

- Defaults on debt and material restrictions on dividends or other legal constraints on the registrant's use of its assets;
- Material changes in the relative amounts of constituent elements comprising line items presented on the face of the financial statements;
- Significant terms of financings which would reveal material cash requirements or constraints;
- Material subsequent events, such as events that affect the recoverability of recorded assets;
- Material related party transactions (as addressed by Statement 57) that may affect the terms under which material revenues or expenses are recorded; and
- Significant accounting policies and measurement assumptions not disclosed in the financial statements, including methods of costing inventory, recognizing revenues, and recording and amortizing assets, which may bear upon an understanding of operating trends or financial condition.

2. "Free Distributions" by Japanese Companies

Facts: It is the general practice in Japan for corporations to issue "free distributions" of common stock to existing shareholders in conjunction with offerings of common stock so that such offerings may be made at less than market. These free distributions usually are from 5 to 10 percent of outstanding stock and are accounted for in accordance with provisions of the Commercial Code of Japan by a transfer of the par value of the stock distributed from paid-in capital to the common stock account. Similar distributions are sometimes made at times other than when offering new stock and are also designated "free distributions." U.S. accounting practice would require that the fair value of such shares, if issued by U.S. companies, be transferred from retained earnings to the appropriate capital accounts.

Question: Should the financial statements of Japanese corporations included in Commission filings which are stated to be prepared in accordance with U.S. GAAP be adjusted to account for stock distributions of less than 25 percent of outstanding stock by transferring the fair value of such stock from retained earnings to appropriate capital accounts?

Interpretive Response: If registrants and their independent accountants believe that the institutional and economic environment in Japan with respect to the registrant is sufficiently different that U.S. accounting principles for stock dividends should not apply to free distributions, the staff will not

object to such distributions being accounted for at par value in accordance with Japanese practice. If such financial statements are identified as being prepared in accordance with U.S. GAAP, then there should be footnote disclosure of the method being used which indicates that U.S. companies issuing shares in comparable amounts would be required to account for them as stock dividends, and including in such disclosure the fair value of any such shares issued during the year and the cumulative amount (either in an aggregate figure or a listing of the amounts by year) of the fair value of shares issued over time.

E. Requirements for Audited or Certified Financial Statements

1. Deleted by SAB 103

2. Qualified Auditors' Opinions

Facts: The accountants' report is qualified as to scope of audit, or the accounting principles used.

Question: Does the staff consider the requirements for audited or certified financial statements met when the auditors' opinion is so qualified?

Interpretive Response: No. The staff does not accept as consistent with the requirements of Rule 2-02(b) of Regulation S-X financial statements on which the auditors' opinions are qualified because of a limitation on the scope of the audit, since in these situations the auditor was unable to perform all the procedures required by professional standards to support the expression of an opinion. This position was discussed in ASR 90 in connection with representations concerning the verification of prior years' inventories in first audits.

Financial statements for which the auditors' opinions contain qualifications relating to the acceptability of accounting principles used or the completeness of disclosures made are also unacceptable. (See ASR 4, and with respect to a "going concern" qualification, ASR 115.)

F. Financial Statement Requirements in Filings Involving the Formation of a One-Bank Holding Company

Facts: Holding Company A is organized for the purpose of issuing common stock to acquire all of the common stock of Bank A. Under the plan of reorganization, each share of common stock of Bank A will be exchanged for one share of common stock of the holding company. The shares of the holding company to be issued in the transaction will be registered on Form S-4. The holding company will not engage in any

operations prior to consummation of the reorganization, and its only significant asset after the transaction will be its investment in the bank. The bank has been furnishing its shareholders with an annual report that includes financial statements that comply with GAAP.

Item 14 of Schedule 14A of the proxy rules provides that financial statements generally are not necessary in proxy material relating only to changes in legal organization (such as reorganizations involving the issuer and one or more of its totally held subsidiaries).

Question 1: Must the financial statements and the information required by Securities Act Industry Guide ("Guide 3")¹ for Bank A be included in the initial registration statement on Form S-4?

Interpretive Response: No, provided that certain conditions are met. The staff will not take exception to the omission of financial statements and Guide 3 information in the initial registration statement on Form S-4 if all of the following conditions are met:

- There are no anticipated changes in the shareholders' relative equity ownership interest in the underlying bank assets, except for redemption of no more than a nominal number of shares of unaffiliated persons who dissent;

- In the aggregate, only nominal borrowings are to be incurred for such purposes as organizing the holding company, to pay nonaffiliated persons who dissent, or to meet minimum capital requirements;

- There are no new classes of stock authorized other than those corresponding to the stock of Bank A immediately prior to the reorganization;

- There are no plans or arrangements to issue any additional shares to acquire any business other than Bank A; and

- There has been no material adverse change in the financial condition of the bank since the latest fiscal year-end included in the annual report to shareholders.

If at the time of filing the S-4, a letter is furnished to the staff stating that all of these conditions are met, it will not be necessary to request the Division of Corporation Finance to waive the financial statement or Guide 3 requirements of Form S-4.

Although the financial statements may be omitted, the filing should include a section captioned, "Financial Statements," which states either that an annual report containing financial statements for at least the latest fiscal year prepared in conformity with GAAP was previously furnished to shareholders or is being delivered with

¹ Item 801 of Regulation S-K.