AICPA International Practices Task Force Meeting Highlights

April 18, 1996

Location: AICPA Washington Office

NOTICE*: The AICPA SEC Regulations Committee meets periodically with the staff of the SEC to discuss emerging technical accounting and reporting issues relating to SEC rules and regulations. The purpose of the following highlights is to summarize the issues discussed at the meetings. These highlights have not been considered and acted on by senior technical committees of the AICPA, or by the Financial Accounting Standards Board, and do not represent an official position of either organization.*

In addition, these highlights are not authoritative positions or interpretations issued by the SEC or its staff. The highlights were not transcribed by the SEC and have not been considered or acted upon by the SEC or its staff. Accordingly, these highlights do not constitute an official statement of the views of the Commission or of the staff of the Commission.

I. ATTENDANCE

Dick Dieter, Chairman (Arthur Andersen)
Ken Allen (Deloitte & Touche)
Taiwo Danmola (Arthur Andersen)
Bill Decker (Coopers & Lybrand)
Lee Dewey (BDO Seidman)
Roger Jahnke (Ernst & Young)
Lewis Gill (Price Waterhouse)
Cathy Leonhardt (Price Waterhouse)
Larry Leva (KPMG Peat Marwick)
Joel Osnoss (Coopers & Lybrand)
Wayne Carnall (SEC Observer)
Lisa Vanjoske (SEC Observer)
Annette Schumacher Barr (AICPA)

II. HYPERINFLATION IN HUNGARY

The Task Force discussed the question of whether Hungary should be considered hyperinflationary under FASB Statement No. 52, Foreign Currency Translation, and concluded that Hungary should not be considered hyperinflationary as of December 31, 1993, 1994 and 1995. Wayne Carnall agreed with this assessment. The Task Force agreed to periodically address what countries should be considered hyperinflationary.

III. INTERPRETATIONS OF IAS STANDARDS

The Task Force discussed the possibility of the acceptance of International Accounting Standards (IAS) in cross border offerings as well as the need for an authoritative function to interpret IAS. In addition, it was noted that the IAS is considering the establishment of a group that is similar to the EITF. Wayne Carnall indicated that the staff interprets those International Accounting Standards that are used in lieu of reconciling to US GAAP.

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Note: Items IV through XII were also discussed in a meeting in Houston attended by members if the Mexican Accounting Principles Commission and certain members of the Task Force. Minutes of this meeting were prepared by Wayne Carnall and are attached as Exhibit I.

IV. CONSOLIDATION OF FOREIGN SUBSIDIARIES -- MEXICO

Wayne Carnall noted that there are significant differences in Mexican accounting for foreign subsidiaries. He added that the Mexican Accounting Principles Commission is currently addressing the issue and stated that perhaps the application of IAS could be an interim solution until a Mexican standard is developed. He also proposed the following disclosures of information to allow an investor to assess the effect of the different methodologies on the financial statements:

- An indication that Mexican GAAP does not provide specific guidance on the consolidation of foreign operations and there are differences in methodologies.
- A detailed description of the methodology followed.
- Information on the applicable exchange rates and inflation rates that were used in the translation and remeasurement process.
- Condensed financial information (expressed in constant pesos) for each country in which the Mexican company has foreign operations. Generally, this would not be expected to involve a large number of countries. The differences in methodologies will primarily affect the income statement and non-monetary items in the balance sheet. Perhaps, this information would be more valuable if, in addition to the amounts presented in constant pesos, similar information in nominal dollars or any other functional currency, as applicable.

The Task Force reached a tentative conclusion that this approach makes sense, although there were concerns expressed about its practicality in the case of subsidiaries operating in hyperinflationary economies, and agreed to address the recommendations with their Mexican counterparts.

V. HEDGE OF INVESTMENT IN A U.S. SUBSIDIARY -- MEXICO

Circular Number 42 allows Mexican companies to record the exchange loss on foreign currency borrowings (e.g., U.S. dollars) that is used as a hedge of an investment in a foreign subsidiary. The Circular refers to International Accounting Standard No. 21, Accounting for the Effects of Changes in Foreign Exchange Rates, as support for this accounting. Practice appears to be varied in Mexico with respect to the corresponding monetary gain on the debt. Some believe it should be recorded directly to equity along with the foreign exchange loss while others believe it should be included in the income statement. Wayne Carnall expressed concern with the practice of recording the monetary gain in the income statement. The Task Force agreed with Waynes concerns and decided to table discussion of the matter until the Mexican Accounting Principles Commission addresses the issue. In the interim, Wayne recommended that the following disclosures be made by those companies electing to record monetary gains in the income statement:

0. A complete description of the methodology being used and, in addition, a description of the alternate methodology, and
1. The amount of the monetary gain that is included in the income statement relating to this transaction.

VI. MEXICAN EMPLOYEE PROFIT SHARING

Currently, there is diverse practice among Mexican companies in accounting for employee profit sharing plans for purposes of reconciling to US GAAP. Some issuers use an accrual methodology and others use a balance sheet methodology. Under the accrual methodology, a liability is recognized for deferred employee profit sharing purposes on timing differences between income for financial reporting purposes and income for purposes of computing the current amount of the employee profit sharing payment. The balance sheet methodology determines the liability based on the difference between assets and liabilities in the financial statements and assets and liabilities determined in accordance with the law relating to the employees profit sharing. This methodology is conceptually consistent with SFAS No. 109, Accounting for Income Taxes. Wayne noted that the accrual methodology likely results in a lower liability compared to the balance sheet method. Wayne strongly encouraged the Task Force to reach a consensus on one method. The majority of Task Force members noted that their firms do not allow this method. The Task Force agreed to discuss the issue within their firms to communicate Waynes position. This issue will also be discussed at the next task force meeting.

Wayne added that those companies that elect to use the accrual methodology should disclose information on the balance sheet methodology to allow comparability. Such disclosures would include the following:

- A discussion of the differences in methodology;
- The amounts under the balance sheet methodology; and
- The disclosures that would be provided if the balance sheet methodology were used.

VII. ACCOUNTING FOR IMPAIRMENT OF LONG LIVED ASSETS

Pursuant to Bulletin B-10, under Mexican GAAP, fixed assets are recorded at replacement cost. Replacement cost represents the amount that it would cost to replace an asset and does not represent its fair value. Circular 29 provides guidance on the accounting for impairment and establishes a "value in use" concept. Under this guidance, fixed assets cannot exceed the value in use amount which is defined as future cash flow (income less related expenses) expected to be obtained over the life of the asset expressed in pesos of constant purchasing power. Paragraph 4.6 of Circular 29 states that the difference between the value in use amount and the fixed asset balance expressed in beginning of the year pesos (i.e., not adjusted to constant purchasing power) is recorded in the income statement, and the balance is charged directly to retanm (equity). The Task Force concluded that the determination of the amount that should be included in the income statement should be made after the adjustment for the period to replacement cost - i.e., the value in use amount is compared to replacement value.

The Task Force also addressed the issue of whether, in the reconciliation to US GAAP, adjustments of fixed asset balances to replacement cost that result in the asset being recorded below historical cost in constant purchasing power should be recorded in the income statement. The Task Force concluded that for purposes of reconciling to US GAAP, there does not need to be an adjustment to the amount determined under Mexican GAAP. In addition, prospectively, companies will need to comply with FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of.

VIII. MEXICAN PENSION PLANS -- ACTUARIAL ASSUMPTIONS

Wayne Carnall noted that the Accounting Principles Commission is working with actuaries in Mexico in developing a revision to Bulletin D-3 to reflect the unique aspects of applying a pension accounting model to price level adjusted financial statements. The current thinking is that the actuarial assumptions should be determined using real (i.e., net of inflation) rates. Such a standard could be in place for 1996. If, after the possible amendment to Bulletin D-3, the only difference between the funded status under Mexican GAAP and US GAAP is the transition date (i.e., projected benefit obligation and plan assets are the same and there are no differences in methodology), the staff would consider accepting amounts determined under Mexican GAAP for purposes of reconciling to US GAAP.

Wayne also noted that it would be helpful if the Task Force could advise the staff of the general practice in Mexico regarding pension plans (e.g. how termination benefits are handled, what criteria is used in identifying an informal plan, etc.). The Task Force agreed to poll their Mexican counterparts and provide Wayne with a synopsis of the results. Cathy Leonhardt volunteered to assemble a questionnaire to be used by the Task Force in this project.

With respect to pension plan disclosures, Wayne made recommended that companies disclose the assumed rate of inflation that is included in the actuarial assumptions.

IX. APPLICABILITY OF PRICE LEVEL ACCOUNTING TO FINANCIAL INSTITUTIONS -- MEXICO

Wayne noted that representatives of the Mexican Accounting Principles Commission have inquired about the ramifications of possible changes in the reporting requirements involving financial institutions that would require the preparations of price level adjusted financial statements. Currently, financial institutions do not prepare price level adjusted financial statements.

Wayne added that the staff will not object to the Mexican financial institutions preparing price level adjusted financial statements. The representatives from Mexico were further advised that if the cumulative rate of inflation over a three year period exceeds 100% that, pursuant to Rule 3-20 of Regulations S-X, the financial institutions would be required to either prepare price level adjusted financial statements as the primary financial statements or to prepare supplemental price level adjusted financial statements.

X. APPLYING FASB STATEMENT NO. 109 IN MEXICO

Currently, there is diversity in practice among Mexican companies in the reconciliation to US GAAP with respect to the application of FASB Statement No. 109.

Some companies allocate a portion of the change in the deferred tax balance attributable to the use of replacement cost directly to retanm (equity) while others record the entire change in the deferred tax balance as part of the income statement. For purposes of reconciling to US GAAP, the change in the deferred income tax balance attributable to replacement costs accounting should be allocated to retanm. If a company had recorded the entire amount to the income statement, the change to a method allocating a portion directly to retanm would be a change in accounting principle. The staff would not object to the conclusion that such a change was preferable.

With respect to disclosures, Wayne recommended that companies continue to disclose the amount of tax adjustment that has been allocated to retanm. Separate disclosure should be provided for the amount attributable to employee profit sharing that is allocated to retanm.

The Task Force agreed to discuss this recommendation with their Mexican counterparts.

XI. PROVISION FOR DEFERRED INCOME TAXES ON AMOUNTS INCLUDED IN STOCKHOLDERS EQUITY IN EXCESS OF CUFIN

If a Mexican company distributes a dividend out of profits that have not been taxed, the Company would be required to pay taxes on such amounts. The CUFIN represents the amount of retained earnings that have been previously taxed and can be distributed tax free. There can be situations in which there can be differences between book and taxable income that would not appear to give rise to differences between a tax and a book balance sheet. The Task Force discussed whether a deferred tax liability should be established for the amounts that would result in payment of taxes and agreed to discuss the issue with their Mexican counterparts.

XII. USE OF APPROPRIATE INDEX FOR PRICE LEVEL STATEMENTS -- BRAZIL

The Task Force discussed a practice problem relating to the inconsistent use of various indices in computing inflation adjustments. Wayne Carnall commented that the responsibility for using the appropriate index rests with the company and its auditor. The Task Force agreed to consider the issue at the next Task Force meeting; Larry Leva agreed to research the issue and lead the discussion.

XIII. USE OF CURRENCY OTHER THAN U.S. DOLLAR IN DOMESTIC FILINGS

The Task Force asked Wayne Carnall for guidance as to whether it would be appropriate for a domestic registrant whose assets and liabilities are located outside the United States to report in other than U.S. dollars. Wayne replied that if substantially all of the registrants operations existed in a single foreign country, the staff would not object to the registrant reporting in that countrys currency.

XIV. ISRAEL PENSION PLANS

Wayne Carnall noted that registrants in Israel and their accountants have consistently stated their belief that the various pension obligations and related funding commonly used in Israel are not defined benefit plans, and that FASB

Statement No. 87, Employers Accounting for Pensions, is therefore not applicable. Typical disclosures currently being made include the amount of the expense recognized each year and the components of the net liability reported on the balance sheet (gross liability less amounts funded). The amounts can be netted under Israeli GAAP since they are considered plan assets.

The Task Force discussed whether the various pension arrangements commonly used in Israel are defined contribution plans or defined benefit plans under US GAAP and agreed to discuss the issue with their counterparts in Tel Aviv to get more information. Wayne noted that if the plans are deemed defined benefit plans, full relevant disclosures required by FASB Statement No. 87 should be made including funded status, recognized gains or losses and service cost. Alternatively, if the plans are merely deferred compensations plans, it would appear that there would be a difference in presentation under US GAAP in that US GAAP would require gross presentation of assets and liabilities pursuant to FIN 39, since ownership of the insurance contracts generally remains with the company. Such differences should be explicitly addressed in the notes to the financial statements. In addition, the companies should disclose the amount of gross pension expense along with the amount of the investment earnings.

The Task Force agreed to communicate the staffs current position and to discuss the issue at the next Task Force meeting.

XV. ACCOUNTING FOR EMPLOYEE STOCK BONUS ARRANGEMENTS -- TAIWAN

Dick Dieter noted that under Taiwan GAAP, employee bonuses and remuneration to directors and supervisors are paid in accordance with a companys articles of incorporation subsequent to year-end and are subject to shareholder approval. The bonuses may be settled in either cash or stock depending on the provisions of the articles of incorporation. In many cases, the bonuses are settled in stock. For local valuation purposes, only the par value of the stock is considered. As a result, it is common in Taiwan for shares to be issued whose value would significantly exceed the amount of the cash compensation. The Task Force discussed whether it makes it makes sense for US GAAP purposes to limit the accrual to the par value of the securities. Dick stated that there are some that believe that the fair value of the shares should, at a minimum, be accrued at December 31, with the difference between that amount and the amount ultimately paid (based on the value at the shareholders meeting) charged to income in a subsequent period. Wayne Carnall stated that the staff would place significant weight on shareholder approval. Accordingly, absent unusual facts and circumstances, the fair value of the stock issued should be recorded at the date of shareholder approval.

XVI. DERIVATIVES -- ESTABLISHING HEDGE CRITERIA AFTER THE FACT

The Task Force discussed the practice of establishing hedge criteria after the transaction has occurred. Wayne stated that he would be very reluctant to accept such a practice but that he would be willing to consider varying positions. Roger Jahnke agreed to assemble an issues paper for Waynes further consideration.

XVII. COMPLIANCE WITH MJDS -- COMPLIANCE WITH US GAAP -- CANADA

Wayne Carnall noted that a number of compliance issues relating to MJDS and US GAAP have come to his attention. He stated that the staff expects full compliance with the requirements of the Form. Companies filing under Item 18 should provide all of the disclaimers required by US GAAP and Regulation S-X. In an effort to enhance compliance, the SEC is considering the establishment of a consulting program with the Ontario Securities Commission. In this program, the SEC would assist in the review of the US GAAP portion of Canadian filings.

XVIII. ACCEPTABILITY OF LOCAL "EXCEPT FOR" OPINIONS CORRECTED IN US GAAP RECONCILIATION

Wayne Carnall indicated that qualified auditor reports are generally not acceptable in Commission filings. The staff will consider granting a waiver for departures from foreign GAAP that have no effect on the amounts determined under US GAAP provided the Company can provide representation that such departure is acceptable to the Companys primary securities regulator.

XIX. THE USE OF A US FIRMS NAME IN FOREIGN REPORTS

The Task Force discussed a recent request by underwriters that a US firm sign an audit report that its foreign affiliate was associated with, when the US firm has not done any work and none of the operations of the related company are located in the US. In a similar matter, the underwriters requested that the US firm issue a comfort letter on the US GAAP reconciliation, even though the US firm had no audit base.

Most Task Force members stated their belief that it is inappropriate to honor such requests when it appears the reason for the request is to establish a basis for legal responsibility under US laws.

XX. MEXICAN INFLATION

The Task Force discussed the trend in Mexican inflation and the expectation that it would be a hyperinflationary economy in 1996 (estimated cumulative inflation of 111%) and in 1997 (141%), and back to 86% in 1998 with a continued decline in later years. The issue is whether Mexico should be viewed as hyperinflationary for financial reporting purposes for those two years. The consensus of the Task Force was that, if the present trend continues, Mexico would be deemed to be hyperinflationary at December 31, 1996.

XXI. OTHER COMMENTS FROM THE SEC STAFF

Wayne Carnall commented on certain matters noted by the SEC staff in their reviews of recent filings:

- A number of Israeli companies have not complied with paragraph 9.f. of FASB Statement No. 109, which prohibits recognition of deferred taxes for differences related to assets and liabilities that, under FASB Statement No. 52, are remeasured from local currency into the functional currency. These companies use the US dollar for reporting purposes and indicate that they are in compliance with US GAAP. He asked for input from the Task Force regarding current practice in this area.

- The SEC requires the use of US GAAS on audits of financial statements included in filings. The staff would require a supplemental letter from the auditor indicating such compliance with GAAS, unless the auditors report includes a statement to that effect.
- Registrants that prepare financial statements using a GAAP or a reporting currency in Commission filings that is different from that used in its home currency should disclose the amount of retained earnings that is available for distribution if different from the amount presented in the financial statements.

XXII. NEXT MEETING

The next meeting of the Task Force is scheduled for August 15 at the AICPA Washington office.