

the prospectus. If financial statements have been previously furnished, it should be indicated that an additional copy of such report for the latest fiscal year will be furnished promptly upon request without charge to shareholders. The name and address of the person to whom the request should be made should be provided. One copy of such annual report should be furnished supplementally with the initial filing for purposes of staff review.

If any nominal amounts are to be borrowed in connection with the formation of the holding company, a statement of capitalization should be included in the filing which shows Bank A on an historical basis, the pro forma adjustments, and the holding company on a pro forma basis. A note should also explain the pro forma effect, in total and per share, which the borrowings would have had on net income for the latest fiscal year if the transaction had occurred at the beginning of the period.

**Question 2:** Are the financial statements of Bank A required to be audited for purposes of the initial Form S-4 or the subsequent Form 10-K report?

**Interpretive Response:** The staff will not insist that the financial statements in the annual report to shareholders used to satisfy the requirement of the initial Form S-4 be audited.

The consolidated financial statements of the holding company to be included in the registrant's initial report on Form 10-K should comply with the applicable financial statement requirements in Regulation S-X at the time such annual report is filed. However, the regulations also provide that the staff may allow one or more of the required statements to be unaudited where it is consistent with the protection of investors.<sup>2</sup> Accordingly, the policy of the Division of Corporation Finance is as follows:

- The registrant should file audited balance sheets as of the two most recent fiscal years and audited statements of income and cash flows for each of the three latest fiscal years, with appropriate footnotes and schedules as required by Regulation S-X unless the financial statements have not previously been audited for the periods required to be filed. In such cases, the Division will not object if the financial statements in the first annual report on Form 10-K (or the special report filed pursuant to Rule 15d-2)<sup>3</sup> are audited only for the two

latest fiscal years.<sup>4</sup> This policy only applies to filings on Form 10-K, and not to any Securities Act filings made after the initial S-4 filing.

The above procedure may be followed without making a specific request of the Division of Corporation Finance for a waiver of the financial statement requirements of Form 10-K.

The information required by Guide 3 should also be provided in the Form 10-K for at least the periods for which audited financial statements are furnished. If some of the statistical information for the two most recent fiscal years for which audited financial statements are included (other than information on nonperforming loans and the summary of loan loss experience) is unavailable and cannot be obtained without unwarranted or undue burden or expense, such data may be omitted provided a brief explanation in support of such representation is included in the report on Form 10-K. In all cases, however, information with respect to nonperforming loans and loan loss experience, or reasonably comparable data, must be furnished for at least the two latest fiscal years in the initial 10-K. Thereafter, for subsequent years in reports on Form 10-K, all of the Guide 3 information is required; Guide 3 information which had been omitted in the initial 10-K in accordance with the above procedure can be excluded in any subsequent 10-Ks.

*G. Deleted by FRR 55*

*H. Deleted by FRR 55*

#### *I. Financial Statements of Properties Securing Mortgage Loans*

**Facts:** A registrant files a Securities Act registration statement covering a maximum of \$100 million of securities. Proceeds of the offering will be used to make mortgage loans on operating residential or commercial property. Proceeds of the offering will be placed in escrow until \$1 million of securities are sold at which point escrow may be broken, making the proceeds immediately available for lending, while the selling of securities would continue.

**Question 1:** Under what circumstances are the financial statements of a property on which the registrant makes or expects to make a loan required to be included in a filing?

**Interpretive Response:** Rule 3-14 of Regulation S-X specifies the

situation, Rule 15d-2 would require the registrant to file a special report within 90 days after the effective date of the Form S-4 furnishing audited financial statements for the most recent fiscal year.

<sup>4</sup> Unaudited statements of income and cash flows should be furnished for the earliest period.

requirements for financial statements when the registrant has acquired one or more properties which in the aggregate are significant, or since the date of the latest balance sheet required has acquired or proposes to acquire one or more properties which in the aggregate are significant.

Included in the category of properties acquired or to be acquired under Rule 3-14 are operating properties underlying certain mortgage loans, which in economic substance represent an investment in real estate or a joint venture rather than a loan. Certain characteristics of a lending arrangement indicate that the "lender" has the same risks and potential rewards as an owner or joint venturer. Those characteristics are set forth in Exhibit I to the Appendix of the American Institute of Certified Public Accountants' Practice Bulletin 1<sup>1</sup> "ADC<sup>2</sup> Arrangements" ("Exhibit I to PB1"). In September 1986 the EITF<sup>3</sup> reached a consensus on this issue<sup>4</sup> to the effect that, although Exhibit I to PB1 was issued to address the real estate ADC arrangements of financial institutions, preparers and auditors should consider the guidance contained in Exhibit I to PB1 in accounting for shared appreciation mortgages, loans on operating real estate and real estate ADC arrangements entered into by enterprises other than financial institutions.

Statement 133 as amended by Statements 137 and 138, generally requires that embedded instruments meeting the definition of a derivative and not clearly and closely related to the host contract be accounted for separately from the host instrument. If the embedded the expected residual profit component of an ADC arrangement need not be separately accounted for as a derivative under Statement 133, then the disclosure requirements discussed below for ADC loans and similar arrangements should be followed.<sup>5</sup>

<sup>1</sup> "ADC Arrangements" was originally issued as a notice to practitioners (February 1986, as published in the April 1986 issue of the Journal of Accountancy). The notice to practitioners was reprinted without change as Exhibit I to the Appendix of the American Institute of Certified Public Accountants' Practice Bulletin 1 (November 1987).

<sup>2</sup> Acquisition, development and construction.

<sup>3</sup> The Emerging Issues Task Force ("EITF") was formed in 1984 to assist the Financial Accounting Standards Board in the early identification and resolution of emerging accounting issues. Topics to be discussed by the EITF are publicly announced prior to its meetings and minutes of all EITF meetings are available to the public.

<sup>4</sup> See Issue 86-21.

<sup>5</sup> The equity kicker (the expected residual profit) would typically not be separated from the host contract and accounted for as a derivative because

<sup>2</sup> Rule 3-13 of Regulation S-X.

<sup>3</sup> Rule 15d-2 would be applicable if the annual report furnished with the Form S-4 was not for the registrant's most recent fiscal year. In such a