AICPA INTERNATIONAL PRACTICES TASK FORCE
AICPA Washington Office
November 25, 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)
Bill Decker (PricewaterhouseCoopers)
Jon Fehleison (KPMG)
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)
Georgene Palacky (SEC Observer)
Annette Schumacher Barr (AICPA)
Alison Spivey (SEC Observer)

AGENDA ITEMS

1. Inflationary status of certain countries

Background

At its July 2003 meeting the Task Force noted that the cumulative inflation rates for Romania and Turkey have historically exceeded 100% and, therefore, have been and should continue to be considered highly inflationary. The Task Force also agreed that Argentina and Venezuela, while not considered highly inflationary at this time, should be monitored.

Discussion

The Task Force discussed updated inflation data as of September 2003, with projections through December 2003. It was noted that no new countries had inflation rates above 70% and that of the countries with three-year cumulative inflation rates below 70%, only Haiti had projected annual inflation for 2003 above 30% (approximately 32% and 20%, for 2003 and 2004, respectively).

Conclusion

The Task Force noted that Romania's three year cumulative inflation rate dropped below 100%. As a result, the Task Force discussed whether Romania should no longer be considered highly inflationary. The Task Force discussed the current economic environment and noted that at this time there was not sufficient evidence to conclude that the decline in inflation was "other than temporary" as discussed in Example B in EITF Topic D-55. Therefore, the Task Force agreed that Romania should continue to be considered highly inflationary through December 31, 2003. The Task Force will revisit inflation trends at its next meeting.

The Task Force noted that Turkey's three year cumulative inflation rate continues to exceed 100% and that Turkey therefore should continue to be considered highly inflationary.

The Task Force noted that the three year cumulative inflation rates in Venezuela and Argentina are below 100%. It was noted that the economic situation in Argentina is beginning to stabilize. It also was noted that inflation continues to increase in Venezuela with an estimated inflation rate of 27% in 2004. The Task Force agreed that while not considered highly inflationary, both Argentina and Venezuela should continue to be monitored.

1a. Venezuelan currency restrictions

Background

The Venezuelan government continues to impose a currency control regime. Subsequent to the last Task Force meeting, the government announced a more expeditious process to approve and release dollars. There has been some slight evidence of improvement although significant restrictions remain. It was reported in September that the foreign exchange control agency (CADIVI) approved the disbursement of approximately $396 million in the period 1-17 September. Venezuelan Central Bank (BCV) representatives have continued to indicate that the exchange control regime will be made more flexible and responsive before the end of 2003.

The government also has stated that certain measures were being considered, such as an increase in the Official Rate, and a dual exchange regime. The government issued new dollar denominated domestic debt in early August 2003 that could potentially form the basis of a future parallel exchange market. The finance minister was reported as stating on October 10, 2003 that Venezuela will depreciate the VEB by 20% next year, without specifying when the depreciation would take place.

However, since July 2003 there has been no change in the Official Rate and a parallel exchange market has not been formalized. The idea of lifting exchange controls entirely has been dismissed by the BCV over concerns that this would result in a rush by Venezuelans to buy foreign currency and lead to a severe depreciation of the VEB.

Issues

1. Given the restrictions regarding convertibility should companies continue to consolidate Venezuelan subsidiaries at December 31, 2003?

2. Assuming consolidation is appropriate, what rates should be used to remeasure transactions and translate VEB financial statements?

3. Does the fact that companies are required to turn in dollars and need approval to get dollars back impact the ability of a company to conclude that U.S. dollar is the functional currency under Statement 52?

Conclusion

As to Issue 1, the Task Force noted that there is relatively little experience in addressing the general question of how severe and long in duration currency restrictions should be before concluding non-consolidation is appropriate. 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 by itself does not appear to meet the "other than temporary" threshold in paragraph 26 of Statement 52. The Task Force also agreed that it would revisit this issue at its next meeting.

As to Issue 2, it was noted that there had been no significant new facts or circumstances since the Task Force last discussed this issue. The Task Force 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.

As to Issue 3, the Task Force noted that the determination of an entity's functional currency is a matter of facts and circumstances. The Task Force continues to believe that for the present, use of the U.S. dollar as the functional currency would not be precluded as a result of the currency restrictions in place. The Task Force noted that this may become more of an issue in the upcoming year if the currency restrictions continue.

2. Reporting issues

(a) Follow up on GAAP reconciliations

Background

At its July 2003 meeting, the Task Force continued to discuss the practices of those Firms represented on the Task Force regarding the inclusion in the audit report on a foreign private issuer of an informational paragraph ("fourth paragraph") referring to the U.S. GAAP reconciliation footnote. It was generally

agreed that, in order to encourage consistency of reporting in situations where the auditor chooses to include such a paragraph in the auditors' report, it would be useful for the Task Force to provide suggested wording for the fourth paragraph. Mr. Walters and Mr. Carnall agreed to develop suggested wording for the Task Force's consideration.

Conclusion

Mr. Walters and Mr. Carnall provided the following wording for the Task Force's consideration:

> "Accounting principles generally accepted in [registrant's country] vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in Note X to the (consolidated) financial statements."

Task Force members noted that the suggested wording appeared to be an improvement over current language and agreed to undertake steps with their firms to encourage use of the above language as a matter of policy. Given the timing of these discussions and necessary lead time within each firm to implement these changes, the Task Force noted that these changes likely would not be incorporated into reports until the next reporting season.

(b) Follow up on division of responsibility regarding GAAP reconciliations

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.

The SEC staff has indicated in the *International Financial Reporting and Disclosure Issues* outline 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."

At its July 2003 meeting, the Task Force agreed that the fundamental question is whether it is appropriate for the principal auditor, while relying on the work of another (subsidiary) auditor where the subsidiary reports on an accounting (GAAP) basis other than that used in either the primary financial statements or U.S. GAAP, to assume responsibility for:

- The performance of auditing procedures with respect to the conversion of information in the financial statements audited by the other auditor to the GAAP used in the primary financial statements of the foreign private issuer; and

- The performance of auditing procedures with respect to the conversion of the information included in the consolidated financial statements of the foreign private issuer, as it relates to the financial statements audited by the other auditor, from the GAAP used in the foreign private issuer's consolidated financial statements to U.S. GAAP.

Discussion

The Task Force discussed the fundamental question noted above. Some Task Force members raised a question as to the circumstances under which it would be appropriate for the principal auditor to make reference to the report of the subsidiary auditor while, at the same time, taking responsibility for performance of auditing procedures with respect to either the reconciliation of the GAAP used in the subsidiary's financial statements to the GAAP used in the foreign private issuer's primary financial statements, or the reconciliation from the GAAP used in the foreign private issuer's primary financial statements to U.S. GAAP.

It was noted that this is an issue for auditing standard setters. It also was noted that the International Auditing and Assurance Standards Board (IAASB) has undertaken a project that would amend International Standards on Auditing (ISAs) to potentially eliminate the ability to rely on the work of another auditor. Consequently, the auditor of the consolidated financial statements would be required to take full responsibility for the information included in such financial statements. While ISAs are not currently accepted in SEC filings, it was noted that the PCAOB has been liaising with the IAASB on various initiatives.

Clarity in reporting

The Task Force noted that the SEC Staff expects that the division of responsibility for GAAP reconciliations be explicit in audit reports. It was noted that historically the Staff focused on the division of responsibility with respect to the audit of the primary financial statements.

Some Task Force members indicated their belief that, unless the subsidiary's financial statements reported on by the other auditor made specific reference to either the reconciliation to the foreign private issuer's primary GAAP and/or the reconciliation from the foreign private issuer's primary GAAP to U.S. GAAP, it would be clear that the other auditor had not assumed any responsibility with respect to the performance of auditing procedures with respect to the information presented in such reconciliation(s). In these cases, the principal auditor was implicitly taking responsibility for such reconciliations.

Other Task Force members indicated their belief that, unless the financial statements of the subsidiary audited by the other auditor were presented in the document containing the foreign private issuer's consolidated financial statements (as opposed to only the other auditor's report being presented), then it would not be clear that information relating to reconciliations of information from the GAAP used in the subsidiary's financial statements to the GAAP used in the foreign private issuer's consolidated financial statements, and from the GAAP used in the foreign private issuer's consolidated financial statements to U.S. GAAP, had been subjected to auditing procedures performed by either the principal auditor or the other auditor.

The Task Force noted that if the principal auditor wished to rely on the other (subsidiary) auditor with respect to reconciliations to the foreign private issuer's primary GAAP and/or to U.S. GAAP in situations where the financial statements of the subsidiary reported on by the other auditor are not presented, then it would be necessary for the subsidiary auditor's report to make reference to such GAAP reconciliations.

The SEC staff indicated that it would expect the responsibility for auditing the U.S. GAAP reconciliation to be clearly stated in the applicable auditor's report(s). The Task Force agreed to develop alternative formats for reporting the division of responsibility.

(c) Follow-up on Bannerman opinions

Background

Following the Bannerman case in the UK, the ICAEW introduced third party disclaimer wording in UK statutory audit reports. Previously, the SEC Staff had considered whether audit opinions signed by UK auditing firms which contained the disclaimer language would be acceptable in filings with the Commission.

In February 2003, the SEC Staff rejected the inclusion of a disclaimer in audit reports filed with it and wrote to the President of the ICAEW on February 28, 2003 and stated that "audit reports contained in [SEC] filings are intended to be of general use" and added that the SEC "would not accept a filing that contained an audit opinion … that contained the clarifying language" (the "clarifying language" being the Bannerman disclaimer in the UK report). The SEC Staff also indicated that the "wording of the UK audit opinion is an issue of UK law and practice… Our primary concern is that annual reports filed [with the SEC] contain an unrestricted audit opinion".

Discussion

Subsequent to the SEC Staff's position becoming clear, practice developed amongst UK auditors of SEC registrants for the 2002 reporting/filing season that disclaimer language was omitted from all separate U.S. GAAS audit opinions. Certain companies produce an annual report and accounts that comply both with UK Companies Act and SEC requirements and historically auditors have signed a 'dual opinion' (i.e., one report that contains both a UK and a U.S. GAAS opinion). In these circumstances, the SEC's position meant that the Bannerman disclaimer language could not be included in the UK audit opinion. Where there was a separate UK only audit report issued, it included the disclaimer for UK purposes but the corresponding U.S. GAAS audit report included in the Form 20-F or other filing had no disclaimer.

These events have caused audit firms to become concerned about their exposure to third party claims in the U.S. environment, particularly in circumstances where third party claimants may attempt to base their claim on the U.S. GAAS opinion.

It has been suggested by one UK audit firm that, while the audit report filed with the SEC should remain without disclaimer language, the UK only audit report could include a footnote cross-reference to the U.S. GAAS audit report. Such a footnote would note that the third party disclaimer is omitted from the U.S. GAAS audit report because of SEC objections, but that readers of the UK report who read the U.S. GAAS audit report should note that the auditors will not accept responsibility to third parties in respect of the U.S. GAAS opinion unless they are entitled to a duty of care from the auditor under U.S. securities laws and regulations.

Conclusion

The SEC Staff noted that U.S. GAAS audit reports filed with the SEC should be general use reports and that any restrictions as to that general use either explicitly referred to in such reports or implicitly made by language used in other documents would not be acceptable, even if such documents were not filed with the Commission.

The Task Force noted, and the SEC Staff acknowledged, that the UK audit profession may wish to pursue with the staff alternative language in the UK report.

(d) Inflation adjusted financial statements in Argentina

Background

As a result of the inflationary environment prevailing in Argentina in 2002, the *Consejo Professional de Ciencias Económicas de la Ciudad Autónoma de Buenos Aires* approved on March 6, 2002, the application of inflation accounting in financial statements as from January 1, 2002. The Argentine government instructed the C*omisión Nacional de Valores* (National Securities and Exchange Commission in Argentina or "CNV") to issue the necessary regulations for acceptance of financial statements in constant pesos, which was done on July 25, 2002.

Financial statements for fiscal year ended December 31, 2002 were prepared in constant pesos (restated according to the changes in the Argentine wholesale price index published by the *Instituto Nacional de Estadisticas y Censos,* ("INDEC")) in compliance with Argentine GAAP and the regulations issued by the CNV. As a result of Government decree, on April 8, 2003, the CNV issued a resolution discontinuing

inflation accounting as from March 1, 2003. Accordingly, public companies recorded the effects of inflation in their financial statements through February 28, 2003.

Notwithstanding the legal requirements of CNV, Argentine GAAP still required companies to restate financial statements into constant currency for the effects of inflation up to October 1, 2003, from which date it also decided that inflation accounting should be discontinued. Accordingly, the requirements of the CNV conflict with Argentine GAAP but only in respect of the period from March to October, 2003.

Issue

For the limited period that this is an issue, will the SEC staff object to the filing of an opinion on financial statements that are prepared in accordance with Argentine GAAP except for the departure with respect to the fact that the financial statements are not adjusted for the effects of inflation?

Discussion

The SEC staff addressed virtually the same issue several years ago and concluded not to object to a qualified opinion in this situation in a speech before the AICPA SEC conference in September 1996 when the staff member said:

> "The Argentine National Securities Commission was ordered by decree not to accept price level adjustment financial statements for periods after September 1, 1995. Argentine GAAP, however, still requires the preparation of price level adjusted financial statements. Independent accountants in Argentina intend to qualify their report for this departure from GAAP. Argentina has experienced single digit inflation during the last several years, and the economy is clearly not hyperinflationary as defined in Rule 3-20 of Regulation S-X. The staff will not object if the independent accountants' report is qualified for this departure from Argentine GAAP".

Conclusion

The SEC Staff indicated that they would not object to a qualified auditor's report in this situation and emphasized that this situation, involving a direct conflict between GAAP and law, should not be analogized to other situations**.**

3. PCAOB transition and other rules on auditing and MJDS

Background

The PCAOB has issued interim guidance regarding auditing standards. Rule 3200T states that in connection with the issuance of any report, a registered accounting firm needs to comply with SAS 95 as in existence at April 2003. The Commission has approved this rule. The PCAOB will be establishing additional procedures regarding auditing standards that as drafted would appear to apply to all audit reports filed with the SEC. Canadian companies filing on MJDS forms are presently allowed to have the audit conducted in accordance with Canadian GAAS.

Issue

Do the Commission's rules regarding the acceptability of Canadian GAAS for purposes of an entity's filing pursuant to MJDS still apply?

Conclusion

The SEC staff indicated that there has been no change in filing requirements for MJDS filers (i.e., Canadian GAAS continues to be acceptable). However, the Staff may consider the matter in the future as part of a broader assessment of the implications of PCAOB standards on SEC rules that refer to GAAS.

4. Applying Item 512(a)(4) of Regulation S-K to 3-09 statements

Background

Over the past few years, the Task Force has reviewed with the SEC Staff a number of issues relating to compliance with the undertakings required to be given by a foreign private issuer pursuant to Item 512(a)(4) of Regulation S-K. Some of these discussions have been in the context of financial statements of equity investees pursuant to Rule 3-09 of Regulation S-X.

At the November 2002 Task Force meeting, the SEC Staff indicated that a foreign private issuer could take down off a shelf if the issuer is current with respect to its own financial statements, even though the audited financial statements of a significant equity investee that is a foreign business were more than 15 months, but less than 18 months, old (i.e., the financial statements were not due under the Exchange Act).

The Task Force noted at the time that a strict application of Item 512(a)(4) would require a foreign private issuer to update its foreign equity investee financials on a substantially more current basis than would apply to a domestic issuer. The Staff indicated that it was not their intent to apply the rules to require a foreign private issuer to update a shelf registration statement with more current information in respect of Rule 3-09 financial statements than would apply to a similarly situated domestic issuer.

Issue

What are the updating obligations of a foreign private issuer pursuant to its Item 512(a)(4) undertakings with respect to equity investee financial statements pursuant to Rule 3-09 in the context of an already-effective registration statement on Form F-4 regarding an exchange offer or business combination transaction?

Discussion

The Task Force noted that historically the SEC Staff has not drawn distinctions between shelf takedowns, exchange offers and business combinations. In the May 1, 2001 document, "International Financial and Disclosure Issues", the Staff stated, in the context of discussing the Rule 512(a)(4) undertakings, that "For this purpose, delayed or continuous offerings include exchange offers, merger and acquisition transactions registered on Form F-4, and takedowns from effective shelf registration statements."

As in the case of shelf takedowns, it was not intended by the SEC Staff to require a foreign private issuer to furnish financial statements of a foreign equity investee under circumstances where a similarly situated domestic registrant would not be required to furnish such financial statements. The same rationale that would apply to the circumstances reviewed in the November 2002 meeting would also apply to exchange offers and business combinations.

Conclusion

The Task Force believed that the SEC Staff should extend its interpretation of the application of the 512(a)(4) undertaking to Rule 3-09 financials in the context of a shelf takedown, as reflected in the minutes of the November 2002 Task Force meeting, to exchange offers and merger and acquisition transactions registered on Form F-4.

The SEC Staff indicated that they did not intend to draw a distinction between shelf takedowns and Form F-4 transactions and that the Staff's view as expressed in the November 2002 minutes also applies to the latter.

5. Adoption of new standards

(a) Follow up on FIN 46

Background

At its March 2003 meeting, the Task Force discussed the application of FIN 46 to foreign private issuers under different reporting scenarios. The SEC staff indicated that they would not object to the Task Force's recommended approach regarding the effectiveness of FIN 46 for foreign private issuers.

Subsequent to the July 2003 Task Force meeting, the FASB staff issued FSP FIN 46-6 delaying the effectiveness of FIN 46.

Discussion

The Task Force discussed the impact of the FSP on foreign private issuers and noted that FSP FIN 46-6 was issued to delay the application of FIN 46 for entities where FIN 46 was currently effective. However, depending on an enterprise's year end and frequency of reporting of U.S. GAAP information the application of FSP FIN 46-6 may have had the unintended consequence of accelerating the effectiveness of the interpretation.

The Task Force noted that certain foreign private issuers were not yet required to apply FIN 46; for those issuers, FSP FIN 46-6 was not applicable and the original effective date of FIN 46 would apply. The Task Force also noted that foreign private issuers that were already required to apply FIN 46 would have the benefit of the deferral in FSP FIN 46-6.

Conclusion

The SEC staff indicated that they would not object to the Task Force's recommended approach regarding the effectiveness of FIN 46 for foreign private issuers.

Subsequent to the Task Force meeting in December 2003, the FASB issued FIN 46-R. In discussions between Task Force representatives and the SEC staff, it was noted that the effective date for certain foreign private issuers of FIN 46-R is earlier than that under the original FIN 46. In issuing FIN 46-R, the FASB Staff has advised representatives of the Task Force that the intent was not to accelerate the application of either FIN 46 or FIN 46-R, but rather to provide for a deferral of the effective date of FIN 46 and FIN 46-R in order to provide enterprises sufficient time to understand and implement the guidance. This is consistent with the discussion in paragraphs D62-D65 and paragraph E49 of FIN 46-R.

The SEC Staff suggested that the Task Force discussions to date be summarized in a letter to be sent to the Chief Accountant who will confirm such understanding.

(b) Application/adoption of new standards during an interim period

Background

The Task Force has on several occasions addressed issues surrounding when new U.S. GAAP guidance is required to be adopted by foreign private issuers. Many of the recent U.S. GAAP standards require application for periods **beginning** after vs. periods **ending** after a certain date. In addition, some standards refer to interim periods "beginning after…" while others indicate that application is as of "the first day of fiscal quarter beginning after…"

Issue

Rather than evaluating each one of these issues individually, is it possible to determine how new U.S. GAAP guidance should be applied during an interim period?

Discussion

The Task Force noted that its approach in resolving such issues has been to apply the literal language in the standard giving regard to the fact that a foreign private issuer often does not prepare interim information on a U.S. GAAP basis. For example, for those standards that require implementation as of the beginning of the quarter, a calendar year-end company would apply the guidance as of January 1 of the following year if U.S. GAAP information is presented only on an annual basis.

The Task Force briefly discussed a related issue of how foreign private issuers should apply U.S. GAAP in certain situations when they do not present interim information on a U.S. GAAP basis (e.g., the timing of impairment testing). The Task Force agreed to discuss this issue further at its next meeting.

6. Independence issues

(a) Compliance with independence requirements in prior years

Background

Rule 2-01(f)(5)(iii) of Regulation S-X provides an accommodation for auditors of foreign private issuers regarding compliance with the U.S. independence rules, solely with respect to the second and third year of audited financial statements included in an initial registration statement or report filed with the SEC. Under the accommodation, an auditor of a foreign private issuer need not comply with the U.S. independence rules with respect to the second and third years provided the auditor has complied with the home country independence requirements during such periods. While adopted in 2000, this was the SEC Staff's practice for a number of years and was based on an accommodation that was provided in the rules for companies filing under the MJDS rules.

Issue

Is this accommodation limited only to the incremental independence requirements of the SEC or would it also apply to the independence rules of the AICPA?

Conclusion

The Task Force agreed that there is no distinction in the intent of the Rule and the accommodation is applicable regardless of who issued the rule. The Task Force also agreed that if there was a known violation of the independence rules in a prior year but which was accommodated under this practice, there was no need to mention this fact in the auditor's report.

The SEC Staff indicated it would not object this interpretation, given that the auditor would have fully complied with U.S. independence requirements for the most recent audited year included in the initial registration statement or other report filed with the SEC and would have complied with home country independence requirements for the two earlier years.

(b) 144A Offerings

Background

Financial Reporting Policy 602.02.a states the following:

> "Rule 2-01 deals with the qualifications of accountants and broadly illustrates how the qualification of independence may be impaired. Audited financial statements which are used in connection with an offering of securities within the Commission's jurisdiction, including those offerings which are exempted from certification under the Securities Act, and those included in certain filings under the Exchange Act, must be audited by an accountant who satisfies the independence requirements of this rule."

Issue

Do auditors need to be independent under U.S. rules in a 144A offering, when the financial statements included in the offering were audited in accordance with non-U.S. GAAS?

Discussion

In the adopting release – Securities Act Release No. 6862, the Commission concluded that reports that would be included in a submission under Rule 12g3-2(b) of the Exchange Act would generally satisfy the requirements in a 144A offering. Rule 12g3-2(b) states that the only information that needs to be provided is that which is publicly distributed in its home country – that is, the distribution of home country financial statements that satisfy the home country requirements will satisfy the 144A requirements. There appears to be no requirement to provide information with respect to U.S. GAAP, U.S. GAAS or to comply with U.S. independence rules in a 144A offering. Thus, the Task Force agreed that compliance with US independence rules is not required when the financial statements included in the offering are audited in accordance with non-U.S. GAAS.

Conclusion

The SEC Staff confirmed that in a 144A offering the auditor need not be independent under SEC rules.

7. **Changes in year end by foreign private issuers**

Background

AICPA INTERNATIONAL PRACTICES TASK FORCE
AICPA Washington Office
November 25, 2003
HIGHLIGHTS

The following is an extract from SEC Staff Training Manual, Topic Six.II.E ***Changes in Fiscal Year:***

1. Transition reports for foreign private issuers are filed on Form 20-F as follows:

Transition period is:	***In a transition report on Form 20-F, include:***	***File the transition report within:***
More than 6 months	*Audited financial statements reconciled to U.S. GAAP.* *All information required to be filed when Form 20-F is used as an annual report.*	*Later of 6 months after either the end of the transition period or the date the issuer elected to change its fiscal year-end.*
6 months or less, but more than one month	*Unaudited financial statements, reconciled to U.S. GAAP* *Information required by Items 3, 9, 15, 16, and 17 or 18 of Form 20-F* ***NOTE:** The next annual report on Form 20-F must include audited financial statements for this transition period.*	*Later of 3 months after either the end of the transition period or the date the issuer elected to change its fiscal year-end.*
One month or less	*No separate filing is required but the one-month transition period must be audited and included in the next annual report on Form 20-F.*	*No separate filing is required.*

2. The staff will consider requests for a transition period of more than 12 months if a longer period is accepted in the issuer's home country. Issuers that receive this accommodation are required to provide complete unaudited financial statements with all of the applicable disclosures for both the 12-month period and the remaining portion of the transition period.

3. Foreign private issuers filing a registration statement after electing to change their fiscal year end may need to provide more current audited financial statements than are required under the Exchange Act transition reporting rules. A foreign private issuer's most recently audited financial statements cannot exceed the age specified by Item 8 (generally 15 months) at the registration statement's date of effectiveness.

Assume Company A, a foreign private issuer, changes its fiscal year end from September 30 to December 31, commencing in its 2003 fiscal year. In accordance with UK company law, its next financial statements will be for the 15 months ended December 31, 2003. Consequently, Company A would appear to have the following choices:

(a) File a transition report on Form 20-F on the later of three months after the date that it decided to change its year-end or March 31, 2003 (being three months after the end of the transition period on December 31, 2002). This transition report would include unaudited financial statements reconciled to U.S. GAAP for the three months ended December 31, 2002 and that period would be audited when included in the next annual report on Form 20-F for the 12 months ended December 31, 2003; or

(b) Request that the Staff accept a transition report on Form 20-F for December 31, 2003, which would include audited financial statements for the 15-month period ended December 31, 2003 and unaudited financial statements for the three months ended December 31, 2002 and the 12 months ended December 31, 2003. In order to meet the three-month filing requirement for transition reports,

it would be necessary for this Form 20-F to be filed within three months of the new fiscal year end, rather than the usual six months afforded to foreign private issuers.

The SEC Staff has indicated that alternatives (a) and (b) above would be acceptable as financial statements covering 15 months are being presented in the home jurisdiction.

Issue

Assuming a foreign private issuer adopts item (b) above, should comparatives to be presented for the three months ended December 31, 2002 (i.e., for the 3 months ended December 31, 2001)?

Discussion

For domestic issuers the rules seem clear - full financial statements in respect of income statement and cash flows for the transition period with condensed comparatives, however, Rule 13a-10(g) specifically excludes foreign private issuers as follows:

(g) (1) Paragraphs (a) through (f) of this section shall not apply to foreign private issuers.

(2) Every foreign private issuer that changes its fiscal closing date shall file a report covering the resulting transition period between the closing date of its most recent fiscal year and the opening date of its new fiscal year. In no event shall a transition report cover a period longer than 12 months.

(3) The report for the transition period shall be filed on Form 20-F responding to all items to which such issuer is required to respond when Form 20-F is used as an annual report. Such report shall be filed within six months after either the close of the transition period or the date on which the issuer made the determination to change the fiscal closing date, whichever is later. The financial statements for the transition period filed therewith shall be audited.

(4) If the transition period covers a period of six or fewer months, in lieu of the report required by paragraph (g)(3) of this section, a report for the transition period may be filed on Form 20-F responding to Items 5 , 8.A.7. , 13 , 14 , and 17 or 18 within three months after either the close of the transition period or the date on which the issuer made the determination to change the fiscal closing date, whichever is later. The financial statements required by either Item 17 or Item 18 shall be furnished for the transition period. Such financial statements may be unaudited and condensed as permitted in Article 10 of Regulation S-X, but if the financial statements are unaudited and condensed, the issuer shall file with the first annual report for the newly adopted fiscal year separate audited statements of income and cash flows covering the transition period.

(5) Notwithstanding the foregoing in paragraphs (g)(2), (g)(3), and (g)(4) of this section, if the transition period covers a period of one month or less, a foreign private issuer need not file a separate transition report if the first annual report for the newly adopted fiscal year covers the transition period as well as the fiscal year.

The SEC Staff Training Manual is clear that the foreign private issuer would need to present full financial statements of income, cash flows and footnotes for the 3 and 12-month periods. However, there is no mention of the need to produce comparatives.

Conclusion

The Task Force agreed that there was no need to produce comparatives for the 3 month period.

For selected financial data, the Task Force noted that Item 3A of Form 20-F requires that "the company shall provide selected historical financial data regarding the company, which shall be presented for the five most recent financial years (or such shorter period that the company has been in operation)…" If the company were to adopt the approach set forth above, where under a 15-month transition period were presented, the Task Force agreed that period would represent one of the fiscal years. Accordingly, the appropriate periods to be presented would be the 15-month period ended December 31, 2003 and the years ended September 30, 2002, 2001, 2000, and 1999. For comparability purposes, the Task Force agreed that unaudited disclosures should be made for the year ended December 31, 2003 and the three months ended December 31, 2002, in line with the financial statement disclosures.

For MD&A, the Task Force noted that in order to facilitate comparability between reporting periods, investors would likely find most useful a comparison of two 12-month periods - the 12 months ended December 31, 2003 and the 12 months ended September 30, 2002. This would avoid the necessity for discussion under each heading within MD&A of variations arising simply as a result of one period being of 15 months long and the other being of 12 months.

While the SEC Staff did not object to the above, the Staff encourages registrants with this fact pattern to discuss their proposed approach to MD&A with the Staff.

8. Non-GAAP disclosures

Background

The Task Force has been discussing issues related to the implementation of the SEC's non-GAAP measures release. At its July 2003 meeting, the Task Force discussed the SEC Staff publication Frequently Asked Questions Regarding Use of non-GAAP Measures. Question 28 of the FAQ addresses the meaning of "expressly permitted".

Discussion

The Task Force discussed the income statement formats used by some UK registrants and the extent to which these formats were "expressly permitted" by UK GAAP and as a consequence were exempt from the prohibitions on non-GAAP measures set out in Item 10 of Regulation S-K.

In particular, the Task Force noted that:

- UK FRS 3 permits exceptional items to be shown on the face of the income statement and requires that certain specified exceptional items are so shown. FRS 3 defines exceptional items broadly; the term is not defined in U.S. GAAP, and is interpreted much more broadly than the term "extraordinary items" in the United States.

- Historically, a large number of companies from the UK have presented subtotals or amounts in the income statement that exclude amortization expense. Some companies also present subtotals that exclude depreciation expense. The Task Force noted that disclosure within UK financial statements of the amortization expense relating to intangibles for the period is required by FRS 10.

Conclusion

No conclusions were reached and the SEC Staff indicated that it would reconsider the acceptability of the various UK income statement formats.

Subsequent to the meeting, the Task Force noted that if a UK company presents an income statement that segregates exceptional items and amortization/depreciation expense from other costs with subtotals (e.g. either by the three column format or the boxing format) it should either follow the guidance below or discuss its specific fact pattern with the SEC Staff. If a company presents the disclosures specified below, the SEC Staff has indicated that it will not object to the income statement format included in the UK GAAP financial statements. Additional disclosures required would include the following:

1. If a company wants to include a subtotal that excludes an exceptional charge or credit, then it needs to describe the nature of the item that management has concluded is exceptional and why it considers the item to be exceptional. That is, there is an obligation on the company to make a positive assertion on the reasons why such items are considered exceptional. If an item does not meet the definition of exceptional, then the company should not present a subtotal that excludes such item.

2. If a company wants to include a subtotal that excludes amortization of intangibles, including goodwill, then it needs to explain why such a subtotal is meaningful to investors. An explanation that such an expense is excluded or substantially excluded under U.S. GAAP would not be a sufficient reason for presenting information in this manner under UK GAAP. A company also could present a subtotal that excludes depreciation expense if the income statement uses a "nature of expense" format, but could NOT present a subtotal that excludes depreciation expense if the income statement is presented using a "functional" format (e.g., cost of sales). Likewise, if depreciation expense is excluded, then the company should explain why such a subtotal is meaningful to investors.

3. If a company presents a subtotal in the financial statements under the concept of "expressly permitted" that would require the additional disclosures in Item 10(e)(1)(i)(C) and (D) of Regulation S-K, then the company should provide those disclosures inside the audited financial statements.

4. If a company presents a subtotal or an item such as a restructuring charge that would be prohibited from disclosure absent it being “expressly permitted” by FRS 3, then the company should disclose that fact.

5. If a company presents an income statement with subtotals that exclude any of the items above, then the Company should provide in the U.S. GAAP note a reformatted condensed income statement that complies with Article 10 of Regulation S-X for the applicable periods. This condensed income statement may be based on either U.S. GAAP or UK GAAP amounts. Where U.S. GAAP amounts are used to prepare the condensed income statement, the company should provide the reconciling disclosures in Item 10(e)(1)(i)(A) and (B) inside the audited financial statements unless such a presentation is already set out in the primary GAAP income statement (i.e., the columnar format). Such disclosures would not be necessary where the condensed income statement is prepared using UK GAAP amounts.

6. If a company presents a subtotal or item under the concept of "expressly permitted" outside the financial statements, for example, in the MD&A/OFR, then the company would need to comply with all the disclosure requirements in item 10(e)(1)(i)(A)-(D).

The Task Force further noted that issues relating to per share information have been discussed in Question 28 of the FAQ, which specifies that the numerator for all per share information must be a single amount appearing directly 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.

Registrants that believe they have a similar fact pattern under a non-UK reporting regime should consult the Staff.

9. Issues related to first-time application of IFRS

Background

The Task Force discussed issues related to the first-time application of International Financial Reporting Standards—IFRS at its July 2003 meeting. At that meeting, the SEC Staff noted its consideration of a proposal on how certain matters relating to the first-time application of IFRS should be addressed in the context of financial statements filed with the SEC and, in particular, the issue of whether three years of income statements would need to be presented in the year of adoption on the basis of consistent GAAP.

Discussion

The Task Force noted that many European companies are beginning the process of converting from local GAAP to IFRS and the issue of how far back a foreign private issuer would need to go in the context of financial statements filed with the SEC is an urgent matter that needs resolution.

The SEC Staff indicated that these issues continue to be under consideration and will make every effort to address them at the earliest possible time.

Mr. Gannon also noted that The Committee of European Securities Regulators had recently issued a consultation paper "Draft Recommendation for Additional Guidance Regarding the Transition to IFRS".

10. SEC Staff issues

(a) Non-consolidation of controlled subsidiaries

The SEC Staff noted that it was not acceptable in filings with the Commission to exclude from consolidation various small subsidiaries on the grounds that they were immaterial individually. Firstly, a proper consideration of materiality involves looking at the subsidiaries both individually and in aggregate. Secondly, in applying the provisions of Staff Accounting Bulletin 99 on materiality it should be noted that management's decision to exclude subsidiaries would not ordinarily be viewed by the Staff as inadvertent, nor would it be viewed as an accounting estimate involving subjective judgment. The Staff also indicated that failure to consolidate all subsidiaries could result in financial statements that do not contain an information content substantially similar to U.S. GAAP as required by Item 17(b) and 18 of Form 20-F.

(b) Audit report issues

Going concern uncertainties

The SEC Staff noted that in respect of U.S. GAAS audit reports filed with the Commission involving a going concern modification, use of the words "substantial doubt" should be included in order to comply with U.S. GAAS (AU 341). Similarly, the staff noted that reports that include conditional or contingent language about the existence of substantial doubt would not be acceptable under US GAAS. The Staff also noted that it would require such language to be used in an audit report that referred to both local GAAS and U.S. GAAS. The Staff would generally consider alternative expressions about going concern uncertainties to be substantive differences rather than local "style variations."

Comparative periods

The SEC Staff reiterated that where an audit report made reference to the report of another auditor, whether in relation to the current year (subsidiary auditor) or a prior year (predecessor auditor), the other auditor's report should be included in the filing and, in predecessor auditor situations, the predecessor auditor would have to reissue their opinion following all procedures required under U.S. GAAS.

Subsidiary auditors

The SEC Staff noted that they have encountered numerous deficiencies in filings with respect to the reports of other auditors on subsidiaries and investees required under Rule 2-05 of Regulation S-X when the principal auditor relies upon and makes reference to other auditors. The Staff will require amendment of filings that contain audit report deficiencies. The most common deficiencies include:

- Failure to file all required audit reports
- Audits not conducted in conformity with U.S. GAAS
- Deviations from conformity with the subsidiary or investee's GAAP
- Subsidiary or investee uses a different GAAP than the registrant, but responsibility for the conversion to the registrant's GAAP is unclear

Follow up on audit-related issues

The SEC Staff clarified that the auditor qualification requirements and practices described at the July 2003 meeting (pre-PCAOB registration) were meant to apply to other subsidiary auditors under Rule 2-05, equity investee financials under Rule 3-09, target companies on Form S-4 or F-4, and guarantors under Rule 3-10. The Staff has generally not insisted on compliance for Rule 3-05 financial statements where the auditor does not otherwise practice before the Commission and doesn't intend to do so.

It was noted that the PCAOB had included the SECPS Appendix K quality control procedures as part of its interim adoption of auditing, attestation, quality control, ethics, and independence standards. The Appendix K procedures are identified in PCAOB Rule 3400T.

(c) PCAOB registration

The SEC Staff noted the current deadlines for registering with the PCAOB. Audit firms not registered will face restrictions on their ability to issue audit reports on an issuer's financial statements (defined as any public company required to file a report with the SEC or that has filed a registration statement for public offering of securities), reissue audit reports on an issuer's financial statements and issue consents for the use of audit reports on an issuer's financial statements depending on what stage of PCAOB registration they are in.

The Staff summarized the following points (currently applicable to domestic issuers) to illustrate the importance of timely registration with the PCAOB and the potential impact on filings. The Staff noted that these rules have transitional implications with respect to reviews of interim financial information if the audit firm is not registered with the PCAOB:

- Interim reviews can be done in the short term as long as the audit firm is registered before the next Form 10-Q or Form 10-K is due;

- Audit firms must be registered with the PCAOB in order to commence any significant work regarding the review of interim financial statements for fiscal periods ending after November 30, 2003;

- If the audit firm is not ultimately registered by the time the next Form 10-Q or Form 10-K is reviewed/audited, the issuer will need to engage a PCAOB-registered firm to re-review the prior interim financial statements. (The SEC has stated that it considers interim financial statement reviews to be integral to the audit of annual financial statements; accordingly, an unregistered audit firm cannot perform the interim reviews and a registered firm perform the audit of the annual financial statements.)

The Staff also noted that these rules have implications regarding association with other audit firms in a registration statement:

- *Financial statements provided under Rule 3-05 of Regulation S-X*—Rule 3-05 financial statements (financial statements of companies acquired or to be acquired) are not issuer financial statements, so it is possible to have Rule 3-05 financial statements audited by a nonregistered audit firm.

- *Financial statements provided under Rule 3-09 of Regulation S-X*—The SEC Staff is considering whether Rule 3-09 financial statements, which form the basis of the equity pick-up for a significant equity investee, can be audited by a nonregistered firm. Rule 3-09 financial statements are not issuer financial statements; however, they may have a material bearing on the issuer's financial statements via the equity pick-up and amounts on the balance sheet.

  Based on subsequent discussions, the Staff understands that reliance by the principal auditor on, and filing of, an investee audit report (or subsidiary audit report) does not automatically trigger a registration requirement for the investee or subsidiary auditor. Rather it is based on the numerical significance tests specified in PCAOB Rule 1001(p)(ii)(1) and Note 1 thereto.

The foreign accounting firm PCAOB registration deadline is April 19, 2004 (a 90-day extension may be considered). Until the registration deadline, foreign firms continue to be subject to the existing rules.

(d) Voluntary filing on domestic form

Foreign private issuers that voluntarily file on domestic forms are expected to fully comply with the requirements of the forms. If such a foreign private issuer meets the definition of an accelerated filer, it would be required to file its periodic reports on an accelerated basis, and also to adopt the internal control reporting rules related to Section 404 of Sarbanes-Oxley on the basis applicable to accelerated filers.

The Task Force noted that certain registrants who had previously filed on domestic forms voluntarily might choose to revert to filing on foreign forms so as to delay the implementation date of Section 404 reporting.

(e) Oil & gas disclosure issuers

Registrants are reminded to include advisory disclosures in MD&A and the financial statement footnotes that highlight situations when there are unresolved implementation issues relating to an accounting standard that has been adopted. Registrants should continue to include the advisory disclosures in their filings with the Commission until the issues are resolved.

Applicability of Statement 142 to oil and gas producing activities

As noted in the July 15, 2003 Task Force highlights, an issue has arisen regarding the applicability of Statement 142 to the reporting of oil and gas producing activities. If it is determined that Statement 142 does apply, amounts capitalized for mineral/drilling rights that are determined to be contract-based intangible assets that have historically been classified as a component of property (tangible assets) would be reclassified and separately reported on the face of the balance sheet as intangible assets. The related intangible asset disclosures under Statement 142 would also be required. 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 for each balance sheet period reported. This issue is currently being considered by the EITF.

Impact of Statement 143 on Statement 69, Disclosures about Oil and Gas Producing Activities

Subsequent to the November 2003 Task Force meeting, a letter addressed to Chief Financial Officers of registrants identified as being primarily engaged in the production of oil and gas was posted to the SEC website by the Division of Corporation Finance. This letter includes the Staff's observations concerning questions that have arisen regarding the required disclosures of FASB Statement 69, Disclosures about Oil and Gas Producing Activities, upon the adoption of FASB Statement 143, Accounting for Asset Retirement Obligations. This letter is located at:
http://www.sec.gov/divisions/corpfin/guidance/oilgasletter.htm.

All Item 18 filers with subsidiaries or operations engaged in the production of oil and gas, and Item 17 filers that provide Statement 69 information, should consider this letter in the preparation of their filings with the Commission. The guidance in the letter applies to registrants that present the amounts in their Statement 69 information on the basis of US GAAP, as well as those that present such amounts on the basis of a GAAP that recognizes asset retirement obligations in a similar manner, such as UK GAAP and IFRS.

Application of Statement 143 by oil and gas producing companies following the full cost accounting method

The SEC Staff noted that the application of Statement 143 by oil and gas producing companies that follow the full cost method could impact the accounting under the full cost method in certain areas, including the following:

- The calculation of the full cost ceiling
- Accounting for insignificant and significant assets sales and disposals
- Depletion, depreciation and amortization

The Staff indicated that SEC registrants should include disclosure in both MD&A and financial statement footnotes as follows:

- State whether or not the implementation of Statement 143 changed the accounting for oil and gas operations under the full cost method.
- As applicable, identify each area of the full cost accounting that changed as a result of the application of Statement 143.
- Explain that there are differing interpretations of the application of Statement 143 to the full cost accounting.

The Staff indicated that it will continue consideration of issues relating to Statement 143.

11. Follow up on auditor licensing and signature requirements

Discussion deferred to the next meeting.

12. Issues related to discontinuing operations

Discussion deferred to the next meeting.

13. Issues related to changes in auditors

Discussion deferred to the next meeting.

14. Issues related to reverse acquisitions

Discussion deferred to the next meeting.

15. Incorporation of Form 6-K's into Form S-8's

Background

Assume a foreign private issuer is looking to file a new Form S-8 sometime in November. It has a calendar year end and since December 31, 2002, has furnished the Commission numerous Form 6-Ks for a variety of reasons including, but not limited to, quarterly interim information for the first and second quarters. Part II, Item 3(b) of Form S-8 requires all other reports filed pursuant to Section 13(a) of the Exchange Act since the end of the fiscal year to be incorporated into the registration statement.

AICPA INTERNATIONAL PRACTICES TASK FORCE
AICPA Washington Office
November 25, 2003
HIGHLIGHTS

Issue

Can this requirement be read to exclude Form 6-Ks from being incorporated since they are not filed, but furnished – that is, apply a literally reading?

Discussion

The Task Force noted that no other form on which a foreign private issuer would file requires all subsequent 6-Ks to be included. Generally, 6-Ks are only incorporated into a registration statement when required to comply with some other requirement - such as the age of financial statements. Therefore, the Task Force agreed that Form 6-K's need not be incorporated in a Form S-8.

The SEC Staff indicated that it would not object to the above.

DATE OF NEXT MEETING

The Task Force agreed to meet on March 9, 2004.