AICPA INTERNATIONAL PRACTICES TASK FORCE
AICPA Washington Office
July 15, 2003
HIGHLIGHTS

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

ATTENDANCE

Task Force Members

D.J. Gannon, Chairman (Deloitte & Touche)
Wayne Carnall (PricewaterhouseCoopers)
Paul Curth (Ernst & Young)
Melanie Dolan (KPMG)
Scott Gehsmann (PricewaterhouseCoopers)
Debra MacLaughlin (BDO Seidman)
Tim Martin (McGladrey & Pullen)
Peter Nurczynski (Ernst & Young)
Joel Osnoss (Deloitte & Touche)
Eric Phipps (Deloitte & Touche)
Carol Riehl (Grant Thornton)
Michael Walters (KPMG)

Observers

Jill Davis (SEC Observer)
Paul Dudek (SEC Observer)
Susan Jones (AICPA)
Susan Koski-Grafer (SEC Observer)
Craig Olinger (SEC Observer)
Annette Schumacher Barr (AICPA)
Alison Spivey (SEC Observer)

AGENDA ITEMS

1. Inflation status of certain countries

Background

At the last meeting of the Task Force in March 2003, it was agreed that inflation rates be monitored regularly in order to identify cases where the Task Force could discuss a country's inflationary status

under Statement 52. Based on the cumulative inflation information, countries would be categorized as follows:

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

Based on the screening process previously agreed, including the potential for a registrant to have material operations, the Task Force agreed to discuss the inflationary status of the following countries: Argentina, Romania, Turkey and Venezuela.

Issue

What should be the inflationary status of the countries discussed?

Conclusion

The Task Force noted that the cumulative inflation rates for the following countries have historically exceeded 100% and, therefore, have been and should continue to be considered highly inflationary:

- Romania
- Turkey

The Task Force also agreed that the following countries, while not considered highly inflationary at this time, should be monitored:

- Argentina
- Venezuela

2. Issues related to Venezuela

Background

As discussed in the March 2003 Task Force meeting, in January 2003, the Venezuelan government suspended the exchange of bolivars (VEB) for dollars. In February 2003, the government implemented an exchange control regime, under which it created a foreign exchange control agency (CADIVI) that approves all foreign currency transactions and instructs the Central Bank (BCV) to release foreign currency to approved companies.

At the time of the March 2003 Task Force meeting, there had been no dollars released by the BCV. As a result, there was a practical issue as to the appropriate foreign exchange rate that should be used for remeasurement purposes and the translation of financial statements. At the March 2003 meeting the Task Force agreed that there were only two acceptable rates -- either the government's Official Rate (1,600

VEB) or the last available market-closing rate (approximately 1,900 VEB as of January 22, 2003) -- that could be used for remeasurment and translation purposes.

Subsequent to the March 2003 Task Force meeting, the BCV began releasing dollars pursuant to instructions of CADIVI. Under the exchange control regime, approved dollars are released by the BCV at the Official Rate. However, such releases have been minimal in relation to amounts requested. On July 9, a director of the BCV stated publicly that while CADIVI had received requests for US$ 5.34 billion, and US$1.07 billion of such requests had been *approved* by CADIVI, the BCV had only received orders from CADIVI to release US$180 million. The amount of dollars released represents 3.37% of transactions *requested*, and 17% of the amounts *approved* by CADIVI for release.

The Venezuelan government recently announced a more expeditious process to approve and release dollars. The government also has publicly stated that certain measures are being considered, such as an increase in the Official Rate, and a dual exchange regime. As a result of these announcements, as well as discussions with CADIVI officers, the Task Force understands that additional dollars will be released in the next few weeks; however, the business community is doubtful that there will be a significant increase in the volume of dollars released by the BCV in the near term.

Issue

In light of the fact that the Venezuelan government has begun the release of dollars, albeit in insignificant amounts relative to amounts requested, should the Official Rate be used to remeasure and translate bolivar financial statements -- because it constitutes a rate at which "exchanges could be made"?

Conclusion

In cases where an entity was previously using 1,900 VEB (i.e., the last available market rate), the Task Force expressed concern over using the Official Rate of 1,600 VEB if, in fact, very few dollars were being released at that rate or there were significant restrictions on the types of items for which the Venezuelan government would, in practice, settle at the 1,600 VEB rate.

The Task Force also reaffirmed its prior conclusion that a registrant should continue to use its originally chosen rate until a sufficient change in circumstances occurs. The Task Force noted that the disclosures previously discussed at its March 2003 meeting would continue to be applicable. In addition, the Task Force agreed to monitor developments in Venezuela and consider the need to revisit its conclusion, as appropriate, based on new facts and circumstances.

The Task Force reaffirmed its prior view that it would not be appropriate to deconsolidate Venezuelan operations absent any other control considerations as the lack of exchangeability does not appear to meet the "other than temporary" threshold in paragraph 26 of Statement 52.

3. Reporting issues

a. Follow up on GAAP reconciliations

Background

At its meeting in March 2003, the Task Force discussed the issues relating to the inclusion of an explanatory paragraph referring to the U.S. GAAP reconciliation footnote in audit reports of foreign private issuers.

The Task Force agreed to consider further whether or not to include language in the additional paragraph when included in auditors' reports which make clear management's responsibility. It was proposed that each Task Force member consider whether their firm could accept language along the following lines:

> "Accounting principles generally accepted in [registrant's country] vary in certain significant respects from accounting principles generally accepted in the United States of America. Management has disclosed the effect of the application of accounting principles generally accepted in the United States of America on results of operations for each of the years in the three-year period ended December 31, 20X2 and stockholders' equity as of December 31, 20X2 and 20X1, to the extent summarized in Note X to the (consolidated) financial statements."

Discussion

The Task Force discussed whether it was necessary to explicitly state management's responsibility for the U.S. GAAP reconciliation footnote. It was noted that this is addressed in the overall statement that management is responsible for the financial statements in their entirety. Mr Carnall and Mr Walters agreed to develop new wording, which could be considered by the Task Force at its next meeting.

b. Division of responsibility regarding GAAP

Background

AU 543 provides guidance on the wording of the auditor's report if the principal auditor decides to make reference to the work performed by other auditors. In these situations, Rule 2-05 of Regulation S-X requires the inclusion of all auditor reports in the filing. In situations involving a multinational company, the basic accounting principles used to prepare the financial statements of entities audited by the other auditor may be different than that used by the issuer.

To illustrate, assume the financial statements of the issuer are prepared in accordance with UK GAAP. The principal auditor refers to the work performed by another auditor on Subsidiary A. The financial statements of Subsidiary A are prepared in accordance with German GAAP. In this illustration, one of the auditor's must assume responsibility for auditing the conversion of Subsidiary A from German GAAP to UK GAAP. In addition, the UK issuer would be required to present a reconciliation from UK GAAP to U.S. GAAP (which would include reconciling subsidiary A's UK GAAP net income and shareholders' equity to U.S. GAAP).

The SEC staff has indicated in their paper on *International Financial Reporting and Disclosure Issues* that "[T]he staff expects the division of responsibility among the auditors to be clear. One of the auditor's reports should clearly state who is responsible for auditing the "conversion" of the financial statements from the foreign GAAP into the GAAP used in the primary financial statements."

Issue

The SEC Staff has recently raised questions about the division of responsibility for auditing the reconciliation to U.S. GAAP. In the example above, should one of the auditor's reports specifically indicate that they are assuming responsibility for the U.S. GAAP information as it relates to Subsidiary A?

Discussion

The Task Force agreed that the fundamental question is whether or not it is appropriate for the principal auditor to assume responsibility for auditing both the conversion to the GAAP used in the primary financial statements and to U.S. GAAP while relying on the work of a subsidiary auditor, where the subsidiary reports on an accounting basis other than either that used in the primary financial statements or U.S. GAAP.

Some Task Force members did not believe it was appropriate for the principal auditor to refer to relying on the subsidiary auditor while appearing to take responsibility for auditing the conversion of the GAAP used in the subsidiary's financial statements to the GAAP used in the primary financial statements and the reconciliation to U.S. GAAP.

One possible approach noted was for the subsidiary to include in its financial statements a reconciliation from the GAAP used in it's financial statements to the GAAP used in the financial statements of the issuer, and a reconciliation from the GAAP used in the financial statements of the issuer to U.S. GAAP. Using the illustration above, subsidiary A would include reconciliation from German GAAP to UK GAAP and from UK GAAP to U.S. GAAP. The auditor's report on subsidiary A should mention that the notes to the audited financial statements include the aforementioned reconciliations – similar to what the principal auditor generally does on the financial statements of the issuer.

The Task Force agreed to discuss this issue further at the next meeting.

c. Canadian review reports

Background

The Canadian CICA has established a report that should be used if a Canadian Chartered Accountant performs a review of an interim period in accordance with Canadian GAAS and issued a report based on that review. Such reports include restrictions regarding duty of care that are similar to the language in the so-called Bannerman reports in the UK. Unlike in the U.S., Canadian securities administrators do not require a review of interim financial statements by the issuer's auditor. However, the Canadian auditing standards require that the review report be published if the issuer refers to the review in a document (see CICA Handbook Section 7050). Since there is no requirement to have the interim information reviewed, many companies want to advise investors of this fact, which triggers the inclusion of the review report.

Issue

Is it acceptable to include the above review report on interim financial statements included in a SEC filing?

Discussion

The Task Force noted that, outside of MJDS, the SEC does not accept Canadian GAAS audit reports. In certain cases, the SEC Staff has accepted the inclusion of a Canadian compilation report in a registration statement that involves a situation in which the Canadian regulators require it in the Canadian document. However, that is not the case for this report. In addition, the compilation report is included solely to allow the use of one document for both jurisdictions.

The Task Force also noted the SEC Staff's recent concern over restrictions regarding duty of care (e.g., language that was included in the so-called Bannerman reports in the UK that is included in the Canadian review report). While the Bannerman situation involved audited financial statements, the same concept would appear to apply to a review report.

Conclusion

The Task Force agreed that such reports should not be included either directly or through incorporation by reference, in any filing with the SEC, including MJDS filings. This conclusion would be equally applicable in non-MJDS filings if the restrictions regarding duty of care were removed and the review report only made reference to Canadian GAAS.

It was noted that the above conclusions would not apply to a report that is included on a Form 6-K, provided it is not incorporated by reference into a filing.

4. Applicability of Section 404

Background

Task Force members have started to encounter questions about the applicability of Section 404 to affiliates of a foreign private issuer and whether or not management's statement as to its responsibility for establishing and maintaining adequate internal control over financial reporting for the company and its assessment of the effectiveness of this internal control includes such affiliates.

Paragraph 55 of the latest AICPA recommendation for a standard as sent to the PCAOB proposes:

> ***55.*** *As it relates to entities consolidated under Financial Accounting Standards Board Interpretation No. (FIN) 46, Consolidation of Variable Interest Entities, the responsible party would be required to evaluate internal control at those entities if the responsible party also has voting control. In the case of proportionate consolidation where the responsible party holds an undivided interest in each asset and liability and no other separate legal entity exists, the responsible party would be required to evaluate internal control at those entities if the responsible party either has a undivided interest greater than 50 percent or is responsible for managing the assets. In proportionate consolidation situations where there is a longstanding industry practice to use proportionate consolidation and where the responsible party does not own an undivided interest, the responsible party would be required to evaluate internal control at those entities if the responsible party has voting control.*

Issue

A foreign private issuer may prepare its financial statements using a GAAP with consolidation rules that differ from U.S. GAAP. In certain cases, an entity may be consolidated on the basis of effective or de facto

control even though it does not own a majority of the voting stock. In other cases, an entity may be proportionately consolidated when it shares joint control with another party. Would a foreign private issuer be required to evaluate internal control over financial reporting for such entities?

Discussion

The Task Force noted the following:

- The AICPA proposal suggests that whether or not an entity is consolidated is irrelevant to whether or not the entity's controls over financial reporting should be assessed by the issuer's management. As such, the GAAP itself would not be relevant.

- The AICPA proposal appears to view as the critical issue whether an entity is legally controlled. Therefore, absent holding a majority of the voting stock or some other legally enforceable means of control, in all circumstances, an issuer would not be responsible for evaluating the internal control over financial reporting for such an entity.

- If the AICPA proposal were to be accepted by the PCAOB, it would appear that the management of a foreign private issuer would not need to assess the internal controls over financial reporting for:

    - Proportionately consolidated joint ventures, which the entity only jointly controls (e.g., under IAS 31);

    - Entities, which are consolidated on the basis of de facto control (e.g., under FRS 2 in the UK);

    - SPEs, which are consolidated on the basis of other than legal control (e.g., under SIC 12).

Some Task Force members were concerned over the practicality of an investor having to assume responsibility for the internal controls over financial reporting at an investee that was proportionately consolidated in the investor's primary financial statements.

The SEC Staff noted that issues regarding whether responsibility for internal control over financial reporting should be based on control or consolidation are still being considered. The Staff indicated that the Task Force's input was useful to the Staff's understanding of issues related to Section 404 rules and encouraged the Task Force to discuss its views with the PCAOB.

5. Effective date of EITF 00-21 for foreign issuers

Background

There have recently been some questions regarding the effective date of EITF 00-21, "Revenue Arrangements with Multiple Deliverables," as it relates to foreign registrants. Paragraph 19 of the final EITF consensus states that "... this Issue is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003" (earlier application is permitted).

Issue

Because the term "fiscal periods" is not precisely defined in U.S. GAAP, it is unclear to some foreign private issuers whether the effective date of EITF 00-21 should be interpreted to include fiscal months, quarters, six-month periods, and/or years, and whether it was relevant that the registrant reported externally interim data under U.S. GAAP.

Conclusion

The Task Force agreed that application of the transition date requirements of EITF 00-21 for foreign private issuers should follow the guidance it provided relative to FIN 46, which has transition provisions similar to EITF 00-21. Thus, EITF 00-21 should be applied by foreign private issuers as illustrated in the following examples (note that all of the following examples assume the foreign private issuer's fiscal year coincides with the calendar year, ending on 31 December):

- If the foreign private issuer only reports U.S. GAAP information annually, it will be required to apply the guidance in its 31 December 2004 financial statements (i.e., apply it to revenue arrangements entered into on or after 1 January 2004);

- If the foreign private issuer reports U.S. GAAP information each quarter or half-year, but such information is only reported on a cumulative basis from 1 January (i.e., no stand-alone quarterly or half-year U.S. GAAP information; e.g., the foreign private issuer does not release quarterly information for the quarters ending 30 September 2003 or 31 December 2003, nor stand-alone half-year financial statements for the six months ending 31 December 2003), it will be required to apply the guidance in its financial statements for the first quarter or the first six-month period in 2004 (i.e., apply it to revenue arrangements entered into on or after 1 January 2004); or

- If the foreign private issuer reports U.S. GAAP information each quarter and reports stand-alone quarterly information (normally such information is reported in addition to cumulative information), it would be required to apply this guidance for the three months ended September 30, 2003 (i.e., apply it to revenue arrangements entered into on or after 1 July 2003) -- note that this is the method required to be used by U.S. domestic registrants with a 31 December year-end.

In other words, the implementation date should be determined based on when the company reports U.S. GAAP information (i.e., when is the first reporting date of the first stand-alone period of U.S. GAAP information that begins after 15 June 2003). The beginning of that period will then be the first date on which revenue arrangements must be accounted for under the provisions of EITF 00-21. The timing of public distributions of local GAAP financial information is not relevant to the analysis.

6. First-time adoption of IFRS

Background

The IASB recently issued IFRS 1 "*First-time Adoption of International Financial Reporting Standards*". IFRS 1 provides guidance on how an entity should adopt IFRS for the first-time. While IFRS 1 generally requires retrospective application of all IFRSs effective at the balance sheet date of the entity's first IFRS financial statements, it provides a number of exemptions from the retrospective application of IFRS. In addition, IFRS 1 only requires an entity to include one comparative period in it's first IFRS financial statements.

Issues

Some of the issues that may impact an SEC registrant include the following:

- The number of comparative periods presented in the audited financial statements prepared on a consistent IFRS basis.
- The number of periods to be included in selected financial data prepared on a consistent IFRS basis.
- The acceptability of some or all of the exceptions from applying IFRS retrospectively. Will the conclusion change if the information is actually available (e.g., prepared similar information on a U.S. GAAP basis)?
- Do the exceptions in IFRS 1 result in the need for the auditor to address the lack of consistency in their report?
- The need for additional disclosure related to the first-time adoption of IFRS. If additional disclosure is required, where should it be located (MD&A/OFR or the financial statements).
- The applicability of the "uniting of interest" accommodation under Item 17/18.

Discussion

The SEC Staff noted that some of the issues that may arise from first-time adoption of IFRS had been under consideration for some time. The Staff also noted that the SEC is expected to consider issuing a proposal that would solicit input on how certain matters related to the first-time adoption of IFRS may be addressed in the context of financial statements filed with the SEC. The Staff acknowledged a need to resolve these issues for registrants as soon as possible.

In regards certain of the issues noted above, the SEC Staff indicated the following:

- An issuer adopting IFRS for the first-time may avail itself of the present accommodation in Form 20-F related to omitting the fourth and fifth years back of selected financial data, if the criteria set forth in Item 3.A are met.
- If a registrant took advantage of valid exceptions permitted by IFRS 1, then the financial statements presented could be described as being in conformity with IFRS. It also was noted that an issuer may rely upon the exceptions permitted by IFRS 1 even if it has the applicable data needed to prepare corresponding U.S. GAAP information.
- Adequate disclosure should exist in describing the effects of adopting IFRS for the first-time.
- The present accommodation related to "uniting of interests" applies to compliance with IAS 22. With respect to business combinations, a company would not be able to avail themselves of the accommodation of not reconciling to U.S. GAAP for business combinations accounted for as a "uniting of interest" unless the combination qualified as a uniting of interest under IAS 22.

7. Implementation of non-GAAP measures release

Background

Subsequent to the March 2003 meeting, the SEC Staff issued its publication Frequently Asked Questions Regarding Use of non-GAAP Measures. Question 28 of the FAQ addresses the meaning of "expressly permitted" as follows:

> ***Answer 28:*** *A measure is expressly permitted if the particular measure is clearly and specifically identified as an acceptable measure by the standard setter that is responsible for establishing the GAAP used in the company's primary financial statements included in its filing with the Commission.*
>
> *Some non-U.S. GAAP standard setters specify a minimum level of caption detail for financial statement presentation, but require or permit additional caption detail. In some cases, the standard setter does not specify the particular additional captions to be presented. The staff believes that additional detail of the components of the financial statements determined in conformity with the GAAP used in the primary financial statements will generally be useful to US investors. The "expressly permitted" condition is not intended to prohibit the inclusion of those captions.*
>
> *Some non-U.S. GAAP standard setters permit or require subtotals in financial statements that are not calculated consistently with those permitted or required by U.S. GAAP. Provided that the subtotal is clearly derived from the appropriately classified financial statement captions that precede it, the "expressly permitted" condition is not intended to prohibit inclusion of those subtotals.*
>
> *Although additional detail of the components of the primary financial statements is acceptable as discussed above, measures that are prohibited by Item 10(e) of Regulation S-K should not be added to the face of the primary financial statements unless expressly permitted under the GAAP used in the company's primary financial statements.*
>
> *Some non-U.S. GAAP standard setters specifically permit alternative earnings per share measures to be presented but do not specify the particular earnings measures that may be used. In those circumstances, the expressly permitted condition is not intended to prohibit inclusion of earnings per share measures where the numerator of the per share measure is directly derived from an appropriately presented measure in the home country GAAP income statement.*

Issue

What does the Staff mean by "directly derived from an appropriately presented measure in the home country GAAP income statement"?

Conclusion

The Task Force understood that with regard to per share measures the numerator must itself be presented as a single number on the face of the income statement in accordance with home country GAAP and that the word "derived" was not intended to permit other items to be added to or subtracted from that number.

The SEC Staff noted that this had been their intention in Question 28.

8. Definition of a foreign business

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Background

Rule 1-02(l) of Regulation S-X defines a foreign business as follows:

> *A business that is majority owned by persons who are not citizens or residents of the United States and is not organized under the laws of the United States or any state thereof, and either:*
>
> 1. *More than 50% of its assets are located outside of the United States; or*
>
> 2. *The majority of its executive officers and directors are not United States citizens or residents.*

When the Commission established the definition of a foreign business it was designed to provide an accommodation involving companies that acquire or have significant equity affiliates of non-US companies that would have the same difficulty in obtaining information on a U.S. GAAP basis as a foreign private issuer. As indicated in the SEC staff's paper on International Financial Reporting and Disclosure Issues "[T]he definition of a foreign business is designed to provide the accommodations where the acquiree or investee would not reasonably be expected to have U.S. GAAP information or be subject to US reporting requirements." It was assumed that entities that did not meet this definition would have a reason to be preparing U.S. GAAP data and are not entitled to the accommodation.

The staff's paper on International Financial Reporting and Disclosure Issues states that the ownership and officer/director criteria are based on the attributes of the ultimate holding company. Accordingly, these criteria are not impacted in situations in which the financial statements are those of the reporting entity that is a carve out of a larger entity vs. situations in which the financial statements are of a legal entity. However, the criteria regarding country of organization can be impacted in carve out situations.

In carve out situations, the financial statements are not those of one legal entity; rather, the financial statements of the reporting entity could be a part of one legal entity, part of several legal entities or comprised of different legal entities or some combination. To determine the country that the reporting entity is organized in these situations, it is necessary to look at the specific facts and circumstances including the legal and organizational structure.

Issue

How should the definition of a foreign business be applied where the entity for which financial statements are being prepared ("reporting entity") is a carve out from a larger business (i.e., in situations involving Rule 3-05 of Regulation S-X)? This issue addresses situations in which the reporting entity is not a legal entity.

Conclusion

The Task Force discussed the following scenarios:

Situation 1

If the reporting entity is a carve out entirely from an entity organized in the U.S., then the reporting entity also should be viewed as being organized in the United States. Accordingly, regardless of any other attribute, the reporting entity would not be considered a foreign business.

To illustrate, assume a UK company sells a portion of its business in the U.S. that is entirely part of a company that is incorporated in the United States. Because the reporting entity is entirely part of the U.S. subsidiary, it would be considered organized in the United States.

Situation 2

If the components that comprise the reporting entity were all or substantially all subsidiaries or were carved out from businesses that were subsidiaries of a U.S. company regardless of the tier and regardless of the country the components are organized in, then it is presumed that the reporting entity be viewed as organized in the United States. Entities that believe this presumption is overcome should discuss the specific fact pattern with the SEC Staff.

To illustrate, assume the reporting entity consists of three legal entities all organized outside of the U.S. but which are subsidiaries of a U.S. entity. In this situation, it would be presumed that the three legal entities would have prepared U.S. GAAP information to be consolidated into the U.S. entity and the reporting entity would be considered organized in the United States.

Situation 3

If the components that comprise the reporting entity consist of both entities organized in the U.S. and outside of the U.S. or components of such legal entities, then the determination of the country that the reporting entity is organized should be assessed on the specific facts and circumstances. In making this determination, it may be relevant to consider the relative significance of the parts of the business. In this regard, the asset test described above would be a logical measure of relative significance. If the majority of the entity is not from entities organized in the U.S. or parts of entities organized in the U.S., then it is presumed that the reporting entity is not organized in the United States. Entities that believe this presumption is overcome should discuss the specific fact pattern with the SEC Staff.

To illustrate, assume the reporting entity consists of two legal entities - one incorporated in the U.S. and the other incorporated in the UK, with 30% of the assets in the U.S. and 70% in the UK. Further assume the UK entity is not a subsidiary of the U.S. entity. Despite the fact that a portion of the business is organized in the U.S., the reporting entity is presumed not to be organized in the United States.

Situation 4

If the fact pattern in Situation 3 were to change such that the UK entity is a subsidiary of the U.S. entity, then the reporting entity would be considered to be organized in the United States. Likewise, if the asset split were the majority of the assets were in the U.S., then the reporting entity would be presumed to be organized in the United States.

9. Applicability of SOP 90-7 to non-US jurisdictions

Discussion was deferred until the next meeting.

10. Disclosure of audit fees and VAT

Background

In January 2003, the SEC adopted new auditor independence rules as mandated by the Sarbanes-Oxley Act of 2002. One of the significant new requirements relates to the disclosure of fees for audit and non-audit services. The new rule requires the following disclosures:

- Comparative fee information for four fee classifications for each of the last two fiscal years,
- The audit committee's pre-approval policies and procedures, and
- The percentage of fees that were approved under the de minimis (5% of total amount revenues paid by the client) exception.

Foreign private issuers will be required to disclose aggregate fee information in their annual financial statements on Form 20-F (or Form 40-F for certain Canadian issuers) for years ending after December 15, 2003.

Issue

In a number of European jurisdictions VAT is required to be levied on the provision of professional services. Should VAT that is charged by an accounting firm be included in the amounts disclosed as fees?

Conclusion

The Task Force noted that generally, the accounting for VAT is to reflect the role of the reporting entity as a collector of VAT on behalf of the taxing authority. Consequently, VAT levied is not included in revenue nor is the VAT suffered by the reporting entity on the goods and services it buys included in expenses. Therefore, the Task Force concluded that audit fees disclosed should not include VAT.

11. Applicability of U.S. GAAP/GAAS to Regulation D offerings

Background

A number of foreign issuers offer securities in the U.S. and claim exemption from registering under Regulation D. This would involve instances in which the company is not able to rely on Rule 144A – buyers are not QIBS. The following is an excerpt form Rule 502 of Regulation D that describes the financial statement requirement:

> *Financial statement information.*
>
> *Offerings up to $2,000,000.* The information required in Item 310 of Regulation S-B, except that only the issuer's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited.
>
> *Offerings up to $7,500,000.* The financial statement information required in Form SB-2. If an issuer, other than a limited partnership, cannot obtain audited financial statements without unreasonable effort or expense, then only the issuer's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited. If the issuer is a limited partnership and cannot obtain the required financial statements without unreasonable effort or expense, it may furnish financial statements that have been prepared on the basis of Federal income tax

requirements and examined and reported on in accordance with generally accepted auditing standards by an independent public or certified accountant.

Offerings over $7,500,000. The financial statement as would be required in a registration statement filed under the Act on the form that the issuer would be entitled to use. If an issuer, other than a limited partnership, cannot obtain audited financial statements without unreasonable effort or expense, then only the issuer's balance sheet, which shall be dated within 120 days of the start of the offering, must be audited. If the issuer is a limited partnership and cannot obtain the required financial statements without unreasonable effort or expense, it may furnish financial statements that have been prepared on the basis of Federal income tax requirements and examined and reported on in accordance with generally accepted auditing standards by an independent public or certified accountant.

If the issuer is a foreign private issuer eligible to use Form 20-F, the issuer shall disclose the same kind of information required to be included in a registration statement filed under the Act on the form that the issuer would be entitled to use. The financial statements need be certified only to the extent required by paragraph (b)2(i) (B) (*1*), (*2*) or (*3*) of this section, as appropriate.

Issues

If the financial statements are prepared in accordance with standards other than U.S. GAAP do they need to include reconciliation to U.S. GAAP? To the extent that financial statements are required to be audited, does the audit need to be done in accordance with U.S. GAAS?

Discussion

The Task Force noted that it would appear that the objective of the disclosure under Regulation D is to provide the same information in an offering document as would be required if the offering were subject to registration. Accordingly, the Task Force concluded that a reconciliation to U.S. GAAP should be included and prepared in accordance with either Item 18 or Item 17, depending on the nature of the offering to conform to the requirements if the offering were subject to registration.

In addition, the Task Force noted that only U.S. GAAS is allowed to be used in filings with the SEC. As a result, it concluded that if such information is required to be audited, it should be audited in accordance with U.S. GAAS.

The Task Force also noted this language could be contrasted to that under Rule 144A that states the holder has a right to receive from the issuer financial statements and such financial statements should be audited to the extent practicable. There is no implication that it should be of the same level of disclosure as would be required if the offering and subsequent reporting were subject to the SEC's reporting requirements.

12. U.S. GAAP selected financial data

Background

The May 2001 Task Force meeting highlights address an issue related to the U.S. GAAP required information in selected financial data by a foreign private issuer. Those highlights state the following:

VII. SELECTED FINANCIAL DATA

Background

The SEC Staff Training Manual says:

> ***B. Selected Financial Data [Item 3A of revised Form 20-F]***
>
> 1. *Selected financial data should include amounts under U.S. GAAP, if different. The selected data should be provided for 5 years.*
>
> 2. *Selected data for the earliest two years of the five year period may be omitted if the registrant represents that the information cannot be provided without unreasonable effort or expense, and states the reasons for the omission in the filing.*

Issue

Does selected financial data need to be presented for every line item specified by Item 3 of new Form 20-F where different under U.S. GAAP from the primary GAAP.

Discussion

The SEC staff confirmed that if any amount required to be presented in selected financial data on a primary GAAP basis is different on a U.S. GAAP basis, then the corresponding amount under U.S. GAAP should also be shown.

This also applied to income from continuing operations even if that item was not presented under primary GAAP income, because primary GAAP had no distinction between continuing and discontinued operations."

Item 17 of Form 20-F gives an exemption from the reconciliation requirements of that Item where the foreign private issuer has proportionately consolidated another entity. The exemption reads:

> *(vii) Issuers that prepare financial statements on a basis of accounting other than U.S. generally accepted accounting principles that allows proportionate consolidation for investments in joint ventures that would be accounted for under the equity method pursuant to U.S. GAAP may omit differences in classification or display that result from using proportionate consolidation in the reconciliation to U.S. GAAP specified by paragraphs (c)(2)(i), (c)(2)(ii) and (c)(2)(iii) of this Item; Provided, the joint venture is an operating entity, the significant financial operating policies of which are, by contractual arrangement, jointly controlled by all parties having an equity interest in the entity. Financial statements that are presented using proportionate consolidation must provide summarized balance sheet and income statement information using the captions specified in Rule 1-02(aa) and summarized cash flow information resulting from operating, financing and investing activities relating to its pro rata interest in the joint venture.*

Issue

If the view of the Staff was that the U.S. GAAP information in selected financial data could still take advantage of the exemption, how should the amounts be described since they would not be U.S. GAAP?

Would it be acceptable to footnote the disclosure with a prominent note stating the amounts were U.S. GAAP except in respect of the proportionate consolidation of an entity?

Discussion

The Task Force noted that in practice this issue generally was handled in either of the following ways;

- The selected financial data should not take advantage of the exemption in Item 17 and should be presented on a full U.S. GAAP basis, assuming that the adjustments required to do that were straightforward and easily obtainable.

- Footnoting the "U.S. GAAP" selected financial data to the effect that it was not full U.S. GAAP because the registrant had taken advantage of the exemption in Item 17. The footnote should reference back to the US GAAP reconciliation where the accommodation is more fully described.

Conclusion

The Task Force agreed that it was not acceptable where the selected financial data took advantage of the exemption for the amounts to be described as "U.S. GAAP" without comment. One Task Force member noted that where the registrant took advantage of the exemption, special language should be used to describe the reconciliation, as it was not a reconciliation to U.S. GAAP.

The SEC Staff noted that it was not their intention to take away from registrants the presentation and classification exemption in Item 17 for those entities that proportionately consolidated investees as it relates to selected financial data. Consequently, the SEC Staff indicated that it would not object to the approach of footnoting the U.S. GAAP information in selected financial data in an appropriate manner explaining why in this respect the amounts were not U.S. GAAP.

13. Updating on Form S-8 for interim financial statements

Background

A number of foreign private issuers have various plans, such as stock options, for their U.S. employees that necessitates that they register the securities on Form S-8. There is no separate form for foreign private issuers. These plans offer their shares continuously, and, therefore, the registration statement needs to be kept current throughout the year or the company would be forced to suspend the offer to employees and have a blackout period.

Issue

Does a foreign private issuer need to provide interim information on a U.S. GAAP basis to keep the registration statement current?

Discussion

The following is an excerpt from the Chief Counsel's Telephone Interpretations:

Form S-8

Item 3-19(d) of Regulation S-X requires foreign private issuers to provide a balance sheet as of an interim date within 10 months of the effective date. Item 3-19(e) extends this period to one year for certain offerings such as rights offerings and dividend reinvestment plans. The Division staff expressed the view that the extension provided for in 3-19(e) also would be available with respect to offerings by foreign private issuers on Form S-8.

While Rule 3-19 of Regulation S-X has been replaced with Item 8A of Form 20-F, the concepts of Rule 3-19(e) are included in instruction 2 of Item 8 of Form 20-F. This guidance would imply that after a period of 12 months that a company would need to keep a S-8 current with interim U.S. GAAP information. To illustrate, assume a calendar year company filed a 20-F with financial statements for the year ended December 31, 2002, on January 1, 2004, the company would either need to suspend the offering on Form S-8 – i.e., create a blackout period – or provide interim information such as June 30, 2003 on U.S. GAAP basis – until it filed its annual report for the year ended December 31, 2003.

The guidance above from the Office of Chief Counsel regarding the age of financial statements would be applicable to the initial filing of an S-8; however, it does not appear that it would be applicable to keep the registration statement current once declared effective for the reasons presented below:

The provisions of Item 512(a)(4) of Regulation S-K that require updating for most registration statements would not be applicable. Item 512(a)(4) of Regulation S-K states "If the registrant is a foreign private issuer, to file a post effective amendment to the registration statement to include any financial statements required by Item 8.A. of Form 20-F at the start of any delayed offering or throughout a continuous offering. Securities Act Release No. 6867 "*Registration and Reporting Requirements for Employee Benefit Plans*" issued in 1990 amended Form S-8 to specifically indicate that the provisions of Item 512(a)(4) of Regulation S-K are not applicable. An excerpt from the release includes the following.

> *Two notes have been added to Item 9, Undertakings. The first explains that the Regulation S-K Item 512(a) undertakings are required since Form S-8 registration statements usually involve the delayed or continuous offering and sale of securities. The second clarifies that the undertaking requiring foreign private issuers to file a post-effective amendment to the registration statement, including any financial statements required by Article 3-19 of Regulation S-X, at the start of any delayed offering or throughout a continuous offering, does not apply in the Form S-8.*

As a result, Item 9 of Form S-8 states "with respect to registration statements filed on this Form, foreign private issuers are not required to furnish the Item 512(a)(4) undertaking. Form S-8 does not refer to maintaining timeliness of financial statements. (In contrast, Form F-1, Item 4 requires information required by Part I of Form 20-F, which includes Item 8 of Form 20-F relating to timeliness of financial statements. Item 5 of both Forms F-2 and F-3 require timeliness of financial statements to be maintained by requiring compliance with the requirements of Item 8.A of Form 20-F.)

General Instruction A to Form S-8 requires that a registrant subject to requirements to file reports under Section 13 or 15(d) of the Exchange Act is required to have filed all reports and other material required to be filed by such requirements during the preceding 12 months. Since there is no requirement for foreign private issuers to "file" interim financial information under the 1934 Act, it does not appear that interim timeliness requirements of Item 8.A to Form 20-F are applicable to offerings by foreign private issuers on Form S-8.

Conclusion

The SEC Staff agreed that, once effective, it is not necessary to incorporate interim information in a Form S-8 by a foreign private issuer that does not file using domestic forms in order to keep an S-8 current. In order to prevent the S-8 going stale it was only necessary to incorporate a timely filed Form 20-F and 40-F.

14. Age of Rule 3-09 financial statements in a 1933 Act filing

Background

A domestic company has a significant equity affiliate that meets the definition of a foreign business. Financial statements will be filed under Rule 3-09 of Regulation S-X. Assume for discussion that the domestic issuer has a calendar year end and the foreign affiliate has a year-end of March 31. Further assume that issuer has filed a 10-K with financial statements of the issuer for the year ended December 31, 2002.

Issue

When are the financial statements for the foreign equity affiliate required to be filed?

Discussion

Rule 3-09(b) of Regulation S-X states that the financial statements can be filed via an amendment within six months after the year-end of the investee fiscal year - September 30, 2003. This would be the same date that the financial statements would be due on Form 20-F if the foreign equity investee were a separate registrant. However, while the financial statements are not required to be filed under the Exchange Act, this does not apply to a registration statement under the Securities Act.

FRR 44 states that the filings can be updated on the same time schedule as a foreign private issuer. The disclosure states that registration statements need not include audited financial statements until six months after year-end. Footnote 34 of FRR 44 makes reference to Rule 3-19 of Regulation S-X. This release amended Rule 3-12 of Regulation S-X and established paragraph (f) that made reference to Rule 3-19. However, when the Commission adopted International Disclosure Standards in 1999 Rule 3-19 was replaced with Item 8.A. and that new rule shortened the age of annual financial statements in a registration statement to be no older than 15 months at effective date. This age of financial statement requirement applies equally to financial statements filed under Rule 3-09 as to the issuer. Accordingly, after June 30, 2003, the company would be required to include the financial statements of the equity affiliate. This is the same time period if the foreign business were itself a registrant and filing a 33 Act registration statement.

The SEC staff paper on International Financial Reporting and Disclosure Issues would appear to issue conflicting guidance on this item as it makes reference to having six months under both the 1933 Act and the 1934 Act to provide such statements. Another section of the paper indicated that 3-09 and 3-05 financial statements are subject to the same age of financial statements requirements as the issuer under Item 8 of Form 20-F.

Conclusion

The SEC staff agreed that the material in the International Financial Reporting and Disclosure Issues was incorrect in referring to having 6 months to file 3-09 financial statements under the 1933 Act. Financial statements filed under that Act needed to comply with Item 8A of Form 20-F as it applies to a registration statement.

15. SEC Staff issues

(a) Issues related to Rule 3-09 financial statements

The SEC Staff noted that during the recent season of Form 20-F filings it had encountered a number of "last minute" issues with Rule 3-09 financial statements in which the registrant had realized at the last moment that Rule 3-09 financial statements were required and had asked for waivers. In some cases, there was a disagreement between the registrant and the investee as to the basis of accounting to be adopted by the investee and registrants also had asked for waivers of the Rule 3-09 requirements on that basis. Generally, the Staff will not waive financial statements under Rule 3-09, except where the investee was historically insignificant to the registrant, the investment was disposed of during the most recent year, and the gain on sale caused the significance test to be met for the first time. Neither operating or impairment losses of an investee, nor impairments of the registrant's investment would ordinarily be a basis for waiver, even if the registrant's investment was reduced to nil under U.S. GAAP. The SEC Staff encourages registrants to discuss the need to test the significance of investees as soon as possible in the timetable for preparing and filing the Form 20-F.

(b) SECPS Appendix K compliance

The SEC Staff reiterated its current policy of accepting auditor's reports from foreign audit firms where either (1) the foreign firm was affiliated with a U.S. Firm which was subject to Appendix K of the SECPS rules, or (2) the foreign firm had gone through the process of demonstrating to the SEC Staff sufficient knowledge and experience in applying U.S. GAAP, U.S. GAAS, SEC financial reporting rules, and SEC independence requirements. An auditor seeking to practice before the SEC for the first-time is ordinarily expected to demonstrate its knowledge and experience before its audit reports are included in SEC filings.

The Task Force noted that with the requirement for non–U.S. Firms to register with the PCAOB, the ultimate applicability of Appendix K was not clear. Members of the Task Force noted that the Appendix K requirements have been helpful in practice and encouraged that something similar be included in any future PCAOB rules.

The SEC Staff also acknowledged the important role of the filing reviewer procedures under Appendix K in enhancing the quality of financial reporting and disclosure in SEC filings. Where circumstances warrant, the SEC Staff may ask an unaffiliated foreign auditor currently practicing before the SEC to

provide information which will reassure the Office of the Chief Accountant that the auditor has maintained the knowledge, experience and professional standards necessary to practice before the Commission.

Mr Gannon agreed to discuss the issue further with the Chair of the SECPS.

(c) Bannerman follow up

The SEC Staff asked Task Force Members what approach their Firms were adopting in audit reports on the financial statements in a combined UK Annual Report and Form 20-F given the SEC staff position precluding the use of the Bannerman language in audit reports filed with the SEC. Task Force members noted that where a combined UK Annual Report and Form 20-F was issued, Bannerman language was not being included. On stand-alone UK Annual Reports the language was included whereas on a stand-alone Form 20-F it was not.

(d) Mining industry issues

The SEC Staff noted that there had been meetings between the SEC staff and both representatives of accounting Firms and representatives of industry in late May and early June. Accounting issues with respect to the application of FASB Statements 141, *Business Combinations* and 142, *Goodwill and other Intangible Assets* were discussed and included:

- The classification of certain mining assets as intangible versus tangible.
- The allocation of the cost of an acquired entity to the assets acquired and the liabilities assumed. In particular the following topics were discussed:
    - As noted in paragraph A14(d)(7) of Statement 141, intangible assets acquired include contract-based "use rights such as drilling, water, are, mineral timber cutting and route authorities."
    - Goodwill could arise in a business combination involving the acquisition of a mining company.
- Amortization of intangible assets

The SEC Staff also noted that the EITF Agenda Committee recently directed the FASB staff to convene a working group of mining industry specialists to report back to the Agenda Committee at a future meeting on numerous mining industry issues.

An issue has also arisen whether Statement 142 requires oil and gas companies to reclassify the contract-based mineral/drilling rights shown in their balance sheets from tangible to intangible assets and provide the related intangible asset disclosures under Statement 142. Leasehold costs as well as the costs of acquiring hydrocarbons in-place would require reclassification to intangible assets. The aforementioned EITF directive also seeks consideration of this matter by the working group. Where the amount subject to possible reclassification is material, SEC registrants should disclose in their financial statement notes and MD&A the nature of this issue and the amount that is subject to reclassification.

(e) Auditor licensing and signature requirements under Article 2 of Regulation S-X

Subsequent to the July 15 Task Force meeting, the Staff became aware of an arrangement involving the membership of certain Canadian audit firms in an international association of independent accounting firms. As part of the arrangement, audit reports were signed in the name of the association for inclusion in filings with the SEC. The firms that performed the audit work were licensed in the jurisdiction in which the reports were signed. However, the association was not licensed in that jurisdiction.

Rule 2-01(a) of Regulation S-X requires that the auditor be duly registered and in good standing [licensed] under the laws of the place of his residence or principal office. The staff considers "place of his residence or principal office" to be the city and state (or country) in which the report is signed, as contemplated in Rule 2-02(a) of Regulation S-X. The auditor is expected to sign the report in the name under which it is licensed. An auditor that is not licensed in the jurisdiction in which it signs the report does not meet the requirements of Rule 2-01(a).

While this situation occurred in Canada, the requirements of Rule 2-01(a) apply to auditors in all jurisdictions including the U.S.

16. Issues related to discontinued operations

Discussion deferred to the next meeting.

17. Issues related to changes in auditors

Discussion deferred to the next meeting.

18. Application of FIN 46 when a government is involved

Discussion deferred to the next meeting.

DATE OF NEXT MEETING

The Task Force agreed to meet on November 25, 2003.