



U.S. Securities and Exchange Commission

International Reporting and Disclosure Issues in the Division of Corporation Finance

November 1, 2004

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International Reporting and Disclosure Issues in the Division of Corporation Finance

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I. OVERVIEW OF DISCLOSURE RULES APPLICABLE TO FOREIGN ISSUERS

Over the last ten years, the number of foreign companies accessing the U.S. public markets has increased dramatically. Since 1997, over 600 foreign companies have registered securities with the SEC for the first time. As of December 31, 2003, there were over 1,200 foreign companies from 57 countries filing periodic reports with the Commission.

A foreign company that seeks to list its securities on the New York or American Stock Exchanges or the Nasdaq Stock Market must register its securities with the SEC by filing an Exchange Act registration statement, and must subsequently file annual reports. Form 20-F is the form used by most publicly traded, foreign companies for Exchange Act registration and annual reporting because its requirements are tailored specifically for foreign issuers. Form 20-F requires comprehensive disclosure about the company, including information about its business operations and its financial statements.

The Securities Act requires companies to register each public offering of securities in the U.S. In an initial public offering, a foreign company registers its securities using a Form F-1 registration statement. The registration statement includes the prospectus, which is the principal document used to market securities to investors. The disclosure contained in a prospectus generally is the same as that required by Form 20-F and also includes various matters that are specific to the offering.

The integrated disclosure system designed for foreign private issuers provides a number of accommodations to practices in other jurisdictions. These accommodations include:

- interim reporting on the basis of home country and stock exchange practice rather than quarterly reports;
- exemption from the proxy rules and the insider reporting and short swing profit recovery provisions of Section 16;
- aggregate executive compensation disclosure rather than individual disclosure, if so permitted in an issuer's home country;
- acceptance of three International Financial Reporting Standards (IFRS) relating to cash flow statements (IAS # 7), business combinations (IAS # 22) and operations in hyperinflationary economies (IAS # 21);
- offering document financial statements updated principally on a semi-annual, rather than a quarterly basis; and
- foreign companies may prepare their financial statements using a comprehensive body of generally accepted accounting principles (GAAP) other than U.S. GAAP. Foreign companies that present their financial information in accordance with the GAAP of their home country or International Financial Reporting Standards must include a reconciliation of significant variations from U.S. GAAP.

Instructions for financial statements and the reconciliation to US GAAP are included in Item 8.A, Item 17 and Item 18 of Form 20-F.

The Division of Corporation Finance has a separate office -- the Office of International Corporate Finance (OICF) -- that serves as the central point of contact for foreign private issuers registering with the SEC. Senior attorneys in the Office are able to help guide foreign registrants through the registration process. OICF may be contacted at (202) 942-2990.

II. RECENT COMMISSION ACTIONS AND OTHER TOPICAL INFORMATION

A. Proposed Rule regarding IFRS First-time Adopters

On March 11, 2004, the Commission proposed to amend Form 20-F to provide a one-time accommodation relating to financial statements prepared under IFRS for foreign private issuers registered with the SEC (Securities Act Release 33-8397). The proposed amendments would apply to companies that publish IFRS financial statements for the first time for any financial year beginning no later than Jan. 1, 2007.

Form 20-F generally requires a company to provide in its SEC filings three years of audited financial statements prepared on a consistent basis of accounting. The accommodation would permit eligible foreign private issuers

for their first year of reporting under IFRS to file two years rather than three years of statements of income, changes in shareholders' equity and cash flows prepared in accordance with IFRS, with appropriate related disclosure. The accommodation would retain current requirements regarding the reconciliation of financial statement items to U.S. GAAP, but modify the form in which the reconciliations are presented in the first filing that includes IFRS financial statements by requiring certain additional condensed US GAAP information.

The proposed amendments also would require *any* company that adopts IFRS for the first time, in *any* financial year to provide disclosure related to exceptions from IFRS on which it relied, and to include a specified level of information in the reconciliation from its previous system of accounting to IFRS.

The proposals are intended to ease the burdens that foreign companies may face when they adopt IFRS for the first time, while improving the quality of financial disclosure that they provide to investors. The proposals are addressed particularly at foreign issuers located in the European Union (EU), which under current EU law will generally be required to adopt IFRS for reporting on their 2005 financial year.

B. MD&A Interpretive Release

On December 19, 2003, the Commission issued an interpretive release regarding Management's Discussion & Analysis of Financial Condition and Results of Operations, commonly called MD&A, included in reporting companies disclosure documents (Securities Act Release 33-8350). The release reminds companies of existing disclosure requirements and provides additional guidance, designed to elicit more informative and transparent MD&A that satisfies the principal objectives of MD&A: (1) to provide a narrative explanation of a company's financial statements that enables investors to see the company through the eyes of management; (2) to enhance the overall financial disclosure and provide the context within which financial information should be analyzed; and (3) to provide information about the quality of, and potential variability of, a company's earnings and cash flow, so that investors can ascertain the likelihood that past performance is indicative of future performance.

Specifically, the guidance emphasizes that MD&A should not be merely a recitation of financial statements in narrative form or an otherwise uninformative series of technical responses to MD&A requirements, neither of which provides the important management perspective called for by MD&A. Instead, the release encourages top-level management involvement in the drafting of MD&A, and provides guidance regarding:

- the overall presentation and focus of MD&A (including through executive-level overviews, a focus on the most important information and a reduction of duplicative information);

- emphasis on analysis of financial information;
- known material trends and uncertainties;
- key performance indicators, including non-financial indicators;
- liquidity and capital resources; and
- critical accounting estimates.

III. ADOPTION OF INTERNATIONAL DISCLOSURE RULES

A. General

On September 28, 1999, the Commission adopted changes to its non-financial statement disclosure requirements for foreign private issuers, to conform those requirements more closely to the International Disclosure Standards endorsed by IOSCO in September 1998 (Securities Act Release No. 7745). The changes are intended to harmonize disclosure requirements on fundamental topics among the securities regulations of various jurisdictions.

B. Age of Financial Statements

a) General

Form 20-F includes new Item 8 that specifies the form, content and age of financial statements of the registrant. New Item 8 supercedes Rule 3-19 of Regulation S-X. The US GAAP reconciliation requirements in Items 17 and 18 of Form 20-F have been retained without substantive change. In general, the financial reporting requirements for foreign registrants will not change, except for the age of financial statements in a registration statement.

Item 8.A.4 of Form 20-F reduces the period before audited financial statements of the most recent fiscal year are required in a registration statement from 18 months old (six months after fiscal year end) to 15 months old (three months after fiscal year end). However, an instruction to Item 8 retains the 18 month period for the following types of offerings where the "blackout" period would be disruptive – (a) exercise of outstanding rights granted by the issuer, if the rights are granted pro rata to all existing security holders, (b) dividend or interest reinvestment plans, and (c) conversion or exercise of outstanding convertible securities or warrants.

b) Annual Updating

Item 8.A.4 requires a foreign registrant to update a registration statement with audited *annual* financial statements three months after its fiscal year-end. This updating is required regardless of whether the registration statement includes audited *interim* financial statements for a recent period. A registrant cannot satisfy its obligation to file *annual* statements by filing

interim statements. The Commission's June 2001 release of technical corrections to Form 20-F clarified this point.

c) Initial Public Offerings

Also, Item 8.A.4 requires that audited financial statements in initial public offerings be no more than 12 months old *at the time of filing*. The Item states that this requirement may be satisfied with an audit as of an interim date. This requirement is *in addition to* the requirement that the audited *annual* financial statements be no more than 15 months old *at the time of effectiveness* of a registration statement. However, an instruction clarifies that this applies only where the registrant is not public in any jurisdiction. Further, the instruction indicates that the staff will waive the 12-month requirement where it is not applicable in the registrant's other filing jurisdictions and is impracticable or involves undue hardship. As a result, we expect that the vast majority of IPOs will be subject only to the 15-month rule. The only times that we anticipate audited financial statements will be filed under the 12-month rule are when the registrant must comply with the rule in another jurisdiction, or when those audited financial statements are otherwise readily available. If the 12-month audit is waived in a filed registration statement, the representation must be filed as an exhibit per Instruction 2 to Item 8.A.4. The staff will consider a request for waiver of the 12-month audit at the time of filing the initial registration statement or submitting the initial confidential draft when the registrant knows that a waiver will be necessary prior to effectiveness of the registration statement.

d) Interim updating

Item 8.A.5 reduces the updating period for interim financial statements from 10 months after fiscal year end to nine months after fiscal year end. If interim financial statements are required, they must cover a period of at least six months. Item 8.A.5 also requires financial information more current than the required interim period to be included in a registration statement if that information has been made public. Instructions to this item essentially retain the disclosure provisions of old Rule 3-19(f).

e) Delayed and Continuous Offerings

Item 512(a)(4) of Regulation S-K requires a foreign private issuer to file a post-effective amendment to its registration statement to include any financial statements required by Item 8.A of Form 20-F at the start of a delayed offering or throughout a continuous offering under Rule 415. 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. For these types of offerings, Item 8.A. ordinarily requires the annual audited financial statements to be not more than 15 months old, and the unaudited interim financial statements to be not more than nine months old. Takedowns from existing shelf registration statements and other types of delayed offerings may not be commenced, and continuous offerings must be suspended, during periods when the financial

statements are not current under the Item 512(a)(4) undertaking. This means that the financial statements must remain current throughout the entire time that an exchange offer is outstanding. It also means that the financial statements must remain current in a merger or acquisition transaction until shareholder approval has occurred. However, this provision does not apply to a registration statement for a typical firm commitment underwritten offering priced under Rule 430A or a listing.

Item 512(a)(4) applies to the age of *any* financial statements included in a registration statement. This includes the financial statements of other entities such as acquired businesses under Rule 3-05 of Regulation S-X, equity method investees under Rule 3-09, target companies in a pending business combination transaction on Form F-4/S-4 or proxy statement, guarantors under Rule 3-10, and entities whose securities are pledged as collateral for another registered security under Rule 3-16. However, the staff will consider requests for relief in circumstances where the application of Item 512(a)(4) would result in the need to provide financial statements of other entities more current than those that would be provided by a similarly situated domestic registrant.

Further, Item 512(a)(4) is not intended to require in a post-effective amendment the inclusion of financial statements of entities that were not required in the original effective registration statement (for example, subsequently acquired businesses). However, the "fundamental change" provisions of Item 512(a)(1) may require such financial statements.

f) Capitalization Table

Item 3.B of Form 20-F requires a capitalization table prepared as of a date within 60 days of the effectiveness of a registration statement. However, Item 8 permits the most recent balance sheet (from which a capitalization table is ordinarily derived) to be as much as 9 months old. As written, the age requirement for the capitalization table is also considerably more stringent than the 135-day window customarily used by US issuers in their registration statements.

Consistent with historical practice, the staff will not object if a foreign private issuer presents its capitalization table as of the same date as the most recent balance sheet required in the registration statement. If there have been significant subsequent changes in capitalization such as debt or equity issuances, recapitalizations, or special dividends, these changes should be reflected in "as adjusted" columns or footnotes to the table.

g) Annual Report

The revised age of financial statement requirements in Item 8 did not change the due date for filing an annual report on Form 20-F, which continues to be six months after fiscal year end.

C. Updating Interim Financial Information -- Item 8.A.5 of Form 20-F

NOTE - Rule 3-19(f) was superceded by Item 8.A.5 of Form 20-F and related instructions beginning October 1, 2000. The disclosure requirements of Rule 3-19(f) have been retained in the new Item and the staff intends to continue to interpret the requirements as described below.

Item 8.A.5 requires interim financial information that is made available to shareholders, exchanges or others on a more current basis than that otherwise required by SEC rules to be included in the registration statement. This information is not required to be reconciled to US GAAP. However, narrative disclosures about differences in accounting principles are required and material reconciling items that have not been previously addressed in the filing must be quantified. The intent of the disclosure is to ensure that the information available to a US investor is as current as information available to a foreign investor.

Item 8.A.5 should not be interpreted as limiting the disclosure only to information on revenues and income. Rather, if the information disclosed in the foreign jurisdiction includes revenues and income, then all financial information that is made public should be included in the registration statement.

Item 8.A.5 applies to annual as well as interim financial information. For example, if the foreign issuer publicly distributes annual financial information before the audited statements are available, the registration statement should include such information.

Occasionally, the interim information that is publicly distributed in the issuer's home country will be prepared using accounting standards that are different from those used in the US registration statement. In this instance, the US investor has not had the benefit of knowing the reconciling items between home-country GAAP and US GAAP. Therefore, the information disclosed pursuant to Item 8.A.5 would have to be supplemented with a description and quantification of differences in accounting principles.

For example, a foreign issuer uses US GAAP in its primary financial statements in filings with the Commission, but reports in a foreign GAAP in its home country. The company releases more recent earnings information in its home country in foreign GAAP. Item 8.A.5 requires that information to be included in the prospectus. However, the issuer has never filed reconciliations from foreign GAAP to US GAAP, so a US investor cannot interpret the foreign GAAP information. In this situation, an issuer may either (a) reconcile the Item 8.A.5 information to US GAAP or (b) provide a reconciliation from US GAAP to foreign GAAP (reverse reconciliation) for at least the most recent fiscal year required in the registration statement.

Issuers occasionally will be required to adopt a new US accounting standard in their first interim financial statements. The disclosure of financial information required by Item 8.A.5 does not result in the requirement to adopt the new standard and quantify its effect under US GAAP.

Inclusion of published information under Item 8.A.5 does not ordinarily trigger a requirement to include full interim financial statements more recent than otherwise required. For example, if complete financial statements related to the most recent quarter (but not the comparative period) are distributed in a foreign issuer's home country, that information must be included in the US registration statement. Comparative prior period information is not required because the information provided is included only because of Item 8.A.5. In order to avoid confusing US readers, the registrant should include disclosure explaining why the information is provided particularly when the information is placed with other financial statements and may look incomplete.

However, if the information provided contains a reconciliation to US GAAP, the staff believes that inclusion of reconciled information for the comparative prior periods generally will also be necessary to prevent the current period information from being misleading. A foreign private issuer is not ordinarily required to provide US GAAP information in its home jurisdiction. Accordingly, when a foreign private issuer presents more current US GAAP information, it effectively has decided to present interim financial statements, and is also required to present comparatives as required by Item 8.A.5 of new Form 20-F. In these circumstances the current and comparative interim period would need to be covered by MD&A and pro forma information would need to be updated to that date.

D. Audit Report Reference to Compliance with GAAS

Prior to PCAOB Auditing Standard No. 1

Item 8 of Form 20-F requires the annual financial statements to be audited "in accordance with a comprehensive body of auditing standards." An instruction clarifies that in SEC filings the financial statements must be audited in accordance with US generally accepted auditing standards (US GAAS). This instruction changes the staff's practice of accepting audit reports that state the audit was conducted in accordance with local auditing standards that are "substantially similar" or "similar in all material respects" to US GAAS. That practice was originally adopted to accommodate audit report styles in different jurisdictions that differ from the audit report wording specified by US GAAS. The practice was not intended to relieve the auditor of the responsibility to perform all auditing procedures necessary under US GAAS.

PCAOB Auditing Standard No. 1

In December 2003 the Public Company Accounting Oversight Board (PCAOB) adopted Auditing Standard No. 1 (AS 1). On May 14, 2004, the Commission approved AS 1, effective for auditors' reports issued or reissued on or after May 24, 2004. AS 1 requires auditors' reports to state compliance with "the standards of the Public Company Accounting Oversight Board (United States)". In addition, AS 1 states that a reference to generally accepted

auditing standards in auditors' reports is no longer appropriate or necessary. The reference to compliance with the standards of the Public Company Accounting Oversight Board (United States) is required for all periods covered by the auditor's opinion, including those preceding the adoption of AS 1. AS 1 is available on the PCAOB website at www.pcaobus.org.

Note – this Outline will hereafter refer to “the standards of the Public Company Accounting Oversight Board (United States)” rather than “US GAAS” throughout unless the context requires otherwise. “The standards of the Public Company Accounting Oversight Board (United States)” will be abbreviated as “PCAOB Standards”.

On May 14, 2004, the Commission also issued an interpretation *Commission Guidance Regarding the Public Company Accounting Oversight Board's Auditing and Related Professional Practice Standard No. 1* (Securities Act Release 33-8422). The guidance notes that many parts of Commission rules and SEC staff guidance include direct or indirect references to US GAAS or specific auditing standards under US GAAS. Effective May 14, 2004, references in Commission rules and staff guidance and in the federal securities laws to GAAS or to specific standards under GAAS, as they relate to issuers, should be understood to mean the standards of the PCAOB plus any applicable rules of the Commission. Further, AS 1 does not supersede Commission rules or regulations. When an independent accountant prepares a report for submission or filing with the Commission, the independent accountant would be considered to be representing that it has complied with the applicable federal securities laws and Commission rules and guidance, as well as with PCAOB Standards, as referenced explicitly in AS 1. In a note to PCAOB Rule 3600T, Interim Independence Standards, the Board specifically provided that the PCAOB's rules do not supersede the Commission's rules, and, therefore, registered public accounting firms must comply with the more restrictive of the Commission's or the PCAOB's rules.

Historically, some foreign private issuers have filed audit reports that made reference to compliance with both US GAAS and home-country (or international) auditing standards. The staff had not objected to that practice. As described above, under AS 1 a reference to US GAAS is no longer appropriate or necessary in auditors' reports on financial statements of issuers. Consistent with historical practice, the staff will not object to audit reports that make reference to compliance with both PCAOB Standards and home-country (or international) auditing standards.

PCAOB rules require the entire audit of a registrant to be conducted in accordance with PCAOB Standards. Where a principal auditor relies upon and makes reference to other auditors, the subsidiary audit reports filed under Rule 2-05 of Regulation S-X must also refer to compliance with PCAOB Standards.

As stated in the 1999 Form 20-F adopting release, the staff will continue to accept wording variations solely to comply with local reporting formats. For example, the staff views the Canadian “addendum” paragraph that describes

substantial doubt about a registrant's ability to continue in business as an acceptable style variation of the going concern reporting requirement under PCAOB Standards.

AS 1 addresses audit reports with respect to "issuers" as defined in Section 2 (a)(7) of the Sarbanes-Oxley Act. Filings with the SEC may include financial statements of various entities that are not issuers. For example, acquired businesses under Rule 3-05 of Regulation S-X, equity method investees under Rule 3-09, target companies in a pending business combination transaction on Form F-4/S-4 or proxy statement, and entities whose securities are pledged as collateral for another registered security under Rule 3-16 are not considered to be "issuers" unless they separately meet the definition of an issuer. Audit reports with respect to the financial statements of such non-"issuers" may continue to make reference to US GAAS. Subsidiary issuers or guarantors of debt required to file separate financial statements under Rule 3-10 are considered issuers, and their audit reports must refer to compliance with PCAOB Standards.

This guidance is intended to apply to all foreign private issuers other than those reporting under the Canadian Multi-Jurisdictional Disclosure System (MJDS). Under the special Canadian MJDS rules, Canadian GAAS audits continue to be acceptable in filings on MJDS forms.

Inclusion of Canadian GAAS reports by MJDS registrants is acceptable only when their financial statements are included in MJDS forms. In certain circumstances, financial statements of a MJDS company may be required in a filing by a domestic issuer or a non-MJDS foreign private issuer. For example, the MJDS company may be a target company in a business combination transaction on Form F-4 or S-4, an acquired business under Rule 3-05, an equity investee under Rule 3-09 or a guarantor under Rule 3-10. In those situations, an audit in accordance with PCAOB Standards is required.

The staff has historically viewed audit reports which state that the financial statements "give a true and fair view" of financial position, results of operations and cash flows as constituting an acceptable style variation of the "fairly presents" language in US GAAS. However, the staff has encountered circumstances where the true and fair view language continued to be used despite the discovery of material uncorrected errors in the financial statements. Given the lack of a practicable way to distinguish which "true and fair view" reports mean "presents fairly", the staff now expects the *opinion paragraph* to follow the wording requirements of PCAOB Standards.

Historically, some registrants have filed an audit report that contained both a local GAAS opinion paragraph and a US GAAS opinion paragraph. The staff had not objected to that practice. Consistent with historical practice, the staff will not object to audit reports that contain both a local GAAS opinion paragraph and an opinion paragraph under PCAOB Standards.

E. Other Issues Associated with Form 20-F

a) Selected Financial Data

Under Item 3.A of Form 20-F, 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. If only some of the required data, such as revenues, is available for the two earliest years, that data usually should be provided. The Instruction to Item 3.A requires that the document disclose any omission as well as the reasons supporting the omission. Pre-clearance from the staff is not required if a registrant meets the criteria. As with any disclosure, the explanation of the reasons for omission is subject to staff review.

Instruction 2 to Item 3.A requires selected financial data to include amounts under US GAAP in addition to those presented on the basis of the primary financial statements. If any amount required to be presented in selected financial data on a home-country GAAP basis is different on a US GAAP basis, then the corresponding amount under US GAAP should also be shown. However, measures that are neither required by home-country GAAP nor US GAAP need not be presented in selected financial data. For example, income from operations per share specified by Item 3.A need not be presented if it is not presented in the primary financial statements.

As clarified in the Commission's June 2001 technical corrections to Form 20-F, selected data is required for any predecessors of a registrant.

b) Impact on MJDS

Canadian registrants that use the MJDS are not required to follow revised Form 20-F and are generally not affected by those rule revisions. However, Form F-10 under MJDS requires *any* financial statements included in the registration statement to be reconciled to US GAAP using Item 18 of Form 20-F. A literal application of that requirement would result in MJDS registrants reconciling interim information more currently than any other foreign private issuers. Historically, the staff has not objected if a MJDS registrant reconciled to US GAAP only those periods that would be required if the filing had been made on a regular foreign form. That is, the registrant could apply the age of financial statement requirements in Rule 3-19 of Regulation S-X. However, as of October 1, 2000, Item 8 of revised Form 20-F superceded Rule 3-19. An MJDS registrant may still rely on this age of financial statement accommodation, but it must now follow the more stringent age requirements in new Form 20-F.

IV. STAFF PROCESSING AND REVIEW OF FILINGS

A. Matters of Interest to Initial Filers

Pre-filing Issues and Confidential Reviews

As foreign issuers plan to list or offer securities in the United States,

management may identify many procedural or substantive compliance questions. Issuers are encouraged to contact the staff of the Commission to discuss these questions when they arise. The Commission staff also has implemented procedures to review foreign issuers' initial disclosure documents in draft form, if requested by the issuer. Companies are encouraged to contact Paul Dudek, Chief of the Office of International Corporate Finance (202-942-2990), early in their planning process to answer questions, arrange meetings, or discuss the timing of a confidential review.

Questions about the required financial statements or unusual accounting and financial reporting issues may be directed to Craig Olinger, Deputy Chief Accountant in the Division of Corporation Finance (202-942-2850). On complex accounting questions, the Division's staff will consult with the Commission's Office of the Chief Accountant.

While the staff will respond to inquiries about form requirements or procedures informally, more complex or sensitive disclosure and accounting issues are usually best submitted to the staff on a pre-filing basis in writing. The inquiry should identify clearly the company, its country of incorporation and the issue on which staff guidance or relief is requested. Because the form, content and periods of financial information required in an SEC filing may vary depending on the security or transaction being registered, the request should also describe the company's capital structure and listing or offering plans. The request should also identify the comprehensive basis of accounting and reporting currency to be used in the company's financial statements, as well as the number of periods being reconciled to US GAAP. The extent of information provided about the company's business will depend on the nature of the issue, but should be sufficient to permit the staff to make an informed analysis of the question. The request should explain clearly the basis for the company's conclusion or need for relief. The request should indicate whether the company's auditor has been consulted about the matter, and whether it concurs with the company's conclusion.

The Office of the Chief Accountant has published a Protocol for Submissions to the Office of the Chief Accountant that outlines the information issuers should include in pre-filing requests about accounting matters. This guidance can be found on the Commission's website at www.sec.gov/info/accountants/ocasubguidance.htm.

US GAAP Reconciliation in an Initial Registration Statement

A first-time registrant must reconcile its home-country GAAP financial statements for only the two most recently completed fiscal years plus interim periods, rather than all three of the years for which complete financial statements must be included. The transition reconciliation requirements do not affect the basic financial statements that are required. Statements of cash or funds flow and shareholders' equity are required for all periods for which an income statement is presented in the primary financial statements.

Foreign Issuers that Use US GAAP for their Primary Financial Statements

A foreign private issuer that presents US GAAP financial statements as its primary financial statements in its initial registration statement may include those audited income statements and cash flow statements for two years, without furnishing complete audited financial statements for the earlier of the three years. In this case, the registrant may present the 5 years of selected financial data required in the registration statement on the basis of its home-country GAAP, rather than 5 years of US GAAP selected financial data.

Pension Accounting under US GAAP in an Initial Registration Statement

Some foreign registrants have concluded that it is not feasible to obtain the actuarial information necessary to implement FASB Statement 87 as of the effective date specified in the standard, which was January 1, 1989 for foreign plans with a calendar year-end. The staff will not object if a foreign registrant that cannot implement FAS 87 as of that effective date due to the unavailability of actuarial data adopts the standard as of a later date. However, the standard must be adopted as of a date no later than the beginning of the first period for which US GAAP reconciled data is required in a Commission filing.

A foreign registrant adopting FAS 87 later than the effective date specified in the standard should allocate a portion of the transition obligation/asset directly to equity on the adoption date based on the ratio of: (a) the years elapsed between the effective date in the standard and the adoption date, to (b) the remaining service period of employees expected to receive benefits as estimated at the adoption date. This process uses the service period at the adoption date as a surrogate for the service period at the effective date specified in FAS 87. Using this method, the transition asset/obligation should be extinguished at the same date as if FAS 87 were adopted on the effective date.

To illustrate the mechanics of this accommodation, assume FAS 87 is adopted on January 1, 1998. At that date, the transition obligation is £15,000 and the remaining service period is 15 years. Nine years have elapsed since the effective date of FAS 87. Accordingly, 9/15ths, or £9,000 of the transition obligation would be recorded as a direct reduction of equity in the opening balance sheet under US GAAP. The remaining £6,000 would be amortized as part of pension expense over the next 6 years.

Foreign registrants implementing this accommodation should include the following disclosures:

- the date FAS 87 was adopted for purposes of the financial statements;
- a statement that it was not feasible to apply FAS 87 on the effective date specified in the standard; and
- the amortization period for the transition obligation/asset, and the amount that was recorded directly to equity in the opening balance

sheet under US GAAP.

The disclosure of this information is necessary for financial statements prepared under either Item 17 or Item 18 of Form 20-F, and should be furnished whenever an income statement for the period in which FAS 87 was adopted is included in the filing.

As a result of the passage of time, this accommodation will no longer be necessary for registrants whose original remaining service period is 15 years or less. However, the accommodation may still be relevant for registrants with other post-employment benefit (OPEB) plans accounted for under FASB Statement 106.

B. Draft Submissions

Staff Willingness to Review Draft Submissions

The SEC's review of filings by public companies is generally transparent to the public and usually involves the public filing of amendments to remedy disclosure deficiencies identified by staff reviewers. The SEC staff recognizes that a foreign registrant often has special concerns about that transparency. This is particularly true when a foreign registrant's securities trade publicly in its home market, and the company will be making new and different disclosure as a result of its registration with the SEC. To address these concerns, the SEC staff often reviews and screens draft submissions of foreign registrants on a non-public basis. In 2001, however, the staff revised its practice in this area. The staff generally will continue to accept draft submissions in connection with an issuer's initial registration with the SEC. Except in unusual circumstances, however, once a foreign issuer has registered a transaction under the Securities Act or a class of securities under the Exchange Act, the staff will no longer accept from that issuer additional draft submissions and will not review or screen a registration statement until it is publicly filed. The timing and scope of staff review of these draft registration statements is generally the same as for publicly filed registration statements. Foreign companies are encouraged to contact the Office of International Corporate Finance (202-942-2990) to discuss the availability of any relief or accommodation early in the planning stages of a transaction or listing.

Completeness of Draft Submission

The time period required for the staff to review, comment on, and ultimately declare effective a registration statement depends upon the completeness of the draft registration statement and degree of compliance with the disclosure requirements. Draft registration statements must be complete in all material respects at the time of first submission, unless special arrangements have been agreed in advance with the Office of International Corporation Finance. Common examples of incompleteness include missing or partial US GAAP reconciliations, missing or partial US GAAP disclosure under Item 18, missing annual or interim periods, missing Industry Guide data, and missing financial

statements of acquirees and investees. The staff will defer the review of an incomplete or deficient draft registration statement.

Audit Reports in Draft Submissions

The staff will expect the auditor's report to be signed and dated at the time the draft registration statement is first submitted, unless special arrangements have been agreed in advance with the Office of International Corporation Finance.

C. Quality of Audits and Reconciliations to US GAAP

Prior to Registration with the PCAOB

Accounting firms that routinely audit financial statements that are prepared in accordance with US GAAP and filed with the Commission can be expected to be most knowledgeable about current US accounting practices and interpretations. Because of the importance of the reconciliation to US GAAP in filings with the Commission, registrants and their accountants should assure that appropriate competence is brought to that disclosure before materials are filed or submitted.

Most accountants that practice before the Commission were members of the SEC Practice Section (SECPS) of the American Institute of Certified Public Accountants. Effective January 1, 2000, SECPS members had to seek the adoption of policies and procedures by their foreign associated firms whose audit reports are included in SEC filings that were consistent with SECPS objectives for audits of SEC registrants. The SECPS member reported to the AICPA the name and country of any foreign associated firms that demonstrated compliance with that objective. The foreign associated firm would be subject to scrutiny as part of the peer review process for the SECPS member firm. The rules also established minimum requirements for the review of SEC filings and confidential submissions by a designated "filing reviewer" within the US firm or international organization knowledgeable about US GAAP, US GAAS, US auditor independence and SEC reporting requirements.

To complement those rules, the staff adopted certain practices upon receipt of draft submissions from foreign registrants audited by foreign associated firms. Prior to commencing review, the staff requests written confirmation that the SECPS member firm's review procedures were applied to the submission. We also request the name of the designated filing reviewer that the staff may contact with any questions concerning the application of those policies and procedures to the draft submission. The purpose of the procedure is to ensure that foreign associated firms appropriately involve their designated filing reviewer prior to submission of draft registration statements. The staff will consider deferring the review of a draft submission where the application of the firm's policies and procedures to that submission cannot be confirmed.

SEC rules did not require an auditor to be a member of the SECPS. A foreign auditor that was not a member or affiliate of a SECPS member firm could practice before the SEC, provided that the auditor met all requirements of Article 2 of Regulation S-X and demonstrated sufficient knowledge and experience in applying US GAAP, US GAAS (now PCAOB Standards), SEC financial reporting rules, and SEC independence requirements. An auditor practicing before the SEC for the first time is expected to demonstrate its knowledge and experience before its audit reports are included in SEC filings. The Office of the Chief Accountant may request supplemental information from a foreign auditor to ascertain that the foreign auditor has the necessary knowledge and experience.

The demonstration of an auditor's knowledge and experience in advance of filing generally applies to all financial statements presented in SEC filings, including target companies in registration statements on Form F-4 or S-4, equity-method investees under Rule 3-09, and guarantors under Rule 3-10. The staff has generally not requested such a demonstration with respect to financial statements of acquired businesses under Rule 3-05 where those financial statements are not expected to be required in future filings, the auditor does not otherwise practice before the SEC, and the auditor does not intend to do so.

In late 2003, the activities of the SECPS were discontinued. However, the SECPS membership requirements described above regarding quality control policies and procedures and reviews of SEC filings by designated filing reviewers were adopted by the PCAOB in April 2003 as part of its interim establishment of auditing, attestation, quality control, ethics, and independence standards. The interim quality control standards are contained in Rule 3400T, available in PCAOB Release No. 2003-006 on the PCAOB website at www.pcaobus.org.

The staff reminds registrants that the review by the designated filing reviewer is required for all annual reports filed with the SEC as well as for registration statements.

Registration with the PCAOB

Foreign audit firms whose audit reports are included in SEC filings are required to be registered with the PCAOB by July 19, 2004. Under Section 102 of the Sarbanes-Oxley Act of 2002, it is unlawful, after the registration deadline, for any audit firm that is not registered to prepare, issue, or participate in the preparation or issuance of any audit report with respect to any issuer.

A foreign audit firm's registration with the PCAOB does not supercede existing means by which a firm demonstrates its knowledge and experience in applying US GAAP, PCAOB Standards, SEC financial reporting rules, and SEC independence requirements. Foreign auditors are still expected to demonstrate their knowledge and experience, as described above under "Prior to Registration with the PCAOB".

In limited situations where a foreign audit firm audits a registrant that files on domestic forms (see Section V.K), there may be an issue with regard to the timing of PCAOB registration and the need to conduct the quarterly review required by Rule 10-01(d) of Regulation S-X. Foreign audit firms had until July 19, 2004 to complete their registration with the PCAOB. However, there may be situations involving reviews of quarterly financial statements where the audit firm's application is still pending with the PCAOB.

Where an application for registration has been submitted prior to commencing review procedures, and is pending PCAOB approval, a foreign audit firm may, for a limited time, conduct the quarterly review required by Rule 10-01(d) of Regulation S-X. This "grace period" would be limited to quarters-ended no later than August 30, 2004. Foreign audit firms that need to conduct a review for quarters-ended after August 30, 2004 that still have applications pending PCAOB approval should consult the staff before commencing any work. This guidance also would apply to the review of a domestic registrant's subsidiary by a foreign audit firm, where the principal auditor relies upon such a review. However, if the foreign audit firm ultimately is not registered with the PCAOB, the quarterly review would need to be re-performed by a registered firm.

Reporting Requirements for Audit Clients of Andersen

In Financial Reporting Release 62 (March 18, 2002), the Commission adopted temporary reporting rules and accommodations for audit clients of Andersen. These rules and accommodations are applicable to foreign private issuers. On April 1, 2002, the staff published *Application of Requirements for Arthur Andersen Auditing Clients - Frequently Asked Questions* which provides additional guidance about the rules and accommodations.

Section IV.B below, *Quality of Reconciliation to US GAAP*, describes the policies and procedures followed by AICPA SEC Practice Section member firms with foreign associated firms whose audit reports were included in SEC filings. During 2002, Andersen's foreign associated firms ceased to be associated with Andersen. Many of these firms (or their partners and staff) became part of other firms that were associated with an SECPS member firm. Provided that the new firm immediately made the former Andersen affiliate part of its Appendix K quality control practices and procedures, the staff will continue to accept audit reports of the former Andersen affiliate. If a former Andersen affiliate did not become part of a new member firm's SECPS practices and procedures, the staff would expect the former affiliate to demonstrate its knowledge and experience in applying US GAAP, PCAOB Standards, SEC financial reporting rules and SEC independence requirements before the staff would accept its audit reports.

In September 2002, the US Auditing Standards Board issued an interpretation of Statement on Auditing Standards 58 (AU Section 508) *Reporting As Successor Auditor When Prior-Period Audited Financial Statements Were Audited by a Predecessor Auditor Who Has Ceased Operations*. The Interpretation addresses the current auditor's responsibilities

in circumstances where retroactive reclassifications, adjustments or corrections of errors will result in revisions to comparative financial statements that were audited by a predecessor auditor who has ceased operations.

V. AUDIT REPORTS AND INDEPENDENT AUDITORS

A. Audit Report Signature Requirements

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 SEC 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.

Rule 2-02(a) of Regulation S-X "*Technical Requirements for Audit Reports*" does not specifically address how the audit report should be signed. Historically, certain foreign affiliates of U.S. accounting firms have signed audit reports in SEC filings using the "international name" of the firm rather than the legal name of the foreign affiliate. The staff has not objected to use of the international name in circumstances where the affiliated SECPS member firm was readily determinable from the international name.

Foreign audit firms required to register with the PCAOB have registered using the legal name of the firm. In March 2004, the AICPA International Practices Task Force concluded that, once registered in their legal name, the firms should sign audit reports filed with the Commission using that name. The staff believes that transparent disclosure of a firm's identity and registration status would benefit investors. The staff encourages firms to make both of these items clear on the face of the audit report. If the firm's legal name does not include the international name, the report also should indicate the international affiliation.

B. Restrictions on Use of Audit Report

An audit report that contains language restricting the use of the report is not acceptable in SEC filings.

In 2002 the Supreme Court of Scotland issued a ruling in *Royal Bank of Scotland v. Bannerman Johnston MacLay and Others* (the Bannerman case) regarding the auditor's duty of care to third parties. In response to the ruling, the Institute of Chartered Accountants in England and Wales (ICAE&W) issued a technical release in January 2003 entitled *The Audit Report and Auditors' Duty of Care to Third Parties*. The release recommended that auditors provide specific language regarding a disclaimer of responsibility in their report and suggested the following wording:

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members

those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Further information regarding the Bannerman case may be found in the November 25, 2002 Highlights of the AICPA International Practices Task Force at www.aicpa.org/belt/sec-hl.htm. In a letter to the ICAE&W dated February 28, 2003, the staff stated that an audit report that contains language restricting the use of the report is not acceptable in SEC filings. The staff's letter may be found on the SEC website at www.sec.gov/info/accountants/staffletters/icaew022803.htm.

The prohibition on reports that contain language restricting the use of the report also applies to other types of reports issued by auditors, such as review reports on interim financial statements.

C. Audit Opinion Qualifications

General

The staff has received several requests to accept audit report qualifications in circumstances where a foreign registrant has deviated from home-country GAAP or IFRS to facilitate a position taken for tax purposes, to produce an accounting effect similar to that of a particular accounting principle generally accepted in a different country, or for other purposes. Home-country law or regulation did not require these deviations, although the home-country securities or industry regulator may have approved them at the registrant's request. The deviations might have continuing effects on reported results of future periods, and might be applicable to similar transactions occurring in future periods.

Financial statements that require a qualification in the accompanying audit report as to compliance with the applicable body of accounting standards do not satisfy the requirements for filings with the Commission. This is true whether the primary basis of accounting is US GAAP, home country GAAP, or IFRS. Adjustment of the deviation as part of the reconciliation to US GAAP would not cure the deficiency.

Rule 3-05

Under Rule 3-05 of Regulation S-X, the period for which audited financial statements must be presented for a recently acquired business varies from one to three years depending upon its significance to the registrant. Some systems of GAAP, such as IFRS, specifically require prior year comparative financial statements to be presented when the most recent fiscal year is presented.

In situations where only one year is required by Rule 3-05, the staff would not object if the audit report includes a qualification under IFRS or home-country GAAP solely for the absence of comparative prior year financial statements.

D. Corrections of Errors

Certain GAAPs do not require the restatement of previously issued financial statements upon discovery of an error that relates to prior periods. For example, IAS 8 permits two treatments when fundamental errors in the financial statements are discovered in a subsequent period. The benchmark treatment is restatement of prior periods. The allowed alternative treatment is cumulative adjustment in the current period income statement, with pro forma disclosures. While both are acceptable under IFRS, use of the allowed alternative would ordinarily cause comparative periods to continue to be materially misstated. Accordingly, the allowed alternative treatment would not be acceptable in SEC filings. Generally, the staff would also follow the same approach for registrants that report under home-country GAAP. Registrants who report in a home-country GAAP that *requires* correction of an error in the current period income statement, rather than restatement of prior periods, should consult with the staff prior to filing.

Certain registrants have presented US GAAP reconciling items for errors that were considered immaterial under home-country GAAP, but material for US GAAP, where there was no difference in the underlying accounting principles involved. The staff will ordinarily challenge that practice.

E. Reference to the US GAAP Reconciliation

The reconciliation provided pursuant to Item 17 or 18 of Form 20-F must be included in notes to the financial statements and, accordingly, must be considered by the auditor when expressing an opinion of the financial statements taken as a whole. The auditor's report is required to comply with Rule 2-02 of Regulation S-X, and need not refer specifically to the note containing the reconciliation. However, if the reconciliation furnished in the notes to the financial statements fails to include disclosure of all material departures from US GAAP or the quantification of the effects of accounting differences is materially misstated, the financial statements would be presumed to be materially misleading and an exception should be cited in the auditor's report. Similarly, the restatement of a previously filed US GAAP reconciliation to correct errors should be referenced in the auditor's report.

The staff expects that there would be no material difference between net income and shareholders' equity amounts reported in a reconciliation to US GAAP and the corresponding amounts that would be reported if the financial statements were presented directly in US GAAP. Accordingly, neither the auditor's report nor the notes to the financial statements should characterize US GAAP net income or shareholders' equity amounts as "estimated" or "approximated."

F. Reports on Comparative Periods

Form 20-F requires compliance with the audit reporting provisions of Article 2 of Regulation S-X. Article 2 requires a manually signed audit report for each period required to be audited. Audit reports on all comparative periods must be included in all registration statements and annual reports on Form 20-F. This is true even if comparative periods were audited by a different auditor. The former auditor must perform the procedures specified by PCAOB Standards in order to re-issue its report, and must manually sign that report. Rule 402 under the Securities Act, Rule 12b-11 under the Exchange Act and subpart 232.302 of Regulation S-T address the mechanics of furnishing signatures in typewritten or electronic form, and how long the manually signed report must be retained by the registrant. Registrants should note that it is *not* acceptable to merely file the previously issued audit report, without obtaining a manually-signed, re-issued report. Among other potential consequences, the staff will not declare effective, or commence the review of, a registration statement where the staff is aware that this has occurred.

Notwithstanding the above, registrants formerly audited by Andersen may obtain the relief outlined in Financial Reporting Release 62 with respect to comparative period reports and consents.

G. Consents

20-F Registration Statements

Item 10.G of Form 20-F requires an accountant's consent to be filed when an audit report is included in the filing. Instruction 1 to that Item clarifies that a consent need not be filed in annual reports on Form 20-F. However, the consent is required in an Exchange Act registration statement on Form 20-F. For example, the consent would be required in the registration statement for a listing on the NYSE. The consent should be dated as close as practicable to the effective date of the registration statement on Form 20-F, in the same manner as a 1933 Act registration statement.

40-F Annual Reports

General Instruction D of Form 40-F requires an accountant's consent to be filed when an audit report is included in the filing. Form 40-F is used for Exchange Act registration and annual reports by Canadian registrants under the MJDS system. In this case, the Form specifically requires the consent to be provided for the annual report. Because an annual report has no effective date, the staff will not object as long as the consent is dated on or after the date of the audit report.

H. Changes in Accounting Principles

If the primary financial statements are prepared in accordance with home-country GAAP and reconciled to US GAAP, the auditor's report does not need to refer to a change in *United States* accounting principles. In this situation,

however, the staff would expect the following items to be disclosed:

- The reconciliation to US GAAP should indicate prominently the change in accounting principle along with all of the disclosures regarding the change in a manner consistent with the requirements of the applicable US standard, including disclosure of the justification for the change, and clear explanation of why it is preferable per paragraph 17 of APB 20.
- Selected financial data that includes US GAAP information should be footnoted to advise readers of the change in accounting principle.
- The reference to the US GAAP reconciliation provided in the MD&A should discuss the change in accounting principle.

Pursuant to Article 2 of Regulation S-X, a change in the accounting principles used to prepare the primary financial statements should be disclosed in the auditor's report. Disclosure in a separate addendum to the report in the style suggested by Canadian standard setters for US- Canada Reporting Conflicts is acceptable.

Form 20-F does not have a requirement for a preferability letter. Therefore no preferability letter is required for a change in home country *or* US GAAP accounting principles.

I. True and Fair Overrides

Legislation in certain foreign jurisdictions requires the financial statements to give a "true and fair view" of the state of affairs (balance sheet) of the company and its profit or loss. Such provisions may require the departure from a specific accounting standard (override) to the extent necessary to give a true and fair view.

In some cases, an override is necessary to address a conflict between the particular requirements of UK GAAP and the UK Companies Act. For example, Financial Reporting Standard 6 requires certain "group reconstruction" transactions (similar to reorganizations of entities under common control in the US GAAP literature) to be recognized at historical cost. But under the Companies Act, all business combination transactions must be characterized as either acquisitions (purchases) or mergers (pooling of interests). Since a group reconstruction ordinarily will not meet the conditions for merger accounting, an override of the Companies Act is necessary to comply with UK GAAP. The staff may inquire about such a matter to ensure that it is adequately explained to US investors, but would not object to this type of override.

In other situations, registrants have overridden specific requirements of home-country GAAP or IFRS in the absence of any legal conflict. Generally, the accounting treatments adopted in lieu of the prescribed treatment have been highly unusual. In some cases, the registrant's adopted treatment

appeared to be unique, and not identifiable as an accepted accounting practice in any system of GAAP. In some cases, the *prescribed* treatment would be consistent with US GAAP, and a reconciliation to the prescribed treatment was furnished. In each case, the staff will challenge the basis on which such an override has been used and the basis on which the auditors have given an unqualified report.

Both UK GAAP and IAS have specific disclosure requirements that include identification of the required treatment from which the enterprise has departed, the nature of the departure, including the treatment that would be required, the reason why that treatment would not give a true and fair view, the treatment adopted and the financial impact of the departure on the enterprise's financial statements. Certain additional disclosures are required under IFRS. In the rare circumstances where an override can be justified by the registrant's circumstances and home country practices, the staff will expect full compliance with the disclosure requirements. The disclosure should discuss why an override is necessary, clearly describe the adopted treatment, explain how and when it is applied, disclose the key assumptions or estimates inherent in the method, and quantify its effects on the financial statements.

J. References to Another Auditor

Whenever the principal auditor refers to the work of another auditor, the report of the other auditor must be included in the filing. In some cases, the report issued by the other auditor may refer to financial statements that have been prepared using different accounting standards. For example, the consolidated financial statements may be prepared in accordance with US GAAP, but the other auditor's report on a subsidiary refers to financial statements prepared in accordance with UK GAAP. The 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. The staff also expects the division of responsibility among the auditors with respect to the U.S. GAAP reconciliations included in an issuer's financial statements pursuant to Item 17 or 18 of Form 20-F to be explicit in audit reports.

In fulfilling a principal auditor's responsibility under AU 543 to determine whether the principal auditor may rely on the work of a subsidiary auditor, it may not be clear to the principal auditor whether or not an unaffiliated foreign audit firm that serves as a subsidiary auditor has demonstrated sufficient knowledge and experience in applying US GAAP, PCAOB Standards, SEC financial reporting rules, and SEC independence requirements. A foreign auditor that has demonstrated such knowledge and experience to the SEC staff in the manner described in Section IV.C above generally should have documentation of that fact.

The staff has 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.

Deficiencies that commonly warrant amendment of filings include:

- the report of the subsidiary auditor is not included in the filing;
- the audit of the subsidiary is conducted under local auditing standards, not PCAOB Standards;
- the subsidiary auditor's report contains limitations as to the scope of the audit;
- the subsidiary auditor's report refers to deviations from GAAP, and the resolution of the matter in the consolidated financial statements of the registrant is unclear; and
- the subsidiary auditor has not demonstrated to the SEC staff its knowledge and experience in applying U.S. GAAP, PCAOB Standards, and SEC Rules and Regulations (see Section IV.C).

K. Location of the Auditor

General

Article 2 of Regulation S-X requires that an independent accountant be licensed and in good standing under the laws of the place of the accountant's residence or principal office. The rule does not address whether the accountant's state or country of licensure must coincide with the location of the registrant's corporate offices or place where the registrant conducts its principal operations.

Foreign Private Issuers

The staff ordinarily will not object if a foreign private issuer is audited by a foreign accountant that meets the requirements of Article 2 and has demonstrated sufficient knowledge and experience in applying US GAAP, PCAOB Standards, SEC financial reporting rules, and SEC independence requirements. See Section IV.C. The staff may question the location from which the audit report was rendered if there does not appear to be a logical relationship between that location and the location of the registrant's corporate offices or place where the registrant conducts its principal operations.

Issuers Other than Foreign Private Issuers

The Staff interprets Article 2 to require the audit report on the financial statements of a registrant that is not a foreign private issuer to be rendered ordinarily by an auditor licensed in the US. This includes both US-incorporated registrants and foreign-incorporated registrants that do not

meet the foreign private issuer definition. However, certain of these registrants may be headquartered, conduct their principal operations, or have most of their assets, outside the US. In these circumstances, the staff encourages registrants and their auditors to consult the staff prior to filing. The staff will consider all relevant factors in evaluating the appropriateness of the location from which the audit report was rendered. The following factors are likely to be significant in most situations:

- Are the majority of the registrant's assets, revenues, and operations located outside the US?
- Are the majority of the registrant's assets, revenues, and operations located in the country where the auditor resides?
- Are the registrant's management and accounting records located in the country where the auditor resides?
- Is the majority of the audit work conducted outside the US?

The staff will not ordinarily consider the language of the country where the auditor resides to be a presumptive factor.

In determining whether to accept a report from a non-US auditor, the staff also will expect the auditor to be subject to the same quality controls, including completion of filing reviewer procedures, as described in Section IV. C above under "Quality of Audits and Reconciliations to US GAAP" with respect to audits of foreign private issuers.

The staff has recently become aware of situations where a US auditor predominantly performed the audit but one of its foreign affiliated firms signed the audit report. In these cases the U.S. auditor will be expected to sign the audit report. If there is a legal requirement for the foreign affiliated firm to sign the audit report, the staff ordinarily would not object if both firms signed the report.

VI. ISSUES ENCOUNTERED IN RECONCILIATIONS TO US GAAP

A. Issues Related to Recent US GAAP Pronouncements

FASB Interpretation No. 46-R – Implementation Dates

FASB Interpretation No. 46 (revised December 2003) *Consolidation of Variable Interest Entities* (FIN 46-R) contains new requirements regarding the application of consolidation principles under US GAAP. The required implementation dates for FIN 46-R will vary depending on a foreign private issuer's fiscal year end and how frequently the issuer reports US GAAP information. Further information regarding this matter can be found on the SEC website at <http://www.sec.gov/info/accountants/staffletters/aicpa03152004.htm>.

FASB Statement 133 – Application in Initial Filings

Generally, financial statements filed with the SEC are required to be presented in, or reconciled to, US GAAP as if the financial statements had always been prepared in accordance with US GAAP. An entity applying US GAAP for the first time must account for derivative instruments and hedging activities in accordance with Statement 133 in all fiscal years beginning after June 15, 2000. Statement 133 provides that, upon its adoption by a company, all hedging relationships must be designated anew and documented pursuant to the provisions of Statement 133. Thereafter, companies may use hedge accounting for those hedging relationships that, at inception of the hedging relationship, were documented and designated as hedges in a manner that would satisfy the requirements of Statement 133.

A registrant that prepares US GAAP financial statements (or reconciles to US GAAP) for the first time in a period subsequent to the required adoption date of Statement 133 may apply hedge accounting pursuant to Statement 133 if the entity had formally documented its hedging relationships in a manner consistent with Statement 133's requirements. For example, an entity that had previously prepared its financial statements in accordance with IFRS, including preparation of documentation of its hedging relationships that satisfies the requirements of Statement 133, could apply Statement 133 hedge accounting when preparing (or reconciling to) US GAAP financial statements for the first time.

FASB Statement 130 - Comprehensive Income

FAS 130 defines the required presentation of comprehensive income as a new basic financial statement, rather than an item of disclosure. Therefore, a statement of comprehensive income or its equivalent is required under both Item 17 and Item 18 of Form 20-F. A foreign registrant may present the statement of comprehensive income in any format permitted by FAS 130. It may be prepared using either US GAAP or home-country GAAP amounts. In the later case, reconciliation to comprehensive income measured on a US GAAP basis is encouraged, but not required.

Paragraph 26 of FAS 130 requires presentation of the components of the accumulated balance of other comprehensive income items on the face of the financial statements or in footnotes. This disclosure is not required under Item 17.

In certain countries, equity components under home-country GAAP are included in retained earnings and are not separately tracked. Reconstruction of these amounts may be impracticable. The staff will generally not object if a registrant concludes, and discloses in its filings, that it is not practical to present the components of the accumulated balance of other comprehensive income items specified by paragraph 26 of FAS 130.

A Statement of Total Recognized Gains and Losses prepared under UK GAAP in accordance with FRS 3 is regarded as being consistent with FAS 130. Also,

a statement of changes in equity prepared under IFRS in accordance with IAS 1 is regarded as consistent with the requirements of FAS 130.

If a registrant recognizes revaluations of assets in conformity with home country GAAP, the statement of other comprehensive income should include such changes.

FASB Statement 131 - Segment Reporting

a) Home-country versus US GAAP basis

FAS 131 requires reported segment information to conform to the information reported to management even if that information is not US GAAP. A foreign registrant preparing segment information to comply with the disclosure requirements of US GAAP should present the information using whatever basis of accounting is used for internal management reporting, even if that information is on a home-country GAAP basis. However, segment data should be presented in the same reporting currency as the consolidated financial statements, even if a different currency is used for internal management reporting. As required by FAS 131, the measurement basis for this data would be disclosed. For purposes of applying the 10% significance criteria in FAS 131, a foreign registrant should use its internal basis of accounting in determining whether segments are reportable. As required by FAS 131, reported segments must comprise at least 75% of consolidated revenues.

FAS 131 requires a reconciliation of the segment data to the consolidated financial statements. This presentation should be reconciled to the basis of accounting used in the primary financial statements. Reconciling items from the internal management-reporting basis should be isolated in a separate column and described. A foreign registrant using home country GAAP is not required to further reconcile the segment amounts to US GAAP.

Segment reporting in some countries is based on products and services rather than the management approach. For example, possible differences between the types of segments that would be reported under IAS 14 and FAS 131 could require certain registrants to present two sets of segment data.

Item 5 of Form 20-F permits the MD&A discussion to be based on the primary financial statements. However, Instruction 2 to Item 5 and Staff Accounting Bulletin 88 require discussion of matters relating to differences between home country GAAP and US GAAP that impact an understanding of the financial statements taken as a whole. If the Statement 131 segment information provides new information as to how management views the business, or indicates material trends or relationships not apparent from the local GAAP segmental disclosures, that information should be discussed within MD&A.

b) Changes in Reportable Segments

Paragraphs 34 and 35 of FAS 131 require registrants to recast prior period information to correspond with current reportable segments, or to otherwise provide comparable information. If management changes the structure of its internal organization after fiscal year end, or intends to make a change, the new segment structure should not be presented in financial statements until operating results are reported on the basis of the new management structure.

When a period is being reported for the first time, the staff would expect the segment presentation to be based on the structure that was actually used to manage the business during that period. This is true for the most recent annual period even if a registrant has published information for a more recent interim period based on its new reportable segments. However, the staff would not object if a registrant also provided supplementary data based on the new segment structure.

FASB Statement 123 - Stock Compensation Disclosures

The applicability of FAS 123 to foreign registrants depends on whether the financial statements are prepared in accordance with Item 17 or Item 18 of Form 20-F. Registrants filing under Item 18 should comply with the disclosure and pro forma measurement principles of FAS 123 in the same manner as a US company. If a foreign registrant elects not to use the fair value method of accounting for stock based compensation in the reconciliation to US GAAP, the pro forma disclosures of net income and earnings per share, along with all of the other disclosures required by FAS 123, should be provided in the annual financial statements. Foreign registrants filing under Item 17 would not be required to provide pro forma net income and earnings per share or any of the other disclosures specified by FAS 123. However, the registrant should disclose the method of accounting that is followed for purposes of complying with US GAAP. Foreign registrants that follow APB Opinion 25 are reminded that recently issued FASB Interpretation 44 provides significant guidance regarding the application of APB 25.

Under both Item 17 and Item 18 registrants must comply with the requirements of FAS 123 and 148 in accounting for transactions with non-employees.

FASB Statement 109 – Income Taxes

FAS 109 states that deferred tax assets and liabilities should be adjusted for the effects of a change in tax law or rates in the period that includes the enactment date. In the US, enactment date is considered to be the date that the President of the United States signs the legislation and it becomes law.

FAS 109 does not address specifically how to determine the enactment date in jurisdictions outside the US. Simply stated, enactment date is when all steps in the process for legislation to become law have been completed. For example, in Australia enactment date would be when Royal Assent is given to the bill, not when a bill is passed by Parliament. This conclusion is equally

applicable to foreign subsidiaries of US companies.

In Brazil, the tax law is sometimes significantly altered by provisional measures that remain in force for three months and expire automatically if they are not extended for an additional three-month period. The provisional measures are not enacted by the legislature and should not be used as the enacted rate for the purpose of recognizing the tax effect of temporary differences under FAS 109.

B. Business Combinations

Reconciliation Disclosures when Pervasive Differences Exist between US and Home-country GAAP relating to Business Combinations

In some cases there may be pervasive differences between the accounting for business combinations under home-country GAAP and US GAAP. For example:

- The combination is accounted for as a merger (pooling of interests) in the primary financial statements but as a purchase business combination under US GAAP.
- The combination is accounted for as an acquisition (purchase) by the legal issuer in the primary financial statements but as a reverse acquisition under US GAAP, or visa versa.

In both of these situations, virtually all of the amounts for pre-acquisition periods in the primary financial statements would be materially different from the amounts presented under US GAAP. In effect, the financial statements presented as the primary financial statements are of a different reporting entity than would be required under US GAAP.

In these circumstances, reconciliation of net income and stockholders' equity alone will not produce an information content substantially similar to US GAAP with respect to the pre-acquisition periods. Additional reconciling disclosures that result in an information content consistent with Item 17 or 18 of the US GAAP reporting entity for the pre-acquisition periods will be necessary.

The reconciliation should be in sufficient detail to allow a user to understand the differences between the amounts reflected in the primary financial statements and the amounts reflected in the US GAAP reconciliation. For example, if the income statement is pooled for all periods under home-country GAAP, then a columnar reconciliation that removes the acquired business and a separate column with "normal" US GAAP adjustments to reconcile to the US GAAP amounts may be appropriate. In some cases, the differences may be so pervasive that a complete set of US GAAP financial statements may be necessary.

While each situation is unique, the following generally is the minimum level

of disclosure that would be expected:

- A US GAAP condensed income statement and cash flow statement for all years presented, in a level of detail that would comply with Article 10 of Regulation S-X, generally would be required for as long as the accounting for the combination resulted in materially different amounts.
- For each year that an income statement is presented for periods prior to and including the acquisition (but not after), a condensed statement of comprehensive income and changes in shareholders' equity using US GAAP balances should be provided.
- For each balance sheet presented for year-ends prior to the year of acquisition, the normal reconciliation of differences should be supplemented with a condensed balance sheet that complies with Article 10 of Regulation S-X. Generally, balance sheet differences in the current year can be addressed in the "normal" reconciliation.
- Financial statement notes that support the pre-acquisition income statements on a US GAAP basis (e.g., income taxes, pensions) should be provided.

In addition, depending on the circumstances condensed Operating and Financial Review and Prospects using US GAAP amounts may be necessary.

Discontinued Operations under US GAAP versus Home-country GAAP

A similar situation can exist with respect to differences relating to discontinued operations in which the disposal of a business is presented as discontinued operations under US GAAP but not under home-country GAAP. As a result of the issuance of FASB Statement 144, *Accounting for the Impairment or Disposal of Long Lived Assets*, the frequency of discontinued operations under US GAAP is likely to increase.

The following disclosures would ordinarily be appropriate:

- The US GAAP reconciliation should be in sufficient detail to allow a user to understand the differences between the amounts reflected in the primary financial statements and amounts reflected in the U.S. GAAP reconciliation. A columnar reconciliation that addresses the business that is treated as discontinued operations under one GAAP but not the other GAAP with a separate column for "other reconciling items" may be necessary. With respect to the balance sheet, issuers should provide the disclosures in paragraph 46 of Statement 144. This disclosure should be provided even if filing under Item 17.
- A condensed income statement for the applicable years in a level of detail to comply with Article 10 of Regulation S-X may be necessary.
- If there are fundamental differences in the notes to the financial

statements, the U.S. GAAP reconciliation footnote may be expanded to present information on a U.S. GAAP basis. The extent of this disclosure will depend on the level of significance of the entity that is considered to be discontinued operations under one GAAP but not the other.

- Additional discussion in the MD&A on a U.S. GAAP basis may be appropriate.

Date of Consummation under US GAAP

Paragraph 48 of FASB Statement 141 specifies the date that a purchase business combination should be recognized in the financial statements under US GAAP. Ordinarily that is the date assets of the acquired business are received in exchange for consideration from the acquirer. A purchase business combination should not be recognized as of an earlier date unless a written agreement provides that effective control is transferred to the acquirer at an earlier date without restrictions except those required to protect the stockholders of the acquired company.

Some merger agreements in various countries may include designation of a retroactive effective date, such as the beginning of the fiscal year. In most of these cases, the rare conditions in paragraph 93 of APB Opinion 16 are not met prior to the exchange of consideration, and the business combination should not be recognized for any period before consummation.

FAS 141 and FASB Statement 94 require consolidation of a business acquired in a purchase beginning with the date of acquisition. Some registrants have a practice of applying the equity method or cost method to newly acquired businesses for the period from the consummation date through the end of the fiscal year in which the acquisition occurred. US GAAP does not permit that practice. Further, recognizing the business combination as of a date subsequent to the date assets of the acquired business are received in exchange for consideration from the acquirer, such as a monthly or quarterly closing date, would not be appropriate unless the registrant is able to demonstrate that the effects are immaterial.

Financial Statement Requirements after a Reverse Acquisition

A number of foreign companies have obtained a listing in the US by merging into a nonoperating US public shell company whose securities are already registered with the Commission. The transaction is typically accounted for as a "reverse recapitalization." Notwithstanding that substantially all of the registrant's operations after the merger will be conducted outside of the US, the registrant is not a foreign private issuer and must comply with the rules applicable to US public companies. Accordingly, the registrant must file a Form 8-K containing financial statements of the foreign company within 75 days of the merger. To facilitate the initial filing of the foreign company's statements, the staff will not object if the financial statements included in the 8-K are prepared in accordance with a foreign GAAP, but reconciled to US GAAP in accordance with Item 18 of Form 20-F. However, the first Form 10-K

following the merger, and any registration statement, should include financial statements prepared in accordance with US GAAP for all periods presented, including those periods prior to consummation of the reverse recapitalization. Financial statements in a foreign GAAP reconciled to US GAAP would not be acceptable.

Age of Pro Forma Information in a Cross-border Business Combination

The age of the pro forma financial information included in a registration statement should be based on the age of financial statements requirement applicable to the registrant. If a foreign private issuer files a Form F-4 and the target company is a US domestic registrant, the age of the pro forma information may be determined by reference to Item 8 of Form 20-F. That is, the pro forma information need only be as current as the most recent balance sheet date required for the registrant, which could be as much as 9 months old at the time of effectiveness. By contrast, if a US domestic registrant files a Form S-4 and the target company is a foreign private issuer, the age of the pro forma information must be determined by reference to Rule 3-12 of Regulation S-X. That is, the pro forma information would generally need to be current within 135 days (or less for accelerated filers) at the time of effectiveness.

Depending on the fiscal year ends of a domestic registrant and a foreign target company, application of the age of financial statement rules may require the foreign target company to include a period in the pro forma information more current than its separate historical financial statements. Article 11 of Regulation S-X permits the ending date of the periods included for the target company to differ from those of the registrant by up to 93 days, and may provide sufficient relief. The staff also will consider combinations of periods that involve overlaps or gaps in the information of the target company of up to 93 days, provided that the resulting annual and interim periods are of the same length required for the registrant, and there are no overlaps or gaps in the registrant's information. However, the staff would not permit a registrant to omit an interim pro forma presentation because of different fiscal periods.

C. Consolidation and Proportional Consolidation

Consolidation of All Controlled Subsidiaries

Item 17(b) of Form 20-F requires that the financial statements of a foreign private issuer disclose an information content substantially similar to financial statements that comply with US GAAP and Regulation S-X. Ordinarily, consolidation of all controlled subsidiaries is necessary to meet this requirement, regardless of the GAAP being used. An accounting policy that excludes subsidiaries from consolidation on the basis that they are individually immaterial would not satisfy this requirement.

Consolidation Policy Disclosures

Companies are required to disclose the accounting principles used in the preparation of their financial statements. That disclosure should include the consolidation principles applied. In some circumstances, the staff has noted instances where majority-owned subsidiaries were not consolidated, yet disclosure of the reasons for non-consolidation was not made. The staff has objected to the use of boilerplate disclosures regarding an enterprise's consolidation policy when majority owned subsidiaries are appropriately excluded from consolidation. The disclosure should allow an investor to clearly understand why the registrant does not control the subsidiary.

The staff also believes that a comparable level of disclosure should be provided when a registrant appropriately consolidates a less-than majority owned subsidiary. The requirement for clear and complete consolidation policy disclosure applies to foreign registrants using home-country GAAP, and applies both under Item 17 and Item 18 of Form 20-F. The staff believes the disclosure in this area is necessary to meet the requirement for an information content that is substantially similar to U.S. GAAP.

Item 17/18 Accommodation for Proportional Consolidation

Issuers that use proportional consolidation under home country GAAP for investments in joint ventures that would be equity method investees under US GAAP may omit reconciling differences related to classification or display, and instead provide summarized footnote disclosure of the amounts proportionately consolidated. Equity investee financial statements would not be required under Rule 3-09 as the joint venture is included in the registrant's consolidated financial statements. The accommodation is available only if 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*. The accommodation does not apply to situations in which the "joint venture" would be consolidated under US GAAP.

The staff has recently noted situations where the accommodation was used for investees that were characterized as joint ventures, but not all parties with an equity interest had the right to share in control. For example, a supermajority voting provision permitted several large equity holders to control the investee without the consent of several small equity holders. The staff has objected to use of the accommodation in these circumstances.

Certain investments in majority-owned entities are accounted for using the equity method under US GAAP because EITF 96-16 precludes consolidation where certain minority shareholders have substantive rights to participate in certain financial and operating policies of the entity. It is unlikely that such an investment would meet the relevant conditions for the accommodation. For example, the existence of significant participating rights that preclude consolidation under EITF 96-16 would ordinarily mean that not all significant financial and operating policies of the entity are jointly controlled by all parties with an equity interest.

Proportionate Consolidation in US GAAP Financial Statements

Generally, financial statements of foreign private issuers prepared using a comprehensive basis of accounting but containing a departure from that basis with respect to a material item are not acceptable in Commission filings. However, in limited circumstances the staff has not challenged presentations financial statements using US GAAP except that investments in joint ventures are reported using the proportionate consolidation method. This is consistent with the accommodation in Form 20-F that permits registrants to not reconcile classification and display differences of proportionately consolidated joint ventures to the equity method.

The staff would generally not challenge that accounting departure by a foreign private issuer that meets the following conditions:

- the registrant explains the reasons for the departure in writing before filing;
- the joint venture is an operating entity, the significant financial operating policies of which are, by contractual arrangement, jointly controlled by all entities having an equity interest in the entity;
- the auditors' report addresses this departure from US GAAP;
- the disclosures required by Item 17/18(c)(2)(vi) of Form 20-F regarding proportionate consolidation are provided; and
- retained earnings relating to the joint venture are disclosed similar to entities accounted for under the equity method consistent with Rule 4-08(e)(2) of Regulation S-X.

Consolidated Businesses that would be under Equity Method in US GAAP

Foreign registrants with significant subsidiaries that are consolidated under home-country GAAP, but would be accounted for using the equity method under US GAAP, are encouraged to discuss with the staff the information that should be disclosed in the US GAAP reconciliation. At a minimum, the staff would expect disclosure of the following information: 1) condensed information of the equity investee required by Rule 4-08(g) of Regulation S-X, and 2) a sufficiently detailed reconciliation to allow an investor to reconstruct financial statements prepared in accordance with US GAAP and Regulation S-X. Based on the specific facts and circumstances, the staff may request additional disclosure either in the financial statements or MD&A as well as financial statements of the investee pursuant to Rule 3-09 of Regulation S-X.

VII. AICPA INTERNATIONAL PRACTICES TASK FORCE

A. General

The International Practices Task Force reports to the AICPA SEC Regulations Committee and acts as a liaison with other AICPA committees that deal with international matters affecting accountants and auditors. The Task Force provides advice and assistance to the accounting profession on financial reporting matters and auditing issues applicable to non-US entities entering the US capital markets, with particular focus on those entities that register with the US SEC. In this capacity, the Task Force brings to the attention of the SEC staff issues and suggestions for improving and expediting filings by foreign registrants with respect to financial accounting issues (including issues that come to its attention relative to IFRS matters) and financial statement form and content matters.

B. Summary of Relevant Issues since Inception of the Task Force

The International Practices Task Force has published a Summary of Issues discussed at meetings of the Task Force from its inception through March 2003 that continue to be relevant to foreign issuers. The Summary is periodically updated to reflect recently discussed topics. The Summary is available on the AICPA website at www.aicpa.org/download/belt/iptf2003_01.pdf.

C. Recent Issues affecting Particular Countries

The following issues affecting particular countries were discussed at recent meetings of the Task Force. Further information regarding these issues is published in Highlights of the applicable meetings available on the AICPA website at www.aicpa.org/belt/sec-hl.htm.

Argentina

- Exchange rate for translation of foreign currency transactions and operations at December 31, 2001 (January 2002)
- Impact of Argentine government's early-2002 monetary policy actions on December 31, 2001 financial statements (March 2002)
- Inflation index for determining Argentina's highly inflationary status under FAS 52 (September 2002)
- Status as a highly inflationary economy (November 2002)
- Inflation adjusted financial statements under Argentine GAAP (November 2003)

Brazil

- Tax issues (May 2002)
- Actuarial assumptions for pension plans (May 2002)

Canada

- Applicability of AcG 11 to mining company exploration costs (November 2001)
- Valuation Allowance on Pension Plan Assets (November 2002)

China

- Land use rights (March 2003)

Europe

- Dormant bank deposits (March 2003)

Mexico

- Tax issues – temporary differences and classification of monetary gains/losses (May 2001)
- Enactment date for new tax law (November 2001)

Romania

- Status as a highly inflationary economy (March 2003)

Russia

- Using US dollars as the reporting currency (May 2001)
- Determining the carrying value of fixed assets acquired prior to 1992 (November 2001).
- Status as a highly inflationary economy (November 2002)

South Africa

- Tax on Undistributed Income (November 2002)

Taiwan

- Tax on Undistributed Income (November 2002)

Turkey

- Status as a highly inflationary economy (September 2004)

United Kingdom

- Non-GAAP financial measures and the meaning of “expressly permitted” (November 2003)

Venezuela

- Status as a highly inflationary economy (September 2004)
- Foreign currency exchange restrictions (March 2003)

VIII. REPORTING CURRENCY

A. Selection of Reporting Currency

Rule 3-20 of Regulation S-X permits a foreign private issuer to file financial statements prepared in any currency that management believes is appropriate. The rule requires disclosure of:

- the currency that is used to prepare financial statements prominently on the face of the financial statements;
- the currency that will be used to pay dividends if different from the reporting currency; and
- a description of material exchange restrictions or controls relating to the reporting currency, the currency of the issuer's domicile or the currency in which the issuer will pay dividends.

The rule does not apply to financial statements of acquirees or equity investees. However, these financial statements can be prepared either in the same currency as the issuer or in the currency that normally is used for preparation of such entities' financial statements. Accordingly, a domestic issuer can prepare financial statements of an acquiree or investee in US dollars.

B. Currency for Measurement

While there is effectively free choice in the selection of the reporting currency, there is not free choice in the selection of the currency used for measurement. All operations including the parent company that do not operate in a hyperinflationary environment should use the currency of their primary economic environment to measure transactions. While not specifically referring to FASB Statement 52, Rule 3-20 of Regulation S-X is conceptually consistent with that standard. That is, assets and liabilities are translated at the period end exchange rate, and the income statement is translated at the weighted average exchange rate. The translation effects of exchange rate changes are included in a separate component of equity.

C. Changes in Reporting Currency

General

Rule 3-20 requires the financial information for all periods presented in a filing to be stated in the same reporting currency. If an issuer elects to change its reporting currency, financial information for previous periods should be recast into the new reporting currency using a methodology consistent with FAS 52. The objective of this procedure is to present financial statements as if the issuer had always used the new reporting currency. This means that an issuer should translate income statements from the old reporting currency into the new reporting currency using weighted average exchange rates for the applicable period, and the balance sheets should be similarly translated using the applicable period end exchange rates. The methodology used should produce the same results as though the respective consolidating functional currency statements had been translated directly into the new reporting currency.

Reporting in a Currency Different from the Registrant's Predecessor

Rule 3-20 of Regulation S-X requires that the financial statements should be stated in the same currency for all periods presented. This requirement applies to financial statements of a predecessor as well as those of the registrant. That is, the reporting currency used in financial statements of the predecessor should be the same as that of the registrant.

D. Convenience Translations

SEC rules permit, but do not require or encourage, presentation of a convenience translation. If a convenience translation is presented, Rule 3-20 (b) of Regulation S-X specifies that the translation should be presented using the exchange rate as of the most recent balance sheet included in the filing, except that a rate as of the most recent practicable date shall be used if materially different.

Various Asian currencies declined significantly in value subsequent to December 31, 1997. The staff has received questions regarding the applicability of the guidance in Rule 3-20(b) to registrants that report in a currency with a significant decline after the balance sheet date. Some believe that literal application of the rule using the more recent rate could result in a potentially misleading presentation. For example, if a registrant's debt were denominated in US dollars or other major currencies, the convenience translation would depict the debt at a much lower US dollar amount than the registrant's actual debt service requirements.

The staff will not object if a registrant uses the exchange rate at the date of the most recent balance sheet in preparing a convenience translation for inclusion in an annual report on Form 20-F or a registration statement, or if it omits a convenience translation. The staff also will not object if a registrant uses a more current exchange rate. However, all amounts presented for a

given period must be translated using the same exchange rate. If convenience translations are presented in a registration statement that includes all required financial statements, such as Form F-1, the same exchange rate should be used for the most recent fiscal year presented and any subsequent interim period. If a registrant files a registration statement that incorporates by reference financial statements previously filed on Form 20-F, the staff will not require amendment of the previously filed financial statements to reflect a convenience translation based on a more current exchange rate.

In any event, registrants should highlight a material currency devaluation and provide full, balanced disclosures regarding its effects on the registrant's results of operations, liquidity, and cash flows in MD&A. Also, FAS 52 requires disclosure of significant changes in currency exchange rates occurring after the balance sheet date and the effects on unsettled balances pertaining to foreign currency transactions.

E. Reporting Currency for Domestic Registrants and non Foreign Private Issuers

Regulation S-X presumes that a US-incorporated registrant will present its financial statements in US dollars. In rare instances, the staff has not objected to the use of a different reporting currency. Those instances have been limited to situations where the US-incorporated registrant had little or no assets and operations in the US, substantially all the operations were conducted in a single functional currency other than the US dollar, and the reporting currency selected was the same as the functional currency. In these circumstances, reporting in the foreign currency would produce little or no foreign currency translation effects under FASB Statement No. 52. The staff has also not objected when a foreign issuer who does not meet the definition of a foreign private issuer applies this approach in similar circumstances.

IX. FINANCIAL STATEMENTS OF OTHER ENTITIES

A. Regulation M-A – Merger and Acquisitions

Forms F-4 and S-4 permit foreign target companies that present financial statements under home-country GAAP to reconcile to US GAAP using Item 17 of Form 20-F. These Forms also permit a foreign target company that is not subject to Exchange Act reporting requirements to omit the US GAAP reconciliation if the reconciliation is unavailable or not obtainable without unreasonable cost or expense. If the conditions for omission of the numerical reconciliation are met, a narrative description of all material variations in accounting principles, practices, and methods is required.

Registrants should consider all relevant facts and circumstances in determining whether the US GAAP reconciliation is unavailable or not obtainable without unreasonable cost or expense. For example, the staff has objected to the omission of the US GAAP reconciliation in circumstances

where the non-reporting target company was a subsidiary (or investee) of a larger reporting company, and considerable reconciling information for the subsidiary would have already been necessary to prepare the parent company's US GAAP reconciliation.

Registrants should note that the accommodation to omit the US GAAP reconciliation for a target company does not extend to the pro forma information required by Form F-4 and S-4. Pro forma information reflecting the effects of the business combination between the registrant and target company must be either presented on a US GAAP basis or reconciled to US GAAP, even if the target company is permitted to omit the US GAAP reconciliation in its separate financial statements.

The instructions to Item 17(b)(5) to Form F-4 state that the financial statements of a non-reporting target company for the fiscal years before the latest fiscal year need not be audited if they were not previously audited. A similar provision is included in Form S-4. However, if financial statements of a non-reporting foreign target have been previously audited using auditing standards other than US GAAS, and those financial statements have been published for general distribution in the target's home jurisdiction or elsewhere, the staff would generally expect financial statements to be audited in accordance with US GAAS and included in the registration statement. Registrants that anticipate difficulties should consider contacting the staff in advance.

B. Financial Statements for Subsidiary Issuers and Guarantors

Revised Rule 3-10 provides guidance for presenting condensed consolidating financial information about subsidiary issuers and guarantors in the notes to the parent company's consolidated financial statements. Where the parent company's consolidated financial statements are prepared on a basis other than US GAAP, Rule 3-10(i)(12) requires the information in each column of the condensed consolidating information to be reconciled to US GAAP to the extent necessary to allow investors to evaluate the sufficiency of the guarantees. The reconciling information may be based on Item 17 of Form 20-F, and need not duplicate information included elsewhere in the reconciliation of the consolidated financial statements. When applying this guidance, registrants should consider all relevant facts and circumstances regarding the nature, magnitude, direction and trend of reconciling items affecting subsidiary issuers and guarantors, and the extent to which those items are fully communicated in the reconciliation of the parent company's consolidated reconciliation.

The Release addresses the application of Rule 3-10 and Rule 12h-5 to the Exchange Act reporting requirements for parent companies that are foreign private issuers. The Release clarifies that a parent company that files annual reports on Form 20-F is not required to provide quarterly condensed consolidating information about its subsidiary issuers and guarantors, even if those subsidiaries are incorporated in the US.

In a registration statement under the Securities Act, however, a parent company that is a foreign private issuer is required to include condensed consolidating information about its subsidiary issuers and guarantors for all required annual and interim periods. The periods to be presented are determined by reference to Item 8.A of Form 20-F.

C. Financial Statements under Rule 3-05 for Pooling of Interests under Home Country GAAP

Pre-combination financial statements of an acquired business under Rule 3-05 of Regulation S-X are not required in a registration statement if the business combination was accounted for as a "pooling of interests" and is already reflected in the registrant's restated audited financial statements. While Rule 3-05 was originally written in the context of US GAAP, the staff historically had not required pre-combination financial statements of the acquired business in situations where pooling was applied in the home-country GAAP financial statements, even if the business combination was reported as a purchase in the US GAAP reconciliation.

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

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

D. Financial Statements of Equity-Method Investees under Rule 3-09

Rule 3-09 of Regulation S-X requires a registrant to file audited financial statements of significant equity-method investees. An investee is significant when either the registrant's investment in the investee (as defined in Rule 1-02(w)(1) of Regulation S-X) constitutes 20% or more of the registrant's total assets, or the registrant's equity in the income of the investee (as defined in Rule 1-02(w)(3) of Regulation S-X) constitutes 20% or more of the registrant's income. The significance tests are applied using US GAAP amounts. The computation of the income test is based on all elements impacting the registrant's accounting for the investee. For example, the numerator will include the registrant's amortization of the excess purchase price of the investment as well as any impairments the registrant has recognized on the investment.

In recent years, the staff has received numerous requests for waivers of the requirements under Rule 3-09. The staff will consider novel circumstances

that clearly demonstrate the investee is insignificant. However, waivers are ordinarily limited to circumstances where the investee was insignificant to the registrant for all prior years, the investee has been disposed during the current year, and the investee is significant to the registrant's income in the current year only because the disposal has resulted in a significant gain. Operating losses, impairments, or disposal losses at the registrant and/or investee level, or difficulty obtaining cooperation from the investee, would not ordinarily provide a basis for waiver.

E. Reconciliation Requirements for *Domestic Issuers with Acquired Foreign Businesses and Investees*

Rule 3-05 and 3-09 of Regulation S-X provide domestic registrants that prepare financial statements for an acquiree or an investee that is a foreign business, as defined, the same accommodations that foreign registrants have. Specifically, these financial statements would not be required to include a quantified reconciliation to US GAAP unless the significance level exceeds 30%. If no quantified reconciliation is required, material differences between home-country GAAP and US GAAP must be described in an audited note to the financial statements. Where quantified reconciliation is required, the reconciliation can be prepared in accordance with Item 17 of Form 20-F. In addition, the age of financial statements of a foreign business can be the same as a foreign private issuer.

The definition of a foreign business is similar to, but not the same as, the definition of a foreign private issuer. One of the primary differences is that majority ownership by US citizens or residents will disqualify a business from foreign business status regardless of the other attributes. A foreign subsidiary of a US company is not a foreign business. The ownership and officer/director criteria in the definition of a foreign business are based on the attributes of the ultimate holding company. Under this definition, an entity that is 50% owned by a domestic entity and 50% owned by a foreign entity would not be deemed to be a foreign business even though it may be exclusively located outside the US. The definition of a foreign business is designed to provide the accommodations where the acquiree or investee would not reasonably be expected to have US GAAP information or be subject to US reporting requirements. As stated in footnote 31 to Release 33-7118, if the acquired business or investee does not meet the foreign business definition, the issuer can file financial statements prepared in accordance with home-country GAAP provided a reconciliation to US GAAP under Item 18 is included regardless of the level of materiality.

The accommodation to not reconcile separate financial statements of less than 30% significant equity investees does not affect a domestic issuer's measurement of earnings or disclosures under Regulation S-X. APB Opinion 18 requires equity investees to be accounted for using US GAAP. Further, Release 33-7118 requires summarized data under Rule 4-08(g) to be presented in accordance with US GAAP.

These accommodations apply to financial statements required by Rule 3-05

and 3-09 of Regulation S-X but do not apply to financial statements of a predecessor of a registrant. If the registrant is not a foreign private issuer, predecessor financial statements must be prepared in accordance with US GAAP and Regulation S-X applicable to domestic issuers.

X. OTHER DISCLOSURE ISSUES AND STAFF INTERPRETATIONS

A. Loss of Foreign Private Issuer Status

General

A registrant that loses its foreign private issuer status becomes subject to the reporting requirements for a domestic company on that date. While previous Exchange Act reports do not need to be amended upon the loss of foreign private issuer status, all future filings are required to fully comply with the requirements for a domestic company. The financial statements and selected financial data should be recast into US GAAP and US dollar reporting currency for all periods presented. The first filing containing US GAAP financial statements should set out in full the accounting policies under US GAAP that the registrant has adopted.

Registrants must also comply with the requirement of Item 302(a) of Regulation S-K to provide summarized quarterly data for each quarter of the two most recent fiscal years, beginning with the first Form 10-K that the registrant must file after its change in status. This means that the registrant must provide quarterly information on a US GAAP basis for certain periods preceding the change in status. Prospective application is not acceptable. In some cases the change in status may be triggered by transactions among shareholders or other circumstances outside the control of the registrant. The staff will not ordinarily waive the requirements of Item 302(a). However, registrants that believe it is impracticable to obtain the comparative data may consult with the staff in advance of the filing of the Form 10-K.

Accelerated Filer Status

Loss of foreign private issuer status may also cause a registrant to become subject to the accelerated filing deadlines for Forms 10-K and 10-Q adopted by the Commission in 2002. Under Exchange Act Rule 12b-2, a registrant is an accelerated filer if:

- Its common equity public float was \$75 million or more as of the last business day of its most recently completed second fiscal quarter;
- The registrant has been subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act for a period of at least 12 calendar months;
- The registrant has previously filed at least one annual report pursuant to Section 13(a) or 15(d) of the Exchange Act; and

- The registrant is not eligible to use Forms 10-KSB and 10-QSB (Securities Act Release 33-8128).

Foreign private issuers may come within the “accelerated filer” definition, but it generally has no practical effect because the filing deadline for annual reports on Form 20-F has not been changed. However, this will affect registrants that are accelerated filers and that lose their foreign private issuer status. Those registrants must immediately comply with the filing deadlines for accelerated filers. There is no “phase-in” period to comply with the accelerated filer deadlines.

For example, if a registrant loses its foreign private issuer status in the first quarter of its fiscal year (e.g., March 7 for a calendar year end), it would need to file Form 10-Qs beginning with the quarter ended March 31 of that year. The due date for that first Form 10-Q (as well as subsequent Form 10-Qs and 10-Ks) would be the accelerated deadlines under General Instruction A.1.a to Form 10-Q and Instruction A.2.a to Form 10-K.

However, the accelerated filing deadlines do not apply to reports for periods that ended before the registrant lost its foreign private issuer status. Because the registrant in the above example was still a foreign private issuer at the end of its most recently completed fiscal year, its annual report for that year could still be filed on Form 20-F. That final Form 20-F would be due six months after the end of the fiscal year.

Additionally, an accelerated filer’s Form 10-K for the year ended December 31, 2004 is required to comply with the Section 404 internal control reporting requirements in Release 33-8238. Registrants that believe they face unusual circumstances in implementing the Section 404 requirements for 2004, because of loss of foreign private issuer status and other unique facts, should consult the staff.

MJDS

Canadian foreign private issuers filing under MJDS are required to follow the guidance in Exchange Act Release No. 34-29354, which permits the determination of foreign private issuer status to be made annually rather than throughout the year for purposes of Exchange Act reporting. However, an MJDS issuer must meet the MJDS eligibility requirements at the time any registration statement under the Securities Act is filed, and at the time the registration statement becomes effective.

B. Changing to US GAAP for the Primary Financial Statements

Similarly, when a registrant voluntarily changes from home-country GAAP to US GAAP all periods must be restated. The timing of the restatement will depend on whether the registrant has also voluntarily elected to file on domestic forms. If so, the change is ordinarily made in the first quarter of a new fiscal year. The first Form 10-Q and each subsequent Form 10-Q should reflect US GAAP in all current and comparative interim periods presented.

The annual comparative periods are then recast when the next annual report is filed.

However, the timing of the restatement will be accelerated in the event of a registration statement. Interim financial statements included in a registration statement must be prepared on the same basis of accounting and reporting currency as the annual financial statements, so all comparative interim and annual periods must be restated at that time. This is true even if a registrant is eligible to incorporate previously filed documents by reference.

C. Changing from US GAAP to Home-Country GAAP

Under the present rules, a registrant may change the basis of presentation of its primary financial statements from US GAAP to home-country GAAP in their filings with the SEC. However, the staff would be troubled if a registrant filed an initial registration statement under US GAAP and then immediately thereafter, for the purpose of their periodic reporting requirements, changed their primary GAAP.

In any event, registrants intending to change their primary GAAP should consider any undertakings made to investors in the past regarding the basis of presentation and should consult their own attorneys on matters of interpretation.

D. Pro Forma Information that Departs from Article 11 of Regulation S-X

A foreign regulator may require presentation of certain "pro forma" information that may be a mixture of historical and forecasted amounts or otherwise not comply with Article 11 of Regulation S-X. For example, it might eliminate the impact of certain charges such as restructurings or recalculate revenues based on new sales contracts. Since the information is included in the foreign prospectus, the registrant may conclude that the information must also be included in the US prospectus so that the same information is disclosed to all investors. Although the presentation does not comply with Article 11, the staff has not objected to the disclosure in the US registration statement provided the information indicates clearly what the presentation represents, states that this pro forma information does *not* comply with Article 11 and explains why the information is included.

E. Disclosure in Specialized Industries

Disclosure by Banking and Insurance Companies

Foreign banks will frequently have difficulty obtaining certain information to comply with the statistical disclosure requirements of Industry Guide 3. The staff recognizes that the categories and classifications specified by Guide 3 are heavily influenced by US banking regulation, and that some categories and classifications may not be the most relevant in understanding a foreign bank's operations. The staff will generally accept alternative classifications and presentation formats that provide an information content substantially

similar to that specified by Guide 3, and may grant accommodations on the number of periods to be presented in certain circumstances. However, the staff believes that a robust presentation about loan quality and loss reserving is critical to an investor's understanding, and will pay particular attention to the completeness and meaningfulness of the information provided in response to Items III and IV of the Guide.

Foreign insurance companies will often have difficulty obtaining sufficient data regarding property casualty (general insurance) claim reserves to prepare the 10-year loss reserve development table in Industry Guide 6. When appropriate, the staff has granted limited accommodations on the number of periods to be presented. The staff will also consider presentations that encompass substantially all of the loss reserves, if the registrant lacks sufficient data in certain jurisdictions with small operations.

Oil and Gas Full Cost Ceiling Test

US oil and gas companies are required to file quarterly reports containing full cost ceiling tests under Rule 4-10(c) of Regulation S-X. Foreign registrants generally are not required to file quarterly reports. As a result, the staff does not object to foreign registrants limiting the application of the full cost ceiling test to the periods in which US GAAP balances are provided. In the event that comparative interim information is included in a registration statement for a period that was not previously presented, the full cost write-down for the interim period would be the lesser of the write-down for the year, or the excess over the ceiling amount at the end of the interim period. Foreign registrants should disclose the frequency with which the ceiling test is performed and the date of the latest test.

Mining Reserves and Depletion

Mining companies should provide explicit disclosure of the types of reserves that are included in the base used for computing depletion – proven and probable reserves. The SEC staff has indicated in Industry Guide 7 that disclosure of reserve information is limited to proven and probable reserves. As disclosure of possible reserves is prohibited, the base of depletion should also not include such amounts. Excluding possible reserves from the base may result in a difference from home-country GAAP that needs to be addressed in the reconciliation to US GAAP.

F. Disclosure about New Accounting Rules

Staff Accounting Bulletin 74 requires that when a new accounting standard has been issued but has not yet been adopted, the registrant should discuss the effect that the new standard will have on the registrant's financial statements when adopted. If alternative adoption methods and dates are permitted, the registrant should indicate the anticipated method and adoption date.

The SAB 74 disclosure requirement applies not only to the US GAAP

information presented by foreign registrants but also to the GAAP used to prepare the primary financial statements included in SEC filings. Accordingly, it applies to Item 17 as well as Item 18 filers. The following disclosures should be provided:

- A brief description of the new standard, the date that adoption is required, and the date the registrant plans to adopt the standard, if earlier;
- A discussion of the method of adoption allowed by the standard and the method expected to be utilized by the registrant, if determined; and
- A discussion of the impact that adoption of the standard is expected to have on the financial statements, unless not known or reasonably estimable. In that case, a statement to that effect should be made.

In addition, disclosure of the potential impact of other significant matters that the registrant believes might result from the adoption of the new standard (e. g., technical violations of debt covenants, planned or intended changes in business practices) is encouraged.

In a number of the IAS standards, the impact of adopting the new or revised standard is likely to be known because similar determinations are necessary to prepare the US GAAP reconciliation.

G. Management Discussion and Analysis

Effects of Accounting Methods on Reported Results and Liquidity

In certain circumstances, the unusual nature or highly significant amount of a particular US GAAP reconciling item warrants further MD&A disclosure based on the guidance in Staff Accounting Bulletin 88. In these situations, the following factors may indicate the need for additional MD&A disclosure:

- Significant differences in key financial indicators highlighted in the home-country GAAP disclosures but not ordinarily required to be reconciled, such as revenues or operating income.
- Differences resulting in a significant divergence of trends between key home-country GAAP and US GAAP amounts.
- Differences that are likely to grow significantly in future periods because they relate to outstanding long-term contracts with fixed terms.
- Differences related to specialized industry accounting that may be unfamiliar to US investors, particularly where home-country GAAP would not ordinarily be expected to produce significant differences.
- Significant differences reflected in the separate financial statements of

a recently acquired business that are not yet fully reflected in the registrant's financial statements.

- Differences reflected in the separate financial statements of an equity method investee, whose effects are not fully apparent in the registrant's financial statements.

An expanded presentation of selected financial data on a US GAAP basis also may be necessary in these circumstances to highlight unusual or highly significant matters that otherwise might not be disclosed with sufficient prominence.

H. Parent Company Financial Statement Schedule

Item 17 of Form 20-F and Rule 5-04 of Regulation S-X require condensed financial statements of the registrant on a "parent-company-only" basis to be filed as an audited Schedule to the registrant's consolidated financial statements when the restricted net assets of the registrant's subsidiaries and equity method investees exceed 25% of the registrant's consolidated net assets as defined in Rule 4-08(e)(3) of Regulation S-X. "Restricted net assets" means the amount of the registrant's proportionate share of net assets reflected in the balance sheets of its subsidiaries and equity method investees which may not be transferred to the parent company without the consent of a third party such as a lender, regulatory agency, or foreign government. This requirement applies to both domestic issuers and foreign private issuers. Registrants that are incorporated in one jurisdiction, but have a significant portion of their assets or operations in a different jurisdiction that restricts the transfer of assets or dividends outside the country (such as the PRC), are subject to the "parent-company-only" Schedule requirement.

I. Use of Non-GAAP Measures – the Meaning of "Expressly Permits"

Item 10(e) of Regulation S-K prohibits the inclusion of certain types of non-GAAP financial measures in filings with the SEC. For foreign private issuers, Item 10(e) permits presentation of an otherwise prohibited non-GAAP measure if the measure is required or expressly permitted 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.

The staff has received questions about whether otherwise-prohibited measures historically included as part of a registrant's home-country GAAP income statement presentation would automatically be acceptable when the registrant adopts IFRS.

FAQ 28 of the June 13, 2003 *Frequently Asked Questions Regarding the Use of Non-GAAP Financial Measures* states that 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 registrant's primary financial statements included in its filing with the Commission. Registrants are expected to apply this guidance in

determining whether an otherwise-prohibited measure would be expressly permitted by IFRS. The FAQ is available on the SEC website at <http://www.sec.gov/divisions/corpfin/faqs/nongaapfaq.htm>.

XI. REPORTING IN HIGHLY INFLATIONARY ECONOMIES

A. Price-Level Adjusted Financial Statements

General

Various countries that have experienced high rates of inflation require or permit financial statements to comprehensively include the effects of price level changes under home-country GAAP. In some countries, that reporting continues to apply even though the cumulative three-year inflation rate may be below 100%. The most commonly used approach is historical cost/constant currency, which recasts comparative period amounts into equivalent units of current purchasing power using a general price-level index. In some countries, a current (replacement) cost approach may be used. Form 20-F permits the inclusion of comprehensive price-level adjusted financial statements in SEC filings where that reporting is required or permitted by home-country GAAP.

Price-level adjustment approaches differ fundamentally from the methods used to translate historical cost results of foreign operations under FAS 52. Because of the inherent difficulties in producing meaningful information, an accommodation in Form 20-F permits foreign registrants that prepare comprehensive price-level adjusted financial statements to *not* reconcile the effects of price level changes to US GAAP. Registrants who use this accommodation must describe the basis of presentation of the price-level adjustments, and must state that the effects of the price level adjustments have not been reconciled to US GAAP.

2. Price Level Adjusted Financial Statements under US GAAP

Foreign private issuers operating in a highly inflationary environment that would like to prepare their primary financial statements in accordance with US GAAP can apply APB Statement No. 3, *Financial Statements Restated for General Price-Level Changes* (APS 3). The effects of the application of price level accounting do not have to be quantified in the reconciliation to US GAAP, as APS 3 is US GAAP. The staff has addressed several issues regarding the application of APS 3 including the acceptability of netting certain costs, discounting of trade receivables and payables and capitalization of interest. The definition of "highly inflationary" in FAS 52 and Rule 3-20 of Regulation S-X should be used when applying APS 3.

3. Updating Price Level Adjusted Financial Statements

All price level adjusted financial information in a foreign private issuer's registration statement should be presented in equivalent purchasing power

units of the reporting currency. That is, all measurements are restated retroactively to the purchasing power unit at the date of the most recent balance sheet in the filing. If a company updates to include interim financial information, the prior annual financial information must be recast in equivalent purchasing power units. A company that incorporates by reference a prior annual report on Form 20-F need not amend the prior filing, but must file restated financial statements in the registration statement or under cover of a Form 6-K that is incorporated by reference.

Many historically inflationary economies have experienced declining rates of inflation in recent years. If the rate of inflation during the interim period is very low such that the effect of restatement does not materially affect apparent trends and is clearly immaterial, the staff has not insisted that prior period financial information be restated. If the information is not restated, the rate of inflation and the reason why restatement was not considered to be necessary should be disclosed.

If the interim information is included in a registration statement solely because more recent interim financial information than otherwise required by Item 8.A.5 of Form 20-F was published, the staff encourages but will not insist that prior periods be restated in units of equivalent purchasing power as of the most recent date. Registrants should provide disclosure necessary to prevent the updated data from being misleading in relation to prior period financial information. For example, the issuer should provide supplemental selected financial data recast in equivalent purchasing power units, accompanied by disclosure of the rate of inflation that would be used to restate all prior financial information in equivalent purchasing power units.

4. Price-Level Adjusted Cash Flow Statements

FASB Statement 95 and Form 20-F do not address the presentation of the statement of cash flows by registrants that prepare price-level adjusted financial statements in filings with the SEC.

Inclusion of the effects of inflation in the line items comprising the three major categories of the cash flow statement may make the presentation less meaningful and possibly misleading. For example, the financing activities section may depict reductions of foreign-currency denominated debt because of the recasting of prior balance sheet amounts for inflation, even though no cash repayment has occurred. In some cases, these effects may permeate the statement of cash flows. However, presentation of a "fourth caption" that comprehensively segregates the effects of inflation/currency devaluation from the cash flows from operating, investing and financing activities has been adopted in several countries (Chile, Colombia).

Registrants are required to prepare price-level adjusted cash flow statements in a manner that comprehensively segregates the effects of inflation from the cash flows from operating, investing and financing activities. The November 1998 AICPA International Practices Task Force minutes include an illustrative example. Because of the difficulties of retroactive compliance, this guidance

should be adopted for fiscal years *ending* after November 1998. Recasting of comparative periods is encouraged but not required.

B. Determining whether an Economy is Highly Inflationary for FASB Statement 52

Where an economy's cumulative three-year inflation rate has increased to 100% or more, EITF Topic D-55 "Determining a Highly Inflationary Economy under FAS 52" states that the economy should be considered highly inflationary in all instances. Where the inflation rate has fallen below 100%, EITF Topic D-55 states that "historic inflation rate trends (increasing or decreasing) and other pertinent factors should be considered to determine whether such information suggests that [continued] classification of the economy as highly inflationary is appropriate." A change in status from highly inflationary to non-highly inflationary is implemented at the beginning of the reporting period that immediately follows the date the economy is determined to be no longer highly inflationary.

Before Topic EITF D-55 was announced in November 1996, practice was inconsistent and some issuers did not make these types of changes for extended periods. The staff believes that similarly situated issuers should reach reasonably consistent judgments about when an economy ceases to be highly inflationary. The longer the period and the greater the amount by which the three year cumulative inflation rate is below 100%, the more difficult it will be for "other pertinent factors" to outweigh a conclusion that the economy is no longer highly inflationary.

Registrants with material operations in an economy that is no longer considered highly inflationary should provide the following disclosures in the financial statements and MD&A:

- a description of the economy's status as a highly inflationary economy,
- the date the economy ceased being considered a highly inflationary economy,
- the functional currency used by those operations, and
- the effects on the financial statements of the change in the functional currency, if practicable.

C. Other Reporting Questions

Reporting in US Dollars

Like all foreign private issuers, registrants based in countries with highly inflationary economies are permitted by Form 20-F to present US GAAP financial statements in US dollars. The amounts presented for non-monetary assets and liabilities as well as total stockholders' equity should not be materially different than if the US dollar had always been used as the

reporting currency, and thus the currency for measurement, during the period that the economy is highly inflationary as defined by FAS 52. Under US GAAP it is not acceptable to use price level adjusted financial statements expressed in local currency and then translate those amounts into US dollars.

Accommodation for IAS 21 for Highly Inflationary Foreign Operations

As specified in Form 20-F, foreign registrants that account for operations in a highly inflationary economy in a manner consistent with IAS 21, using the historical cost/constant currency method, need not quantify differences in the translation methodology compared to US GAAP. FAS 52 requires financial statements of an entity in a highly inflationary economy to be remeasured as if the functional currency were the reporting currency. Under IAS 21, the financial statements of the entity in the highly inflationary economy would first be adjusted for inflation and then translated into the reporting currency using the period end exchange rate.

The rule defines highly inflationary economy in a manner consistent with FAS 52 - cumulative inflation of approximately 100% over the most recent three-year period. This definition of a highly inflationary economy and the limitation of using the historical cost/constant currency method does not apply to issuers that prepare financial statements in a reporting currency that comprehensively includes the effects of inflation.

XII. PRIVATIZATIONS OF GOVERNMENT-OWNED ENTERPRISES

Significant accounting and reporting issues often arise in connection with the privatization of a government-owned enterprise. Where appropriate, the staff will consider accommodations consistent with the particular circumstances and the protection of investors.

A. Predecessor Financial Statements

The staff has not challenged the omission of certain comparative financial statements when the issuer or significant acquiree changed from a state-owned and operated enterprise to one that operates in a market-based economy. This may occur when a government privatizes an industry, or when fundamental changes occur in the economy itself. The accommodation generally applies to periods preceding the time that the fundamental change occurred. In determining whether an accommodation is appropriate in a particular situation, the staff considers the following:

- the impossibility of obtaining reliable financial information because the necessary records were never maintained and cannot be developed, and
- more importantly, the lack of relevance to an investor because of significant changes to the entity and its environment. The evaluation generally is made using criteria similar to those in Rule 11-01 of Regulation S-X.

B. Fixed Asset Valuations

Government-owned enterprises may use expenditure-based accounting systems in which perpetual fixed asset records are not maintained. Where reliable fixed asset records are not available and cannot reasonably be produced, the staff has not objected to the establishment of fixed asset amounts based on fair values at the opening balance sheet date. In these circumstances the staff expects the issuer to undertake a rigorous process of identification and appraisal of the assets. The opening fair value balances are considered to be the registrant's cost basis, and thereafter the assets are reported in the usual manner with respect to recognition of depreciation and evaluation of impairment. Ordinarily, the auditor's report will include an "except for" qualification regarding conformity to US GAAP related to this matter. A qualification, in these particular circumstances, would be acceptable to the staff.

C. Restructuring Activities

A government-owned enterprise may close facilities, curtail activities, change its methods of doing business, or alter its pension plans or other arrangements with employees in connection with a privatization. The changes may be initiated by the issuer or required by the government. These changes may result in recognition of significant balance sheet accruals or income statement charges under home country GAAP. Issuers should be aware that significant differences in amounts, timing and classifications might arise under US GAAP. For example, issuers should carefully consider the requirements of FASB Statements 87, 88, 106, 112, and related pronouncements regarding employee benefit plans, and FAS 144 and 146 regarding asset impairments, exit activities, and disposal activities. MD&A should clearly explain the effects of these types of transactions on reported results and the expected impact on future operations, liquidity and cash flows. Additional MD&A discussion may be necessary to address significant differences between home country and US GAAP results.

D. Issuances of Government-owned Shares to Employees

Frequently, the government shareholder will offer shares to employees of the issuer at a discount in connection with a privatization. These transactions generally are not considered compensatory events under home-country GAAP. However, Interpretation 1 to APB Opinion 25 requires the costs of employee compensation plans offered by a significant shareholder to be reflected in the company's financial statements except in certain limited circumstances. Interpretation 1 does not specifically address stock grants related to privatization transactions.

In evaluating these transactions, the staff first considers whether the issuance meets the conditions of a non-compensatory plan in paragraph 7 of APB Opinion 25. If the shares are offered to substantially all employees on an equal basis, there are no continuing performance or employment (vesting) conditions, and the discount from market (offering) price is reasonably small,

the issuance would not be considered compensatory. Otherwise, the staff believes that Interpretation 1 should be applied, and an income statement charge should be reflected under US GAAP for the difference between market price and the employees' purchase price. The staff generally would not expect a government shareholder to meet any of the three exceptions in Interpretation 1.

The staff recognizes that privatization transactions are influenced by various economic, social, and political goals, and that compensation of employees is not their primary purpose. Where the issuance is concurrent with the privatization transactions, accomplished in a single reporting period, and will not result in periodic income statement charges, the staff has not objected to characterization of the charge as an extraordinary item.

E. Oil & Gas Properties

Some governments do not permit private parties to own oil & gas properties. Instead, the governments grant leases or concession rights to explore, develop and produce the underlying oil & gas reserves. Those rights are usually granted for a fixed term, which may be shorter than the estimated period required to extract the underlying reserves.

For purposes of determining proved reserves under FAS 19, FAS 69 and Rule 4-10 of Regulation S-X, a registrant's estimate of oil & gas reserves should be limited to quantities expected to be produced during the term of its leases or concessions. Renewals should not be assumed unless the registrant has a demonstrated history of obtaining renewals.

Additional materials:

- [Appendix A — Country Specific Issues](#)
- [Appendix B — International Accounting Standards](#)

<http://www.sec.gov/divisions/corpfin/internatl/cfirdissues1104.htm>