

**B. Common Control Accounting**

The staff would expect the full historical financial statements as specified in Rules 3–01 and 3–02 of Regulation S–X would be included in the registration statement for exchange offers accounted for as reorganizations, including all required supplemental reserve information. The presentation of individual or combined financial statements would depend on the circumstances of the particular exchange offer.

Registrants are also reminded that wherever historical results are presented, it may be appropriate to explain the reasons why historical costs are not necessarily indicative of future expenditures.

*E. Deleted by SAB 103*

*F. Deleted by SAB 103*

**Topic 3: Senior Securities****A. Convertible Securities**

*Facts:* Company B proposes to file a registration statement covering convertible securities.

*Question:* In registration, what consideration should be given to the dilutive effects of convertible securities?

*Interpretive Response:* In a registration statement of convertible preferred stock or debentures, the staff believes that disclosure of pro forma earnings per share (EPS) is important to investors when the proceeds will be used to extinguish existing preferred stock or debt and such extinguishments will have a material effect on EPS. That disclosure is required by Article 11, Rule 11–01(a)(8) and Rule 11–02(a)(7) of Regulation S–X, if material.

*B. Deleted by ASR 307*

**C. Redeemable Preferred Stock**

*Facts:* Rule 5–02.28 of Regulation S–X states that redeemable preferred stocks are not to be included in amounts reported as stockholders' equity, and that their redemption amounts are to be shown on the face of the balance sheet. However, the Commission's rules and regulations do not address the carrying amount at which redeemable preferred stock should be reported, or how changes in its carrying amount should be treated in calculations of earnings per share and the ratio of earnings to combined fixed charges and preferred stock dividends.

*Question 1:* How should the carrying amount of redeemable preferred stock be determined?

*Interpretive Response:* The initial carrying amount of redeemable preferred stock should be its fair value at date of issue. Where fair value at date

of issue is less than the mandatory redemption amount, the carrying amount shall be increased by periodic accretions, using the interest method, so that the carrying amount will equal the mandatory redemption amount at the mandatory redemption date. The carrying amount shall be further periodically increased by amounts representing dividends not currently declared or paid, but which will be payable under the mandatory redemption features, or for which ultimate payment is not solely within the control of the registrant (e.g., dividends that will be payable out of future earnings). Each type of increase in carrying amount shall be effected by charges against retained earnings or, in the absence of retained earnings, by charges against paid-in capital.

The accounting described in the preceding paragraph would apply irrespective of whether the redeemable preferred stock may be voluntarily redeemed by the issuer prior to the mandatory redemption date, or whether it may be converted into another class of securities by the holder. Companies also should consider the guidance in EITF Topic D–98.

*Question 2:* How should periodic increases in the carrying amount of redeemable preferred stock be treated in calculations of earnings per share and ratios of earnings to combined fixed charges and preferred stock dividends?

*Interpretive Response:* Each type of increase in carrying amount described in the Interpretive Response to Question 1 should be treated in the same manner as dividends on nonredeemable preferred stock.

**Topic 4: Equity Accounts****A. Subordinated Debt**

*Facts:* Company E proposes to include in its registration statement a balance sheet showing its subordinate debt as a portion of stockholders' equity.

*Question:* Is this presentation appropriate?

*Interpretive Response:* Subordinated debt may not be included in the stockholders' equity section of the balance sheet. Any presentation describing such debt as a component of stockholders' equity must be eliminated. Furthermore, any caption representing the combination of stockholders' equity and only subordinated debts must be deleted.

**B. S Corporations**

*Facts:* An S corporation has undistributed earnings on the date its S election is terminated.

*Question:* How should such earnings be reflected in the financial statements?

*Interpretive Response:* Such earnings must be included in the financial statements as additional paid-in capital. This assumes a constructive distribution to the owners followed by a contribution to the capital of the corporation.

**C. Change In Capital Structure**

*Facts:* A capital structure change to a stock dividend, stock split or reverse split occurs after the date of the latest reported balance sheet but before the release of the financial statements or the effective date of the registration statement, whichever is later.

*Question:* What effect must be given to such a change?

*Interpretive Response:* Such changes in the capital structure must be given retroactive effect in the balance sheet. An appropriately cross-referenced note should disclose the retroactive treatment, explain the change made and state the date the change became effective.

**D. Earnings Per Share Computations In An Initial Public Offering**

*Facts:* A registration statement is filed in connection with an initial public offering (IPO) of common stock. During the periods covered by income statements that are included in the registration statement or in the subsequent period prior to the effective date of the IPO, the registrant issued for nominal consideration<sup>1</sup> common stock, options or warrants to purchase common stock or other potentially dilutive instruments (collectively, referred to hereafter as "nominal issuances").

Prior to the effective date of Statement 128, the staff believed that certain stock and warrants<sup>2</sup> should be treated as outstanding for all reporting periods in the same manner as shares issued in a stock split or a recapitalization effected contemporaneously with the IPO. The dilutive effect of such stock and warrants could be measured using the treasury stock method.

*Question 1:* Does the staff continue to believe that such treatment for stock and warrants would be appropriate upon adoption of Statement 128?

<sup>1</sup> Whether a security was issued for nominal consideration should be determined based on facts and circumstances. The consideration the entity receives for the issuance should be compared to the security's fair value to determine whether the consideration is nominal.

<sup>2</sup> The stock and warrants encompasses by the prior guidance were those issuances of common stock at prices below the IPO price and options or warrants with exercise prices below the IPO price that were issued within a one-year period prior to the initial filing of the registration statement relating to the IPO through the registration statement's effective date.