CURRENT ACCOUNTING ISSUES AND RELATED DEVELOPMENTS AFFECTING THE DIVISION OF CORPORATION FINANCE
(as of November 20, 1993)

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CURRENT ACCOUNTING ISSUES AND RELATED DEVELOPMENTS AFFECTING THE DIVISION OF CORPORATION FINANCE
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I. Rules Recently Proposed or Adopted by the Commission

A. Simplification of Registration and Reporting Requirements of Foreign Private Issuers

On November 3, 1993, the Commission proposed amendments to streamline the registration, reporting and reconciliation requirements for foreign companies. Among others, revisions have been proposed to Securities Act Forms F-1, F-2, F-3 and F-4, Exchange Act Form 20-F and Rule 139 under the Securities Act.

1. Reconciliation Requirements

As part of the proposals to streamline the requirements that foreign issuers reconcile their financial statements to U.S. GAAP, the Commission has proposed to accept without reconciliation a foreign issuer's cash flow statement prepared in accordance with International Accounting Standard No. 7, as amended.

In addition, the requirement that a foreign private issuer reconcile five years of financial information has been proposed to be reduced so that first-time foreign registrants need only reconcile the required financial statements and selected financial data for the two most recently completed fiscal years (of the five years) and any interim periods required in the registration statement. Forms F-1, F-2, F-3 and F-4 also are proposed to be revised to allow registration of investment grade securities where the simpler reconciliation pursuant to Item 17 of Form 20-F, rather than Item 18 reconciliation, is provided.

Another aspect of the proposal streamlines the requirement that foreign private issuers furnish audited financial statements of significant acquired businesses. Under the proposal, financial statements of an acquiree would not have to be reconciled unless the acquiree exceeds the 30% significance level based on the size of the registrant's investment in the business, the total assets of the business and the business' pre-tax income relative to amounts reported in the registrant's most recently audited financial statements as calculated on a U.S. GAAP basis. Similarly, financial statements of significant equity investees would not have to be reconciled unless the

investee exceeds the 30% significance level, using the investment and pre-tax income tests for significance.

Reconciliation also would be streamlined with respect to foreign private issuers that use pro rata consolidation for certain joint ventures that would be accounted for under the equity method pursuant to U.S. GAAP. Under the proposals, such an issuer would provide summarized financial information of the current assets/liabilities, noncurrent assets/liabilities, net sales, gross profit and net income relating to its pro rata interest in the joint venture. Separate financial statements of a joint venture accounted for using the pro rata method would not be required.

Finally, the proposals to streamline reconciliation would eliminate the following financial statement schedules that are currently required to be furnished by foreign private issuers:

a. Rule 12-02 - Marketable Securities - Other Investments
b. Rule 12-03 - Amounts Receivable from Related Parties and Underwriters, Promoters, and Employees Other Than Related Parties
c. Rule 12-05 - Indebtedness of and to Related Parties -Not Current
d. Rule 12-06 - Property, Plant and Equipment
e. Rule 12-07 - Accumulated Depreciation, Depletion and Amortization of Property, Plant and Equipment
f. Rule 12-08 - Guarantees of Securities of Other Issuers.

2. Registration Requirements

If adopted, the proposed amendments to Form F-3 would expand the class of foreign companies eligible to use short-form and shelf registration for their securities offerings, much as the amendments to Form S-3 described above have done for domestic issuers. The amendments would shorten the Form F-3 minimum reporting history requirement from 36 months to 12 months, and reduce the minimum public float requirement from $300 million to $75 million. (The minimum public float standard for Form F-2 would be similarly reduced from $300 million to $75 million.) The proposed amendments also would extend unallocated shelf registration to foreign issuers to the same extent permitted for domestic issuers. Thus, under the proposal, a Form F-3-eligible company could register debt, equity and other securities on a single shelf registration statement,

without having to specify in the registration statement the amount of each class of securities to be offered.

It is also proposed that non-convertible investment grade securities, whether or not they are debt securities, would be permitted to be registered on Form F-2 or F-3 without regard to the issuer's reporting history or the public float of the issuer's securities. The proposed revisions also would clarify that offerings of securities other than traditional debt securities may be registered on Form F-3 by majority-owned subsidiaries of Form F-3-eligible issuers if the securities are rated investment grade or the parent guarantees the payment obligations on the securities.

With respect to secondary offerings and certain rights offerings, dividend or interest reinvestment plans, conversions of convertible securities and exercises of warrants, the proposed revisions would allow short-form registration without regard to the public float of the issuer's voting securities. In addition, Form F-3 would be revised to allow immediate effectiveness upon filing for registration statements relating to dividend or interest reinvestment plans.

3. Safe Harbor for Broker-Dealer Research Reports

Rule 139 under the Securities Act provides safe harbor protection from the registration requirements of that Act with respect to the distribution by broker-dealers of information, opinions or recommendations concerning reporting companies in the process of registration. The conditions for relying on that safe harbor are simpler where issuers are eligible to use Form F-3 based on their public float or their offering of investment grade securities. Because of the reporting history required for Form F-3 eligibility, however, broker-dealers publishing research reports on certain sizeable foreign issuers have been foreclosed from the simpler conditions of the safe harbor and have been required to satisfy the more restrictive conditions to rely on the safe harbor.

The Commission therefore has proposed to revise the Rule 139 safe harbor to provide an alternative offshore trading history test for offerings by reporting companies that would be Form F-3-eligible but for the 12-month reporting history condition. Under the proposal, broker-dealers would be able to rely upon the simpler conditions of the safe harbor with respect to such issuers if such issuers have had securities listed

or quoted on a "designated offshore securities market," as defined in Rule 902(a) of Regulation S, for at least 12 months. As in the case of Form F-3 eligible issuers, the research reports covered by the revised safe harbor would be those distributed with reasonable regularity in the normal course of business.

B. Requirements Governing Age of Financial Statements of Foreign Private Issuers

On June 5, 1991, the Commission published for comment proposed amendments to Regulation S-X Rule 3-19, Securities Exchange Act Rule 15d-2 and Forms F-2 and F-3 which relate to the age of financial statements of foreign private issuers that register securities for sale under the Securities Act. Final amendments were adopted by the Commission on November 3, 1993. The amendments generally revise the requirements which govern the age of financial statements in registration statements to conform such requirements to the financial statement updating requirements of the home jurisdictions of a substantial majority of foreign issuers. Such conformity is intended to reduce the impediments to foreign issuers making securities offerings in the United States.

1. Amendments Regarding Age of Financial Statements and Updating Requirements

The amendments extend the Securities Act and Exchange registration statement updating requirement for annual audited financial statements of foreign private issuers by one month and extend the updating requirement for interim audited financial statements by four months. In addition, the maximum age of financial statements in a Securities Act filing was extended from six months to ten months. Thus, the amendment enables registration statements of foreign private issuers to go effective with audited financial statements as old as 18 months (as compared to 17 months under the rule previously applicable to foreign issuers), with the most recent interim statements as old as 10 months (as compared to 6 months under the previous rule).

Under this system, a foreign issuer can have uninterrupted access to the US public market by providing within four months following the end of its fiscal year either its unaudited financial statements for that year or unaudited interim financial statements as of the end of the third quarter of that year.

2. Amendment to Requirement to Reconcile Financial Information Otherwise Provided

Rule 3-19(f) requires interim financial information that is made available to shareholders, exchanges or others on a more frequent basis than that required by Rules 3-19(b) and (c) to be included in any registration statement filed with the Commission. Prior to the adoption of the recent amendments, the rule required this additional information to be reconciled to U.S. generally accepted accounting principles (GAAP). The amendments provide that such additional information need not be reconciled to U.S. GAAP if adequate narrative disclosures are provided. Specifically, if a registration statement includes reconciled financial statements as of a date which complies with Rules 3-19(b) and (c), more current financial information need not be reconciled to U.S. GAAP provided that any material variation in accounting which was not previously disclosed and quantified in the reconciliation for earlier periods is described and the quantified effects of the material variation are disclosed.

3. Other Amendments Relating to Financial Statement Updating

Other amendments: (1) Clarify language in Forms F-2 and F-3 to reflect staff practice of allowing incorporation of interim financial statements filed on Form 6-K (which is not deemed filed otherwise); and (2) amend Rule 15d-2 to permit foreign private issuers to file special year end financial statement reports (subsequent to the effectiveness of a registration statement that did not contain the audited financial statements for the most recent year end) by the later of 90 days following the effective date or six months following the registrant's fiscal year end. This amends the current rule to recognize that foreign issuers are allowed up to six months following the end of the fiscal year within which to file their annual report including audited year end financial statements.

C. Amendments to Multijurisdictional Disclosure System and Other Changes Affecting Canadian Issuers

1. Changes to Forms and Rules Affecting All Canadian Issuers

Rules and forms preventing certain Canadian issuers, but not other foreign issuers, from using the Commission's foreign integrated disclosure system for

registration and reporting have been removed in conjunction with the MJDS (Securities Act Release No. 702S; November 3, 1993). Form 20-F is now available for all Canadian foreign private issuers for annual reports and registration of securities under the Exchange Act. Rather than registering on Forms S-1, S-2, S-3 and S-4 designed for U.S. issuers, all Canadian foreign private issuers are able to register securities under the Securities Act on Forms F-1, F-2, F-3 and F-4 on the same basis as other foreign issuers. The exemption from the proxy regulations of Section 14 and the share ownership and short-swing profit recapture provisions of Section 16 is now available to all Canadian foreign private issuers.

2. Retention of Reconciliation Requirement in MJDS

On July 1, 1993, the Commission adopted amendments to the MJDS (Securities Act Release No. 7004) to provide for retention of the requirement that financial statements included in filings on Forms F-10 and 40-F include a reconciliation to U.S. GAAP. In connection with the adoption of the MJDS in 1991 the Commission had provided that the reconciliation requirement would cease for certain MJDS filings after July 1, 1993 unless the Commission acted to retain the requirement. A staff report regarding reconciliation of financial statements of foreign issuers indicated that there continue to be significant differences in accounting principles and practices between Canadian and U.S. GAAP. The Commission concluded that the differences between Canadian and U.S. GAAP materially affect reported financial position and results of operations and related trend information which warrant retention of the currently existing reconciliation requirements.

D. Small Business Initiatives

On July 30, 1992, and April 27, 1993, the Commission adopted new rules and forms under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Trust Indenture Act of 1939 to facilitate capital raising by small businesses. Specifically, the Commission revised Regulation A and Rule 504 of Regulation D to expand the categories of companies eligible to use those exemptions and increased the dollar ceiling for an offering under Regulation A. In addition, for "small business issuers" reporting under the Securities Act and the Exchange Act, the Commission adopted a system of simplified registration and reporting.

1. Integrated Disclosure System for Registration and Reporting for Small Business Issuers

The Commission adopted a new integrated disclosure system for Small Business Issuers. The system consists of specialized forms under the Securities Act and the Exchange Act that reference disclosure requirements located in one central depository - Regulation S-B. The new forms adopted by the Commission include forms SB-2, 10-SB, 10-QSB, and 10-KSB. Old Form S-18 has been rescinded. The new disclosure system for small business issuers is optional: an issuer that would qualify as a small business may elect to continue to use the present reporting system.

A small business issuer is defined as a U.S. or Canadian entity that meets all of the following tests:

* revenues of less than $25 million,
* the aggregate market value of the entity's voting stock held by non-affiliates (referred to as the "public float") is less than $25 million,
* if the small business issuer is a majority owned subsidiary of another company, its parent must also meet the definition of a small business issuer, and
* investment companies are excluded from the definition.

An estimated 3,000 reporting public companies fall within the definition of a small business issuer.

The information required by Regulation S-B is substantially the same as that required by old Form S-18. The financial statements required to be included in small business registration statements and annual reports are an audited balance sheet as of only the most recently completed year end (unless such year end occurred within the last 90 days) and statements of operations and cash flows for each of only the last two fiscal years. Interim financial statements must be provided if the fiscal year end financial statements are more than 135 days old. Both annual and interim financial statements must comply with generally accepted accounting principles, but are not required to comply with Regulation S-X. Financial statement schedules are not required to be included in filings on small business forms. The narrative disclosure requirements in Regulation S-B generally parallel those of Regulation S-K, but where such requirements were simplified or not omitted by Form S-18, Regulation S-B generally tracks the reduced requirements of Form S-18.

In connection with the development of Regulation S-B,
Item 17A (disclosures concerning mining operations) of old Form S-18 has been redesignated as Guide 7 under the Securities Act and Exchange Act. The Commission indicated in the adopting release that small business issuers engaged in operations involving real estate, mining, insurance, banking, utilities, and oil and gas should also refer to the applicable industry guide. In addition, roll-up transactions are required to furnish the disclosure required by subpart 900 of Regulation S-K.

Form SB-2 is the new designated Securities Act registration form for small business issuers. There is no dollar limit for offerings on Form SB-2 and the form may be used for both initial and repeat offerings.

For a company entering the Commission's disclosure system, either through a Securities Act or an Exchange Act registration statement, its eligibility to use the optional SB system will depend on the level of its revenues in its last full fiscal year, and its capitalization as of a date within 60 days prior to the offering in a Securities Act registration statement or the filing of the registration statement under the Exchange Act. The determination as to the reporting category at the time a non-reporting company enters the disclosure system (i.e. the use of Form S-1 or Form SB-2) governs all reports relating to the remainder of the fiscal year. After the initial registration statement on Form S-B, a company may continue to report under the SB system until it exceeds the revenue test for two consecutive years or the public float test for two consecutive years, based on its annual report on Form 10-KSB. A small business issuer that elects to file its initial registration using Form S-1 must report for the remainder of its fiscal year pursuant to Regulation S-K and Regulation S-X.

In order for a company currently reporting with the Commission to enter the SB disclosure system, it must meet the definition of a small business issuer for two consecutive years. The determination made for a reporting company at the end of its fiscal year (after filing its Form 10-K or 10-KSB) governs all reports relating to the next fiscal year. An issuer may not change from one category to another with respect to its reports under the Exchange Act for a single fiscal year.

Notwithstanding an issuer's classification as a small business, small business issuers are permitted to register securities on Forms S-2, S-3 and S-8 if they otherwise meet the eligibility requirements for use of those forms. References in those forms to the disclosure requirements of Regulation S-K will be deemed to be references to Regulation S-B for small business issuers. Form SB-2 is available only for the registration of securities to be sold for cash. Accordingly, small business issuers wishing to enter business combination transactions which involve the registration of securities will continue to be required to register those transactions on Form S-4 or Form S-1. If a small business issuer elects, or is required, to use Form S-1, the filing must contain all the disclosure requirements of Regulation S-K and the financial statements required by Regulation S-X.

2. Additional Initiatives Relating to SB Disclosure System

On April 27, 1993, the Commission adopted additional rules and forms to ease a small business issuer's transition from non-reporting to reporting status and to simplify the disclosure requirements for small business issuers that engage in exempt offerings.

Under the transitional filer rules, a small business issuer may enter the reporting system using Regulation A disclosure and only one year of audited financial statements either through an Exchange Act registration statement and two years of audited financial statements for a public offering of up to $10 million in any continuous 12 month period. These small business issuers would be permitted to meet their subsequent Exchange Act reporting requirements using the Regulation A model of disclosure until such time as they either (1) register more than $10 million in any continuous 12 month period, (2) elect to graduate to another disclosure system, or (3) are no longer small business issuers.

In order to implement this transitional system, amendments to Forms S-2, S-4, 10-SB, 10-KSB, and 10-QSB were adopted, in addition to amendments to Schedule 14A under the proxy rules. Further a new Securities Act registration statement, Form SB-1, was adopted to permit qualifying small business issuers to make small registered offerings up to $10 million annually using the Regulation A format with two years of audited financial statements.

Two refinements to the financial statement requirements for small business issuers were also adopted. The first provides an automatic waiver of the requirements for audited financial statements of specified significant acquired businesses if the required audited financial statements are not otherwise available. If an issuer has other financial statements or information which constitute less than the full audited financial statements required, such other financial statements or information will be required to be provided. If none of the conditions in the definitions of significant subsidiary exceeds 20%, and the required audited financial statements are not readily available, an automatic waiver of the required audited financial statements would be granted. In addition, if none of the conditions in the definitions of significant subsidiary exceeds 40% and the required audited financial statements are not readily available, an automatic waiver would be available for the fiscal year preceding the latest fiscal year. The second refinement widens the initial public offering (IPO) financing window for small business issuers by permitting them to proceed throughout the first quarter of their fiscal years without having to wait for completion of the audit for the preceding fiscal year, rather than update 45 days after fiscal year-end.

3. Changes to Regulation A

The new rule raises the dollar ceiling for a Regulation A offering from $1,500,000 to $5,000,000, including no more than $1,500,000 in non-issuer resales. The Regulation A exemption is now available to all U.S. and Canadian issuers not subject to Section 13 or 15(d) of the Exchange Act, except the following:

* "blank check" companies (issuers having no specific business or plan),
* investment companies required to be registered pursuant to the Investment Company Act of 1940,
* registrants issuing fractional undivided interests in oil or gas rights or similar interests in other mineral rights,
* registrants disqualified because of the "Bad Boy" disqualification provisions of Section 262 of Regulation A.

The Commission's safe harbor provisions for forward looking information have been revised to apply to statements made in a Regulation A offering statement. Therefore, good faith projections, with a reasonable basis, of revenues, income, earnings per share, capital expenditures, dividends, capital structure and other

financial items may be made in Regulation A filings under the same conditions as for other Commission filings.

As discussed in the March 1992 Proposing Release, one of the major impediments to a Regulation A financing for a small start-up or development company was the costs of preparing the mandated offering statement without knowing whether there would be any investor interest in the company. To remedy this situation, the Commission adopted the proposal to permit companies relying on the Regulation A exemption to "test the waters" for potential interest in the company prior to filing and delivery of the mandated offering statement. As adopted, the "testing of the waters" must begin with a written solicitation of interests. The solicitation document must also be submitted to the Commission at the time of its first use. Although the rules generally provide for a "free writing" of the solicitation document, the document must include the following items:

(a) a statement that no money is being solicited, or will be accepted; that no sales can be made until delivery and qualification of the offering circular, and that indications of interest involve no obligation or commitment of any kind; and

(b) a brief, general identification of the company's business, products and chief executive officer.

Once the offering statement required by Regulation A is filed with the Commission, the issuer may not continue to use its written "test the waters" solicitation materials.

4. Changes to Rule 504 of Regulation D

As amended in April 1993, Rule 504 permits a public offering of up to $1 million in a 12-month period by a non-Exchange Act reporting company subject only to the anti-fraud and other civil liability provisions of the federal securities laws. The amendment eliminated the conditions regarding state registration previously imposed by the Rule. In addition, Rule 504, as amended, permits general solicitation and general advertisement in connection with all offers and sales under the exemption. Rule 504 is not available to "blank check" companies.

E. Executive Compensation Disclosure

On October 15, 1992, the Commission adopted (Securities Act Release No. 6962) amendments to the executive compensation disclosure requirements of Item 402 of

Regulation S-K. The amendments are designed to make compensation disclosure clearer and more concise, and of greater utility to shareholders. In furtherance of this goal, the new rules require strict adherence to the specified tabular formats for disclosure.

On August 9, 1993, the Commission issued a release (Securities Act Release No. 7009) reporting on the first year's experience with the new disclosure rules. In the release, the Commission identified common issuer mistakes in complying with the new rules and discussed several questions of general application. The Commission also proposed for comment several refining and technical amendments to the executive compensation rules. The proposals were adopted in substantially the form proposed on November 22, 1993.

The new rules require disclosure of all compensation to the named executive officers and directors of the registrant for services rendered to the registrant in all capacities. The named executive officers consist of the chief executive officer ("CEO") and the other four most highly compensated officers (collectively, the "named executive officers"). The amended rules broaden the persons covered by the rule to require compensation disclosure about named executive officers who left the company during the last fiscal year. Except for the CEO, disclosure is limited to those executives with salary and bonus of over $100,000 (an increase from the former $60,000 threshold) for the last completed fiscal year.

The Summary Compensation Table is the linchpin of the Commission's revised executive compensation disclosure scheme. It is intended to provide shareholders with a comprehensive overview of the registrant's executive pay practices, identify trends in the registrant's compensation of its top managers and allow shareholders to compare such trends with those disclosed by other registrants. The Summary Compensation Table covers compensation of the named executive officers in each of the registrant's last three fiscal years, although two of the columns ("Other Annual Compensation" and the catch-all "All Other Compensation") may be phased in by companies over the first three years of reporting. In addition, small business issuers may phase in the entire table over 3 years. The Summary Compensation Table is required to be presented in the tabular format specified in Item 402 of Regulation S-K. Specifically the table contains three specific columns relating to annual compensation (Salary, Bonus, and Other), three specific columns relating to long-term compensation

(Restricted Stock Awards, SARS & Options, and Long Term Incentive Payouts), and a final column reporting any compensation not reported under the any other column.

In addition to the information provided in the Summary Compensation Table, the new rules require several additional tables containing more specific data on the components of compensation disclosed in the Summary Compensation Table. The five additional tables require the registrant provide detailed information concerning:

* Grants of options and SARs to each of the named executives during the last fiscal year.
* Exercises by the named executives of options and SARs during the last fiscal year and the value of each of the named executives' outstanding options and SARs at year end.
* Awards under long-term incentive plans during the last fiscal year. Included in this table is compensation that is based on the registrant's performance for a period of more than one year.
* Compensation and disclosures related to pension and other defined benefit or actuarial plans.
* Disclosures relating to the repricing of options or SARs during the last fiscal year.

Further, in order to allow shareholders to compare compensation trends with those disclosed by other registrants, the new rules require a Performance Graph requiring registrants to provide a line graph comparing the registrant's cumulative total shareholder return (stock price appreciation plus dividends, on a reinvested basis) with a overall stock market return performance indicator (such as the S&P 500 stock index) and either a published industry index or registrant-determined peer comparison. Registrants not included in the S&P 500 may choose another broad equity market index for comparison. Registrants have broad discretion in determining their peer comparison. If they do not believe a peer comparison is feasible, they may disclose this belief and compare their shareholder return to one or more companies selected on the basis of similar market capitalization.

In addition, the new rules require a Board Compensation Committee Report on executive compensation which discloses, among other items, the registrant's compensation policies, including the specific relationship of corporate performance to executive compensation (Item 402(k)).

The information required by the option/SAR repricing table, the Board Compensation Committee Report, and the performance graph need not be provided in any filings other than the registrant's proxy or information statement relating to an annual meeting of security holders at which directors are to be elected (or special meeting or written consents in lieu of such meeting). Such information will not be deemed incorporated by reference into any filing under the Securities Act or Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

Small business issuers eligible to use the small business integrated disclosure system will be required to provide only the summary compensation table, the option and SAR grant and exercise tables (omitting option valuation information), the long-term incentive plan awards table, and disclosure concerning option or SAR repricing (omitting the 10-year repricing history), named executive officer employment contracts and termination/severance arrangements, and director compensation (see Item 402 to Regulation S-B, as amended). Small businesses not electing to use the small business integrated disclosure system may nonetheless provide this more streamlined disclosure pursuant to Item 402(a)(1)(i) of Regulation S-K. In addition, small business issuers are eligible to file under the rules in effect prior to the effective date until May 1, 1993.

F. EDGAR (Electronic Data Gathering, Analysis and Retrieval)

On February 23, 1993, the Commission issued four releases adopting the rules that had been proposed in July 1992 requiring most documents processed by the Divisions of Corporation Finance and Investment Management to be filed electronically by direct transmission, diskette, or magnetic tape. The releases also contain phase-in schedules to bring registrants (as well as parties making filings with respect to these registrants) onto the EDGAR system. That phase-in began on April 26, 1993. The new rules became effective April 26, except the provisions relating to Financial Data Schedules were delayed -- originally until November 1, 1993, but due to technical difficulties the staff will not expect filers to furnish the schedule until the second quarter of 1994. The rules were published in the Federal Register on March 18, 1993. The EDGAR Filer Manual was published in the Federal Register on April 9, 1993.

The first release (Securities Act Release No. 6977) explains the EDGAR system generally and sets forth rules and procedures that apply to electronic submissions by the Division of Corporation Finance and in some cases, to those processed by the Division of Investment Management. The second release (Investment Company Act Release No. 19284) adopts rules specific to electronic submissions made by investment companies. The third release (Public Utility Holding Company Act Release No. 25746) adopts rules specific to electronic submissions made by public utility holding companies and their subsidiaries. The fourth release (Securities Act Release No. 6980) relates to the payment of filings fees, by both paper and electronic filers, to the Commission's lockbox depository at Mellon Bank in Pittsburgh, Pennsylvania pursuant to Rule 3a of the Rules Relating to Informal and Other Procedures.

The EDGAR pilot has been operational since September 24, 1984. Through the closing of the EDGAR Pilot on July 14, 1992, the Commission received over 116,000 electronic filings from over 1800 filers. The new EDGAR system began receiving live filings by the former EDGAR participants ("Transitional Filers") on July 15, 1992. On April 26, 1993, the temporary rules were superseded by the new rules adopted in February 1993. The new rules, including the most recent version of the EDGAR Filer Manual, will govern the preparation and transmission of electronic submissions. Section 35A(c)(5) of the Exchange Act requires that mandated filings from a "significant test group" of registrants be received and reviewed by the Commission for at least six months before the final adoption of any rule requiring electronic filing by registrants. Accordingly, the rules adopted in February 1993 are referred to as "interim rules."

The "significant test group" was phased in between April and December 1993, in four groups. The first group began phase-in on April 26, 1993. Group CF-01 consists of approximately 230 companies - mostly Transitional Filers, with a few additional volunteers. The second group, Group CF-02, consisting of approximately 700 registrants whose filings are processed by the Division of Corporation Finance, began mandated electronic filing on July 19, 1993. The third group (Group CF-03) and fourth group (Group CF-04) of the significant test group consist of approximately 700 and 900 registrants, respectively, whose filings are processed by the Division.

After the significant test group has successfully filed for at least six months, the Commission will adopt final EDGAR rules modified to reflect the experience gained during that period. Registrants will then be phased in, in groups of approximately 500, every three months (except for the first calendar quarter of every year), with any new registrants or others not named in the phase-in schedule included in the last group phased in. This residual category does not include foreign private issuers or foreign governments, which will not be required to file on EDGAR at this time, although they will be considered if they wish to volunteer.

II. Recently Issued Staff Accounting Bulletins

A. Accounting and Disclosures Regarding Discontinued Operations

On November 4, 1993, the staff issued Staff Accounting Bulletin No. 93 ("SAB 93") which expresses certain views of the staff regarding accounting and disclosures relating to discontinued operations and related matters. The issues addressed by SAB 92 are summarized below:

** A plan to dispose of a segment does not satisfy the conditions of APB 30 for presentation of the segment as discontinued if management has not determined the particular method of disposition.

** A segment should not be reported as a discontinued operation unless discontinuation of all the components of that segment is likely to be complete within a year of the measurement date. However, an orderly liquidation of a segment over a period that exceeds one year may be reported as a discontinued operation provided that the registrant ceases accepting new business (other than that which it is obligated by contract or regulation to accept) within twelve months of the measurement date, and that the results of operations through final termination of the business can be estimated with reasonably accuracy.

** The results of operations of a segment of a business that has been sold should not be reported within discontinued operations if the registrant retains significant influence (as defined by APB 18) over its operations through minority ownership.

** Subsequent writedowns of securities received as consideration upon the sale of a disposed segment should be classified within continuing operations.

** Subsidiaries intended for disposal that do not satisfy the criteria for presentation as discontinued operations should continue to be consolidated unless matters outside the control of the registrant are

indicative that control does not rest presently with the registrant or is likely to be lost as a result of events outside the registrant's control.

** A registrant with a continuing reporting duty under the Exchange Act should not account for the spin-off of a subsidiary by restating its financial statements to present the spun-off entity as if it had never been a subsidiary (ie., a change in reporting entity).

** MD&A should include disclosure of known trends, events and uncertainties involving discontinued operations that may materially affect the registrant's liquidity, financial condition, and results of operations (including net income) between the measurement date for accounting purposes and the date when the material risks of those operations will be transferred or otherwise terminated. Contingent liabilities, such as product or environmental liabilities, that may remain with the registrant notwithstanding disposal of the underlying business should be disclosed in the financial statements pursuant to SFAS 5 and discussed in MD&A pursuant to Item 303 of Regulation S-K.

B. Environmental and Product Liability Loss Contingencies

On June 8, 1993, the staff issued Staff Accounting Bulletin No. 92 ("SAB 92") which expresses certain views of the staff regarding accounting and disclosures relating to loss contingencies. This SAB pertains to all loss contingencies, but provides additional guidance for environmental and product liabilities.

The SAB states that offsetting a claim for recovery that is probable of realization against a probable contingent liability in the balance sheet ordinarily is not appropriate. This view is consistent with the consensus reached by the Emerging Issues Task Force (EITF) on Issue No. 93-5 that indicated that an environmental liability should be evaluated separately from any potential claim for recovery. Any loss arising form the recognition of an environmental liability should be reduced by a potential claim only when that claim is probable of realization. Since the risks and uncertainties associated with the liability are different from those associated with any potential recovery from third parties, the staff believes that the liability and the probable recovery should be presented separately on the face of the balance sheet. The staff will not object to net presentation until the adoption of FIN 39 (to be applied to fiscal years beginning after December 15, 1993) provided that the notes to the financial statements disclose the gross

amount of each component of the net liability. The staff believes there is a rebuttable presumption that no asset should be recognized for a claim for recovery from a party that is asserting that it is not liable to indemnify the registrant. Registrants that overcome that presumption should disclose the amount of recorded recoveries that are being contested and discuss the reasons for concluding that the amounts are probable of recovery.

The EITF also reached a consensus to Issue 93-5 stating that discounting of environmental liabilities is appropriate only when the aggregate obligation and the amount and timing of the payments are fixed or reliably determinable. That consensus sets forth criteria for discounting and disclosure requirements where discounting is appropriate. The staff believes an estimate that represents the minimum in a range of equally likely outcomes, pursuant to FIN 14, does not qualify for discounting. The EITF could not reach a consensus on the appropriate discount rate. The staff believes that the rate applicable is that rate where the liability could be settled in an arm's length transaction. If that rate is not readily determinable, the SAB states that the rate should not exceed the interest rate on risk free monetary assets having maturities comparable to that of the liability.

Registrants should avoid boiler plate disclosures regarding the possible impact of significant uncertainties. For example, a statement that the contingency is not expected to have a material effect on financial condition could be incomplete or confusing if the possible loss would be material to an investor based on another reasonable measure, such as one relating to liquidity or operating results. Further, this representation implies that management has determined the range of possible loss. If it is reasonably possible that the outcome of uncertainties may result in a liability exceeding the accrued liability by an amount which would be material, paragraph 10 of SFAS 5 requires disclosure of that range of reasonably possible loss or a clear statement that a range cannot be estimated.

Registrants are reminded that, notwithstanding significant uncertainties affecting the measurement of contingencies, management may not delay loss accrual until only a single amount can be reasonably estimated. If management is able to determine that the amount of the liability is likely to fall within a range and no amount within the range can be determined to be the

better estimate, the registrant should record the minimum amount of the range pursuant to FIN 14.

Measurement of a liability for environmental clean-up should be based on currently enacted laws and regulations and on existing technology. A registrant should consider all available evidence including its own and other companies' prior experience in cleaning up contaminated sites and data released by EPA. The staff believes information necessary to support a reasonable estimate or range of loss may be available prior to the performance of any detailed remediation study. Estimates of costs associated with alternative remediation strategies may provide a reasonable basis to recognize a minimum probable loss.

Information necessary to an understanding of material uncertainties affecting both the measurement of the liability and the realization of recoveries should be furnished. This may include the following: the extent to which unasserted claims are reflected in any accrual or may affect the magnitude of the contingency; the extent to which joint and several liability with other parties may affect the magnitude of the contingency, including disclosure of the aggregate expected cost to remediate sites where the likelihood of contribution by other significant parties has not been established; the nature and terms of cost-sharing arrangements with other PRPs; the extent to which disclosed but unrecorded contingent losses are subject to recovery through insurance, indemnification arrangements, or other third parties, with disclosure of the limitations of that recovery; the extent to which insurance coverages are subject to dispute; and the effects on the company's liquidity and capital resources of expected expenditures in light of the expected timing of reimbursement by third parties.

Registrants may succeed to a material contingent liability as a result of a business combination. If the registrant is awaiting additional information necessary for the measurement of a contingency of the acquired company during the allocation period specified by SFAS 38, the registrant should disclose that the purchase price allocation is preliminary. In this circumstance, the registrant should describe the nature of the contingency and furnish other available information which will enable a reader to understand the magnitude of any potential accrual and the range of reasonably possible loss. Discussion of the contingency is likely to be warranted in MD&A.

The SAB advises registrants operating in a rate regulated environment that the recordation of a liability for a loss contingency does not automatically give rise to a regulatory asset. Registrants are directed to the criteria for asset recognition in paragraph 9 of SFAS 71. The SAB indicates that recognition of a contingent loss should not be delayed until the registrant is advised by the regulator as to whether such costs are allowable for rate making purposes.

III. Other Accounting and Disclosure Issues of Current Interest

A. Selection of Discount Rates under SFAS 87 and 106

General interest rates have been declining in recent months, indicating a likelihood that many companies will reduce the discount rate from that used in their last annual financial statements. Registrants are reminded that discount rates selected to measure obligations for pension benefits and post retirement benefits other than pensions are expected to reflect the current level of interest rates at the measurement date. The guidance in paragraph 186 of SFAS 106, which is applicable to discount rates selected under both SFAS 106 and 87, states that "[t]he objective of selecting assumed discount rates is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the benefit obligation when due." That paragraph further states that, to the extent that a company must consider expected reinvestment rates available in the future to estimate a discount rate applicable to expected cash flows, "[t]hose rates should be extrapolated from the existing yield curve at the measurement date." Companies must reevaluate the discount rate at each measurement date (at least annually). "If the general level of interest rates rises or declines, the assumed discount rate should change in a similar manner." FASB's guidance refers to high-quality, fixed-rate debt instruments. The staff believes a "high-quality" security is generally considered to be one receiving a rating no lower than the second highest rating given by a recognized rating agency (for example, "AA").

B. Disclosures Regarding the Realization of a Deferred Tax Asset Recognized Pursuant to SFAS 109

SFAS 109 ("Accounting for Income Taxes") requires recognition of future tax benefits attributable to tax net loss carryforwards and deductible temporary

differences between financial statement and income tax bases of assets and liabilities. Deferred tax assets must be reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the benefits will not be realized. Notes to financial statements must disclose the amount of the valuation allowance and changes therein. If a registrant has recognized a net deferred tax asset that is material to stockholders equity, it may be necessary to discuss uncertainties surrounding realization of the asset and material assumptions underlying management's determination that the net asset will be realized. If the asset's realization is dependent on material improvements over present levels of consolidated pre-tax income, material changes in the present relationship between income reported for financial and tax purposes, or material asset sales or other nonroutine transactions, a description of these assumed future events, quantified to the extent practicable, should be furnished in the MD&A. For example, the minimum annualized rate by which taxable income must increase during the tax NOL carryforward period should be disclosed if realization of the benefit is dependent on taxable income higher than currently reported. Also, if significant objective negative evidence indicates uncertainty regarding realization of the deferred asset, the countervailing positive evidence relied upon by management in its decision not to establish a full allowance against the asset should be identified.

Material changes in the allowance for realization of a deferred tax asset from one period to the next also should be fully explained in MD&A, highlighting changes in assumptions and environmental factors that necessitated the change.

C. Restructuring Charges

In recent years, a number of registrants have recognized charges to income that are characterized as "restructuring charges." Registrants that recognize these and other infrequent or unusual charges to income should ensure that filings include sufficient explanation of the nature and amounts of material components of the charge, and the likely effects of the restructuring plan on future reported results and liquidity.

Amounts of asset write-downs and other noncash provisions should be distinguished from provisions made in anticipation of probable cash expenditures. The

periods in which material cash outlays are anticipated and their source of funding should be identified. Provisions and write-downs that would have been recognized even if management did not adopt a formal restructuring plan should be disclosed and discussed separately from those charges arising solely as a result of that discretionary decision.

Likely effects of the restructuring (reduced depreciation, reduced employee expense, etc.) should be quantified, and the initial period in which those effects are expected to be realized should be identified. If the cost savings are expected to be offset by anticipated increases in other expenses or reduced revenues, this should be discussed.

In periods after a restructuring has been recognized, material changes in the accrued balance (either as a result of expenditures or changes in estimates) should be discussed in MD&A. If actual savings anticipated by the restructuring are not achieved as expected, MD&A should discuss this outcome, its reasons, and its likely effects on future results.

The staff may be expected to challenge the appropriateness under GAAP of restructuring charges that include provisions for suboptimal performance, allocated overhead, or other indirect costs. Provisions that are incurred and recognized solely as a result of management's adoption of a restructuring plan should include only the specific incremental and direct costs and activities clearly identifiable with the plan that can be estimated with reasonable accuracy.

SFAS 5 does not permit provisions for general contingencies or losses that are not probable, or for liabilities or asset impairments that have not been incurred as of the latest balance sheet date. Accordingly, many costs that can be anticipated by management as a result of its business plans are not recognizable in the current period but must be recognized in the period in which they are incurred. MD&A should include discussion of the likely effects of management's plans on future operating results to the extent material.

D. Disclosure of Accounting Policy Regarding Assessment of Recoverability of Goodwill

In periods subsequent to the recognition of goodwill or other intangible assets, companies are required by paragraph 31 of APB 17 to evaluate continually whether

later events and circumstances warrant revised estimates of useful lives or recognition of a significant charge-off of carrying amounts. The standard does not specify a particular quantitative methodology for measuring the existence or extent of an impairment. In the near future, the FASB is expected to expose for public comment a proposed standard addressing the recognition and measurement of impairment of long-lived assets and intangibles, including goodwill. In the absence of guidance of this issue, a number of different methodologies have been employed by public companies to measure an impairment of goodwill. Until a final standard is adopted, the staff expects that different accounting practices will continue to be followed. In this environment, the staff believes public companies should consider the applicability of paragraph 12 of APB 22, which calls for disclosure of accounting methods that a company selects from existing acceptable alternatives, to the company's method of assessing and measuring impairment of goodwill and similar intangibles. This disclosure would be expected, in particular, of companies that report unamortized goodwill that is significant relative to equity or that recognize goodwill amortization that is very material relative to pre-tax income. The disclosure of the accounting policy should address the manner in which recoverability is assessed and how impairment would be measured. Conclusions regarding the impairment of goodwill and uncertainties affecting its recoverability should be consistent with disclosures in management's discussion and analysis of operations and financial position.

E. Disclosures about New Accounting Standards

1. Before Adoption by the Registrant

Staff Accounting Bulletin 74 (Topic 11:M) discusses disclosures that a registrant should provide in its financial statements and/or in management's discussion and analysis regarding the impact that recently issued accounting standards will have on its financial statements when the standard is adopted in a future period. Disclosures that should be considered include a brief description of the standard and its anticipated adoption date, the method by which the standard will be adopted, the impact that the standard will have on the financial statements to the extent reasonably estimable, and any other effects that are reasonably likely to occur (eg., changes in business practices, changes in availability or cost of capital, violations of debt covenants, etc.). In this regard, registrants

should consider the effects of not only standards recently issued by the FASB, but also Statements of Position and Practice Bulletins issued by the AICPA and consensus positions of the EITF.

2. Adoption of New Standard in Interim Period

Rule 10-01(a)(5) of Regulation S-X permits registrants to omit from interim reports on Form 10-Q footnote disclosures that would be repetitive of information included in the annual financial statements, except that disclosures about material contingencies must always be furnished. The rule also indicates that if events occur subsequent to the fiscal year-end, such as a change in accounting principles and practices, informative disclosure shall be made. Registrants should describe the accounting change and its impact pursuant to APB 28, as amended by SFAS 3. In addition, the staff believes the interim financial statements should include, to the extent applicable, all disclosures identified by the adopted standard as required to be included in annual financial statements. If the change in accounting principle is made in a period other than the first quarter of the year, no amendment of prior filings is required; however, a restatement of each of the prior quarter's results should be included in the filing for the quarter in which the new accounting principle is adopted pursuant to SFAS 3. If the new accounting principle is applied retroactively to prior years, the prior comparable interim quarters should be presented on a restated basis also.

F. Management's Discussion and Analysis - Recent Enforcement Action

The Commission announced that on March 31, 1992, administrative proceedings under the Exchange Act were instituted against Caterpillar Inc. ("Caterpillar") for violations of Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 promulgated thereunder. Simultaneously with the institution of these proceedings, the Commission accepted Caterpillar's Offer of Settlement in which it consented to the entry of a Cease and Desist Order. (Rel. No. 34-30532).

The Commission determined that Caterpillar failed to adequately disclose the importance of its Brazilian subsidiary's 1989 earnings to Caterpillar's overall results of operations in the MD&A portion of Caterpillar's 10-K for the year ended December 31, 1989. The Commission also determined that Caterpillar

failed to adequately disclose known trends and uncertainties regarding its Brazilian operations in its 1989 10-K and in its Report on Form 10-Q for the quarter ended March 31, 1990.

The Commission's Order requires Caterpillar to cease and desist from violating Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder, and implement and maintain procedures designed to ensure compliance with the MD&A requirements.

The Commission previously issued an interpretive release (Rel. No. 33-6835; May 18, 1989) on MD&A (Item 303 of Regulation S-K). The release sets forth the Commission's views regarding several disclosure matters that should be considered by registrants in preparing MD&As. The release emphasized the distinction between prospective information that is required to be disclosed, and voluntary forward-looking disclosure. The release states that if there is a known trend, demand, commitment, event or uncertainty, management must make two assessments to determine what prospective information is required.

First management must determine whether the known trend, demand, commitment, event or uncertainty is likely to come to fruition. If management determines that it is not reasonably likely to occur, no disclosure is required.

Second, if management cannot make the determination that the event is not likely to occur, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur. Each final determination resulting from the assessments made by management must be objectively reasonable, viewed as of the time the determination is made. The release clarifies that the safe harbor rules apply not only to voluntary forward-looking statements, but also to prospective information that is required to be disclosed.

The release also provides interpretive guidance regarding the following matters: long and short-term liquidity and capital resources analysis; material changes in financial statement line items; required interim period disclosure; MD&A analysis on a segment basis; participation in high yield financing, highly

leveraged transactions or non-investment grade loans and investments; the effects of federal financial assistance upon the operations of financial institutions; and preliminary merger negotiations.

G. Disclosures about Foreign Operations and Foreign Currency Transactions

An increasing number of registrants conduct material operations outside their home country and enter into material transactions denominated in currencies other than the currency in which their financial statements are reported. These registrants should review management's discussion and analysis and the notes to financial statements to ensure that disclosures are sufficient to inform investors of the nature and extent of the currency risks to which the registrant is exposed and to explain the effects of changes in exchange rates on its financial statements. SFAS 14 requires quantitative disclosures regarding export revenues and foreign operations. MD&A should include discussion of the historical and reasonably likely future effects of changes in currency exchange rates on revenues, costs, and business practices and plans. Identification of the currencies of the environments in which material business operations are conducted is recommended. Discussion of foreign operations in a disaggregated manner may be necessary, particularly with respect to businesses operating in a highly inflationary environment or if operating cash flows of a foreign operation are not available for legal or economic reasons to meet the registrant's other short term cash requirements. Registrants also should quantify the extent to which trends in amounts reported in their financial statements are attributable to changes in the value of the reporting currency relative to the functional currency of the underlying operations, and any materially different trends in operations or liquidity that would be apparent if reported in the functional currency should be analyzed. Finally, registrants should identify material unhedged monetary assets, liabilities or commitments denominated in currencies other than the operation's functional currency, and strategies for management of currency risk should be described.

H. "Other Than Temporary" Declines in Value of Debt and Equity Marketable Securities

During 1991 and 1992, the Commission instituted proceedings and issued cease and desist orders against four financial institutions for violations of Sections

13(a), 13(b)(2)(A) and (B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder in connection with financial statements and disclosures concerning investment securities which had experienced other than temporary declines in market value. (See Fleet/Norstar Financial Group, Release No. 34-29557; Excel Bancorp, Inc., Release No. 34-29675; Abington Bankcorp, Inc., Release No. 34-30614; Presidential Life Corporation, Release No. 34-31934). In each of these situations, the registrant reported an investment securities portfolio at a carrying value that substantially exceeded the market value of the securities. In each case, the registrant accounted for certain market declines as temporary.

Generally accepted accounting principles provide that temporary declines in the value of non-current investment securities generally may be recognized through adjustments to a valuation allowance account within stockholders' equity. However, Statement of Financial Accounting Standard No. 12, Accounting for Certain Marketable Securities (SFAS 12), requires that a determination be made as to whether a decline in market value below cost as of the balance sheet date of an individual security is "other than temporary". If the decline is judged to be other than temporary, the cost basis of the individual security must be written down to a new cost basis and the amount of the write down must be accounted for as a realized loss. The new cost basis is not changed for subsequent recoveries in market value.

In each of these cases the registrant held a portfolio of equity and/or debt securities which had substantial and continuing unrealized losses. Staff Accounting Bulletin No. 59 (SAB 59) sets forth the staff's views concerning the evaluation of some of the factors which, individually or in combination, indicate that a decline in market value below an investor's carrying value is other than temporary and that a write down of the carrying value is required. These factors are: (a) the length of time and the extent to which the market value has been less than cost; (b) the financial condition and near term prospects of the issuer, including any specific events which may influence the operations of the issuer such as changes in its technology that may impair earnings potential of the investment or the discontinuance of a segment of the business that may affect the future earnings potential; and (c) the intent and ability of the holder to retain its investment in the issuer for a period sufficient to allow for any anticipated recovery in market value.

Pursuant to SAB 59, "unless evidence exists to support a realizable value equal to or greater than the carrying value of the investment, a write down accounted for as a realized loss should be recorded." The Commission stated in the Fleet/Norstar order that "Recoveries that cannot be reasonably expected to occur within an appropriate period should not be considered in the assessment of realizable value."

In each of these cases the Commission concluded that the registrant had failed to timely recognize losses on other than temporary declines in investments.

IV. Frequent Inquiries Regarding Application of Regulation S-X and Other Disclosure Practices

A. Financial Statements of Businesses Acquired (Rule 3-05)

1. Definition of a business. Identified by evaluating whether there is sufficient continuity of operations so that disclosure of prior financial information is material to an understanding of future operations. (See Rule 11-01(d) of Regulation S-X.) There is a presumption that a separate entity, subsidiary, or division is a business; a lesser component may be a business, too. Consideration should be given to --

* whether the nature of the revenue producing activity will remain generally the same;
* whether the facilities, employee base, distribution system, sales force, customer base, operating rights, production techniques, or trade names remain after the acquisition.

2. Tests of Significance. Rule 1-02.v. describes three tests of significance that must be applied to determine the level at which an acquisition is significant for purposes of determining the number of years for which financial statements of the acquiree are required. Significance of the acquiree is determined by comparing the most recent pre-acquisition annual statements of the acquired business to the registrant's pre-acquisition consolidated statements as of the end of the most recently completed fiscal year for which audited financial statements are filed with the Commission.

For a combination accounted for as a purchase, compare registrant's investment in (or consideration paid for)

acquiree and advances to (including loans and receivables) to registrant's consolidated assets;

a. Contingent consideration should be considered as part of the total investment in the acquiree unless its payment is deemed remote.

b. For a pooling or reorganization, compare the number of shares exchanged to registrant's outstanding shares immediately before combination;

c. Compare registrant's share of acquired entity's total assets to the registrant's consolidated assets;

d. Compare registrant's equity in the acquired entity's income from continuing operations before taxes to that of registrant.

* If registrant's income for the most recent fiscal year is 10% or more lower than average of last five fiscal years, average income of the registrant may be used for this computation. Loss years should be assigned value of zero in computing numerator for this average, but denominator should be "5". This rule is not applicable if the registrant reported a loss, rather than income, in the latest fiscal year. The acquiree's income may not be averaged pursuant to this rule.

e. Other guidance:

** If the aggregate of all "insignificant" businesses exceed 20% in any condition above, financial statements for the majority (combined if appropriate) should be furnished for most recent fiscal year and the latest interim period preceding the acquisition.

** If the acquisition was consummated shortly after the most recent fiscal year and the registrant files its Form 10-K for that year before the due date of the Form 8-K (including the 60 day extension), significance may be evaluated relative to that fiscal year.

** If the registrant has previously made a significant acquisition and it was fully reported on Form 8-K, significance test may be applied to that pro forma data rather than historical pre-acquisition data. The acquired business for which the test is made is not considered part of the registrant's base in determining significance.

** If a registrant increases its investment in a business relative to the prior year, the tests of significance should be based on the increase in

the registrant's proportionate interest in assets and net income during the year, rather than the cumulative interest to date.

** Significance should be evaluated on basis of U.S. GAAP, rather than the foreign GAAP of the acquirer or acquiree.

** Ordinary receivables not acquired should nevertheless be included in tests of significance on the theory that working capital will be required after the acquisition.

** Registrant's assets may not be increased by pro forma effect of anticipated public offering proceeds for purposes of significance tests.

f. Registrants may request staff interpretation in unusual situations or obtain relief where strict application of the rules and guidelines results in a requirement that is unreasonable under the circumstances.

3. Division or Lesser Component Acquired. The staff may accept audited statements of assets and liabilities acquired and revenues and expenses directly related to the business where the registrant can demonstrate that it is impracticable to prepare the full financial statements required by Regulation S-X, and the registrant includes this explanation in the filing. Unallocated items (corporate overhead, interest, taxes) may be excluded from these statements, but the amounts expected after the acquisition should be reflected in the pro forma statements.

4. Special Rule Applicable to an IPO. SAB 80 (Topic 1:J) is an interpretation of Rule 3-05 for application in the case of initial public offerings involving businesses that have been built by the aggregation of discrete businesses that remain substantially intact after acquisition. The guidance is intended to ensure that the registration statement include not less than three, two and one year(s) of audited financial statements of not less than 60%, 80% and 90%, respectively, of the constituent businesses that will comprise the registrant on an ongoing basis.

B. Financial Statements of Subsidiaries that Guarantee Securities Issued by Parent Company

It is increasingly common for an offering of parent debt or preferred equity securities to be guaranteed by one or more of its subsidiaries. Typically, the guarantee is full and unconditional; and thus covers 100% of the parent's debt servicing obligations on the

primary (guaranteed) security. Further, the guarantee generally is enforceable by the holder of the guaranteed security directly against the guarantor-subsidiary's assets without first taking action against the parent-obligor.

Under the Securities Act, each guarantee (as well as the guaranteed security) must be covered by an effective registration statement. Rule 3-10(a) of Regulation S-X requires financial statements of guarantors of registered securities to be included in the registration statement. The non-financial statement disclosures in registration statements are set forth in Regulation S-K. Moreover, the guarantor subsidiary, like its parent, will be required to file periodic reports pursuant to section 15(d) of the Exchange Act at least for the fiscal year during which the Securities Act registration statement became effective.

Generally, separate disclosure and reporting by a guarantor subsidiary is required. In certain circumstances, however, the staff will accept a registrant's proposal to include other disclosures in lieu of full separate audited financial statements of the guarantor subsidiary, and take no-action with respect to a guarantor that does not file separate Exchange Act reports. Issuers seeking such relief ordinarily should address their requests to the Office of the Chief Counsel of the Division of Corporation Finance prior to filing a registration statement.

Topic 1.G. of the Staff Accounting Bulletins (SAB 53) provides relief from the general requirement of full separate disclosure and reporting by subsidiary-issuers where investors rely upon the parent's guarantee for the repayment of principal and interest on the subsidiary-issuer's guaranteed securities. However, Topic 1.H. states as a general rule that separate financial statements for a subsidiary-guarantor and a parent-issuer would be material to investors. The staff, however, in certain circumstances where subsidiary-guarantors are present, has provided relief based upon the materiality of the full financial information provided to investors. In all cases, it is the issuer's responsibility to include full and complete disclosure of (1) the legal aspects of the guarantee arrangement that would be material for a investor to evaluate the sufficiency of the guarantee, (2) financial information in sufficient detail to allow investors to determine the nature of the assets held by, and the operations and cash flows of, each of the

issuers, including the investors' priority position in the event of a default by the issuers, and (3) any significant restrictions on the parent's ability to obtain funds from its subsidiaries by dividend or loan.

Notwithstanding the general rule of Topic 1.H., the staff has stated, in Anheuser-Busch, that the three levels of disclosure set forth in Topic 1.G. will be applied to those situations in which the subsidiary is a guarantor of its parent's debt or preferred equity securities. If the registered security is guaranteed by all direct and indirect subsidiaries of the parent company and the parent has no operations or assets separate from its investment in its subsidiaries, the staff generally would not require the registration statement to include any audited financial information of the guarantor subsidiaries provided that the registrant indicates the basis for their omission. If the registered security is guaranteed by all direct and indirect consolidated subsidiaries of the parent but the parent does have other assets or operations, the staff generally will accept, in lieu of separate financial statements of the guarantor subsidiaries, either summarized parent-only financial information or summarized combined financial information of the guarantor subsidiaries provided in an audited note to the parent's financial statements. The alternative disclosures described in this paragraph have also been accepted where the nonguarantor subsidiaries are inconsequential (i.e., when the assets, pre-tax income and parent's net investment in the nonguarantor subsidiaries on an individual and combined basis is less than 3%).

The staff has addressed all other circumstances based upon the materiality of the information in the light of the particular terms and conditions of the guarantees. In circumstances in which the security is guaranteed on a full, unconditional, and joint and several basis by one or more of the issuer's wholly owned subsidiaries, the financial information required in the note to the parent's financial statements ordinarily should be consolidating condensed financial statements which depict, in separate columns, the parent company, the guarantor subsidiaries (on a combined basis), and the nonguarantor subsidiaries (on a combined basis), with an additional column reflecting eliminating adjustments. Additional columns may be necessary if the enforceability of the guarantees may be affected differently under the laws of the foreign or domestic jurisdictions in which they can be enforced.

Registrants should follow the general guidance in Rule 10-01 of Regulation S-X concerning the form and content of condensed financial statements. However, the condensed consolidating financial information should be in sufficient detail to allow investors to determine the nature of the assets held by, and the operations and cash flows of, each of the consolidating groups and include a discussion of any significant restrictions on the parent's and the guarantors' ability to obtain funds from their subsidiaries by dividend or loan. Additional financial and narrative information about individual guarantors should be disclosed if the information would be material for an investor to evaluate the sufficiency of the guarantee.

If one or more of the guarantor subsidiaries is not wholly owned or if one or more of the guarantees is not full, unconditional, and joint and several, the staff will expect the issuer to furnish full audited financial statements of the guarantor subsidiaries pursuant to Rule 3-10.

C. Financial Statements Relating to Third Party Credit Enhancements

Third party credit enhancements differ slightly from guarantees. A guarantee running directly to the security holder is a security within Section 2(1) of the Securities Act. A guarantor is a co-issuer under the Securities Act and provides required business and financial information and signs the registration statement. A third party credit enhancement is an agreement between a third party and the issuer or a trustee. A party providing credit enhancement generally is not a co-issuer. However, if an investor's return is materially dependent upon the third party credit enhancement, the staff requires additional disclosure. The disclosure must provide sufficient information about the third party to permit an investor to determine the ability of the third party to fund the credit enhancement. In most cases, the third party's audited financial statements presented in accordance with generally accepted accounting principles would be required. However, if such financial statements are not available, alternative presentations may be acceptable. For example, statutory financial statements of insurance companies serving as credit enhancers may be accepted.

The staff considers the following factors in assessing the sufficiency of the disclosure in this area: (i) amount of the credit enhancement in relation to the

issuer's income; (ii) duration of the credit enhancement; (iii) conditions precedent to the application of the credit enhancement; and (iv) other factors that indicate a material relationship between the credit enhancer and the purchaser's anticipated return.

D. Financial Statements of Real Estate Operations Collateralizing Significant Loans

Separate financial statements of real estate operations collateralizing significant loans are required pursuant to SAB 71:

* Acquisition, development and construction (ADC) loans: If over 10% of offering proceeds (or total assets, if greater) have been or will be invested in an single acquisition, development, and construction loan, financial statements of the property securing the loan should be provided in '33 Act filings. Also, where no single loan exceeds 10%, but the aggregate of such loans exceed 20%, a narrative description of the properties and arrangements is required. In '34 Act reports, the requirement for full financial statements is triggered at the 20% level, but summarized information is required at the 10% level.
* Other loans: If over 20% of offering proceeds (or total assets, if greater) have been or will be invested in a single loan (or in several loans on related properties to the same or affiliated borrowers), financial statements of the property securing the loan are required in '33 and '34 Act filings.

E. Surviving Company in a Reverse Acquisition

APB No. 16, paragraph 70 states in part "...that presumptive evidence of the acquiring corporation in a combination effected by an exchange of stock is obtained by identifying the former common stockholder interests of a combining company which either retain or receive the larger portion of the voting rights in the combined corporation. That corporation should be treated as the acquirer unless other evidence clearly indicates that another corporation is the acquirer..." SAB Topic 2A affirms the above principle and discusses some of the factors which may rebut the normal presumption.

In December 1989, the Emerging Issues Committee of the Canadian Institute of Chartered Accountants reached a consensus concerning Reverse Takeover Accounting which is compatible with the guidance included in Topic 2A. The EIC consensus indicates that the post reverse-

acquisition comparative historical financial statements should be those of the "legal" acquiree, with appropriate footnote disclosure concerning the change in the capital structure.

The merger of a private operating company into a non-operating public shell corporation is considered by the staff to be essentially a capital transaction, rather than a business combination. That is, it is equivalent to the issuance of stock by the private company for the net monetary assets of the shell corporation, accompanied by a recapitalization. The accounting is identical to that resulting from a reverse acquisition, except that no goodwill or other intangible should be recorded.

F. Redeemable Equity Securities

The staff considers the guidance in SX 5-02, FRC 211, SAB 3C, and SAB 6B(1) to be applicable to <u>all</u> equity securities (not only preferred stock) the cash redemption of which is outside the control of the issuer. For example, the guidance is applicable to common stock and common stock options and warrants that are subject to a put, and to stock subject to rescission rights.

Redeemable equity securities should be presented separately from "stockholders' equity" if they are redeemable at the option of the holder, or at a fixed date at a fixed price, or redemption is otherwise beyond the control of registrant. The presentation is required even if the likelihood of the redemption event is considered remote. Disclosures include title of security, carrying amount, and redemption amount on face of balance sheet; in notes, disclose general terms, redemption requirements in each of the succeeding five years, number of shares authorized, issued and outstanding.

Redeemable securities are initially recorded at their fair value. In subsequent periods, the security should be accreted to the redemption amount using the interest method (unless the likelihood of redemption is remote or the earliest date which redemption may legally occur is indeterminable). The amount of periodic accretion reduces income applicable to common shareholders in the calculation of EPS. [SAB 3C] If accretion is material, separate disclosure of income applicable to common shareholders on the face of the income statement is required. [SAB 6B(1)] If the redemption amount is currently redeemable and variable (eg., based on market

value of common stock), the security should be adjusted to its full redemption value at each balance sheet date. The staff believes that _any_ extinguishment of redeemable securities for consideration that exceeds the carrying amount of the securities at that time should be treated as a reduction of income applicable to common shareholders.

G. Distributions to Promoters/Owners at or prior to Closing of IPO [SAB Topic 1.B.3]

If a planned distribution to owners (whether declared or not, whether to be paid from proceeds or not) is not reflected in the latest balance sheet but would be significant relative to reported equity, a pro forma balance reflecting the distribution (but not giving effect to the offering proceeds) should be presented along side the historical balance sheet in the filing.

If a distribution to owners (whether already reflected in the balance sheet or not, whether declared or not) is to be paid out of proceeds of the offering rather than from the current year's earnings, historical per share data should be deleted and pro forma per share data should be presented (for the latest year and interim period only) giving effect to the number of shares whose proceeds would be necessary to pay the dividend. For purposes of this SAB, a dividend declared in the latest year would be deemed to be in contemplation of the offering with the intention of repayment out of offering proceeds to the extent that the dividend exceeded earnings during the previous twelve months.

H. Other Changes in Capitalization at or prior to Closing of IPO

Generally, the historical balance sheet or statement of operations should not be revised to reflect conversions or term modifications of outstanding securities that become effective after the latest balance sheet date presented in the filing, although pro forma data presented along side of the historical statements (as discussed below) may be necessary. However, if the registrant and its independent accountants elect to present a modification or conversion as if it had occurred at the date of the latest balance sheet (with no adjustment to earlier periods), the staff ordinarily will not object unless the original instrument legally accrues interest or dividends or accretes toward redemption value after that balance sheet date, or if the terms of the conversion do not confirm the

historical carrying value at the latest balance sheet as current value.

If the terms of outstanding equity securities will change subsequent to the date of the latest balance sheet and the new terms result in a material reduction of permanent equity, or if redemption of a material amount of equity securities will occur in conjunction with the offering, the filing should include a pro forma balance sheet (excluding effects of offering proceeds) presented along side of the historical balance sheet giving effect to the change in capitalization.

If a conversion of outstanding securities will occur subsequent to the latest balance sheet date and the conversion will result in a material reduction of earnings applicable to common shareholders (excluding effects of offering), the staff will not object to the deletion (or inclusion solely in the notes to financial statements) of historical earnings per share if such information is not meaningful. Pro forma EPS for the latest year and interim period should be presented giving effect to the conversion (but not the offering).

I. Calculation of EPS in an Initial Public Offering [SAB Topic 4D]

In the Initial Offering Document: <u>All</u> stock, options and warrants issued within one year prior to filing of the registration of an entity's initial public offering of its equity securities are deemed outstanding for all periods presented (in the manner of a stock split), except that the registrant may assume that the difference between the IPO offering price and the amount received for the stock or the exercise price of the options is applied to repurchase outstanding shares in the manner of the "treasury stock method" outlined in APB 15. (However, the "modified treasury stock method" described in APB 15 should not be applied, regardless of the proportion of equity represented by cheap stock, options, and warrants.) In periods prior to the offering, these securities should be deemed outstanding even if anti-dilutive (ie., when the registrant reports a loss).

In filings subsequent to the IPO: Stock, options and warrants deemed outstanding in the IPO pursuant to the SAB should continue to be deemed outstanding in all periods prior to the year in which the IPO is declared effective. In calculations of EPS for the fiscal year in which the IPO became effective, shares, options and

warrants issued within one year prior to the IPO effective date should continue to be deemed outstanding as prescribed by the SAB throughout the interim period includes in the IPO prospectus. The determination of common stock and equivalents outstanding in remainder of the fiscal year (and in all subsequent reporting periods) should be determined on a basis consistent with APB 15. That is, outstanding options and warrants should be included in the EPS computation only if they have a dilutive effect; the application of the treasury stock method should not assume the IPO price to be the market price.

For example: Assume an option granted on January 1, with the IPO containing March 31 interims; an exercise price of $1; a IPO price of $2; and a weighted average market price at year-end of $3. Using the treasury stock method, the option represents one-half outstanding share in the first quarter and two-thirds share in the last three quarters; or five-eighths share for the full year.

J. Accounting for Shares Placed in Escrow in connection with an Initial Public Offering

In order to facilitate an initial public offering by some companies, underwriters have requested certain promoter/shareholder groups (or all shareholders of a closely held company) to place their shares in escrow, with subsequent release of the shares contingent upon the registrant's attainment of certain performance-based goals. Although these shares are legally outstanding and are reported as such on the face of the balance sheet, the staff considers the escrowed shares to be "contingent shares" for purposes of calculating earnings per share under APB 15. In addition, the staff views the placement of shares in escrow as a recapitalization by promoters similar to a reverse stock split. The agreement to release the shares upon the achievement of certain criteria is presumed by the staff to be a separate compensatory arrangement between the registrant and the promoters. Accordingly, the fair value of the shares at the time they are released from escrow should be recognized as a charge to income in that period. However, no compensation expense need be recognized with respect to shares released to a person that has had no relationship to the registrant other than as a shareholder (for example, is not an officer, director, employee, consultant or contractor), and that is not expected to have any other relationship to the company in the future.