Registrants that wish to apply the accommodation in General Instruction G under these circumstances should consult with the staff prior to filing.

B. Regulation S-X, Rule 3-05 - One year of significant acquiree financial statements with a basis of IFRS as issued by the IASB

Separate financial statements of significant acquirees are required to be provided in accordance with S-X Rule 3-05 in registration statements of foreign private issuers and domestic registrants, if certain significance thresholds are met. Additionally, domestic registrants are required by Form 8-K to include acquiree financial statements for completed acquistions for the periods required by S-X Rule 3-05, if the significance levels are met.

If significance is met at equal to or greater than 20% and less than 40%, one year of acquiree financial statements is required. Significance is required to be measured on an IFRS as issued by the IASB (IFRS-IASB) basis for IFRS-IASB filers and on a US GAAP basis for all other filers. Financial statements can be provided for a "foreign business" (as defined in S-X Rule 1-02(l)) on either a local GAAP basis, IFRS- IASB basis, or a US GAAP basis. A quantified reconciliation to US GAAP is required for foreign business financial statements prepared on basis other than US GAAP or IFRS-IASB, if significance exceeds 30%.

Comparative information under IFRS-IASB is specifically required by paragraphs 38 and 39 of IAS 1, *Presentation of Financial Statements*. Furthermore, IFRS 1.21 requires that to comply with IAS 1, an entity's first IFRS financial statements shall include at least three statements of financial position, two statements of comprehensive income, two separate income statements (if presented), two statements of cash flows and two statements of changes in equity and related notes, including comparative information.

The SEC staff allows in situations where only one year is required by Rule 3-05, for the audit report to include a qualification under IFRS or home-country GAAP solely for the absence of the comparative prior year financial statements. Section V.C. of the staff's publication of the *International Financial Reporting and Disclosure Issues in the Division of Corporation Finance* provides for this relief as follows:

> "Under Rule 3-05 of Regulation S-X, the period for which audited financial statements must be presented for a recently acquired business varies from one to three years depending upon its significance to the registrant. Some systems of GAAP, such as IFRS, specifically require prior year comparative financial statements to be presented when the most recent fiscal year is presented.
>
> In situations where only one year is required by Rule 3-05, the staff would not object if the audit report includes a qualification under IFRS or home-country GAAP solely for the absence of comparative prior year financial statements."

Instruction G to Form 20-F allows a foreign private issuer that is a first-time adopter of IFRS-IASB to file in applicable filings only two years (the current year or "IFRS Adoption Year" and the prior comparative year or "IFRS Transition Year") of financial statements prepared in accordance with IFRS-IASB, with appropriate related disclosures. (This same guidance is applicable to a first-time adopter of IFRS-IASB that qualifies as a foreign business.) The foreign private issuer (or foreign business) must adopt IFRS-IASB for the first time by an explicit and unreserved statement of compliance with IFRS-IASB. Such compliance must be unreservedly and explicitly stated in the notes to the financial statements and the auditor's report must include an opinion on whether the financial statements comply with IFRS-IASB.

A question arises as to whether the SEC staff's accommodation to allow an exception in an audit report for the absence of a prior comparative year would also be applicable to a set of financial statements which includes an exception in the audit report for the absence of the current year or IFRS Adoption Year.

Example: Assume that a calendar year-end registrant consummated an acquisition of a foreign business in April, 2012 that was significant at a level greater than 30% and less than 40%, measured on an IFRS-IASB or US GAAP basis, as required by the rules. The foreign business acquiree has prepared local GAAP financial statements as of and for the year ended December 31, 2011and has not previously published IFRS-IASB financial statements.

The company could satisfy its S-X Rule 3-05 financial statement requirements by:

- Presenting one year of local GAAP financial statements for the acquiree, reconciled to U.S. GAAP under Item 17 of Form 20-F.
- Presenting audited financial statements for two years of IFRS-IASB financial statements for 2011 and 2010 and a transition balance sheet at January 1, 2010 in accordance with IFRS 1, and the reconciliation disclosures required by IFRS 1.

The registrant is proposing to have the acquiree prepare financial statements that would present one year IFRS-IASB financial statements as of and for the year ended December 31, 2011, with an IFRS transition date of January 1, 2011 (i.e., a balance sheet as of December

31, 2011; statements of comprehensive income, stockholders equity and cash flows for the year ended December 31, 2011; and, a transition balance sheet as of January 1, 2011), and all the reconciliation disclosures required by IFRS 1. Registrants should also consider the need for cautionary language that discusses the risks of preparing financial statements in advance of an IFRS adoption date (See Q 6 in Appendix B of the May 2005 IPTF Highlights, http://thecaq.org/iptf/pdfs/highlights/2005_0517_IPTF_HLs.pdf.). A qualified audit report would also be included related to the financial statements for the absence of the "IFRS Adoption Year."

In situations where only one year is required by Rule 3-05, the staff indicated that it would not object if the audit report includes a qualification under IFRS solely for the absence of the IFRS Adoption Year financial statements. The staff views this accommodation as consistent with their prior policy of allowing an exception for the absence of the prior comparative year financial statements.

C. Transition guidance for adoption of IFRS No. 10 *Consolidated Financial Statements,* IFRS No. 11 *Joint Arrangements* and IFRS No. 12 *Disclosure of Interests in Other Entities*

IFRS 10, IFRS 11 and IFRS 12 require companies to adjust comparative periods retrospectively if the conclusion reached at the date of initial application (which is the beginning of the period of adoption) is different under previous IFRS guidance. As preparers began considering the adoption of IFRS 10, IFRS 11, and IFRS 12, commentators shared their view that retrospective application would be burdensome in many circumstances, particularly for multiple prior periods where information may be difficult to obtain.

In June, 2012, the IASB issued amendments to IFRS 10, IFRS 11 and IFRS 12 revising the transition guidance to provide relief from full retrospective application. As a result of the amendment, an entity need only make a retrospective adjustment for the annual period immediately preceding the date of initial application of these new standards (the "Immediately Preceding Period"). Additionally, under the amendment, an entity may present adjusted comparative information for any earlier periods presented, but is not required to do so. If an entity presents unadjusted comparative information for any earlier periods, it shall clearly identify the information that has not been adjusted, state that it has been prepared on a different basis, and explain that basis.

The impact of these amendments is particularly relevant to SEC foreign private issuers that are required to present audited statements of income, cash flows and equity for three periods, and also present five years of comparative financial information in the table of selected financial data.

The staff has indicated that it will not require restatement of the earlier periods presented beyond the Immediately Preceding Period for IFRS 10, IFRS 11 and IFRS 12.

However, the staff would expect that it be made clear on the face of the financial statements that the earlier periods have not been adjusted (e.g., through a footnote reference or otherwise). In addition, appropriate transparency should be provided in the table of five years of selected financial data and MD&A such that it is clear which periods have been retroactively adjusted and which periods have not been adjusted.

D. Monitoring Inflation in Certain Countries

Introduction

Registrants are responsible for monitoring inflation in countries in which they have operations. Application of "highly-inflationary" accounting as defined by ASC 830 is a judgment to be made by the financial statement preparer. The approach and the related assumptions used to monitor country inflation rates are described below. Under ASC paragraph 830-10-45-12, the determination of a highly-inflationary economy begins by calculating the cumulative inflation rate for the three-year period that precedes the beginning of the reporting period, including interim reporting periods. If that calculation results in a cumulative inflation rate in excess of 100%, the economy should be considered highly-inflationary in all instances. However, if that calculation results in the cumulative rate being less than 100%, historical inflation rate trends and other pertinent factors should be considered.

The Task Force discussed three-year cumulative inflation rates for certain countries. Countries were categorized as follows:

1. Countries with three-year cumulative inflation rates exceeding 100%

2. Countries where the three-year cumulative inflation rates had exceeded 100% in recent years

3. Countries (a) with three-year cumulative inflation rates between 70% and 100%; (b) where the last known three-year cumulative inflation rates previously exceeded 100% and current actual inflation data has not been obtained; or (c) with a significant increase in inflation during the current period

Description of how inflation rates are calculated

For all countries, data is extracted from the International Monetary Fund ("IMF") website. IMF data is extracted from www.imf.org as follows:

On the home page, click the "Data and Statistics" tab, then click:

- "World Economic Outlook Databases (WEO)" link
    - ◦ Select the most recent database
    - ▪ Select "By Countries (country-level data)"
        - Select "All Countries", then click the "continue" button.
            - ◦ Select "Inflation, end of period consumer prices" (both the index and percent change)
              ▪ Select a date range (e.g., 2008-2012); click "prepare report" and a table is produced with the data; click the "download" link to export to excel. The data table includes the actual and estimated end of period price indices for each country.

The IMF World Economic Outlook ("WEO") report estimates inflation when actual inflation data has not been obtained. The text of the report describes the assumptions and conventions used for the projections in the WEO. The data that are estimated are highlighted. While the IMF data has limitations (projected inflation data and varying dates through which actual data is included in the table), the calculated three-year cumulative inflation allows us to determine which country's calculations require further analysis.

> Note: From time to time the WEO refines or updates previously reported actual Consumer Price Index (hereafter referred to as "Index" or "CPI") data for certain countries.

Using the downloaded table, the three-year cumulative inflation rate is calculated as follows (assuming the current year is end of year 2011): (2011 End of Year CPI– 2008 End of Year CPI) / 2008 End of Year CPI

For certain countries, month-end CPI is obtained from each country's respective central bank website or other publicly available information. Often, that data must be converted because of differences in presentation or other reasons (for example, some countries have reset their base index back to 100 during recent years). Once the data has been converted to an end of period price based on a consistent index, the same calculation described above is used to calculate the three-year cumulative inflation rate. Using the central bank inflation data also has limitations. While it is often more current than the IMF data, each country releases its inflation data at different times. Finally, some countries' central banks do not currently publish inflation data.

The following information, based on the WEO Database – October 2012, is provided to assist registrants in applying the US GAAP guidance in determining which countries are considered highly-inflationary:

1. Countries with three-year cumulative inflation rates exceeding 100%

- **Belarus -** The three-year cumulative inflation rate for September 30, 2012 of Belarus was 153%, while the three-year cumulative rate is projected to be 193% by the end of 2012.

  The staff would expect registrants to continue to treat the economy of Belarus as highly-inflationary. [See November 22, 2011 IPTF Highlights Excerpt Link http://www.thecaq.org/iptf/pdfs/highlights/2011_November 22_IPTF_JointMeetingHLs.pdf].

- **South Sudan** – South Sudan, which became independent of Sudan in July 2011, became a member of the IMF since the release of the April 2012 WEO report. Index data is available beginning in 2010, and South Sudan's data was included in Sudan's index through July 9, 2011. Although data is not yet available to calculate a three-year cumulative inflation rate, the index increased 66% in 2011 compared with 2010 and 2012 is projected to increase 60%. The two-year cumulative inflation rate is projected to be 166% by the end of 2012.

  The staff would expect registrants to begin treating the economy of South Sudan as highly-inflationary no later than the first reporting period beginning on or after January 1, 2013.

2. Countries where the three-year cumulative inflation rates had exceeded 100% in recent years

- **Venezuela** - The three-year cumulative inflation rate for Venezuela was estimated to be 103% for 2011 and the three-year cumulative inflation rate at the end of 2012 is projected to be 98%.

  The staff would expect registrants to continue to treat the economy of Venezuela as highly-inflationary.

- **Democratic Republic of Congo -** The three-year cumulative inflation rate for The Democratic Republic of the Congo was 95% for 2011. The IMF projects the three-year cumulative inflation rate to drop to less than 40% by the end of 2012.

The staff expects registrants to cease treating the economy of the Democratic Republic of Congo as highly-inflationary no later than the first reporting period beginning on or after January 1, 2013.

3. Countries (a) with projected three-year cumulative inflation rates between 70% and 100%; (b) where the last known three-year cumulative inflation rates previously exceeded 100% and current actual inflation data has not been obtained; or (c) with a significant increase in inflation during the current period

(a) Countries with projected three-year cumulative inflation rates between 70% and 100%

- **Ethiopia** – The index increased 36% from 2010 to 2011 after a 15% increase from 2009 to 2010; the three-year cumulative inflation rate is projected to be 82% by the end of 2012.
- **Islamic Republic of Iran** – The index increased 22% from 2010 to 2011 after a 20% increase from 2009 to 2010; the three year cumulative inflation rate is projected to be 78% by the end of 2012.
- **Sudan** – The index is estimated to have increased by 19% from 2010 to 2011 after a 15% increase from 2009 to 2010; the three year cumulative inflation rate is projected to be 76% by the end of 2012. Sudan's data for 2011 excludes South Sudan after July 9, 2011. Projections for 2012 and onward pertain to the current Sudan.

(b) Countries where the last known three-year cumulative inflation rates previously exceeded 100% and current actual inflation data has not been obtained

None.

(c) Countries with a significant increase in inflation during 2012

- **Guinea –** The index increased 19% from 2010 to 2011 after a 21% increase from 2009 to 2010; the three year cumulative inflation rate is expected to be 61% by the end of 2012.
- **Yemen** – The index is estimated to have increased 23% from 2010 to 2011 after an estimated 12% increase from 2009 to 2010; the three year cumulative inflation rate is projected to be 58% by the end of 2012.

Notes:

- **Argentina**

Argentina had an estimated three year cumulative inflation rate of 31% in 2011 and the three year cumulative inflation rate is projected to be 33% by the end of 2012.

Although not appearing in any of the lists above, Argentina is highlighted in the WEO report as follows:

> Figures are based on Argentina's official GDP and consumer price index (CPI-GBA) data. The IMF has called on Argentina to adopt remedial measures to address the quality of the official GDP and CPI-GBA data. The IMF staff is also using alternative measures of GDP growth and inflation for macroeconomic surveillance, including data produced by private analysts, which have shown significantly lower real GDP growth than the official data since 2008, and data produced by provincial statistical offices and private analysts, which have shown considerably higher inflation figures than the official data since 2007.

Developments resulting from the IMF's efforts to address the quality of the official data should continue to be monitored.

The SEC staff has noted the IMF's concerns on the accuracy of the CPI-GBA data. Given the apparent lack of any other objectively verifiable inflation data, and the relatively low level of reported three-year cumulative inflation, the SEC staff has not observed data to date that would support Argentina being considered highly-inflationary in 2012. The Task Force intends to continue to monitor the situation in Argentina.

- **Countries not analyzed in the IMF WEO report**

  There may be additional countries with three-year cumulative inflation rates exceeding 100% or that should be monitored which are not included in the above analysis because the sources used to compile this list do not include inflation data for all countries or current inflation data. For example, countries that are not members of the IMF are not included in the WEO reports.

E. Satisfying the Registration Statement Requirements for Restated Financial Statements with IFRS-IASB financial information

The Task Force discussed the interaction between (1) the requirements for restated financial statements (e.g. Form F-1, Item 4A(b)(2); Form F-3, Item 5(b)(1)(ii); Form F-4, Item 10(c)(2)) to be included (or incorporated by reference) in a registration statement in circumstances where there has been a retroactive accounting change reported in a subsequent interim period that will require a material retroactive restatement of comparative annual periods in financial statements to be issued in the future and (2) the IAS 10, *Events after the Reporting Period*, requirement to have a single authorized for issue date for evaluating adjusting and non-adjusting subsequent events.

The staff noted that the registration statement requirements to update previously issued financial statements to reflect retroactive accounting changes (such as changes in accounting principles, discontinued operations or changes in segments) was intended to provide investors with relevant material information related to the changes being given retroactive effect. However, this requirement was not meant to result in changing the cut-off date for adjusting subsequent events. . Various possible alternatives for compliance with the registration statement requirements for restated IFRS financial statements were discussed with the staff. The Task Force agreed to study more fully the issue with the view of continuing the discussion at future meetings.

III. Staff Matters

A. Staff Observations Regarding the Use of IFRS XBRL Taxonomy by FPIs

The staff noted that the SEC has not yet approved an IFRS XBRL Taxonomy for IFRS filers. He does not expect that calendar year IFRS filers will have to comply with XBRL in their 2012 annual reports filed with the SEC. IFRS filers cannot comply with XBRL until the SEC approves the XBRL Taxonomy.

B. Staff Observations Regarding the Use of US GAAP XBRL Taxonomy by IFRS FPIs

The staff has observed instances of Form 20-F Filers submitting XBRL exhibits with IFRS financial information using the US GAAP taxonomy. The staff emphasized that the US GAAP XBRL taxonomy should be used for US GAAP financial information only. Using the US GAAP taxonomy for IFRS financial information carries the risk of incorrect and confusing information being provided to investors. It is important, therefore, that Form 20-F filers refrain from submitting XBRL exhibits for IFRS financial information until the IFRS taxonomy is finalized.

C. Reporting of Monetary Adjustments in Statements of Income and Cash Flows

The staff noted that certain registrants have arrangements where the contractually-determined future payments are adjusted for inflation. Where such arrangements are material, the staff reminds registrants to specifically address the nature and effects of the arrangements in Management's Discussion and Analysis and, for registrants that present IFRS financial statements, in the market risk sensitivity disclosures required by IFRS 7.

IV. Next Meeting

The next meeting of the Task Force has been set for May 21, 2013.