

Year 1 (most recent fiscal year)—Entity E is the only acquiree for which pre-acquisition financial statements may be omitted for the latest year since significance for each other entity exceeds 10% under one or more test.

Year 2 (preceding fiscal year)—Financial statements for E and F may be omitted since their combined significance is 20% and no other

combination can be formed with E which would not exceed 20%.

Year 3 (second preceding fiscal year)—Financial statements for D, E and F may be omitted since the combined significance of these entities is 33%⁵ and no other combination can be formed with E and F which would not exceed 40%.

The financial statement requirements must be satisfied by filing separate pre-acquisition audited financial statements for each entity that was not included in the consolidated financial statements for the periods set forth above. The following table illustrates the requirements for this example.

Component entity	Date of acquisition	Minimum financial statement requirement (months)	Period in consolidated financial statements (months)	Separate pre-acquisition audited financial statement (months)
Registrant	N/A	33	36	
A	1/1/x7	33	24	9
B	4/1/x7	33	21	⁶ 12
C	9/1/x7	33	16	17
D	2/1/x8	21	11	10
E	11/1/x8		2	
F	To be acquired	9		9

⁶ The audited pre-acquisition period need not correspond to the acquiree's pre-acquisition fiscal year. However, audited periods must not be for periods in excess of 12 months.

K. Financial Statements of Acquired Troubled Financial Institutions

Facts: Federally insured depository institutions are subject to regulatory oversight by various federal agencies including the Federal Reserve, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation and Office of Thrift Supervision. During the 1980s, certain of these institutions experienced significant financial difficulties resulting in their inability to meet necessary capital and other regulatory requirements. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 was adopted to address various issues affecting this industry.

Many troubled institutions have merged into stronger institutions or reduced the scale of their operations through the sale of branches and other assets pursuant to recommendation or directives of the regulatory agencies. In other situations, institutions that were taken over by or operated under the management of a federal regulator have been reorganized, sold or transferred by that federal agency to financial and nonfinancial companies.

A number of registrants have acquired, or are contemplating acquisition of, these troubled financial institutions. Complete audited financial statements of the institutions for the periods necessary to comply fully with Rule 3-05 of Regulation S-X may not be

reasonably available in some cases. Some troubled institutions have never obtained an audit while others have been operated under receivership by regulators for a significant period without audit. Auditors' reports on the financial statements of some of these acquirees may not satisfy the requirements of Rule 2-02 of Regulation S-X because they contain qualifications due to audit scope limitations or disclaim an opinion.

A registrant that acquires a troubled financial institution for which complete audited financial statements are not reasonably available may be precluded from raising capital through a public offering of securities for up to three years following the acquisition because of the inability to comply with Rule 3-05.

Question 1: Are there circumstances under which the staff would conclude that financial statements of an acquired troubled financial institution are not required by Rule 3-05?

Interpretive Response: Yes. In some case, financial statements will not be required because there is not sufficient continuity of the acquired entity's operations prior to and after the acquisition, so that disclosure of prior financial information is material to an understanding of future operations, as discussed in Rule 11-01 of Regulation S-X. For example, such a circumstance may exist in the case of an acquisition solely of the physical facilities of a

banking branch with assumption of the related deposits if neither income-producing assets (other than treasury bills and similar low-risk investment) nor the management responsible for its historical investment and lending activities transfer with the branch to the registrant. In this and other circumstances, where the registrant can persuasively demonstrate that continuity of operations is substantially lacking and a representation to this effect is included in the filing, the staff will not object to the omission of financial statements. However, applicable disclosures specified by Industry Guide 3, Article 11 of Regulation S-X (pro forma information), and other information which is descriptive of the transaction and of the assets acquired and liabilities assumed should be furnished to the extent reasonably available.

Question 2: If the acquired financial institution is found to constitute a business having material continuity of operations after the transaction, are there circumstances in which the staff will waive the requirements of Rule 3-05?

Interpretive Response: Yes. The staff believes the circumstances surrounding the present restructuring of U.S. depository institutions are unique. Accordingly, the staff has identified situations in which it will grant a waiver of the requirements of Rule 3-05 of Regulation S-X to the extent that

⁵ Combined significance is the sum of the significance of D's investment test (13%), E's earnings test (9%) and F's earnings test (11%).