RECENT DEVELOPMENTS IN THE SEC ACCOUNTING FIELD

Prepared by
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The topic assigned to me this afternoon is "Recent Developments in the SEC Accounting Field".[1/] The problems a CPA faces when he finds out that his client is considering an initial offering to the public will also be covered generally.

GENERAL CONSIDERATIONS

Upon learning that his client is proposing to file a registration statement, the accountant should satisfy himself (1) that his firm is independent in the light of the Commission's requirements as to independence expressed in Rule 2-02 of Regulation S-X and in its relatively numerous Accounting Series Releases which have dealt with independence questions, (2) that he has determined the financial statements which will not only meet the Form S-1 or other applicable form requirements but also afford the most appropriate presentation to investors, and (3) that his firm, together with other independent accountants, if necessary, will be in a position to certify the financials required (at least latest three years or life of registrant, if less).

Oftentimes, there have been relationships between the client and the accountant which preclude a finding of independence. Examples may be that the accountant is a stockholder or officer of the client, is acting as trustee for the client's pension fund, or is performing write-up work or legal services for the client.

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In some instances a different accountant may be required; in other cases, some action might be taken in regard to less serious matters, so that after such action the accountant may be deemed to be independent. Any questions as to independence should obviously be resolved as soon as possible after they arise.

If a registrant has had many corporate changes, principally acquisitions and dispositions, and capital adjustments, or if its present status comprises or is to comprise the "put together" of various companies, there usually arise problems as to the most informative presentation under the circumstances. These circumstances may vary widely, as may also the proposed presentation.

The scope of the audits performed by the CPA for the client in prior years, particularly with respect to inventories and receivables, may not have been such as to enable him to render an unqualified opinion, there may have been subsidiaries acquired which have not been audited or companies proposed to be included in a put-together have not been audited.

In arriving at determinations with respect to these three broad areas, the CPA should obviously acquire and study the applicable laws, regulations and forms, with particular reference to Regulation S-X, the Accounting Series Releases and Form S-1 (or other applicable form). ASR Nos. 79,81,and 90 might be considered of particular interest. These set forth an amendment to Rule 2-01, a compilation of representative administrative rulings in cases involving independence of accountants

and a discussion of certification of income statements, respectively.

CONFERENCES WITH SEC ACCOUNTING PERSONNEL

After having studied the situations with respect to independence, presentation of financials and their certifications in the light of SEC requirements and made determinations relating thereto, there may still be problems present which in the CPA's opinion warrant a pre-filing conference with the SEC accounting staff.

Preliminary inquiries as to accounting matters may be made by letter or telephone. If the question relates to the accountants' independence or to a unique problem of accounting principle, the conference should be arranged with the Office of the Chief Accountant of the Commission. Appointments relating to questions as to the form on which to file, the manner of presentation of the financials and the application of generally accepted accounting principles therein should usually be made with the Chief Accountant of the Division of Corporation Finance.

The conference should include representatives from the registrant and the independent accountant, usually a senior financial officer of the former and a partner of the latter. In many instances there are also present attorneys for the registrant and for the underwriters.

Prior to the conference the CPA should have done his home work and have sufficient knowledge of the client's business and accounting practices to present the specific problem areas and his proposed solutions with reasons therefor. Written agenda of the matters to be discussed and preliminary financial statements to the extent available are desirable.

Conferences should be held as early as practicable, and sufficiently ahead of the proposed filing date to allow time for further research and study by the staff where this may be required in order that the necessary determinations may be made.

TIMING OF FILINGS, AND LATER BRING-UPS

Unless a registrant meets the six months requirements specified in Form S-1 Instruction 1 (a) as to Financial Statements, financial statements should be as of a date within 90 days of the date of filing (counting the financial statements date as the first of 90 days). Each material pre-amendment is deemed to start anew the 90 days or six months requirements. Securities Act Release No. 4666 sets forth in Paragraph 11 our policies with respect to financial statement bring-ups.

Registration statements filed shortly after the close of the registrant's fiscal year, and including a long interim period set of unaudited financials, often are substantially processed just about or shortly before the time full year certified financials are or will be available. In many such instances, certified bring-ups are required by us, and with much unhappiness on the part of the registrant. In such cases, the registrant (and his accountants) should be aware that such updating is desirable and may be required and should be prepared to include the later certified statements in the amendment. All in all, we feel, that the added protection to investors from such additional certification in the cases of many relatively unknown and smaller companies outweighs some short delay in effectiveness at this time of the registrant's fiscal

year end.

Within the last year we have applied the above general principles of certified financials bring-ups in two merger proxy filings, with especially drastic changes in one situation. We intend to follow this policy where such action is justified, even if delays in meetings are necessary.

ACCOUNTING SERIES RELEASE NO. 102

The Commission released in December 1965 its Accounting Series Release No. 102 relating to the balance sheet classification of deferred income taxes arising from installment sales. This release requires that assets and related liabilities entering into the operating cycle shall be classified consistently as current or noncurrent items, with appropriate disclosure of the classification followed and the amounts involved. In effect, deferred income taxes arising from related installment receivables classified as current assets should be included in current liabilities.

While this release may seem applicable primarily to many retail merchandisers selling on an installment basis, it is intended to apply also to other types of businesses in which installment receivables are material. Companies in the construction industry using a completed contract basis for income tax reporting and percentage-of-completion basis for financial reporting set up deferred income taxes, which relate to certain current asset items. It is our opinion that the deferred taxes related to such current assets should be classed as current liabilities.

In some types of companies, such as real estate, leasing and certain types of finance companies we have not required that current assets and current liabilities be classified in balance sheets. Release 102 would not affect these presentations. As future classification problems arise which involve Release 102, they will be considered on a case by case basis.

LEASES

We have, at various times in the past, raised question as to consolidation of real estate subsidiaries and capitalization of leases. The issuance of Opinion No. 5 by the Accounting Principles Board of the AICPA now provides an up-to-date guide as to when a lease should be capitalized and we are presently witnessing its implementation. The problems which arise generally relate to the retroactivity provisions, to the creation of a material equity or to the application of paragraph 12 which deals with affiliated lessors. You will remember that the language with respect to retroactivity was changed in this opinion. This was done to encourage companies to put their accounting on a consistent basis and we have urged retroactivity in a number of cases.

Each lease must be examined to determine whether a material equity is created. The factors considered include the life of the asset acquired as compared to the length of the lease and the renewal and purchase options. The existence of a declining payment schedule may also indicate creation of equity. The proposed opinion on "Accounting for Leases in Financial Statements of Lessors" will further clarify principles of accounting

for leases. However, we note that under this proposed opinion and the existing Opinion No. 5, it is possible that some fixed assets may not be shown on any balance sheet. We hope that this will soon be remedied by further action by the Institute.

BUSINESS COMBINATIONS - PURCHASES & POOLINGS OF INTERESTS

The standards set forth in Accounting Research Bulletin No. 48 to determine that a particular business combination may be deemed a pooling of interests have been interpreted with increasing liberality over the years, so that many transactions previously considered to be a purchase may now be treated as a pooling or a part-purchase, part-pooling. The 90%-to-95% test set forth in Bulletin 48 has been eroded to the situation where a contribution as little as 1/2% by the minor party to a pooling is deemed acceptable. ARB Opinion No. 6 concurs that the test of relative size no longer is a factor in poolings.

The continuity of management standard formerly used in many cases was evidenced by representation on the boards of directors of the combined enterprises. With increasing disparities in the relative sizes of the pooling partners, representation on the board of directors is no longer practicable and we have agreed that if the direct operating management of the minor business remains in such capacity, the continuity of management standard for a pooling is satisfied.

A pooling also presumes continuity of the business carried on by the pooling partners. The discontinuance or sale of a large part of the business of one or more of the constituents militates against considering

a combination as a pooling of interest (paragraph 6 of Bulletin 48). In some instances, Company A has been pooled with only a portion, such as a specific division or divisions, of Company B, if such divisions have been in effect a more or less integrated and complete, separate business and accounting entity. Where the situation is such that separate accounting data cannot be developed for the portion being combined, a purchase would seem to be indicated. On the other hand, in most combinations, whether purchase or pooling, the obvious intent is to so shape the operations, particularly of the acquired company, as to further increase profitability. This definitely implies elimination of unprofitable elements of the acquired company in most instances.

The continuity of ownership by the former stockholders of Company B in a Company A - Company B merger is a key factor which we have deemed crucial in all poolings. The disposition by the former control group in B of more than 25% of the A shares received by the former B control group has been considered fatal to a pooling of interests by the SEC, absent very unusual circumstances. In a great many more instances, old group B shareholders have scaled down their disposition plans for the A shares received by them. Among the unusual circumstances where a greater than 25% disposition has occurred in poolings are advanced ages of inactive B control group members with attendent potential estate problems, and ownerships of shares through long established trusts with independent trustees having supervision over trust investment decisions. In other instances a major interest may have been bought out shortly prior to the proposed pooling.

We have also felt that in exchange offers where shares of Company B, as contrasted with assets of B, are to be acquired in a pooling transaction, it is incumbent that very near to 100% of B shares be acquired, as say 96% with an intent to acquire the rest. In most cases, this seems to be accomplished.

Part pooling - part purchase transactions usually arise in one of two ways. Company A may acquire by use of cash or debt a large ownership in Company B, and later make an offer in the form of common or convertible preferred shares for the remaining B shares. Occasionally some combination offer of cash or debt securities with common or convertible preferred shares may be made simultaneously by A for the shares or assets of B. In these types of transactions, goodwill and step-up in the value of assets is recognized for the purchased portion of the acquisition in most instances. There have been some instances of part-poolings, part-purchases where the subsequent merger has been downstream into Company B, in which goodwill has not been required to be recognized. The question arises as to how small can the pooling portion be in a simultaneous part-purchase, part-pooling transaction. Last year, we had one which comprised 40% pooling, and I have heard of reference to one which was 28%. I would think 28% or perhaps 25% should be the lowest permitted. Where a company presently owns a portion of another, the acquisition of the remaining interest may be considered to be a pooling regardless of size.

The general principle has been that any combination may properly be treated as a purchase, but that a pooling is permissive only and not mandatory. In some few instances, pooling has been required, principally where the disparity between the value of A stock issued for B stock or net assets is extreme or in order to present more appropriate financial statements.

In the comparative income statement presentation of part pooling-part purchase transactions, Company A's income statement should show supplementally, or otherwise, its equity in the purchased B shares from date of acquisition. In the pro forma combined A and B income statement, the pooled portion of B would be reflected back retroactively for all periods in the statement. For the latest fiscal year and the latest comparative interim periods, or for the latest twelve months, as appropriate, the pro forma income statement should reflect, in the lower portion, the adjustments necessitated by the purchase transaction, i.e., additional interest and depreciation charges resulting from debt incurred to finance purchase or from increases in carrying values of fixed assets, etc. These increased expenses should normally result in a reduction in income tax provisions, also shown as an adjustment.

Where such a part pooling - part purchase transaction is deemed by the Internal Revenue Service to be a purchase for Federal income tax purposes, the tax basis of not only the purchased but also the pooled portion of depreciable assets may be increased. Under such circumstances, we believe that there should be some recognition of the additional

depreciation through an upward revision of the book stated amount for the property by an amount equated to an appropriate deferred income tax provision.

INTANGIBLES & OTHER DEFERRALS & THEIR AMORTIZATION

Many companies acquire intangibles in connection with acquisitions of businesses and also defer start-up costs, research and development costs, store, finance office and bowling alley opening expenses and, in rare instances, special unusually large advertising programs with an expected longer life.

In our opinion the method and amortization rates of intangibles and deferred costs capitalized should be included in notes. Where there is a material amount of excess costs of subsidiaries over tangible assets at dates of acquisition it is desirable to explain the justification for nonamortization of such amount. Our Accounting Series Release No. 50 expresses a preference for timely charges to income.

Two areas in which we have required amortization of excess purchase prices paid for businesses acquired have been in the small loan finance and mortgage servicing fields. For some years, we have permitted an upper limit of six years for small loan acquisition premiums paid. In a few instances, where it has been clearly established that some of the premium represents a price paid for the inherent value in a State-granted license to operate an office, we have permitted an appropriate portion of the premium to be treated as a permanent license cost. This area

presumably needs further study in instances where a manufacturing or industrial company in a widespread diversification program acquires at a large premium a successful small loan or finance company along with, let us guess, other unrelated types of businesses.

During the last decade we have with very few exceptions required that goodwill or excess purchase price paid on purchase of mortgage servicing companies acquired by other such or related companies (as real estate) should be amortized over a period not exceeding eight or nine years, on the basis that the then currently held portfolio of mortgages being serviced had an approximate life of that period. In one recent case the amortization was limited to the Federal income tax benefits that were derived from the addition of the mortgage servicing company to the acquiring company.

Where the balance sheet reflects a material amount of "Research and Development Expense" or similar items we have requested an analysis of this account in the notes to the financials showing the following:

(a) Additions to, amortization and charge-offs for a minumum of three years,

(b) Policy of amortization followed by the registrant,

(c) A representation that such amounts relate to items being commercially produced or are deemed to be commercially feasible,

(d) Upon determination that any amounts capitalized cannot be recovered by future sales a representation as to immediate write-off to income, and

(e) The Federal income tax treatment accorded the deferred expenses.

The periods of time used in amortizing intangibles and deferred costs have been the subject of much discussion but not too clear results as to specific, consistent determinations. In the majority of instances, excess purchase costs attributable to acquired businesses are not amortized. If amortization is voluntary, we cannot be too critical about the period of time selected. These might range from five to twenty-five years, but mostly under ten or twelve years.

As to research and development expenses, we feel that five years is usually the top time limit, this coinciding with the maximum allowed if deferral and later amortization is chosen for both financial reporting and Federal income tax purposes. We believe also that the amortization should be on a unit of production or sale basis which could amortize the deferrals over considerably less than five years, with a minimum floor, as say 20%, in a five year time period, for each year.

For purchases of small loan finance paper, we have limited excess purchase price amortization to three years. Three years is also deemed applicable to costs of opening new bowling alleys and stores. In general, we deem deferred advertising and special promotional costs have a very short li and that these should be amortized over periods ranging from three to six months. Plant moving and relocation costs also occur frequently. Where these are deferred we have in a few instances accepted some deferrals with maximums up to six years, although three years is considered realistic in most cases.

In addition to determination of amortization periods, numerous questions arise as to the range of expense items to be included in the deferred costs, i.e., direct costs, overhead costs and perchance items of dubious relationships. In general, a policy of limiting deferrals to direct costs and related overhead on conservative and realistic bases should be followed. The deferred income taxes related to deferred expenses should not be netted against the latter, but rather included with other deferred income tax amounts on the balance sheet. In some instances the accountants! certificate is qualified with reppect to the recovery of unusually large amounts of deferred research and development costs based upon future successful exploitation thereof.

Often times these deferred costs arise in the cases of smaller and rapidly growing enterprises, which larger and better established companies would expense immediately. These matters can have significant effects upon reported net income and thereby affect investors significantly.

I am afraid some of us look upon many deferrals with a jaundiced eye, inasmuch as the practice of expense deferrals may be used not only by profitable companies but also by companies whose long term earnings prospects are poor. In some instances the practice may mask a deteriorating situation in a company previously reporting profits.

The example comes to mind of a manufacturing company in the electronics field which some years ago issued and sold a debenture issue with a balance sheet presenting a relatively large deferred product development account as to which we were furnished considerable information. Within 1½ years interest on the debentures had to be deferred and within

approximately three years the business had become bankrupt, been liquidated and completely disappeared. Incidentally, in a prior Regulation A offering similar deferred expenses of this registrant had been classed as inventories. A similar misclassification was recently discovered in unaudited financial periods included in a currently pending Form S-1 of another company.

INCOME TAX REPORTING

In income statements, various sub-classifications should be made, even though Rule 5-03.15 of Regulation S-X is relatively obsolete. Each of the following income taxes should be stated separately: Federal-currently payable, Federal-deferred, foreign, foreign-deferred if material, and tax loss carrybacks, also tax loss carry forwards utilized should be disclosed by line items or by a referenced note. In conjunction with the per share data, the benefits arising through use of operating loss carry forwards should be shown on a per share basis in a note to the summary of earnings. A desirable presentation when material loss carry forward utilizations are involved is to present net income after provision for full normal Federal taxes, followed by net income including the benefit of loss carry forward utilizations. When State income taxes are relatively immaterial, these may be included with foreign or with Federal-current. Income taxes related to special items or extraordinary credits should be disclosed parenthetically or in referenced notes.

Disclosure of the reasons for variations in rates of income taxes paid should be made. These will include among others the filing of sepa-

rate returns in a multi-corporate organization, the existance of untaxed foreign earnings or earnings in tax shelter areas as Puerto Rico. If upon completion of the offering, the corporation proposes to file subsequent tax returns upon a consolidated basis and thus lose valuable individual surtax benefits, this is required to be disclosed in an income statement note.

We have also encountered special situations which call for different accounting. When a company acquires through purchase another corporation which has an existing operating loss carry forward for income tax purposes and pays in excess of the value of tangible assets acquired, it is our opinion that any benefits derived from use of the operating loss carry forwards should be used to reduce the intangible created with an appropriate charge to net income.

Also when a company elects to have a quasi-reorganization to eliminate a deficit in retained earnings, in our opinion future tax benefits resulting from operating loss carry forwards existing at the date of the quasi should be credited to capital surplus with an appropriate charge to net income.

OPERATIONS OF UNCONSOLIDATED SUBSIDIARIES AND 50% OWNED AFFILIATES

We have long considered that recognition should be given in consolidated financial statements to the results of important unconsolidated operations in order properly to reflect reported net income. Revision in this regard by a well established company in 1965 resulted in a significant downward change in 1964 net income. In our opinion recognition should also be given to losses in 50% - owned corporations, unless it can

be clearly substantiated that there has been no diminution in value in the investment. In view of the corporate relationship involved, the equity in undistributed net income or loss of 50% - owned corporations should be reflected in the income statement as the last item preceding net income.

PETROLEUM ACCOUNTING

Insofar as the petroleum industry is concerned, the American Petroleum Institute published in 1965 a "Report of Certain Petroleum Industry Accounting Practices," which was directed primarily at areas where variations in accounting practices exist. I understand that API intends to continue this survey and, if possible, to extend it to other areas of accounting and to more companies. This continuing effort should further the desirable goal stated in the first survey "to narrow differences to the extent that practices which do not have authoritative support or cannot be justified by varying circumstances are dropped from current usage."

Within the past few years several oil and gas producing companies have changed to so called "full cost accounting," whereby all exploration and development costs, whether productive or non-productive, are capitalized and amortized in relation to the estimated life of the total oil and gas' reserves. We have given some consideration as to whether, under Rule 3-20(c) (2) of Regulation S-X the producing companies on such basis should not also disclose the depletion rates used for income reporting purposes. This information would be of value to investors.

In one instance recently, we insisted because of special circumstances, upon a producing company changing its method of computing depreciation on producing equipment from one generally accepted practice to another,

in order to present net income more appropriately.

In producing company income statements depletion, depreciation and amortization should be classed with other operating expenses, rather than be shown on a sort of cash flow concept as the last or next to last item preceding net income or loss.

LIFE INSURANCE AND HOLDING COMPANY ACCOUNTING

Filings of life insurance companies and life insurance holding companies have become very numerous in the last few years. The holding companies, a relatively recent development, usually are created with a minimum amount of capital paid in by the organizers. Stock is usually sold through a public offering and the funds raised are invested in one or more new 100% owned life insurance company or companies which typically operate at a loss in their early years. It is common practice for the holding company to maintain its investments in subsidiaries at cost, the justification being that although the life companies are incurring losses, they are building up insurance in force, plus a more effective selling and underwriting organization. It is our present thinking that life insurance subsidiaries should be carried at cost plus or minus changes in equity as adjusted to include those non-admitted assets which would be properly includible in a balance sheet and reflected in equity except for insurance regulatory requirements. If investments are carried at cost, disclosure is necessary in the holding company statements as to underlying equity in investments and equity in losses or profits by years.

When the holding company carries its life insurance subsidiaries at equity values, the statements are not generally deemed to be in accordance with generally accepted accounting principles since the underlying life

companies' statements follow accounting prescribed by the regulatory authorities. This situation has to be covered in the accountants' certificate covering the holding company statements. Exceptions to this will be discussed later in this paper.

Article 7A to Regulation S-X was adopted in October 1964 to set forth the specific accounting requirements for life insurance companies in filings with the SEC. In general, these are based on those in the Annual Statement filed with the State insurance commissions. Although there is some reclassification or combination of some of the items in the statutory financial statements, the total assets, total liabilities and stockholders' equity and net income or gain from operations are usually the same amounts in both the Annual Statement and in filings with the SEC. Our requirements exceed those of the Annual Statement in the areas of supplementary disclosure.

It should be noted that financial statements of insurance companies included in registration statements under the 1933 Securities Act must, by statutory requirement, be certified by an independent public or certified public accountant, whereas those filed under the Securities Exchange Act of 1934, (Forms 10, 10-K and 8-K) need not be so certified.

If the certifying accountant relies on the certification of an actuary, we require that the actuary must also be independent. In such case, the prospectus should include a copy of the actuary's report or certification, and Part II should include a consent of the actuary to use of such certification.

The expressions of opinions by CPAs relative to life companies varies among the various firms. Some express the opinion as:

> "... in conformity with generally accepted accounting principles except as affected by the accounting practices required for life insurance companies as explained in Note A ..." or "(as mentioned in the next preceding paragraph)";

or use the recommendations of the American Institute as set forth in the January 1964 Journal of Accountancy:

> "... in conformity with accounting practices prescribed or permitted by the Insurance Department of the State of (blank) ...".

Some accounting firms have concluded that, under certain conditions, with or without certain adjustments, life insurance statements may be deemed to be in accordance with generally accepted accounting principles and that an opinion may be expressed that they fairly present the financial position and results of operation and changes in surplus "... in accordance with generally accepted accounting principles ...".

Some life companies have adopted compensation plans for agents wherein compensation is made in the form of options to purchase shares of the company's (or controlling holding company's) stock at a reduced price in addition to cash commissions. In a typical plan, options are granted to agents as policies are issued with the number of options per $1,000 of insurance in force declining as total insurance in force increases. Exercise price is frequently $1 per share in the case of newly organized companies or a percentage (say 75-80%) of market at grant date. These options are generally not exercisable for specified periods of time, often three years, and exercise is frequently conditioned upon the related policy still being in force. We understand these are not "qualified"

or "restricted" stock options under the Internal Revenue Code, and the company is allowed a deduction for the difference between option price and fair market value of the stock at exercise date, as compensation paid.

Because of the significance of the additional compensation amounts involved, we have in a number of cases required recognition of the value of the options at the date of grant in the financial statements or in supplementary adjusting statements. Recognition of the value of the options should be made by a charge to profit and loss and a corresponding credit to capital surplus. Where the option must be held for a period of time before it becomes exercisable, it is appropriate to amortize the charge over that period. This procedure, while reducing income, results in no net change in aggregate stockholders' equity.

Since realized gains (losses) of life companies go direct to surplus, in the related summary of earnings the per share data should be shown as two elements:

1. Net income (loss) and,
2. Where significant realized gains (losses) on investments.

We have had some recent instances of holding companies merging downstream into their life subsidiaries after several years of operations.

REAL ESTATE COMPANIES

Our Accounting Series Release No. 95 was issued in December 1962 to set forth examples of accounting for real estate transactions where

circumstances indicated that profits were not earned at the time the transactions were recorded. We still run into cases where we feel that profits are recorded prematurely and prior to the time they were really earned. An example of this was a company which in 1964 recorded a profit of approximately $600,000 on an approximately $800,000 sale, in which sale $75,000 was received in cash and the balance in the form of an interest bearing note secured by a first deed of trust. One year later the company had foreclosed on the property and was again its owner, and proposed to reverse the previously recorded profit. The very unsatisfactory operating results of some real estate organizations in recent years indicate that more care and conservatism should have been used in recording real estate profits.

Form S-11 requires, in respect of new acquisitions, certified statements of operations (down to net income before depreciation, interest expense and Federal income taxes) of properties under the predecessor owners, yet we are beseiged with requests for waivers of this requirement. Often these circumstances result in delays which could be avoided if arrangements for certified statements were made at the time of acquisition.

In hotel and motel income statements, sales and cost of sales should be stated separately from operating revenues and expenses. Also, depreciation should be classed with the other operating expenses. In real estate construction activities conducted through joint ventures,we have

accepted the inclusion of pro rata portions of the joint ventures in income statement income and expense accounts such as sales and cost of sales.

Where mortgage servicing and title insurance operations are included, escrow and agency funds in which the company has no beneficial interest and the related contra obligations should not be included with corporate assets and liabilities, but rather shown with appropriately described captions immediately below "Total assets" and"Total liabilities and stockholders' equity", respectively.

INTERNATIONAL FINANCE COMPANIES

During the last year there have been numerous filings of what might be classed international finance companies, formed for the purpose of enabling their United States parents to raise funds outside the United States. Such international finance companies typically offer their debentures, guaranteed by the parent company as to principal, sinking fund and interest to foreign investors. In some instances the debentures have included conversion privileges. After the debentures are sold, many are registered for listing on American securities exchanges. Since the debentures basically represent unsecured debentures of the guarantor company, the Commission was requested to waive the requirement to file separate financial statements for the registrant and other data for the registrant alone. The applicants urged that financials of the guarantor corporation should suffice. After consideration of the matter, the Commission decided that financials for the registrant alone should also

be furnished which are applicable for annual report, Form 8-K, Form 9-K and other reporting purposes.

PREFERRED SHARES WITH UNUSUAL CHARACTERISTICS

Recently there appears to have been a trend for companies to issue shares entitled "Preferred" or Preference" having very slight prior dividend and/or liquidation privileges as compared to those usually connoted by such terms. Although described as convertible preferred shares, and legally having small or nominal dividend preferences and other privileges, these are in essence common shares. These are proposed for use as a vehicle that should appeal to owners of businesses which may be acquired by acquisition minded companies. Many of such owners are not interested in dividends, but rather desire to be able to sell out the shares received in such deals at capital gain tax rates and to have some market protection on the downside.

It is our opinion that such preferred or preference shares should be recognized for what they are in the computation of net income per common share, and should be treated as common shares in the per common share computations.