

Burdick
Bruce

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS

Arthur Andersen & Co. :
Plaintiff, :
v. : Civil Action No. 76 C 2832
Securities and Exchange Commission, :
Defendant. :

MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION
IN OPPOSITION TO PLAINTIFF'S MOTION FOR A
TEMPORARY RESTRAINING ORDER

Preliminary Statement

Defendant, Securities and Exchange Commission ("Commission"), submits this memorandum in opposition to the motion of plaintiff, Arthur Andersen & Co., ("Andersen"),^{1/} for an order temporarily restraining the operation of the Commission's Accounting Series Release 150 ("ASR 150")^{2/} and of instruction H(f) to Form 10-Q as adopted by the Commission's Accounting Series Release 177 ("ASR 177").^{3/}

The Commission respectfully requests that Andersen's motion be denied for the following reasons:

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- ^{1/} At the time these papers were prepared, the Commission's Washington based Counsel had not seen Plaintiff's papers. Rather, reliance was placed upon the telephone representation by Plaintiff's counsel that this motion would be based upon the same arguments presented in Plaintiff's papers in support of its motion for preliminary injunction. Defendant reserves its right to supplement these papers orally and to seek leave to file a supplemental memorandum.
 - ^{2/} A copy of ASR 150, in full text, is annexed hereto as Exhibit A.
 - ^{3/} A copy of ASR 177, in full test, is annexed hereto as Exhibit B.

(1) Andersen has failed to demonstrate that it will suffer irreparable injury if the temporary relief sought is denied.

(2) Andersen has made no showing that there is a substantial likelihood that it will prevail on the merits of this action.

(3) It would be adverse to the public interest to grant the relief sought, which would, in effect, amount to a temporary judicial declaration that the Commission's longstanding policy regarding accounting principles, first pronounced in 1938 ^{4/}and reaffirmed in 1973, should be suspended. Likewise, in the absence of a specific factual context, an attack in gross upon a rule (instruction H(f)) which was first published by the Commission for comment in 1974 and not adopted until September 1975, does not present the proper setting for issuance of a temporary judicial declaration restraining its implementation. This is particularly true here where Andersen, despite its claim that the Commission failed to comply with Administrative Procedure Act requirements, itself submitted 2 written comments and appeared before the Commission and presented oral comments on the proposed rule.

(4) It is highly questionable whether Andersen has standing to raise issues in this court which, if they may be raised at all, may only properly be raised by Andersen's clients.

Moreover, although Andersen's complaint is purportedly concerned only with the acts of the Commission in issuing two specific accounting series releases, it appears that this lawsuit is, in reality, a direct assault on the longstanding policy of the Commission that "the development of accounting principles within the private sector is consistent with the public interest." SEC News Digest No. 72-85, p. 4/ A copy of ASR 4, in full text, is annexed hereto as Exhibit C.

1 (May 4, 1972). Despite our reluctance to speculate as to the reasons for the institution of this lawsuit, we are constrained to view this lawsuit as an attempt by Andersen to undermine the continued viability of the Financial Accounting Standards Board ("FASB"), the entity invested by the accounting profession with the authority to establish accounting principles, practices and policies for the profession. 5/

This somewhat enigmatic attack upon the very entity which Andersen publicly supported only a few years ago, renders it even more inappropriate for this court to consider the issues raised in this action on the very short schedule allowed for by the instant motion.

Introduction

This action was instituted with the filing of a lengthy and detailed complaint on July 29, 1976. Despite the fact that the present request for temporary relief suggests that this lawsuit involves issues of recent origin warranting a temporary maintenance of the status quo, quite the contrary appears to be true.

The complaint first assails ASR 150, a statement of policy issued by the Commission over three years ago which merely reaffirmed the longstanding administrative policy of the Commission of looking "to the standard setting bodies designated by the profession to provide leadership in establishing and improving accounting principles." (ASR

5/ Andersen could not maintain this lawsuit if it were brought directly against the FASB. See, Appalachian Power Co. v. American Institute of Certified Public Accountants, 177 F. Supp. 345 (S.D.N.Y.), aff'd per curiam, 268 F. 2d 844 (2d Cir.), cert. denied, 361 U.S. 887

150). In ASR 4, issued in 1938, the Commission first advised the public that its staff would look to generally accepted accounting principles established in the private sector as a frame of reference in connection with the staff's informal review of registration statements and reports filed with the Commission. The Commission reaffirmed that policy in 1973, recognizing in that release that the FASB was the entity established by the private sector to adopt accounting principles.

As a general statement of the Commission's policy, ASR 150 imposes no legal obligation on accountants or any other persons, nor does it establish any rights on behalf of such persons. It is difficult to see how plaintiff will be irreparably injured by a policy of the Commission which has been in effect since at least 1938 and which imposes no independent obligation upon plaintiff to do or to refrain from doing anything.

Plaintiff has also challenged instruction H(f) to Form 10-Q, rule which was published for comment by the Commission over one and one half years ago, regarding which plaintiff submitted extensive written and oral comments, and which was adopted by the Commission and has been in effect for nearly one year. The rule that plaintiff challenge requires an entity whose securities are registered with the Commission to provide a letter from its accountant, when the registrant elects to change its accounting methods, in which the accountant states whether or not the change is to an alternative accounting principle which in the professional judgment of the accountant is preferable under the circumstances. In the eleven months since the adoption of the rule

such letters have been submitted by other major public accounting firms. (See, Affidavit of John C. Burton, dated August 10, 1976, paragraph 9 and Exhibit thereto.) Thus, whatever personal feelings Andersen's colleagues may harbor regarding ASR 177, they have managed to comply with it. The fact that Andersen does not like one of the Commission's rules does not render that rule illegal or justify a temporary judicial declaration restraining its implementation.

Argument

THIS COURT SHOULD DENY THE MOTION FOR A TEMPORARY RESTRAINING ORDER, SINCE PLAINTIFF HAS NOT DEMONSTRATED THE PREREQUISITES FOR SUCH EXTRAORDINARY RELIEF.

Although Rule 65(b) of the Federal Rules of Civil Procedure provides for the issuance of temporary restraining orders in carefully limited circumstances, the courts have recognized that the party seeking this drastic relief bears the heavy burden of establishing its necessity. See, e.g., Sampson v. Murray, 415 U.S. 61 (1974); Virginia Petroleum Jobbers Association v. Federal Power Commission, 259 F. 2d 921 (C.A.D.C., 1958); Murphy v. Society of Real Estate Appraisers, 388 F. Supp. 1046 (E.D. Wis., 1975). Cf. Canal Authority of State of Florida v. Callaway, 489 F. 2d 567 (C.A. 5, 1974).

In considering applications for temporary restraining orders, the courts traditionally have viewed four elements as necessary prerequisites for granting temporary relief:

- (1) whether plaintiff has demonstrated that, in the absence of temporary relief, plaintiff will suffer irreparable injury;
- (2) whether plaintiff has made a substantial showing that they are likely to prevail on the merits of the action;

- (3) whether, on balance, granting such temporary relief best serves the public interest; and
- (4) whether the threatened injury to plaintiff is outweighed by the harm which the temporary relief may cause to the defendant or other interested parties.

Virginia Petroleum Jobbers Association v. Federal Power Commission, supra, 259 F. 2d at 925; Murphy v. Society of Real Estate Appraisers, supra, 388 F. Supp. at 1049; Thompson Van Lines, Inc. v. United States, 381 F. Supp. 184 (D.D.C., 1974). See also, Canal Authority of State of Florida v. Callaway, supra, 489 F. 2d at 572; Ament v. Kusper, 370 F. Supp. 65, 67 (N.D. Ill., 1974).

Particularly here, where plaintiff seeks to restrain the operation of an administrative agency, the plaintiff should be required to demonstrate clearly that it has fully satisfied each and every one of these four criteria. In instances such as this, "[t]he interests of private litigants must give way to the realization of public purposes." Virginia Petroleum Jobbers Association v. Federal Power Commission, supra, 259 F. 2d at 925. As we show below, plaintiff has not satisfied any of these criteria, much less all of them.

A. Plaintiff Has Failed To Demonstrate That It Will Suffer Irreparable Injury If The Relief Requested Is Denied.

On page 13 of its memorandum in support of its present motion,^{6/} plaintiff sets forth the ostensible reasons why it will suffer irreparable

^{6/} As noted, we understand plaintiff will here rely upon its memorandum of law in support of its motion for preliminary injunction. Accordingly, all page references are to plaintiff's said memorandum.

harm if the temporary relief it now seeks is not granted. It argues, by way of incorporation, that paragraphs 16, 17, 23 and 24 of its complaint and the affidavit of George R. Catlett filed in support of its motion establish irreparable injury.

It is alleged in paragraph 16 of the complaint that the publication of financial statements which fail to comply with ASR 150 could result in the institution of civil or criminal proceedings for violations of the Securities Act of 1933 and the Securities Exchange Act of 1934. But this merely states a hypothetical possibility, the realization of which is not even suggested by plaintiff's complaint. No extended argument need be made to demonstrate that the mere possibility of such sanctions does not constitute a showing of irreparable injury.

Similarly, in paragraph 17 of the complaint, plaintiff suggests that if its conduct fails to comport with the Commission's rules and regulations it may be subject to sanctions under Rule 2(e) of the Commission's rules of practice. (17 CFR 201.2(e)). Again, this theoretical possibility does not constitute irreparable injury.

Paragraph 23 of plaintiff's complaint summarizes the rule challenged by plaintiff, instruction H(f) to Form 10-Q, and makes an argument that a determination of preferability as to a change by one of plaintiff's clients could stigmatize the financial statements of its other clients who wish to continue to follow the accounting principle abandoned by the client making the change and might result in burdensome lawsuits against such other clients. Although we disagree with such contentions, in any event, again these are hypothetical possibilities which do not amount to irreparable injury.

The Court of Appeals for the District of Columbia has observed that in determining whether irreparable injury has been demonstrated, "[t]he key word in [the court's] . . . consideration is irreparable. Mere injuries, however substantial, in terms of money, time and energy necessarily expended in the absence of a stay are not enough." Virginia Petroleum Jobbers Association v. Federal Power Commission, supra, 259 F. 2d at 925. The conjectural possibilities posited by plaintiff do not even establish that there has been injury, much less irreparable injury.

In paragraph 24 of its complaint and, similarly, at paragraph 12 of the August 5, 1976 affidavit of George R. Catlett, plaintiff suggests that it will suffer irreparable harm by virtue of the Commission's alleged refusal to permit certain of its clients' registration statements to become effective and thereby prohibiting their clients from selling securities to the public. But this allegation is erroneous as a matter of law.

Section 8(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. 77h(a), provides, in part, that:

" . . . the effective date of a registration statement shall be the twentieth day after the filing thereof or such earlier date as the Commission may determine. . ." (emphasis added)

By operation of this section, a registration statement automatically becomes effective twenty days after it is filed with the Commission. The Commission's staff has, however, developed a practice of informally reviewing such registration statements. This review ordinarily requires more than the

twenty day period allotted by Section 8(a). Accordingly, to provide the Commission's staff with additional time to conduct its review, registrants will frequently insert a "delaying amendment", as provided for by 17 CFR 230.473(a), which, in effect, states that the registration statement will become effective after the staff has completed its review -- a procedure known as "acceleration" of the registration statement -- or twenty days after the delaying amendment is withdrawn by the registrant. Thus, although the staff may have refused to accelerate the effectiveness of certain of plaintiff's clients' registration statements, where a letter regarding preferability was not provided, the clients can remedy this by self-help -- i.e., by withdrawing their delaying amendments. In which case their registration statements would soon become effective.

It is clear, therefore, that any purported injury that, arguably, may flow from the failure of plaintiff's clients' registration statements to become effective, is due to a client's own failure to act and not due to the Commission's deficiency letter. 7/

Assuming, arguendo, that one of plaintiff's clients might suffer injury by the Commission's issuance of a deficiency letter stating that the staff would not accelerate registration, that still provides no standing for plaintiff to bring this action.

Plaintiff lacks standing to bring this suit. Simon v. Eastern Kentucky Welfare Rights Organization, _____ U.S. _____, 44 U.S.L.W. 4724 (No. 74-1124, June 1, 1976); Warth v. Seldin, 422 U.S. 490 (1975).

7/ For a general discussion of Registration Procedure see 1 Loss, Securities Regulations (2'd ed, 1961) Pgs. 272-283.

In Simon, supra, plaintiffs, like plaintiff here, sought both a declaratory judgment and injunctive relief under § 10 of the Administrative Procedure Act ("APA") 5 U.S.C. §702. 8/ In dismissing the action for lack of standing, the Supreme Court stated that:

"In sum, when a plaintiff's standing is brought into issue the relevant inquiry is whether, assuming justiciability of the claim, the plaintiff has shown an injury to himself that is likely to be redressed by a favorable decision. . . . the constitutional standing requirement under this section [5 U.S.C. §702] (this court has held) to be allegations which, if true, would establish that the plaintiff had been injured in fact by the action he sought to have reviewed." (emphasis added, citations omitted) Simon, supra, slip op. at B2700.

In the present case neither the complaint nor the moving papers establish that plaintiff "had been" and, further, that it will continue to be, "injured in fact" by the S.E.C. action now sought to be temporarily restrained, and later enjoined, pending the outcome of the trial on the merits.

Plaintiff has not established irreparable injury to itself. The best Andersen offers is purported injury to an unidentified client, a nonparty. This falls far short of the minimal standing requirements as announced by Simon, supra, and Warth, supra.

B. There Is No Substantial Likelihood Of Plaintiff Succeeding On The Merits Of This Action

8/ In its motion here, plaintiff refers to violations of §4 of the Administrative Procedure Act, 5 U.S.C. §553. However, as is clear from paragraph 1 of plaintiff's complaint, jurisdiction under the APA is afforded by §10, 5 U.S.C. §702.

Much of plaintiff's argument is based on the erroneous legal premise that ASR 150 constitutes a substantive rule of the Commission. But ASR 150 is no more than a statement of the Commission's longstanding policy.

Neither ASR 4 nor ASR 150 prohibits an accountant from utilizing another accounting principle -- all that these releases do is advise him that he may have to demonstrate that the principles employed have authoritative support and are not ones conjured up by the accountant or his client. 9/

ASR 150 imposes no rights or obligations on plaintiff or any other person. See, Airport Commission of Forsyth County v. Civil Aeronautics Board, 300 F. 2d 185 (C.A. 4, 1962). In the Attorney General's Manual on the Administrative Procedure Act, page 30 n. 3, (1947) such statements of policy were described as "statements issued by an agency to advise the public prospectively of the manner in which the agency proposed to exercise discretionary power." The precise situation exists here where the Commission has, through ASR 150, advised the public that in the staff's informal review of filings made with the Commission the staff will presume that accounting principles published by the FASB are those principles which are generally accepted by the accounting profession. Thus, when such principles are followed in connection with the preparation of financial reports filed with the Commission, the

9/ All auditors, including Andersen, state in their reports of audit examinations (commonly referred to as certificates) that the client's financial statements were prepared in accordance "with generally accepted accounting principles." Presumably, Andersen does not employ these words without understanding their meaning.

Commission will presume that such reports are not misleading. However, as noted, the auditor and his client may urge that use of another principle is appropriate under the circumstances, and, in such instances the Commission may permit or require the use of the other principle.

In any event, the instant lawsuit may also be premature since, as Andersen notes, it has petitioned the Commission to revoke both ASR 150 and instruction H(f). Although the Commission has denied the petition as it relates to the narrow question of whether a letter regarding "preferability" must be filed, the Commission has advised Andersen that it will solicit public comments on certain questions it believes are raised by the petition before responding further.

Accordingly, there is a serious question whether plaintiff has exhausted its administrative remedies before encumbering this court with its present demands.

In addition, as we noted, substantial questions concerning plaintiffs standing to bring this action particular as it relates to the so-called "preferability rule" (instruction H(f)) are also present here.

C. Plaintiff Has Not Demonstrated That The Supposed
Threatened Injury Outweighs The Harm That A
Restraining Order Would Have On The Public Interest

As we mentioned earlier, the Commission's staff has developed a practice over the years of examining registration statements, prior to their becoming effective, for compliance with the standards of adequate and accurate disclosure. In reviewing those statements it has been the Commission's policy, since at least 1938 with the issuance of ASR 4 and as reaffirmed in 1973 in ASR 150, that if the reports filed with the Commission follow generally accepted accounting principles, they generally will be presumed not to be misleading. Thus, the public, the accounting profession and companies filing financial statements with the Commission are offered some assurance that conformity with such principles will facilitate the review and filing of reports with the Commission. Should the Court restrain the operation of ASR 150, it will undoubtedly create substantial confusion in the minds of these persons as to the manner in which the Commission's staff will review financial reports filed with it. The potentially widespread effect of such uncertainty is evident when one considers that last year alone 2,912 registration statements and thousands of other reports containing financial statements were filed with the Commission.

Regarding instruction H(f), moreover, that rule was adopted after notice and comment in strict compliance with the requirements of the APA, and based in part on the Commission's broad authority to define "accounting ... terms ... and to prescribe the form or forms in

which required information shall be set forth, the items or details to be shown in the balance sheet and earning statement, and the methods to be followed in the preparation of documents . . ." Section 19(a) of the Securities Act of 1933, 15 U.S.C. 77s(a). See also, 78c(b), Sections 3(b), 13(a) and (b) of the Securities Exchange Act of 1934, 15 U.S.C. 78m(a) and (b).

The Commission, in the exercise of its expertise as the agency charged with administering the federal securities laws, concluded that the adoption of instruction H(f) would further the objectives of the federal securities laws. Such determinations are "entitled to great deference," see Albermarle Paper Co. v. Moody, 422 U.S. 405, 431 (1975) and cases cited therein, and should not be overturned, even temporarily, particularly since plaintiff, here, has failed even to demonstrate injury in fact to itself, much less irreparable injury.

Conclusion

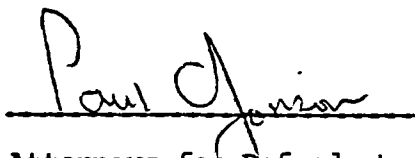
For the foregoing reasons, the motion for a temporary restraining order should be denied.

Dated: Washington, D.C.
August 10, 1976

Respectfully submitted,

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APPENDIX

THE SECURITIES AND EXCHANGE COMMISSION AND THE ACCOUNTING PROFESSION--A SHORT HISTORY

To place Andersen's action in bringing this lawsuit in perspective, it is necessary to have an understanding of the historical relationship between the SEC and the accounting profession.

A. The Federal Securities Laws:

The events leading to the Securities Act of 1933 (Securities Act) , and the subsequent federal securities laws, are well known. In considering the appropriate remedy for the debacles of the 1920's, Congress considered, among other alternatives, a corps of federal auditors to conduct examination of companies seeking to obtain money from the public. However, in response to testimony from the accounting profession, Congress opted for reliance on the certification of an independant public or certified accountant.^{1/} Broad authority was given to the Federal Trade Commission (the first administrator of the Securities Act) to define accounting terms and to prescribe the form and details by which financial information was to be shown.^{2/}

In 1934, administration of the Securities Act was transferred to the newly created Securities and Exchange Commission. Again, the role of the independant accountant was recognized^{3/} as was

^{1/} 15 USC 77aa(25), (26), (27)

^{2/} 15 USC 77s(a)

^{3/} 15 USC 78m(a)

the Commission's authority to define accounting terms^{4/} and to prescribe the forms, detail and the method to be followed in the presentation of financial statements.^{5/}

B. The Commission's Policy in Accounting Matters.

1. Northern States Power Company

The Securities Act is a disclosure statute. As expressed in its preamble, its purpose was to "provide full and fair disclosure of the character of securities sold in interstate and foreign-commerce and through the mails, and to prevent fraud in the sale thereof." How to conform this policy to varying accounting policies was the subject of early Commission debates. The first major action by the Commission involved a registration statement which had been filed which included certain accounting treatments which appeared inappropriate. The Commission was divided:

Three of the Commissioners thought that these circumstances were sufficiently disclosed in the registration statement and prospectus as amended, while two thought that adequate disclosure and treatment required that the balance sheets, the earnings, the earned surplus accounts and statements of dividends paid should be restated and should be accompanied by a statement of the company's past accounting practices. A more detailed expression of the circumstances and of the views of the majority and minority will be filed and made public at an early date. Securities Act Release No. 254 (1934)

Thus, according to the majority, disclosure could cure improper accounting treatment.

4/ 15 USC 78c(b)

5/ 15 USC 78m(b)

2. Accounting Series Release No. 4

The more detailed explanation was never issued by the Commission, but the debate eventually led to a definitive statement of the Commission's policy. On April 25, 1938, the Commission issued Accounting Series Release No. 4.

ASR No. 4 was an expression of the Commission's administrative policy. It stated that the Commission would presume that financial statements which were prepared in accordance with accounting principles for which there was no substantial authoritative support were misleading notwithstanding disclosure. If there was a difference in view with the Commission, the Commission would accept disclosure in lieu of a change in the financial statements only when there was substantial authoritative support for the proposed accounting principle and the Commission had not expressed a contrary view in an official release.^{6/}

3. Regulation S-X:

On February 21, 1940, the Commission adopted Regulation S-X, which contained the rules and requirements as to the form, content and detail of financial statements and schedules filed under the Securities Act and the Securities Exchange Act of 1934

^{6/} In Accounting Series Release No. 1, issued on April 1, 1937, the Commission has "announced a program for the publication, from time to time, of opinions on accounting principles for the purpose of contributing to the development of uniform standards and practice in major accounting questions."

Regulation S-X did not purport to establish accounting principles; it was limited to securing consistency in the form and structure of financial statements. Accounting principles continued to evolve in the private sector and as a result of the Commission's informal review procedures.

On December 20, 1950, the Commission, following extensive public comment, adopted a comprehensive amendment to Regulation S-X. In its release announcing adoption of the revised regulation, the Commission stated:

The amendment makes it clear also that the several requirements previously expressed in published opinions continue to reflect considered Commission policy. This has been accomplished, to a large extent, by amending Rule 1-01, which now reads, in part, as follows:

'Rule 1-01 (a). This regulation (together with the Accounting Series Releases) states the requirements applicable to the form and content of all financial statements required to be filed...' ^{7/}

The Commission's policy of relying on the accounting principles established in the private sector remained the governing policy of the Commission.

4. ASR 96:

In January 1963, the Commission reaffirmed its policy in issuing ASR 96. The relevant portion of the release stated:

In Accounting Series Release No. 1, published April 1, 1937, the Commission announced a program for the purpose of contributing to the development of uniform standards and practices in major accounting questions. Accounting Series Release No. 4 recognizes that there may be sincere differences of opinion between the Commission and the registrant as to the proper principles of accounting to be followed in a given situation and indicates that, as a matter

^{7/} Accounting Series Release No. 70, December 20, 1950

of policy, disclosure in the accountant's certificate and footnote will be accepted in lieu of conformance to the Commission's views only if such disclosure is adequate and the points involved are such that there is substantial authoritative support for the practice followed by the registrant, and then only if the position of the Commission has not been expressed previously in rules, regulations, or other official releases of the Commission, including the published opinion of its Chief Accountant. This policy is intended to support the development of accounting principles and methods of presentation by the profession but to leave the Commission free to obtain the information and disclosure contemplated by the securities laws and conformance with accounting principles which have gained general acceptance.

5. The Financial Accounting Standards Board

In 1971, the American Institute of Certified Public Accountants authorized a study of how accounting principles should be established. Following an extensive inquiry, a seven person committee recommended establishment of a Financial Accounting Standards Board. The Committee's report was well received, and at the urging of many, including the SEC and Andersen,^{8/} the FASB was established and began operations in April of 1973.

With the establishment of the FASB, which it had supported, the Commission believed that it should publicly reaffirm its historic policy of relying on the private sector to establish generally accepted accounting principles. On December 20, 1973, the Commission issued ASR 150 in which it reaffirmed its

^{8/} A copy of the Commission's letter is attached as Exhibit D.

historical policy of deferring to the private sector for the establishment of accounting principles. The Commission emphasized that it had the responsibility to assure that investors were provided with adequate information. The Commission noted that if it were necessary to depart from statements specified in the release as those presumed to have substantial authoritative support in order to prevent misleading financial statements, the Commission might require the use of other principles.

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

ACCOUNTING SERIES

Rel. No. 150/December 20, 1973

STATEMENT OF POLICY ON THE ESTABLISHMENT AND IMPROVEMENT OF ACCOUNTING PRINCIPLES AND STANDARDS

Various Acts of Congress administered by the Securities and Exchange Commission clearly state the authority of the Commission to prescribe the methods to be followed in the preparation of accounts and the form and content of financial statements to be filed under the Acts and the responsibility to assure that investors are furnished with information necessary for informed investment decisions. In meeting this statutory responsibility effectively, in recognition of the expertise, energy and resources of the accounting profession, and without abdicating its responsibilities, the Commission has historically looked to the standard-setting bodies designated by the profession to provide leadership in establishing and improving accounting principles. The determinations by these bodies have been regarded by the Commission, with minor exceptions, as being responsive to the needs of investors.

The body presently designated by the Council of the American Institute of Certified Public Accountants (AICPA) to establish accounting principles is the Financial Accounting Standards Board (FASB). This designation by the AICPA followed the issuance of a report in March 1972 recommending the formation of the FASB, after a study of the matter by a broadly based study group. The recommendations contained in that report were widely endorsed by industry, financial analysts, accounting educators, and practicing accountants. The Commission endorsed the establishment of the FASB in the belief that the Board would provide an institutional framework which will permit prompt and responsible actions flowing from research and consideration of varying viewpoints. The collective experience and expertise of the members of the FASB and the individuals and professional organizations supporting it are substantial. Equally important, the commitment of resources to the FASB is impressive evidence of the willingness and intention of the private sector to support the FASB in accomplishing its task. In view of these considerations, the Commission intends to continue its policy of looking to the private sector for leadership in establishing and improving accounting principles and standards through the FASB with the expectation that the body's conclusions will promote the interests of investors.

In Accounting Series Release No. 4 (1938) the Commission stated its policy that financial statements prepared in accordance with accounting practices for which there was no substantial authoritative support were presumed to be misleading and that footnote or other disclosure would not avoid this presumption. It also stated that, where there was a difference of opinion between the Commission and a registrant as to the proper accounting to be followed in a particular case, disclosure would be accepted in lieu of

correction of the financial statements themselves only if substantial authoritative support existed for the accounting practices followed by the registrant and the position of the Commission had not been expressed in rules, regulations or other official releases. For purposes of this policy, principles, standards and practices promulgated by the FASB in its Statements and Interpretations 1/ will be considered by the Commission as having substantial authoritative support, and those contrary to such FASB promulgations will be considered 2/ to have no such support.

In the exercise of its statutory authority with respect to the form and content of filings under the Acts, the Commission has the responsibility to assure that investors are provided with adequate information. A significant portion of the necessary information is provided by a set of basic financial statements (including the notes thereto) which conform to generally accepted accounting principles. Information in addition to that included in financial statements conforming to generally accepted accounting principles is also necessary. Such additional disclosures are required to be made in various fashions, such as in financial statements and schedules reported on by independent public accountants or as textual statements required by items in the applicable forms and reports filed with the Commission. The Commission will continue to identify areas where investor information needs exist and will determine the appropriate methods of disclosure to meet these needs.

It must be recognized that in its administration of the Federal Securities Acts and in its review of filings under such Acts, the Commission staff will continue as it has in the past to take such action on a day-to-day basis as may be appropriate to resolve specific problems of accounting and reporting under the particular factual circumstances involved in filings and reports of individual registrants.

The Commission believes that the foregoing statement of policy provides a sound basis for the Commission and the FASB to make significant contributions to meeting the needs of the registrants and investors.

By the Commission.

George A. Fitzsimmons
Secretary

1/ Accounting Research Bulletins of the Committee on Accounting Procedure of the American Institute of Certified Public Accountants and effective opinions of the Accounting Principles Board of the Institute should be considered as continuing in force with the same degree of authority except to the extent altered, amended, supplemented, revoked or superseded by one or more Statements of Financial Accounting Standards issued by the FASB.

2/ It should be noted that Rule 203 of the Rules of Conduct of the Code of Ethics of the AICPA provides that it is necessary to depart from accounting principles promulgated by the body designated by the Council of the AICPA if, due to unusual circumstances, failure to do so would result in misleading financial statements. In such a case, the use of other principles may be accepted or required by the Commission.

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

SECURITIES ACT OF 1933
Rel. No. 5611/September 10, 1975

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 11641/September 10, 1975

PUBLIC UTILITY HOLDING COMPANY ACT OF 1935
Rel. No. 19162/September 10, 1975

ACCOUNTING SERIES
Rel. No. 177/September 10, 1975

NOTICE OF ADOPTION OF AMENDMENTS TO FORM 10-Q AND
REGULATION S-X REGARDING INTERIM FINANCIAL REPORTING

A. General Statement

In Securities Act Releases No. 5549 and No. 5579, the Commission proposed alternative methods of increasing disclosure of interim results by registrants. More than 700 letters of comments have been received in response to these proposals. In addition, the Commission held public hearings on the proposals and heard testimony from 14 witnesses. The Commission has given careful consideration to all comments and to the evidence received in the public hearings. It has now determined to adopt certain of the proposals, to modify others and propose revised rules for further comment and to withdraw other proposals, all as discussed below. The proposals for revised rules are contained in Securities Act Release No. 5612 dated September 10, 1975.

Adoption of Amendments to Regulation S-X

The Commission has determined to adopt, substantially as proposed, a new rule [Rule 3-16(t)] which will require disclosure of selected quarterly financial data in notes to annual financial statements of certain registrants. In making this determination, the Commission has concluded that footnote disclosure of net sales, gross profit, income before extraordinary items and cumulative effect of a change in accounting, per share data based upon such income, and net income for each quarter within the two most recent fiscal years and any subsequent fiscal period for which income statements are presented, is appropriate for the protection of investors in the case of large companies whose shares are actively traded. The Commission believes that the greatest investor need for these data exists in the

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case of such companies whose activities are most closely followed by analysts and investors. Accordingly, registrants whose shares are not actively traded or whose size is below certain limits have been exempted from this rule at the present time. In making this judgment the Commission also recognized that the costs of such disclosure would be relatively a greater burden to smaller companies. Nevertheless, the Commission urges registrants who are exempt from the rule to consider the desirability of including such data in their annual reports. The exemption applies to all registrants who do not meet the following criteria:

A.1. The registrant has securities registered pursuant to Section 12(b) of the Exchange Act; or

2. The registrant has securities registered pursuant to Section 12(g) of the Exchange Act that are quoted on the National Association of Securities Dealers Automated Quotation System and these securities meet the Regulation T requirements for continued inclusion on the list of OTC margin stock; and

B. The registrant and consolidated subsidiaries had income after taxes but before extraordinary items and cumulative effect of a change in accounting of \$250,000 for each of the last three fiscal years or had total assets at the last fiscal year end of \$200,000,000 or more.

The Commission believes that such disclosures will materially assist investors in understanding the pattern of corporate activities throughout a fiscal period and it feels that such an understanding is important if financial statements are to serve their objective of allowing investors to develop reasonable expectations about the future prospects of enterprises in which they are investing or considering investment. ^{1/} Presentation of such quarterly data will supply information about the trend of business operations over segments of time which are sufficiently short to reflect business turning points. Annual periods may obscure such turning points and may reflect a pattern of stability and growth which is not consistent with business reality. In addition, quarterly data will reflect seasonal patterns which are of significance to an investor's understanding of the business operations of a reporting entity.

1/ See the report of the Trueblood Committee appointed by the American Institute of Certified Public Accountants to study the objectives of financial statements.

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Numerous commentators took issue with the Commission's view that the footnote information proposed to be required by the proposals and adopted herein was necessary for investors. They suggested that interim results are materially affected by random events, that short period estimates are by their nature imprecise and that putting such data into annual financial statements will mislead by lending them an appearance of reliability which cannot in fact exist. In addition, numerous respondents suggested that if the Commission did believe that quarterly data should be presented to investors at the end of the year, this could best be achieved by including the quarterly data in management's analysis of the summary of operations or elsewhere in the annual report, but not in the notes to financial statements.

The Commission has concluded that it should not amend its proposal in response to these comments. While it recognizes that random events can materially affect quarterly results, it believes that Section (3) of Rule 3-16(t), which requires disclosure in the note of any unusual items occurring in any quarter disclosed, will enable investors to ascertain the effect of such items and hence not be misled. It also recognizes that short period estimates are imprecise, and it emphasized in Securities Act Release No. 5549 that it was not proposing any change in the traditional accounting practice of making the best estimate practicable at the time the estimate must be made, and then reflecting subsequent adjustments in the estimate in subsequent periods as the need became apparent. Estimates are a necessary part of all financial reporting, and since registrants have had many years experience in making the estimates required in quarterly reporting and investors have had equivalent experience in using the reports encompassing these estimates, the Commission is not prepared to conclude that including quarterly data in a footnote to the financial statements will create an impression of reliability which will mislead investors. In addition, Section (3) of Rule 3-16(t) requires the disclosure of the aggregate effect and the nature of year end or other adjustments which are material to the results of each quarter presented. This disclosure will permit investors to determine the nature and effect of substantial changes in estimates.

The Commission also does not agree that the required disclosure should only be made outside the financial statements. In general, it believes that significant financial disclosures about business operations during

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a period should be included in the financial statements for that period. The burden is therefore on those who believe that significant financial data should be outside the financial statements to demonstrate the reason for its exclusion. Commentators did not offer any compelling reasons to support their position in this regard. Accordingly, the Commission believes that it is appropriate to require disclosure in the notes to financial statements of those companies in which there is the most substantial public investor interest.

Involvement of Independent Public Accountants

The inclusion of interim data in the footnotes to annual financial statements necessarily will associate the independent public accountant with these data in some fashion. In its initial proposal in Securities Act Release No. 5549, the Commission indicated that it was not prepared to have these data labeled "unaudited." After receiving many comments and estimates of cost which suggested that an audit of interim data would be very costly to registrants, the Commission published an additional set of proposals (in Securities Act Release No. 5579) which would permit this note to be labeled "unaudited" and at the same time would set forth as an amendment to Rule 2-02 of Regulation S-X a set of limited review procedures which auditors would be expected to follow when they were associated with a set of financial statements which included such an unaudited footnote.

After careful consideration of costs and benefits of auditor involvement, the Commission has determined to permit the required note to be identified as "unaudited." Even though this note will not be audited, independent accountants will be associated with such a note when they report on financial statements which include such a note. The Commission does not believe it is appropriate for independent accountants to be subjected to unknown responsibilities in connection with their association with this note. Accordingly, the Commission is proposing, in Securities Act Release No. 5612, dated this date, a slightly amended set of review and reporting procedures which the Commission believes will satisfactorily set forth its expectation as to the responsibilities of independent accountants who report on financial statements filed with it which include such a note. The Commission plans to adopt final standards for auditors' reports which spell out these expectations prior to the effective date of the amendment to Rule 3-16 adopted hereby.

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The Commission notes, however, that the subject of auditor involvement with interim financial data has been under active consideration by the Auditing Standards Executive Committee of the American Institute of CPAs (AudSEC). It also notes that historically the Commission has not been required to set forth the standards and procedures which underlie an independent public accountant's report because the public accounting profession has developed appropriate standards and procedures to provide protection to the investing public who rely upon such reports:

The Commission believes that it is preferable to continue its past policy of permitting the accounting profession to determine the auditing standards and procedures underlying accountant's reports as long as this policy is consistent with the interests of investors. Accordingly, it urges AudSEC to continue its study of auditor involvement with interim financial data in the light of the Commission's determination that certain interim data shall be included in annual financial statements of certain registrants in a note labeled "unaudited" and the Commission's further determination that auditor association with these data will necessarily occur and the responsibilities for such association must be satisfactorily defined. If AudSEC adopts a Statement on Auditing Standards prior to December 10, 1975 which sets forth the standards and procedures to be followed by independent accountants in connection with the data in the unaudited note required by Rule 3-16(t), and the Commission is satisfied that these standards and procedures adequately protect the interests of investors, it is the intention of the Commission to withdraw the proposed sections of Rule 2-02(e) which set forth specific procedures of review and reporting and to indicate that the AudSEC statement identifies the "appropriate professional standards and procedures" presumed to have been followed by the reporting independent public accountant under Rule 2-02(e).

The Commission received many comments on the subject of auditor involvement, nearly all of which raised questions as to whether the benefits of such involvement would warrant the cost. The Commission has considered these comments with great care since it believes that it should not lightly impose additional costs on registrants and that the benefits of new requirements to present and prospective investors should outweigh any additional costs involved. Since the benefits of the increased involvement of independent accountants in interim reporting are not subject

to quantification, and the measurement of costs includes many variables which are highly uncertain, the weighing of costs and benefits will inevitably require the exercise of subjective judgments rather than arithmetical computations.

In its releases proposing increased auditor involvement, the Commission specifically invited comments on the cost of its proposals to registrants. Many responses were received, but relatively few indicated that the respondent had undertaken any systematic research into the costs involved. Those that did report a systematic study of costs reported that the costs would vary depending on the nature of the registrant, but the most common estimates indicated that a quarterly review following the procedures set forth in the proposal would cost between 5% and 25% of the current annual audit fee. In the Commission's hearings, several of those making such estimates were asked whether the studies took into account any savings in year-end audit time which might result from quarterly reviews and they responded that no such savings had been included. In addition, several witnesses stated that current auditing procedures frequently included analytical reviews of results of time periods within the year in searching for unusual items which would require additional auditing steps, even though these reviews did not focus specifically on quarterly periods.

The Commission believes that as reviews of quarterly information become a regular part of the audit examination of public companies, auditors will revise the timing of their audit examinations so that they will perform procedures related to the testing of internal controls and the analytical review of internal financial reports on a regular basis throughout the year. In addition, programs encompassing regular analytical review should increase the efficiency of auditors in finding and focusing promptly on potentially troublesome areas in the audit. The Commission believes, therefore, that many of the costs included in the studies reported to the Commission will not prove to be incremental costs but will reduce the cost of the year-end audit examination. In addition, it is the Commission's view that many of the costs will be of a one time rather than a continuing nature since audit programs and corporate control systems will be improved promptly to keep costs at a minimum. The Commission does not suggest that the cost of auditor involvement in quarterly data will be trivial, but it does believe that some of the higher estimates supplied to it will not prove to be correct.

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The benefits resulting from such increased costs cannot be quantified, but the Commission is satisfied that they will be substantial. While the new rules will not mandate the timely involvement of the independent accountant with quarterly reports, the Commission believes that it is likely that such involvement will occur so that management will be less likely to face the necessity of revising quarterly data at the time year-end statements are published. Either timely or retrospective involvement should increase the care and attention devoted to quarterly reports which will increase the likelihood that management will discover needed adjustments on a timely basis. In addition, management may be able to identify problem areas more promptly so that unusual charges and credits are not made so frequently in the last month of a fiscal year. Finally, the involvement of independent accountants will add the expertise of professional accountants with wide experience in reporting problems to the quarterly reporting process. This should improve individual company reporting and direct greater professional attention to the general problems of interim reporting.

The Commission has brought a number of enforcement actions involving quarterly reports and it has observed other cases where quarterly reports have required correction. In addition, it has noted the preponderance of Form 8-K filings covering unusual charges and credits to income being made late in the year. While these are not suggested to be evidence of systematic abuse in quarterly reporting, they do indicate that deficiencies exist. Although auditor involvement will not prevent all deficiencies, the Commission does believe that it will enhance the reliability of interim reports and reduce the likelihood of abuse. In the final analysis, however, the benefits of auditor involvement in quarterly data are expected primarily to result from improvement in the quality of interim reporting and the annual auditing process and only secondarily from the prevention of specific abuses currently perceived.

After appraising the costs and benefits, the Commission has determined that the benefits of mandatory involvement of independent accountants in quarterly data on the basis set forth in the rules adopted hereby substantially outweigh the costs thereof and that such involvement is required in the interests of investors.

In exempting certain registrants from these rules, the Commission has noted that the cost of auditor

involvement will fall with the greatest relative severity on smaller registrants in which public investor interest is not of great magnitude. In these cases, the Commission believes that it is less clear that the benefits of auditor involvement with interim data outweigh the costs. Accordingly, it has not required such involvement for such registrants at the present time, although it will continue to study the question as it evaluates the experience gained from the rules adopted hereby.

Effective Date of Amendments to Regulation S-X

Because quarterly data have not previously been included in financial statements for a year and because the Commission recognizes that specific implementation of auditor involvement and improved systems of internal control relative to quarterly data may take time to achieve, the Commission is not requiring the inclusion of such data in financial statements for fiscal periods beginning prior to December 26, 1975. In addition, quarterly data will not be required for quarterly periods beginning prior to that date. Earlier implementation of the requirements by registrants is encouraged.

Inclusion of Quarterly Data in Financial Statements Included in Annual Reports to Stockholders

The rules adopted hereby require that large companies whose shares are actively traded include the disclosure of certain quarterly data in financial statements filed with the Commission. The Commission believes that these companies also should include this disclosure in financial statements furnished to stockholders.

Adoption of Amendments to Form 10-Q

The Commission has determined to adopt substantially increased requirements for the content of quarterly reports on Form 10-Q which will be applicable to all registrants. These requirements include condensed financial statements, a narrative analysis of results of operations, the approval of any accounting change by the registrant's independent public accountant, and a signature by the registrant's chief financial officer or chief accounting officer. In addition, the revised form permits additional financial disclosures deemed appropriate by management and permits management to state that financial data in the form has been reviewed by independent public accountants and to include as an exhibit to the

form a letter from the independent public accountant in regard to this review.

The Commission originally proposed to require financial statements prepared in accordance with Regulation S-X except for the exclusion of certain footnote disclosure. A number of commentators suggested that such statements would be more detailed than required by investors and would be costly to prepare. Accordingly, the rule adopted provides that the financial statements furnished need only include the major captions set forth in Regulation S-X and permits the combination of such captions when certain materiality tests are met. The only subcaptions required by the rule are those which set forth the components of inventory (raw materials, work in process and finished goods), if applicable, since users of financial statements have indicated that these subcaptions are of considerable importance in evaluating the significance of changes in inventory. In addition, the rule permits a summarized statement of source and application of funds. The rule retains the original proposed provision that rules included in Regulation S-X which call for detailed footnote disclosures and schedules do not apply to financial statements filed in Form 10-Qs. A number of commentators indicated that the proposed language was not sufficiently specific since all footnote disclosures required in annual financial statements could be said to meet the test of being necessary to prevent the statements from being misleading. The Commission did not intend this interpretation, since it believes that detailed footnote disclosures required annually need not be updated quarterly in the absence of highly unusual circumstances. It has attempted to clarify the language to make its intent clear although it has retained in the rule the general obligation to make disclosures adequate to make the information presented not misleading. This is a requirement for all filings with the Commission and has been included in Form 10-Q since the time of its adoption.

The new rules require income statements for the most recent quarter, the equivalent calendar quarter in the preceding year and year-to-date data for both years. Condensed funds statements are required on a year-to-date basis for the current and prior year. In addition, registrants are permitted to show income statement data and funds statement data for the twelve month period ending at the interim reporting date for both years if they elect to do so. Balance sheets are required as of the end of the most recent quarter and at the same date in the preceding year.

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In addition, the new rules require increased pro forma information in the case of business combinations accounted for as purchases, conformity with the principles of accounting measurement set forth in the Accounting Principles Board opinion on interim financial reports, and increased disclosure of accounting changes.

In connection with accounting changes, a letter from the registrant's independent public accountant is required to be filed in which the accountant states whether or not the change is to an alternative principle which in his judgment is preferable under the circumstances. A number of accountants objected to this requirement on the grounds that no standards exist for judging preferability among generally accepted accounting principles and that authoritative accounting principles only require that management justify that a change is to a preferable method. The Commission believes that professional accounting judgment can be applied to determine whether an alternative accounting principle is preferable in a particular set of circumstances. Since a substantial burden of proof falls upon management to justify a change, the Commission believes that the burden has not been met unless the justification is sufficiently persuasive to convince an independent professional accounting expert that in his judgment the new method represents an improved method of measuring business operations in the particular circumstances involved. The proposed rule has therefore been adopted as proposed.

In addition to financial statements, a new instruction to Form 10-Q requires management to provide a narrative analysis of the results of operations. The Commission's original proposal required such an analysis to follow the guidelines set forth in Guide 1 of "Guides for Preparation and Filing of Reports and Registration Statements under the Securities Exchange Act of 1934." Commentators pointed out that this Guide was designed to apply to a summary of earnings covering a period of several years and that some of the tests set forth in that Guide were not precisely applicable to interim reporting on Form 10-Q. While the Commission believes that the general principles set out in Guide 1 would be relevant to a quarterly analysis, it recognizes that certain quantitative tests are inapplicable, and that the shorter period covered by interim reports may have an impact on the types of analysis which will be most meaningful to investors. Accordingly, this instruction has been redrafted to make it specifically applicable to Form 10-Q and to give more general guidance

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to registrants rather than setting down quantitative tests. The new instruction requires explanation of the reasons for material changes in the amount of revenue and expense items from one quarter to the next (even though the preceding quarter may not be reported as such in the Form 10-Q), between the most recent quarter and the equivalent quarter in the preceding year, and between the year-to-date data and comparable data for the prior year. While such explanations are to be presented in narrative form, it is expected that they will include quantitative data in explaining the reasons for changes. In addition to requiring an analysis of operations, the new form includes an instruction which permits the registrant to furnish any additional information which management believes will be of significance to registrants. This same instruction requires the registrant to indicate whether a Form 8-K was filed during the quarter reporting either unusual charges or credits to income or a change of auditors.

Under the new rules, Form 10-Q must be signed by either the chief financial officer or the chief accounting officer of the corporation. This requirement was included in recognition of the fact that the data in the form were primarily financial, and that it was appropriate to emphasize the responsibility of the chief financial or accounting officer for the representations explicit and implicit in the filing. This signature will not relieve other corporate officers of their responsibilities.

Rescission of Form 7-Q

Since the rules and instructions adopted herein for Form 10-Q require a condensed quarterly statement of source and application of funds for all companies, the separate form (Form 7-Q) which sets forth this requirement for certain real estate companies is no longer required. Accordingly, Form 7-Q and the rules specifying its application are rescinded.

Review of Form 10-Q Data by Independent Public Accountant

The financial information included in Form 10-Q need not be reviewed prior to filing by an independent public accountant. However, certain registrants will be required to include certain data contained in the Form 10-Q in an unaudited note to financial statements for the year. Such a note must be reviewed by an independent public accountant in accordance with prescribed professional standards

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in connection with the annual audit. Since review procedures must be applied to quarterly data in connection with the annual audit of such registrants in any event, the additional cost to these registrants of having a review made on a timely basis should be small, particularly if the annual audit is planned with such a review in mind.

The Commission believes that all registrants would find it useful and prudent to have independent public accountants review quarterly financial data on a timely basis during the year prior to the filing of Form 10-Q and it encourages registrants to have such a review made. While such a review does not represent an audit and cannot be relied upon to detect all errors and omissions that might be discovered in a full audit of quarterly data, it will bring the reporting, accounting and analytical expertise of independent professional accountants to bear on financial reports included in Form 10-Q and therefore should increase the quality and the reliability of the data therein in a cost-effective way.

Instruction K of Form 10-Q permits registrants to state that an independent accountant has reviewed the financial information included therein if the accountant has reviewed the data in accordance with established professional standards and procedures for such a review. In Release No. 33-5612 of this date the Commission has proposed for comment such professional standards and procedures and it plans to adopt such standards prior to the effective date of the Form 10-Q revisions. The Commission notes, however, that AudSEC has issued for exposure a set of proposed standards and procedures for such a review, and if professional standards are adopted which the Commission believes are satisfactory to protect the interests of investors, it is the intention of the Commission to withdraw its proposed standards and rely on the standards established by AudSEC.

If the registrant has the independent public accountant perform such a review and elects to state this fact, the statement must also indicate whether all adjustments or additional disclosures proposed by the independent accountant have been reflected in the data presented, and if not, why not.

In addition, if the registrant states that such a review has been made, there may (but need not be) included as an exhibit to the form a letter from the registrant's

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independent accountant confirming or otherwise commenting upon the registrant's representations and making such other comments as the independent accountant deems appropriate.

A number of commentators have indicated that they do not believe that independent accountants should be permitted to associate their names with data on the basis of limited review procedures. This position is also taken in the AudSEC exposure draft on interim reviews referred to above. This view is based on the concern that users of the accountant's report will not be able to distinguish between a report covering an audit conducted in accordance with generally accepted auditing standards and a report on a limited review following specified procedures, and hence will be misled. The Commission has considered these comments, but is not prepared to conclude that investors will be unable to distinguish appropriately between different types of reports. It believes that an accountant's report on a limited review may provide significant and useful information to investors and that such reports should be encouraged. At the present time, however, the Commission does not propose to require such reports in connection with Form 10-Q filings.

In Securities Act Release No. 5579, the Commission proposed to amend the facing sheet of Form 10-Q to require registrants to indicate by check mark whether or not financial statements required by the form had been reviewed by independent public accountants. A number of commentators suggested that such a requirement would imply that a review was mandatory and that a "no" answer would indicate a deficiency in the form. Others commented that a simple yes or no answer on the front of the form would oversimplify a complex matter and would increase the likelihood of investors being misled.

The Commission has concluded that at the present time, the proposed check mark on the facing sheet of Form 10-Q is not necessary and it has determined not to adopt the amendment to the facing sheet.

Amendments to Forms S-7 and S-16

In Securities Act Release No. 5579 the Commission proposed amendments to Forms S-7 and S-16 which would have had the effect of permitting the use of Form S-7 by registrants not presently qualified to do so if the financial

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information included in their Form 10-Q filings was reviewed by independent public accountants and this fact was stated on Form 10-Q. Many commentators suggested that the involvement of public accountants on a review basis was not an equivalent test as compared to the current tests of financial strength and stability now required for the use of Form S-7. With few exceptions, they recommended that the amendments not be adopted.

The Commission is concerned about the cost of registering securities for sale and it is desirous of keeping such costs at a minimum consistent with the protection of investors. Accordingly, the Commission has approved publication for comment amendments to Forms S-7 and S-16. While such proposed amendments do not include timely auditor involvement as one of the criteria for use of the forms, they are designed to broaden the availability of the use of the forms by a larger number of companies.

Effective Date of Form 10-Q Amendments

The Commission has determined to make changes in Form 10-Q adopted hereby effective for Form 10-Q reports filed covering periods beginning after December 25, 1975, but in no event shall disclosure of comparative balance sheet data and source and application of funds data be required for interim periods beginning prior to that date.

B. Amendments Adopted

The text of the amendments to Regulation S-X, Form 10-Q and Form 7-Q and related rules follows (amendments are underlined or designated as new; deletions are bracketed or designated as deleted.)

I. Regulation S-X

Rule 2-02. Accountants' Reports.

(a) through (d) (No change)

(e) Association with unaudited note covering interim financial data. (New paragraph)

If the financial statements covered by the accountant's report designate as "unaudited" the note required by Rule

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3-16(t), it shall be presumed that appropriate professional standards and procedures with respect to the data in the note have been followed by the independent accountant who is associated with the unaudited footnote by virtue of reporting on the financial statements in which it is included.

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Rule 3-16. General Notes to Financial Statements. (See Release No. AS-4.)

* * * * *

(t) Disclosure of selected quarterly financial data in notes to financial statements. (New rule)

Exemption. This rule shall not apply to any registrant that does not meet the following conditions:

(a) The registrant (1) has securities registered pursuant to Section 12(b) of the Securities Exchange Act of 1934 or (2) has securities registered pursuant to Section 12(g) of that Act which also (i) are quoted on the National Association of Securities Dealers Automated Quotation System and (ii) meet the requirements for continued inclusion on the list of OTC margin stocks set forth in Section 220.8(i) of Regulation T of the Board of Governors of the Federal Reserve System; and

(b) The registrant and its consolidated subsidiaries (1) have had a net income after taxes but before extraordinary items and the cumulative effect of a change in accounting, of at least \$250,000 for each of the last three fiscal years; or (2) had total assets of at least \$200,000,000 for the last fiscal year end.

(1) Disclosure shall be made in a note to financial statements of net sales, gross profit (net sales less costs and expenses associated directly with or allocated to products sold or services rendered), income before extraordinary item and cumulative effect of a change in accounting, per share data based upon such income, and net income for each full quarter within the two most recent fiscal years and any subsequent interim period for which income statements are presented.

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(2) When the data supplied in (1) above vary from the amounts previously reported on the Form 10-Q filed for any quarter, such as would be the case when a pooling of interests occurs or where an error is corrected, reconcile the amounts given with those previously reported describing the reason for the difference.

(3) Describe the effect of any disposals of segments of a business, and extraordinary, unusual or infrequently occurring items recognized in each full quarter within the two most recent fiscal years and any subsequent interim period for which income statements are presented, as well as the aggregate effect and the nature of year-end or other adjustments which are material to the results of that quarter.

(4) Where this note is part of financial statements which are presented as audited, it may be designated "unaudited."

* * * * *

Article 11A. Statement of Source and Application of Funds.

Rule 11A-01. Application of Article 11A.

This article shall be applicable to statements of source and application of funds filed pursuant to requirements in registration and reporting forms under the Securities Act of 1933 and the Securities Exchange Act of 1934[, except that companies which are required to file quarterly reports on Form 7-Q shall comply, in all filings, with the requirements as to type, form and content of a funds statement specified in that form].

II. Rule 13a-13. Quarterly Reports on Form 10-Q.

(a), (b)(1), (c) and (d) (No change)

(b)(2) (Deleted)

(b)(3), (4) and (5) become (b)(2), (3) and (4), respectively.

III. Rule 13a-15. Quarterly Reports of Certain Real Estate Companies on Form 7-Q.

(This rule is rescinded.)

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IV. Rule 15d-13. Quarterly Reports on Form 10-Q.

(a), (b)(1), (c) and (d) (No change)

(b)(2) (Deleted)

(b)(3), (4) and (5) become (b)(2), (3) and (4), respectively.

V. Rule 15d-15. Quarterly Reports of Certain Real Estate Companies on Form 7-Q.

(This rule is rescinded.)

VI. Form 7-Q. For Quarterly Reports of Certain Real Estate Companies Under Section 13 or 15(d) of the Securities Exchange Act of 1934.

(This form is rescinded.)

VII. Form 10-Q. For Quarterly Reports Under Section 13 or 15(d) of the Securities Exchange Act of 1934.

Instructions A through G (No change)

H. Financial Statements. [Presentation of Financial Information]

(a) (Existing paragraph deleted) (New rule) The registrant shall furnish an income statement, balance sheet and statement of source and application of funds for the periods set forth in (b) below. These statements shall follow the general form of presentation set forth in Regulation S-X with the following exceptions:

(1) Balance sheets and income statements shall include only major captions (i.e., numbered captions) set forth in Regulation S-X, with the exception of Inventories where data as to raw materials, work in process and finished goods shall be included, if applicable. Where any major balance sheet caption is less than 10% of total assets, and the amount in the caption has not increased or decreased by more than 25% since the previous balance sheet presented, the caption may be combined with others. When any major income statement caption is less than 15% of average net income for the most recent three years and the amount in the caption has not increased or decreased by more than 20% as compared to the next preceding

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comparable income statement, the caption may be combined with others. In calculating average net income, loss years should be excluded. If losses were incurred in each of the most recent three years, the average loss shall be used for purposes of this test. Notwithstanding these tests, Rule 3-02 of Regulation S-X applies and de minimis amounts therefore need not be shown separately.

(2) The statement of source and application of funds may be abbreviated, starting with a single figure of funds provided by operations and showing other sources and applications individually only when they exceed 10% of the average of funds provided by operations for the most recent three years. Notwithstanding this test, Rule 3-02 of Regulation S-X applies and de minimis amounts therefore need not be shown separately.

(3) Rules 3-08 and 3-16 of Regulation S-X and other requirements which call for detailed footnote disclosure and schedules shall not apply. As with all information filed with the Commission, however, disclosures must be adequate to make the information presented not misleading.

A company in the promotional or development stage to which paragraph (b) of Rule 5A-01 of Article 5A of Regulation S-X is applicable shall furnish the information specified in Rules 5A-02, 5A-03, 5A-04 and 5A-06 of Regulation S-X in lieu of the above financial statement requirements.

(b) (Existing paragraph deleted) (New rule) The condensed financial statements shall be provided for periods set forth below:

(1) The condensed income statement shall be presented for the most recent fiscal quarter, for the period between the end of the last fiscal year and the end of the most recent fiscal quarter, and for corresponding periods of the preceding fiscal year. It also may be presented for the cumulative twelve month period ended during the most recent fiscal quarter and for the corresponding period of the preceding fiscal year.

(2) The balance sheet shall be presented as of the end of the most recent fiscal quarter and for the end of the corresponding period of the preceding fiscal year. However, balance sheets for dates prior to December 26, 1975, are not required.

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(3) The statement of source and application of funds shall be presented for the period between the end of the last fiscal year and the end of the most recent fiscal quarter, and for the corresponding period of the preceding fiscal year. It also may be presented for the cumulative twelve month period ended during the most recent fiscal quarter and for the corresponding period of the preceding fiscal year.

(c) (First sentence of existing paragraph is deleted.) For registrants engaged in the seasonal production and the seasonal sale of a single-crop agricultural commodity, the [summarized financial information may include information] income statement may be presented for the twelve months ended with the current interim quarter, with comparative data for the corresponding period of the preceding fiscal year in place of the current quarter and year-to-date information specified by [(a)] (b)(1) above.

(d) If, during the current period specified in [(a)] (b) above, the registrant or any of its consolidated subsidiaries, entered into a business combination treated for accounting purposes as a pooling of interests, the [results of operations reported herein--] interim financial statements for both the current year and the preceding year[--] shall reflect the combined results of the pooled businesses. Supplemental disclosure of the separate results of the combined entities for periods prior to the combination shall be given, with appropriate explanations.

(e) In case the registrant has disposed of any significant portion of its business [or has acquired a significant amount of assets in a transaction treated for accounting purposes as a purchase,] during any of the periods covered by the report, the effect thereof on revenues and net income--total and per share--for all periods shall be disclosed. In addition, where a material business combination accounted for as a purchase has occurred during the current fiscal year, pro forma disclosure shall be made of the results of operations for the current year up to the date of the end of the most recent fiscal quarter (and for the comparable period in the preceding year) as though the companies had combined at the beginning of the period being reported on. This pro forma information should as a minimum show revenue, income before extraordinary items and the cumulative effect of accounting changes, such income on a per share basis and net income.

(f) (Existing paragraph deleted) (New rule) The financial statements to be included in this report shall be

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prepared in conformity with the standards of accounting measurement set forth in Accounting Principles Board Opinion No. 28 and any amendments thereto adopted by the Financial Accounting Standards Board. In addition to meeting the reporting requirements for accounting changes specified therein, the registrant shall state the date of any change and the reasons for making it. In addition, in the first Form 10-Q filed subsequent to the date of an accounting change, a letter from the registrant's independent accountants shall be filed as an exhibit indicating whether or not the change is to an alternative principle which in his judgment is preferable under the circumstances; except that no letter from the accountant need be filed when the change is made in response to a standard adopted by the Financial Accounting Standards Board which requires such change.

(g) (Existing paragraph deleted) (Formerly paragraph k) If appropriate, the [summary] income statement shall [be prepared to] show earnings per share and dividends per share applicable to common stock [Per share earnings and dividends declared for each period of the summary shall be included] and the basis of the earnings per share computation shall be stated together with the number of shares used in the computation. The registrant shall file as an exhibit a statement setting forth in reasonable detail the computation of per share earnings, unless the computation is otherwise clearly set forth in the report.

(h) and (i) (No change)

(j) (Deleted)

(k) (Now becomes (g).)

I. (New rule) Management's Analysis of Quarterly Income Statements. (Existing Instruction I becomes Instruction L)

The registrant shall provide a narrative analysis of the results of operations explaining the reasons for material changes in the amount of revenue and expense items between the most recent quarter and the quarter immediately preceding it, between the most recent quarter and the same calendar quarter in the preceding year, and, if applicable, between the current year to date and the same calendar period in the preceding year. Explanations of material changes should include, but not be limited to, changes in the various elements which determine revenue and expense

levels such as unit sales volume, prices charged and paid, production levels, production cost variances, labor costs and discretionary spending programs. In addition, the analysis should include an explanation of the effect of any changes in accounting principles and practices or in the method of their application that have a material effect on net income as reported.

J. (New rule) Other Financial Information. (Existing Instruction J become Instruction N)

The registrant may furnish any additional information related to the periods being reported on which, in the opinion of management, is of significance to investors, such as the seasonality of the company's business, major uncertainties currently facing the company, significant accounting changes under consideration and the dollar amount of backlog of firm orders. In addition, the registrant shall indicate whether any Form 8-K was required to be filed reporting any material unusual charges or credits to income during the most recently completed fiscal quarter or whether any Form 8-K was required to be filed during that period reporting a change in independent accountants.

K. (New rule) Review by Independent Public Accountant.

The financial information included in this form need not be reviewed prior to filing by an independent public accountant. If, however, a review of the data is made in accordance with established professional standards and procedures for such a review, the registrant may state that the independent accountant has performed such a review. If such a statement is made, the registrant shall indicate whether all adjustments or additional disclosures proposed by the independent accountant have been reflected in the data presented, and, if not why not. In addition, a letter from the registrant's independent accountant confirming or otherwise commenting upon the registrant's representations and making such other comments as the independent accountant deems appropriate may be included as an exhibit to the form.

L. Filing of Other Statements in Certain Cases. (Formerly Instruction I) (No change)

M. Sales of Unregistered Securities (Debt or Equity). (Formerly Part C)

The information called for herein shall be given as to each "security" as defined in Section 2(1) of the Securities

Act of 1933. If the information called for has been previously reported on another form, it may be incorporated by a specific reference to the previous filing.

Give the following information as to all securities of the registrant sold by the registrant during the fiscal quarter, which were not registered under the Securities Act of 1933, in reliance upon an exemption from registration provided by Section 4(2) of that Act. Include sales of the registrant's reacquired securities as well as new issues, securities issued in exchange for property, services or other securities, and new securities resulting from the modification of outstanding securities:

(1) Give the date of sale, and the title and amount of the registrant's securities sold;

(2) Give the market price on the date of sale, if applicable;

(3) Give the names of the brokers, underwriters or finders, if any. As to any securities sold but which were not the subject of a public offering, name the persons or identify the class of persons to whom the securities were sold;

(4) As to securities sold for cash, state the aggregate offering price and the aggregate underwriting discounts, brokerage commissions, or finder's fees. As to any securities sold otherwise than for cash, state the nature of the transaction and the nature and aggregate amount of consideration received by the registrant;

(5) Indicate the section of the Act or rule of the Commission under which exemption from registration was claimed, and state briefly the facts relied upon to make the exemption available; and

(6) State whether the securities have been legended and stop-transfer instructions given in connection therewith, and if not, state the reasons why not.

N. Signature and Filing of Report. (Formerly Instruction J)

Eight copies of the report shall be filed with the Commission. At least one copy of the report shall be filed with each exchange on which any class of securities of the registrant is listed and registered. At least one copy of

the report filed with the Commission and one copy filed with each such exchange shall be manually signed on the registrant's behalf by a duly authorized officer of the registrant and by the principal financial officer or chief accounting officer of the registrant. Copies not manually signed shall bear typed or printed signatures.

A. Summarized Financial Information

(Existing Part A deleted)

B. Capitalization and Stockholders' Equity

(Existing Part B deleted)

C. Sales of Unregistered Securities (Debt or Equity)

Part C becomes general Instruction M.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

(Registrant)

Date _____

(Signature)*

Date _____

(Signature)*

* Print name and title of the signing officer under his signature.

* * * * *

These amendments are adopted pursuant to authority in Sections 6, 7, 8, 10 and 19(a) of the Securities Act of 1933; Sections 12, 13, 15(d) and 23(a) of the Securities Exchange Act of 1934; and Sections 5(b), 14 and 20(a) of the Public Utility Holding Company Act of 1935.

The amendments of Rule 11A-01 of Regulation S-X, Exchange Act Rules 13a-13, 13a-15, 15d-13, 15d-15 and Forms 7-Q and 10-Q will be effective for reports filed for periods beginning after December 25, 1975, but in no event shall comparative balance sheet data or source and application of funds data be required for interim periods beginning prior to December 25, 1975. Rules 2-02(e) and 3-16(t) of Regulation S-X shall be applicable to financial statements for all fiscal periods beginning subsequent to December 25, 1975, but in no event shall disclosure of quarterly data be required for quarters beginning prior to that date.

By the Commission.

George A. Fitzsimmons
Secretary

For IMMEDIATE Release Monday, April 25, 1938

SECURITIES AND EXCHANGE COMMISSION
Washington

ACCOUNTING SERIES
Release No. 4

Administrative Policy on Financial Statements

The Securities and Exchange Commission today issued the following statement of its administrative policy with respect to financial statements:

"In cases where financial statements filed with this Commission pursuant to its rules and regulations under the Securities Act of 1933 or the Securities Exchange Act of 1934 are prepared in accordance with accounting principles for which there is no substantial authoritative support, such financial statements will be presumed to be misleading or inaccurate despite disclosures contained in the certificate of the accountant or in footnotes to the statements provided the matters involved are material. In cases where there is a difference of opinion between the Commission and the registrant as to the proper principles of accounting to be followed, disclosure will be accepted in lieu of correction of the financial statements themselves only if the points involved are such that there is substantial authoritative support for the practices followed by the registrant and the position of the Commission has not previously been expressed in rules, regulations or other official releases of the Commission, including the published opinions of its Chief Accountant."

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

ARTHUR ANDERSEN & CO.,
Plaintiff,

v.

SECURITIES & EXCHANGE COMMISSION,
Defendant.

Civil Action No. 76 C 2832

John C. Burton, having been duly sworn, states as follows:

1. He is the Chief Accountant of the Securities and Exchange Commission.
2. He is a graduate of Haverford College, and received his masters and doctorate degrees from Columbia University.
3. Prior to joining the Commission as Chief Accountant in June of 1972, he had for the past ten years been a Professor of Accounting and Finance at the Graduate School of Business, Columbia University.
4. He is a certified public accountant under the laws of the state of New York, and practiced as a public accountant for four years with the national accounting firm of Arthur Young & Co.

5. As Chief Accountant of the Commission, he is responsible to the Commission for all accounting matters arising in the administration of the Acts administered by the Commission, particularly with respect to new accounting policy determinations, the form and content of financial statements to be filed with the Commission, and the supervision of procedures to be followed in audit or accounting investigations conducted by the Commission staff.

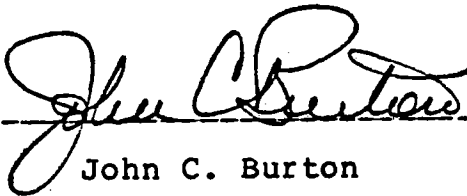
6. He has monitored the compliance with instruction H(f) to Form 10-Q since the instruction became effective.

7. He is not aware of any accounting firm, with the exception of Arthur Andersen & Co., that has adopted a policy of refusing to comply with the requirements of instruction H(f) by refusing to provide the requested letter commenting on their client's change in accounting principles.

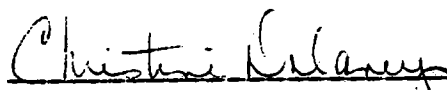
8. Other major public accounting firms have given letters to their clients for filing with the Commission in conformity with the requirements of instruction H(f).

9. In his judgment, the determination of whether or not an accounting change is preferable, as called for by instruction H(f), is within the professional competence of members of the accounting profession. See, for example, the attached letter from the auditors for General Motors Corporation.

Executed at Washington, D.C., the 10th day of
August, 1976.


John C. Burton

Subscribed and sworn to before me, a notary public,
in and for the District of Columbia, the 10th day of August, 1976.


Notary Public, D.C.

My Commission expires ~~My Commission Expires Dec. 14, 1978~~

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS

ARTHUR ANDERSEN & CO.,	:	Civil Action No. 76 C 2832
Plaintiff,	:	(Judge Lynch)
	:	
v.	:	NOTICE OF APPEARANCE
	:	AND DESIGNATION OF
SECURITIES AND EXCHANGE COMMISSION	:	LOCAL COUNSEL FOR
	:	<u>PURPOSES OF SERVICE</u>
Defendant.	:	

SIR:

PLEASE TAKE NOTICE that, pursuant to Rule 6 of the Civil Rules of this Court, the following persons hereby enter their respective appearances as attorneys of record herein for defendant Securities and Exchange Commission; all papers may be served upon the undersigned counsel at the indicated address;

Paul Gonson, Esq.
Telephone: 202-755-1178

Marvin G. Pickholz, Esq.
Telephone: 202-755-4874

Melvin A. Brosterman, Esq.
Telephone: 202-376-8004

Lloyd H. Feller, Esq.
Telephone: 202-755-1180

The address of each of the above persons is c/o Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549.

PLEASE TAKE FURTHER NOTICE that, pursuant to Rule 7 of the General Rules of this Court, defendant Securities and Exchange Commission hereby designates William M. Hegan, Assistant Regional Administrator, a member of the bar of this Court, whose local address is c/o Securities and Exchange Commission,

Everett McKinley Dirksen Building, Room 1204, 219 South Dearborn Street, Chicago, Illinois 60604 as a person upon whom papers may be served within this district, in addition to service of papers upon any or all of the above indicated attorneys of record herein for defendant Securities and Exchange Commission.

PLEASE TAKE FURTHER NOTICE that by complying with the aforesaid Civil and General Rules of this Court, and by filing this notice of appearance and designation of local counsel, defendant Securities and Exchange Commission does not intend and shall not be deemed to have waived, and expressly reserves its right to assert or make, any defense which it might assert or make by motion or pleading as permitted by Rule 12 of the Federal Rules of Civil Procedure.

Respectfully submitted,


Marvin G. Pickholz

Attorney for Defendant
SECURITIES AND EXCHANGE COMMISSION
500 North Capitol Street
Washington, D.C. 20549
Telephone: 202-755-4874

HASKINS & SELLS

CERTIFIED PUBLIC ACCOUNTANTS

1114 AVENUE OF THE AMERICAS
NEW YORK, NEW YORK 10036

May 13, 1976

General Motors Corporation,
3044 West Grand Boulevard,
Detroit, Michigan 48202.

Dear Sirs:

At your request, we have read the description included in your Form 10-Q for the quarter ended March 31, 1976 of the facts relating to your intention to change to the Last-in, First-out (LIFO) method of inventory valuation from the First-in, First-out (FIFO) the average cost method, for certain components of the inventories in the United States. We believe, on the basis of the facts so set forth and other information furnished to us by appropriate officials of the Corporation, that the accounting change described in your Form 10-Q is to an alternative accounting principle that is preferable under the circumstances.

We have not examined any consolidated financial statements of General Motors Corporation and consolidated subsidiaries as of any date or for any period subsequent to December 31, 1975. Therefore we are unable to and do not express any opinion on the facts set forth in the above-mentioned Form 10-Q, on the related information furnished to us by your officials, or on the financial position, changes in financial position, or results of operations of General Motors Corporation and consolidated subsidiaries as of any date or for any period subsequent to December 31, 1975.

Yours truly,

