AICPA INTERNATIONAL PRACTICES TASK FORCE
AICPA Washington Office
May 23, 2002

HIGHLIGHTS

The AICPA SEC Regulations Committee's International Practices Task Force (the "Task Force") meets periodically with the Staff of the SEC to discuss emerging technical accounting and reporting issues relating to SEC rules and regulations. The purpose of the following highlights is to summarize the issues discussed at the meetings. These highlights have not been considered and acted on by senior technical committees of the AICPA, or by the Financial Accounting Standards Board, and do not represent an official position of either organization. In addition, these highlights are not authoritative positions or interpretations issued by the SEC or its Staff. The highlights were not transcribed by the SEC and have not been considered or acted upon by the SEC or its Staff. Accordingly, these highlights do not constitute an official statement of the views of the Commission or of the Staff of the Commission.

ATTENDANCE

Task Force Members

D.J. Gannon, Chairman (Deloitte & Touche)
Wayne Carnall (PricewaterhouseCoopers)
Melanie Dolan (KPMG)
Roger Jahncke (Ernst & Young)
Joseph Kelly (KPMG)
Debra MacLaughlin (BDO Seidman)
Tim Martin (McGladrey & Pullen)
Peter S. Nurczynski (Ernst & Young)
Joel Osnoss (Deloitte & Touche)
Eric Phipps (Arthur Andersen)
Carol Riehl (Grant Thornton)
Michael Walters (KPMG)

Observers

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

NEW CHAIRMAN

Mr. D. J. Gannon took the Chair in succession to Mr. Richard Dieter.

The Task Force wished to record their appreciation of Dick Dieter's time as Chairman. Dick was founding member of the Task Force and served as its chair for over eleven years. Under Dick's outstanding initiative and leadership, the Task Force became an effective and efficient forum for the discussion of emerging issues facing foreign filers and their auditors. The Task Force joined in thanking Dick for all the time, professionalism and expertise he has devoted to the Task Force and its mission.

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AGENDA ITEMS

1. Issues relating to the implementation of Appendix K of the SECPS rules

Background

At the November 2001 meeting, the Task Force discussed the application of the Appendix K of the SECPS Rules to a number of fact patterns. The Task Force noted the following points:

- The Task Force believes that the requirements only apply to the principal auditors and, therefore, if the principal auditor referred to another auditor, that secondary auditor did not need to comply with Appendix K of the SECPS Rules.
- The Task Force also believed that Appendix K did not apply to the auditor of financial statements included in a SEC filing pursuant to Rule 3-05 and Rule 3-09 of Regulation S-X.
- The Task Force believes that in joint audit situations both auditors are subject to the application of the Appendix K requirements.

The Task Force recognized that these interpretive matters were for the SECPS of the AICPA to determine.

Mr. Gannon provided the Task Force with an update on the recent discussions with the SECPS regarding the application of Appendix K. Mr. Gannon noted that a joint task force had been formed between the SECPS and the Task Force to address Appendix K issues (the "Appendix K Task Force"). Members of the Appendix K Task Force include D.J. Gannon and Eric Phipps, representing the Task Force and Mike Conway of KPMG and Wayne Kolins of BDO, representing the SECPS.

The SEC Staff has noted previously that while the filing reviewer procedures may not be required in certain of the circumstances described above, it believes that those procedures can improve the quality of financial reporting and disclosure, and encourages their application.

Appendix K Task Force

Mr. Gannon reported that the Appendix K Task Force met via conference call and discussed the following matters:

- The survey undertaken by the Task Force of the implementation of the requirements of Appendix K of the SECPS rules by those Firms represented on the Task Force (see minutes of November 2001 meeting). It was agreed that the survey had been intended to be no more than a sharing between the participating Firms of their experiences and practices and was not intended to highlight areas where the filing reviewer requirements in Appendix K needed to be changed.

  No significant comments were made. It was noted that the survey related to practices by the largest eight firms and did not include input from smaller firms. There were no other suggestions for distribution. A revised version of the results of the survey is attached as Appendix A.

- The scope issues raised by the Task Force (see above). It was agreed that the SECPS would consider these further.

  Mr. Gannon noted that the SECPS was scheduled to discuss, but did not, the scope issues raised by the Task Force at its November 2001 meeting (i.e., applicability to Rule 3-05, 3-09 and other auditors when there is a principal auditor).

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Mr. Gannon noted that the SECPS representatives raised the issue of updating annual report requirements as a result of changes in a Member's network affiliates. Current SECPS rules require all practice section Members to file an annual list of foreign firms but the rules do not mandate any quarterly or other periodic updates.

It was noted that the SECPS member firm should update the information contained in its annual report to reflect additions or deletions in the foreign associated firms that are part of its international organization and subject to the objectives as set forth in Appendix K. Such updates should be made as soon as practicable (ordinarily presumed to be within 30 days).

Application of Appendix K to certain filings on Form 6-K

The Task Force also discussed the applicability of Appendix K to certain filings on Form 6-K. Mr. Martin noted that the French COB has requested that companies include U.S. GAAP reconciliations in French GAAP Financials with French GAAP opinion, which are subsequently filed with SEC in 6-K filings. Additionally some French Foreign Registrants file 6-K's including interim financial information using U.S. GAAP.

Task Force agreed that Appendix K would not be applicable in these circumstances.

2. Reporting issues related to Andersen foreign affiliates

Following the March 14, 2002 indictment against Arthur Andersen LLP, various foreign affiliates of Andersen had announced that they were in the process of concluding transactions with other Firms whereby generally partners and staff would transfer to another Firm. Those Firms were presently considering their policies and guidance regarding issuance of reports and consents relating to former Andersen clients and reports.

The Task Force discussed several issues related to former Andersen affiliates. Issues included the name of the firm signing audit reports when a former Andersen affiliate is awaiting acceptance into another firm's network, the nature and scope of the filing reviewer requirements, the ability to issues consents, and situations where a re-audit is required.

In its discussion, the Task Force noted that:

- The SEC Staff had indicated it was unwilling to accept a written consent from Andersen once the engagement partner and manager have both left Andersen;
- In its Release date March 18, 2002 (Release 33-8070), the SEC addressed circumstances where Andersen was unable to issue a consent or reissue an opinion and in those circumstances permitted the registrant to include a copy of the prior Andersen report in the filing and "make prominent disclosure that the report is a copy of the previously issued … report and that the report has not been reissued by Andersen"; and
- AU Section 315 states that when one Firm has issued a report stating compliance with U.S. GAAS, another Firm cannot issue a U.S. GAAS report on the same financial statements without performing a reaudit.

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3. Future acceptance of IFRS

The Task Force discussed a recent speech given by Chief Accountant Bob Herdman on future acceptance of IFRS in the U.S. (see the speech, "Moving Towards the Globalization of Accounting Standards" by the Chief Accountant of the SEC on April 18, 2002 in Cologne, Germany).

It was noted that the increased use of IFRS would impact the Task Force. The Task Force agreed to discuss further issues related to the future acceptance and implementation of IFRS in the United States as needed.

4. Proposed legislation that may impact foreign affiliates of accounting firms

Mr. Gannon provided the Task Force with an update on certain proposed legislation that would impact foreign affiliates of accounting firms. Pending bills noted included Sen. Sarbanes bill, Sen. Enzi's bill, and Rep. Oxley's bill.

Mr. Gannon noted the applicability of the Sarbanes and Enzi bills to foreign accounting firms and foreign affiliates of U.S. accounting firms. In particular, it was noted that these bills would require consents related to working paper access and access to personnel in the context of an enforcement action raised by the oversight board.

5. Argentina: conference call on March 6, 2002

The Task Force noted the discussion by conference call on March 6 of certain further developments in Argentina since the last meeting of the Task Force (see Items XXVI and XXVII of the November 20, 2001 minutes). The minutes of the conference call are attached as Appendix B.

6. Update on the analysis of Task Force issues by country

As agreed at the November 2001 meeting, Mr. Jahncke and Ms Riehl had worked with Mr. Carnall on the analysis of issues addressed by the Task Force from its inception through January 2002.

The Task Force noted that this analysis would be a valuable tool in bringing together the conclusions reached by the Task Force over a number of years on issues that remained current. It was suggested that an introduction be drafted. Mr. Carnall agreed to revise the analysis and maintain the summary for future Task Force discussions. It was agreed that Annette Schumacher-Barr should arrange for its publication on the AICPA website.

7. Highly inflationary status of Russia

Since its transition to a market based economy in 1991, Russia has been considered to be hyperinflationary. The Task Force discussed the issue of whether or not Russia should come off hyperinflation given the recent declines in inflation rates. Mr. Carnall noted that the three-year cumulative inflation rate for Russia has declined from over 100% to approximately 77% at the end of March 2002. It also was noted that the current annual inflation rate is approximately 12%, which may suggest further declines in the cumulative inflation rate.

The Task Force noted that EITF Topic D-55 requires a change in inflationary status to be "other than temporary" before hyper inflationary accounting can be ceased. The Task Force agreed that there was not sufficient evidence that Russia's decline in inflation was "other than temporary" at this time.

However, it was noted that if inflation continued at the expected level, Russia may no longer be considered hyperinflationary beginning January 1, 2003. It was agreed that the Task Force would revisit the issue at its November meeting.

At that time the Task Force also would have a discussion of the status of other countries that were being treated as highly inflationary even though their cumulative rates of inflation were below 100%.

8. Swedish audit reports

Background

The Task Force had discussed this issue at its May 2001 and November 2001 meetings. The Task Force noted that auditors' reports in Sweden that were prepared in accordance with Swedish GAAS and company law referred to the auditor having responsibilities regarding the "administration of the company" and for determining whether the directors should be "discharged from their liability" to the company.

Discussion

Mr. Kelly provided an update on issues related to Swedish audit reports and noted that the Swedish audit profession was still discussing this issue. Mr. Walters agreed to follow up with the Swedish profession.

9. Valuation allowances of pension assets under Canadian GAAP

Background

Canadian GAAP was changed recently to provide additional guidance on the requirement that all pension assets be subject to an impairment test. These changes were made, in part, because of the possibility that legal and other restrictions may affect the employer's access to plan assets.

A major objective of pension legislation and ongoing regulatory action in Canada is to "protect" the retirement savings/income of current and future pensioners. Pension legislation requires certain minimum funding levels. As a result of significant investment returns and conservative funding requirements, Canadian pension plans tend to be over-funded. To access a surplus, companies can usually take a "contribution holiday". Withdrawals of a surplus are more difficult.

In the mid-1980s certain provincial governments instituted moratoriums on the withdrawal of surplus from pension plans. In most jurisdictions moratoriums have subsequently been replaced with requirements to share the surplus (between the company, plan members, former members, and others entitled to benefits from the plan) along with requirements for approvals by the respective regulatory body.

Labor unions have been particularly active in "protecting pensioners rights". A number of lawsuits were launched by unions/retirees/employees to obtain "a share" of plan surpluses that companies otherwise wished to withdraw. Some of the lawsuits were settled with the retirees receiving a portion of the plan surplus. Other lawsuits are still before the courts with the outcome uncertain.

The legislative environment continues to be in flux. In Ontario, temporary regulations dealing with surplus withdrawals have been extended a number of times with the current extension expiring in December 2002. The core proposals include: (1) surplus sharing based on negotiations between employers, members and pensioners; (2) consent levels for surplus sharing agreements of two-thirds of members and a similar proportion of former members; and (3) a mechanism, on full wind up, to avoid

delays in surplus distribution and to provide a process for members and pensioners to prompt surplus withdrawals.

Current practice

Canadian GAAP (CICA 3461) requires that any time a surplus is recognized as an asset, it should be reviewed for impairment. The impairment test consists of three parts:

- The first step is to isolate the portion of the accrued benefit asset that actually relates to the plan surplus. This is done by reducing the accrued benefit asset by (a) the aggregate of unamortized past service costs, unamortized actuarial losses and any unamortized transitional obligation over (b) the aggregate of unamortized gains and any unamortized transitional asset (the "adjusted benefit asset").
- The second step is to determine the portion of the plan surplus from which the employer can derive benefit (the "expected future benefit").
- The final step is to compare the expected future benefit with the adjusted benefit asset. If the adjusted benefit asset exceeds the expected future benefit, a valuation allowance is necessary. Allowances and changes to allowances are charged fully to earnings in the periods they arise.

Canadian SEC registrants typically have excluded from the U.S. GAAP reconciliation the effects of recognizing a valuation surplus on pension assets.

Issues

Should the recognition of a valuation allowance for pension assets be presented as a difference between U.S. GAAP and Canadian GAAP? If so, how should a company that historically has not included a reconciling difference characterize the elimination of the valuation allowance in the U.S. GAAP reconciliation?

Discussion

The Task Force noted that U.S. GAAP does not provide for valuation allowances against a pension asset. As a result, the Task Force believes that valuation allowances recognized under Canadian GAAP should be presented as a reconciling item for purposes of the U.S. GAAP reconciliation.

In cases where a Canadian SEC registrant historically has not included a reconciling item for the effects of recognizing a valuation allowance, the Task Force suggested that such amounts should be accounted for as a prospective change.

The SEC Staff indicated that it would consider this issue further and agreed to work with the Task Force in developing a way forward.

10. Brazilian tax issues

The Task Force had discussed this issue at its November 2000 and November 2001 meetings. Mr. Osnoss provided an update on recent guidance issued by the Brazilian IBRACON and noted that IBRACON had now issued Technical Interpretation 3/2002 in response to the Task Force's request that it address the various questions surrounding the accounting for contingent tax recoveries in Brazil.

While the IBRACON's interpretation addresses the accounting for gain contingencies, in general, it also specifically addresses the question of when a tax recovery is assured, and therefore recognizable. An English translation is attached as Appendix C.

The Task Force noted that the application of this guidance should ensure consistency between Brazilian GAAP and U.S. GAAP.

11. Actuarial assumptions used by pension plans in Brazil

Background

Companies in Brazil have historically prepared information relating to pension and post employment benefits using assumptions for both the discount rate and the rates of return on plan assets at around 6% above inflation. Historically, there has not been a market for long-term high quality fixed income securities in Brazil. Accordingly, this rate was used for the following reasons:

- 6% is the rate required by the Brazilian Regulatory Agency to be used by pension funds for local reporting and funding purposes (it was noted that this rate is subject to change by the Brazilian Regulatory Agency);
- 6% is the rate applied to the Savings Accounts System, which is, in most part, guaranteed by the Federal Government. The savings accounts could be considered the most conservative and low risk investment in the country; also, actuaries have also believed 6% above inflation was an adequate long-term rate to be applied to the Brazilian economic environment.

However, as most companies disclose their assumptions on a combined basis (estimated inflation + real interest rate) there is a wide range of rates being applied by the Brazilian SEC registrants.

As from the end of last year, the Brazilian government has been issuing long-term securities (over 30 years). These securities pay 6% interest plus inflation measured by the consumer price index and have been rated as "brAA" by Standard & Poors, in their Brazilian ratings list. However, it is not AA rated outside of Brazil. The Sovereign rating for Brazil is less than AA in the United States.

In EITF Topic D-36, the SEC Staff suggested that fixed income debt securities that receive one of the two highest ratings by a recognized ratings agency be considered high quality – i.e., Aa or higher.

Issues

Can the new government security be used to base the discount rate?

In making an assessment, there are several sub issues:

- Does the fact that the bond is linked to inflation make it variable as opposed to fixed?
- Does a bond with an AA rating in Brazil but not outside of Brazil qualify as a high quality debt instrument under EITF Topic D-36?
- Should actuarial assumptions be based on real or nominal rates?
- Should there be different rates used for discount rates and rates of return of assets?

Discussion

The Task Force tentatively concluded that the Brazilian government security should be considered a variable rather than a fixed rate security as it is linked to inflation. Consequently, that security could not be used as a basis for the discount rate.

The SEC Staff noted that in EITF Topic D-36 the Staff suggestion was framed in the context of a recognized rating agency's rating of U.S. corporate bonds. The Task Force tentatively concluded that, in

general, foreign registrants should have regard for the local rating scheme in making the determination of whether or not a security is considered "high quality".

The Task Force noted paragraph 186 of Statement 106 suggests that the rate of return on high quality zero coupon bonds be expressed in nominal terms. The Task Force tentatively concluded that other actuarial assumptions be based on nominal rates as well.

The Task Force expectation was that rates of return on assets would be determined separately from the appropriate discount rate. Statement 87 indicates that the expected long-term rate of return should reflect the average rate of earnings expected on invested funds that provide for benefits included in the projected benefit obligation. This rate is meant to be long-term in nature and company-specific. Considerable judgment is required in determining the appropriate expected rate of return.

12. Taiwan taxes

Discussion postponed until the next meeting.

13. German proforma financial statements

Discussion postponed until the next meeting.

14. Definition of a U.S. GAAS audit

Background

As discussed at the November 2001 meeting, certain SEC rules permit the financial statements of non-reporting target companies in an exchange offer to be unaudited. However, in the question and answer below (from the SEC Division of Corporation Finance Telephone Interpretations, dated July 2001) the Staff response was that the exception did not apply when the statements had been audited in accordance with local GAAS. In a particular situation the SEC Staff had insisted that the audit be expanded to U.S. GAAS. In its prior discussions, the Task Force noted that one area that may need to be assessed is compliance with the SEC's independence requirements.

Q: The instructions to Item 17(b)(5) to Form F-4 state that the financial statements of a non-reporting target company for the fiscal years before the latest fiscal year need not be audited if they were not previously audited. A similar provision is included in Form S-4. How do these instructions apply to a situation where those financial statements have been previously audited in accordance with non-U.S. GAAS?

A: If financial statements of a non-reporting foreign target have been previously audited in accordance with non-U.S. GAAS and those financial statements have been published for general distribution in the target's home jurisdiction or elsewhere, financial statements for those periods must be audited in accordance with U.S. GAAS and included in the registration statement.

The Staff will consider granting relief on a case-by-case basis in unusual circumstances.

The Staff had previously agreed to consider further its position.

Discussion

The Staff indicated that the above Q&A guidance continues to be appropriate. The Staff will consider requests for relief on a case-by-case basis. The Staff could be expected to grant relief where the registrant

demonstrates that obtaining a U.S. GAAS audit of the target company would require undue effort or expense.

15. SEC Staff issues

Andersen foreign affiliates – continuity of SECPS association and filing reviewer procedures

The SEC Staff noted that foreign affiliates of Andersen LLP were in various stages of transition to new relationships. Some foreign affiliates would continue to be subject to the Andersen system of quality assurance for the current 20-F reporting season. Others were joining other Firms and would be subject to the quality assurance procedures of the relevant new Firm.

The Staff noted that to the extent an Andersen foreign affiliate was no longer subject to the Andersen quality assurance procedure but had not yet formed an association with another SECPS Member and was not subject to such quality assurance procedures, the SEC Staff would require that ex-Andersen foreign affiliate to go through the process of being validated as competent to practice before the Commission prior to the Commission accepting reports signed in the name of that Firm.

Mandatory use of EDGAR

It was noted that the Commission has approved the SEC's rule proposal on mandatory use of EDGAR by foreign private issuers. The Staff noted that the Release contained a number of amendments to the proposed rule partly in response to the Task Force's comments. On transition, the Staff believed that a period of approximately six months was sufficient to enable a foreign issuer to prepare itself for EDGAR and had therefore adopted the following transition:

- The new rules applied to any documents filed or submitted on or after November 4, 2002; and
- A registrant filing its registration statement in paper before the effective date would be able to complete its filing in paper through December 31, 2002.

Critical accounting policies

The SEC Staff noted that in December 2001 the Commission had issued a Release " Cautionary Advice Regarding Disclosure about Critical Accounting Policies" (Release 33-8040). Subsequently, the Commission had issued a Proposed Rule: Disclosure in Management Discussion and Analysis about the Application of Critical Accounting Policies (Release 33-8098).

The Staff noted that under the Proposed Rule if financial statements were in non-U.S. GAAP, the registrant would have to consider the application of critical accounting polices in connection with both its primary financial statements and its reconciliation to U.S. GAAP. In addition, the Staff encouraged foreign private issuers and all other interested parties to comment on this aspect of the proposal.

Home country style variations in U.S. GAAS audit reports

Since the amendments to Form 20-F have been in effect, the Staff has no longer accepted audit reports in respect of foreign registrants that did not state explicitly and unconditionally that the audit was conducted in accordance with U.S. GAAS. However, the Staff had not changed its practice of accepting wording variations in audit reports to comply with local reporting formats, as these variations were stylistic reporting differences only.

The SEC Staff noted that it had dealt with a recent situation where a "true and fair" view opinion was issued in the context of a UK GAAP financial statement that meant something different than "presents fairly". In this case, a UK auditor desired to reissue a "true and fair" opinion on previously issued

financial statements that contained a material misstatement that was not considered a "fundamental error" under UK GAAP.

The UK Auditing Standard, SAS 450, states:

> " The comparatives form part of the financial statements on which the auditors express an opinion, although they are not required to express an opinion on the comparatives as such. Their responsibility is to establish whether the comparatives are the amounts which appeared in the preceding period's financial statements or, where appropriate, have been restated either to achieve consistency and comparability with the current period's amounts or to reflect a change of accounting policy or the correction of a fundamental error. "

UK GAAP states that prior year financial statements should only be restated for a material misstatement when that misstatement amounted to a fundamental error. The UK Standard FRS 3, " Reporting financial Performance" states:

> ***Prior period adjustments***
>
> 60 The majority of items relating to prior periods arise mainly from the corrections and adjustments which are the natural result of estimates inherent in accounting and more particularly in the periodic preparation of financial statements. They are dealt with in the profit and loss account of the period in which they are identified and their effect is stated where material. They are not exceptional or extraordinary merely because they relate to a prior period; their nature will determine their classification. Prior period adjustments, that is prior period items which should be adjusted against the opening balance of retained profits or reserves, are rare and limited to items arising from changes in accounting policies or from the correction of **fundamental errors**.
>
> 63 In exceptional circumstances it may be found that financial statements of prior periods have been issued containing **errors** which are of such significance as to destroy the true and fair view and hence the validity of those financial statements. The corrections of such **fundamental errors** and the cumulative adjustments applicable to prior periods have no bearing on the results of the current period and they are therefore not included in arriving at the profit or loss for the current period. They are accounted for by restating prior periods, with the result that the opening balance of retained profits will be adjusted accordingly, and highlighted in the reconciliation of movements in shareholders' funds. As the cumulative adjustments are recognised in the current period, they should also be noted at the foot of the statement of total recognised gains and losses of the current period."

In this case, the Staff objected to the issuance of a "true and fair" opinion without restatement for the error. The Staff indicated that it expects financial statements for all years on which an auditor provides an unqualified opinion in an SEC filing to be free from material misstatement, having regard to Staff Accounting Bulletin No 99 – "Materiality".

While the SEC Staff indicated that in some cases a "true and fair" view is meant to be the same as "presents fairly", there may be other cases where it is not. Although the 1999 Commission release adopting revisions to Form 20-F specifically permits style variations, the Staff noted that there is no practicable way of distinguishing which "true and fair" reports mean "presents fairly". As a result of this situation, the Staff has revised its position to require the opinion paragraph of all audit reports in filings with the SEC to follow the wording requirements of U.S. GAAS.

The Task Force noted some foreign affiliates filed their annual report to shareholders at the same time as their Form 20-F and consequently would need to have an auditors' report under local GAAS as well as under U.S. GAAS. However, it was recognized that a number of companies, principally UK companies,

already addressed this issue by having an auditors' report with a UK GAAS opinion paragraph and a U.S. GAAS opinion paragraph. The Staff would not object to that practice.

The SEC Staff would expect foreign affiliated firms to issue "presents fairly" opinion paragraphs for reports issued on or after September 30, 2002.

Audit reports signed outside the U.S. but audit conducted predominantly in the United States

The SEC Staff has become aware of a number of situations involving companies incorporated in Bermuda (but file on domestic forms as they do not meet the definition of a "foreign private issuer") where mainly a U.S. audit firm performed the audit work but the Bermudan firm signed the audit report. The SEC Staff indicated that in these cases it would expect the U.S. firm to sign the audit report. In cases where there is a legal requirement for the local firm to sign the audit report, both firms should sign the opinion for purposes of an SEC filing.

In these cases, the Staff would expect the U.S. firm to sign the report in the registrant's next annual report or registration statement. While the discussion largely concerned situations involving incorporation in Bermuda, the Staff also would expect similarly-situated registrants incorporated in other non-US jurisdictions to follow this approach.

Identification of IFRS practice issues warranting IASB/IFRIC attention.

The SEC Staff noted that it would be willing to raise any IFRS practice issues that are identified by the Task Force with the IASB or IFRIC, as appropriate.

Rule 3-05 financials for poolings under home country GAAP

Rule 3-05 financial statements are not required in a registration statement if the business combination was accounted for as a "pooling of interests" and is presently reflected in the registrant's restated audited financial statements. While Rule 3-05 was originally written in the context of U.S. GAAP, the Staff has not required 3-05 financial statements in situations where pooling was applied in the home-country GAAP financial statements, even if the business combination is reported as a purchase in the U.S. GAAP reconciliation.

With the adoption of Statement of Financial Accounting Standards No. 141, Business Combinations, pooling of interests is no longer an acceptable method of accounting for a business combination under U.S. GAAP. In addition, certain other jurisdictions also have recently changed their GAAP to prohibit poolings, or are contemplating such a change.

As a result, the Staff believes that the historical interpretation no longer produces an information content similar to that required by U.S. GAAP. Consequently, even if a foreign issuer adopted pooling of interests accounting in its primary home country GAAP financial statements, the Staff would require the registrant to file the financial statements required under Rule 3-05. This would apply in respect of business combination transactions initiated after June 30, 2002.

Rule 3-05/Rule 3-09 financial statements below 30% significance

Under Rule 3-05 and Rule 3-09, if financial statements are required to be filed by registrants for foreign acquirees or foreign equity investees and the financial statements are prepared on a basis other than U.S. GAAP, reconciliations to U.S. GAAP, complying with the reconciliation requirements of Item 17 of Form 20-F, must be provided only when the foreign acquiree or foreign investee is significant to the registrant at the 30% level or greater.

The SEC Staff noted that in cases where Rule 3-05 and 3-09 financial statements are issued and a U.S. GAAP reconciliation is not required because the significance level is below 30%, qualitative footnote

disclosures discussing the areas of difference in accounting principles, practices and methods used in preparing the non-U.S. GAAP financial statements from those accepted in the United States is still required. Such disclosures should be included in the notes to the audited financial statements.

U.S. GAAS for MJDS companies in filings on non-MJDS forms

At the November 2001 meeting, the Staff stated that the MJDS regime and its exception to allow registrants under the MJDS to have their financial statements audited in accordance with Canadian GAAS did not apply to the financial statements of a target (even though the target itself may have previously been reporting under the MJDS) when the registration statement itself was not filed under the MJDS.

The Staff clarified that this conclusion would apply to any circumstance where the financial statements of the MJDS company are required in the filings of a non-MJDS registrant, including under Rules 3-05, 3-09 and 3-10 of Regulation S-X.

16. Re-implementation of inflation accounting in Argentina.

Background

Mr. Carnall noted that Argentine GAAP now requires the use of inflation accounting. Under Argentine GAAP, prior year amounts are not fully restated for the effects of inflation, but rather all prior year amounts are recast for the current period effects of inflation to present all amounts in constant pesos as of the balance sheet date. As a result, companies are not required to make price-level adjustments for the inflation during periods through 2001.

Issue

Are inflation adjusted financial statements under Argentine GAAP in conformity with Rule 3-20 of Regulation S-X?

Discussion

The Task Force agreed that such financial statements would be in accordance with Rule 3-20 as the method constitutes a comprehensive system of price-level accounting. In addition, registrants should disclose the method of applying the re-implementation and its effects on the financial statements.

Hyperinflationary status of Argentina

In addition, the Task Force discussed the status of Argentina as hyperinflationary. The Task Force noted that the three-year cumulative inflation rate was approximately 21% through April. On that basis, and consistent with paragraph 11 of Statement 52 and EITF Topic D-55, the Task Force concluded that Argentina was not highly inflationary for the purpose of U.S. GAAP based on present information. The Task Force agreed to revisit the issue later in the year at its November meeting (or earlier, if warranted).

17. Disclosure of cash flow per share and other alternative per share numbers in financial statements

Background

Mr. Carnall noted the increasing use of alternative per share amounts in financial statements. A number of non-U.S. companies in home country GAAP financial statements are disclosing alternative per share numbers and frequently on the face of the income statement. The practice is especially prevalent among UK companies. These per share numbers are sometimes amounts derived directly from the income

statement (e.g., operating income) but frequently there are various adjustments to net income that must be made to determine the per share amounts.

U.S. GAAP prohibits the disclosure of cash flow per share. ASR 142 also prohibits the disclosure of cash flow per share. Historically, it is has been the view of the SEC Staff that in countries in which there was a specific standard that allowed cash flow per share to be presented, that such information should be excluded from the financial statements in a SEC filing.

Issues

Are alternative per share amounts permitted to be disclosed in SEC filings? If so, should there be required additional disclosures explaining the information?

Discussion

The Task Force concluded that provided registrants complied fully with the requirements of home country GAAP in presenting alternative per share amounts, such measures could be presented in SEC filings, if appropriately described.

As to disclosure, it was noted that UK FRS 3 contained disclosure provisions when presenting alternative per share measures. The following is an excerpt from paragraph 25 of the UK standard, FRS 3:

> "If an additional earnings per share calculated at any other level of profit is presented it should be presented on a consistent basis over time and, wherever disclosed, reconciled to the amount required by the FRS. Such a reconciliation should list the items for which an adjustment is being made and disclose their individual effect on the calculation. The earnings per share required by the FRS should be at least as prominent as any additional version presented and the reason for calculating the additional version should be explained. The reconciliation and explanation should appear adjacent to the earnings per share disclosure, or a reference should be given to where they can be found."

The Task Force agreed that, at a minimum, disclosure similar to the above should be included in an SEC filing when alternative performance measures are presented. Such disclosures should ensure that the performance measures used are not misleading.

In light of the Staff's longstanding views regarding non-GAAP measures, registrants can expect to be challenged in cases where at least the above disclosures are not made. The SEC Staff also noted that IOSCO has issued a cautionary statement on Non-GAAP earnings measures. It is on the IOSCO website (www.iosco.org, in the "Documents—Press Releases" section).

Subsequent to the Task Force meeting, the U.S. Congress enacted the Sarbanes-Oxley Act of 2002, which applies to both domestic and foreign private issuers. Registrants should be aware that Section 401(b) of the Act requires the SEC to adopt rules by early 2003 addressing, among other things, the presentation of pro forma (non-GAAP) financial information included in any periodic or other report filed with the Commission.

18. Applicability of SAB 74 disclosures to first-time application of IFRS

Discussion postponed until the next meeting.

19. ED on first-time application of IFRS

Mr. Gannon noted that the IASB is close to issuing its exposure draft on first-time application of IFRS. The Task Force noted that with the issuance of the ED, several disclosure issues will need to be addressed by the SEC, including the impact on the selected financial data requirements, and the disclosures required

in industry guides such as Guide 3 and 6. The SEC Staff acknowledged that certain issues would need to be addressed, although offered no views.

The Task Force will consider commenting on the ED once issued.

20. Life of intangible assets – U.K. FRS 10 vs. FAS 142

Discussion postponed until the next meeting.

21. Item 512(a)(4) of Regulation S-K – applicability to age of financial statements under Rule 3-09 of Regulation S-X

Discussion postponed until the next meeting.

22. Disclosures relating to business combinations when differences exist between U.S. and home country GAAP

Discussion postponed until the next meeting.

23. IAASB project on principal auditors

Discussion postponed until the next meeting.

24. Revaluations and land use rights in the People's Republic of China

Discussion postponed until the next meeting.

25. Update on impairment of investments under U.S. GAAP and IFRS

Discussion postponed until the next meeting.

Survey on SECPS Rules on Foreign Filers

In 1999, the SECPS introduced new rules that required the international organization or individual foreign associated firms of SECPS member firms to adopt policies and procedures consistent with the following objectives:

a) Procedures for Certain Filings by SEC Registrants – The policies and procedures should address the performance of procedures with respect to certain SEC filings by SEC registrants that are clients of foreign associated firms by a person or persons knowledgeable in accounting, auditing, and independence standards generally accepted in the U.S., independence requirements of the SEC and ISB, and SEC rules and regulations in areas where such rules and regulations are pertinent (the "filing reviewer"). The procedures are performed to provide assistance to the partner of the foreign associated firm responsible for the audit (the "audit partner-in-charge of the engagement") and the foreign associated firm. Such filings are limited to registration statements, annual reports on Forms 20-F, 40-F and 10-K, and other SEC filings that include or incorporate the foreign associated firm's audit report on the financial statements of a SEC registrant. The procedures performed by the filing reviewer should generally include the following:

1. Reading the document to be filed with the SEC with particular attention given to compliance as to form of the financial statements (and related schedules) and auditors' report with the applicable accounting and financial reporting requirements for such filings by the SEC registrant.

2. Discussing with the audit partner-in-charge of the engagement:

   (i) the engagement team's familiarity with and understanding of the applicable U.S. auditing, accounting, financial reporting, and independence standards, including independence requirements of the SEC and the ISB;

   (ii) the significant differences between: (a) the accounting and financial reporting standards used in the presentation of the financial statements included or incorporated in the document to be filed with the SEC and those applicable in the U.S., and (b) the auditing and independence standards of the foreign associated firm's domicile country and those applicable in the U.S.; and

   (iii) any significant auditing, accounting, financial reporting, and independence matters that come to the attention of the filing reviewer when performing the procedures described above, including how any such matters were addressed and resolved by the audit partner-in-charge of the engagement.

3. Documenting the results of the procedures performed. The procedures performed by the filing reviewer described above do not relieve the audit partner-in-charge of the engagement of any of the responsibilities for the performance of the audit of, and the report rendered by the foreign associated firm on, the financial statements included in the document to be filed with the SEC. Also, the filing reviewer does not assume any of the responsibilities of the audit partner-in-charge of the engagement or of any concurring reviewer. Because of the limited nature of the procedures described above, it is recognized that the filing reviewer can not and does not assume any responsibility for detecting a departure from, or non-compliance with, accounting, auditing, and independence standards generally accepted in the U.S., independence requirements of the SEC and ISB, or SEC rules and regulations."

The International Practices Task Force of the AICPA SEC Regulations Committee conducted a survey of its members in 2001 to determine how these rules were being applied in practice and to see whether there were any evolving common practices.

The remainder of this article sets out the results of the survey.

1. Identity of Filing Reviewer

The SECPS rules provide that the filing reviewer must be somebody with an appropriate knowledge of US Generally Accepted Accounting Principals ("GAAP") and US Generally Accepted Auditing Standards ("GAAS"). Beyond that it provides no further guidance and does not require the person to be a certified public accountant in the United States. The survey covered the following issues:

a) The seniority of the reviewer. The filing reviewer should be a partner or a senior manager.

b) The location of the filing reviewer. Firms organize themselves differently. Some firms require that the filing reviewer should be located in the National Office or possibly elsewhere within the United States. Other firms use filing reviewers that are designated by the National Office but which are generally located in local offices around the world. The key point was that the filing reviewer should be somebody with the appropriate experience of not just US GAAS and US GAAP, but also of the rules and requirements of the SEC including those relating to independence.

c) Is it possible for the filing reviewer to fulfill other engagement responsibilities such as the engagement partner? Generally, the filing reviewer is someone other than the engagement partner.

d) Does the filing reviewer need to be a specialist in that role? Generally for the firms in the survey, the filing reviewer would be a specialist in that role.

e) Can the filing reviewer delegate some of the review functions to another Staff member? Although some of the work may be delegated to managers and other support Staff, the filing reviewer retains his or her responsibilities and, therefore, cannot delegate responsibility.

f) Are filing reviewers always approved in advance by the National Office? For all the firms in the survey the answer was yes, on the basis that it is the National Office that is responsible overall generally for the firm's relationship with the SEC.

2. Role of Filing Reviewer

The SECPS requirements as to what the filing reviewer must do are general rather than specific. Some firms have developed practice aids to assist the filing reviewer to discharge his or her responsibilities for reviewing the SEC filing to determine their compliance with US GAAS, US GAAP and SEC requirements including independence.

The SECPS rules require that the filing reviewer assess the knowledge of the engagement team in US GAAP and US GAAS, but are not specific about how this should be done or how the assessment should determine the subsequent level of review. For most firms, evaluating the knowledge and experience of the engagement team is a matter of professional judgment for the filing reviewer. Where the level of knowledge of the team about US GAAP and US GAAS is strong, then most firms would influence the level of involvement by the filing reviewer. But where the filing reviewer identified weaknesses in team knowledge, then filing reviewers had a potentially significant input into addressing training needs for people working on foreign filer engagements. It was noted that the SECPS rules do not prohibit the filing reviewer from providing guidance and advice to the engagement team on the application of US GAAS, US GAAP, and the SEC's requirements throughout the performance of the engagement. In most cases, firms recognize that it is desirable, over the longer term, to increase the capability of local engagement teams regarding US GAAP and US GAAS issues if the investment of resources makes economic sense.

3. Application of US GAAS

The SECPS rules require that the filing reviewer assess the US GAAS competency of the engagement team and, of course, the SEC requires that the auditor state that the audit was conducted in accordance with US GAAS (possibly in addition to local GAAS). The changes in the Commission's rules relating to explicit statements as to compliance with US GAAS has reinforced the minds of many firms the SEC's requirement that audits of foreign private issuers be conducted in accordance with US GAAS. It was noted that most firms covered in the survey have additional practice aids to assist foreign engagement teams in the identification of any additional audit procedures that may be necessary in order to make sure that the audit of the foreign private issuer has been conducted in accordance with US GAAS.

4. Application of US GAAP

Many foreign private issuers choose to file financial statements in local GAAP, with reconciliation to US GAAP, pursuant to either item 17 or item 18 of Form 20-F. All firms covered in the survey believe that it is the responsibility of the foreign registrant to identify the relevant differences between local GAAP and US GAAP, and all firms covered in the survey have developed various approaches to assisting engagement teams in identifying such differences. In some cases this is done by the use of summaries of GAAP differences on a country-by-country basis. In addition, the relevant filing reviewer will often be selected as someone with experience of the local GAAP of a particular country, such that they can more readily identify differences from US GAAP or build up that expertise by experience.

5. Review of Work Papers

Most firms specify the minimum documentation that the filing reviewer must review. Generally, it should be possible for the filing reviewer to discharge their responsibilities without reviewing underlying audit work papers, although if necessary, the filing reviewer may consider it appropriate to ask for certain working papers dependent upon their professional judgment.

6. Documentation of Review

The SECPS rules require that the filing reviewer document the fact that they have appropriately discharged their responsibilities. All firms require some form of documentation that the review has been performed and a sign-off by the filing reviewer that they have discharged their responsibilities. However, it is emphasized that the filing reviewer is not required, in the same way that the engagement partner is required, to be satisfied that the financial statements are US GAAP compliant and US GAAS compliant.

7. Other US GAAP Engagements

The requirements of the SECPS as to the involvement of filing reviewers, only apply to SEC filings. In recent years there has been a tendency for financial statements of non-US companies to be prepared in accordance with US GAAP, even though those financial statements are not intended for use in a SEC filing. Some firms already require that those financial statements also are subject to review by a filing reviewer, and others are evolving their policy in this area.

While the SECPS requirements are only applicable if the company is a foreign private issuer, the SEC Staff will expect similar procedures to be applied if a non US firm signs an opinion on financial statements of an entity that is not a foreign private issuer as a condition to accepting the opinion.

AICPA INTERNATIONAL PRACTICES TASK FORCE
Meeting by telephone

March 6, 2002

HIGHLIGHTS

NOTICE: The AICPA SEC Regulations Committee's International Practices 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

William Decker (PricewaterhouseCoopers)
Wayne Carnall (PricewaterhouseCoopers)
Joseph Kelly (KPMG)
Melanie Dolan (KPMG)
Craig Olinger (SEC Observer)
Joel Osnoss (Deloitte & Touche)
Cindy Sobieski (Deloitte & Touche)
Eric Phipps (Arthur Andersen)
Carol Riehl (Grant Thornton)
Annette Schumacher Barr (AICPA)
Lisa Vanjoske (SEC Observer)
Debra MacLaughlin (BDO Seidman)

II. ARGENTINA

Background

The Task Force previously discussed on a January 14 conference call certain aspects of the situation in Argentina, in particular, the exchange rate to be used in remeasuring foreign currency transactions and translating December 31, 2001 financial statements. This telephone call addressed certain additional developments in Argentina.

I. Impact of Difference in Argentine GAAP and U.S. GAAP for companies filing with the U.S. Securities and Exchange Commission (SEC)

In response to the events occurring in Argentina, Argentine GAAP has been interpreted by the Argentine standard-setting body to require the use of a 1:1 (Argentina Peso/US$) exchange rate in remeasuring transactions and translating December 31, 2001 financial statements in accordance with Argentine GAAP.

II. Monetary Policy

From mid-December 2001, there was uncertainty as to who would ultimately take power in Argentina and what measures would be put in place to stabilize the economic turmoil that ensued following the resignation of the country's president and economic minister. Exchange holidays were put in place and the government restricted withdrawals from Argentine banks. In addition, all reports were that the historical "peg" of the Argentine Peso to the US$ on a 1:1 basis would be abandoned. There was significant civil unrest in Argentina in response to these measures although reports were that the Argentine government would include measures in its monetary policy to help consumers in order to ease the civil unrest.

On January 7, 2002, the new Argentine government released the details of its monetary policy, including:

- An official exchange rate of 1.4:1 for use in certain international trade transactions (i.e., import/export transactions).
- A re-denomination of certain US$ consumer loan balances into Pesos at a rate of 1:1.
- US$ obligations between private parties not subject to the 1.4:1 exchange rate or re-denomination at 1:1 would be liquidated at a negotiated rate.

The free market exchange of the Argentine Peso re-opened on January 11, 2002 with limited activity due to continued government controls over the amounts of transactions.

In early February 2002, the Argentine government announced several changes to the January 7 monetary policies, including:

- All US$ loans in Argentine banks would be re-denominated at a rate of 1:1. This would include loans between private parties (e.g. receivables and payables).
- All US$ deposits in Argentine banks held by depositors domiciled in Argentina would be re-denominated at a rate of 1.4:1, except that for deposit accounts less than $30,000, depositors would have 90 days to decide whether to convert those accounts at 1.4:1 or receive 10-year US$ denominated Argentine government bonds.

Effective February 11, 2002, there would no longer be an "official" exchange rate for import/export transactions (previously fixed at 1.4:1 on January 7, 2002), thus all transactions would be subject to the free market exchange rate.

Issues

I. Impact of Difference in Argentine GAAP and U.S. GAAP for companies filing with the U.S. Securities and Exchange Commission (SEC)

1. Should the home country financial statements of a foreign filer with the SEC using Argentine GAAP use the exchange rate in accordance with U.S. GAAP (January 11, 2002 free-market rate) or the exchange rate in accordance with Argentine GAAP?

Conclusion

The Task Force understood that the Argentine standard-setter had determined that the application of Argentine GAAP required the use of the 1:1 exchange rate at and for the year ended December 31, 2001. Therefore, the Task Force would expect an entity filing with the SEC financial statements prepared in accordance with Argentine GAAP to report a reconciling item to U.S. GAAP in respect of the differences in exchange rates used to remeasure foreign currency transactions and translate December 31, 2001 financial statements.

II. Monetary Policy

1. For US$ functional entities domiciled in Argentina, what is the impact of the January 7, 2002 decree (including the re-denomination of US$ consumer loans)?

Conclusion

The Task Force believes that the effect of the January 7, 2002 monetary policy announcement re-denominating US$ consumer loan balances into Pesos should be recorded in 2002. This is supported by analogy to paragraph 27 of FAS No. 109, *Accounting for Income Taxes*, that requires the adjustment of deferred tax liabilities and assets for a change in the tax laws or rates in the period that includes the enactment date. In other words, recognition and measurement is linked to the enactment date and cannot be anticipated.

The Task Force also recognizes that considerable uncertainty existed following the January 7, 2002 monetary policy announcement, noting that the Argentine government's actions were unprecedented and that an exchange holiday was in effect from late December 2001 until January 11, 2002. In addition, on January 14, 2002 the Task Force deliberated how to apply EITF Topic D-12, *Foreign Currency Translation – Selection of Exchange Rate When Trading Is Temporarily Suspended*, as it applied to the determination of the appropriate exchange rate to use for Argentine peso remeasurement/translation purposes as of December 31, 2001 (see Items 1-5 of the January 14, 2002 minutes). At that time, the Task Force noted that no foreign currency exchangeability existed in Argentina at December 31, 2001 and up until January 11, 2002 (the date on which limited exchangeability was restored) and concluded that the dividend remittance rate for December 31, 2001 financial statements was the free-market rate as of January 11, 2002 (pursuant to paragraph 26 of FAS 52), therefore exchange rates ("official" and "free market") in effect on January 11 should be used to remeasure/translate pesos at December 31, 2001.

The Task Force noted that prior to the date of these minutes (March 6, 2002) there was diversity in the treatment of the January 7, 2002 re-denomination. Given the unusual circumstances, those companies would not be required to change their accounting.

In addition, the Task Force believes that receivable and loan balances of Argentine companies should be assessed for impairment based on current information and events (i.e., based on all relevant facts and circumstances available at the date of the impairment test). That analysis would consider, whether or not, it is probable the debtor can pay all amounts due under the contractual terms of the receivable or loan in existence at the balance sheet date (i.e., December 31, 2001). Consequently, the subsequent re-denomination of any receivable or loan balances as a result of the emergency orders in 2002 would not result, in and of itself, in impairment. However, the impact of such events, as well as any other relevant events, should be considered when determining whether or not the debtor can make payment.

The Task Force notes that any impairment may result in a write-down of a receivable or loan to an amount that may be different than that resulting of any subsequent re-denomination.

The Task Force also notes that disclosure of events occurring subsequent to year-end, but before the issuance of financial statements, would be required, if material.

2. For Peso functional entities domiciled in Argentina, what is the impact under U.S. GAAP of the January 7, 2002 decree (including the re-denomination of US$ consumer loans)?

Conclusion

The Task Force notes that under paragraph 26 of FAS 52 foreign currency transactions would be remeasured based on the first rate subsequent to December 31, 2001 at which transactions may be settled. In many circumstances that rate may be the free market exchange rate in effect on January 11, 2002. Presumably transactions could have been settled between January 11, 2002 and the dates of the subsequent law changes. If the market rate could not have been used to settle foreign currency transactions, then the applicable rate should be used based on the Argentine government's emergency order. The Task Force also notes that paragraph 32 of FAS 52 specifies that subsequent rates should not be used to adjust financial statements.

Registrants that may have recognized the effects of the January 7, 2002 re-denomination as of December 31, 2001 given the diversity in treatment as described in Item II.1 above, would record no accounting impact as of December 31, 2001 for the remeasurement of those assets from US$ to Pesos.

3. When should the effect of the February 3, 2002 decree be recorded?

The Task Force concluded that the effect of the February 3, 2002 decree should be recorded as a 2002 event. The decree should be considered a Type II subsequent event for financial statements as of December 31, 2001. In addition, companies should consider applicable requirements to disclose the anticipated effect of the decree.

Consistent with the conclusion in question 1 above, the Task Force believes that receivable and loan balances of Argentine companies should be assessed for impairment based on current information and events.

4. Do the events in Argentina provide a reason for an entity to change its functional currency from US$ to Pesos?

Conclusion

The Task Force noted that changes in an entity's transactions and activities following the devaluation may require a re-evaluation of the entity's functional currency. An entity's functional currency is a matter of fact. FAS 52 explains that, once a determination of an entity's functional currency is made, "that decision shall be consistently used for each foreign entity unless *significant changes in economic facts and circumstances indicate clearly* that the functional currency has changed" (emphasis added).

The Task Force understands that the use of the US$ and other foreign currencies appear to be severely restricted by the Argentine government. Therefore, subsequent to January 1, 2002, the Task Force concluded that entities may need to reassess whether the Argentine Peso should be the functional currency. The Task Force noted that all facts and circumstances should be

considered in making this assessment, including an assessment of the expected duration of changes in circumstances.

IBRACON Technical Interpretation 03/2002.

Accounting Treatment of Contingent Gains

(This is a free translation of the original issued in Portuguese)

Due to the difficulties that have been encountered by professionals in addressing legal, tax and other claims filed in court by companies, the Brazilian Institute of Independent Auditors – IBRACON, considers it appropriate to reaffirm its understanding on the accounting treatment of so-called contingent gains. Within this context, the objective of this Interpretation is to provide guidance on the application of paragraph 7 of Pronouncement XXII – Contingencies, on the accounting treatment of contingent gains, specifically focusing on litigation related to recoverable tax or extinction of tax liabilities previously recorded.

Question 1

What is the nature of a contingent gain?

Response

Based on Pronouncement XXII – Contingencies, issued by IBRACON, they are potential gains contingent on conditions or situations that are undefined at the time the financial statements are prepared and, as such, depend on events that may or may not occur.

Within this context, a contingent gain represents the potential right to recover tax paid or the potential extinction of tax liabilities previously recorded.

Question 2

Under what circumstances may a company record a contingent gain in accordance with accounting practices generally accepted in Brazil?

Response

As set forth below, Paragraph 7 of Pronouncement XXII – Contingencies defines when a contingent gain shall be recognized:

"As a general rule, contingent gains shall not be recorded under the concept of conservatism, an accounting convention which provides that revenue / income be recognized only when realized."

In this regard, the Brazilian Securities Commission – CVM issued its Guidance Opinion 15/87, which reads:

"The convention of Conservatism (also called Prudence) provides that between valuation alternatives considered equally valid, pursuant to generally accepted accounting principles, the accounting treatment selected shall be that which presents the lower current amount for assets and the higher amount for liabilities. Such understanding shall not be mistaken or misinterpreted as the effects of manipulation of accounting results; rather, it must be viewed in the light of discretion, care and neutrality required of Accounting, principally to forego excesses of enthusiasm and valuations on the part of management and owners of the legal entity concerned (see item 6.3 of the pronouncement attached to CVM Resolution 29/86).

Under such convention, contingent assets or contingent gains shall not be recorded; only upon their effective realization or recovery shall they be recognized. Accordingly, a possible gain on administrative or judicial disputes shall be recognized only after such proceedings have been closed by a final judgement, at all court levels, favorable to the company. If the company has already recognized income relating to assets in litigation (for instance, trade receivables), it is required to recognize an allowance for losses equal to the contingent amount."

Question 3

In situations when the Company is awarded a final favorable decision on a contingent gain, when should this gain be accounted for - upon such court decision or upon cash collection?

Response

In the event the other party has no further right to appeal, the risk of nonrealization of the contingent gain is deemed "remote" and therefore the Company shall recognize the gain upon the final decision, which normally occurs after publication in the Official Gazette ("Diário Oficial"). This means that it will no longer be considered a contingent gain, but rather a right or asset of the company; prior to its recording, however, company management must take into account the procedure described in the following paragraph.

Prior to recording the contingent gain and periodically after having recorded it, company management shall assess the ability to recover such asset inasmuch as the other party may become incapable of honoring this commitment or its future utilization may be uncertain. For assessments subsequent to such recording, the need for recognizing a valuation allowance shall be considered.

Question 4

In situations in which the company has not yet obtained a final decision favorable to the recovery of a specific tax or to the extinction of a tax liability previously recorded, but there are precedent-setting decisions favorable to other companies in identical cases and the attorneys are of the opinion that the chances of a favorable outcome are probable, may this company recognize the contingent gain supported by such legal precedent and the attorney's opinion?

Response

Even in situations in which favorable legal precedent exists, this is not enough to support contingent gain since it does not ensure a final decision favorable to the company because many other factors may weigh on this decision; for instance, type of business, formal procedural steps, etc.

Likewise, even if the company is supported by a preliminary injunction and favorable legal precedents exist, the above concept shall prevail (nonrecognition of the gain). The company should disclose the status of the matter in the footnotes to its financial statements.

Question 5

For cases pending a final outcome, in which the company is challenging tax amounts allegedly overpaid and obtains an injunction authorizing it to offset such amounts against other taxes, should it record the contingent gain supported by this injunction?

Response

As an injunction is a temporary order, contingent gain recognition is not yet possible because the realization of such gain is not definitive.

The company will offset the amounts financially; however, the tax amounts offset will still be considered as a liability until the final outcome of the respective dispute, since settlement is also temporary, and in the event of an unfavorable outcome, the company will be required to pay the tax amounts previously offset plus applicable fines and interest.

Question 6

Is the practice followed in Brazil consistent with the best international practices?

Response

Yes, the accounting practices followed in Brazil are consistent with international standards prescribed by IAS 37 addressing this specific matter, issued by the International Accounting Standards Committee. These standards, in brief, conclude that *"A company shall not recognize a contingent asset."*

The provisions of SFAS 5 for U.S. accounting treatment are also in line with the above standards.

São Paulo, February 18, 2002.

Márcio Martins Villas
President

Francisco Papellás Filho
Director for Technical Matters

AICPA INTERNATIONAL PRACTICES TASK FORCE
Addendum to
May 23, 2002

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.

ARGENTINA – ISSUES REGARDING INFLATION

Background

In Argentina there are two primary inflation indexes – the Wholesale Price Index (WPI) and the Consumer Price Index (CPI). Argentine GAAP requires use of the WPI to measure inflation. A general discussion of the two indexes follows:

Wholesale Price Index (WPI)

This index measures the progress of the wholesale price of domestic and foreign products offered in the domestic market. The observed prices include value added tax, internal taxes and other charges included in the price.

The measurement of WPI is based on domestic primary products (agricultural, fishery, petroleum (crude) and natural gas and nonmetalic minerals), domestic manufactured products (foods and beverages, tobacco, textile products, clothing and other textile garments, leather articles and footwear, lumber and wood products except furniture, paper and paper products, printing and recordings, refined petroleum products, chemicals and chemical products, rubber (latex) and plastics products, nonmetal mineral products, basic metal products, metal products except machines and equipment, machines and equipment, electrical machines and appliances, radio and TV sets, medical equipment and measuring instruments, motor vehicles, vehicle bodies and spare parts, other means of transportation, furniture and other industrial products), electric power and import products.

Consumer Price Index (CPI)

This index measures the progress of the prices of a group of goods and services that represents the people consumption.

The measurement of CPI is based on prices of foods and beverages, apparel, housing, household equipment and maintenance, medical attention and health-care expenses, transportation and communication services, leisure, education and various supplies and services.

At September 30, 2002, the cumulative inflation rates for the year were approximately 121% and 40% for the WPI and CPI, respectively (Note: these rates approximate the three-year cumulative inflation rates). The main reason of the gap between the WPI and CPI relates to restrictions imposed by the government on the prices of certain services (i.e. public utilities including transportation). In addition, other services adjusted their prices in a lesser extent.

AICPA INTERNATIONAL PRACTICES TASK FORCE
Addendum to
May 23, 2002

HIGHLIGHTS

Issue

Which index should be used to measure inflation in Argentina under US GAAP – the WPI or the CPI?

Discussion

Statement 52, *Foreign Currency Translation*, refers to a "general price index" when measuring inflation. The Task Force noted that Statement 89, *Financial Reporting and Changing Prices*, which provides additional guidance on the measurement and presentation of supplementary information related to the effects of changing prices, also refers to a "general price index" and requires use of the Consumer Price Index when applying the "restate-translate" method.

Mr. Carnall noted that their Firm's accounting manual contained the following guidance:

> *The FASB staff have indicated that the FASB intended that inflation rates used to derive cumulative inflation broadly based measures of general inflation similar to the U.S. CPI. Accordingly, it would generally not be appropriate to compute the index based upon company or industry data only. International Financial Statistics, issued monthly by the Bureau of Statistics of the International Monetary Fund, is a recognized source of international statistics on various aspects of international trade, including inflation statistics.*

Mr. Carnall also noted that the report published by the IMF includes the Argentine CPI.

Conclusion

The Task Force concluded that for purposes of measuring inflation in Argentina under US GAAP that the Consumer Price Index should be used. The SEC staff did not object to this conclusion.

Other issues

As a result of the above conclusion, the Task Force noted the following:

Financial statements prepared in accordance with Argentine GAAP and in pesos

As noted in Item 16 of the May 23, 2002 highlights, the method of accounting for inflation under Argentine GAAP constitutes a comprehensive system of price-level accounting. Item 17(c)(2)(iv)(A) of Form 20-F allows a company to omit the effects of applying the historical cost/constant currency method in the US GAAP reconciliation regardless of the rate of inflation.

Therefore, companies preparing financial statements in pesos that are price-level adjusted reflecting the effects of inflation in accordance with Argentine GAAP will NOT be required to adjust such amounts in reconciling to US GAAP.

Financial statements prepared in accordance with US GAAP and in pesos

The SEC staff has indicated in its outline, *International Financial Reporting and Disclosure Issues* that the definition of highly inflationary in Statement 52 and Rule 3-20 of Regulation S-X should be the same when applying APS 3, *Financial Statements Restated for General Price-Level Changes*. As a result, the CPI would be used in the determining the historical cost/constant currency amounts.

Therefore, companies preparing financial statements in pesos in accordance with US GAAP would adjust for the effects of inflation **only** if the economy is highly inflationary as defined by Statement 52 and Rule 3-20 of Regulation S-X.

AICPA INTERNATIONAL PRACTICES TASK FORCE
Addendum to
May 23, 2002

HIGHLIGHTS

Financial statements prepared in accordance with non-U.S. GAAP standards and in a hyperinflationary functional currency

Item 17(c)(2)(iv)(B) of Form 20-F only would be applicable in cases where the local economy would be considered highly inflationary as defined by Statement 52 and Rule 3-20 of Regulation S-X. Accordingly, if a local economy was considered highly inflationary under the GAAP used in the primary financial statements but not under US GAAP, a company would need to quantify the differences in accounting for hyperinflation in the US GAAP reconciliation.