Publications in Deloitte’s Roadmap Series

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Preface

June 2020

To the clients, friends, and people of Deloitte:

We are pleased to present the 2020 edition of *A Roadmap to SEC Reporting Considerations for Business Combinations*. This Roadmap is intended to help registrants navigate their SEC reporting requirements related to the acquisition or probable acquisition of a business. It combines the SEC’s[1] guidance on reporting for business acquisitions — including acquisitions of real estate operations and pro forma financial information — with Deloitte’s interpretations (Q&As) and examples in a comprehensive, reader-friendly format. Most of the updates in the 2020 edition of the Roadmap expand on or clarify existing text.

Registrants may be required under SEC rules to file the acquiree’s separate annual and interim preacquisition financial statements along with the related pro forma financial information. Disclosure of this information can be important to investors because an acquisition will generally affect a registrant’s financial condition, results of operations, liquidity, and future prospects. While registrants are also required to disclose the nature and financial impact of a business combination under the FASB’s accounting standards, the SEC’s requirements are significantly more detailed and can result in considerable financial reporting responsibilities regardless of whether a company acquires businesses frequently or only occasionally.

In May 2020, the SEC issued a *final rule*[2] to improve the information investors receive regarding acquired or disposed businesses, reduce the complexity and costs of preparing the required disclosures, and facilitate timely access to capital. For example, the final rule modifies certain significance tests to reduce the potential for anomalous results that may have required a registrant to provide acquiree financial statements that may not be material to investors. Further, it allows registrants to (1) present fewer acquiree financial statement periods, (2) present acquiree financial statements in fewer circumstances, and (3) when certain criteria are met, use abbreviated financial statements without requesting permission from the SEC staff.

The final rule also modifies the criteria for pro forma adjustments by replacing current requirements with two categories of required adjustments that depict (1) only the accounting for the transaction (referred to as transaction accounting adjustments) and (2) the registrant as a stand-alone entity (referred to as autonomous entity adjustments). In addition, the final rule gives management the option to disclose, in the form of a reconciliation in the notes to the pro forma financial information, synergies and “dis-synergies” (referred to as management’s adjustments) if certain conditions are met. The final rule must be adopted for fiscal years beginning after December 31, 2020; however, early application is permitted. For more information about the final rule, see the *Changing Lanes* discussion in the Roadmap’s introduction; *Appendix C*, which summarizes a registrant’s disclosure requirements before

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1 For a list of abbreviations used in this publication, see *Appendix E*.
and after adoption of the final rule; and Deloitte’s June 2, 2020, *Heads Up*. Note that the final rule’s amendments are not yet reflected in this Roadmap — stay tuned for future updates.

Subscribers to the [Deloitte Accounting Research Tool (DART)](https://dart.deloitte.com) may access any interim updates to this publication by selecting the document from the “Roadmaps” tab on DART’s home page. If a “Summary of Changes Since Issuance” displays, subscribers can view those changes by clicking the related links or by opening the “active” version of the Roadmap.

This Roadmap is not a substitute for the exercise of professional judgment, which is often essential to applying the financial reporting guidance for various business acquisitions and pro forma financial information. It is also not a substitute for consulting with Deloitte professionals on complex transactions and SEC reporting matters.

We hope that you will find this publication to be a valuable resource when considering the SEC reporting requirements related to business combination transactions.

Sincerely,

Deloitte & Touche LLP
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Introduction to SEC Reporting
Considerations for Business Combinations

Overview
To ensure that investors receive relevant financial information about a company’s significant activities, the SEC requires registrants to report financial information about significant acquired or to be acquired businesses or the acquisition of real estate operations (the acquiree) in certain filings under Regulation S-X, Rules 3-05 and 3-14, respectively. This Roadmap discusses the SEC’s requirements related to the reporting and disclosure of business acquisitions as well as its related guidance on pro forma financial information under Regulation S-X, Article 11.

A registrant’s requirement to present the separate historical financial statements of an acquiree under Rule 3-05 depends on certain factors, including (1) whether the acquired assets and liabilities meet the definition of a business for SEC reporting purposes, (2) the significance of the acquisition, and (3) whether consummation of the business acquisition is probable or has recently occurred. The financial statement periods that must be presented are determined on the basis of the highest level of significance for the acquisition, which is assessed by performing the asset, investment, and income significance tests outlined in Regulation S-X, Rule 1-02(w).

Rule 3-14 differs from Rule 3-05 in a number of ways, including its requirements that a registrant file only abbreviated income statements for significant acquired or to be acquired real estate operations and that the number of periods to be presented is generally limited to the most recent fiscal year and interim period, if applicable.

In addition to filing the separate financial statements of an acquired or to be acquired business or the abbreviated income statements of an acquired or to be acquired real estate operation, registrants also need to consider whether they must provide pro forma financial information in accordance with Article 11. Pro forma financial information helps investors evaluate the impact of a significant business acquisition by showing how that acquisition (or acquisitions) might have affected the registrant’s historical financial position and results of operations had the transaction occurred at an earlier date.

Rule 3-13 Waivers and Other Requests
There may be situations in which registrants wish to seek relief from complying with the various reporting requirements under Regulation S-X, including the omission of financial statements of an acquiree under Rule 3-05 or Rule 3-14. Regulation S-X, Rule 3-13, has historically given the SEC staff the authority to permit the omission or substitution of certain financial statements otherwise required under Regulation S-X “where consistent with the protection of investors.” SEC leadership continues to encourage registrants to seek relief from financial reporting requirements as permitted under Rule 3-13.

1 For a list of the titles of standards and other literature referred to in this publication, see Appendix D.
particularly when the requirements are burdensome but may not be material to the total mix of information available to investors.

The SEC has provided the following examples of potential Rule 3-13 waivers related to financial statement requirements for acquired or to-be-acquired businesses (“acquirees”) under Regulation S-X, Rule 3-05:

- **Anomalous income test** — An acquiree may be significant solely on the basis of the income test; this may be the case when the registrant reports near break-even results. In these circumstances, the staff may look at other financial and nonfinancial measures to supplement the income test. For example, the staff may compare the revenue and operating income of the acquiree with those of the registrant (or with other, nonfinancial measures) when evaluating the registrant’s request to waive financial statements of the acquiree for one or more years.

- **Anomalous investment test** — When an acquiree is significant solely on the basis of the investment test, the staff may want to understand why the registrant is acquiring the acquiree at a premium. The staff indicated that in this situation, the staff may consider whether an audited statement of assets acquired and liabilities assumed, which reflects the application of the purchase price at fair value on the transaction date, may be more relevant and useful to investors than historical audited financial statements.

- **Related businesses** — Acquisitions of related businesses must be evaluated for significance as a single business combination. If these acquisitions are significant in the aggregate, audited financial statements are generally required for all of the related businesses. The staff will consider waivers for individual related businesses that are not significant to the overall transaction.

- **IPOs** — The financial statement periods presented during an IPO may exhibit significant growth. Businesses acquired in the earliest period presented may be significant under the literal application of the significance tests but may not be material to the registrant’s current operations. The staff may consider relief from providing one (or more) financial statement periods required in these circumstances.

- **Acquisition of a foreign entity** — A registrant may acquire an entity that meets the definition of a foreign private issuer, but not a foreign business, because of nuances in the ownership requirements in the two definitions. In the absence of a waiver, the financial statements for a foreign entity that does not qualify as a foreign business would need to be (1) prepared in accordance with U.S. GAAP or (2) reconciled to U.S. GAAP if presented under IFRS® Standards or local GAAP. The staff may grant relief by allowing a registrant to file IFRS financial statements for an acquiree without reconciliation to U.S. GAAP in such circumstances.

Registrants may consider seeking a waiver of the Rule 3-05 financial statement and related pro forma requirements even before an acquisition is consummated. For example, a registrant may not want to finalize an acquisition until it is assured that it can meet the Rule 3-05 financial statement requirements or secure a waiver. While a registrant may be granted relief from providing Rule 3-05 financial statements and related pro forma requirements before consummating an acquisition, we understand that it is still required to file Form 8-K, Item 2.01, to disclose the completion of the acquisition, because the waiver under Rule 3-13 applies only to the historical and pro forma financial statement requirements. The SEC staff has indicated that it is available to discuss potential waiver fact patterns by phone before a registrant submits a written request.

For additional guidance on Rule 3-13 waivers and prefiling letter requests, see Appendix B of Deloitte’s *SEC Comment Letter Considerations, Including Industry Insights*.
Changing Lanes

In May 2020, the SEC issued a final rule that amends the financial statement requirements for acquisitions and dispositions of businesses, including real estate operations, and related pro forma financial information. In addition, the final rule includes amendments to financial disclosures specific to smaller reporting companies (SRCs) and investment companies. The amendments are intended to improve the information investors receive regarding acquired or disposed businesses, reduce complexity and costs of preparing the required disclosures, and facilitate timely access to capital.

Key amendments in the final rule will:

- Change the investment test to use the aggregate worldwide market value of common equity of the registrant when available.
- Change the income test to use the lower of significance based on (1) income from continuing operations before taxes or (2) revenue.
- Reduce the number of required acquiree annual financial statement periods to a maximum of the two most recent fiscal years.
- Require acquiree financial statements for an IPO in fewer circumstances.
- Modify the disclosure requirements for individually insignificant acquirees.
- Permit the use of abbreviated financial statements for an acquiree in certain circumstances without a request for SEC staff permission.
- Extend the use of, and allow the reconciliation to, IFRS® Standards as issued by the International Accounting Standards Board (IASB®) (IFRS-IASB) in certain circumstances.
- Amend the pro forma financial information disclosures to require adjustments and certain disclosures for (1) transaction accounting adjustments and (2) if a registrant was previously part of another entity, autonomous entity adjustments.
- Permit a registrant to present, in the explanatory notes to the pro forma financial information, management’s adjustments (e.g., synergies or dis-synergies for which there is a reasonable basis), if certain conditions are met.
- Align certain requirements for a real estate acquiree with those in Rule 3-05.
- Raise the significance threshold for reporting dispositions of a business from 10 percent to 20 percent to conform the threshold with that of a significant acquisition.
- Make other changes specific to SRCs and investment companies.²

Despite these changes, many elements of Rule 3-05 were retained under the amendments in the final rule. For example, although the amendments modify two of the significance tests, the final rule retains the use of bright-line significance thresholds. In addition, the final rule retains the existing definition of a business for SEC reporting purposes (see Section 1.3.1 for a discussion of the definition of a business). Further, some of the amendments codify existing SEC staff practice or interpretations and thus may not result in a significant change in practice. Also, although the amendments may reduce the financial statement requirements under Rule 3-05 (e.g., by eliminating a third year of acquiree financial statements), they do not extend to

² SRCs and investment companies registered under the Investment Company Act of 1940 should refer to the discussion in the Smaller Reporting Companies and Investment Companies sections, respectively, of Deloitte’s June 2, 2020, Heads Up for summaries of how the final rule would affect them.
target companies included in a proxy statement or registration statement on Form S-4 or
(2) a company that is considered the predecessor\(^3\) of a registrant.

The final rule will become effective at the beginning of the registrant's fiscal year that starts
after December 31, 2020 (e.g., the mandatory compliance date would be January 1, 2021, for
calendar-year-end companies). However, voluntary compliance is permitted before the effective
date as long as the final rule is applied in its entirety on that date. For more information, see
Appendix C, which summarizes a registrant's disclosure requirements before and after adoption
of the final rule, and Deloitte's June 2, 2020, Heads Up.

Note that since registrants may continue to apply the existing requirements (i.e., before the
final rule's amendments) for some time, the final rule's changes are not yet reflected in this
Roadmap — stay tuned for future updates.

**Additional Guidance**

When determining the appropriate SEC reporting requirements, registrants should review the Q&As in
this Roadmap in conjunction with Regulation S-X and should also consider consulting with their audit
and legal professionals.

Given the interrelated nature of certain topics, such as Rule 3-05 and pro forma financial information,
readers should refer to the various relevant sections of this Roadmap to understand the reporting
implications of a registrant's significant activities.

Note that this Roadmap does not provide guidance on U.S. GAAP requirements related to business
combinations. For such guidance, readers should refer to ASC 805 and other applicable accounting
standards as well as Deloitte's Roadmaps on business combinations, carve-out transactions, and other
topics that address business combinations.

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\(^3\) See paragraph 1170.1 of the FRM.
1.1 Introduction to SEC Reporting Considerations for Business Combinations by Domestic Filers Under Regulation S-X

This introduction outlines the considerations used to determine the SEC reporting requirements for business combinations by domestic SEC registrants. The Q&As that follow offer additional interpretations, and registrants should be certain to review both those interpretations and Regulation S-X, as well as consider consulting with their audit and legal professionals, to determine the appropriate SEC reporting requirements. Note that this chapter does not provide guidance on business combinations under U.S. GAAP. For such guidance, see ASC 805 and Deloitte’s A Roadmap to Accounting for Business Combinations.

When an SEC registrant (acquirer) consummates or it is probable that it will consummate a significant business acquisition, the SEC may require the filing of certain financial statements for the acquired or to be acquired business (acquiree). For example, the filing in a Form 8-K of financial statements for the acquired business, if significant, may be required. Further, if the acquirer files a registration statement or a proxy statement, separate financial statements for the acquiree may be required in addition to the financial statements for the acquirer. Including the acquiree’s separate financial statements in the filing allows current and prospective investors to evaluate the future impact of the acquiree on the registrant’s consolidated results. Pro forma financial information is required in addition to these financial statements. Separate financial statements for the acquiree are not required in Form 10-K or 10-Q. See Chapter 3 for a discussion of the requirements related to pro forma financial information.

The following factors govern whether, and for what period, financial statements for the acquiree are required:

• Whether the acquired or to be acquired assets and liabilities meet the definition of a business.
• Significance of the acquired or to be acquired business.
• Whether consummation of the business acquisition is probable or has recently occurred.

Each of these considerations is explained in more detail below.

Whether the Acquired or to Be Acquired Assets and Liabilities Meet the Definition of a Business

Separate financial statements of the acquired or to be acquired assets and liabilities are required only if they meet the definition of a business for SEC reporting purposes. If a registrant acquires or it is probable that it will acquire a group of assets and liabilities that do not meet the definition of a business for SEC reporting purposes, no financial statements for the acquired or to be acquired assets and liabilities are required to be filed. The definition of a business for SEC reporting purposes is not the same as the definition for U.S. GAAP accounting purposes.

1 To determine when an acquisition is consummated under U.S. GAAP, refer to ASC 805.
Significance of the Acquired or to Be Acquired Business

Three tests are used to determine the significance of the acquiree:

1. Investment or purchase price (investment test).
2. Income from continuing operations, before income taxes, exclusive of amounts attributable to any noncontrolling interests (income test).
3. Proportionate share of total assets (asset test).

All three tests must be performed, and the one that results in the highest significance level will determine the financial statement periods that must be presented. Various significance thresholds (i.e., does not exceed 20 percent, exceeds 20 percent but not 40 percent, exceeds 40 percent but not 50 percent, and exceeds 50 percent) are applied to a business acquisition. Each of these threshold levels requires a different number of financial statement periods to be presented.

Generally, the most recent preacquisition annual financial statements of both the acquirer and the acquiree should be used for the significance tests.

Whether Consummation of the Business Acquisition Is Probable or Has Recently Occurred

The financial statements of a significant business acquisition are generally required 75 days after the acquisition is consummated.2 However, there is a different threshold for determining whether financial statements are required for an acquisition whose consummation is probable or an acquisition that has been recently consummated (i.e., consummated less than 75 days ago). The following guidance applies to registrants with a business acquisition whose consummation is probable or to those whose business acquisition has been recently consummated, but in which the filing of financial statements in a Form 8-K is not yet required because the acquisition was consummated less than 75 days ago.

Financial statements for a probable business acquisition or a recently consummated business acquisition that exceeds the 50 percent significance level are required in a registration statement and in certain proxy statements that are filed or declared effective prior to the 75th day after consummation. Financial statements are not required for a probable business acquisition or a recently consummated business acquisition that is at or below the 50 percent significance level in a registration statement and in certain proxy statements that are filed or declared effective prior to the 75th day after consummation unless the financial statements have been previously filed by the registrant.

For example, assume that within the last 75 days, a U.S. registrant acquired a business that exceeds the 50 percent significance level. However, filing the financial statements in a Form 8-K for the recently acquired business is not yet required because 75 days have not elapsed since the consummation date. Notwithstanding the Form 8-K due date, the registrant is required to include the financial statements of the recently acquired business in a registration statement that is filed or declared effective before the required Form 8-K, because it exceeds the 50 percent significance level. Assuming the business acquired did not exceed the 50 percent significance level, and the acquisition was consummated less than 75 days before the date the registration statement was filed or declared effective, these financial statements would not be required in a registration statement.

In accordance with the Form 8-K rules, a registrant has four business days after the consummation of a significant business acquisition to file the initial Form 8-K. A registrant has 71 calendar days after the initial Form 8-K was required to be filed to file the required financial statements of the significant business acquiree and pro forma financial information. Therefore, a registrant may have a period longer than 75 calendar days to file the amended Form 8-K.
Rule 3-13 Waivers and Other Requests

There may be situations in which registrants may wish to seek relief from complying with the various reporting requirements under Regulation S-X, including the omission of financial statements of an acquired or to be acquired business under Rule 3-05. Rule 3-13 has historically given the SEC staff the authority to permit the omission or substitution of certain financial statements otherwise required under Regulation S-X “where consistent with the protection of investors.”

For additional guidance on Rule 3-13 waivers and prefiling letter requests, see the introduction of this Roadmap and Appendix B of Deloitte’s SEC Comment Letter Considerations, Including Industry Insights.

1.2  Identifying a Probable Business Acquisition

1.2.1  Identifying a Probable Business Acquisition

Q&A Regulation S-X: Rule 3-05(a)(1)(i)-1

Rule 3-05 requires presentation of financial statements for an acquired business or a business whose acquisition is probable.

Question

For SEC reporting purposes, what is the definition of “probable” as it relates to a business acquisition?

Answer

The term “probable” is not defined in Rule 3-05. However, in the Codified Financial Reporting Release Section 506.02(c)(ii), the SEC offers the following guidance:

Guidance as to when consummation of a transaction is probable cannot be given because such a determination is dependent upon the facts and circumstances. In essence, however, consummation of a transaction is considered to be probable whenever the registrants' financial statements alone would not provide investors with adequate financial information with which to make an investment decision.

This point is reinforced by paragraph 2005.4 of the SEC Financial Reporting Manual (FRM), which states, “Assessment of ‘probability’ requires consideration of all available facts. Acquisition is probable where registrant's financial statements alone would not provide adequate financial information to make an investment decision.”

Note that this guidance on the term “probable” is not necessarily the same as that in ASC 450,\(^3\) under U.S. GAAP.

The following factors may be considered in determining whether the acquisition is “probable” for SEC reporting purposes:

- A signed definitive agreement or letter of intent.
- Approval from the board of directors or shareholders of the companies.
- Submission of the terms of the proposed transaction to appropriate regulatory agencies for approval.
- Evaluation of the overall status of negotiations.

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\(^3\) ASC 450-20-20 defines “probable” as “[t]he future event or events [that] are likely to occur.”
• Incurrence of financial penalties if the acquisition is not consummated.
• Public announcement of a business acquisition.

Other factors may be present, and an acquisition may still be considered probable when none of the above factors exist if the registrant’s financial statements alone would not provide investors with adequate financial information with which to make an investment decision.

It is the responsibility of the registrant to assess probability. An assessment of probability requires careful analysis of all facts and circumstances, and advice from SEC legal counsel should be considered.

<table>
<thead>
<tr>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Registrant A and Company B entered into a letter of intent for A to acquire B.</td>
</tr>
<tr>
<td>• The significance of the acquisition to A was estimated to exceed the 50 percent level.</td>
</tr>
<tr>
<td>• The letter of intent was not a definitive merger agreement.</td>
</tr>
<tr>
<td>• Both companies made public announcements regarding the acquisition.</td>
</tr>
</tbody>
</table>

On the basis of an evaluation of these facts and circumstances, A’s management determined that the acquisition of B by A was probable.

See Section 1.4.1 for further discussion of filings requiring financial statements of a significant business acquisition or significant probable business acquisition. See Section 1.6.1 for further discussion of significance thresholds and financial statement requirements.

1.2.2 Identifying a Probable Business Acquisition When Control Is Obtained Through an Event Other Than a Purchase Transaction

Q&A Regulation S-X: Rule 3-05(a)(1)(i)-8

ASC 805-10-20 defines a business combination as “[a] transaction or other event in which an acquirer obtains control of one or more businesses.” For example, a business combination can occur when one entity obtains control of another as a result of the expiration of rights held by others that precluded consolidation, such as those described in ASC 810-10-25-1 through 25-14 and ASC 810-20.

A contract may specify the date on which rights held by others that preclude consolidation will lapse, which may be many years in the future.

**Question**

At what point should a business combination that will result from an event other than a transaction (e.g., the expiration of rights held by others that precluded consolidation) be considered a probable acquisition?

**Answer**

This issue was addressed at the April 2008 CAQ SEC Regulations Committee joint meeting with the SEC staff in Issue 5, Question 2, of Discussion Document A. At that meeting, the SEC staff indicated that the determination of whether an acquisition is probable should be made on the basis of the facts and circumstances and the guidance in Section 506.02(c)(ii) of the Codified...
Financial Reporting Releases. This guidance focuses on the relevance of the acquiree’s financial statements and states:

Guidance as to when consummation of a transaction is probable cannot be given because such a determination is dependent upon the facts and circumstances. In essence, however, consummation of a transaction is considered to be probable whenever the registrants’ financial statements alone would not provide investors with adequate financial information with which to make an investment decision.

This point is reinforced by paragraph 2005.4 of the FRM, which states, “Assessment of ‘probability’ requires consideration of all available facts. Acquisition is probable where registrant’s financial statements alone would not provide adequate financial information to make an investment decision.”

For more information on determining when a business acquisition is probable, see Section 1.2.1. Also see Section 1.2.3 below as well as Section 11.4 of Deloitte’s A Roadmap to Consolidation — Identifying a Controlling Financial Interest for more information about reporting requirements for businesses acquired through events other than purchase transactions.

1.2.3 Requirements for an Acquired Business When Control Is Obtained Through an Event Other Than a Purchase Transaction

Q&A Regulation S-X: Rule 3-05(a)(1)(i)-9

ASC 805-10-20 defines a business combination as “[a] transaction or other event in which an acquirer obtains control of one or more businesses.” While most business acquisitions occur when an acquirer purchases the equity interests or the net assets of a business, some occur through events other than a purchase transaction (i.e., without the transfer of any consideration). ASC 805-10-25-11 provides the following examples:

- An entity “repurchases a sufficient number of its own shares for an existing investor (the acquirer) to obtain control.”
- “Minority veto rights lapse that previously kept the acquirer from controlling an acquiree in which the acquirer held the majority voting interest.”
- “The acquirer and acquiree agree to combine their businesses by contract alone. The acquirer transfers no consideration in exchange for control of an acquiree and holds no equity interests in the acquiree, either on the acquisition date or previously. Examples of business combinations achieved by contract alone include bringing two businesses together in a stapling arrangement or forming a dual-listed corporation.”

Question

If a registrant obtains control of a business through an event other than a purchase transaction, is the event subject to the reporting requirements under Form 8-K, Item 2.01; Rule 3-05; and Article 11?

Answer

Yes. The SEC staff’s response to Issue 5, Question 1, in Discussion Document A of the April 2008 CAQ SEC Regulations Committee joint meeting with the SEC staff states, “In Item 2.01 of Form 8-K the term acquisition includes every purchase, acquisition by lease, exchange, merger, consolidation, succession or other acquisition.” An acquirer obtaining control of a business through an event other than a purchase transaction meets the definition of an acquisition. Thus,
a business acquisition that occurs through an event other than a purchase transaction is subject to the reporting requirements under Item 2.01, Rule 3-05, and Article 11.4

See Section 1.4.1 for further discussion of the various SEC filings in which a registrant may be required to present financial statements of a significant business acquisition or significant probable business acquisition. Also see Section 1.2.2 for additional guidance on identifying a probable business acquisition and Section 11.4 of Deloitte's A Roadmap to Consolidation — Identifying a Controlling Financial Interest for more information about the SEC reporting requirements that apply upon the initial consolidation of a subsidiary (e.g., initial consolidation of a variable interest entity).

1.3 Business Versus Asset Acquisition

1.3.1 Definition of a Business for SEC Reporting Purposes

Q&A Regulation S-X: Rule 11-01(d)-1

Question

What is the definition of a business for SEC reporting purposes?

Answer

Rule 3-05(a)(2) refers to the definition of a business in Rule 11-01(d), which states, in part:

[T]he term business should be evaluated in light of the facts and circumstances involved and whether there is sufficient continuity of the acquired entity's operations prior to and after the transactions so that disclosure of prior financial information is material to an understanding of future operations. A presumption exists that a separate entity, a subsidiary, or a division is a business.

However, a lesser component (e.g., a product line) may also constitute a business. Rule 11-01(d) also provides several attributes that should be considered in this determination, including:

- Whether the nature of the revenue-producing activity will generally remain the same after the acquisition.
- Whether any of the following attributes will remain after the acquisition: the physical facilities, employee base, market distribution system, sales force, customer base, operating rights, production techniques, or trade names.

The SEC staff's analysis of whether an acquisition meets the definition of a business focuses primarily on whether the nature of the revenue-producing activity generally remains the same after the acquisition. In addition, the note to paragraph 2010.2 of the FRM states, in part:

New carrying values of assets, or changes in financing, management, operating procedures, or other aspects of the business are not unusual following a business acquisition. Such changes typically do not eliminate the relevance of historical financial statements. Registrants that have succeeded to a revenue producing activity by merger or acquisition, with at least one of the other factors listed above remaining after the acquisition, are encouraged to obtain concurrence from the staff in advance of a filing if they intend to omit financial statements related to the assets and activity. Registrants may direct requests related to appropriate financial statements of an acquired entity or group of assets to CF-OCA.

4 Article 11 requires a registrant to provide pro forma financial information when, among other circumstances, a significant business acquisition is consummated or a significant disposition is completed. The pro forma financial information may be included in (1) a registration statement, (2) certain proxy materials, or (3) a Form 8-K. When historical financial statements of an acquired or to be acquired business are filed, pro forma financial information must also be presented. See Article 11 and the Q&As in Chapter 3 for further discussion.
If the revenue-producing activity continues after the acquisition, it is presumed that a business was acquired and that prior financial information would be relevant to the understanding of future operations. However, it is possible for an acquiree that does not have revenue to still meet the definition of a business under Rule 11-01(d).

As indicated above, under Rule 11-01(d) there is a presumption that a “separate entity, a subsidiary, or a division is a business.” However, registrants should be mindful that an acquisition can take many forms and that such forms typically will not affect the determination of whether the acquisition is a business. For example, the transaction may involve the acquisition of the stock of an entity or the acquisition of selected assets and the assumption of selected liabilities of that entity. Either form can constitute the acquisition of a business.

Note that paragraph 2010.1 of the FRM indicates that it is possible for the determination of what constitutes a business under Rule 11-01(d) to differ from that under ASC 805-10. See Section 1.3.3 for more information.

### Example 1

The following fact pattern summarizes an issue addressed at the March 2001 AICPA SEC Regulations Committee joint meeting with the SEC staff (the “joint meeting”).

Registrant A acquired a power plant from Company X. Before the acquisition, the output from the power plant was historically transferred to X's transmission and distribution operations. During some periods, X sold a small amount of the power plant output to third parties. Registrant A expected to sell the output from the power plant to third parties, including X. Did the acquisition of the power plant by A meet the definition of a business under Rule 11-01(d)?

According to the SEC staff, the acquisition of the power plant does not meet the definition of a business for SEC reporting purposes. At the joint meeting, the SEC staff noted:

> Generally, the absence of third party sales is a persuasive indicator that historical information would not be meaningful. However, determinable market prices directly attributable to a commodity (such as posted oil prices for a producing property) may permit the preparation of meaningful historical financial information.

The SEC staff also stated that “pre-clearance may continue to be wise in many circumstances.”

### Example 2

The following fact pattern summarizes an issue discussed with the SEC staff.

Registrant B acquired 100 contracts, intellectual property, leases, and certain other assets from Registrant C. Registrant B also acquired the right and obligation to hire approximately 1,200 employees from C. Upon completion of the acquisition, B performed the activities obligated by the contracts; however, there were some changes in the cost structure and management. Did the acquisition meet the definition of a business under Rule 11-01(d)?

The SEC staff concluded that B's acquisition of 100 contracts, intellectual property, leases, and certain other assets meets the definition of a business under Rule 11-01(d). The SEC staff noted that the contractual nature of the revenue streams acquired suggests that the revenue producing activity will generally remain the same. Changes in cost structure and management are not unusual after an acquisition. The SEC staff believes that the historical financial statements would be relevant to the understanding of future operations.
Additional Types of Acquisitions That May Constitute a Business for SEC Reporting Purposes

Paragraphs 2010.3 through 2010.6 of the FRM note that the following types of acquisitions may also meet the definition of a business:

- **An investment accounted for under the equity method** — According to Rule 3-05(a)(1)(i), the definition of a business acquisition includes the purchase of an interest in a business accounted for under the equity method. This also includes the acquisition of a joint venture investment that is accounted for under the equity method.

- **A working interest in an oil and gas property** — As discussed in paragraph 2010.4 of the FRM, the Office of the Chief Accountant of the Division of Corporation Finance (CF-OCA) (1) considers the acquisition of a working interest in an oil and gas property to be a business for reporting purposes and (2) refers registrants to paragraph 2065.11 of the FRM for guidance on when abbreviated financial statements will be accepted. See the Q&As in Section 1.5 for further discussion of abbreviated financial information.

- **Customer deposits at bank branches** — Paragraph 2010.5 of the FRM states that the “assumption of customer deposits at bank branches may constitute the acquisition of a business if historical revenue producing activity is reasonably traceable to the management or customer and deposit base of the acquired branches, and that activity will remain generally the same following the acquisition.”

- **Blocks of insurance policies acquired by an insurance company and liabilities assumed in reinsurance transactions** — Paragraph 2010.6 of the FRM states that “[a]cquisitions of blocks of insurance policies by an insurance company or the assumption of policy liabilities in reinsurance transactions may also be deemed the acquisition of a business because the right to receive future premiums generally indicates continuity of historical revenues. The degree of continuity between historical investment income streams and the assets acquired to fund the acquired policy liabilities should also be considered.”

In addition, a cost center (i.e., part of a company that incurs internal expenses but does not generate revenues) or an entity that has not commenced planned principal operations, or has commenced planned principal operations but has not generated significant revenue, may also meet the definition of a business, and the criteria in Rule 11-01(d) should be evaluated.

Additional information on applying Rule 11-01(d) can be found in other Q&As in this section.

### 1.3.2 Inability to Prepare Abbreviated Financial Information May Indicate Acquisition Is Not a Business for SEC Reporting Purposes

**Q&A Regulation S-X: Rule 11-01(d)-3**

In certain circumstances, a registrant may be permitted to provide abbreviated financial information to satisfy the requirements of Rule 3-05, when it acquires a business. See Section 1.5.2 for further discussion.

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5 Paragraph 2065.11 of the FRM states, in part, “An acquisition of an interest in a producing oil or natural gas property is considered by the staff to be the acquisition of a business pursuant to S-X 11-01(d)” (emphasis added). On the basis of informal discussions with the SEC staff, we understand that the acquisition of nonproducing oil or natural gas properties are generally not considered to be the acquisition of a business under Article 11. Therefore, a registrant may calculate significance by considering only the producing properties when it acquires both producing and nonproducing properties.

6 For considerations related to the acquisition or probable acquisition of a troubled financial institution in a federally assisted transaction, see paragraph 2055.3 of the FRM and SAB Topic 1.K.
**Question**

In preparing abbreviated financial information, the registrant may be unable to identify all of the direct revenues and direct expenses associated with the assets acquired and liabilities assumed. Does this inability of the registrant indicate that the acquisition or probable acquisition is not a business as defined in Rule 11-01(d)?

**Answer**

It depends. In making this determination, we believe a registrant should consider whether it can identify all costs directly associated with the revenue producing activity, including but not limited to, all related costs of sales and other selling, general and administrative, distribution, marketing and research, and development costs. Specific to the accommodation to present abbreviated financial statements, the note to paragraph 2065.6 of the FRM indicates that such an accommodation “is premised on the registrant’s ability to identify all costs directly associated with producing revenues of the acquired product line.” Therefore, if a registrant cannot identify such costs, it may indicate that the acquisition is not a business as defined in Article 11.7

A registrant is not required to provide financial statements for an acquisition of assets and/or an assumption of liabilities that does not meet the definition of a business. However, certain disclosures about significant asset acquisitions may be required in a Form 8-K. See Section 1.3.4 for further discussion.

### 1.3.3 Differences Between the Definition of a Business for SEC Reporting Purposes and U.S. GAAP Accounting Purposes

**Q&A Regulation S-X: Rule 11-01(d)-4A**

**Question**

Is the definition of a business for SEC reporting purposes the same as the definition for U.S. GAAP accounting purposes?

**Answer**

No. The definition of a business for SEC reporting purposes in Rule 11-01(d) is different from the definition for U.S. GAAP accounting purposes.

ASC 805 provides the U.S. GAAP accounting guidance on defining a business for purposes of determining whether an acquisition should be accounted for as a business combination or an asset acquisition. The definition of a business in ASC 805-10 focuses on whether inputs, processes, and outputs have been acquired. In contrast, Rule 11-01(d) provides the SEC guidance on defining a business for purposes of determining whether financial statements of an acquired or to be acquired business must be filed with the SEC. Rule 11-01(d) focuses on whether the nature of the revenue producing activities or other attributes will remain the same after that acquisition and indicates that sufficient continuity of operations after the acquisition is a key factor in the determination of whether the acquisition is a business for SEC reporting. If sufficient continuity of operations exists, then presentation of historical financial statements is material to an understanding of future operations.

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7 In addition to considering the guidance in Rule 11-01(d) to determine whether a business has been acquired, the SEC provides guidance on the determination of a business within Section 2010 of the FRM.
As noted in paragraph 2010.1 of the FRM, it is possible for the determination of what constitutes a business to be different under the SEC and FASB requirements. A registrant must perform a separate evaluation under Rule 11-01(d) to determine its SEC reporting requirements. Note that although the FASB changed its definition of a business when it issued ASU 2017-01, the highlights of the March 2017 CAQ SEC Regulations Committee joint meeting with the SEC staff indicate that the issuance of that ASU “did not affect [the application of] Article 11 of Regulation S-X.” See Section 1.3.1 for further discussion of a definition of a business for SEC reporting purposes.

1.3.4 Disclosure Requirements for the Acquisition of Assets and Assumption of Liabilities That Does Not Meet the Definition of a Business for SEC Reporting Purposes

Q&A Regulation S-X: Rule 3-05(a)(2)-1

Rule 3-05 provides guidance on the financial statements required in certain SEC filings for a significant business acquisition or significant probable business acquisition. However, Rule 3-05 does not apply to the acquisition of assets and the assumption of liabilities that does not meet the SEC definition of a business. Therefore, no historical financial statements are required for this type of acquisition.

Question

What are the disclosure requirements for an acquisition of assets and an assumption of liabilities that does not meet the definition of a business for SEC reporting purposes?

Answer

There may be separate Form 8-K filing requirements for acquisitions of assets and assumptions of liabilities that do not meet the definition of a business in accordance with Rule 11-01(d). Form 8-K, Item 2.01, requires disclosures for acquisitions of significant assets that differ from the disclosures required for a significant business acquisition. The registrant should provide sufficient disclosures to (1) clearly describe the assets acquired and the anticipated effects of the acquisition on the registrant’s financial condition and (2) indicate that the purchase did not constitute the acquisition of a business. The registrant may consider including a pro forma balance sheet reflecting the effects of the asset acquisition or a narrative discussion. The significance thresholds that trigger the filing requirements for a Form 8-K for an asset acquisition are also different. In accordance with Instruction 4 of Form 8-K, Item 2.01, an asset acquisition is deemed significant if:

\[ \text{The registrant's and its other subsidiaries' equity in the net book value of such assets or the amount paid or received for the assets upon such acquisition or disposition exceeded 10% of the total assets of the registrant and its consolidated subsidiaries.} \]

The registrant must make a careful evaluation to determine whether it acquired a business. See Section 1.3.1 for further discussion. Also see Appendix D of Deloitte’s A Roadmap to Accounting for Business Combinations for a discussion of asset acquisitions and the related disclosure requirements.
1.4 Financial Statements Required in SEC Filings

1.4.1 Filings Requiring Financial Statements of a Significant Business Acquisition or Significant Probable Business Acquisition

Q&A Regulation S-X: Rule 3-05-1

Question
What are the various SEC filings in which a registrant may be required to present financial statements of a significant business acquisition or significant probable business acquisition?

Answer
The types of SEC filings in which a registrant may be required to present historical financial statements of a significant business acquisition or significant probable business acquisition include the following:

- Form 8-K.
- Registration statements.
- Prospectus supplements.
- Proxy materials for business combinations.

Each is discussed in more detail below. The inclusion of financial statements of a significant business acquisition or significant probable business acquisition is not required in annual or quarterly reports on Form 10-K or 10-Q.

See the Q&As in Section 1.2 for guidance on identifying a probable business acquisition and Section 1.6.1 for information on significance thresholds and financial statement requirements for a business acquisition or probable business acquisition.

Form 8-K

Significant Business Acquisition
A registrant must file an initial Form 8-K within four business days of the consummation of a business acquisition that exceeds the 20 percent significance level. If they are available, the financial statements required by Rule 3-05 may be filed by the registrant along with the initial Form 8-K. Otherwise, the registrant has an additional 71 calendar days to file an amended Form 8-K that includes these financial statements.

As noted in the discussion of Rule 3-13 waivers in the Roadmap’s introduction, in certain situations, registrants may wish to seek relief from complying with the financial statement requirements of Rule 3-05. We understand that if a registrant is granted relief from providing financial statements for a business combination or probable business acquisition, the registrant may file the financial statements required by Rule 3-05 on Form 8-K.

In addition to filing the financial statements of the acquired or to be acquired business, a registrant is required under Rule 11-01 to include pro forma financial information. See Chapter 3 for further discussion.

As indicated in the instructions to Form 8-K, Item 2.01, “the term acquisition includes every purchase, acquisition by lease, exchange, merger, consolidation or succession or other acquisition.” See Form 8-K, Item 2.01, and Section 1.2.3 of this Roadmap for further information. Also, see paragraph 2025.4 of the FRM and Section 1.10.1 of this Roadmap for a discussion of an exchange transaction that constitutes both an acquisition and a disposition of a business that may require the registrant to file a Form 8-K.

In certain circumstances, the financial statements required by Rule 3-05 may not be required in a Form 8-K if they were previously filed by the registrant. Refer to paragraph 2045.16 of the FRM and Section 1.11.1 for additional information.

If the registrant is a shell company, the financial statements and related pro forma financial information and all the content required by Form 10 must be filed in the initial Form 8-K. That is, the registrant does not have an additional 71 calendar days to include these financial statements. See Items 2.01(f) and 9.01(c) of Form 8-K and paragraphs 2040.1 and 12220.1(b) of the FRM.
the Rule 3-05 financial statements and related pro forma requirements, the registrant is still required to file Form 8-K, Item 2.01, to disclose the completion of the acquisition. The waiver granted by the CF-OCA under Rule 3-13 only applies to the historical and pro forma financial statement requirements and does not provide relief from filing Item 2.01.

For business acquisitions that do not exceed the 20 percent significance level, a registrant may elect to report the business acquisition in accordance with Form 8-K, Item 8.01.

**Significant Probable Business Acquisition**

A registrant is not required to file a Form 8-K that includes financial statements for a significant probable business acquisition. However, upon consummation of an acquisition, a registrant is required to comply with the applicable Form 8-K filing requirements for a significant business acquisition. Irrespective of this, the registrant may be required to file a Form 8-K to comply with Form 8-K, Item 1.01.

**Significant Asset Acquisition**

There may be separate Form 8-K filing requirements for acquisitions of assets and assumptions of liabilities that do not meet the definition of a business for SEC reporting purposes. See Section 1.3.4 for further discussion. Also, see Form 8-K, Item 2.01, for filing requirements related to a significant asset acquisition.

**Registration Statements**

The financial statement and audit requirements for a registration statement filed on a Form S-4 to register securities being offered to security holders of a business that has been identified as a potential acquisition (i.e., target) may be different from the requirements specified in Rule 3-05. See the section below for guidance on the financial statement and audit requirements of target companies.

For business acquisitions or probable business acquisitions (other than of the target in a Form S-4), a registrant is required to file the financial statements of a significant business acquisition that was consummated 75 or more days before a registration statement is filed or declared effective. Such financial statements may be included in the registration statement or incorporated from a previously filed Form 8-K. In addition, Rule 3-05(b)(4)(i) requires financial statements for a probable acquisition or a recently consummated acquisition that exceeds the 50 percent significance level in registration statements.

If the acquisition does not exceed the 50 percent significance level (on the basis of any of the three tests), a registrant may exclude financial statements of (1) a business acquisition consummated less than 75 days before the registration statement is filed or declared effective or (2) a probable business acquisition. Upon consummation of this acquisition, the registrant has a specified period to file the financial statements of the acquired business (see the Form 8-K section in this Q&A). Therefore, such financial statements are not required in a registration statement that is filed or declared effective before the 75th day after consummation unless they have been previously filed by the registrant. If a significant acquisition is consummated 75 or more days before a registration statement is filed or declared effective, the financial statements of a significant acquiree are required. See also paragraph 2040.1 of the FRM.

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12 See footnote 8.

13 For IPO registration statements, the financial statements of a significant acquiree must be included in the initial registration statement once the initial registration statement is filed or declared effective and 75 or more days have passed since the acquisition was consummated. Also see the Q&As in Section 1.13 for additional information.
In certain circumstances, Rule 3-05 may require financial statements of individually insignificant businesses to be filed in a registration statement. For additional information, see the Q&As in Section 1.9.

In addition, Rule 3-05(b)(4)(iii) allows a registrant to apply certain exceptions for significant business acquisitions in which the operations of an acquired business are included in the registrant's consolidated financial statements. See paragraph 2040.2 of the FRM for further discussion.

Section 1.6.1 discusses accommodations that may be available in a draft registration statement that is voluntarily submitted to the SEC staff for a nonpublic review before a registrant's public filing. In certain circumstances, a registrant may be able to omit the financial statements of a significant acquired or to be acquired business from a draft registration statement. A draft registration statement may be voluntarily submitted to the SEC staff for nonpublic review before the registrant's public filing for (1) IPOs and initial registration statements under the Securities Act of 1933 (“Securities Act”), (2) initial registration statements under Section 12(b) of the Securities Exchange Act of 1934 (“Exchange Act”) for a class of securities (e.g., Form 10), and (3) Securities Act offerings within one year of an IPO or Exchange Act Section 12(b) registration (the latter circumstance is only available for the initial submission).

A registrant may be able to omit historical financial statements of a significant business acquisition or significant probable business acquisition and the related pro forma information required by Article 11 in a draft registration statement if it reasonably believes that those financial statements will not be required at the time of the public filing (or, for EGCs, at the time of the contemplated offering).

Example

A calendar-year-end company that plans to submit a draft registration statement in the fall of 20X7 completes a significant acquisition in the fourth quarter of 20X6. The acquisition is significant in such a way that one year of the acquiree's financial statements would generally be required under Rule 3-05. The company plans to update its draft registration statement to include its 20X7 annual financial statements before a public filing in 20X8. Thus, after that update, the acquired business will have been part of the company's financial statements for a sufficient amount of time to eliminate the need for separate financial statements. In this scenario, the staff in the Division of Corporation Finance will not delay its review of the draft registration statement in the fall of 20X7 if the acquiree's financial statements and the related pro forma financial information are omitted from the submission.

Under a recently issued final rule that established new Regulation S-X, Rules 13-01(a)(5) and 13-02(a)(5), registration statements for debt securities or securities collateralized by securities of an affiliate, respectively, must include the preacquisition summarized financial information of any recently acquired subsidiary guarantor or recently acquired affiliate whose securities collateralize the issued securities if (1) the subsidiary has not been included in the registrant's most recent balance sheet and (2) the subsidiary or affiliate is considered a significant business. The significance tests under the final rule are the same as those under Rule 3-05, and a recently acquired guarantor subsidiary or recently acquired affiliate is significant if it exceeds the 20 percent threshold. See Deloitte's March 10, 2020, Heads Up for more information about the

14 See Deloitte's August 24, 2017, Heads Up (originally published July 11, 2017), which discusses draft registration statements and the nonpublic review process.

15 This guidance regarding omitting financial information is consistent with certain accommodations that are available for the historical financial statements of the registrant.

16 See the C&DIs on Securities Act Forms (Questions 101.04 and 101.05) and the C&DIs on the FAST Act (Questions 1 and 2).
final rule, including its simplified disclosure requirements related to registered guaranteed or collateralized debt securities.

**Prospectus Supplements to Registration Statements That Currently Are Effective**

For currently effective registration statements (e.g., an existing Form S-3) upon which a registrant wishes to draw down or issue securities, a registrant may use a prospectus supplement. The requirement to provide historical financial statements of the acquiree before issuing securities on an effective registration statement depends on various factors, including (1) the significance of the acquisition, (2) whether the financial statements of the acquiree have been provided within the 71 calendar-day extension (i.e., the grace period), (3) whether the acquisition has been consummated or is probable, and (4) whether the acquisition represents a fundamental change.

**Paragraph 2045.3** of the FRM indicates that “a domestic registrant has no specific obligation to update the prospectus except as stipulated by 1933 Act Section 10(a)(3) and S-K 512(a) with respect to any fundamental change.” If a consummated acquisition does not exceed 50 percent significance and does not represent a fundamental change, the registrant has no specific obligation to provide or update the financial statements of the acquiree. It is the responsibility of management, in consultation with SEC legal counsel, to determine what constitutes a fundamental change.

In addition, paragraph 2045.3 of the FRM further states that if a consummated acquisition exceeds 50 percent significance and a registrant has not yet provided financial statements during the grace period, “offerings pursuant to effective registration statements cannot proceed” without the historical financial statements of the acquiree (except in certain limited types of offerings specified in **paragraph 2050.3** of the FRM). As discussed at the October 2015 CAQ SEC Regulations Committee joint meeting with the SEC staff, the SEC staff confirmed that the guidance in paragraphs 2045.3 and 2050.3 of the FRM does not apply to a probable business acquisition unless management determines that the probable business acquisition constitutes a fundamental change. The SEC staff confirmed that the “bright line” guidance (i.e., exceeds 50 percent significance) only applies to completed acquisitions.

All post-effective amendments are considered “new filings” and are subject to the guidance in **Registration Statements** above.

**Registration Statements on Form S-4 to Register Securities Being Offered to Security Holders of a Target**

A registration statement filed on a Form S-4 may be used to register securities being offered to security holders of a business that has been identified as a potential acquisition (i.e., target). As noted above, the financial statement and audit requirements for Form S-4 filings may be different from the requirements specified in Rule 3-05.

**Financial Statement Requirements**

The financial statement requirements for a target in a Form S-4 vary according to the facts, which may include whether an issuer’s shareholder vote is required or whether the target is a registrant. In addition, a Form S-4 may or may not include proxy materials for a shareholder vote to approve the potential transaction.
Table 1 summarizes the financial statement requirements for a target in a Form S-4:\textsuperscript{17}

<table>
<thead>
<tr>
<th>Are the Issuer’s Shareholders Voting?</th>
<th>Is the Target an SEC Reporting Entity?</th>
<th>Target Financial Statement Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>Yes</td>
<td>• Balance sheets as of the two most recent fiscal years (audited).</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Statements of operations, comprehensive income,\textsuperscript{18} cash flows, and changes in shareholders’ equity for the three most recent fiscal years (audited).</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Required interim information (unaudited), if applicable.\textsuperscript{19}</td>
</tr>
<tr>
<td>No</td>
<td>Yes</td>
<td>• Financial statements of the target’s significant acquired or to be acquired business under Rule 3-05.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Note that the target financial statements above are required regardless of significance.</td>
</tr>
<tr>
<td>Yes</td>
<td>No</td>
<td>• Balance sheets as of the two most recent fiscal years.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Statements of operations, comprehensive income,\textsuperscript{20} cash flows, and changes in shareholders’ equity for the three most recent fiscal years.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Required interim information, if applicable.\textsuperscript{21}</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Financial statements of the target’s significant acquired or to be acquired business under Rule 3-05 if the omission of those financial statements renders the target company’s financial statements substantially incomplete or misleading.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Note that the target financial statements above are required regardless of significance.</td>
</tr>
</tbody>
</table>

See Table 2 for the applicable audit requirements.

\textsuperscript{17} As noted in paragraph 2200.1 of the FRM, the periods to be presented for the target may depend, in part, on whether the target is an SRC or whether the acquirer is an emerging growth company (EGC). Table 1 does not any reflect differences in the Form S-4 requirements that may apply to EGCs or SRCs; for a summary of such differences, see the discussions below and in Section 2200 and paragraph 10220.6 of the FRM.

\textsuperscript{18} ASC 220 provides two alternative presentations for reporting comprehensive income. In addition, the statement of equity may be presented in a note to the financial statements.

\textsuperscript{19} Interim financial statement requirements differ depending on whether the target is a reporting company or a nonreporting company. Refer to Form S-4, Items 15, 16, 17(a), and 17(b).

\textsuperscript{20} See footnote 18 above.

\textsuperscript{21} See footnote 19 above.
<table>
<thead>
<tr>
<th>Are the Issuer’s Shareholders Voting?</th>
<th>Is the Target an SEC Reporting Entity?</th>
<th>Target Financial Statement Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td>No</td>
<td>If the significance of a target does not exceed 20 percent, the target's financial statements are generally not required. However, individually insignificant business acquisitions, including the insignificant target, must be aggregated to assess compliance with Rule 3-05. Refer to the Q&amp;As in Section 1.9 for additional discussion.</td>
</tr>
</tbody>
</table>

If the significance of the target exceeds 20 percent and Form S-4 will be used for resale by persons considered underwriters under Rule 145(c) of the Securities Act, financial statements are required for the periods required by Rule 3-05(b)(2).

If the significance of a target exceeds 20 percent and the Form S-4 will not be used for resale by persons considered underwriters under Rule 145(c) of the Securities Act, the financial statements of the most recent fiscal year and interim period are required in the registration statement. Prior years’ financial statements are also required if they were previously furnished to a target’s security holders.

See Table 2 for the applicable audit requirements.

If the target is eligible to apply the SRC reporting requirements because it is an issuer or is a currently reporting SRC, only two years of financial statements are required.\(^2\) If the transaction involves an EGC, two years of target financial statements may be appropriate in certain circumstances. See paragraph 10220.6 of the FRM.

In addition, as indicated in the note to paragraph 1140.8 of the FRM, the provisions of Rule 3-06(b), which permit the filing of “financial statements covering a period of nine to twelve months to satisfy the one-year financial statement requirement” for an acquiree, do not apply to financial statements of a target in a proxy statement or Form S-4. However, registrants with unusual circumstances may preclear these with the CF-OCA. If preclearance with the SEC staff is contemplated, registrants should consider consultation with their auditors and SEC legal counsel.

Pro forma financial information reflecting the acquisition is only required in a Form S-4 if the acquisition exceeds the 20 percent significance level under Rule 3-05. In addition to the requirements noted above, financial statements of other acquired businesses (unrelated to the acquisition of the target company) may be required in a registration statement or a merger proxy statement under Rule 3-05. For example, if a registrant previously consummated an unrelated significant business acquisition or is considering an unrelated significant probable business acquisition, financial statements may be required for that business acquisition.

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\(^2\) See paragraph 5210.2 of the FRM, which notes that in certain circumstances, the financial statement requirements may be different for a subsequent Form 8-K. In the Form 8-K reporting the acquisition, the financial statements “must comply with the other S-X reporting requirements . . . unless the acquirer is a currently reporting SRC.” As a result of this requirement, potentially three years of financial statements may need to be provided in certain circumstances.
Example

Registrant A contemplated a merger with Registrant B. Registrant A was preparing a Form S-4 to register the securities being offered to B’s shareholders. Registrant A's shareholders will vote on the potential acquisition of B. Accordingly, financial statements for the three years and interim periods were required for A and B (see Table 1).

In addition to the potential merger between A and B, during the latest year (more than 75 calendar days ago), A consummated an acquisition of Company X. Upon acquiring X, A concluded the acquisition was significant under Rule 3-05, and audited financial statements of X were filed on Form 8-K. Therefore, given that A did not meet any exemptions related to requirements of Rule 3-05 (see paragraph 2040.2 of the FRM), the filing of (1) historical financial statements of X and (2) pro forma financial statements that give effect to the acquisition of X was also required in the Form S-4.

For additional information, see Section 2200 of the FRM.

SPAC Transactions

In certain situations, a special-purpose acquisition company (SPAC) is created to raise cash in an IPO for the purpose of using that cash to fund the acquisition of one or more private operating companies. After the IPO, the SPAC will complete an acquisition of a target company within a specified time. Since SPACs hold no assets other than cash before the completion of an acquisition, they are nonoperating public “shell companies” as defined by the SEC. A Form S-4 or proxy statement may be filed by the SPAC because shareholders will often be required to vote on the merger transaction. For guidance on SPACs, see Section 12220 of the FRM and the highlights of the September 2018 CAQ SEC Regulations Committee joint meeting with the SEC staff.

Audit Requirements

As discussed in paragraph 2200.6 of the FRM, if the target company is an SEC reporting entity, all fiscal years presented for the target must be audited. If the target is not an SEC reporting entity, the audit requirements for the target financial statements referred to in Table 1 depend on whether the securities that are being registered on Form S-4 will be used for resale by persons considered underwriters under Rule 145(c) of the Securities Act. Table 2 details these audit requirements.
Table 2 — Audit Requirements When the Target Is Not an SEC Reporting Entity

<table>
<thead>
<tr>
<th>Form S-4 to Be Used for Resales</th>
<th>Form S-4 Not to Be Used for Resales</th>
</tr>
</thead>
<tbody>
<tr>
<td>An audit is required for the same periods required to be audited in accordance with Rule 3-05(b)(2).</td>
<td>The financial statements for the latest fiscal year must be audited only if practicable to do so. A registrant determines practicability by considering the feasibility of completing the audit on a timely basis. Since a target's audited financial statements will be required in a Form 8-K once an acquisition is consummated, a registrant must be able to explain why audited financial statements cannot be completed in time for the Form S-4, but can be completed in time to meet the Form 8-K requirements. Although relief from obtaining an audit of financial statements may be available as described above, a registrant is still required to furnish all financial statements specified by Form S-4, Item 17, on an unaudited basis. The financial statements for the fiscal years before the latest fiscal year need not be audited if they were not previously audited.</td>
</tr>
</tbody>
</table>

As stated in the notes to paragraph 2200.7 of the FRM, “relief from the audit requirement for a target company's financial statements applies only to merger proxies and transactions registered on Form S-4” and not to other forms. Even if not required for the Form S-4, if an acquisition exceeds the 20 percent significance level, audited financial statements for the appropriate periods “will ordinarily be required in a Form 8-K after consummation.”

Proxy Materials for Business Combinations

Financial Statement Requirements

As indicated in paragraph 1140.3 of the FRM, the financial statement requirements for a business combination in a merger proxy statement vary according to factors such as (1) who the voting shareholders are and (2) the form of consideration. If the consideration issued in the business acquisition includes registered securities, the registrant must comply with the financial statement requirements of Form S-4 (see Registration Statements on Form S-4 to Register Securities Being Offered to Security Holders of a Target above). Table 3 summarizes the financial statement requirements for transactions that do not involve registered securities.
Table 3 — Financial Statement Requirements for Proxy Statements

<table>
<thead>
<tr>
<th>Voting Shareholders</th>
<th>Consideration Issued to Effect the Business Combination</th>
<th>Financial Statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquirer only</td>
<td>• Cash only or</td>
<td>Financial statements of a target are required because the information is material to a voting decision. These financial statements include:</td>
</tr>
<tr>
<td></td>
<td>• Exempt securities only or</td>
<td>• Balance sheets as of the two most recent fiscal years.</td>
</tr>
<tr>
<td></td>
<td>• Combination of cash and exempt securities</td>
<td>• Statements of operations, comprehensive income, cash flows, and changes in shareholders’ equity for the three most recent fiscal years.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Required interim information, if applicable.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>An acquirer’s financial statements are not required unless they are material to an informed voting decision because shareholders are presumed to have access to information about the acquirer.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Pro forma financial information is required if it is material to a voting decision.</td>
</tr>
<tr>
<td>Target only</td>
<td>• Cash only</td>
<td>Financial statements of the target are not required because the security holders are presumed to have access to information about their company unless it is a going-private (as defined by Exchange Act Rule 13e-3) transaction.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Financial statements of the acquirer are not required unless the information is material to an informed voting decision. If acquirer financial statements are required, only the two most recent fiscal years and interim periods are required.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>No pro forma information is required.</td>
</tr>
<tr>
<td>Target only</td>
<td>• Exempt securities only or</td>
<td>Financial statements of a target are not required because the security holders are presumed to have access to information about their company unless it is a going-private (as defined by Exchange Act Rule 13e-3) or a roll-up transaction (as described by Regulation S-K, Item 901).</td>
</tr>
<tr>
<td></td>
<td>• Combination of cash and exempt securities</td>
<td>Financial statements of an acquirer are generally required because the information is material to a voting decision. If financial statements are required, the acquirer need only present the two most recent fiscal years and interim periods.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Pro forma financial information is required, if material.</td>
</tr>
</tbody>
</table>

23 See footnote 18.
24 When the consideration is cash only and the acquirer financial statements are not required because the information was deemed not material to an informed decision, the acquirer should be current with its Exchange Act reports; otherwise, the registrant should consult with the CF-OCA. Registrants encountering these situations are encouraged to consult with their audit and legal professionals.
25 A registrant is encouraged to consult with its SEC counsel when making this assessment.
Table 3 — Financial Statement Requirements for Proxy Statements (continued)

<table>
<thead>
<tr>
<th>Voting Shareholders</th>
<th>Consideration Issued to Effect the Business Combination</th>
<th>Financial Statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquirer and target</td>
<td>Cash only</td>
<td>Financial statements of a target are required. These financial statements include:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Balance sheets as of the two most recent fiscal years.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Statements of operations, comprehensive income, cash flows, and changes in shareholders' equity for the three most recent fiscal years.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Required interim information, if applicable.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>An acquirer's financial statements are not required unless they are material to an informed voting decision. If the acquirer financial statements are required, only the two most recent fiscal years and interim periods need to be provided.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Pro forma financial information is required if it is material to a voting decision by the acquirer's shareholders.</td>
</tr>
</tbody>
</table>

If the target is eligible to apply the SRC reporting requirements because it is an issuer or is a currently reporting SRC, only two years of financial statements are required.\(^{29}\) If the transaction involves an EGC, two years of target financial statements may be appropriate in certain circumstances. See paragraph 10220.7 of the FRM.

In addition, as indicated in the note to paragraph 1140.8 of the FRM, Rule 3-06(b), which permits the filing of “financial statements covering a period of nine to twelve months to satisfy” the one year requirement for an acquiree, do not apply to financial statements of a target in a proxy statement or Form S-4. However, registrants with unusual circumstances may preclear

\(^{26}\) See footnote 18.
\(^{27}\) See footnote 25.
\(^{28}\) See footnote 18.
\(^{29}\) See footnote 22.
these with the CF-OCA. If preclearance with the SEC staff is contemplated, registrants should consider consultation with their auditors and SEC legal counsel.

Audit Requirements

If a target is an SEC registrant, then all annual financial statements must be audited. If a target is not an SEC registrant, only the financial statements for the latest fiscal year must be audited, if practicable. Financial statements for prior years need not be audited if they were not previously audited. As paragraph 1140.5 of the FRM notes, “the [SEC] staff will assess the merits of a registrant’s assertion that an audit for the latest fiscal year is impracticable based on the particular facts and circumstances including the specific actions taken by the registrant (acquirer) to obtain a timely audit of the target.” Although relief from obtaining an audit of financial statements may be available as described above, the registrant is still required to file the target’s audited financial statement in Form 8-K once the acquisition is consummated, if significant.

1.4.2 Application of PCAOB Standards to Financial Statements Required in SEC Filings

Q&A Regulation S-X: Rule 3-05-2

SEC rules require the filing of audit reports related to issuers and certain entities that are not issuers (nonissuers), such as consolidated subsidiaries, equity method investees, predecessors, targets, and acquired or to be acquired businesses.

Question

Should audit reports filed with the SEC refer to the standards of the PCAOB, AICPA, or both, and does an independent public accounting firm issuing the report have to be registered with the PCAOB?

Answer

It depends. The table below, which is adapted from paragraphs 4110.5 and 4110.8 of the FRM, outlines the applicability of PCAOB requirements in various filings with the SEC.

Although the SEC may require auditors to refer to the standards of the PCAOB in certain circumstances, audits of nonissuers are under the jurisdiction of the AICPA. For audits of nonissuers, auditors are required by AICPA AU-C 700.31 to state that the audit was conducted in accordance with auditing standards generally accepted in the United States of America (GAAS). However, AICPA AU-C 700.42 states that “an auditor may indicate that the audit was also conducted in accordance with another set of auditing standards” (e.g., the standards of the PCAOB). Therefore, in situations in which an audit of a nonissuer is required by the SEC to refer to the standards of the PCAOB, the audit report will refer to both sets of standards.

30 The term “issuer” means an issuer (as defined in Section 3 of the Exchange Act), the securities of which are registered under Section 12 of the Exchange Act, or that is required to file reports under Section 15(d) of that Act, or that files or has filed a registration statement that has not yet become effective under the Securities Act, and that it has not withdrawn. See Section 2(a)(7) of the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley Act”) and PCAOB Rule 1001.

31 Sometimes a registrant is a successor to a predecessor company or presents financial statements that include predecessor and successor results. Examples include (1) adoption of fresh-start accounting after emergence from bankruptcy or (2) the use of push-down accounting to reflect a change in basis because of an acquisition of the company. In these situations, the period(s) before the change in basis represents the predecessor period(s), and the period(s) after the change in basis represents the successor period(s). See also Section 1.6.7.9 for other information regarding predecessor and successor circumstances.

32 In accordance with Section 102 of the Sarbanes-Oxley Act, “it shall be unlawful for any person that is not a registered public accounting firm [with the PCAOB] to prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any issuer.”
Circumstances in which audit reports are required to refer to both the standards of the PCAOB and AICPA include, but are not limited to, those in which entities (1) make confidential submissions of an initial public registration statement (e.g., confidential submissions by EGCs under the JOBS Act and confidential submissions by non-EGCs under the Securities Act), (2) file a Form 10 to effect an initial registration of securities (e.g., spinoff from a public parent company), (3) file voluntarily with the SEC, and (4) file auditors’ reports with the SEC under Regulation S-X, Rule 2-05, because the auditors of an issuer are referring to another auditor’s report of a nonissuer.

Although the table below specifies when the auditor is required to refer to the standards of the PCAOB, it does not indicate when the auditor is required to refer to GAAS in addition to the standards of the PCAOB.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Issuer and its predecessor</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>2 Entity that has filed an initial registration statement</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>3a Operating company (predecessor) whose financial statements are filed by a special-purpose acquisition company</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>3b Operating company (predecessor) whose preacquisition financial statements are filed by an issuer that at the time the reverse merger is consummated is a public “shell company” (see paragraph 12250.1 of the FRM)</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>3c Operating company (predecessor) whose preacquisition financial statements are filed by an issuer that at the time the reverse merger is consummated is not a public “shell company” (see paragraph 12250.2 of the FRM)</td>
<td>No, but see paragraph 12250.2 of the FRM</td>
<td>No, but see paragraph 12250.2 of the FRM</td>
</tr>
<tr>
<td>3d Operating company (predecessor) whose postacquisition audited financial statements are filed by the issuer after consummation of a reverse merger</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

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34 This table describes the SEC staff’s application of PCAOB registration requirements for an auditor whose report is included in a filing with the SEC. There are instances, not included in the table, when a principal auditor will use the work of another auditor and take responsibility for the other auditor’s work. In these instances, the other auditor’s report is not included in the filing with the SEC. The determination of whether the other auditor must be registered with the PCAOB is made by reference to the Sarbanes-Oxley Act and the PCAOB’s rules. In all such instances, the principal auditor is responsible for performing the audit in accordance with PCAOB standards.
35 As discussed in the highlights of the March 2018 CAQ SEC Regulations Committee joint meeting with the SEC staff, financial statements reissued in either an annual periodic filing or a registration statement once the period in which the consummation of the merger is reported must include a PCAOB opinion for all periods for which financial statements are presented.
36 See footnote 35 above.
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>4 Nonissuer subsidiary, division, branch, component, or investment for which an audit report is filed under Regulation S-X, Rule 2-05</td>
<td>37</td>
<td>Yes38</td>
</tr>
<tr>
<td>5 Nonissuer entity whose financial statements are filed to satisfy Rule 3-05 or 3-14</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>6 Nonissuer entity whose financial statements are included in proxy statement or Form S-4/F-4 as target</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>7 Nonissuer entity whose financial statements are filed to satisfy Regulation S-X, Rule 3-09 or 3-16</td>
<td>39</td>
<td>40</td>
</tr>
<tr>
<td>8 Subsidiary — guarantor whose separate financial statements are filed to satisfy Regulation S-X, Rule 3-10</td>
<td>Yes41</td>
<td>Yes</td>
</tr>
<tr>
<td>9 Employee benefit plan filing Form 11-K</td>
<td>Yes42</td>
<td>Yes</td>
</tr>
<tr>
<td>10 Nonissuer general partner whose balance sheet is filed in a transactional filing or registration statement of a limited partnership (see paragraph 4110.8 of the FRM)</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

37 The auditor of the financial statements of the nonissuer entity must be registered if, in performing the audit, the auditor played a “substantial role” in the audit of the issuer, as that term is defined in PCAOB Rule 1001(p)(ii). If the “substantial role” test is not met, the firm is not required to be registered. The inclusion or exclusion of such a report under Regulation S-X, Rule 2-05, does not affect this determination.

38 Regulation S-X, Rule 2-02, requires that the auditor’s report state whether the audit was conducted in accordance with GAAS. SEC Interpretive Release No. 34-49708 stated that “references in Commission rules . . . to GAAS or to specific standards under GAAS, as they relate to issuers, should be understood to mean the standards of the PCAOB plus any applicable rules of the Commission” (emphasis added). In the situation identified in the chart above, the view of the SEC staff is that the reference to GAAS in Regulation S-X, Rule 2-02, as applied to the other auditor’s report, does “relate to an issuer” for purposes of Release No. 34-49708 and that, therefore, the other auditor’s report must refer to the standards of the PCAOB.

39 See footnote 37 above.

40 If a principal auditor is making a reference to another auditor’s report on the financial statements of the nonissuer entity, the other auditor’s report must refer to the standards of the PCAOB. See footnote 30. If a principal auditor does not make reference to another auditor’s report on the financial statements of the nonissuer entity, the other auditor’s report need not refer to the standards of the PCAOB.

41 The entity is itself an issuer and so must comply with the rules applicable to issuers.

42 See footnote 41 above.
1.4.3 Form and Content of Financial Statements of Businesses Acquired or to Be Acquired

Q&A Regulation S-X: Rule 3-05-3

Question

What are the form and content requirements for the separate financial statements of businesses that are acquired or to be acquired?

Answer

As indicated in paragraph 2005.1 of the FRM, the form and content of such financial statements are “generally the same as those as if the acquired company were a registrant . . . except that the number of years of audited financial statements is determined by the level of significance.” Therefore, while the determination of periods to be presented is based on the level of significance, the form and content of the acquiree's financial statements must meet the relevant requirements of Regulation S-X and U.S. GAAP.43

However, as noted in paragraph 2005.2 of the FRM, supplemental schedules under Regulation S-X, Articles 5 and 12, are not required. In addition, certain disclosures required by GAAP may not be required in the financial statements. Paragraph 2005.1 of the FRM states that “[a]n acquired business that is a nonpublic entity, as that term is defined in GAAP, need not include disclosures if specifically excluded from the scope of the FASB standard.” For example, the following disclosures are not required:

- Segment information if the acquiree does not meet the definition of a public entity under ASC 280-10-20.
- Certain disclosures about employers' pensions and other postretirement benefits (see ASC 715-20-50-5) if the acquiree meets the definition of a nonpublic entity under ASC 715-20-20.
- Earnings per share if the acquiree does not have “publicly held common stock or potential common stock” as stated in ASC 260-10-05-1 and as further defined in ASC 260-10-15-2.

Note that an acquired or to be acquired business whose financial statements are included in a filing under Rule 3-05 would meet the definition of a public business entity (PBE) under GAAP.45 The definition of a PBE in ASU 2013-12 includes a business entity that is required by the SEC “to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).” Accordingly, since an acquired business meets the definition of a PBE, it is not eligible to elect certain accounting and reporting alternatives in U.S. GAAP, including those developed by the Private Company Council and

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43 If the acquiree is a foreign business or a foreign private issuer, see Topic 6 of the FRM.
44 The term “public entity” generally refers to an entity that files its financial statements with the SEC. However, public or nonpublic entities may be variously defined in U.S. GAAP depending on which ASC topic is being applied (e.g., ASC 280 on segment reporting). Some ASC topics may refer to a “public business entity” as defined in ASU 2013-12.
45 See paragraph BC12 of ASU 2013-12. Also see Section 8.1 of Deloitte’s A Roadmap to Accounting for Business Combinations and Section 3.2 of Deloitte’s A Roadmap to Initial Public Offerings.
subsequently endorsed by the FASB. Also, the effects of any previously elected private-company alternatives would have to be eliminated in the acquiree’s financial statements.46

Further, certain accounting standards have adoption dates for PBEs that differ from those for entities other than PBEs. If a standard defines a public entity as a PBE with respect to the application of that standard’s transition requirements, an acquiree’s financial statements must conform to the PBE adoption dates in the financial statements that meet the requirements of Rule 3-05. Therefore, an acquiree that does not otherwise meet the definition of a PBE (except for its requirement to include its financial statements or financial information in another entity’s filings with the SEC) could be required to adopt certain accounting standards earlier than planned. However, the SEC staff has announced that it would not object if certain PBEs use the non-PBE effective dates for the sole purpose of adopting the FASB’s new standards on revenue and leasing when management prepares financial statements of these acquirees.47,48

In November 2019, the FASB issued ASU 2019-10, which introduces a new “two-bucket” framework to stagger effective dates for certain major ASUs. Under this framework, different adoption dates are permitted for (1) PBEs that are SEC filers (Bucket 1) and (2) all other entities, including SRCs, other PBEs that are not SEC filers, private companies, not-for-profit organizations, and employee benefit plans (Bucket 2). PBEs that are not SEC filers generally include other entities whose financial statements or financial information is required to be or is included in other entities’ filings (e.g., financial statements or financial information required under SEC Regulation S-X, Rule 3-05). Therefore, financial statements of an acquiree would reflect Bucket 2 adoption dates under the new framework given that acquirees under Rule 3-05 are PBEs that are not SEC filers. See Deloitte’s November 19, 2019, Heads Up for more information about ASU 2019-10 and the two-bucket framework.

If interim financial statements of an acquired or to be acquired business are required under Rule 3-05, a registrant should ensure that the financial statements comply with the requirements related to form and content in Article 10. SEC regulations do not require a registrant to audit or review interim financial statements provided under Rule 3-05. However, a registrant should consider whether there are other reasons why such interim financial statements should be audited or reviewed, such as if an underwriter requires the interim information be reviewed by an independent registered public accounting firm for due-diligence or comfort-letter purposes.

46 ASU 2013-12 states that an “entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity’s filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.” Accordingly, an acquiree can elect to use private-company accounting alternatives in its standalone financial statements that are not included in an SEC filing. However, making such an election would require the acquiree to maintain two sets of accounting records and financial information.

47 See Deloitte’s July 20, 2017, Heads Up for further information. The SEC staff’s announcement at the EITF’s July 20, 2017, meeting was codified in ASU 2017-13 and makes clear that the ability to use non-PBE effective dates for adopting the new revenue and leasing standards is limited to the subset of PBEs “that otherwise would not meet the definition of a public business entity except for a requirement to include or the inclusion of its financial statements or financial information in another entity’s filing with the SEC” (specified PBEs). The adoption date for the new leasing standard for specified PBEs was amended in ASU 2020-02 to align with the additional time afforded to certain entities to adopt the leasing standard provided by ASU 2019-10. In April 2020, the FASB proposed to further defer the effective dates for the new revenue and leasing standards for certain entities as a result of coronavirus disease 2019 (for more information, see Deloitte’s Heads Up, “Highlights of the CARES Act,” for details). The FASB’s actions do not change the SEC’s prior relief provided for specified PBEs. Companies should monitor any future announcements by the SEC staff.

48 Note that when preparing pro forma financial statements that satisfy the requirements of Article 11, the registrant must conform the acquiree’s date and method of new accounting-standard adoption to those of its own. As indicated in paragraph 3250.1(m) of the FRM, the SEC “will consider requests for relief from this requirement.” See also Section 3.4.2.6 of this Roadmap for further information regarding the pro forma requirements.
1.5 Acquisition of Selected Parts of an Entity

1.5.1 Form of Required Financial Statements When Selected Parts of an Entity Are Acquired

Q&A Regulation S-X: Rule 3-05(b)(1)-1

Question
When a company acquires selected, but not all, parts of an entity in a significant business acquisition, in what form should the financial statements of the acquired or to be acquired business (acquiree) be presented?

Answer
If the selected parts of an entity being acquired represent substantially all of the entity, full audited financial statements of the entire entity are generally required. **Paragraph 2065.1** of the FRM states that in these circumstances, “full audited financial statements of the entity are presumed to be necessary in order to provide investors with the complete and comprehensive financial history of the acquired business.”

In other situations, the selected parts of an acquiree do not represent substantially all of the selling entity. **Paragraph 2065.2** of the FRM notes that in these circumstances, “financial statements of the larger entity of which the acquired business was a part may not be informative.” Therefore, the audited financial statements should only represent the selected parts of the entity acquired, excluding the operations retained by the seller. These financial statements are often referred to as carve-out financial statements. Carve-out financial statements include (1) balance sheets; (2) statements of operations, comprehensive income, and cash flows and an analysis of changes in stockholders’ equity (which may be in a note or separate statement) for the relevant periods; and (3) related financial statement disclosures. The SEC staff believes that carve-out financial statements should reflect all assets and liabilities of the acquired business (even if they are not acquired or assumed as part of the acquisition) and all costs of doing business. See SAB Topic 1.B, **Section 7200** of the FRM, and **Section 7400** of the FRM for further discussion.

In certain circumstances, full financial statements or carve-out financial statements may not be practicable to prepare, such as when the acquiree is a small portion or a product line of a much larger business and separate financial records were not maintained. **Paragraph 2065.4** of the FRM notes that in these circumstances, the SEC staff “may allow audited statements of assets acquired and liabilities assumed and statements of revenues and direct expenses.” This type of presentation is referred to herein as “abbreviated financial information.” See **Sections 1.5.2** and **1.6.7.6** for further discussion.

Abbreviated financial statements are generally not available for an acquired business identified as a predecessor of a registrant. However, as indicated in the note to **Section 2065** of the FRM, the SEC staff will consider requests to provide abbreviated financial statements for an acquired business identified as a predecessor of the registrant (e.g., when full successor financial statements have been presented in the initial registration statement for some periods). Such requests should be directed to the CF-OCA before filing.

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49 Financial statements of the selected parts of an entity are required if they meet the definition of a business in Rule 11-01(d) and are significant. See **Section 1.3.1**. See also Article 11 and **Chapter 3** of this Roadmap for a discussion of pro forma requirements.
1.5.2 Understanding Abbreviated Financial Information

Q&A Regulation S-X: Rule 3-05(b)(1)-2

In certain circumstances, it may not be practicable to prepare full financial statements or carve-out financial statements. See Section 1.5.1 for further discussion. Paragraph 2065.4 of the FRM states that in these circumstances, the SEC staff “may allow audited statements of assets acquired and liabilities assumed and statements of revenues and direct expenses.” This type of presentation is referred to herein as “abbreviated financial information.”

Question
What is abbreviated financial information?

Answer
Abbreviated financial information typically consists of a statement of revenues and direct expenses (in lieu of a full statement of operations) and a statement of assets acquired and liabilities assumed (in lieu of a full balance sheet). The periods required to be presented for abbreviated financial information are the same as the periods required by Rule 3-05 to be presented for full financial statements or carve-out financial statements.

Section 2065 of the FRM provides guidance on abbreviated financial information. The statement of revenues and direct expenses should include all direct revenues and direct expenses associated with the assets acquired and liabilities assumed. Typically, the only costs excluded are those not directly involved with the revenue-producing activity. For example, the SEC staff will not object to the exclusion of corporate overhead, interest, and taxes, provided that the footnotes to the statements indicate the basis of the presentation and the nature of the omitted expenses and the reasons for the omission. All related costs of sales and other selling, general, and administrative; distribution; marketing; and research and development (R&D) costs directly associated with producing revenues must be included. The statement should also include a reasonable allocation of other expenses incurred by the seller on behalf of the business sold. The footnotes should include (1) management’s assertion that the allocation method used is reasonable, as noted in the Interpretive Response to Question 2 of SAB Topic 1.B; (2) disclosure of the omitted expenses, if known or reasonably available, on an unaudited basis; (3) an explanation of the impracticability of preparing full financial statements; and (4) a statement that the financial statements are not indicative of financial condition or results of operations of the acquiree because operating expenses have been omitted.

The statement of assets acquired and liabilities assumed is generally presented on the basis of the seller’s historical carrying value. In certain circumstances, the CF-OCA will consider a request to present a statement of assets acquired and liabilities assumed on the basis of the allocation of the registrant’s purchase price as of the acquisition date. See paragraph 2065.5 of the FRM. In situations in which preclearance is required, registrants should consider consulting with their auditors and SEC legal counsel.

Generally, it may not be practicable for a registrant to prepare statements of cash flows when presenting abbreviated financial information in lieu of full financial statements or carve-out financial statements. However, as noted in paragraph 2065.8 of the FRM, information about the
business's operating, investing and financing cash flows are required in the notes to the financial statements or in unaudited supplemental disclosures.

Except for acquisitions of certain oil and gas properties discussed in paragraph 2065.11 of the FRM, the use of this abbreviated financial information in lieu of full financial statements or carve-out financial statements is not permitted without prior written request to the CF-OCA. The request should include an explanation of the impracticability and should also contain:

- The company's background.
- The acquiree's background.
- The nature and timing of the transaction.
- The significance level of the acquisition and the periods to be presented for the acquiree.
- The basis for using abbreviated financial statements. At a minimum, the discussion should include:
  - An explanation of the impracticability of preparing full financial statements.
  - Whether the acquired business was accounted for as a separate legal entity or managed as a stand-alone business.
- A description of the proposed financial statements to be provided and an explanation of the expenses included in or excluded from the abbreviated financial statements.
- A conclusion.

A template has been developed for use in preparing the request (see Appendix B). This template is only a guide and should be tailored to a registrant's specific facts and circumstances. In situations in which preclearance is required, registrants should consider consulting with their auditors and SEC legal counsel.

See the following sections of this Roadmap for additional information:

- **Section 1.6.1** on the significance thresholds and financial statement requirements for an acquiree for SEC reporting purposes.
- **Section 1.6.6.6** on performing an asset test when only abbreviated financial information is available for an acquired or to be acquired business (acquiree).
- **Section 1.6.7.6** on performing an income test when only abbreviated financial information is available for an acquiree.

As noted above, abbreviated financial statements are generally not available for an acquired business identified as a predecessor of a registrant. However, as indicated in the note to **Section 2065** of the FRM, the SEC staff will consider requests to provide abbreviated financial statements for an acquired business identified as a predecessor of the registrant (e.g., when full successor financial statements have been presented in the initial registration statement for some periods). Such requests should be directed to the CF-OCA before filing.
1.6 Measuring Significance

1.6.1 Significance Thresholds and Financial Statement Requirements for a Business Acquisition or Probable Business Acquisition for SEC Reporting Purposes

Q&A Regulation S-X: Rule 3-05(b)(2)-1

In specifying the financial statement requirements for a significant business acquisition or probable business acquisition (acquiree), Rule 3-05 refers to the definition of a significant subsidiary in Rule 1-02(w). However, the thresholds used in Rule 3-05 to determine significance for an acquiree differ from those included in Rule 1-02(w) to determine the significance of a subsidiary.

Question

What are the significance thresholds for an acquiree, and what effect do these thresholds have on the financial statement requirements?

Answer

As described in Rule 1-02(w) a registrant must perform the following three tests to determine the significance of an acquiree: the investment test, the asset test, and the income test. When evaluating significance, the registrant must use U.S. GAAP amounts. The test that results in the highest significance level will be used to determine the financial statement periods of the acquiree that must be presented.

The following table depicts the various significance thresholds and the general financial statement requirements for an acquiree under Rule 3-05.

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50 Foreign private issuers should refer to Section 6350 and paragraph 2015.3 of the FRM as well as SEC Final Rule Release No. 33-8879. This guidance indicates that issuers should use amounts determined under IFRS Standards in performing the significance tests required by Rule 3-05 when the issuer’s financial statements are prepared in accordance with such IFRS Standards. A registrant that files its financial statements in accordance with or is required to provide reconciliation to U.S. GAAP should determine significance by using amounts for both the acquired business and the registrant determined in accordance with U.S. GAAP. See the Q&As in Section 1.12.

51 For further information regarding SEC filings that may require financial statements of a significant business acquisition or a significant probable business acquisition and when these financial statements are required, see Section 1.4.1.
## Financial Statement Requirements

<table>
<thead>
<tr>
<th>Significance Thresholds</th>
<th>Business Acquisition</th>
<th>Probable Business Acquisition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Does not exceed 20 percent(^{52})</td>
<td>No financial statements required. (However, see the Q&amp;As in Section 1.9 for additional considerations.)</td>
<td>No financial statements required. (However, see the Q&amp;As in Section 1.9 for additional considerations related to aggregating individually insignificant acquisitions.)</td>
</tr>
</tbody>
</table>
| Exceeds 20 percent but not 40 percent \(^{53}\) | • Audited balance sheet as of the end of the most recent fiscal year.  
• Audited statements of operations, comprehensive income,\(^{54}\) cash flows, and changes in stockholders’ equity for the most recent fiscal year,\(^{55}\)  
• Unaudited financial statements as of and for the appropriate interim period preceding the acquisition and the corresponding interim period in the prior year. | No financial statements required. (However, see the Q&As in Section 1.9 for additional considerations.) |
| Exceeds 40 percent but not 50 percent \(^{56}\) | • Audited balance sheets as of the end of the two most recent fiscal years.  
• Audited statements of operations, comprehensive income,\(^{57}\) cash flows, and changes in stockholders’ equity for the two most recent fiscal years,\(^{58}\)  
• Unaudited financial statements as of and for the appropriate interim period preceding the acquisition and the corresponding interim period in the prior year. | No financial statements required. (However, see the Q&As in Section 1.9 for additional considerations.) |

\(^{52}\) The results of the significance tests should not be rounded (see paragraph 2015.13 of the FRM). For practical purposes, many of the significance calculations in the examples in this manual have been rounded up to the nearest whole percent. If the significance calculation were to result in an acquiree being exactly 20 percent significant to the registrant, no financial statements would be required under Rule 3-05. This same concept applies to the financial statement requirements at all levels of significance (i.e., exactly 40 percent, exactly 50 percent).

\(^{53}\) See footnote 52 above.

\(^{54}\) ASC 220 provides two alternative presentations for reporting comprehensive income. In addition, the statement of stockholders’ equity may be presented in a note to the financial statements.

\(^{55}\) As noted in the SEC’s June 2018 final rule that amends the definition of an SRC, the staff revised Rule 3-05(b)(2)(iv) to increase the net revenue threshold from $50 million to $100 million. The final rule became effective on September 10, 2018.

\(^{56}\) See footnote 52 above.

\(^{57}\) See footnote 54 above.

\(^{58}\) See footnote 55 above.
## Financial Statement Requirements

<table>
<thead>
<tr>
<th>Significance Thresholds</th>
<th>Business Acquisition</th>
<th>Probable Business Acquisition</th>
</tr>
</thead>
</table>
| Exceeds 50 percent\(^{59}\) | • Audited balance sheets as of the end of the two most recent fiscal years.  
• Audited statements of operations, comprehensive income,\(^{60}\) cash flows, and changes in stockholders' equity for the three most recent fiscal years.  
• Unaudited financial statements as of and for the appropriate interim period preceding the acquisition and the corresponding interim period\(^{61}\) in the prior year. | • Audited balance sheets as of the end of the two most recent fiscal years.  
• Audited statements of operations, comprehensive income,\(^{64}\) cash flows, and changes in stockholders' equity for the three most recent fiscal years.  
• Unaudited financial statements as of and for the appropriate interim period preceding the acquisition and the corresponding interim period\(^{65}\) in the prior year. |

Exceptions include: (1) if revenues of the acquired business are less than $100 million\(^{62}\) in the most recent fiscal year, the earliest year can be omitted; (2) if the registrant is an operating company EGC, it may present two years of financial statements for its IPO of common equity securities (see paragraph 10220.5 of the FRM); and (3) if the registrant is an SRC, the presentation of financial statements of a nonreporting target may comply with the scaled disclosure requirements applicable to SRCs.\(^{63}\)

Exceptions include: (1) if revenues of the probable business acquisition are less than $100 million\(^{66}\) in the most recent fiscal year, the earliest year can be omitted; (2) if the registrant is an operating company EGC, it may present two years of financial statements for its IPO of common equity securities (see paragraph 10220.5 of the FRM); and (3) if the registrant is an SRC, the presentation of financial statements of a nonreporting target may comply with the scaled disclosure requirements applicable to SRCs.\(^{67}\)

See the following for exceptions to these general requirements:

- **Section 1.13.2.3** on using postacquisition results to satisfy the audited financial statement requirements for a significant acquired business.

- **Section 1.13.2.4** on omitting an audited balance sheet for a significant business acquisition.

- **Rule 3-06**, which permits a registrant to provide **audited** financial statements of an acquiree for a period of 9 to 12 months to satisfy the one year requirement under Rule 3-05. It also permits, by extension, a registrant to use at least 21 months to satisfy a two-year requirement and at least 33 months to satisfy a three-year requirement, provided that no individual audit period exceeds 12 months and that all audited periods are consecutive (i.e., with no unaudited gaps).

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59 See footnote 52.
60 See footnote 54.
61 See footnote 55.
62 As noted in the SEC's June 2018 final rule that amends the definition of an SRC, the staff revised Rule 3-05(b)(2)(iv) to increase the net revenue threshold from $50 million to $100 million.
63 If an SRC acquires a non-SRC, the SEC staff may request three years of audited financial statements for the acquired entity.
64 See footnote 54.
65 See footnote 55.
66 See footnote 62 above.
67 If an SRC acquires a non-SRC, the SEC staff may request three years of audited financial statements for the acquired entity.
• On August 17, 2017, the Division of Corporation Finance updated its June 29, 2017, announcement that the SEC would, as of July 10, 2017, be extending to all companies benefits that are similar to those offered to EGCs regarding the confidential review of draft registration statements under the JOBS Act. A draft registration statement may be voluntarily submitted to the SEC staff for nonpublic review before a registrant’s public filing for (1) IPOs and initial registration statements under the Securities Act, (2) initial registration statements under Section 12(b) of the Exchange Act for a class of securities (e.g., Form 10), and (3) Securities Act offerings within one year of an IPO or Exchange Act Section 12(b) registration (available only for the initial submission). A registrant may be able to omit an acquiree’s interim and annual financial statements (and the related pro forma information) if it reasonably believes that those financial statements will not be required at the time of the public filing (or, for EGCs, at the time of the offering).

Example

A calendar-year-end company that plans to submit a draft registration statement in the fall of 20X7 completes a significant acquisition in the fourth quarter of 20X6. The acquisition is significant in such a way that one year of the acquiree’s financial statements would generally be required under Rule 3-05. The company plans to update its draft registration statement to include its 20X7 annual financial statements before a public filing in 20X8. Thus, after that update, the acquired business will have been part of the company’s financial statements for a sufficient amount of time to eliminate the need for separate financial statements. In this scenario, the company may omit the acquiree’s financial statements and the related pro forma financial information from the draft registration statement in the fall of 20X7.

1.6.2 Financial Statement Disclosures — Materiality Under ASC 805 Versus Significance Under Rule 3-05

Q&A Regulation S-X: Rule 3-05(b)-1A

ASC 805-10-50-1 through 50-8 require annual and interim financial statements to include certain disclosures for business combinations occurring during the current reporting period or after the reporting date but before the financial statements are issued or available to be issued.

Question

If a business acquisition does not meet the significance thresholds of Rule 3-05, for financial statement presentation, may a registrant omit the financial statement disclosures required by ASC 805?

Answer

No. Materiality under ASC 805 is not the same as significance under Rule 3-05. The materiality threshold under ASC 805 is generally lower than that under Rule 3-05. Therefore, registrants must separately determine what financial statement disclosures are required under ASC 805 for an individually material business combination (or for individually immaterial business combinations that are collectively material).

68 This guidance on the omission of financial information is consistent with certain accommodations that are available for the registrant’s historical financial statements. We believe that a company may similarly omit from its draft registration statement the related pro forma financial information required by Article 11.

69 See the C&Is on Securities Act Forms (Questions 101.04 and 101.05) and the C&Is on the FAST Act (Questions 1 and 2). See also Deloitte’s August 24, 2017, Heads Up (originally published July 11, 2017).
1.6.3 Financial Statements Used to Measure Significance

1.6.3.1 Measuring Significance of a Business Acquisition or Probable Business Acquisition

Q&A Regulation S-X: Rule 3-05(b)(3)-1

Question
What financial statements should be used to measure significance of a business acquisition or probable business acquisition (acquiree)?

Answer
Generally, the most recent preacquisition annual financial statements of an acquiree are compared with a registrant's preacquisition consolidated financial statements as of and for its most recently completed audited fiscal year that is required to be filed with the SEC (regardless of whether the registrant and acquiree have different fiscal year-ends). If the acquiree is not a registrant, the financial statements used for the significance tests should be determined as though the acquiree were a registrant. Further, if an acquiree is not a registrant, the acquiree's financial statements are not required to be audited to perform the significance tests. However, if a business acquisition exceeds the 20 percent significance level, the required annual financial statements must be audited. See Section 1.4.1 for further discussion.

Example
- Registrant A's fiscal year-end is December 31.
- Registrant A acquires Company B on June 30, 20X9.
- Company B's fiscal year-end is December 31.

The significance test should be calculated by comparing the acquiree's financial statements for the year ended December 31, 20X8, with the registrant's audited financial statements for the year ended December 31, 20X8.

1.6.3.2 Measuring Significance of a Business Acquisition Consummated Shortly After a Registrant’s Most Recently Completed Fiscal Year

Q&A Regulation S-X: Rule 3-05(b)(3)-2

A registrant may consummate a business acquisition shortly after its most recent fiscal year-end but before filing its Form 10-K for that year. The initial Form 8-K reporting the acquisition must be filed within four business days of the consummation of such acquisition, if significant. In this situation, a registrant may file its Form 10-K for its most recently completed fiscal year before the acquiree's financial statements and pro forma financial information are required to be filed in an amendment to the initial Form 8-K that must be filed within 71 calendar days after the initial Form 8-K was required to be filed. See Section 1.4.1 for further discussion.

Question
What financial statements should be used to measure significance of a business acquired shortly after the completion of a registrant's most recent fiscal year?

See Section 1.6.3.3 for further information.
**Answer**

A registrant should use the financial statements included in its prior year’s Form 10-K to assess significance in determining its initial Form 8-K filing requirements. The registrant may reevaluate significance using its financial statements for the most recent fiscal year reported in the Form 10-K filed after the initial Form 8-K filing as long as the Form 10-K is filed before the due date of the amended Form 8-K. This is acceptable even if the reassessment results in a lower level of significance, thereby reducing the number of periods required. However, the registrant is not obligated to use the more recent financial statements as they were filed after the initial Form 8-K filing, even if using such financial statements results in a higher level of significance.

<table>
<thead>
<tr>
<th>Example</th>
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<tbody>
<tr>
<td>• Registrant A’s fiscal year-end is December 31.</td>
</tr>
<tr>
<td>• Registrant A acquired Company B on February 1, 20X9.</td>
</tr>
<tr>
<td>• Company B is not a registrant and has a September 30 fiscal year-end.</td>
</tr>
<tr>
<td>• As of February 1, 20X9, the December 31, 20X8, audited financial statements of A were not yet filed with the SEC.</td>
</tr>
<tr>
<td>• Company B exceeds the 50 percent significance level using B’s financial statements as of and for the year ended September 30, 20X8, and A’s financial statements as of and for the year ended December 31, 20X7.</td>
</tr>
<tr>
<td>• Registrant A filed a Form 8-K on February 5, 20X9, announcing the consummation of the acquisition of B (within four business days of the consummation of the acquisition).</td>
</tr>
<tr>
<td>• Registrant A filed its December 31, 20X8, Form 10-K on March 1, 20X9.</td>
</tr>
<tr>
<td>• Registrant A filed its Form 8-K/A on April 10, 20X9, including the financial statements of B and the required pro forma financial information (within 71 calendar days of the initial Form 8-K filing).</td>
</tr>
</tbody>
</table>

To assess the significance of B at the date of acquisition, A compared B’s September 30, 20X8, financial statements with its December 31, 20X7, audited financial statements since these were the latest audited financial statements filed. However, because A filed its December 31, 20X8, Form 10-K before it was required to file the Form 8-K/A, Registrant A had the option of reassessing the significance of B using its December 31, 20X8, audited financial statements filed on March 1, 20X9, but was not required to do so.

Pursuant to the reassessment, B was determined to be 30 percent significant to A. Therefore, A presented B’s audited balance sheet as of September 30, 20X8, and audited statements of operations, comprehensive income, cash flows, and changes in stockholders’ equity, for the year ended September 30, 20X8. As indicated above, such reassessment was not required. Therefore, A could have filed B’s financial statements required by its original significance assessment.

See paragraph 2025.2 of the FRM, Section 1.6.3.1, and Section 1.6.3.3 below for further discussion.

**1.6.3.3 Measuring Significance When a Registrant and an Acquired or to Be Acquired Business Have Different Fiscal Year-Ends**

**Q&A Regulation S-X: Rule 3-05(b)(3)-3**

**Question**

What financial statements should be used to measure significance of an acquired or to be acquired business (acquiree) if a registrant’s fiscal year-end is different from an acquiree's?
**Answer**

If a registrant’s fiscal year-end is different from an acquiree’s fiscal year-end, the financial statements for the appropriate respective year-ends should be used. See Section 1.6.3.1. The fiscal year-ends should not be conformed in performing the significance tests.\(^\text{71}\)

<table>
<thead>
<tr>
<th>Example</th>
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</table>
| • Registrant A’s fiscal year-end is December 31.  
• Registrant A acquires Company B on November 15, 20X9.  
• Company B is not a registrant and has a June 30 fiscal year-end.  

To measure significance, A compared B’s financial statements for the fiscal year ended June 30, 20X9, with its audited financial statements for the fiscal year ended December 31, 20X8. |

**1.6.3.4 Measuring Significance When a Business Acquisition Is Consummated or a Probable Business Acquisition Is Contemplated by a Registrant’s Subsidiary**

**Q&A Regulation S-X: Rule 3-05(b)(3)-4**

**Question**

A registrant’s subsidiary acquires, or it is probable that it will acquire, a business. What financial statements should be used to measure significance?

**Answer**

If the subsidiary is not itself a registrant, the acquiree’s financial statements should be compared with the registrant’s consolidated financial statements (the parent of the subsidiary) to measure significance. That is, significance should not be measured using the subsidiary’s stand-alone financial statements when the subsidiary is not a registrant.

However, if the subsidiary is also a registrant, both the parent and the subsidiary must determine whether the acquisition or probable acquisition is significant since they are both registrants. Accordingly, the financial statements of the acquiree should be compared with the financial statements of both the parent and the subsidiary to measure significance.

\(^{71}\) For preparation of pro forma financial statements in accordance with Rule 11-02(c)(3) when the most recent fiscal year-end of the acquiree differs from the registrant’s most recent fiscal year-end by more than 93 days, the acquiree’s income statement must be brought up to within 93 days of the registrant’s most recent fiscal year. See Section 3.3.2.2.
Example

- Company A, a registrant, has multiple consolidated subsidiaries.
- Company A owns 100 percent of the equity in each subsidiary.
- One of A's subsidiaries, Subsidiary B, is also a registrant because it has outstanding public debt.
- On October 1, 20X9, B consummated the acquisition of Company C.
- Company C is not a registrant and has a fiscal year-end of December 31.

Both registrants, A and B, must determine whether the acquisition of C is significant under Rule 3-05. To measure significance, each registrant must use its respective financial statements as of and for its most recently completed audited fiscal year that is required to be filed with the SEC.

The results of the significance tests indicated that the acquisition of C was 30 percent significant to B but only 5 percent significant to A. Accordingly, B complied with the Form 8-K requirements and filed audited financial statements of C for one year, unaudited financial statements as of and for the appropriate interim period preceding the acquisition and the corresponding interim period in the prior year, and filed the required pro forma financial information. Company A was not required to file any financial statements of C under Rule 3-05 because the acquisition was not significant to A under the thresholds provided in Rule 3-05.

See Section 1.6.1 for further discussion on the number of financial statement periods that need to be presented based on significance level.

1.6.3.5 Measuring Significance When a Business Acquisition Is Consummated or a Probable Business Acquisition Is Contemplated by a Shell Company After It Acquires a Predecessor

Q&A Regulation S-X: Rule 3-05(b)(3)-5

A shell company (which may include a SPAC) purchased an entity deemed to be its predecessor in a transaction that is not accounted for as a reverse acquisition or a reverse recapitalization. After this purchase, but before the newly combined company's year-end, the registrant acquires, or it is probable it will acquire, an unrelated business. The registrant's current fiscal year has not yet ended; therefore, no audited financial statements have been filed for the periods after the acquisition of the predecessor entity.

Question

In this situation, what financial statements should be used to measure significance of a business acquisition or probable business acquisition (acquiree)?

Answer

In accordance with paragraph 2025.9 of the FRM, a registrant should assess significance of an acquiree against the historical financial statements of the shell company (registrant). That is, the predecessor financial statements should not be used to measure significance.

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72 In addition to the two transactions referred to in paragraph 2025.9 of the FRM, we believe this would also not apply to a transaction of entities under common control.

73 Refer to the Q&As in Section 1.7 to determine whether business acquisitions are related.
### Example

- Registrant A was formed on November 30, 20X8.
- Registrant A's fiscal year-end is December 31.
- Registrant A acquired Company B on February 1, 20X9.
- Company B is not a registrant and has a December 31 fiscal year-end.
- Registrant A had nominal operations and nominal assets before the acquisition on February 1, 20X9, and was therefore a shell company.
- Company B is the predecessor of A.
- Registrant A completed its initial public offering in March 20X9.
- Registrant A acquired Company C in October 20X9. This acquisition was unrelated to the acquisition of B.
- Company C's fiscal year-end is December 31.
- Company C is not a registrant.

The Form S-1 for the initial public offering included audited financial statements of B (the predecessor) as of December 31, 20X8, and December 31, 20X7, and for the three years then ended. Because A had minimal assets and no operations before the acquisition of B on February 1, 20X9, the only financial statement of A included in the Form S-1 was a balance sheet as of December 31, 20X8.

To determine the significance of C, A compared the financial statements of C as of and for the year ended December 31, 20X8, with its December 31, 20X8, financial statements, which consisted solely of an audited balance sheet. Although A has no income statement activity, the income test, as well as the asset test and investment test, must be performed. Company B's (the predecessor's) financial statements were not considered.

Because A had nominal assets and operations as of and for the year ended December 31, 20X8, C exceeded the 50 percent significance level for all tests of significance.

Registrants who obtain unusual conclusions as a result of the tests may consider consulting with the SEC staff. In fact patterns in which preclearance is considered, registrants should consider consultation with their auditors and SEC legal counsel. See the introduction of this Roadmap for further discussion of waiver requests.

If a registrant’s audited financial statements for its recently completed fiscal year include predecessor and successor operations, then significance of an unrelated business acquisition should generally be measured using the audited successor financial statements. See Section 1.6.3.6 for further discussion.
**1.6.3.6 Measuring Significance of a Business Acquisition or Probable Business Acquisition When a Registrant Is a Successor to a Predecessor Company**

**Q&A Regulation S-X: Rule 3-05(b)(3)-6**

Sometimes a registrant is a successor to a *predecessor* company or presents financial statements that include predecessor and successor results. Examples include (1) adoption of fresh-start accounting after emergence from bankruptcy; (2) use of push-down accounting to reflect a change in basis because of an acquisition of the company; or (3) acquisition, by a shell company, of another entity that is determined to be the shell company’s predecessor. In these situations, a registrant may not have a full year of income statement data reflecting the successor results. For example, if push-down accounting was applied, the period before the change in basis represents the predecessor period and the period after the change in basis represents the successor period.

**Question**

What financial statements should be used to measure significance of a business acquisition or probable business acquisition (acquiree) when a registrant’s audited financial statements for its recently completed fiscal year include predecessor and successor operations?

**Answer**

In accordance with paragraph 2025.10 of the FRM, if a registrant does not have a full year of income statement information available to use as the denominator in the calculation of the income test, the registrant should use the audited results of operations of the successor company as the basis for the income test. Accordingly, the income test would result in the comparison of a full year of operations of the acquiree with the registrant’s operations for the successor period, which may be only a few days or a few months.

If the results of the income test are anomalous, it may be acceptable, if precleared by the SEC, for the registrant to perform the significance test using pro forma amounts. Such amounts would be computed as if the predecessor had been acquired at the beginning of the fiscal year and would be determined in accordance with Article 11. The staff generally believes that using the combined historical results of operations of the successor and predecessor for a full year without the appropriate pro forma adjustments is not an appropriate surrogate for the significance test.

In fact patterns requiring preclearance with the SEC staff, registrants should also consider consultation with their auditors and SEC legal counsel. See the **introduction** of this Roadmap for further discussion of waiver requests.

For the investment and asset tests, the registrant should compare the acquiree’s purchase price and total assets with the registrant’s total assets included in its audited balance sheet as of the most recently completed fiscal year (reflecting the successor’s financial position). See **Section 1.6.3.1**.
Example

- Registrant A has a fiscal year-end of December 31.
- Registrant A was acquired in its entirety by an unrelated entity on November 1, 20X8.
- Registrant A applied push-down accounting as a result of the acquisition and, therefore, had a change in basis of accounting.
- In A's December 31, 20X8, Form 10-K, the predecessor period (January 1, 20X8, through October 31, 20X8) was shown separately from the successor period (November 1, 20X8, through December 31, 20X8).
- In May 20X9, A acquired Company X.
- Company X is not a registrant and has a fiscal year-end of December 31.

Regarding A, the periods before the application of push-down accounting represented the predecessor periods. The periods after the application of push-down accounting represented the successor periods. Given the change in basis of accounting, the predecessor and successor periods were not comparable.

Regarding the significance tests, the financial statements of X as of and for the year ended December 31, 20X8, were compared with the financial statements of A as of December 31, 20X8, and for the successor period from November 1, 20X8, through December 31, 20X8. That is, for the income test, twelve months of operating results of X were compared with two months of successor operating results of A.

Regarding the income test, the SEC staff may permit A to compare financial statements of X for the year ended December 31, 20X8, with the pro forma financial information of A for the year ended December 31, 20X8, as though A had applied push-down accounting on January 1, 20X8. Registrant A would be required to preclear these facts and circumstances with the SEC staff.

If a registrant's audited financial statements for its most recently completed fiscal year do not include periods representing the successor, significance of an unrelated business acquisition or probable business acquisition should be measured using the financial statements of the registrant. See Section 1.6.3.5 for further discussion.

1.6.3.7 Measuring Significance of an Acquired or to Be Acquired Business When Previously Issued Financial Statements Are Required to Be Retrospectively Adjusted

Q&A Regulation S-X: Rule 3-05(b)(3)-7

ASC 250 may require that a change in accounting principle or change in reporting entity be effected by retrospective application. In addition, the transition provisions of certain newly issued standards may require retrospective application. Further, a segment change under ASC 280 and the classification of a component as a discontinued operation under ASC 205-20 are changes that may also require retrospective application. Collectively, these changes are referred to below as “retrospective changes.”

As indicated in Topic 13 and paragraph 2025.1 of the FRM, in certain circumstances (for example, when filing a new registration statement), a registrant may be required to file updated financial statements that reflect the retrospective adjustments for periods before adoption of the change. In some cases, such changes may affect the significance calculations and therefore affect the financial statement periods required to be presented for an acquired or to be acquired business (acquiree). For guidance on determining when a registrant is required to file updated financial statements that reflect the retrospective adjustments for periods before adoption of the change, see Topic 13 of the FRM.
Question
What financial statements should be used to measure the significance of an acquiree when the registrant's previously issued financial statements have been filed and reflect a retrospective adjustment\(^{74}\) for periods before adoption of the change?

Answer
Generally, a registrant should compare the most recent preacquisition annual financial statements of an acquiree with a registrant's preacquisition consolidated financial statements that are required to be filed with the SEC for the most recently completed audited fiscal year. See Section 1.6.3.1 for further discussion.

Paragraph 2025.1 of the FRM states, in part:

>[A registrant is required] to perform significance tests based on the registrant's financial statements that reflect retrospective application for the most recently completed fiscal year for:

- Individual businesses acquired after the date the retrospectively adjusted financial statements are filed;
- Probable acquisitions; and
- Aggregate impact of all individually insignificant businesses that have occurred since the end of the most recently completed fiscal year.

A registrant is not required to remeasure\(^{75}\) significance for previously consummated acquisitions upon filing the retrospectively adjusted financial statements.\(^{76}\)

The note to paragraph 2025.1 of the FRM adds the following clarification:

Solely for purposes of assessing significance of individual acquisitions completed on or before the date the retrospectively adjusted financial statements are filed (and not, for example, for purposes of assessing the aggregate impact of all individually insignificant businesses that have occurred since the end of the most recently completed fiscal year), significance may be measured based on either (A) the registrant's audited financial statements for its most recently completed fiscal year that were filed prior to the retrospectively adjusted financial statements giving effect to the discontinued operation or (B) the registrant's filed financial statements for the most recently completed fiscal year that reflect retrospective application of the discontinued operation. A registrant must consistently use the financial statements it chooses (i.e., either (A) or (B) above) to measure significance of all individual acquisitions completed on or before the date the retrospectively adjusted financial statements are filed.

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\(^{74}\) The retrospective changes referred to in this Q&A do not include revisions resulting from the correction of an error for misapplication of U.S. GAAP.

\(^{75}\) Regulation S-X, Rule 3-09, requires a registrant to file separate financial statements for significant equity method investees. In addition, Regulation S-X, Rule 4-08(g), requires summarized financial information for significant equity method investees. The registrant measures the significance of an equity investee under Rule 3-09 and Rule 4-08(g) by performing significance tests annually, at year-end, in connection with the filing of Form 10-K. Therefore, significance is not remeasured when updated financial statements that reflect retrospective adjustments are filed. However, paragraph 2410.8 of the FRM indicates that a registrant's requirements for filing its next Form 10-K differ depending on whether the retrospective change is a result of a change in accounting principle or a discontinued operation. A registrant is not required to recalculate significance for a period earlier than the one during which the change in accounting principle occurred. However, for a discontinued operation, a registrant must recompute significance for all periods presented. As a result, financial statements and summarized financial information of an equity-method investee may be required under Rule 3-09 and Rule 4-08(g), respectively, in the registrant's next Form 10-K even if they were not required in a prior Form 10-K. See Section 2.1.6 of Deloitte's A Roadmap to SEC Reporting Considerations for Equity Method Investees for further discussion of this issue.

\(^{76}\) When an acquirer files an IPO registration statement, the acquirer must use the retrospectively adjusted financial statements included in the IPO registration statement to measure the significance of all historical acquisitions. See Section 1.13 for additional information.
Chapter 1 — Business Combinations

Example

- Registrant A has a December 31 year-end.
- Registrant A filed its December 31, 20X8, Form 10-K on March 1, 20X9.
- On April 30, 20X9, A disposed of a component of an entity that was classified as a discontinued operation in accordance with ASC 205-20. The component met the criteria to be classified as a discontinued operation during the three-month period ended March 31, 20X9. Discontinued operations treatment was not reflected in the Form 10-K since there was not a measurement date for discontinued operations treatment on December 31, 20X8.
- Registrant A filed its March 31, 20X9, Form 10-Q on May 1, 20X9, which reflected discontinued operations treatment for the quarters ended March 31 in both 20X9 and 20X8.
- Registrant A filed a Form 8-K on May 2, 20X9, revising the annual financial statements included in its December 31, 20X8, Form 10-K to reflect the component that was disposed as discontinued operations for all periods presented. The Form 8-K was filed because A intended to file a new registration statement that would incorporate the most recently filed annual and interim financial statements.
- Registrant A consummated the acquisition of Company B on September 1, 20X9.
- Company B is not a registrant and has a fiscal year-end of December 31.

To measure significance of the acquisition of B, A used the revised financial statements included in the Form 8-K filed on May 2, 20X9.

1.6.3.8 Measuring Significance When a Business Acquisition Is Consummated or a Probable Business Acquisition Is Contemplated After a Reverse Acquisition or a Reverse Recapitalization

Q&A Regulation S-X: Rule 3-05(b)(3)-8

When a registrant consummates a business acquisition that is accounted for as a reverse acquisition or reverse recapitalization, the business acquired (legal acquiree) is treated as the continuing reporting entity that acquired the registrant (legal acquirer). A business acquisition may occur, or a probable business acquisition may be contemplated, after a reverse acquisition or reverse recapitalization was consummated but before a registrant files audited financial statements for the fiscal year in which the reverse acquisition or reverse recapitalization occurred. See Topic 12 of the FRM for further discussion.

Question

What financial statements should be used to measure significance when a business acquisition is consummated, or a probable business acquisition is contemplated (acquiree), after a reverse acquisition or reverse recapitalization?

Answer

Generally, the most recent preacquisition annual financial statements of an acquiree are compared with a registrant’s preacquisition consolidated financial statements that are required to be filed with the SEC as of and for the most recently completed audited fiscal year. However, paragraph 2025.7 of the FRM indicates that in a reverse acquisition, if the audited financial statements of the accounting acquirer have been filed with the SEC, then the registrant should “measure significance against the accounting acquirer’s financial statements.” This is because the financial statements of the accounting acquirer become the financial statements of the registrant under U.S. GAAP.
Similarly, paragraph 2025.8 of the FRM indicates that in a reverse recapitalization, if the audited financial statements of the legal acquiree in a reverse recapitalization have been filed with the SEC, then the registrant should measure significance against the legal acquiree’s financial statements.

**Example**

- Registrant A, an operating company, has a fiscal year-end of December 31.
- Registrant A acquired Company B, also an operating company, on July 1, 20X8.
- Company B is not a registrant and has a fiscal year-end of December 31.
- The transaction was accounted for as a reverse acquisition. Company B was the accounting acquirer and A was the accounting acquiree.
- Registrant A (the legal acquirer) filed a Form 8-K on July 5, 20X8, to report the consummation of the reverse acquisition. Audited financial statements of B as of December 31, 20X7, and December 31, 20X6, and for the three years ended December 31, 20X7, were available and included in the initial Form 8-K.
- On August 15, 20X8, Company B acquired Company C.
- Company C is not a registrant and has a fiscal year-end of December 31.

Company C’s annual financial statements for the year ended December 31, 20X7, were compared with B’s (the accounting acquirer’s) previously filed audited financial statements for the year ended December 31, 20X7, to determine significance. Registrant A’s financial statements were not used to determine the significance of the acquisition because B’s (the accounting acquirer’s) financial statements had been filed with the SEC.

**1.6.3.9 Measuring Significance When a Registrant Plans to Dispose of Certain Assets Acquired or to Be Acquired**

**Q&A Regulation S-X: Rule 3-05(b)(3)-9**

**Question**

What financial statements should be used to measure significance of an acquired or to be acquired business (acquiree) when a registrant plans to sell some of the acquiree’s assets?

**Answer**

The assets to be disposed by a registrant after a business is acquired should not be excluded when calculating significance. The financial statements of the acquiree must be used to measure significance.
1.6.4 Use of Pro Forma Financial Information to Measure Significance When a Business Acquisition Is Consummated or a Probable Acquisition Is Contemplated and a Significant Business Acquisition or Disposition Has Been Reported Previously

Q&A Regulation S-X: Rule 3-05(b)(3)-10

Article 11 requires pro forma financial information after a significant business acquisition is consummated or a significant disposition is completed. The pro forma financial information may be included in (1) a registration statement, (2) certain proxy materials, or (3) a Form 8-K. When historical financial statements of an acquired or to be acquired business (acquiree) are filed, pro forma financial information must also be presented. See Chapter 3 for additional information.

Question

What financial statements should a registrant use to measure significance of an acquiree when a significant business acquisition or disposition has been reported previously?

Answer

A registrant should use preacquisition historical financial statements as of and for its most recently completed audited fiscal year required to be filed with the SEC, except that a registrant may evaluate significance of an acquiree by using the registrant's pro forma financial information that reflects the prior acquisition or disposition as if it had occurred as of the beginning of its fiscal year, provided both of the following conditions are met:

- Audited historical financial statements for the previous significant business acquisition have been filed with the SEC in a Form 8-K or a non-IPO registration statement.
- Pro forma financial statements reflecting the previous significant business acquisition or disposition have been filed with the SEC in a Form 8-K or non-IPO registration statement.

A registrant is not required to use the pro forma financial information to measure significance. Note 2 to paragraph 2025.3 of the FRM states, “If the registrant chooses to compute significance using pro forma [financial] information, it must do so for all three significance tests.” Furthermore, note 1 states that the SEC staff “would expect the registrant to consistently apply that methodology for evaluating significance to all subsequent acquisitions or dispositions for the remainder of the fiscal year.”

A registrant should apply the following guidance if it elects to use pro forma financial information to measure significance:

- **Income test** — Use the pro forma financial information for the latest audited annual period included in the Form 8-K or non-IPO registration statement.
- **Investment and asset tests** — Use the pro forma balance sheet representing the latest audited annual balance sheet. This balance sheet may not be the one included in the Form 8-K or non-IPO registration statement.

The acquired entity's total assets and pretax income from continuing operations should not be adjusted for acquisition accounting. Pro forma financial information of the acquiree may not be used to measure the acquiree's significance.
The registrant’s pro forma amounts should only include those pro forma adjustments directly attributable to the transaction (e.g., purchase price allocation, depreciation and amortization) in the pro forma income statement and balance sheet.

**Example**

- Registrant M has a December 31 year-end.
- Registrant M acquired Company Q on March 15, 20X9.
- Company Q is not a registrant and has a fiscal year-end of December 31.
- Registrant M filed a Form 8-K announcing the consummation of the acquisition of Q on March 19, 20X9.
- On April 25, 20X9, M filed a Form 8-K/A with the required audited historical financial statements of Q, and filed unaudited pro forma financial information as of and for the year ended December 31, 20X8.
- Registrant M acquired Company R on June 15, 20X9.
- Company R is not a registrant and has a fiscal year-end of December 31.

To measure the significance of the acquisition of R, M had the option of using either (1) the pro forma information as of and for the year ended December 31, 20X8, that reflected the acquisition of Q or (2) its historical audited financial statements in its December 31, 20X8, Form 10-K that did not reflect the acquisition of Q. Registrant M must use the option it elects for all three tests of significance.

The following scenarios illustrate situations in which pro forma financial information has been filed with the SEC; however, in these scenarios, use of such pro forma financial information for the significance test is not appropriate.

**Registrant’s Financial Statements Included in Its Most Recent Form 10-K Give Effect to the Previously Reported Significant Business Acquisition**

As indicated at the March 2002 AICPA SEC Regulations Committee joint meeting with the SEC staff, the use of pro forma financial information is only appropriate when a registrant’s annual financial statements that give effect to the previously reported significant business acquisition have not yet been filed in a Form 10-K. At that meeting, the SEC staff concluded that the use of pro forma financial information was not appropriate in a situation similar to the one presented in the following fact pattern:

1. A registrant with a calendar year-end reports a significant business acquisition on Form 8-K/A with the appropriate historical financial statements of the acquired business and pro forma financial information in the fourth quarter of 20X8. Pro forma income statements were presented for the year ended December 31, 20X7, and the subsequent interim period, September 30, 20X8. The pro forma balance sheet was presented as of September 30, 20X8.
2. Subsequently, the registrant filed its Form 10-K for the year ended December 31, 20X8, on February 15, 20X9.
3. On March 1, 20X9, the registrant consummated a second significant business acquisition.

The SEC staff concluded that the historical financial statements included in the registrant’s recently filed Form 10-K should be used in the calculation to measure significance of the second business acquisition. In the fact pattern above, the registrant should use the financial statements included in the Form 10-K for the year ended December 31, 20X8. Such financial statements give effect to the previously reported significant business acquisition that took place.
during the fourth quarter of 20X8. However, the SEC staff indicated that it “will consider requests to use pro forma information in circumstances where the historical test produces an anomalous result.” In fact patterns in which preclearance with the SEC staff is contemplated, registrants should also consider consultation with their auditors.

**Pro Forma Financial Information for Probable or Individually Insignificant Acquisitions or Insignificant Dispositions**

A registrant may voluntarily file pro forma financial information for individually insignificant business acquisitions; however, according to note 6 to paragraph 2025.3 of the FRM, such pro forma financial information should not be used to measure significance for a subsequent business acquisition. Paragraph 2035.6 of the FRM states, in part:

S-X 3-05 permits a registrant to evaluate significance of acquirees using the pro forma financial information filed on Form 8-K in connection with a previous significant acquisition. However, a registrant may not circumvent the requirement to file audited data of a majority of individually insignificant acquirees by filing a Form 8-K containing financial statements of one or more insignificant acquirees and testing significance of the remaining unaudited acquirees, against either the historical or resulting pro forma financial statements.

In addition, pro forma financial information used to measure significance of an acquiree should not give effect to an insignificant disposition or a probable acquisition.

### 1.6.5 Investment Test for an Acquired or to Be Acquired Business

#### 1.6.5.1 Performing the Investment Test

**Q&A Regulation S-X: Rule 1-02(w)(1)-1A**

As described in Rule 1-02(w), a registrant must perform the following three tests to determine the significance of a business acquisition or probable business acquisition (acquiree): the investment test, the asset test, and the income test. When evaluating significance, the registrant must use U.S. GAAP amounts. The test that results in the highest significance is used to determine the financial statement periods of the acquiree that must be presented.

**Question**

How should a registrant perform the investment test to determine the significance of an acquiree?

**Answer**

According to Rule 1-02(w)(1), an acquiree is significant when the following condition is met:

The registrant’s and its other subsidiaries’ investments in and advances to the subsidiary exceed 10 percent of the total assets of the registrant and its subsidiaries consolidated as of the end of the most recently completed fiscal year (for a proposed combination between entities under common control, this condition is also met when the number of common shares exchanged or to be exchanged by the registrant exceeds 10 percent of its total common shares outstanding at the date the combination is initiated).

Regarding performance of the investment test for a business combination, paragraph 2015.5 of the FRM indicates that a registrant should compare the total U.S. GAAP purchase price of the acquiree, adjusted for certain items (described below), with the registrant’s preacquisition

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77 See footnote 50.
consolidated assets. For this test, the U.S. GAAP purchase price means the “consideration transferred,” as used in ASC 805. (See Section 5.3 of Deloitte’s A Roadmap to Accounting for Business Combinations for further guidance on determining the GAAP purchase price.) Note that the consideration transferred includes the acquisition-date fair value of all contingent consideration and excludes acquisition-related (transaction) costs. To perform the investment test calculations, a registrant should adjust the consideration transferred to exclude the carrying value of assets it transferred to the acquiree that will remain with the combined entity after the business combination. See Section 1.6.5.2 for guidance on the effect of contingent consideration on the investment test for an acquiree.

Regarding performance of the investment test for the acquisition of an investment accounted for by the equity method, the note to paragraph 2015.5 of the FRM indicates that the numerator of the investment test of significance for the purchase of an equity method investment should include transaction costs, consistent with ASC 323-10-30-2. The numerator should also include contingent consideration (on a gross basis) if the likelihood of payment is more than remote.

For additional guidance on the effect of contingent consideration on the investment test for the acquisition of an investment accounted for by the equity method, consider the guidance in Section 1.6.5.2. When a registrant contributes assets or a business in exchange for an equity interest in a joint venture, also consider Section 1.10.6.

In addition, paragraph 2015.11 of the FRM indicates that “intercompany transactions between the registrant and acquiree should be eliminated in the same way that would occur if the acquiree were consolidated.”

For guidance on situations involving a reorganization of entities under common control, see Section 1.6.5.3.

The thresholds used in Rule 3-05 to determine significance for an acquiree differ from those used in Rule 1-02(w) to determine the significance of a subsidiary. For guidance on the number of financial statement periods to present for an acquiree, see Section 1.6.1. Also see Section 1.4.1 for information about filings that require financial statements of a significant acquiree.

**Example**

- Registrant A acquired 100 percent of Company B on November 15, 20X9.
- Registrant A's fiscal year-end is December 31.
- On December 31, 20X8, A had total consolidated assets of $100 million.
- Registrant A paid or incurred the following amounts to acquire B:
  - Paid $23.5 million in cash to the former owners of B.
  - Incurred $3 million in acquisition-related costs.

The investment test is calculated as follows:

<table>
<thead>
<tr>
<th>Consideration transferred</th>
<th>$ 23.5 million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets of A as of December 31, 20X8</td>
<td>$100.0 million</td>
</tr>
<tr>
<td>Significance</td>
<td>23.5%</td>
</tr>
</tbody>
</table>

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78 Such amount is generally for the registrant’s most recently completed fiscal year that is required to be filed with the SEC. See the Q&As in Section 1.6.3 for guidance on the appropriate financial statement periods to use in performing the significance tests.
79 See ASC 805-30-30-7 through 30-13 for guidance on determining the consideration transferred.
80 The gross amount is equal to the undiscounted maximum amount that could be paid under the contingency.
1.6.5.2 **Effect of Contingent Consideration on the Investment Test**

**Q&A Regulation S-X: Rule 1-02(w)(1)-2A**

An acquisition agreement may provide that the acquirer transfer additional assets or equity interests to the former owners of the acquiree if a specified future event occurs or conditions are met. Consideration dependent on the occurrence of a future event is called contingent consideration. ASC 805-30-35-1 provides guidance on accounting for contingent consideration.

**Question**

How should a registrant perform the investment test to determine significance of a business acquisition or probable business acquisition (acquiree) when the acquisition agreement includes contingent consideration?

**Answer**

Regarding performance of the investment test for a **business combination**, **paragraph 2015.5** of the FRM indicates that the registrant should compare the “consideration transferred,” as adjusted for certain items, with the registrant’s preacquisition consolidated assets.\(^{81}\) Since the fair value of contingent consideration is included in the “consideration transferred,” such amounts are included in the numerator of the investment test.

Contingent payments to employees or selling shareholders that compensate for future services or use of property are not contingent consideration. ASC 805-10-25-21 and 25-22 require that such payments be accounted for separately from the business combination. Accordingly, we do not believe these payments should be included in the investment test. See **Section 5.3** of Deloitte’s *A Roadmap to Accounting for Business Combinations* for further guidance on contingent payments to employees or selling shareholders.

At the **April 2008 CAQ SEC Regulations Committee joint meeting** with the SEC staff, the SEC staff also addressed whether significance has to be remeasured if the preliminary estimate of the fair value of contingent consideration changes during the measurement period, which may extend a year from the acquisition date. At that meeting, the SEC staff agreed with the view that “significance need not be remeasured when the preliminary estimate of the fair value of contingent consideration changes as long as a good faith estimate was made at the time of acquisition.”

Regarding performance of the investment test for the acquisition of an **investment accounted for by the equity method**, the note to **paragraph 2015.5** of the FRM indicates that the numerator should include contingent consideration (on a gross basis\(^{82}\)) if the likelihood of payment is more than remote. Since contingent consideration is negotiated and agreed to by both parties, there may be a rebuttable presumption that the likelihood of payment is not remote. For additional guidance on the investment test for the acquisition of an investment accounted for by the equity method, see **Section 1.6.5.1**. When a registrant contributes assets or a business in exchange for an equity interest in a joint venture, also see **Section 1.10.6**. For additional information on the accounting for contingent consideration for an equity method investment, refer to ASC 323-10-30-2A and 30-2B.

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\(^{81}\) As described in **Section 1.6.5.1**.

\(^{82}\) The gross amount is equal to the undiscounted maximum amount that could be paid under the contingency.
1.6.5.3  **Effect of a Reorganization of Entities Under Common Control on the Investment Test**

**Q&A Regulation S-X: Rule 1-02(w)(1)-3**

ASC 805-50-05-5 states, "Some transfers of net assets or exchanges of shares between entities under common control result in a change in the reporting entity. In practice, the method that many entities have used to account for those transactions is similar to the pooling-of-interests method." The Transactions Between Entities Under Common Control subsection of ASC 805-50 provides the U.S. GAAP guidance on the accounting for transactions between entities under common control.

**Question**

How should a registrant perform the investment test to determine significance of a business acquisition or probable business acquisition (acquiree) when the transaction is accounted for as a combination of entities under common control (i.e., the accounting is similar to a pooling of interests)?

**Answer**

Rule 1-02(w)(1) states, in part:

> [F]or a proposed combination between entities under common control, this condition is also met when the number of common shares exchanged or to be exchanged by the registrant exceeds 10 percent of its total common shares outstanding at the date the combination is initiated.

Therefore, as indicated in paragraph 2015.7 of the FRM, a registrant must perform both of the following investment tests for a reorganization of entities under common control:

- "Compare the net book value of the acquired business to the registrant's consolidated assets."\(^83\)
- "Compare the number of shares exchanged [in the transaction] to registrant's outstanding shares at the date the combination is initiated."\(^84\)

For guidance on the number of financial statement periods to present for an acquiree, see Section 1.6.1. Also refer to Section 1.4.1.

---

\(^83\) Such amount is generally for the registrant’s most recently completed fiscal year that is required to be filed with the SEC. See the Q&As in Section 1.6.3 for guidance on the appropriate financial statement periods to use when performing the significance tests.

\(^84\) See Section 3.2 of Deloitte's *A Roadmap to Accounting for Business Combinations* for additional guidance on determining the acquisition date.
Example

- Registrant A merged with Company B on June 30, 20X9.
- Company C has controlled A and B for the past eight years.
- Registrant A and B both have fiscal year-ends of December 31.
- Company B is not a registrant.
- The merger was a transaction between entities under common control and, therefore, was accounted for similar to a pooling of interests.
- Registrant A issued 1 million shares of its common stock in exchange for all the outstanding common stock of B.
- Before issuing the 1 million shares, A had 10 million shares outstanding.
- As of December 31, 20X8, A had total consolidated assets of $30 million.
- As of December 31, 20X8, B had a net book value of $10 million.

The two investment tests are calculated as follows:

1. Net Book Value

<table>
<thead>
<tr>
<th>Net book value of B</th>
<th>$ 10 million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets of A as of December 31, 20X8</td>
<td>$ 30 million</td>
</tr>
<tr>
<td>Significance</td>
<td>33%</td>
</tr>
</tbody>
</table>

2. Number of Shares Exchanged

| Number of A's shares exchanged in the merger | $ 1 million |
| Number of A's shares outstanding at the date the merger is initiated | $ 10 million |
| Significance | 10% |

The highest level of significance for the investment test was 33 percent. In addition, A must also consider the results of the asset and income tests to determine the financial statement filing requirements.

1.6.5.4 Effect of Proceeds From an Offering on the Asset Test and Investment Test

Q&A Regulation S-X: Rule 1-02(w)(1)-4

A registrant may sometimes complete a debt or equity offering to provide the necessary capital to consummate a business acquisition. Because the offering may occur concurrently with, or shortly before, the acquisition, the registrant's preacquisition audited financial statements for the fiscal year that have been filed with the SEC would not reflect the receipt of such proceeds.

Question

May a registrant include the pro forma effect of the offering proceeds received after the balance sheet date (as if they were received as of the end of the fiscal year preceding the acquisition) when determining preacquisition consolidated assets to use in the asset test and the investment test?
Answer

No. In accordance with paragraph 2020.6 of the FRM, a registrant may not, when performing the significance tests, increase its assets by including the pro forma effect of proceeds received from a public offering after the balance sheet date. We believe that this would also apply to offering proceeds received in a private placement.

Sometimes, however, it may be appropriate to use pro forma financial information to measure significance. For further discussion, see Sections 1.6.3 and 1.6.4.

1.6.6 Asset Test for an Acquired or to Be Acquired Business

1.6.6.1 Performing the Asset Test

Q&A Regulation S-X: Rule 1-02(w)(2)-1

As described in Rule 1-02(w), a registrant must perform the following three tests to determine the significance of a business acquisition or probable business acquisition (acquiree): the investment test, the asset test, and the income test. When evaluating significance, the registrant must use U.S. GAAP amounts. The test that results in the highest significance is used to determine the financial statement periods of the acquiree that must be presented.

Question

How should a registrant perform the asset test to determine significance of an acquiree?

Answer

According to Rule 1-02(w)(2), an acquiree is significant when the following condition is met:

The registrant’s and its other subsidiaries’ proportionate share of the total assets (after intercompany eliminations) of the subsidiary exceeds 10 percent of the total assets of the registrant and its subsidiaries consolidated as of the end of the most recently completed fiscal year.

The registrant should compare its share of the acquiree’s total assets with its preacquisition consolidated total assets.

The acquiree's total assets used in the asset test must be before any adjustments to step up the acquiree's basis for the acquisition. In addition, paragraph 2015.11 of the FRM indicates, in part, that “intercompany transactions between the registrant and acquiree should be eliminated in the same way that would occur if the acquiree were consolidated.”

In addition, as indicated in paragraph 2015.4 of the FRM, ordinary receivables and other working capital amounts “not acquired should nevertheless be included” as part of the total assets of the acquiree.

The thresholds used in Rule 3-05 to determine significance for an acquiree differ from those used in Rule 1-02(w) to determine the significance of a subsidiary. For guidance on the number of financial statement periods to present for an acquiree and filings that require financial statements of a significant acquiree, see Sections 1.6.1 and 1.4.1, respectively.

85 See footnote 50.
86 Such amount is generally for the registrant’s most recently completed fiscal year that is required to be filed with the SEC. See the Q&As in Section 1.6.3 for guidance on the appropriate financial statement periods to use in performing the significance tests. See Section 1.6.6.2 for information about performing the asset test for an acquiree when less than 100 percent of the entity’s equity is acquired.
87 See Section 1.6.6.5 for information about the effect of working capital assets not acquired.
Example

- Registrant A acquired Company B on November 15, 20X8.
- Registrant A’s fiscal year-end is December 31.
- Company B is not a registrant and has a June 30 fiscal year-end.
- As of December 31, 20X7, A had consolidated total assets of $40 million.
- As of June 30, 20X8, B had consolidated total assets of $16 million before acquisition accounting adjustments and after intercompany eliminations.

The asset test is calculated as follows:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Company B’s total assets as of June 30, 20X8</td>
<td>$ 16 million</td>
</tr>
<tr>
<td>Registrant A’s total assets as of December 31, 20X7</td>
<td>$ 40 million</td>
</tr>
<tr>
<td>Significance</td>
<td>40%</td>
</tr>
</tbody>
</table>

1.6.6.2 Performing the Asset Test When Less Than 100 Percent of the Entity’s Equity Is Acquired

Q&A Regulation S-X: Rule 1-02(w)(2)-2

Question

How should a registrant perform the asset test for an acquired or to be acquired business (acquiree) when less than 100 percent of the entity’s equity is acquired?

Answer

A registrant should compare the acquired or to be acquired percentage of assets of the acquiree with the registrant’s preacquisition consolidated assets.\(^\text{88}\)

If only certain assets are acquired or liabilities are assumed (e.g., a segment of an entity), the asset test should compare 100 percent of the assets acquired with the registrant’s preacquisition consolidated assets.

\(^\text{88}\) Such amount is generally for the registrant’s most recently completed fiscal year that is required to be filed with the SEC. See the Q&As in Section 1.6.3 for guidance on the appropriate financial statement periods to use in performing the significance tests.
Example

- Registrant A acquired 60 percent of Company B on November 15, 20X8.
- Registrant A’s fiscal year-end is December 31.
- Company B is not a registrant and has a June 30 fiscal year-end.
- As of December 31, 20X7, A had total consolidated assets of $10 million.
- As of June 30, 20X8, B had total consolidated assets of $5 million.

The asset test is calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company B’s total assets as of June 30, 20X8</td>
<td>$ 5 million</td>
</tr>
<tr>
<td>Percentage of B acquired by A</td>
<td>60%</td>
</tr>
<tr>
<td>Registrant A’s proportionate share of B’s assets</td>
<td>$ 3 million</td>
</tr>
<tr>
<td>Registrant A’s total assets as of December 31, 20X7</td>
<td>$ 10 million</td>
</tr>
<tr>
<td>Significance</td>
<td>30%</td>
</tr>
</tbody>
</table>

1.6.6.3 **Effect of Indirect Ownership on the Asset Test**

**Q&A Regulation S-X: Rule 1-02(w)(2)-3**

**Question**

How should a registrant consider indirect ownership of an acquired or to be acquired business (acquiree) when performing the asset test to determine its significance?

**Answer**

A registrant should compare the percentage of assets of the acquiree that it directly and indirectly acquired, or that are probable of being acquired, with its preacquisition consolidated total assets.\(^{39}\)

\(^{39}\) Such amount is generally for the registrant’s most recently completed fiscal year that is required to be filed with the SEC. See the Q&As in Section 1.6.3 for guidance on the appropriate financial statement periods to use in performing the significance tests.
Example

- Registrant A owns 80 percent of Subsidiary B.
- On July 15, 20X8, A and B simultaneously purchased 40 percent and 30 percent of Company C, respectively.
- Registrant A, B, and C each have a December 31 fiscal year-end.
- Subsidiary B and C are not registrants.
- Registrant A had total assets of $16 million as of December 31, 20X7.
- Company C had total assets of $10 million as of December 31, 20X7.

The asset test is calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company C’s total assets as of December 31, 20X7</td>
<td>$10 million</td>
</tr>
<tr>
<td>Direct percentage of C acquired by A</td>
<td>40%</td>
</tr>
<tr>
<td>Indirect percentage of C acquired by A (80% × 30%)</td>
<td>24%</td>
</tr>
<tr>
<td>Registrant A’s direct proportionate share of C’s assets</td>
<td>$4 million</td>
</tr>
<tr>
<td>Registrant A’s indirect proportionate share of C’s assets</td>
<td>$2.4 million</td>
</tr>
<tr>
<td>Registrant A’s direct and indirect proportionate share of C’s assets</td>
<td>$6.4 million</td>
</tr>
<tr>
<td>Registrant A’s total assets as of December 31, 20X7</td>
<td>$16 million</td>
</tr>
<tr>
<td>Significance</td>
<td>40%</td>
</tr>
</tbody>
</table>

See Section 1.6.6.2 for guidance on how to perform the asset test for an acquiree when less than 100 percent of the entity’s equity is acquired.

1.6.6.4 [Deleted]

1.6.6.5 **Effect of Working Capital Assets Not Acquired on the Asset Test**

**Q&A Regulation S-X: Rule 1-02(w)(2)-5**

Sometimes the assets acquired in a business combination may not include ordinary receivables and other working capital items.

**Question**

Should a registrant include working capital assets not acquired when performing the asset test to determine the significance of a business acquisition or probable business acquisition (acquiree)?

**Answer**

Yes. In accordance with paragraph 2015.4 of the FRM, ordinary receivables, as well as other working capital amounts, that were not acquired by a registrant must be included as part of the acquiree’s assets in performing the asset test, because it is assumed that such working capital assets are required by the operations of the acquiree. It is, therefore, expected that these working capital assets would be required and funded after the acquisition.
Example

- Registrant A acquired Company B on December 15, 20X8.
- Both A and B have a fiscal year-end of June 30, 20X8.
- Registrant A acquired all of B, except for $0.5 million of trade accounts receivable, which will be retained by the previous owner of B.
- As of June 30, 20X8, A had consolidated assets of $5 million.
- As of June 30, 20X8, B had consolidated assets, including the $0.5 million of trade accounts receivable not acquired, of $2 million.

The asset test is calculated as follows:

<table>
<thead>
<tr>
<th></th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company B’s total assets, including</td>
<td>$2 million</td>
</tr>
<tr>
<td>trade accounts receivable not</td>
<td></td>
</tr>
<tr>
<td>acquired as of June 30, 20X8</td>
<td></td>
</tr>
<tr>
<td>Registrant A’s total assets as of</td>
<td>$5 million</td>
</tr>
<tr>
<td>June 30, 20X8</td>
<td></td>
</tr>
<tr>
<td>Significance</td>
<td>40%</td>
</tr>
</tbody>
</table>

1.6.6.6 Performing the Asset Test When Only Abbreviated Financial Information Is Available

Q&A Regulation S-X: Rule 1-02(w)(2)-6

The SEC staff may sometimes permit a registrant (acquirer) to provide abbreviated financial information of an acquired or to be acquired business (acquiree) to satisfy the requirements of Rule 3-05. Such abbreviated financial statements are often referred to as statements of assets acquired and liabilities assumed and statements of revenues and direct expenses. See Sections 1.5.1 and 1.5.2 for further discussion.

Question

How should a registrant perform the asset test when only abbreviated financial information of an acquiree is available?

Answer

How a registrant should perform the asset test in this situation is discussed in paragraph 2065.9 of the FRM. Since the guidance indicates that registrants should compute all of the significance tests as written, registrants must compare the book value of the assets acquired to the registrant’s total consolidated assets. Also, see Section 1.6.6.5.

Paragraph 2065.9 of the FRM states that the SEC staff will “consider a registrant’s request to waive one or more of the periods specified by [Rule 3-05]” when the literal application of the test “produces anomalous results”; however, the staff may not waive all audited periods required by Rule 3-05. See the introduction of this Roadmap for further discussion of waiver requests.

In situations in which preclearance with the SEC staff is considered, registrants should also consider consulting with their auditors and SEC legal counsel.
1.6.7 Income Test for an Acquired or to Be Acquired Business

1.6.7.1 Performing the Income Test

Q&A Regulation S-X: Rule 1-02(w)(3)-1
As described in Rule 1-02(w), a registrant must perform the following three tests to determine the significance of a business acquisition or probable business acquisition (acquiree): the investment test, the asset test, and the income test. When evaluating significance, the registrant must use U.S. GAAP amounts. The test that results in the highest significance level will be used to determine the financial statement periods of the acquiree that must be presented.

Question
How should a registrant perform the income test to determine significance of an acquiree?

Answer
According to Rule 1-02(w)(3), an acquiree is significant when the following condition is met:

The registrant's and its other subsidiaries' equity in the income from continuing operations before income taxes of the subsidiary exclusive of amounts attributable to any noncontrolling interests exceeds 10 percent of such income of the registrant and its subsidiaries consolidated for the most recently completed fiscal year.

Note that we refer to “income from continuing operations before income taxes . . . exclusive of amounts attributable to any noncontrolling interests” as “pretax income from continuing operations.”

A registrant should compare an acquiree's pretax income from continuing operations with the registrant's preacquisition pretax income from continuing operations. If a registrant or an acquiree presents noncontrolling interest income (or loss) and/or equity in earnings (or losses) of equity method investees on a net-of-tax basis, these items, on a pretax basis, are treated as components of pretax income from continuing operations in this test. Even though these items may be presented after tax on the income statement, a registrant should use pretax amounts in the calculation.

Further, paragraph 2015.11 of the FRM indicates that “intercompany transactions between the registrant and acquiree should be eliminated in the same way that would occur if the acquiree were consolidated.”

The thresholds used in Rule 3-05 to determine significance for an acquiree differ from those used in Rule 1-02(w) to determine the significance of a subsidiary. For guidance on the number of financial statement periods to present for an acquired or to be acquired business, see Section 1.6.1. Also refer to Section 1.4.1 for information on filings that require the financial statements of a significant acquired or to be acquired business.

90 See footnote 50.
91 Such amount is generally for the registrant's most recently completed fiscal year that is required to be filed with the SEC. See the Q&As in Section 1.6.3 for guidance on the appropriate financial statement periods to use in performing the significance tests.
Example 1

- Registrant A acquired Company B on November 15, 20X0.
- Registrant A's fiscal year-end is December 31.
- Company B is not a registrant and has a June 30 fiscal year-end and has no noncontrolling interests or equity method investees.
- The following represents certain income statement information of A for the year ended December 31, 20X9 (in millions):

| Income from continuing operations before taxes | $ 40 |
| Income taxes                               | (16) |
| Income from continuing operations net of taxes | 24  |
| Income from equity method investees (net of tax of $2) | 3   |
| Net income                                 | 27  |
| Net income attributable to noncontrolling interest (net of tax of $4) | (6) |
| Net income attributable to A                | $ 21 |

Therefore, A has $5 million of pretax net income from its equity method investees and $10 million of pretax net income attributable to noncontrolling interests.

- For the year ended June 30, 20X0, B had pretax income from continuing operations of $15 million.

The income test is calculated as follows:

| Company B's pretax income from continuing operations for the fiscal year ended June 30, 20X0 | $ 15 million |
| Registrant A's pretax income from continuing operations (considering the effect of equity earning and income attributable to noncontrolling interests) for fiscal year ended December 31, 20X9 ($40 million + $5 million – $10 million) | $ 35 million |
| Significance | 43% |

Example 2

Assume the same facts as in Example 1 except that A has $10 million of pretax net loss attributable to noncontrolling interests. The following represents certain income statement information of A for the year ended December 31, 20X9 (in millions):

| Income from continuing operations before taxes | $ 40 |
| Income taxes                               | (16) |
| Income from continuing operations net of taxes | 24  |
| Income from equity method investees (net of tax of $2) | 3   |
| Net income                                 | 27  |
| Net loss attributable to noncontrolling interest (net of tax of $4) | 6   |
| Net income attributable to A                | $ 33 |
Example 2 (continued)

Therefore, A has $5 million of pretax net income from its equity method investees.

The income test is calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company B’s pretax income from continuing operations for the fiscal year ended June 30, 20X0</td>
<td>$15 million</td>
</tr>
<tr>
<td>Registrant A’s pretax income from continuing operations (considering the effect of equity earning and loss attributable to noncontrolling interests) for fiscal year ended December 31, 20X9 ($40 million + $5 million + $10 million)</td>
<td>$55 million</td>
</tr>
<tr>
<td>Significance</td>
<td>28%</td>
</tr>
</tbody>
</table>

1.6.7.2 Using Average Income When Performing the Income Test

Q&A Regulation S-X: Rule 1-02(w)(3)-2

In performing the income test, a registrant generally uses pretax income from continuing operations in the preacquisition annual financial statements as of the most recently completed audited fiscal year that is required to be filed with the SEC. Sometimes, however, an average of the registrant’s pretax income from continuing operations for five fiscal years must be used to perform the income test.

**Question**

When must a registrant use an average of its pretax income from continuing operations to perform the income test, and how should the average income be calculated?

**Answer**

Rule 1-02(w) includes the following computational note:

If income of the registrant and its subsidiaries consolidated exclusive of amounts attributable to any noncontrolling interests for the most recent fiscal year is at least 10 percent lower than the average of the income for the last five fiscal years, such average income should be [substituted] for purposes of the computation. Any loss years should be omitted for purposes of computing average income.

Accordingly, a registrant is first required to calculate its average income to determine whether average income must be used in the denominator of its income test.

The SEC staff indicates in paragraph 2015.8 of the FRM that the computational note above is applicable regardless of whether a registrant reports income or a loss in the latest fiscal year. That paragraph further notes that if a registrant reports a pretax loss from continuing operations in any year within the five-year period, the loss years should be assigned a value of zero when the numerator for this average is calculated. The denominator should remain at five. Next, the registrant should determine whether income for its most recently completed fiscal year, or the absolute value of its loss (if a loss is reported), is 10 percent or more lower than the registrant’s five-year average income. If the registrant’s income or the absolute value of its loss is at least 10 percent lower than its five-year average income, the registrant should use its average income in the denominator of the income test.
However, income averaging only applies to a registrant (acquirer). Therefore, this rule cannot be used to average pretax income from continuing operations of the acquired or to be acquired business (acquiree). In addition, we understand that the SEC staff does not permit the use of income averaging in circumstances in which a registrant is a successor to a predecessor since the financial statements for the predecessor and successor periods are not comparable.

**Example**

- Registrant A acquired Company B on April 15, 20X9.
- Registrant A has a December 31 fiscal year-end.
- Company B is not a registrant and has a December 31 fiscal year-end.
- Registrant A’s pretax income from continuing operations for the previous five years is as follows:
  - 20X4 — $4 million.
  - 20X5 — $6 million.
  - 20X6 — $5 million.
  - 20X7 — ($1 million).
  - 20X8 — $1 million.
- Company B’s pretax income from continuing operations for the year ended December 31, 20X8, was $0.8 million.

Registrant A’s average pretax income from continuing operations for this five-year period is calculated as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Pretax Income (Million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X4</td>
<td>4</td>
</tr>
<tr>
<td>20X5</td>
<td>6</td>
</tr>
<tr>
<td>20X6</td>
<td>5</td>
</tr>
<tr>
<td>20X7</td>
<td>—*</td>
</tr>
<tr>
<td>20X8</td>
<td>1 million</td>
</tr>
</tbody>
</table>

\[ \frac{16 \text{ million}}{5} = 3.2 \text{ million} \]

* Loss years are assigned a value of zero.

Because A’s current-year income, $1 million, is at least 10 percent lower than its average income for the last five fiscal years, $3.2 million, A must use its five-year average income when performing the income test.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount (Million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company B’s pretax income from continuing operations for the fiscal year ended December 31, 20X8</td>
<td>$ 0.8 million</td>
</tr>
<tr>
<td>Registrant A’s average pretax income from continuing operations</td>
<td>$ 3.2 million</td>
</tr>
<tr>
<td>Significance</td>
<td>25%</td>
</tr>
</tbody>
</table>
1.6.7.3 Performing the Income Test When a Registrant or an Acquired or to Be Acquired Business Has a Loss in the Fiscal Year Used to Perform the Test

Q&A Regulation S-X: Rule 1-02(w)(3)-3

Question

What amount should a registrant use when performing the income test if either the registrant or an acquired or to be acquired business (acquiree) incurred a pretax loss from continuing operations in the fiscal year used to perform the test?

Answer

If either a registrant or an acquiree, but not both, incurred a pretax loss from continuing operations in the fiscal year used to perform the income test, a registrant should, as noted in paragraph 2015.9 of the FRM, use the absolute value of this loss when performing the income test. For further discussion of the financial statements used to measure significance of an acquiree, see Section 1.6.3.1.

Example

- Registrant A acquired Company B on April 15, 20X9.
- Registrant A has a December 31 fiscal year-end.
- Company B is not a registrant and has a December 31 fiscal year-end.
- For the fiscal year ended December 31, 20X8, A had pretax loss from continuing operations of $1 million.
- For the fiscal year ended December 31, 20X8, B had pretax income from continuing operations of $0.25 million.
- Registrant A determined that it is not required to use income averaging.

The income test calculations are as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company B’s pretax income from continuing operations for the fiscal year</td>
<td>$ 0.25 million</td>
</tr>
<tr>
<td>ended December 31, 20X8</td>
<td></td>
</tr>
<tr>
<td>Registrant A’s pretax loss from continuing operations for the fiscal year</td>
<td>$ 1 million</td>
</tr>
<tr>
<td>ended December 31, 20X8 (absolute value)</td>
<td></td>
</tr>
<tr>
<td>Significance</td>
<td>25%</td>
</tr>
</tbody>
</table>

See Section 1.6.1 for guidance on an acquiree’s significance thresholds and related financial statement requirements.

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A registrant may be required to use income averaging pursuant to paragraph 2015.8 of the FRM regardless of whether it reports income or loss in its most recent annual period. See Section 1.6.7.2 for additional information.
1.6.7.4  **Effect of Special or Nonrecurring Items on the Income Test for a Registrant or an Acquired or to Be Acquired Business**

**Q&A Regulation S-X: Rule 1-02(w)(3)-4**

**Question**

When performing the income test, how should a registrant consider special or nonrecurring items incurred by either the registrant or the acquired or to be acquired business (acquiree)?

**Answer**

When performing the income test, the registrant should not adjust pretax income from continuing operations to exclude any special or nonrecurring items, such as restructuring charges or impairments.

In certain unique circumstances, the SEC may waive certain financial statement requirements when (1) the results of the income test are significantly disproportionate to the results of the other significance tests or (2) the registrant's results are affected by items such as unusual or nonrecurring items or when the registrant's results are near break-even.⁹³

In determining whether a waiver is appropriate, the SEC staff will consider whether the literal application of the income significance test leads to the provision of financial statements for the acquiree that are not material, not relevant, or not meaningful to investors. These circumstances require preclearance with the CF-OCA. In such circumstances, registrants should also consider consultation with their auditors and SEC legal counsel. See the introduction of this Roadmap for additional information about waiver requests.

**Example**

- Registrant A acquired Company B on April 15, 20X9.
- Registrant A has a December 31 fiscal year-end.
- Registrant A’s pretax income from continuing operations for the most recent year (20X8) is $1 million.
- During 20X8, A recorded a $6 million charge for a restructuring. Registrant A has not previously had a restructuring charge and believes that this is not a recurring event. Furthermore, A does not believe that the current-year pretax income from continuing operations is representative of its operating history.
- Registrant A is not required to use income averaging.
- Company B is not a registrant and has a December 31 fiscal year-end.
- For the fiscal year ended December 31, 20X8, B had pretax income from continuing operations of $0.25 million.
- The investment test and the asset test resulted in significance levels of 5 percent and 3 percent, respectively.

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⁹³ A registrant may be required to use income averaging pursuant to paragraph 2015.8 of the FRM regardless of whether it reports income or loss in its most recent annual period. See Section 1.6.7.2 for more information about how a registrant should use average income when performing the income test.
Example (continued)

The income test calculations are as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company B's pretax income from continuing operations for the fiscal year ended December 31, 20X8</td>
<td>$0.25 million</td>
</tr>
<tr>
<td>Registrant A's pretax income from continuing operations for the fiscal year ended December 31, 20X8</td>
<td>$1 million</td>
</tr>
</tbody>
</table>

Significance 25%

* In this situation, A may consider consulting with the SEC staff to request a waiver of the financial statement presentation requirements for B since A believes the income test is disproportionately affected by the nonrecurring restructuring charge. In addition, A believes that the results of the income test are not significantly disproportionate to the investment and asset tests when the effect of the restructuring charge is excluded.

1.6.7.5 Performing the Income Test When a Registrant and/or an Acquired or to Be Acquired Business Has Less Than 12 Months of Operations in the Fiscal Year Used to Perform the Test

Q&A Regulation S-X: Rule 1-02(w)(3)-5

The financial statements for a registrant (acquirer) or an acquired or to be acquired business (acquiree) used to perform the income test may be for a period that comprises less than 12 months of operations. This may occur when the registrant or acquiree began operations less than 12 months ago and there are no predecessor operations. When there are predecessor operations for the registrant, see the Q&As in Section 1.6.3 as well as Section 1.6.7.9 (regarding performing the income test when a registrant is a successor to a predecessor company) for guidance on the appropriate financial statement periods to use in performing the significance tests.

Question

When performing the income test, if a registrant or an acquiree has less than 12 months of operations, should its results of operations be annualized to obtain a full 12-month amount?

Answer

No. In accordance with paragraph 2025.5 of the FRM, if a registrant or an acquiree has existed for less than 12 months, its pretax income from continuing operations should not be annualized when the income test is performed. In circumstances in which the income test produces anomalous results, registrants may request a waiver from the CF-OCA. Registrants encountering these situations are encouraged to consult with their audit and legal professionals.
Example

- Registrant A acquired Company B on April 15, 20X9.
- Registrant A has a December 31 fiscal year-end.
- For the fiscal year ended December 31, 20X8, A had pretax income from continuing operations of $2 million.
- Company B is not a registrant and has a December 31 fiscal year-end.
- Company B began operations on April 1, 20X8.
- For the period from April 1, 20X8, to December 31, 20X8, B had pretax income from continuing operations of $0.3 million.

The income test is calculated as follows:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Company B's pretax income</td>
<td>$ 0.3 million</td>
</tr>
<tr>
<td>from continuing operations</td>
<td></td>
</tr>
<tr>
<td>for the fiscal year ended</td>
<td></td>
</tr>
<tr>
<td>December 31, 20X8</td>
<td></td>
</tr>
<tr>
<td>Registrant A's pretax income</td>
<td>$ 2 million</td>
</tr>
<tr>
<td>from continuing operations</td>
<td></td>
</tr>
<tr>
<td>for the fiscal year ended</td>
<td></td>
</tr>
<tr>
<td>December 31, 20X8</td>
<td></td>
</tr>
<tr>
<td>Significance</td>
<td>15%</td>
</tr>
</tbody>
</table>

Company B's pretax income from continuing operations should not be annualized when the income test is performed.

1.6.7.6 Performing the Income Test When Only Abbreviated Financial Information Is Available for an Acquired or to Be Acquired Business

Q&A Regulation S-X: Rule 1-02(w)(3)-6

The SEC staff may sometimes permit a registrant (acquirer) to provide abbreviated financial information of an acquired or to be acquired business (acquiree) to satisfy the requirements of Rule 3-05. Such abbreviated financial statements are often referred to as statements of assets acquired and liabilities assumed and statements of revenues and direct expenses. See Sections 1.5.1 and 1.5.2 for further discussion.

Question

How should a registrant perform the income test when only abbreviated financial information of an acquiree is available?

Answer

How a registrant should perform the income test in this situation was addressed at the April 2004 AICPA SEC Regulations Committee joint meeting with the SEC staff and is discussed in paragraph 2065.9 of the FRM.

The income test requires the comparison of an acquiree's pretax income from continuing operations with a registrant's corresponding pretax income from continuing operations. The income test in Rule 1-02(w) does not contemplate the use of abbreviated financial information (i.e., an income statement that does not reflect interest expense, corporate overhead, income taxes) in the calculation of significance.

The SEC staff believes that the revenues less direct expenses of an acquiree (i.e., the bottom line amount on the statement of revenue less direct expenses) should be compared with a
registrant’s pretax income from continuing operations when full financial statements or full carve-out financial statements of an acquiree are not available. This calculation is believed to apply Rule 1-02(w) as closely as possible.

Paragraph 2065.9 of the FRM states that the SEC staff will “consider a registrant’s request to waive one or more of the periods specified by [Rule 3-05]” when the literal application of the test “produces anomalous results”; however, the staff may not waive all audited periods required by Rule 3-05. In situations in which preclearance with the SEC staff is considered, registrants should also consider consulting with their auditors and SEC legal counsel. See the introduction of this Roadmap for further discussion of waiver requests.

1.6.7.7 Performing the Income Test When Less Than 100 Percent of the Entity’s Equity Is Acquired

Q&A Regulation S-X: Rule 1-02(w)(3)-7

Question
How should a registrant perform the income test for an acquired or to be acquired business (acquiree) when less than 100 percent of the entity’s equity is acquired?

Answer
A registrant should compare the acquired or to be acquired percentage of the acquiree’s pretax income from continuing operations with the registrant’s preacquisition consolidated pretax income from continuing operations.94

If only certain assets are acquired or liabilities are assumed (e.g., a segment of an entity), the income test calculation should be based on 100 percent of the pretax income from continuing operations generated from the assets acquired or liabilities assumed. If only abbreviated financial information is available for the assets acquired or liabilities assumed, refer to Section 1.6.7.6.

Example

- Registrant A acquired 60 percent of Company B on November 15, 20X8.
- Registrant A’s fiscal year-end is December 31.
- Company B is not a registrant and has a June 30 fiscal year-end.
- For the year ended December 31, 20X7, A had pretax income from continuing operations of $10 million.
- For the year ended June 30, 20X8, B had pretax income from continuing operations of $5 million.

94 Such amount is generally for the registrant’s most recently completed fiscal year that is required to be filed with the SEC. See the Q&As in Section 1.6.3 for guidance on the appropriate financial statement periods to use in performing the significance tests.
Example (continued)

The income test is calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company B's pretax income from continuing operations for the fiscal year ended June 30, 20X8</td>
<td>$ 5 million</td>
</tr>
<tr>
<td>Percentage of B acquired by A</td>
<td>60%</td>
</tr>
<tr>
<td>Registrant A's proportionate share of B's pretax income from continuing operations for the fiscal year ended June 30, 20X8</td>
<td>$ 3 million</td>
</tr>
<tr>
<td>Registrant A's total pretax income from continuing operations for the fiscal year ended December 30, 20X7</td>
<td>$ 10 million</td>
</tr>
<tr>
<td>Significance</td>
<td>30%</td>
</tr>
</tbody>
</table>

1.6.7.8 Effect of Indirect Ownership on the Income Test

Q&A Regulation S-X: Rule 1-02(w)(3)-8

Question

How should a registrant consider indirect ownership of an acquired or to be acquired business (acquiree) when performing the income test to determine its significance?

Answer

A registrant should compare the percentage of the acquiree’s pretax income from continuing operations that it directly and indirectly acquired, or that is probable of being acquired, with the registrant’s preacquisition consolidated pretax income from continuing operations.95

Example

- Registrant A owns 80 percent of Subsidiary B.
- On July 15, 20X9, A and B simultaneously purchased 40 percent and 30 percent of Company C, respectively.
- Registrants A, B, and C each have a December 31 fiscal year-end.
- Subsidiary B and C are not registrants.
- Registrant A had pretax income from continuing operations of $16 million for the year ended December 31, 20X8.
- Company C had pretax income from continuing operations of $10 million for the year ended December 31, 20X8.

---

95 Such amount is generally for the registrant’s most recently completed fiscal year that is required to be filed with the SEC. See the Q&As in Section 1.6.3 for guidance on the appropriate financial statement periods to use in performing the significance tests.
Example (continued)

The income test is calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company C's pretax income from continuing operations for the fiscal year ended December 31, 20X8</td>
<td>$10 million</td>
</tr>
<tr>
<td>Direct percentage of C acquired by A</td>
<td>40%</td>
</tr>
<tr>
<td>Indirect percentage of C acquired by A (80% × 30%)</td>
<td>24%</td>
</tr>
<tr>
<td>Registrant A's direct proportionate share of C's pretax income from continuing operations for the fiscal year ended December 31, 20X8</td>
<td>$4 million</td>
</tr>
<tr>
<td>Registrant A's indirect proportionate share of C's pretax income from continuing operations for the fiscal year ended December 31, 20X8</td>
<td>$2.4 million</td>
</tr>
<tr>
<td>Registrant A's direct and indirect proportionate share of C's pretax income from continuing operations for the fiscal year ended December 31, 20X8</td>
<td>$6.4 million</td>
</tr>
<tr>
<td>Registrant A's pretax income from continuing operations for the fiscal year ended December 31, 20X8</td>
<td>$16 million</td>
</tr>
<tr>
<td>Significance</td>
<td>40%</td>
</tr>
</tbody>
</table>

See Section 1.6.7.7 for guidance on how to perform the income test for an acquiree when less than 100 percent of the entity's equity is acquired.

1.6.7.9 Performing the Income Test When a Registrant Is a Successor to a Predecessor Company

Q&A Regulation S-X: Rule 1-02(w)(3)-9

Sometimes a registrant is a successor to a predecessor company or presents financial statements that include predecessor and successor results. Examples include (1) adoption of fresh-start accounting after emergence from bankruptcy; (2) use of push-down accounting to reflect a change in basis because of an acquisition of the company; or (3) acquisition, by a shell company, of another entity that is deemed to be the shell company's predecessor. In these situations, a registrant may not have a full year of income statement data reflecting the successor results. For example, if push-down accounting was applied, the period before the change in basis represents the predecessor period and the period after the change in basis represents the successor period. Note that the periods before the change and after the change are separately presented because of their lack of comparability.

Question

How should the income test be performed with respect to a business acquisition or probable business acquisition when a registrant's audited financial statements for its recently completed fiscal year include predecessor and successor operations?

Answer

This issue was addressed at the June 2006 AICPA SEC Regulations Committee joint meeting with the SEC staff. See Section 1.6.3.6 for additional information on the financial statements used.
to measure significance of an acquiree when the registrant is a successor to a predecessor company.

1.7 Related Businesses

1.7.1 Introduction to SEC Reporting Considerations for Related Businesses Acquired or to Be Acquired

Q&A Regulation S-X: Rule 3-05(a)(3)-1

This introduction outlines the SEC reporting considerations for related businesses acquired or to be acquired. Before applying the interpretations in this section, readers must understand the general application of the SEC reporting requirements for business combinations under Rule 3-05. (See Section 1.1 for additional information.) In addition to reviewing the Q&As in this section, registrants should consider consulting with their audit and legal professionals to determine the appropriate SEC reporting requirements.

Definition

Rule 3-05 requires that the acquisition or probable acquisition of a group of related businesses be treated as a single business combination. Rule 3-05(a)(3) defines businesses as related if any of the following conditions apply:

- They are under common control or management.
- The acquisition of one business is conditional on the acquisition of each other business.
- Each acquisition is conditioned on a single common event.

Filings Requiring Financial Statements of Related Businesses

A registrant (acquirer) may be required to include the financial statements of related businesses acquired in a registration statement, prospectus supplement to a registration statement that is currently effective, proxy statement, or Form 8-K when the related businesses are significant (see below). In addition, when the acquisition of related businesses is probable, the financial statements may be required to be included in a registration statement, prospectus supplement, or proxy statement. Financial statements of significant acquired or to be acquired related businesses are not required in annual or quarterly reports on Form 10-K or 10-Q. The filings requiring financial statements of related businesses acquired or to be acquired and their related significance thresholds and financial statement presentation requirements are the same as those for individually significant businesses acquired or to be acquired. See Sections 1.4.1 and 1.7.6, respectively, for further discussion.

Performing the Significance Tests

As described in Rule 1-02(w), a registrant must perform the following three tests to determine the significance of a business acquisition or probable business acquisition (acquiree): the investment test, the asset test, and the income test. When evaluating significance, the registrant must use U.S. GAAP amounts. The test that results in the highest significance level will be used to determine the financial statement periods of the acquiree that must be presented.

See footnote 50.
When a registrant performs the significance tests for acquired or to be acquired related businesses, it must aggregate the financial measures used in the investment, asset, and income tests for all related businesses. This aggregation is required, not optional.

**Significance Thresholds and Financial Statement Requirements**

Rule 1-02(w) defines significance according to results of the three tests noted above. Various significance thresholds (i.e., does not exceed 20 percent, exceeds 20 percent but not 40 percent, exceeds 40 percent but not 50 percent, exceeds 50 percent) are applied to a business acquisition. Each of these threshold levels requires a different number of financial statement periods to be presented.

Once the aggregate significance of the acquired or to be acquired related businesses is determined, the same significance thresholds that apply to a single business acquisition should be used to determine the number of financial statement periods to be presented for the related businesses. The financial statement presentation requirements described in Section 1.6.1 should be followed.

In addition, if any one of the aggregate significance thresholds exceeds 20 percent, the financial statements for each related business acquired or to be acquired must be separately presented, except as described below, even if one or more related businesses are individually insignificant. The mathematical majority concept for individually insignificant acquisitions does not apply here.\(^{97}\) The acquirer may present combined financial statements of related businesses that were under common control or management before their acquisition, but only for the periods in which they were under common control or management. This presentation is only appropriate when the criteria for combining financial statements under ASC 810-10-55-1B, are met. See Section 11.1.4.1 in Deloitte’s *A Roadmap to Consolidation — Identifying a Controlling Financial Interest* to determine when combined financial statement presentation is appropriate.\(^{98}\)

### Example

- Registrant A has entered into definitive agreements to acquire Company B and Company C.
- Companies B and C do not have any common members of management or any significant common holders of equity.
- The purchase agreement between A and B states that A will not consummate the acquisition of B unless it also completes the acquisition of C.

Although B and C are not under common control or management, because the acquisition of B by A is conditional on the acquisition of C by A, B and C are related businesses.

When A performs the tests of significance, it must aggregate the financial information of B and C to determine the number of periods of financial statements that must be presented. However, because B and C were not under common control or management, A may not present combined financial statements of B and C. If B and C are over 20 percent significant when aggregated, the financial statements of B and C are required, even if neither B nor C are individually significant. The financial statements of B and C must each be presented separately.

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\(^{97}\) See Section 1.9.9.

\(^{98}\) At the December 2006 AICPA Conference on Current SEC and PCAOB Developments, Leslie Overton, then associate chief accountant in the CF-OCA, in prepared remarks, discussed the form and content of financial statements in a registration statement when entities under common control are combined just before or at the same time as an IPO. Entities engaging in an IPO involving the merger of entities under common control should consider the guidance in this speech as well as the discussion at the April 2007 AICPA SEC Regulations Committee joint meeting with the SEC staff.
Under Rule 3-13, the SEC staff may consider a registrant’s request to waive the financial statements of individual related businesses that are not significant to the overall transaction. See the introduction of this Roadmap for additional information.

**Related Businesses Versus Unrelated Businesses**

The requirements discussed above do not apply to individually insignificant acquisitions of unrelated businesses. See the Q&As in Section 1.9 for additional information.

### 1.7.2 Definition of Related Businesses

**Q&A Regulation S-X: Rule 3-05(a)(3)-2**

Rule 3-05(a)(3) requires that the acquisition or probable acquisition of a group of related businesses be treated as if they are a single business combination.

**Question**

What is the definition of related businesses?

**Answer**

Rule 3-05(a)(3) defines businesses as related if any of the following conditions apply:

- They are under common control or management.\(^99\)
- The acquisition of one business is conditional on the acquisition of each other business.
- Each acquisition is conditioned on a single common event.

Examples of each condition follow.

**The Businesses Are Under Common Control or Management**

<table>
<thead>
<tr>
<th><strong>Example 1</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Company X and Company Y are both wholly owned by Private Equity Investor E when they are both acquired by Registrant A. Companies X and Y are deemed to be related businesses for SEC reporting purposes because they were under common control immediately before their acquisition by A.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Example 2</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Company E and Company F share the same members of their respective boards of directors and the same top five management executives when they are acquired by Registrant T. Companies E and F are deemed to be related businesses for SEC reporting purposes because they had common management immediately before their acquisition by T.</td>
</tr>
</tbody>
</table>

\(^99\) See Section B.2 in Deloitte’s *A Roadmap to Accounting for Business Combinations* for guidance on when common control exists. The presence of “common management,” which is not defined in U.S. GAAP, depends on the relevant facts and circumstances. Registrants may wish to consider obtaining preclearance from the SEC staff when determining whether related businesses are under common management. When preclearance is required, registrants should consider consultation with their auditors and SEC legal counsel.
The Acquisition of One Business Is Conditional on the Acquisition of Each Other Business

Example 3
Registrant A agrees to acquire Company B. However, the purchase agreement between A and B states that A will not consummate the acquisition of B unless it is also able to consummate the acquisition of Company X. Companies B and X are not under common control and do not have any common management immediately before their acquisition by A. Registrant A consummates the acquisition of X and also consummates the acquisition of B. Companies B and X are deemed to be related businesses for SEC reporting purposes because the acquisition of B and X was conditional on the acquisition of each other.

Each Acquisition Is Conditioned on a Single Common Event

Example 4
Registrant A agrees to acquire Company H and Company J. However, the purchase agreements between A and H and between A and J state that A will not consummate the acquisitions unless A is able to raise $10 million via a public offering of its common stock. Registrant A completes the public offering and then consummates the acquisitions of H and J. Companies H and J are deemed to be related businesses for SEC reporting purposes because each acquisition was conditional on a single common event.

1.7.3 Filings Requiring Financial Statements of Related Businesses Acquired or to Be Acquired

Q&A Regulation S-X: Rule 3-05(a)(3)-3

Question
What are the various SEC filings in which a registrant (acquirer) may be required to present financial statements of significant related businesses acquired or to be acquired?

Answer
The types of SEC filings in which a registrant may be required to present historical financial statements of significant related businesses acquired or to be acquired include the following:

- Form 8-K.
- Registration statements.
- Proxy materials.
- Prospectus supplements to registration statements that are currently effective.

An acquirer should determine the aggregate significance of all related businesses acquired or to be acquired and such aggregated results should be used to determine the financial statements required to be presented. An acquirer may be required to include the financial statements of related businesses acquired in a registration statement, prospectus supplement to registration statements that are currently effective, proxy statement, or Form 8-K when the related businesses are significant. In addition, when the acquisition of related businesses is probable, the financial statements may be required to be included in a registration statement, prospectus.
supplement, or proxy statement. Financial statements of significant acquired or to be acquired related businesses are not required in annual or quarterly reports on Form 10-K or 10-Q.

The filings requiring financial statements of related businesses acquired or to be acquired and their related significance thresholds and financial statement presentation requirements are the same as those for individually significant businesses acquired or to be acquired. See Sections 1.4.1 and 1.7.6, respectively, for further discussion.

### 1.7.4 Performing the Significance Tests for Related Businesses Acquired or to Be Acquired

**Q&A Regulation S-X: Rule 3-05(a)(3)-4**

As described in Rule 1-02(w), a registrant must perform the following three tests to determine the significance of a business acquisition or probable business acquisition (acquiree): the investment test, the asset test, and the income test. When evaluating significance, the registrant must use U.S. GAAP amounts.\(^{100}\) The test that results in the highest significance level will be used to determine the financial statement periods of the acquiree that must be presented.

**Question**

How should a registrant (acquirer) perform the significance tests when the acquired or to be acquired businesses are related?

**Answer**

In accordance with Rule 3-05(b)(3), an acquirer must determine the significance of the related businesses by comparing the preacquisition annual financial statements of the related businesses, on a combined (aggregate) basis, to the acquirer’s annual financial statements.\(^{101}\) This aggregation is required, not optional.

If all of the related businesses have losses, the absolute value of the losses should be used.

If related businesses have different fiscal year-ends, a registrant should not conform the fiscal year-ends of the related businesses for purposes of the significance tests.

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\(^{100}\) See footnote 50.

\(^{101}\) Such amounts are generally as of the end of the most recently completed fiscal year that is required to be filed with the SEC. If the related businesses are not registrants, the financial statement periods used for the significance tests should be determined as though the related businesses were registrants. See the Q&As in Section 1.6.
Example

- Registrant A consummated the acquisitions of Company B and Company C on July 31, 20X9.
- Companies B and C were determined to be related businesses because they were under common control since January 1, 20X7.
- Registrant A and Companies B and C all have a December 31 year-end.
- The following summarizes the financial information of A, B, and C as of and for the year ended December 31, 20X8, as well as the calculation of the combined significance of B and C.

<table>
<thead>
<tr>
<th></th>
<th>Investment* (Purchase Price) as of Acquisition Date (millions)</th>
<th>Asset* (millions)</th>
<th>Pretax Income From Continuing Operations (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company B</td>
<td>$ 25</td>
<td>$ 10</td>
<td>$ 0.75</td>
</tr>
<tr>
<td>Company C</td>
<td>10</td>
<td>2</td>
<td>0.25</td>
</tr>
<tr>
<td>Total</td>
<td>35</td>
<td>12</td>
<td>1</td>
</tr>
<tr>
<td>Registrant A</td>
<td>$ 100**</td>
<td>$ 100**</td>
<td>$ 5</td>
</tr>
<tr>
<td>Significance</td>
<td>35%</td>
<td>12%</td>
<td>20%</td>
</tr>
</tbody>
</table>

* Paragraph 2020.9 of the FRM indicates that the asset and investment test should be performed for each related business and the sum of each test should be used to evaluate significance of the related businesses. The example above was calculated using the combined investment and assets of the related businesses as noted in Rule 3-05(b)(3). Both methods yield mathematically consistent results.

** Represents Registrant A’s total assets as of December 31, 20X8.

To perform the significance tests for these related businesses, A must aggregate the financial information of B and C.

On the basis of the results of the significance tests, B and C were determined, in the aggregate, to be 35 percent significant to A. Registrant A must present the financial statements of both B and C even though C would not have been significant to A by itself. Registrant A may present separate or combined financial statements of B and C because the criteria for combining financial statements in ARB 51 (ASC 810-10-55-1B), were met. See Section 1.7.6 for further discussion of the significance thresholds for related businesses and for the number of financial statement periods required for each related business.

Pro forma financial information for the acquirer may be appropriate in certain situations for use in performing the significance tests for related businesses. See Section 1.6.4 for further discussion.

If one or more, but not all, of the related businesses has a loss in the fiscal year that was used to perform the income test of significance, see Section 1.7.5.
1.7.5 Performing the Income Test of Significance for Related Businesses Acquired or to Be Acquired When One or More, but Not All, Related Businesses Have a Loss

Q&A Regulation S-X: Rule 3-05(a)(3)-5

**Question**
How should a registrant perform the income test of significance for related businesses when one or more, but not all, of the related businesses acquired or to be acquired has a loss in the year used to perform the test?\(^{102}\)

**Answer**
In accordance with paragraph 2020.10 of the FRM, a registrant should treat related businesses as a single business combination and use the combined pretax income or loss from continuing operations for all related businesses when performing the income test for significance. Paragraph 2020.10 of the FRM states that a registrant should use this approach to measure income test significance “irrespective of whether any of the related businesses are under common control or management.”

**Example**

- Registrant A and Companies B, C, D, and E all have December 31 year-ends.
- Companies B and C were under common control or management immediately before they were acquired by A. Companies D and E were not under common control or management.
- Registrant A determined that the acquisition of B, C, D, and E was an acquisition of related businesses because the funding of these acquisitions depended on A’s completion of a public offering of stock.
- Registrant A had $10 million of pretax income from continuing operations for the year ended December 31, 20X2.
- The following is a summary of the pretax income (loss) from continuing operations for each business for the year ended December 31, 20X2.

When Registrant A performs the income test to measure significance for these related businesses, it must aggregate pretax income and losses for all related businesses irrespective of whether any of the related businesses are under common control or management.

<table>
<thead>
<tr>
<th>Company</th>
<th>Pretax Income/Loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company B</td>
<td>$2.0 million</td>
</tr>
<tr>
<td>Company C</td>
<td>1.1</td>
</tr>
<tr>
<td>Company D</td>
<td>(1.3)</td>
</tr>
<tr>
<td>Company E</td>
<td>(0.4)</td>
</tr>
<tr>
<td>Combined pretax income from continuing operations</td>
<td>$1.4 million</td>
</tr>
<tr>
<td>Registrant A — Pretax income from continuing operations</td>
<td>$10.0 million</td>
</tr>
</tbody>
</table>

Significance: 14%

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\(^{102}\) Registrants should generally perform the tests by using financial information as of the end of the most recently completed fiscal year filed with the SEC. If the related businesses are not registrants, the financial statement periods used for the significance tests should be determined as though the related businesses were registrants. See the Q&As in Section 1.6.
Example (continued)

On the basis of the test results, the level of significance for the income test is 14 percent. Registrant A must also consider the results of the asset and investment tests to determine the financial statement filing requirements.

See Section 1.7.6 below for guidance on the number of financial statement periods to present for related businesses.

In certain situations, it may be appropriate for the registrant to perform the significance tests for related businesses by using pro forma financial information for the acquirer. See Section 1.6.4 for further discussion.

1.7.6 Significance Thresholds and Financial Statement Requirements for Related Businesses Acquired or to Be Acquired for SEC Reporting Purposes

Q&A Regulation S-X: Rule 3-05(a)(3)-6

As described in Rule 1-02(w), a registrant must perform the following three tests to determine the significance of a business acquisition or probable business acquisition: the investment test, the asset test, and the income test. When evaluating significance, the registrant must use U.S. GAAP amounts. The test that results in the highest significance level will be used to determine the financial statement periods that must be presented. A registrant that files its financial statements in accordance with U.S. GAAP, or is required to provide reconciliation to U.S. GAAP, should determine significance using amounts for both the acquired business and the registrant determined in accordance with U.S. GAAP.

Question

What are the significance thresholds for acquired or to be acquired related businesses, and what effect do these thresholds have on the financial statement requirements?

Answer

As discussed in Section 1.7.4, a registrant must perform the significance tests for a group of acquired or to be acquired related businesses on an aggregate basis. The same significance thresholds and respective financial statement presentation requirements for individual businesses acquired or to be acquired (see Section 1.6.1) apply to the aggregated related businesses. See also Section 1.7.3 for discussion of which SEC filings require financial statements of related businesses acquired or to be acquired.

If any of the significance tests for the group of related businesses exceeds 20 percent, the registrant must present financial statements for all of the related businesses, even if a related business is individually insignificant. The mathematical majority concept for individually insignificant acquisitions does not apply here. Further, a registrant may present combined financial statements if the businesses are under common control or management and they meet the criteria for combination in ASC 810-10-55-1B. Regardless of the method presented, the registrant must present the number of financial statement periods required by the registration statement.

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103 See footnote 50.
104 See Section 1.9.9.
105 The SEC may require combined financial statements of acquired related businesses to be presented separately from combined financial statements of related businesses to be acquired. Registrants that do not comply with this presentation should consider preclearance with the SEC staff. When preclearance is required, registrants should consider consultation with their auditors and SEC legal counsel.
aggregate level of significance as described in Section 1.6.1. If related businesses were under common control or management for only a portion of the required periods, a registrant must present separate financial statements for each related business when the related businesses were not under common control or management.

**Example**

- Registrant A consummated the acquisitions of Company B, Company C, and Company D, all on April 15, 20X9.
- Registrant A and Companies B, C, and D all have a December 31 fiscal year-end.
- Companies B, C, and D have been under common control since 20X3.
- On the basis of the tests of significance, B, C, and D are 35 percent significant to A, in the aggregate.
- Registrant A filed a Form 8-K announcing the consummation of the acquisitions on April 19, 20X9 (i.e., within four business days).

On the basis of the level of significance, A is required to file an amended Form 8-K before June 29, 20X9 (i.e., 71 calendar days after the initial Form 8-K was required to be filed), to present an audited balance sheet as of December 31, 20X8, and audited statements of operations, comprehensive income, cash flows, and changes in stockholders' equity for the year ended December 31, 20X8, for B, C, and D. However, A may present combined financial statements of B, C, and D because they meet the combining criteria under ASC 810-10-55-1B.

### 1.7.7 Multiple Acquisitions or Probable Acquisitions of Related Businesses Over a Fiscal Year

**Q&A Regulation S-X: Rule 3-05(a)(3)-7**

**Question**

If a registrant acquires multiple related businesses over the course of a year, must the registrant aggregate the financial information of all related businesses as of each acquisition date to perform the tests of significance?

**Answer**

Yes. Rule 3-05(a)(3) requires a registrant to evaluate the acquisition of related business that “have occurred subsequent to the latest fiscal year-end for which audited financial statements of the registrant have been filed.” The registrant should perform tests of significance upon each acquisition and should use the aggregate financial information of all of the related businesses acquired as of each acquisition date to determine (1) whether financial statements of the related businesses are required and (2) the number of financial statement periods that are required to be presented. The significance thresholds and financial statement presentation requirements described in Section 1.7.6 should be followed.

If, because of the cumulative significance of the related businesses acquired, a Form 8-K must be filed, financial statements for all related business that have not been previously filed are required.

With respect to registration and proxy statements, this guidance applies to acquired and to be acquired related businesses. The financial statements to be presented must be for all related businesses.

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106 In addition to filing the financial statements of the acquired related businesses, a registrant is also required to include pro forma financial information. See Chapter 3 for additional information.
businesses acquired or to be acquired, even if one or more related businesses are individually insignificant. The mathematical majority concept for individually insignificant acquisitions does not apply here. The financial statement presentation requirements for registration and proxy statements in these circumstances can be difficult to determine. Registrants encountering these situations are encouraged to consult with their audit and legal professionals.

1.8 Acquisition of an Additional Equity Interest (Step Acquisition)

1.8.1 Introduction to SEC Reporting Considerations for an Acquisition or Probable Acquisition of an Additional Equity Interest in a Business

Q&A Regulation S-X: Rule 3-05(a)(4)-1

This introduction outlines the SEC reporting considerations for an acquisition or probable acquisition of an additional equity interest in a business. Before applying the interpretations in this section, readers must understand the general application of the SEC reporting requirements for business combinations under Rule 3-05. (See Section 1.1 for additional information.) In addition to reviewing the Q&As in this section, registrants should consider consulting with their audit and legal professionals to determine the appropriate SEC reporting requirements.

Reporting Considerations for an Acquisition or Probable Acquisition of an Additional Equity Interest in a Business (a Step Acquisition)

When a registrant (acquirer) owns an equity interest in a business and subsequently acquires (or it is probable that it will acquire) any additional equity interest in that business (acquiree), the registrant must consider the additional interest in the acquiree under Rule 3-05. Such an acquisition is generally referred to as a step acquisition for SEC reporting purposes. This may or may not be consistent with a step acquisition for U.S. GAAP accounting purposes.

Example 1

- As of December 31, 20X8, Registrant A owns 40 percent of Company B.
- On March 15, 20X9, A acquires an additional 20 percent interest in B.

Because A acquired an additional interest in B, the transaction is considered a step acquisition for SEC reporting purposes and the additional 20 percent interest must be evaluated for significance under Rule 3-05.

Example 2

Assume the same facts as in Example 1 except that A only acquired an additional 5 percent interest in B and, after the acquisition, continued to use the equity method to account for its investment in B. The acquisition of the additional 5 percent interest is also considered a step acquisition for SEC reporting purposes and must be evaluated for significance under Rule 3-05.

Both an initial acquisition of an investment that is accounted for under the equity method and subsequent acquisitions in the same entity are subject to the requirements of Rule 3-05. See Section 1.3.1 for further discussion.

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107 See footnote 105.
108 See Section 1.9.9.
Filings Requiring Financial Statements

When the acquisition of the additional equity interest in the acquiree is significant, an acquirer may be required to file a Form 8-K to disclose the completion of the acquisition or to include the financial statements of the acquiree in a registration statement, proxy statement, or Form 8-K. In addition, when the acquisition of the additional equity interest in the acquiree is probable and greater than 50 percent significant, the financial statements may be required to be included in a registration statement or proxy statement. Financial statements of significant businesses acquired or to be acquired in a step acquisition are not required in annual or quarterly reports on Form 10-K or 10-Q. Refer to Section 1.4.1 for more information on filings that require financial statements of a significant business acquisition or significant probable business acquisition, including the acquisition of an equity method investee.

Performing the Significance Tests

As described in Rule 1-02(w), a registrant must perform the following three tests to determine the significance of an acquiree: the investment test, the asset test, and the income test. When evaluating significance, the registrant must use U.S. GAAP amounts. The test that results in the highest significance level is used to determine the financial statement periods of the acquiree that must be presented.

For step acquisitions, the registrant should perform the three significance tests. However, for the asset and income tests, the significance tests should be based on the increase in the registrant’s proportionate interests in assets and pretax income from continuing operations during the year, rather than on the cumulative interest to date. However, paragraph 2020.3 of the FRM states that an acquirer should aggregate the financial information of all step acquisitions in the same entity that “are part of a single plan to be completed within a twelve month period.” Also, the significance calculation is the same “even if the registrant must discontinue applying the cost method and start applying the equity method” as a result of the acquisition of the additional equity interest.

Under ASC 805, when control is obtained after an acquirer already owns a noncontrolling interest in an acquiree’s equity, the acquirer’s initial investment in the acquiree is remeasured as of its acquisition-date fair value, with a resulting gain or loss recorded in earnings. Paragraph 2020.4 of the FRM clarifies that the “remeasurement of the previously held equity interest is not included in the asset or the investment test and the resulting gain or loss from remeasurement would be excluded from the income test as it is not included in the registrant’s most recently completed fiscal year.”

Significance Thresholds and Financial Statement Requirements

When a registrant acquires (or it is probable that it will acquire) an additional equity interest in an acquiree, the additional equity interest should be tested for significance, as described above. If any of the significance thresholds exceed 20 percent, separate financial statements of the acquiree may be required.

To determine whether it must file financial statements for an acquiree in accordance with Rule 3-05, a registrant must first consider how it accounted for its ownership interest in the acquiree before the step acquisition. That is, it depends, in part, on whether the registrant is acquiring an interest in an entity that is already in its consolidated results.

109 See footnote 50.
If the acquirer increases its equity interest in an acquiree that was already consolidated in the registrant's audited financial statements for a complete year, it ordinarily does not have to file separate financial statements for the acquiree. However, a Form 8-K with pro forma financial information\textsuperscript{110} may be required, depending on the significance of the step acquisition.\textsuperscript{111}

If the acquirer is making an additional investment in an entity that it did not previously consolidate (e.g., an equity method investment), a Form 8-K with separate financial statements of the acquiree and pro forma financial information may be required, depending on the significance of the additional investment.\textsuperscript{112}

Once the registrant has determined the significance of the additional interest in the acquiree and has considered how it accounted for the interest before the step acquisition, the registrant should follow the financial statement presentation requirements described in Section 1.8.4.

1.8.2 Filings Requiring Financial Statements of Businesses in Which Additional Equity Interests Are Acquired or Are to Be Acquired

Q&A Regulation S-X: Rule 3-05(a)(4)-2

When a registrant (acquirer) owns an equity interest in a business and subsequently acquires (or it is probable that it will acquire) any additional equity interest in that business (acquiree), the registrant must consider the additional interest in the acquiree under Rule 3-05. Such an acquisition is generally referred to as a step acquisition for SEC reporting purposes. This may or may not be consistent with a step acquisition for U.S. GAAP accounting purposes.

Question

In what SEC filings may a registrant be required to present financial statements of businesses in which additional equity interests are acquired or in which it is probable that additional equity interests will be acquired?

Answer

An acquirer may be required to present historical financial statements of an acquiree in the following filings:

- Form 8-K.
- Registration statements.
- Prospectus supplement.
- Proxy materials.

Financial statements of an acquiree are not required in annual or quarterly reports on Form 10-K or 10-Q.

The presentation requirements for a significant equity interest obtained in a step acquisition are the same as those for significant businesses acquired or to be acquired. See Section 1.4.1 for further discussion.

\textsuperscript{110} For further discussion, see Chapter 3.
\textsuperscript{111} For further information, refer to paragraph 2020.5 of the FRM.
\textsuperscript{112} The acquirer may have already presented these financial statements in a Form 10-K in accordance with Regulation S-X, Rule 3-09. However, such financial statements may need to be updated to include the appropriate interim periods (see the Q&As in Section 1.11). The acquirer may also be required to present financial statements of an acquiree in registration statements or proxy materials (see Section 1.8.2).
See the other Q&As in this section for additional information about presentation requirements and performing significance tests for step acquisitions.

1.8.3 Performing the Significance Tests for an Acquisition or Probable Acquisition of an Additional Equity Interest in a Business

Q&A Regulation S-X: Rule 3-05(a)(4)-3

When a registrant (acquirer) owns an equity interest in a business and subsequently acquires (or it is probable that it will acquire) any additional equity interest in that business (acquiree), the registrant must consider the additional interest in the acquiree under Rule 3-05. Such an acquisition is generally referred to as a step acquisition for SEC reporting purposes. This may or may not be consistent with a step acquisition for U.S. GAAP accounting purposes.

As described in Rule 1-02(w), a registrant must perform the following three tests to determine the significance of an acquired or to be acquired business: the investment test, the asset test, and the income test. When evaluating significance, the registrant must use U.S. GAAP amounts. The test that results in the highest significance level is used to determine the financial statement periods that must be presented.

**Question**

How should an acquirer perform the significance tests for the acquisition or probable acquisition of an additional equity interest in an acquiree?

**Answer**

In accordance with paragraph 2020.3 of the FRM, if a registrant increases its investment in a business relative to the prior year, it should base the significance tests on the increase in the registrant's proportionate interest in assets and pretax income from continuing operations during the year, rather than on the cumulative interest to date. However, step acquisitions that “are part of a single plan to be completed within a twelve month period” should be aggregated. The note to paragraph 2020.3 of the FRM clarifies that the significance calculation is the same “even if the registrant must discontinue applying the cost method and start applying the equity method” as a result of the acquisition of the additional interest.

After considering the above paragraph and the information specific to each test below, a registrant will perform the significance tests for step acquisitions in the same manner as those for initial acquisitions of a business. (See the Q&As in Section 1.6 for additional information about performing the tests.) In the asset and investment tests, the registrant's total assets should be used. The registrant's total assets will include the initial investment in the acquiree before the step acquisition.

Under ASC 805, when control is obtained after an acquirer already owns a noncontrolling interest in an acquiree's equity, the acquirer's initial investment in the acquiree is remeasured as of its acquisition-date fair value, with a resulting gain or loss recorded in earnings. Paragraph 2020.4 of the FRM clarifies that the “remeasurement of the previously held equity interest is not included in the asset or the investment test and the resulting gain or loss from remeasurement would be excluded from the income test as it is not included in the registrant's most recently completed fiscal year.”

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113 See footnote 50.
Example

- As of December 31, 20X7, Registrant X owned 22 percent of Company Y, and X used the equity method to account for Y.
- Registrant X and Y both have fiscal year-ends of December 31.
- On August 10, 20X9, X acquired an additional 25 percent interest in Y for $10 million.
- For the year ended December 31, 20X8, X had pretax income from continuing operations of $5 million and total assets of $40 million.
- For the year ended December 31, 20X8, Y had pretax income from continuing operations of $3 million and total assets of $20 million.
- Registrant X’s pretax income from continuing operations does not include any intercompany profits from transactions with Y, since they were eliminated in the application of the equity method of accounting.

Because X acquired an additional equity interest in Y, the transaction is considered a step acquisition for SEC reporting purposes and the additional interest must be evaluated for significance under Rule 3-05.

The income test calculation is as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company Y’s pretax income from continuing operations for the fiscal year ended December 31, 20X8</td>
<td>$3 million</td>
</tr>
<tr>
<td>Proportionate interest acquired by X in Y in 20X9</td>
<td>25%</td>
</tr>
<tr>
<td>Proportionate interest in Y’s pretax income from continuing operations acquired by X</td>
<td>$0.75 million</td>
</tr>
<tr>
<td>Registrant X’s total pretax income from continuing operations for the year ended December 31, 20X8</td>
<td>$5 million</td>
</tr>
<tr>
<td>Significance</td>
<td>15%</td>
</tr>
</tbody>
</table>

The asset test calculation is as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company Y’s total assets as of December 31, 20X8</td>
<td>$20 million</td>
</tr>
<tr>
<td>Proportionate interest acquired by X in Y in 20X9</td>
<td>25%</td>
</tr>
<tr>
<td>Proportionate interest in Y’s total assets acquired by X</td>
<td>$5 million</td>
</tr>
<tr>
<td>Registrant X’s total assets as of December 31, 20X8 (including the equity investment of Y)</td>
<td>$40 million</td>
</tr>
<tr>
<td>Significance</td>
<td>12.5%</td>
</tr>
</tbody>
</table>

The investment test calculation is as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. GAAP purchase price of 25 percent interest in Y</td>
<td>$10 million</td>
</tr>
<tr>
<td>Registrant X’s total assets as of December 31, 20X8 (including the equity investment of Y)</td>
<td>$40 million</td>
</tr>
<tr>
<td>Significance</td>
<td>25%</td>
</tr>
</tbody>
</table>

The highest level of significance is 25 percent.

For further discussion of significance thresholds, financial statement requirements, and filings requiring financial statements, see Sections 1.8.2 and 1.8.4.
1.8.4 Significance Thresholds and Financial Statement Requirements for an Acquisition or Probable Acquisition of an Additional Equity Interest in a Business

Q&A Regulation S-X: Rule 3-05(a)(4)-4

When a registrant (acquirer) owns an equity interest in a business and subsequently acquires (or it is probable that it will acquire) any additional equity interest in that business (acquiree), the registrant must consider the additional interest in the acquiree under Rule 3-05. Such an acquisition is generally referred to as a step acquisition for SEC reporting purposes. This may or may not be consistent with a step acquisition for U.S. GAAP accounting purposes.

As described in Rule 1-02(w), a registrant must perform the following three tests to determine the significance of an acquired or to be acquired business: the investment test, the asset test, and the income test. When evaluating significance, the registrant must use U.S. GAAP amounts. The test that results in the highest significance level is used to determine the financial statement periods that must be presented.

**Question**

What are the significance thresholds for an acquisition or probable acquisition of an additional interest in an acquiree, and what effect do these thresholds have on the financial statement requirements?

**Answer**

As discussed in Section 1.8.3, when a registrant acquires an additional interest in an acquiree, the significance tests should be based on the increase in the acquirer’s proportionate interest in assets and pretax income from continuing operations during the year, rather than on the cumulative interest to date. However, an acquirer should aggregate the financial information of all step acquisitions in the same entity that are part of a single plan that will be completed within a 12-month period. The same significance thresholds for initial interests in businesses acquired or to be acquired apply to the acquiree (see Section 1.6.1). If any of the significance thresholds exceed 20 percent, the financial statements of the acquiree may be required, as discussed below.

To determine whether it must file financial statements for an acquiree in accordance with Rule 3-05, a registrant must first consider how it accounted for its ownership interest in the acquiree before the step acquisition.

**Registrant Acquires an Additional Equity Interest in a Previously Unconsolidated Entity**

If the acquirer is making an additional equity investment in an entity that it previously did not consolidate (e.g., equity method investment), a Form 8-K with separate financial statements of the acquiree and pro forma financial information may be required, depending on the significance of the additional investment.115

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114 See footnote 50.
115 See footnote 112.
Example

- Registrant X owned 25 percent of Company Y as of December 31, 20X8. Registrant X used the equity method to account for Y.
- On April 1, 20X9, X acquired the remaining 75 percent of Y.
- The highest level of significance for the additional interest acquired in Y was determined to be 48 percent.

Because the acquisition of the additional 75 percent interest in Y exceeds 20 percent, X will be required to file separate financial statements of Y in a Form 8-K. In addition to filing the financial statements of the acquiree, a registrant must include pro forma financial information. Refer to Section 1.4.1 for more information on filings that require financial statements of a significant business acquisition or significant probable business acquisition.

Section 1.8.3 includes examples of how to perform the significance tests when a registrant acquires an additional equity interest in an acquiree.

Registrant Acquires an Additional Equity Interest in an Already Consolidated Entity

Paragraph 2020.5 of the FRM states:

When a registrant increases its investment in a company that is already reflected as a consolidated subsidiary in the audited financial statements of the registrant for a complete fiscal year, financial statements of the acquired investment are ordinarily not required. However, pro forma information may be required.

The staffs view that financial statements are ordinarily not required is premised on S-X 3-05(b)(4)(iii) which states that separate financial statements of the acquired business need not be presented once the operating results of the acquired business have been reflected in the audited consolidated financial statements of the registrant for a complete fiscal year unless such financial statements have not been previously filed or unless the acquired business is of major significance [see paragraph 2040.2 of the FRM]. Illustrative, but not all-inclusive, examples of when historical financial statements of an acquired business may be required in a step acquisition include:

- acquired business financial statements have not been previously filed for the entire period for which historical financial statements of the acquired entity would be required under S-X 3-05;
- acquired business is of major significance; or
- S-X 3-05 does not apply; such as a proxy statement or Form S-4 requirement to present the target's financial statements for the same periods that would be required in an annual report sent to security holders, if an annual report was required.

Also, note that while S-X 11-01(c) states that pro forma effects of a business combination need not be presented if the acquired business' financial statements are not presented, we believe such pro forma financial statements are required pursuant to S-X 11-01(a)(8) when pro forma financial information giving effect to the step acquisition would be material to investors.

1.9 Individually Insignificant Acquisitions

1.9.1 Introduction to SEC Reporting Considerations for Individually Insignificant Businesses Acquired or to Be Acquired

Q&A Regulation S-X: Rule 3-05(b)(2)(i)-1

This introduction outlines SEC reporting considerations for individually insignificant businesses acquired or to be acquired. Before applying the interpretations in this section, readers must understand the general application of the SEC reporting requirements for business combinations under Rule 3-05. (See Section 1.1 for additional information.) In addition to
reviewing the Q&As in this section, registrants should consider consulting with their audit and legal professionals to determine the appropriate SEC reporting requirements.

**Summary**

Rule 3-05\(^{116}\) indicates that when a registrant acquires two or more individually insignificant businesses since its latest audited year-end balance sheet required to be filed with the SEC, the registrant (acquirer) must:

- Test the individually insignificant businesses for significance in the aggregate.
- Provide, in a registration or proxy statement, separate financial statements for the substantial majority of the businesses acquired, if the aggregate significance exceeds 50 percent.

Separate financial statements are required for only the most recent fiscal year (audited) and appropriate interim periods (unaudited).

**Reporting Considerations for Individually Insignificant Businesses Acquired or to Be Acquired**

An individually insignificant business is one whose significance does not exceed 20 percent when a registrant applies the conditions specified in the definition of a significant subsidiary in Rule 1-02(w). When determining the aggregate impact (i.e., significance) of individually insignificant businesses, registrants must also consider any consummated or probable business acquisition for which financial statements have not been included in a filing because they have not been otherwise required by Rule 3-05. That is, the SEC requires\(^ {117}\) that in addition to individually insignificant businesses, registrants include the following in the aggregation test:

- Any probable acquisition whose significance does not exceed 50 percent.
- Any consummated acquisition whose significance exceeds 20 percent but not 50 percent for which financial statements are not yet required because of the 75-day rule.\(^ {118}\)

In this section, such businesses are collectively referred to as “individually insignificant businesses.” See also Section 1.6.1 for a discussion of significance thresholds and financial statement requirements.

If a group of individually insignificant businesses includes two or more related businesses, registrants must apply the guidance (i.e., Q&As) in Section 1.7 before applying the guidance in this section.

**Filings Requiring Financial Statements of Individually Insignificant Businesses Acquired or to Be Acquired**

As indicated in paragraph 2035.1 of the FRM, the requirement to provide financial statements of individually insignificant businesses only applies to registration and proxy statements.

Financial statements of individually insignificant businesses are not required in a Form 8-K. However, the acquirer may voluntarily provide these financial statements in a Form 8-K when

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\(^{116}\) See Rule 3-05(b)(2)(i).

\(^{117}\) See paragraph 2035.2 of the FRM.

\(^{118}\) Financial statements of a significant consummated business acquisition that is not more than 50 percent significant (on the basis of any of the three tests of significance) are not required in a registration statement that is filed or declared effective before the 75th day after consummation unless they have been previously filed by the registrant. See Section 1.4.1 for additional information about the “75-day rule.”
the acquirer anticipates that it may incorporate by reference the financial statements into a future registration or proxy statement. If the acquisitions are related businesses, a Form 8-K may be required in certain circumstances. (See Section 1.7.3 for further discussion.)

Financial statements of individually insignificant businesses are not required in annual or quarterly reports on a Form 10-K or 10-Q.

**Financial Statements Used to Measure Significance**

A registrant must perform the aggregate significance tests for individually insignificant businesses when it files a registration or proxy statement and must use, as of the filing date, the most recent preacquisition annual financial statements required to be filed with the SEC. Note that these financial statements may not be the same as those used in the calculation of individual significance performed as of the date of each acquisition. That is, at the time the registration or proxy statement is filed with the SEC, if the registrant or individually insignificant businesses have filed (1) financial statements that are more recent than those used to determine individual significance, the registrant must use the more recent financial statements when recalculating significance or (2) financial statements for the same fiscal year that have been retrospectively adjusted (e.g., a change in accounting principle or a discontinued operation). Such a recalculation could result in a higher or lower level of significance than the amount calculated when the acquisition was consummated. The same concept applies as of the date of effectiveness of a registration statement or the mailing of a proxy statement. Refer to Section 1.6.3.1 for more information on the financial statements required for individually significant acquisitions.

**Performing the Significance Tests**

A registrant must perform the following three tests to determine the significance of an acquired or to be acquired business: the investment test, the asset test, and the income test. When evaluating significance, the registrant must use U.S. GAAP amounts. For individually insignificant businesses, the test that results in the highest significance will be used to determine whether financial statements are required.

When performing the significance tests for individually insignificant acquisitions, a registrant must aggregate the financial measures used in the investment, income, and asset tests. In situations in which one or more of the individually insignificant businesses have losses, a registrant must separate the businesses into two groups (those that have pretax income from continuing operations and those that have pretax losses from continuing operations) when determining significance under the income test. Refer to paragraph 2035.5 of the FRM for more information.

**Significance Thresholds and Financial Statement Requirements**

If the aggregate significance of the individually insignificant businesses exceeds 50 percent, a registrant should provide financial statements covering at least the substantial majority of the aggregated businesses. Financial statements for only the most recent fiscal year and the appropriate interim periods are required.

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119 For more information about other reporting implications of changes that require retrospective application for SEC registrants, see Topic 13 of the FRM.

120 See footnote 50.
The concept of the “substantial majority,” or mathematical majority, refers to the requirement to present financial statements for the individually insignificant businesses that constitute more than 50 percent of the aggregate asset, income, or investment test determined to be the most significant. The substantial majority is not measured by number of acquisitions.

1.9.2 Reporting Considerations for Individually Insignificant Businesses Acquired or to Be Acquired

Q&A Regulation S-X: Rule 3-05(b)(2)(i)-2

Question

What are the reporting considerations for individually insignificant businesses acquired or to be acquired?

Answer

The phrase “individually insignificant” refers to acquired or to be acquired businesses whose significance does not exceed the minimum thresholds required by Rule 3-05 (e.g., 20 percent significance for consummated acquisitions). Because the significance of these businesses does not exceed the minimum thresholds, financial statements are generally not required for such businesses when they do not exceed any of the significance tests individually.

However, under Rule 3-05, when filing a registration or proxy statement, a registrant must aggregate the financial information for individually insignificant businesses acquired or to be acquired after the balance sheet date of the most recent annual audited financial statements included in the registration or proxy statement through the effective date of the registration statement or the mailing date for the proxy statement. If the businesses are significant in the aggregate, the registrant must provide financial statements for the substantial majority of these businesses.

In addition, registrants must consider any consummated or probable acquisitions for which financial statements have not been included in the registration or proxy statement because they have not been otherwise required by Rule 3-05. That is, the SEC requires that in addition to individually insignificant businesses, registrants include the following in the aggregation test:

- Any probable acquisition whose significance does not exceed 50 percent.
- Any consummated acquisition whose significance exceeds 20 percent but not 50 percent for which financial statements are not yet required because of the 75-day rule.

Under the 75-day rule, financial statements of a consummated business acquisition whose significance exceeds 20 percent but not 50 percent (on the basis of any of the three tests) are not required in a registration statement that is filed or declared effective before the 75th day after consummation, unless these financial statements have been previously filed by the registrant. Financial statements of a probable acquisition whose significance does not exceed 50 percent are also not required in a registration statement. However, a registrant must aggregate such businesses with individually insignificant businesses and, if they are significant in

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121 See Section 1.9.3 for further discussion of filings requiring financial statements of individually insignificant businesses acquired or to be acquired.
122 See Section 1.9.9 for further discussion of the meaning of “substantial majority.”
123 If the financial statements of an individually insignificant target company are already provided in a Form S-4, the guidance in Section 1.9 does not need to be considered for that acquisition since the financial statements of the target company are provided in the filing. For more information, see Section 1.9.3.
124 See paragraph 2035.2 of the FRM.
125 See Section 1.4.1 for additional information about the “75-day rule.”
the aggregate (i.e., if the aggregate significance exceeds 50 percent), the registrant must provide financial statements for the substantial majority of these aggregated businesses.

In this section, such businesses are collectively referred to as “individually insignificant businesses.”

The table below illustrates these requirements. For fields marked “Required,” a registrant must provide separate financial statements in a registration or proxy statement for that business because it is individually significant. Therefore, a registrant is not required to include these businesses when determining the impact of individually insignificant businesses. However, a registrant must aggregate the businesses in Groups A, B, and C (defined below) and, if they are significant in the aggregate, the registrant must provide separate financial statements for the substantial majority of these aggregated businesses.

<table>
<thead>
<tr>
<th>Significance</th>
<th>Business Acquisition Completed ≥ 75 Days Before Filing Registration/Proxy Statement</th>
<th>Business Acquisition Completed &lt; 75 Days Before Filing Registration/Proxy Statement</th>
<th>Probable Acquisition (to Be Acquired)</th>
</tr>
</thead>
<tbody>
<tr>
<td>≤ 20%</td>
<td>Group A</td>
<td>Group A</td>
<td>Group C</td>
</tr>
<tr>
<td>&lt; 20% but ≤ 50%</td>
<td>Required</td>
<td>Group B</td>
<td>Group C</td>
</tr>
<tr>
<td>&gt; 50%</td>
<td>Required</td>
<td>Required</td>
<td>Required</td>
</tr>
</tbody>
</table>

- Group A — Individually insignificant consummated acquisitions.
- Group B — Consummated acquisitions whose significance exceeds 20 percent but not 50 percent for which financial statements are not yet required because of the 75-day rule.
- Group C — Probable acquisitions whose significance does not exceed 50 percent.

If a group of individually insignificant businesses includes two or more related businesses, registrants must apply the guidance in Section 1.7 before the guidance in this section.

1.9.3 Filings Requiring Financial Statements of Individually Insignificant Businesses Acquired or to Be Acquired

Q&A Regulation S-X: Rule 3-05(b)(2)(i)-3

The SEC requires that in addition to individually insignificant businesses, registrants aggregate certain other businesses acquired or to be acquired when performing the significance tests. In this section, such businesses are collectively referred to as “individually insignificant businesses.” See Section 1.9.2 for additional information.

Question

What are the various SEC filings in which a registrant (acquirer) may be required to present financial statements of individually insignificant businesses?

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126 See Section 1.6.1 for a discussion of significance thresholds and financial statement requirements for a business acquisition or probable business acquisition.

127 Consummated after the registrant’s most recent annual audited balance sheet included in the registration or proxy statement through the effective date of the registration statement or the mailing date of the proxy statement.

128 See footnote 125.
**Answer**

As indicated in paragraph 2035.1 of the FRM, the requirement to provide financial statements of individually insignificant businesses only applies to registration and proxy statements. An acquirer must determine the aggregate significance of the individually insignificant businesses and, in certain circumstances, may be required to present the financial statements covering at least the substantial majority, or the mathematical majority, of these businesses in a registration or proxy statement.

With respect to delayed or continuous offerings (e.g., an effective shelf registration statement), an acquirer should also consider whether any individually insignificant acquisitions occurring after the effective date of the registration statement, when combined with previously aggregated individually insignificant acquisitions before the effective date, may be of such significance, in the aggregate, that an amendment is necessary. See paragraph 2045.3 of the FRM and Section 1.4.1 for further discussion.

If the financial statements of an individually insignificant target company are already provided in a Form S-4, the guidance in this section does not need to be considered for that acquisition since the financial statements of the target company are provided in the filing. See Section 1.4.1 for financial statement requirements for a target company in a Form S-4. The acquirer would still need to comply with Rule 3-05 for any other individually insignificant businesses (unrelated to the target company).

Financial statements of individually insignificant businesses are not required in an annual or quarterly report on a Form 10-K or 10-Q.

Financial statements of individually insignificant businesses are not required in a Form 8-K. However, the acquirer may voluntarily provide financial statements of individually insignificant businesses in a Form 8-K when the acquirer anticipates that it may incorporate by reference the financial statements into a future registration or proxy statement. If the acquisitions are related businesses, a Form 8-K may be required in certain circumstances. (See Section 1.7.3 for further discussion.)

See Section 1.9.8 for a discussion of the number of financial statement periods required to be presented in each filing.

### 1.9.4 Financial Statements Used to Measure Significance for Individually Insignificant Businesses Acquired or to Be Acquired

**Q&A Regulation S-X: Rule 3-05(b)(2)(i)-4**

The SEC requires that in addition to individually insignificant businesses, registrants aggregate certain other businesses acquired or to be acquired when performing the significance tests. In this section, such businesses are collectively referred to as “individually insignificant businesses.” See Section 1.9.2 for additional information.

**Question**

What financial statements should be used to measure significance for individually insignificant businesses?

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129 See Rule 415 of the Securities Act.
Answer

Generally, the most recent preacquisition annual financial statements of the individually insignificant businesses are aggregated and compared with a registrant’s preacquisition consolidated financial statements as of and for its most recently completed audited fiscal year required to be filed with the SEC. If the individually insignificant businesses are not registrants, the financial statements used for the significance tests should be determined as though the businesses were registrants.

A registrant must perform the aggregate significance tests for individually insignificant businesses when it files a registration or proxy statement and must use, as of the filing date, the most recent preacquisition audited annual financial statements required to be filed with the SEC. Note that these financial statements may not be the same as those used in the calculation of the individual significance performed as of the date of each acquisition. That is, at the time the registration or proxy statement is filed with the SEC, if the registrant or individually insignificant businesses have filed (1) more recent annual financial statements than those used to determine individual significance, the registrant must use the more recent financial statements when recalculating significance or (2) financial statements for the same fiscal year that have been retrospectively adjusted (e.g., a change in accounting principle or a discontinued operation). Such a recalculation could result in a higher or lower level of significance than the amount calculated when the acquisition was consummated.

The same concept applies as of the date of effectiveness of a registration statement or the mailing of a proxy statement. That is, at the time the registration statement is declared effective or the proxy statement is mailed, if the registrant or the individually insignificant businesses have filed more recent annual financial statements than those required to be filed as of the date of the filing of the registration or proxy statement, the registrant must use the more recent financial statements when recalculating significance. See paragraph 2035.4 of the FRM.

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130 See the Q&As in Section 1.6.3 for additional information.
131 For more information about other reporting implications of changes that require retrospective application for SEC registrants, see Topic 13 of the FRM.
132 This recalculation does not change a registrant’s initial reporting obligation under the Exchange Act (i.e., the initial calculation for individual significance). That is, if the significance of an individual business exceeds 20 percent as a result of the recalculation, the registrant is not required to file a Form 8-K. However, the registrant may voluntarily provide the financial statements of the individually insignificant businesses in a Form 8-K if the registrant anticipates that the financial statements may be incorporated by reference into a future registration or proxy statement. Refer to the note to paragraph 2035.4 of the FRM for additional information.
133 A registrant must also consider whether financial statements are required under Rule 3-05 for any acquisitions that were consummated, or that became probable, between the date the registration or proxy statement was filed and the date the registration or proxy statement is declared effective or mailed, respectively.
Example

- Registrant A consummated the acquisitions of Company B, Company C, and Company D during 20X9 on the dates shown in the table below.
- Registrant A and Companies B, C, and D all have a December 31 year-end.
- Companies B, C, and D are not related businesses.
- Company A is a large accelerated filer.
- Companies B, C, and D are nonaccelerated filers.
- The acquisitions of B, C, and D were not individually significant.
- Registrant A intends to file a registration statement on December 1, 20X9.

The following table summarizes the acquisition dates and the level of significance determined when each business was tested for significance individually, as well as the financial statements used to calculate the individual significance:

<table>
<thead>
<tr>
<th>Acquisition Date</th>
<th>Level of Significance % as of Acquisition Date</th>
<th>Most Recent Annual Financial Statements Required to Be Filed With the SEC as of Acquisition Date</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Investment Test</td>
<td>Income Test</td>
</tr>
<tr>
<td>Company B</td>
<td>January 11, 20X9</td>
<td>6</td>
</tr>
<tr>
<td>Company C</td>
<td>March 1, 20X9</td>
<td>8</td>
</tr>
<tr>
<td>Company D</td>
<td>October 5, 20X9</td>
<td>11</td>
</tr>
</tbody>
</table>

To calculate the aggregate significance for purposes of the December 1, 20X9, registration statement, the aggregate significance tests of B, C, and D must be performed by using the most recent annual financial statements required to be filed with the SEC as of December 1, 20X9. That is, A must use the December 31, 20X8, financial statements for A, B, C, and D when calculating the aggregate significance of B, C, and D. The financial statements used to calculate the aggregate significance for purposes of the December 1, 20X9, registration statement are different from the financial statements used to calculate the individual significance of B and C as of the respective acquisition dates, and may result in a higher or lower level of significance than the amount calculated as of the acquisition. Registrant A must comply with the above guidance through the effective date of the registration statement.

See Sections 1.9.5 and 1.9.8 for further discussion about calculating significance and significance thresholds.
1.9.5 Performing the Tests of Significance for Individually Insignificant Businesses Acquired or to Be Acquired

Q&A Regulation S-X: Rule 3-05(b)(2)(i)-5

The SEC requires that in addition to individually insignificant businesses, registrants aggregate certain other businesses acquired or to be acquired when performing the significance tests. In this section, such businesses are collectively referred to as “individually insignificant businesses.” See Section 1.9.2 for additional information.

Rule 1-02(w) describes three significance tests: the investment test, the income test, and the asset test. When evaluating significance, the registrant must use U.S. GAAP amounts. For individually insignificant businesses, the test that results in the highest significance will be used to determine whether financial statements are required. See Section 1.6 for further discussion.

Question

How should a registrant perform the significance tests for individually insignificant businesses?

Answer

A registrant (acquirer) must determine the significance of the individually insignificant businesses by comparing the aggregate of the preacquisition annual financial statements of the individually insignificant businesses with the acquirer’s audited annual financial statements required to be filed with the SEC.

Example

- Registrant A consummated the acquisitions of Company B, Company C, and Company D during 20X9 on the dates shown in the table below.
- Registrant A has determined that its acquisition of Company E is probable as of September 1, 20X9.
- Registrant A and Companies B, C, D, and E all have a December 31 year-end.
- Registrant A intends to file a registration statement on September 1, 20X9.
- The most recent audited annual financial statements required to be filed with the SEC for A as of September 1, 20X9, are for the year ended December 31, 20X8.
- The acquisitions of B, C, and E were not individually significant. The acquisition of D is individually significant.
- Companies B, C, D, and E are not related businesses.
- Registrant A’s total assets as of December 31, 20X8, were $100 million, and its pretax income from continuing operations was $15 million for the year ended December 31, 20X8.

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134 See footnote 50.
135 See Section 1.9.4 for further discussion.
136 See Section 1.2.1 for further discussion of identifying a probable business acquisition.
Example (continued)

The following table summarizes the acquisition dates and financial information of B, C, D, and E as of and for the year ended December 31, 20X8, as well as the calculation of the aggregate significance of B, C, D, and E.

<table>
<thead>
<tr>
<th>Acquisition Date</th>
<th>Investment (Purchase Price)*</th>
<th>%</th>
<th>Assets</th>
<th>%</th>
<th>Pretax Income From Continuing Operations</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company B</td>
<td>February 12, 20X9</td>
<td>$18 million</td>
<td>18</td>
<td>$10 million</td>
<td>10</td>
<td>$2.5 million</td>
</tr>
<tr>
<td>Company C</td>
<td>March 5, 20X9</td>
<td>14 million</td>
<td>14</td>
<td>$11 million</td>
<td>11</td>
<td>2 million</td>
</tr>
<tr>
<td>Company D</td>
<td>July 9, 20X9</td>
<td>22 million</td>
<td>22</td>
<td>$15 million</td>
<td>15</td>
<td>1 million</td>
</tr>
<tr>
<td>Company E</td>
<td>(probable)</td>
<td>12 million</td>
<td>12</td>
<td>$7 million</td>
<td>7</td>
<td>1.5 million</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>$66 million</td>
<td></td>
<td>$43 million</td>
<td></td>
<td>$7 million</td>
</tr>
<tr>
<td>Registrant</td>
<td></td>
<td>$100 million</td>
<td></td>
<td>$100 million</td>
<td></td>
<td>$15 million</td>
</tr>
<tr>
<td>Significance</td>
<td></td>
<td>66%</td>
<td></td>
<td>43%</td>
<td></td>
<td>47%</td>
</tr>
</tbody>
</table>

* As of the acquisition date.

To perform the significance tests, A must aggregate the financial information of B, C, D, and E.

The results of the significance tests indicate that the highest aggregate significance is 66 percent under the investment test. Because the highest aggregate significance exceeds 50 percent, A must provide the appropriate financial statements for the substantial majority of the aggregated businesses for the investment test. See Section 1.9.9 for further discussion about the concept of substantial majority.

Company D’s individual significance under the investment test is greater than 20 percent but less than 50 percent. Since fewer than 75 days have elapsed between A’s acquisition of D and the registration statement, under the 75-day rule, A would not yet be required to present the financial statements of D on the basis of its individual significance (unless they have been previously filed). However, A may be required to provide separate financial statements of D in this registration statement because financial statements of a mathematical majority of the aggregated businesses are required.

See also Section 1.9.6 for a discussion of performing the income test of significance when one or more, but not all, individually insignificant businesses have a loss.

Use of Pro Forma Financial Information

In certain situations, it may be appropriate for the acquirer to use pro forma financial information filed for a previous significant acquisition when performing the significance tests for the individually insignificant businesses. (See Section 1.6.4 for additional information.) A registrant may voluntarily file pro forma financial information for individually insignificant businesses; however, such information should not be used to measure significance for

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137 Financial statements are required for the substantial majority of individually insignificant businesses that are more than 50 percent significant in the aggregate. See Sections 1.9.8 and 1.9.9 for additional information.
138 See Section 1.4.1 for additional information about the “75-day rule.”
139 A registrant should consider consistent application of any voluntary filing of pro forma financial information for individually insignificant businesses.
subsequent businesses acquired or to be acquired. Paragraph 2035.6 of the FRM notes the following:

[Rule] 3-05 permits a registrant to evaluate significance of acquirees using the pro forma financial information filed on Form 8-K in connection with a previous significant acquisition. However, a registrant may not circumvent the requirement to file audited data of a majority of individually insignificant acquirees by filing a Form 8-K containing financial statements of one or more insignificant acquirees and testing significance of the remaining unaudited acquirees, against either the historical or resulting pro forma financial statements. If a registrant has filed a Form 8-K for a previous significant acquisition, the 50% aggregation test may be applied against the pro forma financial statements included in that Form 8-K.

1.9.6 Performing the Income Test of Significance for Individually Insignificant Businesses Acquired or to Be Acquired When One or More, but Not All, Businesses Have a Loss

Q&A Regulation S-X: Rule 3-05(b)(2)(i)-6

The SEC requires that in addition to individually insignificant businesses, registrants aggregate certain other businesses acquired or to be acquired when performing the significance tests. In this section, such businesses are collectively referred to as “individually insignificant businesses.” See Section 1.9.2 for additional information.

Question

How should a registrant perform the income test of significance for individually insignificant businesses when one or more, but not all, businesses have a loss in the most recent fiscal year used to perform the test?140

Answer

The third paragraph of computational note 1 to Rule 1-02(w)(3) indicates that in such situations, “entities reporting losses shall not be aggregated with entities reporting income” for purposes of the income test. A registrant must separate the businesses into two groups (those that have pretax income from continuing operations and those that have pretax losses from continuing operations) and must use the aggregated pretax income and aggregated pretax loss amounts to perform two separate income tests. Paragraph 2035.5 of the FRM notes that the “absolute values of the results of operations of the two groups should not be aggregated for purposes of determining significance.” The significance of the individually insignificant businesses, in the aggregate, is determined on the basis of the higher of the absolute values of the significance of the businesses with income or the significance of the businesses with losses. If the result of either income test is higher than the significance computed under the asset test or the investment test, the higher result from the two income tests should be used to determine whether financial statements are required.

140 See Section 1.9.4 for further discussion of financial statements used to measure significance.
Example 1

- Registrant A and Companies B, C, D, E, F, and G all have a December 31 year-end.
- Companies B, C, D, E, F, and G are not related businesses.
- Registrant A plans to file a registration statement on December 20, 20X9.
- The most recent audited annual financial statements required to be filed with the SEC for A as of December 20, 20X9, are for the year ended December 31, 20X8. Registrant A’s pretax income from continuing operations was $10 million for the year ended December 31, 20X8.
- The acquisitions of B, C, D, E, F, and G were not individually significant.
- The significances calculated in the aggregate investment test and aggregate asset test were less than 50 percent. (Those calculations are not included in this example.)

The following table summarizes the pretax income (loss) from continuing operations of A, B, C, D, E, F, and G for the year ended December 31, 20X8, as well as the aggregate income test calculation for B, C, D, E, F, and G:

<table>
<thead>
<tr>
<th>Company</th>
<th>Pretax Income From Continuing Operations</th>
<th>%</th>
<th>Pretax Loss From Continuing Operations</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company B</td>
<td>—</td>
<td></td>
<td>(1.9) million</td>
<td>19</td>
</tr>
<tr>
<td>Company C</td>
<td>$ 1.5 million</td>
<td>15</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>Company D</td>
<td>2 million</td>
<td>20*</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>Company E</td>
<td>—</td>
<td></td>
<td>(1.9) million</td>
<td>19</td>
</tr>
<tr>
<td>Company F</td>
<td>0.5 million</td>
<td>5</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>Company G</td>
<td>—</td>
<td></td>
<td>(1.5) million</td>
<td>15</td>
</tr>
<tr>
<td>Total</td>
<td>4 million</td>
<td></td>
<td>(5.3) million</td>
<td></td>
</tr>
</tbody>
</table>

Pretax income from continuing operations of A: $10 million
Significance: 40% 53%

* Because the company’s significance to the registrant is calculated as exactly 20 percent, the company would be considered individually insignificant. See Section 1.6.1 for further discussion.

To perform the income test, A must separately combine the pretax income from continuing operations of C, D, and F and the pretax loss from continuing operations of B, E, and G. Registrant A must use the absolute value of the combined loss of B, E, and G in the income test.

As discussed above, the significance of the aggregated businesses is determined on the basis of the higher of the significance of the businesses with income or the significance of the businesses with losses. The test results indicate that the highest aggregate significance for the income test is 53 percent. Because the highest aggregate significance exceeds 50 percent, the appropriate financial statements for the substantial majority of the individually insignificant businesses are required. See Section 1.9.9 for additional information about the concept of substantial majority.

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141 Financial statements are required for individually insignificant businesses if their significance in the aggregate exceeds 50 percent. See Section 1.9.8 for further discussion.
Example 2

Assume the same facts as in Example 1 except that E’s pretax loss from continuing operations is $1.5 million.

<table>
<thead>
<tr>
<th>Company</th>
<th>Pretax Income From Continuing Operations</th>
<th>%</th>
<th>Pretax Loss From Continuing Operations</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>B</td>
<td>—</td>
<td></td>
<td>$(1.9) million</td>
<td>19</td>
</tr>
<tr>
<td>C</td>
<td>$ 1.5 million</td>
<td>15</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>D</td>
<td>2 million</td>
<td>20*</td>
<td>—</td>
<td></td>
</tr>
<tr>
<td>E</td>
<td>—</td>
<td></td>
<td>$(1.5) million</td>
<td>15</td>
</tr>
<tr>
<td>F</td>
<td>0.5 million</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>G</td>
<td>—</td>
<td>5</td>
<td>$(1.5) million</td>
<td>15</td>
</tr>
<tr>
<td>Total</td>
<td>4 million</td>
<td></td>
<td>(4.9) million</td>
<td></td>
</tr>
</tbody>
</table>

Pretax income from continuing operations of A: $10 million

Significance: 40% 49%

* Because the company’s significance to the registrant is calculated as exactly 20 percent, the company would be considered individually insignificant. See Section 1.6.1 for further discussion.

To perform the income test, A must separately combine the pretax income from continuing operations of C, D, and F and the pretax loss from continuing operations of B, E, and G. Registrant A should use the absolute value of the combined loss of B, E, and G in the income test.

As discussed above, the significance of the aggregated businesses is determined on the basis of the higher of the significance of the businesses with income or the significance of the businesses with losses. The test results indicate that the highest aggregate significance for the income test is 49 percent. Because the highest aggregate significance does not exceed 50 percent, there is no requirement to file financial statements.

In certain circumstances, a registrant may use pro forma financial information filed for a previous significant acquisition when performing the significance tests for the individually insignificant businesses. See Section 1.9.5 for further discussion.

1.9.7 Period Over Which a Registrant Must Evaluate Individually Insignificant Businesses Acquired or to Be Acquired

Q&A Regulation S-X: Rule 3-05(b)(2)(i)-7

The SEC requires that in addition to individually insignificant businesses, registrants aggregate certain other businesses acquired or to be acquired when performing the significance tests. In this section, such businesses are collectively referred to as “individually insignificant businesses.” See Section 1.9.2 for additional information.

142 See footnote 141.
**Question**

Over what period must a registrant evaluate, and therefore aggregate, individually insignificant businesses when measuring significance?

**Answer**

A registrant must aggregate the financial information of any individually insignificant businesses acquired or to be acquired after its latest audited annual balance sheet required to be filed with the SEC through the effective date of the registration statement or mailing date of the proxy statement. This could result in the inclusion of acquisitions over more than 12 months, as illustrated in the examples below.

### Example 1

- Registrant A consummated the following acquisitions of individually insignificant businesses:
  - Company B on March 18, 20X8.
  - Company C on August 12, 20X8.
  - Company D on December 21, 20X8.
  - Company E on January 10, 20X9.
  - Company F on February 4, 20X9.
- Registrant A and Companies B, C, D, E, and F all have a December 31 year-end.
- Companies B, C, D, E, and F are not related businesses.
- The acquisitions of B, C, D, E, and F were not individually significant.
- Registrant A plans to file a registration statement on February 10, 20X9.
- The most recent audited annual financial statements required to be filed with the SEC for A as of February 10, 20X9, are for the year ended December 31, 20X7.

Given these facts, A must aggregate the financial information of B, C, D, E, and F when performing the income, asset, and investment tests.

### Example 2

Assume the same facts as in Example 1, except:
- Registrant A plans to file a registration statement on April 23, 20X9.
- The most recent audited annual financial statements required to be filed with the SEC for A as of April 23, 20X9, are for the year ended December 31, 20X8.

Given the facts in this example, A must aggregate the financial information of only E and F when performing the income, asset, and investment tests.

Note that in both examples, A must also include in the significance tests any individually insignificant businesses acquired or to be acquired after the date the registration statement is filed through the effective date or mailing date of the registration or proxy statement, respectively.

See Section 1.9.5 for a discussion of significance tests and Section 1.9.8 for guidance on determining financial statement requirements.
1.9.8 Significance Thresholds and Financial Statement Requirements of Individually Insignificant Businesses Acquired or to Be Acquired

Q&A Regulation S-X: Rule 3-05(b)(2)(i)-8
The SEC requires that in addition to individually insignificant businesses, registrants aggregate certain other businesses acquired or to be acquired when performing the significance tests. In this section, such businesses are collectively referred to as “individually insignificant businesses.” See Section 1.9.2 for additional information.

As described in Rule 1-02(w), a registrant must perform the following three tests to determine the significance of an acquired or to be acquired business: the investment test, the asset test, and the income test. When evaluating significance, the registrant must use U.S. GAAP amounts. The test that results in the highest significance level will be used to determine whether financial statements are required. See Section 1.9.5 for additional information.

Question
What are the significance thresholds for individually insignificant businesses, and what effect do these thresholds have on financial statement requirements?

Answer
Rule 3-05(b)(2)(i) states that if the significance of aggregated individually insignificant businesses exceeds 50 percent:

[F]inancial statements covering at least the substantial majority of the businesses acquired shall be furnished. Such financial statements shall be for at least the most recent fiscal year and any interim periods specified in [Regulation S-X, Rules 3-01 and 3-02].

Therefore, no financial statements are required for individually insignificant businesses whose significance, in the aggregate, does not exceed 50 percent. In the case of individually insignificant businesses whose aggregate significance exceeds 50 percent, for the substantial majority of these aggregated businesses, audited financial statements for only the most recent fiscal year and the appropriate unaudited interim periods are required.

For additional information about the concept of substantial majority, see Section 1.9.9.

1.9.9 Substantial Majority of Individually Insignificant Businesses Acquired or to Be Acquired

Q&A Regulation S-X: Rule 3-05(b)(2)(i)-9
The SEC requires that in addition to individually insignificant businesses, registrants aggregate certain other businesses acquired or to be acquired when performing the significance tests. In this section, such businesses are collectively referred to as “individually insignificant businesses.” See Section 1.9.2 for additional information.

143 See footnote 50.
144 In accordance with Regulation S-X, Article 10, the unaudited interim periods required to be presented should include activity as of and from the latest fiscal year-end to the date of the appropriate interim period preceding the acquisition and the corresponding interim period in the prior year. For additional guidance on determining the appropriate interim period preceding the acquisition, see the Q&As in Section 1.11.
Rule 3-05(b)(2)(i) states, in part:

If the aggregate impact of the individually insignificant businesses acquired . . . exceeds 50%, financial statements covering at least the substantial majority of the businesses acquired shall be furnished.

**Question**

How does a registrant calculate the substantial majority (referred to herein as the “mathematical majority”) of the individually insignificant businesses?

**Answer**

The mathematical majority refers to the requirement to present financial statements for the individually insignificant businesses that constitute more than 50 percent of the aggregate asset, income, or investment test determined to be the most significant. The substantial majority is not measured by the number of acquisitions.

**Example 1**

In this example, assume that all individually insignificant businesses report income.

- Registrant A consummated acquisitions of Company B, Company C, and Company D during 20X9 on the dates shown in the table below.
- Registrant A has determined that its acquisition of Company E is probable as of October 20, 20X9.¹⁴⁶
- Registrant A intends to file a registration statement on October 20, 20X9.
- The most recent audited annual financial statements required to be filed with the SEC for A as of October 20, 20X9, are for the year ended December 31, 20X8.
- Registrant A’s total assets as of December 31, 20X8, were $100 million, and its pretax income from continuing operations was $15 million for the year ended December 31, 20X8.
- Registrant A and Companies B, C, D, and E all have a December 31 year-end.
- Companies B, C, D, and E are not related businesses.
- The acquisitions of B, C, D, and E were not individually significant.

¹⁴⁶ See Section 1.2.1 for a discussion of identifying a probable business acquisition.
### Example 1 (continued)

The following table summarizes the acquisition dates and financial information of A, B, C, D, and E as of and for the year ended December 31, 20X8, as well as the aggregate significance calculation for B, C, D, and E:

<table>
<thead>
<tr>
<th>Acquisition Date</th>
<th>Investment (Purchase Price) as of Acquisition Date</th>
<th>%</th>
<th>Assets</th>
<th>%</th>
<th>Pretax Income From Continuing Operations</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company B</td>
<td>January 11, 20X9</td>
<td>$18</td>
<td>$10</td>
<td>10</td>
<td>$2.5</td>
<td>17</td>
</tr>
<tr>
<td>Company C</td>
<td>April 23, 20X9</td>
<td>14</td>
<td>11</td>
<td>11</td>
<td>2</td>
<td>13</td>
</tr>
<tr>
<td>Company D</td>
<td>August 31, 20X9</td>
<td>9</td>
<td>6</td>
<td>6</td>
<td>1</td>
<td>7</td>
</tr>
<tr>
<td>Company E (probable)</td>
<td>12 million</td>
<td>12</td>
<td>7</td>
<td>7</td>
<td>1.5</td>
<td>10</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>$53</td>
<td>$34</td>
<td>34</td>
<td>$7</td>
<td>47</td>
</tr>
<tr>
<td>Registrant A</td>
<td></td>
<td>$100</td>
<td>$100</td>
<td>100</td>
<td>$15</td>
<td></td>
</tr>
<tr>
<td>Significance</td>
<td></td>
<td>53</td>
<td>34</td>
<td>47</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Represents A’s total assets as of December 31, 20X8.

The highest aggregate significance is 53 percent under the investment test. Therefore, financial statements of the aggregated businesses adding up to more than 26.5 percent under the investment test column must be provided (50 percent of 53 percent, or 26.5 percent). In this example, A could provide financial statements for any one of the following combinations:

- Companies B and C (18% + 14% = 32%).
- Companies B and D (18% + 9% = 27%).
- Companies B and E (18% + 12% = 30%).
- Companies C, D, and E (14% + 9% + 12% = 35%).

Separate financial statements are not required in a registration or proxy statement for acquisitions of businesses whose significance exceeds 20 percent but is less than 50 percent, when the acquisition was consummated within 75 days before the filing or effective date of a registration statement (or mailing date of a proxy statement), unless these financial statements have been previously filed. However, the SEC requires that these businesses be aggregated with any individually insignificant businesses acquired and any probable acquisition whose significance does not exceed 50 percent. When the individually insignificant businesses are significant in the aggregate and financial statements of the mathematical majority are required, registrants may provide separate financial statements of the individually significant businesses to meet the mathematical-majority requirement before they are required to be filed in a Form 8-K. In certain circumstances, a registrant may be required to provide financial statements of such businesses to meet the mathematical-majority requirement, as demonstrated in the example below.

146 See Section 1.4.1 for additional information about the “75-day rule.”
Example 2

In this example, assume that all businesses report income, one recent acquisition is individually significant, and the remaining acquisitions are individually insignificant. Further assume the same facts as in Example 1 except:

- Registrant A consummated the acquisition of Company F on October 1, 20X9.
- Registrant A and Companies B, C, D, E, and F all have a December 31 year-end.
- Companies B, C, D, E, and F are not related businesses.

The following table summarizes the acquisition dates and financial information of A, B, C, D, E, and F as of and for the year ended December 31, 20X8, as well as the aggregate significance calculation for B, C, D, E, and F.

<table>
<thead>
<tr>
<th>Acquisition Date</th>
<th>Investment (Purchase Price) as of Acquisition Date</th>
<th>%</th>
<th>Assets</th>
<th>%</th>
<th>Pretax Income From Continuing Operations</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company B</td>
<td>January 11, 20X9</td>
<td>$18 million</td>
<td>18</td>
<td>$10 million</td>
<td>10</td>
<td>$2.5 million</td>
</tr>
<tr>
<td>Company C</td>
<td>April 23, 20X9</td>
<td>14 million</td>
<td>14</td>
<td>11 million</td>
<td>11</td>
<td>2 million</td>
</tr>
<tr>
<td>Company D</td>
<td>August 31, 20X9</td>
<td>9 million</td>
<td>9</td>
<td>6 million</td>
<td>6</td>
<td>1 million</td>
</tr>
<tr>
<td>Company F</td>
<td>October 1, 20X9</td>
<td>25 million</td>
<td>25</td>
<td>46 million</td>
<td>46</td>
<td>1 million</td>
</tr>
<tr>
<td>Company E (probable)</td>
<td></td>
<td>12 million</td>
<td>12</td>
<td>7 million</td>
<td>7</td>
<td>1.5 million</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>$78 million</td>
<td></td>
<td>$80 million</td>
<td></td>
<td>$8 million</td>
</tr>
<tr>
<td>Registrant A</td>
<td></td>
<td>$100 million*</td>
<td></td>
<td>$100 million*</td>
<td></td>
<td>$15 million</td>
</tr>
<tr>
<td>Significance</td>
<td></td>
<td>78%</td>
<td>80%</td>
<td></td>
<td>54%</td>
<td></td>
</tr>
</tbody>
</table>

* Represents A’s total assets as of December 31, 20X8.

The results of the significance tests indicate that the highest aggregate significance is 80 percent under the asset test. Therefore, A must provide financial statements of the aggregated businesses adding up to more than 40 percent under the asset test column (50 percent of 80 percent, or 40 percent).

The only financial statements that A can provide to meet the asset test’s mathematical-majority requirement are the financial statements of F. Accordingly, A must provide the financial statements of F in this registration statement, even though separate financial statements for this individually significant business are not yet required in a Form 8-K.

See Section 1.9.10 for further discussion of the substantial majority of individually insignificant businesses when one or more, but not all, businesses have a loss.
1.9.10 Substantial Majority of Individually Insignificant Businesses Acquired or to Be Acquired When One or More, but Not All, Businesses Have a Loss

Q&A Regulation S-X: Rule 3-05(b)(2)(i)-10

The SEC requires that in addition to individually insignificant businesses, registrants aggregate certain other businesses acquired or to be acquired when performing the significance tests. In this section, such businesses are collectively referred to as “individually insignificant businesses.” See Section 1.9.2 for additional information.

Rule 3-05(b)(2)(i) states, in part:

“If the aggregate impact of the individually insignificant businesses acquired . . . exceeds 50%, financial statements covering at least the substantial majority of the businesses acquired shall be furnished.

The concept of the substantial majority is covered in more detail in Section 1.9.9. Further, as indicated in Section 1.9.6 entities reporting losses should not be offset with entities reporting income in the computation of significance under the income test. The two groups must be evaluated separately.

Question

How does a registrant calculate the substantial majority (referred to herein as the “mathematical majority”) of the individually insignificant businesses when one or more, but not all, businesses have a loss?

Answer

Paragraph 2035.5 of the FRM states that when a registrant determines that the significance computed under the income test for either the group of individually insignificant acquisitions with income or the group with losses is higher than the significance computed under the investment or asset test, “[t]he absolute values of the income test significance of the [businesses reporting income and the businesses reporting losses] would be aggregated for purposes of selecting the mathematical majority.” That is, a registrant must add together the absolute value of the income test significance of the individually insignificant businesses and provide financial statements for those businesses that constitute more than 50 percent of the result of the total income test.

Example

In this example, assume that some individually insignificant businesses report income and others report losses.

- Registrant A consummated acquisitions of Company B, Company C, Company D, and Company E during 20X9 on the dates shown in the table below.
- Registrant A and Companies B, C, D, and E all have a December 31 year-end.
- Registrant A intends to file a registration statement on September 30, 20X9.
- The most recent audited annual financial statements required to be filed with the SEC for A as of September 30, 20X9, are for the year ended December 31, 20X8. Registrant A’s pretax income from continuing operations was $10 million for the year ended December 31, 20X8.
- The acquisitions of B, C, D, and E were not individually significant.
- Companies B, C, D, and E are not related businesses.
Example (continued)

The following table summarizes the acquisition dates and financial information of A, B, C, D, and E as of and for the year ended December 31, 20X8, as well as the calculation of the aggregate significance of B, C, D, and E:

<table>
<thead>
<tr>
<th>Company</th>
<th>Acquisition Date</th>
<th>Investment Test</th>
<th>Asset Test</th>
<th>Income Test</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Investment (Purchase Price) as of Acquisition Date</td>
<td>Assets</td>
<td>Pretax Income From Continuing Operations</td>
<td>Pretax (Loss) From Continuing Operations</td>
</tr>
<tr>
<td></td>
<td>(millions)</td>
<td>(millions)</td>
<td>(millions)</td>
<td>(millions)</td>
</tr>
<tr>
<td>Company B</td>
<td>February 12, 20X9</td>
<td>$14</td>
<td>$10</td>
<td>$ (2)</td>
</tr>
<tr>
<td>Company C</td>
<td>March 9, 20X9</td>
<td>12</td>
<td>11</td>
<td>(1.6)</td>
</tr>
<tr>
<td>Company D</td>
<td>May 5, 20X9</td>
<td>8</td>
<td>6</td>
<td>1.8</td>
</tr>
<tr>
<td>Company E</td>
<td>July 21, 20X9</td>
<td>10</td>
<td>7</td>
<td>(1.9)</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>$44</td>
<td>$34</td>
<td>$1.8</td>
</tr>
<tr>
<td>Registrant A</td>
<td></td>
<td>$100**</td>
<td>$100**</td>
<td>$10</td>
</tr>
<tr>
<td>Significance</td>
<td></td>
<td>44%</td>
<td>34%</td>
<td>18%</td>
</tr>
</tbody>
</table>

Total significance based on absolute value 73%

* Because this company is calculated as exactly 20 percent significant to the registrant, the company would be considered individually insignificant. See Section 1.6.1 for further discussion.

** Represents A’s total assets as of December 31, 20X8.

The results of the significance tests indicate that the highest aggregate significance is 55 percent under the income test for the entities reporting losses. Therefore, A must present financial statements for the mathematical majority of the tested businesses. When selecting the mathematical majority, A must first aggregate the absolute value of the entities reporting losses (55 percent) with the absolute value of the entities reporting income (18 percent), resulting in a total significance under the income test of 73 percent. Accordingly, the financial statements of the tested businesses adding up to more than 36.5 percent under the income test column must be provided (50 percent of 73 percent, or 36.5 percent). Registrant A must provide financial statements of a mathematical majority of all individually insignificant businesses regardless of whether the businesses have income or losses. Registrant A must comply with the above guidance through the effective date of the registration statement.

Registrant A could provide financial statements for any of the following combinations:

- Companies B and D (20% + 18% = 38%).
- Companies B and E (20% + 19% = 39%).
- Companies D and E (18% + 19% = 37%).
Joint Ventures

Introduction to SEC Reporting Considerations for an Acquired or to Be Acquired Interest in a Joint Venture

Q&A Regulation S-X: Rule 3-05(a)(1)(i)-2

This introduction outlines the SEC reporting considerations for an acquired or to be acquired interest in a joint venture at its formation. Before applying the interpretations in this section, readers must understand the general application of the SEC reporting requirements for business combinations under Rule 3-05. (See Section 1.1 for additional information.) In addition to reviewing the Q&As in this section, registrants should consider consulting with their audit and legal professionals to determine the appropriate SEC reporting requirements.

For a number of reasons, investors (often referred to as “venturers”) form joint ventures rather than undertake business activities on their own. A joint venture is a common form of a business enterprise that possesses specific attributes and is characterized by the presence of joint control among the venturers.  

SEC Reporting Considerations for an Acquired or to Be Acquired Interest in a Joint Venture

According to Rule 3-05(a)(1)(i), a business acquisition for SEC reporting purposes includes “the acquisition of an interest in a business accounted for by the equity method.” This includes the acquisition of an interest in a joint venture that is accounted for by the equity method, even if the venturers do not have joint control over the entity.

When a registrant contributes assets or a business in exchange for an equity interest in a joint venture, the registrant is transferring an interest in its assets or business in exchange for an ownership interest in the joint venture. For SEC reporting purposes, the formation of a joint venture in this manner consists of two events, (1) an acquisition and (2) a disposition, which must be separately measured.

Filing Requirements for an Acquired or to Be Acquired Interest in a Joint Venture

For an acquired or to be acquired interest in a joint venture, a registrant may be required to file a Form 8-K to reflect:

- The disposition of a business.
- The disposition of assets.
- The acquisition of an equity method investment.

A registrant may also be required to include separate financial statements of the business contributed by the other party in a Form 8-K, registration statement, or proxy statement when a significant interest in a joint venture is acquired or to be acquired.

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147 To determine whether a company is a joint venture under U.S. GAAP, refer to ASC 323.
148 For further discussion of the types of acquisitions that may constitute a business for SEC reporting purposes, see Section 1.3.1.
149 See paragraph 2025.4 of the FRM, which discusses exchange transactions noting that the significance of the disposition must be evaluated separately from the acquisition.
150 Registrants should consider the guidance in Sections 2100 and 3120 of the FRM as well as the guidance on dispositions of assets and businesses in Section 7.3 of Deloitte’s A Roadmap to Disposals of Long-Lived Assets and Discontinued Operations.
When a registrant is required to present financial statements for an acquired or to be acquired interest in a joint venture, the financial statements required are those of the **business contributed by the other party** and not the financial statements of the joint venture. This is because there are no historical operations of the joint venture upon formation.

**Performing the Significance Tests for an Acquired or to Be Acquired Interest in a Joint Venture**

The significance tests are generally based on the acquired or to be acquired percentage of the other venturers’ business or assets compared to the registrant’s historical financial statements (without adjustment for the related disposition, if any, of the business contributed by the registrant to the joint venture).

**Financial Statements Used to Measure Significance, Significance Thresholds, and Financial Statement Requirements for an Acquired or to Be Acquired Interest in a Joint Venture**

The financial statements used to measure significance, the significance thresholds, and financial statement requirements for the business contributed by the other party are the same as the requirements for individual businesses acquired or to be acquired as determined under Rule 3-05.

**Pro Forma Financial Statement Requirements**

In addition to filing the financial statements of the business contributed by the other party, a registrant is required under **Article 11** to include pro forma financial information for both significant acquisitions and dispositions. See **Chapter 3** for further discussion. Also, see **Topic 3** of the FRM.

### 1.10.2 Reporting Considerations for an Acquired or to Be Acquired Interest in a Joint Venture

**Q&A Regulation S-X: Rule 3-05(a)(1)(i)-3**

For a number of reasons, investors (often referred to as “venturers”) form joint ventures rather than undertake business activities on their own. A joint venture is a common form of a business enterprise that possesses specific attributes and is characterized by the presence of joint control among the venturers.\(^{151}\)

**Question**

What are the SEC reporting considerations for an acquired or to be acquired interest in a joint venture?

**Answer**

According to **Rule 3-05(a)(1)(i)**, a business acquisition for SEC reporting purposes includes “the acquisition of an interest in a business accounted for by the equity method.”\(^{152}\) This includes an

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\(^{151}\) See footnote 147.

\(^{152}\) See footnote 148.
acquired or to be acquired interest in a joint venture that is accounted for by the equity method even if the venturers do not have joint control over the entity.\textsuperscript{153}

Because there are no historical operations of the joint venture upon formation, the financial statements required are those of the business contributed by the other party and not the financial statements of the joint venture.\textsuperscript{154}

When a registrant contributes assets or a business in exchange for an equity interest in a joint venture, the registrant is transferring a percentage of interest in its assets or business in exchange for an ownership interest in the joint venture.\textsuperscript{155} For SEC reporting purposes, the formation of a joint venture in this manner consists of two events, which must be separately measured:

- The disposition of the business\textsuperscript{156} or assets.
- The acquisition of an equity method investment.

Accordingly, a registrant must determine the filing requirements for the disposition of the business or assets as well as whether and for what periods separate financial statements of the business contributed by the other party may be required under Rule 3-05 in certain filings.

See Section 1.10.3 below for additional information on the SEC filing requirements for an acquired or to be acquired interest in a joint venture.

### Example

- Registrant A and Company B each own 100 percent of several automobile dealerships.
- Registrant A and B each contribute five dealerships to form a new joint venture, Joint Venture X.
- In exchange for contributing the dealerships, A and B both receive 50 percent of the equity in Joint Venture X.

Registrant A must consider the SEC reporting requirements for the disposition of the 50 percent interest in the dealerships it contributed to X, as well as the acquisition of a 50 percent interest in the dealerships contributed by B.

### 1.10.3 Filing Requirements for an Acquired or to Be Acquired Interest in a Joint Venture

**Q&A Regulation S-X: Rule 3-05(a)(1)(i)-4**

For SEC reporting purposes, the formation of a joint venture consists of two events, which must be measured separately:

- The disposition of the business or assets.\textsuperscript{157}
- The acquisition of an equity method investment.

See Section 1.10.2 for further discussion.

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\textsuperscript{153} Registrants must also consider the continuing SEC reporting requirements for significant equity method investments under Regulation S-X, Rule 3-09. See Deloitte’s *A Roadmap to SEC Reporting Considerations for Equity Method Investees*.

\textsuperscript{154} If the other party contributed assets that do not meet the definition of a business, Rule 3-05 does not apply. See Section 1.3.4 for further discussion. Also, see Form 8-K, Item 2.01, for filing requirements related to a significant asset acquisition.

\textsuperscript{155} See paragraph 2025.4 of the FRM.

\textsuperscript{156} See footnote 150.

\textsuperscript{157} See footnote 150.
**Question**

What are the SEC filing requirements for an acquired or to be acquired interest in a joint venture?

**Answer**

**Registrant Contributes a Business in Exchange for Its Interest in the Joint Venture**

A registrant must file a Form 8-K if the significance of the businesses disposed of (i.e., the portion of the business disposed of, not 100 percent of the business contributed) exceeds 10 percent. See below for pro forma considerations related to the disposition of a business in exchange for an interest in a joint venture.

**Registrant Contributes Assets in Exchange for Its Interest in the Joint Venture**

A registrant must file a Form 8-K if the net book value of the assets disposed (i.e., contributed to the joint venture) or the proceeds received for the assets exceed 10 percent of the total assets of the registrant.

Historical financial statements of the disposed business are not required in Form 8-K, but may be required in proxy statements as described in paragraph 2120.1 of the FRM. Pro forma financial statements depicting the disposition are required to be filed in a Form 8-K within four business days of the disposition. As discussed in paragraph 2120.1 of the FRM, the 71-calendar-day grace period does not apply to business dispositions.

**Registrant Acquires an Interest in a Joint Venture Accounted for Under the Equity Method**

The registrant must include separate financial statements of the business contributed by the other party in a Form 8-K (not the financial statements of the joint venture), registration statement, or proxy statement when a significant interest in a joint venture is acquired. See Section 1.4.1 for further discussion. See below for pro forma considerations related to the acquisition of an interest in a joint venture.

**Pro Forma Requirements**

Pro forma financial information is required for significant acquisitions and dispositions pursuant to Article 11. See Section 1.10.5.

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158 As required by Form 8-K, Item 2.01.
159 See the highlights of the March 2011 CAQ SEC Regulations Committee joint meeting with the SEC staff.
160 See Sections 2120 and 2130 of the FRM. For guidance on how to perform the tests of significance, see Question 2 in Attachment D in the highlights of the June 2005 AICPA SEC Regulations Committee joint meeting with the SEC staff and Section 7.3 of Deloitte’s A Roadmap to Disposals of Long-Lived Assets and Discontinued Operations.
161 In accordance with the Form 8-K rules, a registrant has four business days after the consummation of a significant business acquisition to file the initial Form 8-K. A registrant, other than a shell company, has 71 calendar days after the initial Form 8-K was required to be filed to file the required financial statements of the significant business acquiree and pro forma financial information.
1.10.4 Financial Statements Used to Measure Significance, Significance Thresholds, and Financial Statement Requirements for an Acquired or to Be Acquired Interest in a Joint Venture

Q&A Regulation S-X: Rule 3-05(a)(1)(i)-5

Question
What financial statements are used to measure significance for an acquired or to be acquired interest in a joint venture, what are the significance thresholds, and what effect do these thresholds have on the financial statement requirements?

Answer
The financial statements used to measure significance, the significance thresholds, and financial statement requirements for the business contributed by the other party are the same as the requirements for individual businesses acquired or to be acquired as determined under Rule 3-05. For additional information, see Sections 1.6.1 and 1.6.3.1.

For guidance on performing the significance calculations for an acquired or to be acquired interest in a joint venture, see Section 1.10.6.

When a registrant is required to present financial statements for an acquired or to be acquired interest in a joint venture, the financial statements required are those of the business contributed by the other party and not the financial statements of the joint venture. This is because there are no historical operations of the joint venture upon formation.

1.10.5 Pro Forma Financial Statement Requirements for an Acquired Interest in a Joint Venture

Q&A Regulation S-X: Rule 3-05(a)(1)(i)-6

For SEC reporting purposes, the formation of a joint venture consists of two events, which must be measured separately:

- The disposition of the business or assets.\(^{162}\)
- The acquisition of an equity method investment.

See Section 1.10.2 for further discussion.

Question
Are there requirements for a registrant to provide pro forma financial statements related to the formation of a joint venture?

Answer
Yes. In addition to filing the financial statements of the business contributed by the other party, a registrant is also required to include pro forma financial information for both significant acquisitions and dispositions pursuant to Article 11. See Chapter 3. Also, see Topic 3 of the FRM.

\(^{162}\) See footnote 150.
If upon the formation of a joint venture, a registrant is required to report both the disposition and the acquisition on Form 8-K, the registrant should note paragraph 2025.4 of the FRM, which states, in part:

If reporting of both the disposition and the acquisition are required by Form 8-K, a registrant may be unable to present a pro forma income statement depicting the joint venture formation because financial statements of the business contributed by the other party are not available. Those financial statements and related pro forma financial statements need not be filed until 71 calendar days after the date that the initial report reporting the transactions on Form 8-K must be filed (that is, the sum of 4 business days after the transaction is consummated plus 71 calendar days). Pro forma financial statements depicting a significant disposition are ordinarily required to be filed within 4 business days of the disposition. In these circumstances, the initial Form 8-K reporting the transaction should include a narrative description of the effects of the disposition, quantified to the extent practicable, and complete pro forma information depicting the effects of the exchange of interests should be filed at the time that the audited financial statements of the acquired business are filed.

1.10.6 Performing the Significance Tests for an Acquired or to Be Acquired Interest in a Joint Venture

Q&A Regulation S-X: Rule 3-05(a)(1)(i)-7

As described in Rule 1-02(w), a registrant must perform the following three tests to determine the significance of an acquired or to be acquired business: the investment test, the asset test, and the income test. When evaluating significance, the registrant must use U.S. GAAP amounts. The test that results in the highest significance level will be used to determine the financial statement periods of the businesses contributed by the other party that must be presented.

Question
How should a registrant perform the tests of significance for an acquired or to be acquired interest in a joint venture?

Answer

When a registrant contributes assets or a business in exchange for an equity interest in a joint venture, the registrant is transferring an interest in its assets or business in exchange for an ownership interest in the joint venture. For SEC reporting purposes, the formation of a joint venture in this manner consists of the following two events, which must be separately measured:

• The disposition of the business or assets.

• The acquisition of an equity method investment.

See Sections 1.10.2 and 1.10.3 for the SEC reporting requirements related to the disposition of a business or asset.

The significance of an acquired or to be acquired interest in a joint venture should be based on the acquired percentage of the other venturer’s business compared to the registrant’s historical financial statements.

163 See footnote 50.
164 If the other party contributes assets that do not meet the definition of a business, Rule 3-05 does not apply. See Section 1.3.4 for further discussion. Also, see Form 8-K, Item 2.01, for filing requirements related to a significant asset acquisition.
165 See footnote 150.
166 Such amounts are generally for the registrant’s most recently completed fiscal year that has been filed with the SEC and should not be adjusted for the disposition of the assets or business contributed to the joint venture, if any. See paragraph 2025.4 of the FRM.
The three tests of significance for the acquisition of an equity interest in a joint venture should be performed as follows:

- **Investment test** — Regardless of whether the transaction is accounted for at fair value, the investment test should be based on the fair value of the consideration given up or the consideration received, whichever is more reliably determinable. Compare the appropriate percentage in the more reliably determinable amount to the registrant’s total assets.

- **Asset test** — Compare the registrant’s share of the book value of the business(es) contributed by the other venturer to the registrant’s total assets.

- **Income test** — Compare the registrant’s share in the pretax income from continuing operations attributable to the business contributed by the other venturer to the registrant’s pretax income from continuing operations.

### Example

- Registrant A and Company B both have December 31 fiscal year-ends.
- Registrant A and B contribute five restaurants each to form a new joint venture, Joint Venture X on March 31, 20X8.
- In exchange for contributing the restaurants, A and B both receive 50 percent of the equity in X.
- The fair value of the restaurants contributed by B is $1 million (such fair value was more reliably determinable than that of the restaurants contributed by A).
- The book value of the restaurants contributed by B is $0.8 million.
- Registrant A’s total assets as of December 31, 20X7, are $10 million.
- Registrant A’s pretax income from continuing operations for the year ended December 31, 20X7, is $3 million.
- The pretax income from continuing operations for the year ended December 31, 20X7, for the restaurants contributed by B is $0.9 million.

Since the fair value of the consideration received by A is more reliably determinable than the consideration given by A, the investment test calculation is as follows:

| Fair value of restaurants contributed by B | $1 million |
| Percentage acquired by A                   | 50%        |
| Proportionate interest acquired by A in fair value of restaurants contributed by B | $0.5 million |
| Registrant A’s total assets as of December 31, 20X7 | $10 million |
| Significance                                 | 5%         |
**Example (continued)**

The asset test calculation is as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Book value of restaurants contributed by B</td>
<td>$0.8 million</td>
</tr>
<tr>
<td>Proportionate interest of B's restaurants acquired by A</td>
<td>50%</td>
</tr>
<tr>
<td>Proportionate interest acquired by A of book value of restaurants contributed by B</td>
<td>$0.4 million</td>
</tr>
<tr>
<td>Registrant A's total assets as of December 31, 20X7</td>
<td>$10 million</td>
</tr>
<tr>
<td>Significance</td>
<td>4%</td>
</tr>
</tbody>
</table>

The income test calculation is as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pretax income from continuing operations of restaurants contributed by B for the year ended December 31, 20X7</td>
<td>$0.9 million</td>
</tr>
<tr>
<td>Proportionate interest of B's restaurants acquired by A</td>
<td>50%</td>
</tr>
<tr>
<td>Proportionate interest acquired by A in pretax income from continuing operations of restaurants contributed by B</td>
<td>$0.45 million</td>
</tr>
<tr>
<td>Registrant A's pretax income from continuing operations for the year ended December 31, 20X7</td>
<td>$3 million</td>
</tr>
<tr>
<td>Significance</td>
<td>15%</td>
</tr>
</tbody>
</table>

Registrant A must also consider the SEC reporting requirements for the restaurants that were disposed (contributed to the joint venture). For further discussion, see Sections 1.10.3 and 1.10.4.

### 1.11 Age of Financial Statements

#### 1.11.1 SEC Reporting Considerations Regarding Age of Financial Statements for an Acquired or to Be Acquired Business — General

Q&A Regulation S-X: Rule 3-05(b)-2

When a registrant acquires, or it is probable that it will acquire, a business (acquiree), the financial statements of the acquiree may be required in SEC filings if the acquiree is significant. In such cases, the registrant must determine the specific annual and interim periods (i.e., the “age of financial statements”) for which acquiree financial statements are required for the filing.

Financial statements for a significant acquiree are included in Form 8-K and registration and proxy statements. This Q&A discusses age of financial statement considerations that apply to all such filings. Other considerations for registration and proxy statements are discussed in Sections 1.11.2 and 1.11.3. If the acquiree is not incorporated in the United States and does not conduct the majority of its operations there, see the Q&As in Section 1.12.

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167 Rule 3-05 requires presentation of financial statements for an acquired business or a business whose acquisition is “probable.” See Section 1.2.1 for additional information.

168 See Section 1.6.1 for a discussion of significance thresholds and financial statement requirements for a business acquisition or probable business acquisition for SEC reporting purposes.
Considerations Regarding Age of an Acquiree’s Financial Statements

The required age of financial statements for an acquiree is a function of:

- The following dates:
  - **Form 8-K** — The earlier of the date on which the initial Form 8-K is filed or the latest date by which it must be filed.\(^{169}\) (See paragraphs 2045.13 through 2045.16 of the FRM. Also, see the exception discussed in paragraph 2045.17 of the FRM and Section 1.11.2.)
  - **Registration statement** — The date a registration statement is filed and the date it is declared effective.
  - **Proxy statement** — The date a proxy statement is filed and the date it is mailed.\(^{170}\)

- The filing status of the **acquiree and the registrant**.
- The fiscal year-end of the **acquiree**.
- The date of the acquisition.

General Rule for Determining the Age of Financial Statements

To determine the age of financial statements of an **acquiree**, it is helpful to understand the general rules for determining the age of financial statements for the **registrant**. This is because **Rule 3-05**, which applies to acquirees, refers to the same rules that specify the age of financial statements for the registrant.

The general rule for determining the age of the registrant’s financial statements to include in a filing is that the latest balance sheet must be as of a date no more than 134 days (129 days if the company is an accelerated filer or a large accelerated filer) before the filing date, the effective date of the registration statement, or the mailing date of a proxy statement.\(^{171}\) An exception to the general rule allows additional time before audited financial statements for the most recently completed fiscal year are required (i.e., the financial statements for the fiscal year preceding the most recently completed fiscal year are still acceptable).\(^{172}\)

Rules for Determining the Age of Financial Statements for the Acquiree

Rule 3-05 is used to determine the number of periods required for an acquiree’s financial statements on the basis of the acquiree’s significance. (See Section 1.6.1 for additional information.) The following Regulation S-X rules specify, for the registrant, the required age of

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\(^{169}\) The Form 8-K rules allow a registrant four business days after the consummation of a significant business acquisition to file the initial Form 8-K. A registrant, other than a shell company, may file the significant acquiree’s required financial statements and pro forma financial information in the initial Form 8-K or by amendment no later than 71 calendar days after the initial Form 8-K was required to be filed (paragraph 2050.1 of the FRM refers to this as the grace period). Therefore, a registrant may have more than 75 calendar days to file the amended Form 8-K. There is no requirement to “update” the financial statements between the filing of the initial Form 8-K and the Form 8-K/A because financial statement requirements are determined on the basis of the earlier of the (1) filing date of the initial Form 8-K or (2) latest date on which the initial Form 8-K must be filed. The Division of Corporation Finance generally will not waive Form 8-K requirements. If the required financial information is not timely filed, the registrant may be deemed deficient, which may affect the registrant’s Form S-3 eligibility and securities offerings. See paragraph 2050.1 of the FRM for more information.

\(^{170}\) As noted in paragraph 1220.8 of the FRM, when a registrant files a combined registration statement and proxy statement, the “age of financial statements is based on the effective date of the Form S-4 [registration statement] and not the mailing of the proxy statement, unless mailing is delayed beyond the time necessary to prepare the material for mailing (generally no more than a few days after effectiveness of the S-4).”

\(^{171}\) See paragraph 1220.1 of the FRM.

\(^{172}\) See paragraph 1220.3 of the FRM.
financial statements and the number of periods required in a registration statement or proxy statement:

- **Rule 3-01** requires a balance sheet as of a date less than 135 days (130 days if the company is an accelerated filer or a large accelerated filer) from the filing date, the expected effective date of a registration statement, or the mailing date of a proxy statement. A balance sheet for the comparative prior period is not required under Rule 3-01, but balance sheets for more than one year may be required by Rule 3-05, depending on the significance of the acquiree. In addition, **Rule 3-01(c)** notes that if certain conditions are met, a registrant is provided a special accommodation regarding when third-quarter interim financial statements must be updated with audited annual financial statements. See **Section 1.11.2** for more information about the Rule 3-01(c) special accommodation.

- **Rule 3-02** requires statements of income and cash flows for annual periods and the interim period between (1) the latest year-end balance sheet provided in the filing and (2) the interim balance sheet required under Rule 3-01. It also requires statements of income and cash flows for the comparative prior interim period.

- Regulation S-X, Rule 3-04, requires that the changes in each caption of stockholders’ equity and noncontrolling interests be presented in a note or separate statement for each period for which an income statement must be filed. In addition, Article 10 of Regulation S-X states, in part, that for interim financial statements, registrants must “[p]rovide the information required by Rule 3-04 for the current and comparative year-to-date periods, with subtotals for each interim period.” Equity information provided should include activity as of and from the latest fiscal year-end to the date of the appropriate interim period preceding the acquisition.

- **Rule 3-12** specifies the age of financial statements as of the effective date of a registration statement or as of the mailing date of a proxy statement. **Rule 3-12(b)** requires that a registration statement or proxy statement filed more than 45 days but less than 90 days (i.e., between 46 and 89 days) after an **acquiree’s** fiscal year-end include audited financial statements for the most recently completed fiscal year unless the **registrant** meets the conditions in Rule 3-01(c). See **Section 1.11.2** for additional information on age of financial statements in a registration or proxy statement. Although Rules 3-01 and 3-12 use different wording, the requirements for the age of financial statements are the same under both.

When evaluating the age of financial statements of an acquiree in a Form 8-K, **paragraph 2045.14** of the FRM provides an exception to the general rule that the latest balance sheet must be as of a date no more than 134 days before the initial Form 8-K filing date. Specifically, an acquiree’s audited financial statements for the most recently completed fiscal year are not required unless the initial Form 8-K reporting the acquisition is filed 90 days or more after the acquiree’s fiscal year-end.

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173 The number of days depends on the **acquiree’s** filing status as follows: 90 days for nonaccelerated filers and nonregistrants, 75 days for accelerated filers, and 60 days for large accelerated filers. See **paragraph 2045.5** of the FRM.

174 See footnote 173 above.

175 Updated financial statements of a legal target may be required earlier in certain transactions. For example, in a reverse merger of a public shell company and a private operating company in which the registrant ceases to be a shell company (i.e., a SPAC transaction), a Form 8-K must be filed no later than four business days after the consummation of the acquisition and include, for the private operating company, all content required by a Form 10 initial registration statement. See **Section 1.4.1** of this Roadmap and **paragraph 12220.1** of the FRM for additional guidance on the reporting for these transactions.
Example

- Registrant A acquires Company B, a nonaccelerated filer, on Monday, August 11, 20X8. Both A and B have December 31 year-ends.
- Company B is 30 percent significant to A. Registrant A must provide B's audited financial statements covering one year and any required interim periods.
- In accordance with the Form 8-K rules, A has four business days after the acquisition of B is consummated to file the initial Form 8-K reporting the acquisition. Accordingly, A must file the initial Form 8-K on or before Friday, August 15, 20X8.

Registrant A must provide B's audited financial statements for the year ended December 31, 20X7, since the initial Form 8-K is filed more than 90 days after B's fiscal year-end (its most recently completed fiscal year). The appropriate interim-period financial statements for B that are required in the Form 8-K depend on the date the initial Form 8-K is filed (or is required to be filed):

- If A files the initial Form 8-K on or before August 12, 20X8 (i.e., before the 135th day after the end of the first quarter, which is August 13, 20X8), B's interim financial statements for the three months ended March 31, 20X8 and 20X7, would also be required. However, if A were to subsequently file a registration statement, it may need to provide financial statements as of a more recent date. See Section 1.11.2 for more information about the age of financial statement requirements in registration statements.
- If A files the initial Form 8-K after August 12, 20X8 (i.e., 135 days or more after the end of the first quarter), B's interim financial statements for the six months ended June 30 in both 20X8 and 20X7 would also be required.

Registrant A has 71 calendar days to amend the initial Form 8-K to provide B's required financial statements and pro forma financial information. Even though A must file the amended Form 8-K, including B's financial statements, on or before October 24, 20X8, the required interim periods to be provided for B vary depending on the filing date of the initial Form 8-K.

How Previously Filed Financial Statements Affect Form 8-K Requirements

A registrant may have previously filed a registration or proxy statement that included separate historical financial statements of a probable acquisition (as required under Rule 3-05) or that included target financial statements provided in a Form S-4 (see Section 1.4.1 for more information). Upon consummation of the business combination, the registrant must comply with the applicable Form 8-K filing requirement to report the significant business combination. General Instruction B.3 of Form 8-K ("Instruction B.3") indicates that the same information as required by Form 8-K (i.e., financial statements of an acquiree and pro forma financial statements) may not be required in a Form 8-K if they are deemed substantially the same as the information the registrant had previously filed in a registration or proxy statement. Instruction B.3 states, in part:

If the registrant previously has reported substantially the same information as required by this form, the registrant need not make an additional report of the information on this form.

Paragraph 2045.16 of the FRM gives the following examples of when previously filed financial statements of the acquiree are not “substantially the same”:

- the previously filed acquiree financial statements would not satisfy the required age of financial statements in the Form 8-K because operating results for two or more interim quarters are omitted. . . .
- the previously filed acquiree financial statements are interim financial statements and the Form 8-K requires filing of updated audited annual financial statements of the acquiree. . . .
- the previously filed acquiree financial statements were prepared in accordance with the requirements for smaller reporting companies in S-X Article 8, but the registrant is not a smaller reporting company.
A registrant should also separately evaluate whether the pro forma financial statements are required to be provided in the Form 8-K or whether they are deemed substantially the same as the pro forma financial statements the registrant previously filed. While there is no separate SEC interpretive guidance on this determination, we believe registrants should evaluate the “substantially the same” criteria as it relates to the pro forma financial statements consistent with the criteria for evaluating the acquiree financial statements. When performing this evaluation, registrants should also consider whether there was a material change in the underlying assumptions used (e.g., a material change to the consideration transferred) such that the previously filed pro forma financial statements would be materially incorrect or potentially misleading in light of the change.

Although Instruction B.3 may permit a registrant to exclude the acquiree's financial statements and pro forma financial information from the Form 8-K, the registrant may choose to file that information in a Form 8-K to allow the information to be incorporated by reference into an effective shelf registration statement or new registration statement.

**Other Considerations**

**Weekends and Holidays**

Paragraph 1220.12 of the FRM states, “If the last day of the period after which financial statements must be updated (for example, the 134th day after the first, second, or third quarter-end, or the 89th day following a fiscal year-end for a non-accelerated filer) falls on a Saturday, Sunday or holiday, the filing may be made on the next following business day without updating the financial statements [Regulation C, Rule 417].”

**Registrant and Acquiree Have Different Year-Ends**

If a registrant and its acquiree have different year-ends, the age of the acquiree's financial statements to include in a filing is determined by the acquiree's fiscal year-end, not the registrant's.

If an acquiree's year-end precedes the registrant's year-end, a registrant may have to provide audited year-end financial statements for the acquiree that are more recent than those required for the registrant. Paragraph 2045.6 of the FRM states, in part:

> If the registrant believes providing updated audited financial statements would impose an unreasonable burden under the circumstances, the registrant may request CF-OCA to consider granting relief if the acquiree's financial statements are updated on an unaudited basis through either the registrant's latest balance sheet date or the acquiree's year-end. Requests for relief should be made in writing prior to filing.

Registrants should also consider consultation with their auditors and SEC legal counsel.

**Acquiree's Financial Statements Provided in Reliance on Rule 3-06**

Rule 3-06 permits a registrant to provide audited financial statements for an acquiree for a period of nine to twelve months to satisfy the one-year requirement under Rule 3-05 (see Section 1.6.1 for additional information about Rule 3-06). The SEC staff indicated at the March 2013 CAQ SEC Regulations Committee meeting with the SEC staff that that the reporting requirements of an acquiree that presents financial statements for a nine-month period in reliance on Rule 3-06 are not affected by the annual reporting requirements of Rule 3-12. For example, suppose that a calendar-year-end acquiree that is significant at the 25 percent level presents audited financial statements for the nine months ended September 30, 20X7, in
Chapter 1 — Business Combinations

satisfaction of its one-year requirement under Rule 3-05. If the registrant needs to update the financial statements in a subsequent filing under Rule 3-12, it would have to present audited financial statements for the year ended December 31, 20X7. A registrant would not be able to satisfy this requirement by presenting the acquiree’s financial statements for the unaudited three months.

1.11.2 SEC Reporting Considerations Regarding Age of Financial Statements for an Acquired or to Be Acquired Business in Registration or Proxy Statements

Q&A Regulation S-X: Rule 3-12-1

When a registrant acquires, or it is probable that it will acquire, a business (acquiree), the financial statements of the acquiree may be required in a registration statement or proxy statement. For business acquisitions or probable business acquisitions (other than of the target in a Form S-4), a registrant is required to file the financial statements of a significant business acquisition that was consummated 75 or more days before a registration statement is filed or declared effective. In addition, Rule 3-05(b)(4)(i) requires financial statements for a probable acquisition or a recently consummated acquisition that exceeds the 50 percent significance level in registration statements. If the acquisition does not exceed the 50 percent significance level, a registrant may exclude financial statements of (1) a business acquisition consummated less than 75 days before the registration statement is filed or declared effective or (2) a probable business acquisition. See Section 1.4.1 for guidance on filings requiring an acquiree's financial statements in registration and proxy statements as well as a discussion of the Form S-4 requirements.

If acquiree financial statements are required in the filing, the registrant must determine the specific annual and interim periods (i.e., the “age of financial statements”) for which they are required. (See Section 1.11.1 for general considerations about the age of financial statements in Forms 8-K and registration and proxy statements.)

**Question**

What considerations about age of financial statements for a significant acquiree are specific to registration or proxy statements?

**Answer**

*Year-End Financial Statements*

**Filing Date, Effective Date, or Mailing Date Is on or Before the 45th Day After an Acquiree’s Fiscal Year-End**

If the filing date, the effective date of a registration statement, or the mailing date of a proxy statement (hereafter “the filing or effective/mailing date”) is on or before the 45th day after an acquiree’s fiscal year-end, Rules 3-01 and 3-12 permit the registrant to include audited financial statements of a significant acquiree for the fiscal year preceding the acquiree’s most recently completed fiscal year. In such cases, the registrant must also provide interim financial statements.

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176 As discussed in Section 1.11.1, a registrant must file the initial Form 8-K within four business days after the consummation of a significant business acquisition. A registrant, other than a shell company, may file the required financial statements of the significant acquiree and pro forma financial information in the initial Form 8-K or by amendment no later than 71 calendar days after the initial Form 8-K was required to be filed. The period between when a registrant files the initial Form 8-K reporting a significant business acquisition and the date the acquiree's financial statements must be filed is referred to as the “grace period.” See also the note to paragraph 2050.1 of the FRM.
financial information for the significant acquiree through the third quarter of the most recently completed fiscal year. (See Interim Financial Statements below for more information.)

However, as stated in paragraph 1220.3 of the FRM, “[i]f the audited financial statements for the most recently completed fiscal year are available or become available before the effective date of the registration statement or the mailing date of a proxy statement,” the registrant should update the filing to include them. In addition, paragraph 1220.3 of the FRM also states that “[a]vailability is determined on a facts and circumstances basis. Financial statements become available no later than when they are ‘issued’ based on the staff guidance in Topic D-86, contained in Appendix D to the EITF Abstracts [ASC 855-10-S99-2]."

Filing or Effective/Mailing Date Is More Than 45 Days but Less Than 90 Days After an Acquiree’s Fiscal Year-End

If the filing or effective/mailing date is more than 45 days but less than 90 days (i.e., between 46 and 89 days) after an acquiree’s fiscal year-end, Rules 3-01 and 3-12 generally require that the registrant include the financial statements of a significant acquiree for the most recently completed fiscal year. A special accommodation, however, allows additional time before audited financial statements of the acquiree for the most recently completed fiscal year are required (i.e., the financial statements for the fiscal year preceding the most recently completed fiscal year are still acceptable). To be eligible for the special accommodation, the registrant must meet all of the following conditions in Rule 3-01(c):

1. The registrant files annual, quarterly and other reports pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 and all reports due have been filed;
2. For the most recent fiscal year for which audited financial statements are not yet available the registrant reasonably and in good faith expects to report income attributable to the registrant, after taxes; and
3. For at least one of the two fiscal years immediately preceding the most recent fiscal year the registrant reported income attributable to the registrant, after taxes.

If the registrant meets all of those conditions, the registrant has additional time before audited financial statements of the acquiree for the most recently completed fiscal year are required, unless those financial statements are available (as described above). The amount of additional time depends on the acquiree’s filing status:

- **Nonaccelerated filers and nonregistrants** — up to and including the 89th day after year-end.
- **Accelerated filers** — up to and including the 74th day after year-end.
- **Large accelerated filers** — up to and including the 59th day after year-end.

If the registrant meets all of the conditions in Rule 3-01(c) and provides a significant acquiree’s audited year-end financial statements for the year preceding the most recently completed fiscal year, the registrant must also provide interim financial information for the significant acquiree through the third quarter of the most recently completed fiscal year and the corresponding period in the prior fiscal year. (See Interim Financial Statements below for more information.)

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177 The number of days depends on the acquiree’s filing status as follows: 90 days for nonaccelerated filers and nonregistrants, 75 days for accelerated filers, and 60 days for large accelerated filers.
Example 1

- Registrant A acquires Company B, a nonaccelerated filer, on February 20, 20X9. Both A and B have December 31 year-ends.
- Company B is 55 percent significant to A. Registrant A must provide B’s audited financial statements covering three years and any required interim periods.
- Registrant A files its initial Form 8-K announcing the acquisition on February 26, 20X9 (i.e., within four business days). The initial Form 8-K does not contain B’s financial statements. Registrant A has an additional 71 calendar days before it is required to file B’s financial statements and pro forma financial information in a Form 8K/A.\(^{178}\)
- Registrant A files a registration statement on March 1, 20X9 (i.e., more than 45 days after year-end), which A expects will become effective March 25, 20X9 (i.e., less than 90 days after year-end).

Even though A is not required to file B’s financial statements in a Form 8-K/A until May 8, 20X9 (i.e., 71 calendar days after the initial Form 8-K was required to be filed), A must provide B’s financial statements in the registration statement because B is greater than 50 percent significant to A (i.e., A cannot exclude B’s financial statements pursuant to the 75-day rule). If A meets the conditions in Rule 3-01(c), A is allowed to provide B’s financial statements for the three fiscal years ended December 31, 20X7 (the year preceding the most recently completed fiscal year), and B’s interim financial statements for the nine months ended September 30, 20X8 and 20X7, unless the financial statements for the most recently completed fiscal year are available. If A does not meet the conditions in Rule 3-01(c), A would have to provide B’s financial statements for the three fiscal years ended December 31, 20X8, and no interim financial statements would be required.

Filing or Effective/Mailing Date Is 90 Days or More After an Acquiree’s Fiscal Year-End

If the filing or effective/mailing date is 90 days\(^ {79}\) or more after the acquiree’s fiscal year-end, Rules 3-01 and 3-12 require a registrant to include the significant acquiree’s audited financial statements for the most recently completed fiscal year. In addition, if the acquiree’s fiscal year-end balance sheet is as of a date 135 days or more (130 days if the acquiree is a company that is an accelerated filer or a large accelerated filer) from the filing or effective/mailing date, the registrant must provide interim financial information for the significant acquiree. See Interim Financial Statements below for more information.

Pro Forma Financial Information

In addition to filing the financial statements of a significant acquiree, a registrant must include pro forma financial information in accordance with Rule 11-01. See Chapter 3 for further discussion.

Interim Financial Statements

If the audited year-end balance sheet is as of a date no more than 134 days (129 days if the acquiree is a reporting company that is an accelerated filer or a large accelerated filer) from the filing or effective/mailing date, a significant acquiree’s interim financial information is not required. If, however, the year-end balance sheet is as of a date 135 days or more from the filing or effective/mailing date, a registrant must provide a significant acquiree’s financial information as of an interim date that is no more than 134 days from the filing or effective/mailing date in addition to the audited year-end financial statements.

\(^{178}\) See footnote 176 and Section 1.11.1 on determining the specific annual and interim acquiree financial statements that are required in the Form 8-K/A.

\(^{179}\) See footnote 178 above.
Regulation S-X provides guidance for determining which interim financial statements to include in a filing. The rules are the same for the registrant and for a significant acquiree. See Rules for Determining the Age of Financial Statements for the Acquiree in Section 1.11.1 for more information.

“Updating” Requirements for Registration Statements and Proxy Statements

The financial statements in a registration or proxy statement must meet the requirements for age of financial statements both on the filing date and on the effective date of a registration statement or the mailing date of a proxy statement. The effective or mailing date may be weeks or months after the initial filing date. Because of that delay, financial statements that met the requirements for age of financial statements as of the initial filing date may no longer meet those requirements when a subsequent amendment is filed or immediately before the effective or mailing date. Such financial statements are sometimes described as “stale.” Rule 3-12 requires that in such cases, the financial statements included in the initial filing be “updated” (by the registrant providing financial statements as of a more recent date) before (1) an amendment is filed, (2) a registration statement is declared effective, or (3) a proxy statement is mailed.

Typically, the registrant updates the financial statements in a registration statement or proxy statement by amending the filing to include financial statements that meet the requirements for age of financial statements.

### Example 2

- Registrant A acquired Company B, a nonregistrant, on April 2, 20X9. Both A and B have December 31 year-ends.
- Company B is 30 percent significant to A. Registrant A must provide B’s audited financial statements covering one year and any required interim periods.
- Registrant A files the initial Form 8-K announcing the acquisition on April 8, 20X9 (i.e., within four business days). The initial Form 8-K did not include B’s financial statements. Registrant A has an additional 71 calendar days before it is required to file B’s financial statements and pro forma financial information in a Form 8-K/A.
- Registrant A filed the Form 8-K/A on April 30, 20X9, and included B’s financial statements for the year ended December 31, 20X8.¹⁸⁰
- Registrant A filed a registration statement on May 5, 20X9. Even though B is less than 50 percent significant to A and the acquisition occurred less than 75 days from the date A filed the registration statement, A included (or incorporated by reference) in the registration statement B’s financial statements for the year ended December 31, 20X8 (the same financial statements included in the Form 8-K/A), because they were previously filed by the registrant. Registrant A was not required to include (or incorporate by reference) B’s financial statements for the three months ended March 31, 20X9 and 20X8, because the registration statement was filed less than 135 days from B’s year-end.
- Registrant A filed an amendment to the initial registration statement on June 25, 20X9. Since the registration statement was filed more than 135 days from B’s year-end, A is required to update B’s financial statements in the registration statement to include the three months ended March 31, 20X9 and 20X8.

Disclosure of Significant Events When an Acquisition Occurs Within a Quarter

Paragraph 2045.9 of the FRM states that “financial statements of an acquired business need not be updated if the omitted period is less than a complete quarter. However, disclosure of

¹⁸⁰ See footnote 178.
significant events occurring during the omitted interim period may be necessary.” Paragraph 2045.9 of the FRM also provides the following example:

If an acquisition subject to S-X 3-05 or S-X 8-04 (i.e., not a predecessor) was consummated on September 29, the staff generally would not require that the financial statements of the acquired entity be updated past June 30. However, disclosure of significant events occurring during the omitted interim period may be necessary.

However, if the acquisition occurred on October 1, updating the interim financial statements through September 30 would be required in certain circumstances, depending on when the registration or proxy statement is filed, mailed, or declared effective. This is because the period that would otherwise be omitted (July 1–September 30) represents a complete quarter.

See Section 1.11.3 for some exceptions that require a registrant to provide updated financial statements through the acquisition date.

Age-of-Financial-Statement Requirements if an Acquiree’s Financial Statements Are Incorporated by Reference From a Form 8-K

If a registrant files a Form 8-K that includes an acquiree’s financial statements, the registration statement or proxy statement may incorporate those financial statements in the Form 8-K by reference. Sometimes, however, an acquiree’s financial statements in a Form 8-K are not as current as those required for the registration statement or proxy statement. Therefore, the registrant must update the acquiree’s financial statements in the Form 8-K to meet the requirements for age of financial statements for registration statements and proxy statements.

Exception to the Age-of-Financial-Statement Requirements When the Effective Date of a Registration Statement Occurs Within the “Grace Period”

Paragraph 2045.17 of the FRM provides an exception to the rule that the date the Form 8-K must be filed must be used to determine the age of acquiree financial statements when the effective date of a registration statement occurs within the grace period.\(^\text{181}\) It states, in part:

When the effective date of a registration statement occurs subsequent to filing the initial Form 8-K reporting the acquisition, but within the 71 calendar day extension [grace period] to file the acquired business financial statements and the acquired business is significant in excess of 20% but less than 50%, the age of the acquired business financial statements presented in the Form 8-K should be based on the effective date of the registration statement, not the Form 8-K filing date. This is true even though S-X 3-05(b)(4) and S-X 8-04(c)(4) permit a registrant to exclude from its registration statement financial statements of an acquired business if its significance does not exceed 50% and the registration statement is declared effective (or immediately effective for well-known seasoned issuers) not more than 74 days after consummation of the acquisition. S-X 3-05(b)(4) and S-X 8-04(c)(4) were not intended to change the age of financial statements, simply the timing of filing them.

Age-of-Financial-Statement Requirements for Well-Known Seasoned Issuers

Paragraph 2045.4 of the FRM states, in part, that “[a]utomatic shelf registration statements and post-effective amendments of well-known seasoned issuers become effective immediately upon filing [Regulation C, Rule 462(e) and (f)]. Immediate effectiveness does not exempt a well-known seasoned issuer from the requirement to comply with the age of financial statement requirements with respect to itself and all completed and probable acquirees at the time of effectiveness.”

\(^{181}\) See footnote 176.
Age-of-Financial-Statement Requirements for Prospectus Supplements to Registration Statements That Currently Are Effective

Securities Offerings After the Grace Period

For currently effective registration statements (e.g., an existing Form S-3) upon which a registrant wishes to draw down or issue securities, a registrant may use a prospectus supplement. Paragraph 2045.3 of the FRM indicates that “a domestic registrant has no specific obligation to update the prospectus except as stipulated by 1933 Act Section 10(a)(3) and S-K 512(a) with respect to any fundamental change. . . . It is the responsibility of management [in consultation with SEC legal counsel] to determine what constitutes a fundamental change.”

If a registrant consummated a significant acquisition and provided the appropriate financial statements in a Form 8-K (or amendment thereto) within the grace period, there is generally no specific obligation to update the age of the financial statements of the acquiree (unless there is a fundamental change as discussed above).

Securities Offerings During the Grace Period

If a consummated acquisition exceeds 50 percent significance and a registrant has not yet provided financial statements because it is within the 71 calendar-day extension (i.e., grace period), offerings pursuant to effective registration statements cannot proceed. See Section 1.4.1. While paragraph 2045.3 of the FRM is not clear, we believe the age of the required financial statements should be the same as what would be required in the Form 8-K/A. That is, the age of the required financial statements should be determined using the earlier of the (1) filing date of the initial Form 8-K reporting consummation of the acquisition or (2) the fourth business day after consummation of the acquisition.

Securities Offerings and Probable Acquisitions

If an acquisition is probable, financial statements may be required if the probable acquisition would represent a fundamental change. See Section 1.4.1. While the guidance in paragraph 2045.3 of the FRM is not clear, if the financial statements of the probable acquisition are required, we believe the age of the required financial statements should be evaluated as of the date of the prospectus supplement.

All post-effective amendments are considered “new filing” and are subject to the guidance in “Updating” Requirements for Registration Statements and Proxy Statements above.

Noncompliance With the Requirements for Age of Financial Statements

Section 1210 of the FRM states that “[t]he staff may not make a review decision or commence a review of a filing unless the registrant’s financial statements comply with the rules for age of financial statements and audit at the date of filing.” We understand that the same consideration applies to all financial statements that are required in a registration or proxy statement.

See footnote 176.
1.11.3 Circumstances in Which a Registrant Would Be Required to Provide Financial Statements Updated Through the Acquisition Date for an Acquired Business

Q&A Regulation S-X: Rule 3-05(b)(1)-4

The general rule for determining the age of financial statements to include in a filing is that the latest balance sheet must be as of a date no more than 134 days (129 days for a company that is an accelerated filer or a large accelerated filer) before the filing date, the effective date of the registration statement, or the mailing date of a proxy statement.183

**Question**

Are there circumstances in which a registrant would be required to provide financial statements through the acquisition date of an acquired business (acquiree) in a registration statement or proxy statement?

**Answer**

Yes. The following discussion outlines such circumstances.

*An Acquiree is Deemed a Predecessor*

An acquired business may be deemed the registrant’s predecessor (rather than the acquiree). For example, the acquiree may be deemed the predecessor if the registrant is a new entity formed to acquire an existing business and the registrant had no other operations before the acquisition. The new entity is sometimes called a “NewCo” or the “accounting acquirer” in a reverse acquisition. Paragraph 2045.8 of the FRM states:

If the acquired business is a “predecessor” of the registrant (See Section 1170 [of the FRM]), and the acquisition date is on or before the registrant’s most recent audited balance sheet required to be included in the registration statement, then interim financial statements of the predecessor should be presented and audited through the date of acquisition. If the acquired business is a “predecessor” of the registrant and the acquisition date is after the registrant’s most recent audited balance sheet required to be included in the registration statement, then interim financial statements of the predecessor should be presented for the same periods as if the predecessor were the registrant and may be unaudited. In this circumstance, the predecessor period between registrant’s latest balance sheet and acquisition date would need to be audited in registrant’s next Form 10-K.

The distinction between a predecessor and an acquiree is important to make because the requirements for providing financial statements are different for each. Rule 3-05 does not apply to the acquisition of a business that is a predecessor to the registrant. Instead, the requirements in Rules 3-01 and 3-02 must be considered.

*Significance Determined Under SAB Topic 1.J (SAB 80)*

In some IPOs, strict application of Rule 3-05 may result in the registrant providing financial statements for acquirees that may not be significant at the time the initial registration statement is filed. To address this issue, a registrant preparing an initial registration statement may be able to use SAB 80 to measure significance. SAB 80 requires that in certain circumstances, the financial statements of the acquiree be for continuous periods with no gap or overlap between preacquisition and postacquisition periods. (See Section 1.13.4 for additional information.)184

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183 See Section 1.11.1 and paragraph 1220.1 of the FRM for additional information.
184 Also see Section 2070 of the FRM.
Postacquisition Period

In an initial registration statement, a registrant must provide its (1) audited balance sheets as of the end of the two most recent fiscal years and (2) audited statements of operations, comprehensive income, cash flows, and changes in stockholders’ equity for the three most recent fiscal years. The registrant must also provide financial statements for significant acquirees for the number of periods determined in accordance with Rule 3-05(b). The registrant's audited consolidated financial statements will include the postacquisition results of all acquired businesses during the three-year period. The requirement to provide separate audited financial statements of significant acquirees may be partially or fully satisfied by inclusion of their postacquisition results in the registrant's consolidated financial statements. If postacquisition results do not fully satisfy the financial statement requirement, the registrant can provide separate preacquisition audited financial statements of the acquiree through the acquisition date. When the postacquisition and preacquisition results are combined to satisfy a registrant's requirements under Rule 3-05, the audited periods must be consecutive, with no gap or overlap in audited information between the preacquisition and postacquisition results. See Section 1.13.2.3 for additional information.

1.12 Acquisition or Probable Acquisition of a Foreign Business

1.12.1 SEC Reporting Considerations for an Acquired or to Be Acquired Foreign Acquiree

Q&A Regulation S-X: Rule 3-05(c)-3

Businesses that are not incorporated in the United States, and that do not conduct the majority of their operations there, often do not prepare their financial statements in accordance with U.S. GAAP. When a registrant acquires, or it is probable that it will acquire, a business, it may be required to provide financial statements under Rule 3-05.

The term "foreign acquiree" refers to an acquired or to be acquired business that is not incorporated in the United States. Certain foreign acquirees may also meet the definition of a foreign business.

The guidance in this Q&A applies to foreign acquirees that do not meet the definition of a foreign business. For entities that do meet such definition, Section 1.12.2 discusses potential relief that may be available.

Before applying guidance on foreign acquirees, readers must understand the general application of the SEC reporting requirements for business combinations under Rule 3-05. See Section 1.1 for additional information.

Question

Are there special SEC reporting considerations for situations in which a domestic registrant acquires a significant foreign acquiree?

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185 If the registrant is an operating company EGC, it may present two years of financial statements for its IPO of common equity securities (see paragraph 10220.5 of the FRM).
Answer

Yes. A registrant that acquires a significant foreign acquiree may be required to provide the foreign acquiree's financial statements under Rule 3-05. Special considerations regarding the foreign acquiree's financial statements include, but are not limited to, the following:

- Significance tests under Rule 3-05 must use U.S. GAAP results.
- Audits must be performed in accordance with U.S. GAAS.
- Presentation in accordance with U.S. GAAP is not required.
- A reconciliation to U.S. GAAP is required.
- Financial statement periods to be presented are the same as those for a domestic acquiree.

Use of U.S. GAAP in the Performance of the Significance Tests Under Rule 3-05

The significance tests for a foreign acquiree are the same as those for a domestic acquiree. Further, a registrant must use the U.S. GAAP results of the foreign acquiree when performing the significance tests.

If the foreign acquiree uses IFRS Standards or another comprehensive type of GAAP (i.e., local GAAP) when presenting its financial statements, it must reconcile the financial statements to U.S. GAAP when performing the significance tests. The foreign acquiree's financial statements, including the reconciliation to U.S. GAAP, are not required to be audited for the significance tests to be performed. However, if the foreign acquiree exceeds the 20 percent significance level, the required annual financial statements must be audited.

Type of GAAS to Use for Audits of the Financial Statements of a Foreign Acquiree

In accordance with Instruction 2 of Form 20-F, Item 8.A.2, the required financial statements of a foreign acquiree must be audited in accordance with U.S. GAAS. The SEC will not accept audit reports that indicate the audit was performed in accordance with home-country GAAS or international auditing standards. However, the SEC will not object if the audit report refers to compliance with both U.S. GAAS and home-country GAAS.

Type of GAAP to Use for Financial Statements of a Foreign Acquiree

A foreign acquiree may prepare financial statements in accordance with U.S. GAAP, IFRS Standards, or local GAAP. If a foreign acquiree uses IFRS Standards or local GAAP when presenting its financial statements, this fact must be disclosed in the accountant’s report and, as discussed below, a reconciliation to U.S. GAAP must be provided.

Reconciliation to U.S. GAAP Is Required

If a foreign acquiree uses local GAAP or IFRS Standards when preparing its financial statements, a reconciliation to U.S. GAAP prepared in accordance with Form 20-F, Item 18, is required. Item 18 requires not only a quantified reconciliation of net income and shareholder’s equity but also all disclosures required by U.S. GAAP and Regulation S-X.

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186 In addition to filing the financial statements of a foreign acquiree, a registrant may be required to provide pro forma financial information pursuant to Rule 11-01. See the Q&As in Chapter 3 for further discussion.
187 See footnote 50.
188 See paragraphs 6410.6(d) and 6410.9 of the FRM.
Any required interim financial statements of the foreign acquiree must also include a reconciliation to U.S. GAAP. For additional guidance on the U.S. GAAP reconciliation requirements, see Form 20-F, Item 18, and Sections 6400 and 6500 of the FRM.

Only entities that meet the definition of a foreign business are eligible to omit the U.S. GAAP reconciliation when the financial statements are prepared in accordance with IFRS Standards. Foreign acquiree financial statements prepared in accordance with IFRS Standards should include a U.S. GAAP reconciliation prepared in accordance with Item 18.

A foreign acquiree may meet the definition of a foreign private issuer in Rule 240.3b-4(c) of the Code of Federal Regulations if such acquiree were to file an initial registration statement with the SEC. A registrant is advised to consult with its SEC counsel in determining whether an acquiree meets the definition of a foreign private issuer. At the September 2011 CAQ SEC Regulations Committee joint meeting with the SEC staff, the staff stated that if the foreign acquiree would qualify as a foreign private issuer if it were to file a registration statement, registrants may wish to obtain, from the CF-OCA, preclearance regarding their use of financial statements prepared in accordance with IFRS Standards without a reconciliation to U.S. GAAP to comply with Rule 3-05. In determining whether a waiver is appropriate, the SEC staff will consider whether preparing a U.S. GAAP reconciliation presents significant issues for the foreign acquiree, whether the foreign acquiree prepares U.S. GAAP financial information for any other purpose, and the reasons why the foreign acquiree does not qualify as a “foreign business.” In such circumstances, registrants should also consider consultation with their auditors and SEC legal counsel.

**Financial Statement Periods to Be Presented**

The financial statement periods to be presented for a foreign acquiree are the same as those for a domestic acquiree, including interim periods. To determine the appropriate annual and interim financial statement periods that are required for a foreign acquiree, see Rule 3-12 and Sections 1.11.1 through 1.11.3, which pertain solely to acquirees that do not meet the definition of a foreign business. For entities that do meet the definition of a foreign business, see Section 1.12.3 for additional guidance.

A registrant may acquire a business that would meet the definition of a foreign private issuer in Rule 240.3b-4(c) of the Code of Federal Regulations if the entity were to file an initial registration statement with the SEC. A registrant is advised to consult with its SEC counsel in determining whether a foreign acquiree meets the definition of a foreign business or foreign private issuer.

As discussed in Section 1.12.3, acquired foreign businesses are also subject to age of financial statement requirements that differ from those that apply to domestic acquirees. A foreign acquiree may meet the definition of a foreign private issuer. If so, the registrant may wish to apply the age of financial statement requirements that are applicable to a foreign business to satisfy the financial statement requirements of Rule 3-05. At the 2018 AICPA Conference on Current SEC and PCAOB Developments, the SEC staff indicated that such a request would require preclearance with the CF-OCA through the waiver process.

**Financial Statements Prepared for Rule 3-05 Purposes Under IFRS Standards**

As outlined by the SEC staff at the 2019 AICPA Conference on Current SEC and PCAOB Developments, there are certain circumstances in which the periods required for financial statements provided in accordance with SEC regulations, including Rule 3-05, may not be

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189 SEC Final Rule Release No. 33-8879 allows only foreign private issuers (registrants) and foreign businesses that are preparing financial statements to comply with Rules 3-05, 3-09, 3-10, and 3-16 to use IFRS Standards without a reconciliation to U.S. GAAP.
considered a full set of financial statements as defined under IFRS Standards. While the SEC rarely accepts qualified opinions, it would accept an audit opinion that is qualified solely with respect to the following:

- The omission of the comparative period required by IFRS Standards when only one year of financial statements is required in accordance with Rule 3-05.
- The omission of the balance sheet as of the date of adoption required by IFRS 1 when the financial statements provided reflect the first-time adoption of IFRS Standards and such adoption date precedes the periods required under Rule 3-05.

Further, as described in Section 1.5.1, the SEC sometimes accepts a statement of assets acquired and liabilities assumed and revenue and direct expenses (i.e., abbreviated financial information) in lieu of full financial statements. Abbreviated financial information would generally not be considered a full set of financial statements under IFRS Standards. As discussed at the CAQ International Practices Task Force joint meeting with the SEC staff on May 21, 2019, when appropriate and consistent with existing SEC guidance on abbreviated statements (e.g., the guidance in Section 2065 of the FRM), such abbreviated financial information may be prepared in accordance with IFRS Standards provided that certain additional disclosures are provided. As indicated in the minutes of the joint meeting, the abbreviated financial information would include:

- A statement describing the regulatory purpose of such financial statements
- A statement that they are not intended to represent a complete presentation of the financial position or results of operations and the related footnotes of the acquired business
- A statement that the financial statements are prepared on a basis that is “in accordance with IFRS as issued by the IASB relevant to such financial statements”
- A description of the basis for determining the assets and liabilities to be included
- An explanation as to why a complete set of financial statements is not available and cannot be prepared
- A statement that the financial statements have been derived from the accounting records of the entity from which it was acquired and
- Additional disclosures necessary to understanding the abbreviated financial statements

Further, the relevant audit report for such a set of abbreviated financial information should include:

- A statement describing the regulatory purpose of such financial statements
- A statement that they are not intended to represent a complete presentation of the financial position or results of operations of the acquired business
- A statement that the financial statements are prepared on a basis that is “in accordance with IFRS as issued by the IASB relevant to such financial statements”
1.12.2 SEC Reporting Considerations for an Acquired or to Be Acquired Foreign Business

Q&A Regulation S-X: Rule 3-05(c)-1

Businesses that are not incorporated in the United States, and that do not conduct the majority of their operations there, often do not prepare their financial statements in accordance with U.S. GAAP. When a registrant acquires, or it is probable that it will acquire, such a business, it may be required to provide financial statements under Rule 3-05. However, relief from certain reporting requirements may be available for a foreign business acquiree (i.e., an acquired or to be acquired business that meets the definition of a foreign business). A registrant is advised to consult with its SEC counsel in determining whether an acquiree meets this definition.

Relief from certain reporting requirements may also be available to businesses that are incorporated outside the United States but do not meet the definition of a foreign business. See Section 1.12.1 for additional information.

Before applying guidance on foreign business acquirees, readers must understand the general application of the SEC reporting requirements for business combinations under Rule 3-05. See Section 1.1 for additional information.

Question

Are there special SEC reporting considerations for situations in which a domestic registrant acquires a significant foreign business acquiree?

Answer

Yes. When a registrant acquires a significant foreign business acquiree, it may be required to provide the foreign business acquiree’s financial statements under Rule 3-05.190 Special considerations regarding the foreign business acquiree’s financial statements include, but are not limited to, the following:

- Significance tests under Rule 3-05 must use U.S. GAAP results.
- Audits must be performed in accordance with U.S. GAAS.
- Presentation in accordance with U.S. GAAP is not required.
- A reconciliation to U.S. GAAP may be required.
- The financial statement periods to be presented are different.

Use of U.S. GAAP in the Performance of the Significance Tests Under Rule 3-05

The significance tests for a foreign business acquiree are the same as those for a domestic acquiree. Further, a registrant must use the U.S. GAAP results of the foreign business acquiree when performing the significance tests.191

If the foreign business uses IFRS Standards or another comprehensive type of GAAP (i.e., local GAAP) when presenting its financial statements, it must reconcile the financial statements to U.S. GAAP when performing the significance tests. The foreign business’s financial statements, including the reconciliation to U.S. GAAP, are not required to be audited for the significance tests.

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190 In addition to filing the financial statements of a foreign acquiree, a registrant may be required to provide pro forma financial information pursuant to Rule 11-01. See the Q&As in Chapter 3 for further discussion.
191 See footnote 50.
to be performed. However, if the foreign business exceeds the 20 percent significance level, the required annual financial statements must be audited.

**Type of GAAS to Use for Audits of the Financial Statements of a Foreign Business Acquiree**

In accordance with Instruction 2 of Form 20-F, Item 8.A.2, the required financial statements of a foreign business acquiree must be audited in accordance with U.S. GAAS. The SEC will not accept audit reports that indicate the audit was performed in accordance with home-country GAAS or international auditing standards. However, the SEC will not object if the audit report refers to compliance with both U.S. GAAS and home-country GAAS.

**Type of GAAP to Use for Financial Statements of a Foreign Business Acquiree**

Rule 3-05(c) and paragraph 2055.1 of the FRM permit a foreign business acquiree’s financial statements to be presented in accordance with the requirements of Form 20-F. Under Form 20-F, a foreign business acquiree may prepare financial statements in accordance with U.S. GAAP, IFRS Standards, or local GAAP.

If a foreign business acquiree uses local GAAP when presenting its financial statements, this fact must be disclosed in the accountant’s report. In addition, a description of material differences between the basis of accounting applied and U.S. GAAP must be disclosed.

**Reconciliation to U.S. GAAP May Be Required**

If a foreign business acquiree uses local GAAP when preparing its financial statements and any of the conditions under Rule 1-02(w) exceed 30 percent, a reconciliation to U.S. GAAP, prepared in accordance with Form 20-F, Item 17, is required. Item 17 does not require the disclosures required by U.S. GAAP or Regulation S-X.

If the foreign business acquiree’s annual financial statements are required to include a reconciliation to U.S. GAAP, any required interim financial statements of the foreign acquiree must also include a reconciliation to U.S. GAAP. For additional guidance on the U.S. GAAP reconciliation requirements, see Items 17 and 18 of Form 20-F and Sections 6400 and 6500 of the FRM.

If the foreign business acquiree’s financial statements are prepared under IFRS Standards, no U.S. GAAP reconciliation is required.

**Financial Statement Periods to Be Presented**

To determine the appropriate annual and interim financial statement periods that are required for a foreign business acquiree, see Section 1.12.3.

If the results of the significance tests exceed 50 percent, three years of financial statements are generally required. However, the following accommodations are available for a foreign business acquiree that is required to file financial statements with the SEC for the first time:

- A foreign business acquiree’s financial statements that are prepared under U.S. GAAP, rather than home-country GAAP, may be presented for only the two most recent fiscal...
years and the appropriate interim periods; financial statements for the third year are not required.¹⁹⁴

- A foreign business acquiree’s financial statements that are prepared under local GAAP, and have not previously been required in an SEC filing, are only required to be reconciled to U.S. GAAP for the two most recent fiscal years and the appropriate interim periods; audited financial statements for the third year still are required.¹⁹⁵

- If a foreign business acquiree adopts IFRS Standards within two years of being acquired by a domestic registrant, the registrant is only required to file financial statements for the foreign business acquiree for the two most recent fiscal years and the appropriate interim periods, even when the significance test results indicate that three years of financial statements are required.¹⁹⁶

1.12.3 Financial Statement Periods to Be Presented for an Acquired or to Be Acquired Foreign Business

Q&A Regulation S-X: Rule 3-05(c)-2

When a registrant acquires, or it is probable that it will acquire, a business that meets the definition of a foreign business (i.e., a “foreign business acquiree”), the financial statements of the foreign business acquiree may be required in accordance with Rule 3-05.¹⁹⁷ For special considerations regarding a foreign business acquiree’s financial statements, see Section 1.12.2.

The guidance in this Q&A does not apply to acquired businesses that are incorporated outside the United States and do not meet the definition of a foreign business. See Section 1.12.1 for information about such businesses.

Question

For what annual and interim periods is a registrant required to present the financial statements of a foreign business acquiree?

Answer

Generally, a registrant must provide financial statements of an acquired or to be acquired business for the periods specified in Rules 3-01 and 3-02. Paragraph 6220.4 of the FRM clarifies that for a foreign business, the registrant may look to Form 20-F, Item 8 (specifically Items 8.A.4 and 8.A.5), to determine the appropriate annual and interim financial statement periods required.

When determining the appropriate financial statement periods to present for a foreign business acquiree under Rule 3-05, registrants should be mindful that the financial statements must comply with the age of financial statement requirements when a Form 8-K, a registration statement, or a proxy statement is filed and when a registration statement is declared effective or when a proxy statement is mailed.

The guidance below discusses how to determine the appropriate annual and interim periods required to be presented for a foreign business acquiree.

¹⁹⁴ See paragraph 6410.8 of the FRM.
¹⁹⁵ See paragraph 6410.7 of the FRM.
¹⁹⁷ See Section 1.6.1 for further discussion.
**Annual Financial Statement Requirements**

*Form 20-F, Item 8.A.4,* addresses the age requirement for annual financial statements, stating that the “last year of audited financial statements may not be older than 15 months at the time of the offering or listing.”

Generally, financial statements for the most recently completed fiscal year of a foreign business acquiree are not required if the filing date of a Form 8-K, the filing or effective date of a registration statement, or the filing or mailing date of a proxy statement is within three months after the foreign business acquiree's year-end. Filings that are made, mailed, or declared effective three months or more after a foreign business acquiree's year-end must include audited financial statements for the most recently completed fiscal year.

The following examples illustrate how to determine the appropriate annual financial statement periods required for a foreign business acquiree:

**Example 1**

- Registrant A acquires Company B, a foreign business, on January 7, 20X8.
- Both A and B have a December 31 fiscal year-end.
- Company B is 35 percent significant to A.
- Registrant A files its initial Form 8-K on January 11, 20X8, announcing the consummation of the acquisition of B (within four business days of the consummation of the acquisition).

In its Form 8-K/A, which is due within 71 calendar days of the initial Form 8-K filing, A is required to file audited financial statements of B as of and for the year ended December 31, 20X6, since on the date the initial Form 8-K was filed, the audited financial statements were not more than 15 months old. See below for how to determine the appropriate interim periods required for a foreign business acquiree.

**Example 2**

- Assume the same facts as in Example 1, except that A acquired B on March 31, 20X8.
- Registrant A filed its initial Form 8-K on April 4, 20X8, announcing the consummation of the acquisition of B (within four business days of the consummation of the acquisition).

In its Form 8-K/A, which is due within 71 calendar days of the initial Form 8-K filing, A must file audited financial statements of B as of and for the year ended December 31, 20X7, since on the date the initial Form 8-K was filed, the December 31, 20X6, financial statements were more than 15 months old and were required to be updated. See below for how to determine the appropriate interim periods required for a foreign business acquiree.
Example 3

Assume the same facts as in Example 1, except that A files a registration statement with the SEC on April 5, 20X8.

The financial statement requirements in the Form 8-K/A reporting the acquisition are the same as those in Example 1. However, for the registration statement, A must include audited financial statements of B as of and for the year ended December 31, 20X7, since on the date of the registration statement, the December 31, 20X6, financial statements were more than 15 months old and were required to be updated. See below to determine the interim periods required for a foreign business acquiree.

If the registration statement was initially filed on or before March 31, 20X8, financial statements of B as of and for the year ended December 31, 20X7, would not be required. However, if the registration statement was not declared effective before April 1, 20X8, financial statements of B as of and for the year ended December 31, 20X7, would be required in an amendment to the registration statement before the SEC will declare the registration statement effective.

Interim Financial Statement Requirements

Form 20-F, Item 8.A.5, addresses the requirement for interim financial statements. It states, “If the document is dated more than nine months after the end of the last audited financial year, it should contain consolidated interim financial statements . . . covering at least the first six months of the financial year.”

Paragraph 6220.7 of the FRM further clarifies how the requirements of Item 8.A.5 apply to a foreign business acquiree. If the foreign business acquiree is acquired, or it is probable that it will be acquired, within the first six months of its fiscal year, interim financial statements are generally not required. If the foreign business acquiree is acquired, or it is probable that it will be acquired, in the second half of its fiscal year, interim financial statements are required if the Form 8-K, registration statement, or proxy statement is filed more than nine months after the foreign business acquiree’s fiscal year-end. If interim financial statements are required for the foreign business acquiree, they generally must be for a period of at least six months.

Item 8.A.5 further states, “If, at the date of the document, the company has published interim financial information that covers a more current period than those otherwise required by this standard, the more current interim financial information must be included in the document.” Publication of interim financial information is deemed to include any financial information that contains, at a minimum, revenue and income information. See paragraph 6220.6 of the FRM for information about guidance on determining whether additional interim financial information is required.

The examples below illustrate how to determine the appropriate interim financial statement periods required for a foreign business acquiree.
Example 4

- Registrant A acquires Company B, a foreign business, on June 29, 20X7.
- Both A and B have a December 31 fiscal year-end.
- Company B does not prepare interim financial statements under its home country's reporting requirements.
- Company B is 35 percent significant to A.
- Registrant A filed its initial Form 8-K on July 5, 20X7, announcing the consummation of the acquisition of B (within four business days of the consummation of the acquisition).

In its Form 8-K/A, which is due within 71 calendar days of the initial Form 8-K filing, A must file financial statements of B as of and for the year ended December 31, 20X6. No interim financial statements of B are required because the acquisition occurred within the first six months of B's fiscal year.

Example 5

- Registrant A acquires Company B on July 1, 20X7.
- Both A and B have a December 31 fiscal year-end.
- Company B does not prepare interim financial statements under its home country's reporting requirements.
- Company B is 28 percent significant to A.
- Registrant A filed its initial Form 8-K on July 5, 20X7, announcing the consummation of the acquisition of B (within four business days of the consummation of the acquisition).

In its Form 8-K/A, which is due within 71 calendar days of the initial Form 8-K filing, A must file financial statements of B as of and for the year ended December 31, 20X6. Since the initial Form 8-K was filed not more than nine months after B's fiscal year-end, no interim financial statements of B are required in the Form 8-K/A.

Example 6

Assume the same facts as in Example 5, except that A files a registration statement with the SEC on October 5, 20X7.

The financial statement requirements in the Form 8-K/A reporting the acquisition are the same as those in Example 5. However, for the registration statement, A must also include interim financial statements of B as of and for the six months ended June 30, 20X7, and the comparative interim period ended June 30, 20X6. This is because the acquisition closed after June 30, 20X7, and the audited financial statements of B are more than nine months old at the time the registration statement is filed.

Paragraph 6220.7(b) of the FRM further states that there is no requirement to update the interim financial statements of a foreign business acquiree if the omitted period is less than six months. The example below demonstrates this point.
Example 7

- Registrant A acquires Company B on December 17, 20X7.
- Both A and B have a December 31 fiscal year-end.
- Company B does not prepare quarterly financial statements under its home country's reporting requirements.
- Company B is 25 percent significant to A.
- Registrant A filed its initial Form 8-K on December 21, 20X7, announcing the consummation of the acquisition of B (within four business days of the consummation of the acquisition).
- Registrant A files a registration statement on April 1, 20X8.

In its Form 8-K/A, which is due within 71 calendar days of the initial Form 8-K filing, A included audited financial statements of B as of and for the year ended December 31, 20X6, and interim financial statements as of June 30, 20X7, and for the six months ended June 30, 20X7, and 20X6. Company B's interim financial statements were included because the acquisition closed after June 30, 20X7, and the audited financial statements of B were more than nine months old at the time the initial Form 8-K was filed.

Although the latest balance sheet that B included in the 8-K/A is more than nine months old when A files the registration statement in April 20X8, such interim financial statements need not be updated because the omitted period (July 1–December 16) is less than six months.

Pro Forma Financial Statement Considerations

In addition to filing the financial statements of a foreign business acquiree, a registrant may be required to provide pro forma financial information pursuant to Rule 11-01.198 The pro forma financial statement periods to be presented are based on the requirements for the registrant under Rules 3-01 and 3-02. When a registrant prepares its pro forma financial statements in accordance with Article 11, the registrant may require interim financial information of the foreign business acquiree that is more recent than what was required to be separately presented under Rule 3-05. For guidance on the age of pro forma financial information in cross-border business combinations, refer to paragraph 6220.8 of the FRM.

1.13 IPO/Initial Registration Statements

1.13.1 Introduction to SEC Reporting Considerations for Acquired or to Be Acquired Businesses in an Initial Registration Statement

This introduction outlines the SEC reporting considerations for acquired or to be acquired businesses (acquirees) that may be included in a company's initial registration statement, which is also referred to as an IPO. Before applying the interpretations in this section, readers must understand the general application of the SEC reporting requirements for business combinations under Rule 3-05. (See Section 1.1 for additional information.) Registrants should review the Q&As in this section as well as the guidance in Deloitte’s A Roadmap to Initial Public Offerings, which provide additional accounting and reporting considerations related to IPOs. In addition, registrants should consider consulting with their auditors and SEC legal counsel to determine the appropriate SEC reporting requirements.

The reporting considerations in this section are unique to situations in which financial statements of acquirees are required in an initial registration statement. Since a company filing an initial registration statement has not previously filed any financial statements with the public, it may find certain parts of Rule 3-05 for acquired businesses difficult to apply. For example, a new registrant would not have

198 See the Q&As in Chapter 3.
been required to file a Form 8-K with audited financial statements of a significant acquiree when the acquisition was consummated.

A registrant may, in some cases, be able to omit the financial statements of a significant acquired or to be acquired business from a draft registration statement. A draft registration statement may be voluntarily submitted to the SEC staff for nonpublic review before the registrant’s filings for certain registration statements, including IPOs.199

**Testing Acquirees for Significance**

When preparing an initial registration statement, a registrant must test for significance of all acquirees during the (1) periods for which its historical financial statements are presented and (2) subsequent interim period through the date the initial registration statement is filed and declared effective by the SEC. For example, a registrant should generally evaluate significance for all acquirees during the latest three fiscal years and any subsequent interim period through the date the initial registration statement is filed and declared effective by the SEC; however, if a registrant qualifies as an EGC or SRC, it may be able to test acquirees for significance in fewer periods.

In an IPO of common equity securities, an EGC or SRC is only required to present two fiscal years of its historical financial statements and any required subsequent interim periods. Therefore, an EGC filing an IPO for common equity securities only needs to test acquirees for the same period, i.e., the latest two fiscal years and any subsequent interim period through the date the initial registration statement is filed and declared effective by the SEC.

**Financial Statements Used to Measure Significance**

The most recent preacquisition annual financial statements of an acquiree are compared with a registrant’s most recent preacquisition audited annual consolidated financial statements. These financial statements are used even when the acquisition has occurred a number of years before the initial registration statement is filed or declared effective by the SEC.

A company submitting a draft registration statement has the ability to calculate the significance of an acquisition occurring after year-end by using its most recent fiscal-year-end financial statements, even if such financial statements are not included in the draft registration statement, provided that such audited financial statements will be included at the time of the first public filing. Registrants are encouraged to alert the office of the assistant director of the Division of Corporation Finance if they plan to calculate significance in this manner.200

**Using Postacquisition Results or a Combination of Preacquisition and Postacquisition Results to Satisfy the Audited Financial Statement Requirements for a Significant Acquired Business**

In an initial registration statement, the registrant’s audited financial statements may include postacquisition results of an acquired business. In certain circumstances, the SEC staff may allow audited postacquisition results to satisfy the financial statement requirements for the acquired business. If a registrant relies on a combination of preacquisition and postacquisition results, the acquiree's preacquisition and postacquisition audited periods must be consecutive, with no gap or overlap in audited information.

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199 For more information, see Sections 1.4.1 and 1.6.1 as well as Deloitte’s August 24, 2017, Heads Up (originally published July 11, 2017).
200 For more information about draft registration statements and the nonpublic review of them, see Deloitte’s August 24, 2017, Heads Up (originally published July 11, 2017). In addition, see Section 1.13.2.2 of this Roadmap as well as the highlights of the March 2018 CAQ SEC Regulations Committee joint meeting with the SEC staff.
**Omitting the Balance Sheet of a Significant Acquired Business**

When the annual audited balance sheet of the registrant is for a date after the acquisition was consummated, a separate balance sheet of the acquiree is not required.

**Put-Together Transactions**

A put-together transaction is a transaction in which more than two previously unrelated businesses combine concurrently with an IPO. This normally occurs when a shell company is formed and purchases two or more businesses or an operating entity acquires several entities at once. The proceeds from the IPO are generally used to fund the acquisitions.

When a put-together transaction occurs concurrently with an initial registration statement, a registrant must determine which acquirees must be tested for significance. A registrant must first determine which entity in the put-together transaction is the acquiring entity. It must then measure the significance of all other businesses in the put-together transaction against that of the acquiring entity. Since these acquired businesses are considered related under Rule 3-05(a)(3), a registrant must aggregate all the other businesses (besides the acquiring entity) in the put-together transaction and measure their significance against that of the acquiring entity as if they were a single acquisition.

After a put-together transaction occurs concurrently with an IPO, the financial statements used to measure significance for a new or probable acquisition depend on whether significance is measured before or after the registrant’s first Form 10-K has been filed.

**Applying SAB Topic 1.J (SAB 80)**

Rule 3-05 establishes the financial statement requirements for acquired or to be acquired businesses (acquirees) that must be included in a registration statement. In some IPOs, strict application of Rule 3-05 can result in a registrant’s providing financial statements for acquirees that may not be significant at the time the registration statement is filed as a result of a registrant’s recent substantial growth in assets and earnings. To address this issue, a registrant preparing an initial registration statement may determine significance of its acquirees in accordance with SAB Topic 1.J (SAB 80). According to paragraph 2070.1 of the FRM, “SAB 80 is an interpretation of [Rule 3-05] for application in initial registration statements of first-time registrants that have been built by the aggregation of discrete businesses that remain substantially intact after acquisition.” If a registrant chooses to use SAB 80 to measure significance of its acquirees in its initial registration statement, it must use SAB 80 for all such acquisitions.

SAB 80 may or may not reduce the financial statement requirements under Rule 3-05 for the registrant’s acquirees. Registrants should identify the financial statement requirements under both Rule 3-05 and SAB 80 to determine the best alternative to follow. Careful planning is needed when additional acquisitions and probable acquisitions occur during the registration process because the calculations must be continually updated through the effective date of the registration statement, and financial statement requirements may change. Registrants that contemplate using SAB 80 should consider consultation with their auditors and SEC legal counsel.

**Waiver Requests Under Rule 3-13**

When preparing an initial registrant statement, a registrant may wish to seek relief from complying with the various reporting requirements under Regulation S-X, particularly those that are burdensome but

201 For guidance on identifying the acquiring entity, see ASC 805-10-25-5.
202 See Section 1.7.1.
may not be material given the total mix of information available to investors. For example, in an IPO, the registrant’s historical financial statements presented may exhibit significant growth, but certain acquisitions may not be material to the registrant’s current operations, such as a business acquired in the earliest year. If a registrant believes that as a result of the literal application of the significance test it would be required to provide, for an acquired business under Rule 3-05, financial statements that are not material, not relevant, or not meaningful to investors, the registrant is encouraged to submit — to the CF-OCA — a Rule 3-13 waiver request to omit or substitute such financial statements. For more information, see Rule 3-13 Waivers and Other Requests.

1.13.2 SEC Reporting Considerations for Acquired or to Be Acquired Businesses in an Initial Registration Statement

1.13.2.1 Testing Acquired or to Be Acquired Businesses for Significance in the Preparation of an Initial Registration Statement

Q&A Regulation S-X: Rule 3-05-IPO-1

Question

Which acquired or to be acquired businesses (acquirees) must be tested for significance when a company (registrant) is preparing an initial registration statement?

Answer

When preparing an initial registration statement, a registrant must test for significance of all acquirees during the (1) periods for which its historical financial statements are presented and (2) subsequent interim period through the date the initial registration statement is filed and declared effective by the SEC. Therefore, a registrant should generally evaluate significance for all acquirees during the latest three fiscal years and any subsequent interim period through the date the initial registration statement is filed and declared effective by the SEC. As explained further below, if a registrant qualifies as an EGC or SRC, the registrant may be able to test acquirees for significance in fewer periods.

In an IPO of common equity securities (equity IPO), an EGC is only required to present two fiscal years of its historical financial statements and any required subsequent interim periods. Therefore, in its equity IPO, an EGC only needs to test acquirees for the same period, (i.e., its latest two fiscal years and any subsequent interim period through the date the initial registration statement is filed and declared effective by the SEC). This guidance applies even if an EGC voluntarily presents its financial statements for three years. See paragraph 10220.5 of the FRM for further discussion. Similarly, a company that qualifies as an SRC is also only required to present two fiscal years of its historical financial statements and any required subsequent interim periods. Such a company would also only need to test acquirees for the same period.

For more information, see Sections 1.2.1, 1.3.1, and 1.13.2.2.

203 The two-year accommodation is only available for IPOs of common equity securities by an EGC. The presentation of three years of financial statements is required for EGCs in their IPO of debt securities (debt IPO) and in an Exchange Act registration statement (e.g., Form 10). See paragraph 10220.1 of the FRM for additional information.
1.13.2.2 Financial Statements Used to Measure Significance of an Acquired or to Be Acquired Business in the Preparation of an Initial Registration Statement

Q&A Regulation S-X: Rule 3-05-IPO-2

Question

What financial statements should be used to measure significance of an acquired or to be acquired business (acquiree) when a company (registrant) is preparing an initial registration statement?

Answer

The most recent preacquisition annual financial statements of an acquiree are compared with a registrant’s most recent preacquisition audited\(^{204}\) annual consolidated financial statements. These financial statements are used even when the acquisition occurred a number of years before the initial registration statement is filed or declared effective by the SEC. For more information, see Sections 1.6.3.1 and 1.6.3.3.

Example

- Registrant A acquired Company B on December 18, 20X6; Company C on June 15, 20X7; and Company D on May 31, 20X8.
- Registrant A and Companies B, C, and D have December 31 fiscal year-ends.
- Registrant A plans to file an initial registration statement on October 15, 20X8.

Significance should be calculated for each acquisition as follows:

- Compare B’s financial statements for the fiscal year ended December 31, 20X5, with A’s audited financial statements for the fiscal year ended December 31, 20X5.
- Compare C’s financial statements for the fiscal year ended December 31, 20X6, with A’s audited financial statements for the fiscal year ended December 31, 20X6.
- Compare D’s financial statements for the fiscal year ended December 31, 20X7, with A’s audited financial statements for the fiscal year ended December 31, 20X7.

If a company is submitting a draft registration statement,\(^{205}\) it may calculate the significance of an acquisition occurring after year-end by using its most recent fiscal-year-end financial statements, even if such financial statements are not included in the draft registration statement, provided that such audited financial statements will be included at the time of the first public filing. Registrants are encouraged to alert the office of the assistant director of the Division of Corporation Finance if they plan to calculate significance in this manner. See the highlights of the March 2018 CAQ SEC Regulations Committee joint meeting with the SEC staff for further information.

\(^{204}\) In circumstances in which a registrant acquires an entity during the earliest year presented in the filing (e.g., in the example above, during the fiscal year ended December 31, 20X5), it may be appropriate for the registrant to use its unaudited financial statements for the significance tests if such financial statements are not otherwise included in the registration statement.

\(^{205}\) For information about draft registration statements, see Section 1.4.1 and Deloitte’s August 24, 2017, Heads Up (originally published July 11, 2017).
Using Postacquisition Results to Satisfy the Audited Financial Statement Requirements for a Significant Acquired Business

Q&A Regulation S-X: Rule 3-05-IPO-3

Question

In an initial registration statement, the registrant’s audited financial statements may include postacquisition results of a significant acquired business (acquiree). May a registrant use postacquisition results to satisfy its audited financial statement requirements for an acquiree?

Answer

Yes. In accordance with paragraph 2030.4 of the FRM, the SEC staff allows audited postacquisition results to satisfy the audited financial statement requirements for an acquiree. The financial statement requirements for the acquiree may be partly or fully satisfied as a result of postacquisition audited results. If the financial statement requirements for the acquiree are only partly met as a result of the postacquisition audited results, a registrant may rely on a combination of preacquisition and postacquisition results. In this situation, the acquiree’s preacquisition and postacquisition audited periods must be consecutive, with no gap or overlap in audited information. That is, the acquiree’s audited preacquisition results must be presented through the acquisition date.

Example 1

Use of Audited Postacquisition Results

- Registrant A acquired Company B on November 5, 20X6.
- Both A and B have December 31 fiscal year-ends.
- The highest level of significance for the acquisition of B was 25 percent.
- Registrant A plans to file an initial registration statement in March 20X8 that will include A’s audited financial statements as of December 31, 20X6 and 20X7, and for the three years ended December 31, 20X7. Registrant A is required to include B’s audited financial statements for one year in the initial registration statement. For more information, see Section 1.6.1.

Since A’s audited financial statements in the initial registration statement include postacquisition results of B from November 5, 20X6, through December 31, 20X7, the postacquisition audited results fully satisfy B’s one-year financial statement requirement. Accordingly, no additional financial statements are required for B.

206 As a matter of SEC staff policy, financial statements of an acquiree covering 9, 21, or 33 consecutive months may satisfy the financial statement requirements for one, two, or three years, respectively, when the financial statements are required under Rule 3-05.
Example 2

Use of a Combination of Preacquisition and Postacquisition Results

- Registrant A acquired Company B on February 20, 20X6.
- Registrant A and B have December 31 fiscal year-ends.
- The highest level of significance for the acquisition of B was 55 percent.
- Registrant A plans to file an initial registration statement in March 20X8 that will include A's audited financial statements as of December 31, 20X6 and 20X7, and for the three years ended December 31, 20X7. Registrant A will also include B's audited financial statements for three\(^\text{207}\) years in the initial registration statement. For more information, see Section 1.6.1.

Registrant A has two alternatives for presenting B's financial statements:

Alternative 1

Registrant A may include B's audited financial statements for the three years ended December 31, 20X5.\(^\text{208}\) Under this alternative, the audited financial statements required for B may predate the financial statements required for A.

Alternative 2

Because A's audited financial statements included in the initial registration statement include postacquisition results of B from February 20, 20X6, through December 31, 20X7, A may rely on a combination of preacquisition and postacquisition results to meet the three-year financial statement requirement for B.

Accordingly, A may include B's \textbf{audited} financial statements for the year ended December 31, 20X5, and for the period from January 1, 20X6, to February 19, 20X6. When these audited financial statements are combined with the postacquisition results included in A's audited financial statements from February 20, 20X6, through December 31, 20X7, the three-year audited financial statement requirement is satisfied.\(^\text{209}\)

1.13.2.4 Omitting a Balance Sheet for a Significant Business Acquisition

Q&A Regulation S-X: Rule 3-05-IPO-4

\textbf{Question}

Can a registrant omit a balance sheet for a significant acquired business (acquiree)?

\textbf{Answer}

Maybe. As indicated in \textit{paragraph 2030.2} of the FRM, a separate balance sheet of the acquiree is not required if the registrant's audited annual balance sheet is for a date after the acquisition was consummated. The registrant is still required to provide the acquiree's statements of operations, comprehensive income, and cash flows for the appropriate periods.

\(^{207}\) See footnote 205.

\(^{208}\) Company B's balance sheet is not required because the most recent audited balance sheet required for A is for December 31, 20X7, after the acquisition was consummated. For more information, see Section 1.13.2.4.

\(^{209}\) See footnote 205.
Example

- Registrant A acquired Company B on December 15, 20X7.
- Both A and B have December 31 fiscal year-ends.
- The highest level of significance for the acquisition of B was 35 percent.
- Registrant A plans to file an initial registration statement in March 20X8 that will include A's audited financial statements as of December 31, 20X6 and 20X7, and for the three years ended December 31, 20X7.

Registrant A is required to include B's audited financial statements for one210 year in the initial registration statement. See Section 1.6.1.

Because A's audited balance sheet as of December 31, 20X7, is for a date after the acquisition was consummated, B's balance sheet may be omitted. Registrant A is still required to provide B's statements of operations, comprehensive income, and cash flows for the appropriate periods.

1.13.3 Put-Together Transaction That Is Concurrent With an IPO

1.13.3.1 Performing Tests of Significance for an Acquired or to Be Acquired Business in a Put-Together Transaction That Is Concurrent With an IPO

Q&A Regulation S-X: Rule 3-05-IPO-5

A put-together transaction is a transaction in which more than two previously unrelated businesses211 combine concurrently with an IPO. This normally occurs when a shell company is formed and purchases two or more businesses or an operating entity acquires several businesses at once. The proceeds from the IPO are generally used to fund the acquisitions.

Question

Which acquired or to be acquired businesses (acquirees) must be tested for significance in a put-together transaction that is concurrent with an IPO?

Answer

In determining which acquirees must be tested for significance in a put-together transaction, a registrant must first identify the acquiring entity.212 Note that the acquiring entity may be different from the registrant.213

Once the acquiring entity is identified, the significance of all other businesses in the put-together transaction must be measured against that of the acquiring entity. Paragraph 2025.12 of the FRM indicates that these acquired businesses are considered related under Rule 3-05(a)(3). Accordingly, a registrant must aggregate all the other businesses (besides the acquiring entity) in the put-together transaction and measure their significance against that of the acquiring entity as if they were a single acquisition.

For more information on SEC reporting considerations for acquisitions of acquired or to be acquired related businesses, see Section 1.7.1.

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210 See footnote 205.
211 As further explained in this Q&A's answer, previously unrelated businesses may be deemed related under Rule 3-05(a)(3)(ii) and (iii).
212 See ASC 805-10-25 for additional guidance.
213 Registrants must also determine whether one or more of the entities in the put-together transaction are the registrant's predecessor since the predecessor may be different from the registrant. Registrants should consider consultation with their auditors and SEC legal counsel in these unique circumstances.
Note also that SAB Topic 1.J (SAB 80) may not be applied to put-together transactions. See Section 1.13.3.2 below.

<table>
<thead>
<tr>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registrant A is a shell company.</td>
</tr>
<tr>
<td>Registrant A plans to file an initial registration statement in March 20X8.</td>
</tr>
<tr>
<td>Proceeds will be used to acquire Company B, Company C, and Company D in a put-together transaction.</td>
</tr>
<tr>
<td>Company B is deemed the acquiring entity in the transaction.</td>
</tr>
<tr>
<td>Registrant A and Companies B, C, and D have December 31 fiscal year-ends.</td>
</tr>
</tbody>
</table>

Because the acquisition of each business is contingent on a single common event (the IPO), A, C, and D are related businesses and must be aggregated. Significance must be measured against that of B, the acquiring entity.

1.13.3.2 Financial Statements Used to Measure Significance of a Business Acquisition or Probable Business Acquisition After a Put-Together Transaction That Is Concurrent With an IPO

Q&A Regulation S-X: Rule 3-05-IPO-6

A put-together transaction is a transaction in which more than two previously unrelated businesses combine concurrently with an IPO. This normally occurs when a shell company is formed and purchases two or more businesses or an operating entity acquires several entities at once. The proceeds from the IPO are generally used to fund the acquisitions.

Question

What financial statements should be used to measure significance of an acquired or to be acquired business (acquiree) after a put-together transaction has occurred concurrently with an IPO?

Answer

See the table below, which is adapted from paragraph 2025.13 of the FRM.

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214 As further explained in Section 1.13.3.1, previously unrelated businesses may be deemed related under Rule 3-05(a)(3)(ii) and (iii).
New acquisition takes place after an IPO but before the filing of the registrant’s first Form 10-K

Measure significance against the audited financial statements of the acquiring entity\(^{215}\) for the most recent fiscal year that was included in the IPO registration statement.

New acquisition takes place after the filing of the registrant’s first Form 10-K

Measure significance against the audited financial statements of the registrant for the most recent fiscal year in the Form 10-K.

In some cases, such as when the IPO occurs close to the registrant’s year-end, the registrant’s financial statements presented in the Form 10-K may only include operations for a very short period of time. Upon written request, and depending on the proximity of the put-together transaction to the balance sheet date, the SEC staff will consider whether modifications to the financial statement requirements under Rule 3-05 is appropriate.\(^{216}\)

### 1.13.4 Applying SAB Topic 1.J (SAB 80)

#### Q&A Regulation S-X: Rule 3-05-IPO-7

Rule 3-05 establishes the financial statement requirements for acquired or to be acquired businesses (acquirees). Rule 1-02(w) describes three tests of significance a registrant must perform and notes that the test that results in the highest significance level is used to determine which financial statement periods of the acquiree must be presented.\(^{217}\) However, in some IPOs, strict application of Rule 3-05 may result in a registrant providing financial statements for acquirees that may not be significant at the time the registration statement is filed as a result of the registrant’s recent substantial growth in assets and earnings. To address this issue, a registrant preparing an initial registration statement may determine significance of its acquirees in accordance with SAB Topic 1.J (SAB 80).

**Question**

What is SAB 80 and how is it different from Rule 3-05?

**Answer**

Paragraph 2070.1 of the FRM states that “SAB 80 is an interpretation of [Rule 3-05] for application in initial registration statements of first-time registrants that have been built by the aggregation of discrete businesses that remain substantially intact after acquisition.” SAB 80 notes:

It is the [SEC] staff’s view that [IPOs] involving businesses that have been built by the aggregation of discrete businesses that remain substantially intact after acquisition were not contemplated during the drafting of Rule 3-05 and that the significance of an acquired entity in such situations may be better measured in relation to the size of the registrant at the time the registration statement is filed, rather than its size at the time the acquisition was made. [Footnote omitted]

\(^{215}\) See ASC 805-10-25 for additional guidance.

\(^{216}\) Registrants should obtain preclearance from the SEC staff and should consider consulting with their auditors and SEC legal counsel.

\(^{217}\) See Section 1.6.1 for guidance on significance thresholds and financial statement requirements.
SAB 80 allows a registrant that has experienced substantial recent growth to use an alternative method to measure the significance of acquirees when it prepares an initial registration statement. To apply the provisions of SAB 80, a registrant must:

- Be a first-time registrant preparing for an initial registration statement.\(^{218}\)
- Have acquired or it is probable that it will acquire discrete businesses that remain substantially intact after the acquisition or probable acquisition.

SAB 80 may or may not reduce the financial statement requirements under Rule 3-05 for the registrant's acquirees. For example, as discussed below, the significance thresholds used to test the acquisitions are lower than those under Rule 3-05. Registrants should identify the financial statement requirements under both Rule 3-05 and SAB 80 to determine the best alternative to follow.

The following table compares the guidance under Rule 3-05 and SAB 80 in several key areas.

<table>
<thead>
<tr>
<th>Tests of significance(^{219})</th>
<th>Rule 3-05</th>
<th>SAB 80</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment test, asset test, and income test.</td>
<td>Investment test, asset test, and income test.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Financial statements used to measure significance(^{220})</th>
<th>Rule 3-05</th>
<th>SAB 80</th>
</tr>
</thead>
<tbody>
<tr>
<td>The most recent preacquisition annual financial statements of an acquiree are compared with a registrant's most recent preacquisition audited annual consolidated financial statements.</td>
<td>Pro forma financial statements for the registrant as of and for its most recently completed fiscal year should give effect to all acquisitions that were probable or completed as of the effective date of the registration statement. Pro forma financial statements for the acquiree as of and for its most recently completed fiscal year should give effect to any new cost basis arising from the purchase/acquisition accounting regardless of whether push-down accounting is applied. Refer to paragraphs 2070.4 through 2070.6 of the FRM for additional information on the financial statements used to measure significance under SAB 80.</td>
<td></td>
</tr>
</tbody>
</table>

\(^{218}\) In accordance with note 5 to paragraph 2070.2 of the FRM, the SEC staff “will not object to the application of SAB 80 by first time registrants in an initial registration statement not related to a public offering (e.g., a Form 10)” provided the registrant meets the other conditions of SAB 80. In addition, note 6 to paragraph 2070.2 of the FRM states that a subsidiary of a public parent “is not precluded from applying SAB 80 in its initial registration statement.” Further, paragraph 2025.12 of the FRM indicates that SAB 80 may not be applied to a put-together transaction. For more information on put-together transactions, see Sections 1.13.3.1 and 1.13.3.2.

\(^{219}\) See the Q&As in Sections 1.6.5, 1.6.6, and 1.6.7 for additional information.

\(^{220}\) See the Q&As in Sections 1.6.3 and 1.13.2.2 for additional information.
Significance or coverage thresholds

<table>
<thead>
<tr>
<th>Rule 3-05</th>
<th>SAB 80</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audited financial statements of an acquiree are required for one, two, or three years when the significance of an acquiree exceeds 20 percent, 40 percent, and 50 percent, respectively.</td>
<td></td>
</tr>
</tbody>
</table>

As stated in paragraph 2070.7 of the FRM, SAB 80 is intended to ensure that the registration statement includes:

- “at least 33 months of audited financial statements of at least 60% of the constituent businesses that will comprise the registrant on an ongoing basis,
- at least 21 months of audited financial statements of at least 80% of the constituent businesses that will comprise the registrant on an ongoing basis,
- at least 9 months of audited financial statements of at least 90% of the constituent businesses that will comprise the registrant on an ongoing basis.”

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221 See Section 1.6.1 for guidance on significance thresholds and financial statement requirements.

222 SAB 80 incorporates the concept in Rule 3-06 that a registrant may use one period of 9 to 12 months to satisfy a requirement to provide annual financial statements. Thus for SAB 80 purposes, financial statements will be required for any of the following: (1) at least 33 months (equivalent of three years under Rule 3-06), (2) at least 21 months (equivalent of two years under Rule 3-06), or (3) at least 9 to 12 months (equivalent of one year under Rule 3-06). See paragraph 2070.11 of the FRM for a discussion of the significance thresholds used to evaluate the financial statement requirements under SAB 80.
(Table continued)

<table>
<thead>
<tr>
<th>Rule 3-05</th>
<th>SAB 80</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit requirement for interim financial statements of an acquiree</td>
<td>Interim financial statements of an acquiree are generally not required to be audited.</td>
</tr>
<tr>
<td>Types of acquisitions</td>
<td>Applies to all acquired or to be acquired businesses.</td>
</tr>
<tr>
<td>Probable business acquisitions</td>
<td>If a probable business acquisition does not exceed the 50 percent significance level (on the basis of any of the three tests), financial statements of that business may be excluded.</td>
</tr>
</tbody>
</table>

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223 See Section 1.13.2.3 for guidance on circumstances in which interim financial statements of an acquiree may be required to be audited.

224 See Section 1.2.1 for guidance on identifying a probable business acquisition.
Rule 3-05 | SAB 80
---|---
**Financial statements used to measure significance of an acquired or to be acquired business after an IPO**

When Rule 3-05 is applied in an IPO, the most recent preacquisition annual financial statements of an acquiree are compared with a registrant’s most recent preacquisition audited annual consolidated financial statements. Paragraph 2070.13 of the FRM states that “if the provisions of SAB 80 were used in an initial registration statement . . . the [SEC] staff would allow that registrant to separately evaluate the significance of each acquisition that occurs after the effective date of the initial registration statement using the pro forma financial statements that were used to evaluate significance under SAB 80 in the initial registration statement. However, those pro forma financial statements should be adjusted to eliminate:

- pro forma effects of acquisitions for which no audited financial statements are presented in the initial registration statement,
- the pro forma effects of acquisitions that were probable at the time the initial registration statement was declared effective but which have yet to be consummated, and
- pro forma adjustments not directly attributable to the acquisitions.”

Alternatively, a registrant may perform the tests of significance under Rule 3-05.

Once a registrant files its annual audited financial statements (either in a Securities Act or Exchange Act filing) for the fiscal year after the audited financial statements are presented in the initial registration statement, the registrant should measure significance under Rule 3-05.

**Age of financial statements**

The updating requirements of Rule 3-05 should be followed in subsequent registration statements. No updating is required for Exchange Act periodic reporting.

The updating requirements of Rule 3-05 should be followed in subsequent registration statements. No updating is required for Exchange Act periodic reporting. See paragraph 2070.12 of the FRM.

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225 See the Q&As in Section 1.6.3 for additional information.

226 See the Q&As in Section 1.11 for additional information.
SAB 80 includes an example that demonstrates the application and measurement of significance under the alternative method in SAB 80. The steps a registrant must take in performing the alternative significance tests under SAB 80 are detailed and complex. Paragraphs 2070.10 and 2070.11 of the FRM outline additional details on determining the number of preacquisition historical financial statement periods required for completed and probable acquisitions as well as the financial statement requirements. Careful planning is needed when additional acquisitions and probable acquisitions occur during the registration process because the calculations must be continually updated through the effective date of the registration statement, and financial statement requirements may change. Registrants that contemplate using SAB 80 should consider consultation with their auditors and SEC legal counsel.
Chapter 2 — Real Estate Operations
Acquired or to Be Acquired

2.1 Introduction to SEC Reporting Considerations for Acquired or to Be Acquired Real Estate Operations

This introduction outlines the SEC reporting considerations for acquired or to be acquired real estate operations. In addition to reviewing the Q&As in this chapter, registrants should consider consulting with their audit and legal professionals to determine the appropriate SEC reporting requirements.

**Rule 3-05** requires a registrant to provide full financial statements for significant acquired or to be acquired businesses. However, **Rule 3-14** permits a registrant to file only abbreviated income statements for significant acquired or to be acquired real estate operations. Rule 3-14(a)(1) states that such abbreviated income statements “shall exclude items not comparable to the proposed future operations of the property such as mortgage interest, leasehold rental, depreciation, corporate expenses and Federal and state income taxes.” Because the requirements of Rules 3-05 and 3-14 are different, it is important for a registrant to determine whether it acquires a real estate operation. In addition to the abbreviated income statements, pro forma financial information is required.

**Determining Whether Real Estate Is Subject to Rule 3-14**

As indicated in paragraph 2305.2 of the FRM, the SEC staff has generally held that the reduced financial statement requirements under Rule 3-14, which are “premised on the continuity and predictability of cash flows ordinarily associated with leasing real property, [apply] to the acquisition or probable acquisition of real estate operations.” Paragraph 2305.2 further states that under Rule 3-14, “the term ‘real estate operations’ refers to properties that generate revenues [primarily] through leasing,” such as (1) office, apartment, and industrial buildings and (2) shopping centers and malls. Conversely, operations that “are more susceptible to variations in costs and revenues over shorter periods” as a result of “market and managerial factors” (e.g., golf courses, hotels, parking garages, nursing homes, assisted living facilities, automobile dealerships, equipment rental operations) are subject to the requirements of Rule 3-05.

The ability of a registrant to file only abbreviated income statements for acquired or to be acquired real estate operations in accordance with Rule 3-14 is not affected by whether the real estate operation is a business for accounting purposes. For example, an apartment building may meet the definition of a business under ASC 805 and still be subject to Rule 3-14.

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1 For additional information, see the Q&As in Section 2.4.
Filings Requiring Abbreviated Income Statements of Real Estate Operations

A registrant (acquirer) may be required to include the abbreviated income statements of acquired real estate operations in a Form 8-K, a registration statement, or proxy materials when the real estate operations are significant (see below). In addition, when the acquisition of real estate operations is deemed probable, the abbreviated income statements may need to be included in a registration statement or proxy materials. Abbreviated income statements of significant acquired or to be acquired real estate operations are not required in annual or quarterly reports on Form 10-K or 10-Q.

Performing the Significance Test

A registrant only needs to perform the investment test described in Rule 1-02(w) to determine the significance of real estate operations. The asset and income tests do not apply. If there is any debt secured by the property that is assumed by the purchaser, the registrant should include that debt in the investment when determining significance. The SEC staff has not provided any further guidance on determining the registrant's investment in the property, as it has done with Rule 3-05 (see Section 1.6.5.1). When evaluating significance, the registrant must use U.S. GAAP amounts. Foreign private issuers should consult Section 6350 and paragraph 2015.3 of the FRM for guidance on significance testing.

When acquired or to be acquired real estate operations are related to one another, a registrant must use the aggregate investment in these operations when performing the significance test. A registrant should also be aware of the considerations related to aggregating individually insignificant acquired or to be acquired real estate operations.

Significance Threshold and Financial Statement Requirements

A real estate operation is significant when the investment is greater than or equal to 10 percent of the registrant's total preacquisition assets generally as of the end of the most recently completed fiscal year that is required to be filed with the SEC. This is the only threshold (i.e., unlike Rule 3-05, Rule 3-14 does not have a tiered threshold for disclosure requirements), and it applies to both probable and consummated real estate acquisitions.

Registrants are required to present three years of abbreviated income statements (two years for SRCs and EGCs undergoing an IPO) and the latest year-to-date interim period if the real estate operations are acquired from a related party. If the real estate operations are acquired from an unrelated party, an abbreviated income statement is required for only the real estate operation's most recent fiscal year and most recent year-to-date interim period. Pro forma financial information is also required for significant acquired or to be acquired real estate operations. Generally, the financial statements for a significant acquisition of real estate operations may be audited in accordance with AICPA standards.

Paragraph 3220.1 of the FRM states that “[p]ro forma presentation should be based on the latest balance sheet included in the filing” and that “[a] pro forma balance sheet is not required if the acquisition or disposal is already reflected in a historical balance sheet.” Further, paragraph 3230.1 of the FRM states that “[p]ro forma presentation should be based on the latest fiscal year and interim period included in the filing, unless the transaction is already reflected in the audited historical

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2 See Section 1.4.1 for a discussion of when a company may be able to omit financial statements of entities other than the registrant (e.g., financial statements under Rule 3-14) from a draft registration statement.

3 Note 2 to paragraph 2310.1 of the FRM defines the term "related properties," which is similar to the definition of related business in Rule 3-05. See Section 1.7.2 for further discussion.

4 See paragraph 2320.2 of the FRM for more information about calculating the aggregate significance of individually insignificant acquired or to be acquired real estate operations.

5 See Section 1.6.1 for an explanation of tiered thresholds.

6 See paragraph 10220.5(a) of the FRM for more information.
statements for the most recent full fiscal year.” See Rule 11-01(a)(5), and Sections 3130 and 3200 of the FRM for additional information.

It is important to compare the requirements in Rule 3-14 with those in Rule 3-05 to understand the differences between the two rules. See Section 2.2.2 for a summary of key differences between Rules 3-05 and 3-14.

2.2 Scope of Rule 3-14

2.2.1 Determining Whether Real Estate Is Subject to Rule 3-14

Q&A Regulation S-X: Rule 3-14-2

Rule 3-05 requires a registrant to provide full financial statements for significant businesses acquired or to be acquired. However, Rule 3-14 permits a registrant to file only abbreviated income statements for real estate operations acquired or to be acquired. Because the requirements of Rules 3-05 and 3-14 are different, it is important for a registrant to determine whether it acquired a real estate operation.

Question

What real estate is subject to Rule 3-14?

Answer

As indicated in paragraph 2305.2 of the FRM, the SEC staff has generally held that the reduced financial statement requirements under Rule 3-14, which are “premised on the continuity and predictability of cash flows ordinarily associated with leasing real property, [apply] to the acquisition or probable acquisition of real estate operations.” Further, under Rule 3-14, “the term ‘real estate operations’ refers to properties that generate revenues primarily through leasing,” such as (1) office, apartment, and industrial buildings and (2) shopping centers and malls. Conversely, operations that “are more susceptible to variations in costs and revenues over shorter periods” as a result of “market and managerial factors” (e.g., golf courses, hotels, parking garages, nursing homes, assisted living facilities, automobile dealerships, equipment rental operations) are subject to the requirements of Rule 3-05.

The ability of a registrant to file only abbreviated income statements for real estate operations acquired or to be acquired in accordance with Rule 3-14 is not affected by whether the real estate operation is a business for accounting purposes. For example, an apartment building may meet the definition of a business under ASC 805 and still be subject to Rule 3-14.

Paragraph 2305.3 of the FRM states that “[w]hen a registrant acquires an equity interest in a pre-existing legal entity (such as a partnership, LLC or corporation) . . . that engages in [activities other than leasing], such as property management or development, financial statements of that entity meeting the requirements of [Rule] 3-05 generally are required if the acquisition is significant [at 20 percent or greater].” However, a registrant should present Rule 3-14 financial statements of the real estate properties in lieu of Rule 3-05 financial statements when the entity has no operations other than holding real estate and related debt and the significance of the acquisition is 10 percent or greater. Further, paragraph 2305.3 of the FRM states that a “registrant should consult with [the] CF-OCA to the extent it believes [Rule] 3-14 financial statements are more appropriate than [Rule] 3-05 financial statements due to the limited degree of operations other than leasing real estate. If [Rule] 3-14 financial statements are more

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7 For additional information, see the Q&As in Section 2.4.
appropriate due to the limited degree of operations other than leasing real estate, financial statements are required if the 10% or more significance level applicable to [Rule] 3-14 financial statements is met.”

In addition, paragraph 2305.4 of the FRM states:

For purposes of applying [Rule] 3-14, the staff views an investment in a newly formed partnership or corporation (either consolidated or accounted for using the equity method) that will acquire properties under lease simultaneous with or soon after its formation as, in substance, the acquisition of properties by the registrant. In these circumstances, the staff will require [Rule] 3-14 financial statements of the underlying property being acquired instead of [Rule] 3-05 financial statements of the newly formed entity. This assumes that the new entity has no other activities besides leasing real property.

The following table summarizes the general financial statement requirements in Securities Act registration statements regarding the acquisition of real estate operations:

<table>
<thead>
<tr>
<th>Activities of the Acquired or to Be Acquired Entity</th>
<th>Significance</th>
<th>Financial Statements Required</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limited degree of operations other than leasing</td>
<td>Less than 10 percent</td>
<td>None</td>
</tr>
<tr>
<td>Limited degree of operations other than leasing</td>
<td>Greater than or equal to 10 percent and less than 20 percent</td>
<td>Present Rule 3-14 financial statements</td>
</tr>
<tr>
<td>Limited degree of operations other than leasing</td>
<td>20 percent or greater</td>
<td>Present Rule 3-14 financial statements after consulting with CF-OCA to verify that Rule 3-14 financial statements are more appropriate than Rule 3-05 financial statements</td>
</tr>
<tr>
<td>Significant activities other than leasing</td>
<td>Less than 10 percent</td>
<td>None</td>
</tr>
<tr>
<td>Significant activities other than leasing</td>
<td>Greater than or equal to 10 percent and less than 20 percent</td>
<td>Present Rule 3-14 financial statements if underlying property has a rental history</td>
</tr>
<tr>
<td>Significant activities other than leasing</td>
<td>20 percent or greater</td>
<td>Present Rule 3-05 financial statements</td>
</tr>
</tbody>
</table>

Note that the table above assumes that this acquisition represents the sole probable or completed acquisition of the reporting entity for the fiscal year. A registrant must aggregate individually insignificant acquisitions and analyze them for significance to determine the financial statements it is required to present.  

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8 See Rule 3-05(b)(2)(i) and paragraph 2310.1(c) of the FRM.
Example 1

- Registrant A owns several apartment buildings for which it also serves as leasing agent and manager.
- Registrant A acquires Apartment Complex X from Company Y, which owns several apartment complexes.

In this example, X qualifies as a real estate operation to A and therefore A reports the acquisition in accordance with Rule 3-14. Rentals are the principal source of X's revenue before the acquisition.

Assume instead that X was held by a limited partnership that had no operations other than holding X and related debt. If A acquired the limited partnership, the same conclusion would apply.

Example 2

- Registrant G owns and operates several golf courses.
- Registrant G acquires Golf Course Complex R, which consists of a golf course, hotel, and restaurant.
- In addition to charging greens fees for the use of the course, R obtains revenues from cart rentals, food and beverage sales, golf equipment sales, and hotel room charges.

Although the acquisition involves real estate and rental revenue (i.e., greens fees and cart rental fees), R's revenues include food and beverage sales, sales of golf equipment, and hotel room charges, which are highly susceptible to variations attributable to market and managerial factors. In this example, the acquisition of R does not qualify as an acquisition of a real estate operation. Therefore, G reports the acquisition in accordance with Rule 3-05.

2.2.2 Summary of Key Differences Between Regulation S-X, Rules 3-05 and 3-14

Q&A Regulation S-X: Rule 3-14-1

Question

What are some of the key differences between Rules 3-05 and 3-14?

Answer

The following table highlights some of the key differences between the two rules:

<table>
<thead>
<tr>
<th></th>
<th>Rule 3-05</th>
<th>Rule 3-14</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of significance tests</td>
<td>Three (income, asset, investment).</td>
<td>One (investment).</td>
</tr>
<tr>
<td>Significance thresholds for determining the number of financial statement periods to be presented</td>
<td>Tiered threshold (equal to or exceeds 20 percent but not 40 percent, equal to or exceeds 40 percent but not 50 percent, and equal to or exceeds 50 percent).</td>
<td>Equal to or exceeds 10 percent significance to the acquirer.</td>
</tr>
<tr>
<td></td>
<td>Rule 3-05</td>
<td>Rule 3-14</td>
</tr>
<tr>
<td>------------------------------------</td>
<td>---------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Number of financial statement</td>
<td>One, two, or three years (two years for SRCs and EGCs) and current year-to-date interim period (with prior-year comparative period) depending on the level of significance.</td>
<td>One year and current year-to-date interim period for real estate operations acquired from unrelated parties. Three years (two years for SRCs and EGCs) and the latest unaudited interim period based on the property's fiscal periods for real estate operations acquired from related parties.9</td>
</tr>
<tr>
<td>periods to be presented</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Types of financial statements to</td>
<td>Full financial statements (abbreviated financial statements are allowed in certain circumstances).</td>
<td>Abbreviated income statements only (related to the property). For triple-net-leased properties, see Section 2.2.7 for further discussion of the requirement to provide full financial statements of a significant tenant, if applicable.</td>
</tr>
<tr>
<td>be presented</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Use of pro forma information to</td>
<td>Allowed in certain circumstances.</td>
<td>Generally not permitted, unless the acquisition was made after an individually significant acquisition was reported in a Form 8-K, Item 2.01, that included historical audited Rule 3-14 financial statements.10 For information about measuring significance in blind-pool offerings during the distribution period, see paragraphs 2325.3 through 2325.5 of the FRM.</td>
</tr>
<tr>
<td>perform the significance test after</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a previously reported significant</td>
<td></td>
<td></td>
</tr>
<tr>
<td>acquisition</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Presentation of the financial</td>
<td>Present the audited financial statements of the mathematical majority of individually insignificant businesses that are more than 50 percent significant in the aggregate.</td>
<td>Present the audited abbreviated income statements of the mathematical majority of individually insignificant acquired real estate operations that are more than 10 percent significant in the aggregate. In addition, audited abbreviated income statements for the mathematical majority must include all insignificant properties that are individually more than 5 percent significant. Provide financial statements for other acquired properties below the 5 percent level to meet the 50 percent mathematical majority threshold.</td>
</tr>
<tr>
<td>statements of individually</td>
<td></td>
<td></td>
</tr>
<tr>
<td>insignificant acquisitions</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

9 For properties held by the related party for less than three years, financial statements are required for the greater of (1) the period held by the related party or (2) one year.

10 See paragraph 2315.4 of the FRM. For further discussion of exceptions, see Section 2.3.2.
### Chapter 2 — Real Estate Operations Acquired or to Be Acquired

#### 2.2.3 Identifying a Probable Acquisition of a Real Estate Operation

**Q&A Regulation S-X: Rule 3-14-3**

Rule 3-14 requires a registrant to present abbreviated income statements in certain SEC filings for acquisitions or probable acquisitions of real estate operations. See Section 2.4.1 for further discussion.

**Question**

For SEC reporting purposes, what is the definition of “probable” as it relates to an acquisition of real estate operations?

**Answer**

Rule 3-14 does not define the term “probable.” However, the concept is the same as that under Rule 3-05. See Section 1.2.1 for further discussion.

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<table>
<thead>
<tr>
<th>Availability of the substitution of nine-month financial statements to satisfy the 12-month financial statement requirement under Rule 3-06</th>
<th>Rule 3-05</th>
<th>Rule 3-14</th>
</tr>
</thead>
<tbody>
<tr>
<td>Permitted when the conditions of Rule 3-06 are met.</td>
<td>Generally not permitted.</td>
<td></td>
</tr>
</tbody>
</table>

| Significance threshold for including financial statements of a probable acquisition in a registration statement or proxy materials | Exceeds 50 percent significance to the acquirer. | Equal to or exceeds 10 percent significance to the acquirer. |

| Whether registrants are allowed a grace period (74 calendar days after the acquisition) to provide financial statements of a significant acquisition in a new registration statement | Yes, for acquisitions that have a significance between 20 percent and 50 percent. | No, except for blind-pool offerings during the distribution period (subject to Industry Guide 5). A post-effective amendment filed to consolidate stickers or to update the financial statements under Section 10(a)(3) of the Exchange Act does not need to include financial statements for significant property acquisitions during the 71-day extension period allowed by Form 8-K, Item 9.01. |

| Requirement for presentation in a new registration statement of financial statements of acquisitions consummated less than 75 days before the registration statement is filed or declared effective | May be excluded if less than 50 percent significant unless they have been previously filed by the registrant. | Must be included if significant. |

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11 Paragraph 2330.5 of the FRM indicates that Rule 3-06(b) “does not apply to financial statements of real estate properties.”

12 See Section 1.4.1 for the different requirements for a Form S-4 used to register securities being offered to security holders of a target.

13 See Section 1.4.1 for additional information.
2.2.4 New or Recently Developed Properties

Q&A Regulation S-X: Rule 3-14-4

Question

Must a registrant present separate abbreviated income statements for significant new or recently developed acquired or to be acquired properties at which operations have not commenced?

Answer

No. A registrant is not required to present abbreviated income statements for new or recently developed properties for which there is no rental history, such as a previously owner-occupied or newly constructed property, or when the rental history is less than three months\(^\text{14}\) (see paragraph 2330.10 of the FRM). However, if rentals have commenced, a registrant must provide the abbreviated income statements for the appropriate period.\(^\text{15}\)

Paragraph 2330.8 of the FRM states that if “a registrant acquires an operating property with a rental history of more than three months but less than nine months, the financial statements may be presented on an unaudited basis.”

See the other Q&As in this section for information about SEC filings in which abbreviated income statements are required, including the periods for which they are required and their form and content. In addition, if the property is to be net-leased to a single tenant, financial information of the tenant is required. See Section 2.2.7 for additional information.

Example 1

Registrant A acquired a significant property upon completion of its construction. No abbreviated income statements for the property are required under Rule 3-14 because there is no history of operations or results of operations to report.

Example 2

Registrant B acquired a significant property on April 30, 20X8. Construction was completed and rental began on January 15, 20X8. Registrant B filed a registration statement on June 15, 20X8. Registrant B must present an abbreviated income statement for the real estate operation for the quarter ended March 31, 20X8, that includes the results of operations from January 15, 20X8, until March 31, 20X8. This abbreviated income statement would not need to be audited.

\(^{14}\) In this case, registrants must consider whether the requirements of Form 8-K for asset acquisitions apply. For additional information, see Section 2.2.6.

\(^{15}\) Paragraph 2330.6 of the FRM indicates that the “same rules for updating [Rule] 3-05 financial statements apply to [Rule] 3-14 financial statements.” See Section 2045 of the FRM for age of financial statement information for Rule 3-05.
2.2.5 Properties to Be Demolished

Q&A Regulation S-X: Rule 3-14-4.1

Question
Must a registrant present separate abbreviated income statements for a significant property acquired or to be acquired that it will demolish and replace with a new rental property?

Answer
No. As indicated in paragraph 2330.9 of the FRM, the SEC staff “would not object to the omission of the [separate abbreviated income] statements of the acquired property if the prior rental revenues and operating costs of the property are not representative of the new property to be built. The registrant should explain the basis for omission of the financial statements in the filing. In other cases where the registrant believes the leasing history is not representative, it may request relief from [the] CF-OCA in writing.”

2.2.6 Properties With No or a Nominal Leasing History

Q&A Regulation S-X: Rule 3-14-5

Question
If a registrant acquires (or it is probable that the registrant will acquire) a significant property that was previously either owner-occupied or used in non-rental operations, must the registrant (acquirer) provide abbreviated income statements for the property under Rule 3-14?

Answer
Paragraph 2330.8 of the FRM states that when the “rental history [is] more than three months but less than nine months, the financial statements may be presented on an unaudited basis.” However, paragraph 2330.10 of the FRM states that when “the leasing history is less than three months, financial statements of the property are not required.”

In this case, the property’s abbreviated income statements are not required because there is no or nominal prior rental history. However, a registrant may acquire a significant property that will be leased immediately to a single tenant on a long-term basis under a triple net lease that transfers substantially all of the property’s nonfinancial operating and holding costs to the tenant (e.g., in a sale-leaseback). In such cases, the registrant may be required to provide separate financial information for the tenant (or another party that guarantees the lease payment). For more information, see Section 2340 of the FRM. Also see Section 2.2.7.

If a registrant concludes that the acquisition of the property is not within the scope of Rule 3-14 (and the registrant does not provide the abbreviated financial information required by Rule 3-14), the registrant should consider whether the Form 8-K filing requirements for acquisitions of assets apply. Form 8-K, Item 2.01, requires disclosures for acquisitions of significant assets that differ from the financial statements required by Rule 3-14. In accordance with Instruction 4 of Form 8-K, Item 2.01, an asset acquisition is deemed significant if “the registrant's and its other subsidiaries' equity in the net book value of such assets or the amount paid or received for the assets upon such acquisition or disposition exceeded 10% of the total assets of the registrant and its consolidated subsidiaries.”
Example

- Company A sells an office building that it used as its corporate headquarters to Registrant B, a real estate investment trust.
- Registrant B subdivides the building and will lease it to several tenants.

If B concludes that it does not need to present separate abbreviated income statements for the building under Rule 3-14 because it did not have a prior rental history, it should consider the requirements of Form 8-K, Item 2.01.

2.2.7 Financial Statements of Significant Lessees for Real Estate Properties Subject to Triple Net Lease

Q&A Regulation S-X: Rule 3-14-5.1

Question

If a registrant leases real estate properties to a single lessee/tenant, must the registrant provide any financial information of the lessee/tenant because of the risk of an asset concentration?

Answer

Registrants should consider significant asset concentrations when preparing a registration statement, annual report, or current report on a Form 8-K filed in connection with a property acquisition.

See Sections 2.2.4 and 2.2.6 for a discussion of situations in which abbreviated income statements for the property are not required because there is no prior rental history. If a registrant acquires a significant property that will be leased immediately to a single tenant on a long-term basis under a net lease that transfers substantially all of the property's nonfinancial operating and holding costs to the tenant (e.g., in a sale-leaseback), the registrant may be required to provide separate financial information for the tenant (or another party that guarantees the lease payment). A triple net lease requires the lessee to pay costs associated with ownership of the property, such as property taxes, insurance, utilities, and maintenance costs. Given these attributes, the leasing arrangement operates as a financing arrangement for the lessee.

Section 2340 of the FRM states, in part:

When a registrant has triple net leased one or more real estate properties to a single lessee/tenant (including in the capacity as co-lessee or guarantor), and such properties represent a “significant” portion of the registrant's assets, an investor may need to consider the lessee's financial statements or other financial information in order to evaluate the risk to the registrant from this asset concentration. An asset concentration is generally considered “significant” if it exceeds 20% of the registrant's assets as of its most recent [audited or unaudited] balance sheet.

In circumstances where a registrant acquires a property resulting in a significant asset concentration, the registrant should generally provide full audited financial statements of the lessee or guarantor for the periods required by [Rules] 3-01 and 3-02/[Rules] 8-02 and 8-03. If the lessee is a public company subject to the periodic reporting obligations of the Exchange Act, the registrant may instead include in the filing a statement referring investors to a publicly-available website with the lessee's SEC filed financial information. If a registrant with an asset concentration related to a lessee believes that less detailed financial information is appropriate based on the registrant's particular facts and circumstances or the lessee financial statements are not available, the registrant should consult with CF-OCA on a pre-filing basis.
In addition, Section 2340 of the FRM further states that “[i]n an annual report, registrants may provide the lessee financial statements based on the due dates for financial statements of a significant equity method investee under [Rule] 3-09 by analogy. Refer to [paragraphs 2405.7 through 2405.11 of the FRM].”

The requirement to assess a significant asset concentration (when a registrant is providing a lessee’s or guarantor’s financial statements) is separate from the requirement to assess significance when the registrant is providing the property’s Rule 3-14 financial statements. A registrant is required to perform both assessments. For example, Section 2340 of the FRM states that “[i]f a registrant acquires a property subject to a triple net lease and there is a rental history, the registrant should apply [Rule] 3-14 in situations where there is not a significant asset concentration.”

2.3 Measuring the Significance of Real Estate Operations

2.3.1 Measuring the Significance of Acquired or to Be Acquired Real Estate Operations

Q&A Regulation S-X: Rule 3-14-6

Rule 3-14 requires a registrant to present separate abbreviated income statements for significant acquired or to be acquired real estate operations (acquiree).

**Question**

How should a registrant measure the significance of an acquiree?

**Answer**

Paragraph 2315.1 of the FRM indicates that the registrant generally computes the significance of real estate operations by comparing its investment in the real estate operations with its total assets as of the latest audited fiscal year-end required to be filed with the SEC.\(^{16}\) If there is any debt secured by the property that is assumed by the purchaser, the registrant should include that debt in the investment when determining significance. The SEC staff has not provided any further guidance on determining the registrant’s investment in the property, as it has done with Rule 3-05 (see Section 1.6.5.2).

A real estate operation is significant when the investment is equal to or exceeds 10 percent (individually or in the aggregate for related or insignificant acquisitions) of the registrant’s preacquisition consolidated assets.\(^{17}\) This is the only threshold (i.e., unlike Rule 3-05, Rule 3-14 does not have a tiered threshold for disclosure requirements)\(^ {18}\) and it applies to both probable and consummated real estate acquisitions.

When acquired or to be acquired real estate operations are related\(^ {19}\) to one another, a registrant must use the aggregate investment in these operations when performing the

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\(^{16}\) See Real Estate Operations Acquired Before a Registrant Has Completed Its First Fiscal Year in Section 2.3.2 for a discussion of situations in which the SEC staff may allow certain exceptions to this rule. See Section 2320 of the FRM for a discussion of situations in which the registrant should compute significance by using the latest audited fiscal year balance sheet date preceding the acquisition.

\(^{17}\) This amount is determined under U.S. GAAP. If the registrant files the financial statements under IFRS Standards and is not required to reconcile to U.S. GAAP, this amount can be determined under IFRS Standards.

\(^{18}\) See Section 1.6.1 for an explanation of tiered thresholds.

\(^{19}\) Note 2 to paragraph 2310.1 of the FRM provides the definition of “related” properties. This concept is similar to the related business definition in Rule 3-05. See Section 1.7.2 for further discussion. See paragraph 2335.1 of the FRM for further detail on calculation of significance of related acquired or to be acquired real estate operations.
significance test. A registrant should also be aware of the considerations for aggregating individually insignificant acquired or to be acquired real estate operations.20

### Example

- Registrant A acquired Real Estate Operation E on November 15, 20X8.
- Registrant A’s fiscal year-end is December 31.
- On December 31, 20X7, A had total consolidated assets of $100 million.
- The total investment in E was $30 million, including mortgage debt assumed by A of $5 million.

The investment test is calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total investment in E</td>
<td>$30 million</td>
</tr>
<tr>
<td>Total assets of A as of December 31, 20X7</td>
<td>$100 million</td>
</tr>
<tr>
<td>Significance</td>
<td>30%</td>
</tr>
</tbody>
</table>

#### 2.3.2 Financial Statements Used to Measure the Significance of Acquired or to Be Acquired Real Estate Operations

**Q&A Regulation S-X: Rule 3-14-7**

A registrant performs the investment test to calculate the significance of acquired or to be acquired real estate operations. See Section 2.3.1 for additional information.

**Question**

What financial statements should a registrant use to measure the significance of an acquisition or probable acquisition of real estate operations?

**Answer**

An investment in real estate operations should be compared with the registrant’s total consolidated assets, generally from the preacquisition financial statements as of the registrant’s most recently completed fiscal year that is required to be filed with the SEC. The additional considerations below are applicable in certain circumstances.

**“Blind Pool” Offerings**

“Blind pool” offerings have different reporting requirements and significance measurements. See Section 2325 and paragraph 2305.5 of the FRM for more information.

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20 See paragraph 2320.2 of the FRM for further details on calculation of aggregate significance of individually insignificant acquired or to be acquired real estate operations.
The following table summarizes the financial statement requirements for properties acquired for Securities Act registration statements under the general rule and under the blind-pool rules.

<table>
<thead>
<tr>
<th>Acquisition Type</th>
<th>Significance Threshold Percentage</th>
<th>Items Against Which Significance of Registrant’s Investments&lt;sup&gt;21&lt;/sup&gt; Are Measured</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Rule</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regular property acquisition and probable acquisitions</td>
<td><strong>Rule 3-14</strong> financial statements of the property required at 10 percent threshold (also significant in aggregate test triggers)</td>
<td>Registrant’s assets as of last audited balance sheet</td>
</tr>
<tr>
<td>Triple net leased</td>
<td>In the absence of a significant asset concentration, <strong>Rule 3-14</strong> financial statements of the property required at 10 percent threshold (also significant in aggregate test triggers)</td>
<td>Registrant’s assets as of last audited balance sheet</td>
</tr>
<tr>
<td></td>
<td>For significant asset concentrations, full financials of tenant at 20 percent threshold</td>
<td></td>
</tr>
<tr>
<td>Blind-Pool Offerings Subject to Industry Guide 5 (Initial Distribution Only)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regular property acquisition</td>
<td><strong>Rule 3-14</strong> financial statements of the property required at 10 percent threshold (also significant in aggregate test triggers for related acquisitions or properties acquired from a single seller)</td>
<td>Registrant’s assets as of acquisition date, plus the proceeds (net of commissions) in good faith expected to be raised in the registered offering over the next 12 months&lt;sup&gt;22&lt;/sup&gt;</td>
</tr>
<tr>
<td>Triple net leased</td>
<td>In the absence of a significant asset concentration, <strong>Rule 3-14</strong> financial statements of the property required at 10 percent threshold (also significant in aggregate test triggers)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>For significant asset concentrations, full financials of tenant at 20 percent threshold</td>
<td></td>
</tr>
</tbody>
</table>

**Real Estate Operations Acquired Shortly After a Registrant’s Most Recently Completed Fiscal Year<sup>23</sup>**

A registrant may acquire a real estate operation shortly after its year-end but before filing its Form 10-K for that year. If the real estate operation is significant, the initial Form 8-K reporting the acquisition must be filed within four business days of the acquisition's consummation. In this situation, a registrant may file its Form 10-K for its most recently completed fiscal year before the real estate operation’s abbreviated income statements and related pro forma financial information need to be filed in an amendment to the initial Form 8-K, which must be filed within 71 calendar days after the filing due date for the initial Form 8-K.

The registrant should use the total assets included in its prior-year Form 10-K to assess significance when determining its initial Form 8-K filing requirements. As discussed in paragraph 2315.3 of the FRM, the registrant may reevaluate significance by using its total assets for the most recent fiscal year reported in the Form 10-K filed after the initial Form 8-K filing as long as

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<sup>21</sup> The investment includes any debt secured by the property that is assumed by the purchaser.

<sup>22</sup> In estimating the offering proceeds, the registrant should consider (1) the pace of fundraising as of the measurement date, (2) the sponsor or dealer-manager’s prior public fundraising experience, and (3) offerings by similar companies.

<sup>23</sup> This concept is similar to that in Rule 3-05. See Section 1.6.3.2 for further discussion and an example.
the Form 10-K is filed before the due date of the amended Form 8-K. This is acceptable even if the reassessment causes the acquisition to have a lower level of significance to the acquiring entity, thereby eliminating the requirement to present abbreviated income statements. However, the registrant is not obligated to use the total consolidated assets in the more recent financial statements as they were filed after the initial Form 8-K filing, even if using the more recent financial statements causes the real estate operations to become significant.

**Real Estate Operations Acquired Before a Registrant Has Completed Its First Fiscal Year**

For a registrant, other than a newly formed real estate investment trust (REIT) (e.g., a master limited partnership (MLP)), that has not completed its first fiscal year, the total assets in the most recent audited balance sheet filed with the SEC will be used in the significance test. Typically, this will be the audited balance sheet included in the registrant’s initial registration statement. See paragraph 2315.2 of the FRM for further discussion.

If the registrant is a newly formed REIT with no significant operations, it may use a denominator that includes acquired and to be acquired properties to calculate significance. Refer to Section 2335 of the FRM for further discussion.

**Acquired or to Be Acquired Real Estate Operations (Acquiree) by a Registrant’s Subsidiary**

If the subsidiary is not itself a registrant, significance should be measured by comparing the investment in the acquiree with the registrant’s (i.e., the parent of the subsidiary) preacquisition consolidated total assets. That is, when the subsidiary is not a registrant, the subsidiary’s stand-alone total assets should not be used to measure significance.

However, if the subsidiary is a registrant (i.e., both the parent and the subsidiary are registrants), the parent and the subsidiary must each measure whether the acquiree is significant. Accordingly, significance should be measured by comparing the investment in the acquiree with the total assets of both the parent and the subsidiary.

**Previously Issued Financial Statements Are Retrospectively Adjusted**

As indicated in Topic 13 and paragraph 2025.1 of the FRM, in certain circumstances (e.g., when filing a new registration statement), a registrant may be required to file updated financial statements that reflect the retrospective adjustments for periods before adoption of the change. For further guidance on determining when a registrant is required to file these updated financial statements, see Topic 13 of the FRM. In some cases, such changes may affect the significance calculations.

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24 This concept is similar to that in Rule 3-05. See Section 1.6.3.4 for further discussion and an example.
25 This concept is similar to that in Rule 3-05. See Section 1.6.3.7 for further discussion.
26 The retrospective changes referred to in this Q&A do not include revisions resulting from the correction of an error for misapplication of U.S. GAAP. For a correction of an error, a registrant should remeasure the significance of a previously acquired real estate operation by comparing the investment with the registrant’s revised total consolidated assets.
A registrant is required to perform significance tests based on the registrant’s financial statements that reflect retrospective application for the most recently completed fiscal year for the following:

- Individual real estate operations acquired after the date the retrospectively adjusted financial statements are filed.
- Probable acquisitions.
- Aggregate impact of all individually insignificant real estate operations that have occurred since the end of the most recently completed fiscal year for which the registrant’s financial statements have been filed.

**Registrant Plans to Dispose of Certain Acquired or to Be Acquired Assets**

If a registrant acquires a group of properties and plans to dispose of certain of those properties, the assets to be disposed of should not be excluded from the significance calculation. That is, the amount of the investment must include all acquired real estate operations even if the registrant plans to dispose of one or more of them.

**Use of Pro Forma Financial Information to Perform the Significance Test**

A registrant may acquire (or it may be probable that the registrant will acquire) a real estate operation after a previously reported individually significant acquisition or disposal of real estate operations, for which pro forma financial information had been provided in a Form 8-K, Item 2.01. In this situation, Rule 3-14 permits the registrant to perform the significance test by using the pro forma financial information that was included in a previous Form 8-K reporting the acquisition or probable acquisition of significant real estate operations rather than historical preacquisition financial statements. The pro forma effects of any other transaction should be excluded. Paragraph 2315.4 of the FRM states that a registrant that elects to use pro forma financial information to evaluate significance should “consistently apply that methodology for evaluating all subsequent acquisitions for the remainder of the fiscal year.”

### 2.3.3 Performing the Significance Test and Determining the Financial Statements Required in and Subsequent to an IPO of a REIT

**Q&A Regulation S-X: Rule 3-14-8**

Paragraph 2335.1 of the FRM states, in part:

A newly-formed REIT having no significant operations may acquire operating properties immediately prior to filing an IPO, or may identify properties to be acquired upon closing the IPO. In addition, the REIT may identify properties that it will probably acquire soon after the IPO. The staff recognizes in these circumstances that the literal application of S-X 3-14 could result in the registrant providing financial statements of properties that are clearly insignificant to investors.

That is, because there may be few or no assets in a newly formed REIT, every acquired or to be acquired real estate operation could be considered significant.

**Question**

How should a newly formed REIT with no significant operations (referred to herein as a “newly formed REIT”) measure significance of acquired or to be acquired real estate operations and determine the financial statements that are required in its IPO?

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27 This concept is similar to that in Rule 3-05. See Section 1.6.3.9 for further discussion.
Answer
The SEC staff allows a newly formed REIT, in performing the significance test, to compute significance by using a denominator equal to the:

- Total cost of the properties acquired immediately before an initial registration statement is filed, plus
- Properties to be acquired upon closing the IPO, plus
- Properties identified as probable future acquisitions.

That is, a newly formed REIT must compare (1) its investment in acquired or to be acquired properties with (2) the denominator.

The newly formed REIT must include, in the initial registration statement, abbreviated income statements for acquired or to be acquired properties whose significance is individually greater than 10 percent.

In addition, if there are acquired or to be acquired properties whose significance individually is less than or equal to 10 percent but in the aggregate exceeds 10 percent, the newly formed REIT must provide the abbreviated income statements of a majority (more than 50 percent) of the insignificant properties. Registrants should provide Rule 3-14 financial statements for each property acquisition that is 5 percent or more significant. However, as long as the newly formed REIT provides this majority, it may exclude the abbreviated income statements of operations that are individually less than 5 percent significant if the operations are acquired from an unrelated party. See paragraph 2320.3 of the FRM.

If a registrant acquires a group of individually insignificant (i.e., less than or equal to 10 percent significant) related real estate operations, it should apply the guidance in Section 2.3.4 before applying the guidance on individually insignificant real estate operation acquisitions in this Q&A. See note 2 to paragraph 2310.1 of the FRM for additional information.

Example
- Registrant A, a newly formed REIT, is planning to file a registration statement for its IPO.
- Immediately after its formation, A acquired Real Estate Operations B, C, D, and E from unrelated parties.
- In addition, A has identified Real Estate Operations F, G, and H, whose acquisition from unrelated parties immediately after the IPO is probable.

28 See Section 2.3.1 for further discussion of the significance test.

29 Pro forma financial information is also required. See Section 2.4.2 for additional information.
Example (continued)

The following table lists the cost and significance of each of the real estate operations acquired or to be acquired:

<table>
<thead>
<tr>
<th>Real Estate Operation</th>
<th>Cost</th>
<th>Individual Significance (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>B</td>
<td>$ 500</td>
<td>3.5</td>
</tr>
<tr>
<td>C</td>
<td>6,500</td>
<td>44.9</td>
</tr>
<tr>
<td>D</td>
<td>1,800</td>
<td>12.5</td>
</tr>
<tr>
<td>E</td>
<td>1,000</td>
<td>6.9</td>
</tr>
<tr>
<td>F</td>
<td>800</td>
<td>5.6</td>
</tr>
<tr>
<td>G</td>
<td>3,300</td>
<td>22.8</td>
</tr>
<tr>
<td>H</td>
<td>600</td>
<td>4.2</td>
</tr>
<tr>
<td>Base for A</td>
<td>$ 14,500</td>
<td></td>
</tr>
</tbody>
</table>

Registrant A is permitted to compute the significance of the real estate operations by using a denominator equal to the cost of all acquired and to be acquired real estate operations ($14,500). Because C, D, and G are individually more than 10 percent significant, A will present their audited abbreviated income statements in the registration statement. Real Estate Operations B, E, F, and H are individually insignificant. However, in the aggregate, their significance is 20.2 percent (3.5% + 6.9% + 5.6% + 4.2%). The abbreviated income statements of E and F must be presented in the registration statement because they are individually more than 5 percent significant and the total of the individually insignificant acquisitions is greater than 10 percent. Also, because the abbreviated income statements of E and F (which are 12.5 percent significant in the aggregate) represent more than 50 percent of the results of the significance test (20.2% × 50% = 10.1%) for all individually insignificant real estate operations acquired or to be acquired, the abbreviated income statements of B and H can be omitted from the registration statement.

Significance Test After an IPO

For acquisitions or probable acquisitions after the IPO but before the initial Form 10-K is filed, the newly formed REIT can use the same denominator discussed above to calculate significance. However, the denominator should not include properties whose acquisition was probable at the time of the IPO but that were not ultimately acquired, unless audited financial statements of the property were included in the initial registration statement and the acquisition remains probable. Thus, the denominator should be reduced for any property not acquired or no longer probable. The purpose of this restriction is to prevent registrants from using a denominator for significance that is artificially large because of probable acquisitions that will not ultimately occur. See paragraph 2335.2 of the FRM.
2.3.4 Measuring the Significance of Related Real Estate Operations Acquired or to Be Acquired

Q&A Regulation S-X: Rule 3-14-9

Real estate operations acquired or to be acquired are related to one another if they are under common control or management, the acquisition of one real estate operation is conditioned on the acquisition of each other operation, or each acquisition is conditioned on a single common event.  

Question

How should a registrant (acquirer) perform the significance test when it acquires, or it is probable that it will acquire, real estate operations that are related to one another?

Answer

A group of related real estate operations must be treated as a single operation. Therefore, a registrant must compare its aggregate investment in the related real estate operations with the registrant’s total assets generally as of the latest audited fiscal year-end required to be filed with the SEC. The related real estate operations are significant when the aggregate investment exceeds 10 percent of the registrant’s preacquisition total assets.

If the significance of the group of related real estate operations exceeds 10 percent, the registrant must present abbreviated income statements for all of the related real estate operations, even if a related real estate operation is individually insignificant (i.e., the significance is less than or equal to 10 percent). The mathematical majority concept for individually insignificant acquisitions of real estate operations does not apply in such instances. In addition, a registrant may present combined abbreviated income statements if the real estate operations are under common control or management and they meet the criteria for combination in ASC 810-10-55-1B.

Regardless of the method of presentation, the registrant must present the number of abbreviated income statement periods required. (See Section 2.4.2 for additional information.) The abbreviated income statements of acquired or to be acquired related real estate operations may be combined only for the periods during which common control or management existed.

30 This concept is similar to that in Rule 3-05. See Section 1.7.2 for further discussion. Also see note 2 to paragraph 2310.1 of the FRM.

31 See Sections 2.3.1 and 2.3.2 for more information about measuring significance.

32 For this threshold, if the significance calculation were to result in a real estate operation that is exactly 10 percent significant to the registrant, no abbreviated income statements would be required under Rule 3-14.

33 Pro forma financial information is also required. See Section 2.4.2 for additional information.

34 See paragraph 2320.3 of the FRM for additional information about the mathematical majority concept.

35 The SEC may require that combined financial statements of acquired related real estate operations be presented separately from combined financial statements of related real estate operations to be acquired. Registrants that do not comply with this presentation should consider preclearance with the SEC staff. When preclearance is required, registrants should consider consultation with their auditors and SEC legal counsel.
Example

- Registrant A consummated the acquisitions of Real Estate Operations B and C on July 31, 20X9, from an unrelated party.
- Real Estate Operations B and C are related because they were under common control since January 1, 20X2.
- Registrant A and B and C all have a December 31 year-end.

The following table summarizes A’s investments in B and C, as well as the calculation of the combined significance of B and C:

<table>
<thead>
<tr>
<th>Investment as of Acquisition Date</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Estate Operation B</td>
<td>$25 million</td>
</tr>
<tr>
<td>Real Estate Operation C</td>
<td>5 million</td>
</tr>
<tr>
<td>Total</td>
<td>$30 million</td>
</tr>
<tr>
<td>Registrant A</td>
<td>100 million*</td>
</tr>
<tr>
<td>Significance</td>
<td>30%</td>
</tr>
</tbody>
</table>

* Represents A’s preacquisition consolidated total assets as of December 31, 20X8.

The acquisitions of B and C should be treated as a single acquisition since B and C are related to one another. Therefore, to perform the significance test, A must aggregate its investments in B and C. On the basis of the significance test results, B and C are 30 percent significant in the aggregate. Registrant A must present the abbreviated income statements of both B and C, even though C would not have been significant by itself. Because B and C have been under common control and the criteria for combination in ASC 810-10-55-1B were met, A may present separate or combined abbreviated income statements for B and C.

If a registrant acquires a group of individually insignificant related real estate operations, it should apply the guidance in this Q&A before applying the guidance on individually insignificant real estate operation acquisitions. For more information, see Section 2320 of the FRM.

2.4 Financial Statements Required in SEC Filings

2.4.1 Filings Requiring Abbreviated Income Statements for Significant Acquired or to Be Acquired Real Estate Operations

Q&A Regulation S-X: Rule 3-14-13

Question

What are the various SEC filings in which a registrant may be required to present abbreviated income statements for significant acquired or to be acquired real estate operations (acquirees)?

Answer

A registrant is required to present historical abbreviated income statements for significant acquirees in:

- Form 8-K.
- Registration statements.
- Proxy materials.
Under Rule 3-14, abbreviated income statements for significant acquirees are not required in annual or quarterly reports on Form 10-K or 10-Q but must be included in all transactional filings (i.e., proxy statements requiring financial information; Exchange Act registration statements; Securities Act registration statements, except registration statements filed under Securities Act Rule 462(b) or Rule 424 prospectuses; and post-effective amendments filed to reflect a fundamental change).

For further discussion of the significance calculation for real estate operations, see paragraph 2310.1 of the FRM and Sections 2.3.1 and 2.3.2 of this Roadmap.

**Form 8-K**

Requirements for Entities Other Than Blind Pools

Form 8-K, Item 2.01, requires a registrant to report the acquisition or disposition of a significant amount of assets outside of the ordinary course of business. As indicated in the note to paragraph 2310.3 of the FRM, the SEC staff has taken the position that the purchase or disposition of real estate by a registrant whose primary business is real estate activities is not considered to be in the ordinary course of business. Thus, such a registrant must file a Form 8-K when it acquires or disposes of a significant real estate operation.

A registrant must file an initial Form 8-K within four business days of consummating the acquisition of a real estate operation (or group of related real estate operations) that exceeds the 10 percent significance level. If the historical abbreviated income statements and related pro forma financial information are available, a registrant may file them along with the initial Form 8-K. Otherwise, a registrant other than a shell company has an additional 71 calendar days after the initial Form 8-K was required to be filed to file an amended Form 8-K that includes these financial statements.

Even if the acquisition is not within the scope of Rule 3-14, the registrant should consider whether the Form 8-K filing requirements for asset acquisitions under Item 2.01 apply. See Section 2.2.6 for additional information.

While a registrant is not required to report probable acquisitions of real estate operations in a Form 8-K, it must present historical abbreviated income statements for probable acquisitions of real estate operations (or groups of related real estate operations) that equal or exceed the 10 percent significance level in transactional filings, as defined earlier.

Requirements for Blind Pools Subject to Industry Guide 5

Paragraph 2325.4 of the FRM indicates that during the distribution period of a blind-pool offering, a registrant is required to file a “current report on Form 8-K that includes [Rule] 3-14 financial statements and the related pro forma information for each property acquired during the distribution period” that exceeds 10 percent of the registrant’s total assets as of the date of acquisition.

Further, paragraph 2325.5 of the FRM expresses the SEC staff’s view that after the distribution period of a blind-pool offering but before a registrant files its first annual report after the distribution period ends, the registrant is required to “file a Form 8-K with the required [Rule] 3-14 financial statements for every significant property [the registrant] purchases that represents [10 percent] or more of the [registrant’s] total assets as of the acquisition date.”

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36 Exchange Act Form 8-K, Item 2.01.
Paragraph 2325.5 of the FRM also states that the SEC “staff has not objected to the view that the undertaking to provide audited financial statements is not applicable to individually insignificant properties. [Rule] 3-14 financial statements may be omitted for individually insignificant properties.” In addition, paragraph 2325.5 of the FRM indicates that a “registrant may continue to use this modified method of measuring significance until it files its first annual report after the distribution period ends. After that, it would measure significance in the normal manner [as applicable to nonblind-pools] described in Section 2315 [of the FRM].”

**Registration Statements and Proxy Materials**

**Requirements for Entities Other Than Blind Pools**

A registrant is required to include abbreviated income statements for both consummated and probable acquisitions that exceed the 10 percent significance level in registration statements and certain proxy materials. Such abbreviated income statements may be included in the registration statement or incorporated from a previously filed Form 8-K.

Under **Rule 3-05**, a registrant may exclude from a registration statement financial statements of certain business acquisitions consummated less than 75 days before the registration statement is filed or declared effective unless the registrant has previously filed these financial statements. This option is not available under Rule 3-14. Therefore, a registrant must include abbreviated income statements of significant real estate operations acquired even if they were acquired less than 75 days before the registration statement is filed or declared effective.

Under **paragraph 2310.1** of the FRM, Rule 3-14 financial statements must be provided for any of the following:

- “[E]ach completed purchase of an individually significant property made during each year presented and subsequent to the end of the most recently completed fiscal year for which the registrant's financial statements have been filed.”
- “[A]ny probable acquisition of an individually significant property.”
- “[C]ompleted and probable acquisitions of individually insignificant properties that are significant in the aggregate, made or to be made subsequent to the end of the most recently completed fiscal year for which the registrant’s financial statements have been filed.”

Rule 3-14 requires a registrant to file financial statements for real estate properties for only one year and (as applicable) the current year-to-date interim period. Regarding the first bullet point above, however, a registrant must consider acquisitions made during each year for which it presents financial statements in determining whether preacquisition financial statements for the real estate property are required. Although all acquisitions that occurred during the second or third year back would be included in the registrant's financial statements for at least 12 audited months, the registrant cannot consider postacquisition results in assessing compliance with Rule 3-14. If a significant acquisition occurs during any of the periods presented for the registrant, financial statements would be required under Rule 3-14. For acquisitions made in the third year back, this could result in preacquisition financial statements for the property that predate the registrant’s own financial statements.

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37 See **paragraph 1140.1** of the FRM for additional information.

38 See **Section 1.4.1** for further discussion.

39 See **paragraph 2310.2** of the FRM.

40 This requirement applies to acquisitions from unrelated parties. For acquisitions from related parties, financial statements for additional periods may be necessary. For more information, see **Section 2.2.2**.
**Example**

Registrant A acquired real estate operations from unrelated third parties on May 5, 20X4 (Property B); September 21, 20X3 (Property C); and December 1, 20X2 (Property D). Each acquisition was individually significant at the 10 percent level or higher. All entities have December 31 fiscal year-ends. Registrant A plans to file an initial registration statement on March 1, 20X5.

Given that each property was individually significant at the 10 percent level or higher, A is required to provide Rule 3-14 abbreviated financial statements for:

- Property B for the year ended December 31, 20X3 (audited), and the three months ended March 31, 20X4 (unaudited).
- Property C for the year ended December 31, 20X2 (audited), and the six months ended June 30, 20X3 (unaudited).
- Property D for the year ended December 31, 20X1 (audited), and the nine months ended September 30, 20X2 (unaudited).

**Requirements for Blind Pools Subject to Industry Guide 5**

In addition to the requirements mentioned above and as discussed in paragraph 2325.2(b) of the FRM, a registrant must file a post-effective amendment to its registration statement at least every three months during the distribution period. The post-effective amendment “must include or incorporate by reference audited [Rule 3-14] financial statements . . . for all significant property acquisitions that have been consummated. Pro forma information is also required.”

Further, paragraph 2325.2 of the FRM expresses the SEC staff’s view that “[p]ost-effective amendments that consolidate supplements are not considered new filings for purposes of updating the registrant’s financial statements if the duty to file a post-effective amendment is triggered solely by the Item 20.D undertakings.” Accordingly, a “post-effective amendment filed to consolidate stickers or to update the financial statements under Section 10(a)(3) of the Exchange Act does not need to include financial statements for significant property acquisitions during the 71-day extension period allowed by Item 9.01 of Form 8-K” unless it is filed for a fundamental change.

**2.4.2 Form, Content, Number of Periods, and Age of Separate Abbreviated Income Statements of Real Estate Operations and Pro Forma Requirements**

**Q&A Regulation S-X: Rule 3-14-14**

**Question**

If a registrant acquires, or it is probable that it will acquire, significant real estate operations, what factors should the registrant consider with respect to the form, content, number of periods, and age of the required separate financial information?
**Chapter 2 — Real Estate Operations Acquired or to Be Acquired**

**Answer**

**Form and Content of Financial Statements**

Rule 3-14 requires a registrant to include audited abbreviated income statements (not including earnings per unit) for significant real estate operations. As specified in Rule 3-14(a)(1), the abbreviated income statements “shall exclude items not comparable to the proposed future operations of the property such as mortgage interest, leasehold rental, depreciation, corporate expenses and Federal and state income taxes.”

Rule 3-14 does not require a registrant to present balance sheets, statements of changes in equity, or cash flow statements. The audited abbreviated income statements described above are presented in the form of revenues and direct expenses. In addition, since these income statements are abbreviated and follow specific requirements of Rule 3-14, they are considered special-purpose financial statements. The auditors’ report on these financial statements would include an explanatory paragraph indicating the special purpose and the incomplete nature of the presentation of the results of operations, as discussed in AICPA SAS 122 (AU-C Section 805.24).

Paragraph 2330.7 of the FRM states:

> The registrant should describe any material factors which would cause the reported financial information not to be indicative of future operating results, such as a change in how the property will be used, an expected material modification to the property or a material change in property tax assessment.

**Periods to Be Presented — Real Estate Operations Acquired From a Related Party**

If a significant real estate operation is acquired from a related party, the acquiring entity must present the audited abbreviated income statements for the three most recent fiscal years (two years for SRCs) and the current unaudited year-to-date interim period. For a definition of the term “related party,” see Regulation S-X, Rule 1-02(u), which refers to the definition used in ASC 850-10-20. For properties held by the related party for less than three years, financial statements are required for the greater of (1) the period the property was held by the related party or (2) one year.

**Periods to Be Presented — Real Estate Operations Acquired From an Unrelated Party**

Rule 3-14 states that a registrant may present information for only the most recent audited fiscal year and unaudited year-to-date interim period if:

- “The property is not acquired from a related party.”
- “Material factors considered by the registrant in assessing the property are described with specificity in the filing with regard to the property, including sources of revenue . . . and expense.”
- “The registrant indicates in the appropriate filing that, after reasonable inquiry, the registrant is not aware of any material factors relating to that specific property . . . that

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41 Registrants may request relief from the audit requirement for financial statements of properties with a rental history of less than one year (see Section 2.2.4 for more information). In addition, there are exceptions to the requirement to provide abbreviated income statements for properties that will be demolished (see Section 2.2.5) or that were previously owner-occupied or used in nonrental operations (see Section 2.2.6).

42 For the audit requirements for these financial statements, see Section 1.4.2.
would cause the reported financial information not to be necessarily indicative of future operating results.”

Periods to Be Presented — Other

Paragraph 2330.4 of the FRM states:

It is not appropriate to provide audited financial statements for a rolling 12-month period prior to the acquisition in lieu of audited financial statements for the latest fiscal year end of the property. Also, pre- and post-acquisition periods should not be combined to produce a year's financial statements. Only pre-acquisition financial statements satisfy [Rule] 3-14.

Rule 3-06(b), which allows nine months of financial statements to be presented instead of twelve months for acquired businesses, generally does not apply to real estate operations.

Pro Forma Financial Information

Pro forma financial information prepared in accordance with Article 11 is required for acquisitions or probable acquisitions of significant real estate operations. In addition to the Article 11 pro forma financial information, if the estimated operating results and cash distributions per unit of the property are taxable, registrants may also be required to present certain pro forma financial information prepared in accordance with Rules 3-14(a)(2) and 3-14(a)(3). For further discussion of pro forma information for real estate operations, see Section 3440 of the FRM.

Age of Financial Statements

Paragraph 2330.6 of the FRM states that the same rules for updating financial statements prepared in accordance with Rule 3-05 apply to abbreviated income statements for acquired or to be acquired real estate operations prepared under Rule 3-14. For additional information, see Section 1.11.

2.4.3 Financial Statement Disclosures — Materiality Under ASC 805 Versus Significance Under Rule 3-14

Q&A Regulation S-X: Rule 3-14-15

ASC 805-10-50-1 through 50-8 require that annual and interim financial statements include certain disclosures in the period in which a material business combination is consummated.

Question

If a business acquisition does not meet the significance thresholds of Rule 3-14 for financial statement presentation, may a registrant omit the financial statement disclosures required by ASC 805 in the period in which the acquisition is consummated?

Answer

Not necessarily. Materiality under ASC 805 is not the same as significance under Rule 3-14. The materiality threshold under ASC 805 is generally lower than that under Rule 3-14. Therefore, registrants must separately determine what financial statement disclosures are required under ASC 805 for an individually material business combination (or for individually immaterial business combinations that are collectively material). Registrants should use their ASC 805
materiality threshold for financial statement disclosures consistently between years. Also see Section 1.6.2.

2.4.4 SEC Reporting Requirements for REIT Spin and REIT Conversion Transactions

Q&A Regulation S-X: Rule 3-14-16

At the “SEC Speaks in 2015” Conference hosted by the Practising Law Institute in February 2015, the SEC staff in the Division of Corporation Finance observed that there has been an increase in REIT transactions in which an operating company (1) spins off its real estate assets and leases them back (a “REIT spin”) or (2) is converted entirely into a REIT (a “REIT conversion”).

Question

What are the SEC reporting considerations for a REIT spin or a REIT conversion?

Answer

For a REIT spin, the staff indicated that registrants should consider providing the following financial statements in their initial registration statement:

- An audited opening balance sheet (i.e., a “seed money” balance sheet) for the registrant.
- Carve-out financial statements when a rental history exists; alternatively, a schedule of investments may be appropriate if there is no rental history.
- Significant tenant financial statements when the operating company leases back the real estate assets. The staff noted that if the operating company (which is the significant tenant) is an SEC reporting entity, it would be sufficient to explicitly refer to its periodic reports.44
- Pro forma financial statements prepared in accordance with Article 1145 or a forecasted income statement.
- Nonregistrant financial statements (or other entities’ financial statements) in accordance with the guidance in Rule 3-0546 or Rule 3-1447 on acquisitions of businesses or real estate operations, respectively. Such financial statements may need to be provided, for example, if some of the spun-off assets were acquired recently. The staff reminded registrants that in these circumstances, the measurement basis for the significance test under Rule 3-05 or Rule 3-14 would be the carve-out financial statements and not the prior entity.

43 On its Web site, the SEC defines a REIT as follows: “A real estate investment trust (REIT), generally, is a company that owns — and typically operates — income-producing real estate or real estate-related assets. REITs provide a way for individual investors to earn a share of the income produced through commercial real estate ownership — without actually having to go out and buy commercial real estate. The income-producing real estate assets owned by a REIT may include office buildings, shopping malls, apartments, hotels, resorts, self-storage facilities, warehouses, and mortgages or loans.”
44 See Section 2340 of the FRM for additional information.
45 For additional information, see Section 1.1.
46 For additional information, see Section 1.1.
47 For additional information, see Section 2.1.
The SEC staff also discussed the filing requirements of Schedule III\(^{48}\) under which registrants must present detailed supplemental information about real estate investments and accumulated depreciation. The staff observed that many registrants have had difficulties in obtaining some of the required information. In these cases, the SEC has considered waiver requests to (1) disclose certain cost information prospectively or (2) provide levels of aggregated information when a significant number of assets would otherwise need to be disclosed separately.

The staff also has observed a higher frequency of REIT transactions in industries other than real estate (e.g., involving assets such as cell towers, data centers, and billboards). Further, for REIT conversions that do not involve traditional real estate companies, the staff noted that the disclosure requirements for real estate assets have not been appropriately considered. The staff suggested that such registrants should strive to comply with the spirit of the disclosure requirements when considering their unique assets (e.g., portfolio occupancy, effective rents, material tenant concentrations, category and physical location of the assets, significant lease types, and lease expiration dates).

Because REIT transactions (including REIT spin and REIT conversion transactions) can be complex, the SEC staff has encouraged registrants that are contemplating such transactions to consult with the CF-OCA.

\(^{48}\) The schedule is required for certain real estate companies in accordance with Regulation S-X, Rule 12-28.
Chapter 3 — Pro Forma Financial Information

3.1 Introduction to SEC Reporting Requirements for Pro Forma Financial Information

This introduction outlines the considerations used to determine the SEC reporting requirements for pro forma financial information. The applicable SEC reporting requirements are primarily in Article 11 and Topic 3 of the FRM. The Q&As that follow offer additional interpretations, and registrants should be certain to review both those interpretations and Regulation S-X, as well as consider consulting with their audit and legal professionals, to determine the appropriate SEC reporting requirements. Note that this chapter does not provide guidance on U.S. GAAP requirements for pro forma financial information (e.g., pro forma information required for business combinations under ASC 805). For such guidance, readers should refer to ASC 805 and Deloitte’s *A Roadmap to Accounting for Business Combinations*.

The objective of providing pro forma financial information is to enable investors to understand and evaluate the impact of a transaction by showing how that specific transaction (or group of transactions) might have affected the registrant’s historical financial position and results of operations had the transaction occurred at an earlier date.

Article 11 lists several circumstances in which a registrant may be required to provide pro forma financial information. These circumstances include the following:

- A significant business combination has occurred or is probable.
- The disposition of a significant portion of a business has occurred or is probable.
- The acquisition of one or more real estate properties (that are significant in the aggregate) has occurred or is probable.

Article 11 also addresses other transactions for which pro forma financial information would be material to an investor. In certain circumstances, pro forma financial information may need to reflect multiple outcomes or transactions, such as the acquisition of a probable business combination along with the acquisition of another business acquired during the fiscal year. Registrants must consider their specific facts and circumstances to determine whether pro forma financial information is meaningful to an investor and, if so, the appropriate manner of presenting it.

While the following Q&As primarily apply to pro forma financial information for a consummated or probable business combination, most of them also apply to other transactions, such as the disposition of a significant portion of a business. However, when preparing pro forma financial information for transactions other than consummated or probable business combinations, readers should also review other applicable SEC guidance (e.g., Section 2100 of the FRM and Section 8.4 of Deloitte’s *A Roadmap to Disposals of Long-Lived Assets and Discontinued Operations* for considerations related to presenting pro forma financial information for significant consummated or probable business dispositions).
Note also that there may be situations in which registrants wish to seek relief from complying with the various reporting requirements under Regulation S-X, including the omission of financial statements of an acquiree under Rule 3-05 and the related pro forma financial information. See the Roadmap’s introduction for a discussion of waiver requests under Rule 3-13.

**Basic Presentation Requirements for Pro Forma Financial Information**

Pro forma financial information should generally include an introductory paragraph, a pro forma balance sheet, pro forma income statements, and accompanying explanatory notes.

Article 11 does not require the presentation of pro forma statements of cash flows and statements of shareholders’ equity.

Pro forma financial statements should generally be presented in columnar form, with separate columns for the historical financial information, pro forma adjustments, and pro forma results. In limited circumstances, a registrant may present narrative disclosures in lieu of pro forma financial statements.

Article 11 contains various instructions for presenting pro forma financial information but has been written “in a broad fashion since flexibility is necessary to tailor pro forma disclosures to particular events and circumstances.”

**When Pro Forma Financial Information Is Required**

Pro forma financial information may be required in a registration statement, a proxy statement, or a Form 8-K to give effect to a business combination. Pro forma financial information prepared in accordance with Article 11 is not required in a Form 10-K or 10-Q.

Factors that may affect whether a registrant is required to include pro forma financial information in a filing to reflect a business combination include the following:

- Whether the business combination is significant.
- Whether the separate financial statements of the acquired or to be acquired business are included in the filing.
- Whether the transaction is reflected in the historical financial statements.

Each of these considerations is explained in more detail below.

**Whether the Business Combination Is Significant**

A registrant preparing pro forma financial information would generally determine the significance of a consummated or probable business combination in accordance with Rule 3-05. However, the level of significance for pro forma information purposes, unlike the level of significance in Rule 3-05, does not affect the number of periods for which pro forma financial information must be presented.

A registrant must therefore determine whether the business would be a significant subsidiary, as defined in Rule 1-02(w). If a registrant determines that a consummated or probable business combination is significant, pro forma financial information is required unless, as indicated below, the historical financial statements of the acquired or to be acquired business are not required in the filing.

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1 See Codified Financial Reporting Release Section 506.02(a)(ii).
2 Pro forma financial information is required in a merger proxy statement if it is material to a voting decision. For guidance on merger proxy statements, see Section 3.2.1.
under Rule 3-05 or the transaction is already reflected in the registrant’s historical financial statements for the appropriate period.

Whether the Separate Financial Statements of the Acquired or to Be Acquired Business Are Included in the Filing

Pro forma financial information depicting an acquisition is generally only required if the acquisition is significant under Rule 3-05 or if disclosure of such pro forma information would be material to investors (see the Registrant Acquires an Additional Equity Interest in an Already Consolidated Entity discussion for more information). For example, Rule 3-05 indicates that separate financial statements for a probable business acquisition are not required in a registration statement unless the acquisition exceeds the 50 percent significance level. Therefore, if a probable business combination is at or below the 50 percent significance level, historical and pro forma financial information is not required in the filing. In circumstances in which financial statements are required under Rule 3-05, pro forma financial information should be filed at the same time as the financial statements required under Rule 3-05. See paragraph 3110.4 of the FRM.

Whether the Transaction Is Reflected in the Historical Financial Statements

A pro forma balance sheet is not required if the transaction is already reflected in the historical balance sheet. Similarly, a pro forma income statement is not required if the transaction is included in the historical financial statements for the appropriate period for which pro forma financial statements are required. Depending on the facts and circumstances, a registrant may be required to include a pro forma income statement (or statements) but would not be required to include a pro forma balance sheet to reflect a business combination. This situation could occur, for example, if an acquisition was consummated during an interim period but before the balance sheet date.

3.2 Pro Forma Financial Information Required in SEC Filings

3.2.1 SEC Filings Requiring Pro Forma Financial Information for a Significant Consummated or Probable Business Combination

Q&A Regulation S-X: Rule 11-01-1

Question
What SEC filings require the presentation of pro forma financial information for a significant consummated or probable business combination?

Answer
As discussed in more detail below, the types of SEC filings in which a registrant may be required to present pro forma financial information for a significant consummated or probable business combination include the following:

- Form 8-K.
- Registration statements.

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3 See Section 3.2.2 for a discussion of significance and when pro forma financial information is required.

4 For information about situations in which financial statements and pro forma financial information may be required, see Section 1.4.1.
• Proxy statements.
• Prospectus supplements.

Under Article 11, pro forma financial information is not required in a Form 10-K or 10-Q. However, pro forma data required by U.S. GAAP under ASC 805 must be included in the notes to the financial statements in a Form 10-K or Form 10-Q, as appropriate.

Form 8-K

Significant Consummated Business Acquisition

A registrant must file an initial Form 8-K (under Item 2.01) within four business days of the consummation of a business acquisition that exceeds the 20 percent significance level. Pro forma financial information depicting an acquisition is only required if the acquisition is significant under Rule 3-05. A registrant may file such financial statements and pro forma financial information in the initial Form 8-K. Otherwise, the registrant has an additional 71 calendar days to file an amended Form 8-K to include the separate financial statements and pro forma financial information.

Significant Probable Business Acquisition

A registrant is not required to file financial statements or pro forma financial information in a Form 8-K for a significant probable business acquisition. However, upon consummation of an acquisition, a registrant must comply with the applicable Form 8-K filing requirements noted above for a significant consummated business acquisition.

Other

For guidance on the acquisition of real estate operations, see Rule 3-14, Section 2300 of the FRM, and the Q&As in Chapter 2. For Form 8-K requirements and pro forma financial reporting considerations related to asset acquisitions, see Section C.5 of Deloitte’s A Roadmap to Accounting for Business Combinations.

Registration Statements

A registration statement must contain the pro forma financial information of a significant business acquisition consummated 75 or more days ago. (For the acquisition of a target company presented in a Form S-4, see discussion below.) Such pro forma financial information may be included in the registration statement or incorporated from a previously filed Form 8-K. In addition, pro forma financial information is required in registration statements for a probable acquisition or a recently consummated acquisition that exceeds the 50 percent significance level (the 75-day period does not apply to acquisitions that are more than 50 percent significant).

If the acquisition does not exceed the 50 percent significance level, a registrant may exclude pro forma financial information of (1) a business acquisition consummated less than 75 days before the registration statement is filed or declared effective or (2) a probable business acquisition. Upon consummation of this acquisition, the registrant has a specified period to file the pro forma financial information of the acquired business (see the Form 8-K subsection above). Therefore, this pro forma financial information is not required in a registration statement that is filed or declared effective before the 75th day after consummation unless it has been previously filed by the registrant. If a significant acquisition is consummated 75 or more days before a
registration statement is filed or declared effective, the pro forma financial information of a significant acquiree is required.

Paragraph 3110.3 of the FRM notes that pro forma financial statements are not required for individually insignificant businesses unless they exceed the 50 percent significance level in the aggregate. Furthermore, this paragraph notes that “[i]f certain financial statements are included in the filing under S-X 3-05(b)(2)(i), registrants should consider whether the pro forma financial information would be misleading without giving effect to all individually insignificant acquisitions.”

The following table summarizes some of the above-noted circumstances in which a registrant may be required to provide pro forma financial information for a significant business combination in a registration statement:

<table>
<thead>
<tr>
<th>Circumstances</th>
<th>Financial Information Required</th>
</tr>
</thead>
<tbody>
<tr>
<td>Significant business combination is probable; significance threshold exceeds 50 percent.</td>
<td>In this situation, a registrant must provide separate financial statements of the acquiree in accordance with Rule 3-05. Therefore, pro forma financial information would be required in the registration statement.</td>
</tr>
<tr>
<td>Significant business combination is probable; significance threshold is less than 50 percent.</td>
<td>In this situation, a registrant is not required to provide separate financial statements of the acquiree in accordance with Rule 3-05. Therefore, pro forma financial information would not be required in the registration statement.</td>
</tr>
<tr>
<td>Significant business combination is consummated during the most recent fiscal year or the subsequent interim period; significance threshold exceeds 50 percent.</td>
<td>In this situation, a registrant must provide separate financial statements of the acquiree in accordance with Rule 3-05. Therefore, pro forma financial information would be required in the registration statement.</td>
</tr>
<tr>
<td>Significant business combination is consummated during the most recent fiscal year or the subsequent interim period; significance threshold is less than 50 percent; registration statement is filed or declared effective before the 75th day after consummation.</td>
<td>In this situation, a registrant is not required to provide separate financial statements of the acquiree in accordance with Rule 3-05. Therefore, pro forma financial information would not be required in the registration statement.</td>
</tr>
</tbody>
</table>

Registration Statements on Form S-4 to Register Securities Being Offered to Security Holders of a Target

A registration statement filed on a Form S-4 may be used to register securities being offered to security holders of a business that has been identified as a potential acquisition (i.e., target). The financial statement requirements for a Form S-4 will depend on whether an issuer’s shareholder vote is required or whether the target is a registrant, in which case financial statements may be required even if the acquisition does not exceed the 20 percent significance level under Rule 3-05.

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5 For more information about individually insignificant business acquisitions, see Section 1.9.2.
6 See also Section 1.4.1 for a discussion of circumstances in which pro forma financial information may be omitted from draft registration statements.
7 Refer to Section 1.4.1.
However, pro forma financial information reflecting an acquisition on Form S-4 is only required if the acquisition exceeds the 20 percent significance level under Rule 3-05. See Form S-4, Item 5, and other applicable instructions in Form S-4 regarding the requirements for pro forma financial information.

Item 5 notes that pro forma financial information may be required for transactions other than the acquisition that is the subject of the Form S-4. Item 5 and paragraph 3240.6 of the FRM indicate that when the proceeds of an offering are used to fund an acquisition, pro forma information for an unrelated transaction (e.g., another significant acquisition consummated during the fiscal year) should be presented separately.

**Proxy Materials**

The form instructions to Schedule 14A, including Item 13, provide guidance on the financial statement requirements for a proxy statement that relates to an action to authorize, issue, exchange, or modify securities. Item 13 also requires financial statements under Rule 3-05 and pro forma financial information under Article 11 for transactions other than the subject of the proxy statement. However, financial information is not required if it is not material for the exercise of prudent judgment concerning the matter to be voted upon. For other transactions, refer to the proxy rules.

See the discussion under **Registration Statements** above regarding pro forma financial information for individually insignificant business acquisitions.

**Proxy Materials for Business Combinations**

The pro forma financial information requirements for a business combination in a merger proxy statement vary according to factors such as (1) who the voting shareholders are and (2) the form of consideration. If the consideration issued in the business acquisition includes registered securities, the registrant must comply with the pro forma financial information requirements of Form S-4 (see **Registration Statements on Form S-4 to Register Securities Being Offered to Security Holders of a Target** above). For information about the pro forma requirements in proxy materials, see **Section 1.4.1**.

As noted in Instruction 6 of Rule 11-02(b), “If the pro forma financial information is presented in a proxy or information statement for purposes of obtaining shareholder approval of one of the transactions, the effects of that transaction must be clearly set forth.” In addition, paragraph 3240.6 of the FRM indicates that “[p]ro forma information for a particular acquisition or other transaction usually should be presented separately from pro forma information for unrelated transactions for which pro forma information may be required if [among other items] shareholders are being asked to vote on that acquisition or other transaction.” See **Section 3.3.2.4** for a discussion of how multiple transactions should be reflected in pro forma financial information.

**Prospectus Supplements to Registration Statements That Currently Are Effective**

For currently effective registration statements (e.g., an existing Form S-3) upon which a registrant wishes to draw down or issue securities, a registrant may use a prospectus supplement. The requirement to present pro forma financial information is generally predicated on whether
3.2.2 Pro Forma Financial Information Requirements for a Consummated or Probable Business Combination

Q&A Regulation S-X: Rule 11-01(a)-1

Question
In what circumstances must a registrant reflect a consummated or probable business\(^8\) combination in its pro forma financial information?

Answer

Rule 11-01(a) requires that pro forma financial information reflect a business combination in the following circumstances:

- A significant business combination has occurred during the most recent fiscal year or subsequent interim period for which a balance sheet is required by Rule 3-01.\(^9\)
- A significant business combination has occurred, or it is probable\(^9\) that it will occur, after the date of the most recent balance sheet filed.
- A significant business combination to be accounted for as a reorganization of entities under common control is probable,\(^10\) or was consummated after the latest balance sheet date but is not yet reflected in the historical financial statements.
- The registrant (acquirer) is registering securities to be offered to the security holders of a significant business to be acquired, or the proceeds from the offered securities will be used directly or indirectly to purchase a specific significant business.
- The registrant has acquired, during the most recent fiscal year or subsequent interim period for which a balance sheet is required by Rule 3-01, one or more real estate operations or properties that are significant in the aggregate.
- The registrant has acquired, or it is probable that it will acquire, one or more real estate operations or properties that are significant in the aggregate since the date of the most recent balance sheet for which a balance sheet is required by Rule 3-01.

Pro forma financial information is required for a consummated or probable business combination when the business would be a significant subsidiary.\(^11\) As noted in paragraph 3110.1 of the FRM, “This includes any transaction or event that results in the registrant obtaining control over another entity.” The determination of significance for pro forma financial information purposes is the same as the determination of significance for purposes of the separate financial statement requirement of an acquired or to be acquired business (acquiree) in accordance with Rule 3-05.\(^12\) However, the level of significance for pro forma information

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8 See Section 1.3.1 for guidance on determining whether a registrant has acquired, or whether it is probable that it will acquire, a business. A purchase of a business includes, for example, the purchase of an investment accounted for under the equity method. The note to paragraph 3110.1 of the FRM indicates that although the acquisition of an equity method investee meets the definition of a business, “full pro forma financial information prepared under Article 11 generally is not required if the registrant elects the fair value option for the investment under [ASC 825-10].” Instead, registrants should “include a narrative discussion explaining how the application of [ASC 825-10] will impact the results of operations and balance sheet in future periods.”

9 See Section 1.2.1 for a discussion of factors to consider in determining whether an acquisition is “probable” for SEC reporting purposes.

10 A registrant is not required to provide pro forma financial information after the registrant’s historical financial statements have been retroactively restated to reflect a reorganization of entities under common control. See paragraph 3110.1 of the FRM for more information.

11 For guidance on merger proxy statements, see Section 3.2.1.

12 For more information, see Section 1.6.1.
purposes, unlike the level of significance in Rule 3-05, does not affect the number of periods for which pro forma financial information must be presented. Rather, once a consummated or probable acquisition is determined to be significant, pro forma financial information is required unless the transaction is already reflected in the historical financial statements, as discussed below.

**Rule 11-01(b)(1)** indicates that a business combination is significant if:

A comparison of the most recent annual financial statements of the business acquired or to be acquired and the registrant's most recent annual consolidated financial statements filed at or prior to the date of acquisition indicates that the business would be a significant subsidiary pursuant to the conditions specified in [Rule 1-02(w)], substituting 20 percent for 10 percent each place it appears therein.

A registrant must also consider **Rules 11-01(c)** and **11-02(c)**. **Rule 11-01(c)** indicates that the “pro forma effects of a business combination need not be presented pursuant to this section if separate financial statements of the [acquiree] are not included in the filing.” This means that if a registrant is not required to include separate financial statements of an acquiree in accordance with Rule 3-05, pro forma financial information for the consummated or probable business combination is also not required.

**Rule 11-02(c)** further states that a pro forma balance sheet is not required if the transaction is already reflected in the historical balance sheet and, similarly, that a pro forma income statement is not required if the transaction is already reflected in the historical income statement for the entire period.

### 3.3 Form and Content of Pro Forma Financial Information

#### 3.3.1 General Presentation Requirements

##### 3.3.1.1 Basic Presentation of Pro Forma Financial Information

**Q&A Regulation S-X: Rule 11-02(b)-1**

**Question**

What are the basic presentation requirements for pro forma financial information?

**Answer**

**Rule 11-02(b)** outlines the basic presentation requirements for pro forma financial information. Pro forma financial information should generally include the following:

- Introductory paragraph.
- Pro forma balance sheet.
- Pro forma income statements.
- Accompanying explanatory notes.

**Article 11** does not require the presentation of pro forma statements of cash flows and statements of shareholders' equity.

Pro forma financial statements should generally be presented in columnar form, with separate columns for historical financial information, pro forma adjustments, and pro forma results. For information about pro forma financial statement periods to be presented, see **Section 3.3.1.2**.
For a discussion of the limited circumstances in which narrative disclosures may be presented, see the Narrative Presentation in Lieu of Pro Forma Financial Statements section below.

**Introductory Paragraph**
Pro forma financial information should begin with an introductory paragraph that describes, at a minimum, (1) the transaction, (2) the entities involved, (3) the periods for which the pro forma information is presented, and (4) what the pro forma presentation shows. The introductory paragraph should clearly explain the objective of the pro forma financial information.

**Pro Forma Balance Sheet**
A pro forma balance sheet may be presented in condensed form in a manner similar to the interim financial statements required in Form 10-Q under Regulation S-X, Article 10. The pro forma balance sheet should reflect the major (i.e., numbered) captions in Regulation S-X, Rule 5-02. Any balance sheet caption that is less than 10 percent of total assets may be combined with other captions.

A pro forma balance sheet is not required if the transaction is already reflected in the registrant's most recent balance sheet included in the filing.

**Pro Forma Income Statements**
Pro forma income statements may be presented in condensed form in a manner similar to the interim financial statements required in Form 10-Q under Regulation S-X, Article 10. The pro forma income statements should reflect the major (i.e., numbered) captions in Regulation S-X, Rule 5-03. Rule 11-02(b)(3) states, in part:

> When any major statement of comprehensive income caption is less than 15 percent of average net income attributable to the registrant for the most recent three fiscal years, the caption may be combined with others. In calculating average net income attributable to the registrant, loss years should be excluded unless losses were incurred in each of the most recent three years, in which case the average loss shall be used for purposes of this test.

The pro forma income statement requires that income from continuing operations be presented before discontinued operations. SEC Codified Financial Reporting Release Section 506.02(a)(ii) clarifies that "any discontinued operations . . . would not be reflected in the condensed historical [income statement] used as the starting point for the pro forma presentation" (i.e., the “bottom line” in the historical column and the pro forma column should be income from continuing operations). Historical and pro forma earnings per share should be presented on the basis of income from continuing operations (or net income if the registrant does not report discontinued operations), and the number of shares used to compute such amounts should be disclosed.

**Accompanying Explanatory Notes**
The pro forma financial information should be accompanied by notes that clearly explain each pro forma adjustment, the assumptions used, and other relevant information.

**Narrative Presentation in Lieu of Pro Forma Financial Statements**
In the limited cases in which only a few adjustments are required and those adjustments are easily understood, a registrant may include a narrative presentation of the pro forma effects of
a transaction. In such cases, a registrant could provide narrative disclosures in lieu of full pro forma financial statements.

3.3.1.2 Periods to Be Presented in Pro Forma Financial Information

Q&A Regulation S-X: Rule 11-02(c)-1

Question
What periods should be presented in pro forma financial information?

Answer

Article 11 specifies the periods to be presented in the pro forma balance sheet and the pro forma income statements. The registrant should use its fiscal year when presenting pro forma financial statements.

Pro Forma Balance Sheet

Rule 11-02(c)(1) indicates that a pro forma balance sheet should be presented “as of the end of the most recent period for which a consolidated balance sheet of the registrant is required by [Rule 3-01] unless the transaction is already reflected in such balance sheet.”

Therefore, a pro forma balance sheet should be presented for only the most recent balance sheet included in the filing (i.e., one pro forma balance sheet as of the end of the fiscal year or the subsequent interim period, whichever is later). A pro forma balance sheet is not required, however, if the registrant’s most recent balance sheet included in the filing already reflects the consummated transaction (e.g., the transaction occurred before the balance sheet date).

Pro Forma Income Statements

Rule 11-02(c)(2) indicates that pro forma income statements should be presented for “only the most recent fiscal year and for the period from the most recent fiscal year end to the most recent interim date for which a balance sheet is required” by Rule 3-01 (except, as noted below, for a reorganization of entities under common control and to reflect discontinued operations). Rule 11-02(c)(2) also permits, but does not require, a pro forma presentation for the comparative interim period of the previous fiscal year. A pro forma income statement does not, however, need to be presented when the “historical income statement reflects the transaction for the entire period.”

Paragraph 3230.2 of the FRM indicates that pro forma income statements are required for all periods presented in the following circumstances:

- “For a business combination to be accounted for as a reorganization of entities under common control.”
- “For discontinued operations . . . that are not yet reflected in the annual historical [financial] statements.”

In addition, Rule 11-02(c)(4) indicates that a registrant may present, in addition to the required pro forma income statements, an additional pro forma condensed income statement for the

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13 See the highlights of the September 2017 CAQ SEC Regulations Committee joint meeting with the SEC staff, which discuss the nature of pro forma adjustments that should be included in the earliest two periods presented.
most recent 12-month period whenever unusual events occur during the most recent fiscal year.

**Example 1**

- Registrant A, a calendar-year-end company, files a registration statement on December 28, 20X8.
- The registration statement includes A’s (1) historical audited financial statements as of December 31, 20X7, and 20X6 and for the three years ended December 31, 20X7, and (2) unaudited interim financial statements as of September 30, 20X8, and for the nine-month periods ended September 30, 20X8, and 20X7.
- Registrant A acquired Company B on September 1, 20X8, in a business combination.
- Registrant A determines that the acquisition of B is significant such that B's separate financial statements and pro forma financial information for the business combination must be included in the registration statement.

Rule 11-02(c)(1) requires a pro forma balance sheet as of the end of the most recent period included in the filing (i.e., September 30, 20X8), unless the balance sheet already reflects the transaction. Rule 11-02(c)(2) requires a pro forma income statement for the most recent fiscal year and interim period of the registrant unless the transaction has been reflected in the historical income statement for the entire period.

In this example, A is not required to include a pro forma balance sheet in its registration statement because A's historical September 30, 20X8, balance sheet already reflects the acquisition of B.

Registrant A would need to include pro forma income statements for the year ended December 31, 20X7, and the nine-month period ended September 30, 20X8. The pro forma income statement for the year ended December 31, 20X7, would include a separate column for B's results for the entire period. The pro forma income statement for the interim period would include a separate column for B's results for the period from January 1, 20X8, to September 1, 20X8, the date of acquisition.

**Example 2**

Assume the same facts as in Example 1, except that A acquired B on October 5, 20X8.

In this example, A is required to include a pro forma balance sheet as of September 30, 20X8, in the registration statement to give effect to the acquisition of B. The pro forma balance sheet is required because A's historical September 30, 20X8, balance sheet does not reflect the acquisition of B.

Registrant A would need to include pro forma income statements for the year ended December 31, 20X7, and the nine-month period ended September 30, 20X8, including a separate column for B’s results for the entire period.

**Example 3**

Assume the same facts as in Example 2, except that the acquisition of B is considered a reorganization of entities under common control for all periods presented.

In this example, A is required to include a pro forma balance sheet as of September 30, 20X8, in the registration statement to give effect to the acquisition of B. The pro forma balance sheet is required because A's historical September 30, 20X8, balance sheet does not reflect the reorganization.

Registrant A would need to include pro forma income statements for the years ended December 31, 20X7, 20X6, and 20X5 and for the nine-month period ended September 30, 20X8, including a separate column for B's results for the entire period.
3.3.2  Pro Forma Presentation Issues

3.3.2.1  Presentation of Pro Forma Information When a Transaction Is Structured Such That Significantly Different Results May Occur

Q&A Regulation S-X: Rule 11-02(b)(8)-1

Question
How should a registrant present pro forma financial information when a specific transaction is structured such that significantly different results may occur?

Answer
When a transaction is structured such that a range of possible results may occur, a registrant may need to provide multiple sets of pro forma financial information. Rule 11-02(b)(8) states:

If the transaction is structured in such a manner that significantly different results may occur, additional pro forma presentations shall be made which give effect to the range of possible results.

If a transaction is structured with only one variable that may change, a registrant may consider providing only a sensitivity analysis rather than multiple sets of pro forma financial information. Paragraph 3240.5 of the FRM gives an example of a business combination in which the total dollar amount of the acquisition may change. This example notes that the sensitivity analysis presented should give an indication of the potential impact on the pro forma balance sheet for an appropriate incremental fluctuation in the variable that may change.

A registrant should carefully analyze the facts and circumstances when determining how to present pro forma financial information when a transaction is structured such that significantly different outcomes could occur.

3.3.2.2  Combining Entities With Different Fiscal Year-Ends

Q&A Regulation S-X: Rule 11-02(c)-2

Question
What historical financial information should be presented in pro forma financial statements to reflect a business combination if the entities have different fiscal year-ends?

Answer
It depends. Entities with fiscal year-ends that differ by 93 days or less may combine their historical financial information in pro forma financial statements without any recasting of periods. If, however, the fiscal year-ends of the entities differ by more than 93 days, the income statements of the acquiree should be recast and brought to within 93 days of the registrant’s periods.

The fiscal year of the registrant should be used to determine the date for which pro forma financial statements should be presented. See Section 3.3.1.2 for information regarding the periods to be presented in pro forma financial information.
**Pro Forma Balance Sheet**

A pro forma balance sheet should be presented as of the registrant's latest balance sheet date included in the filing. The pro forma balance sheet should include the acquiree's historical financial information as of its most recent balance sheet date.

**Pro Forma Income Statements**

Pro forma income statements should generally be presented for both the registrant's most recent fiscal year and any applicable interim period (except to reflect discontinued operations or a reorganization of entities under common control). If the fiscal year-end of an acquiree differs from that of the registrant by more than 93 days, the acquiree's historical information in the pro forma income statement must be adjusted and brought to within 93 days of the registrant's most recent fiscal year-end in accordance with Rule 11-02(c)(3).

This is generally accomplished by adding subsequent interim-period results to the acquiree's most recent fiscal-year-end information and deducting the comparable preceding year interim-period results to create a 12-month period ending within 93 days of the registrant's most recent fiscal year-end. Since the acquiree's historical income statements will generally include the same number of months as the registrant's income statements, there may be an overlapping period in the acquiree's historical income statement for both the fiscal year and interim period or an omitted period excluded from both.

The notes to the pro forma financial information should disclose (1) the periods combined and (2) the sales or revenues and income for any periods that were excluded or included more than once (e.g., an interim period that is included both as part of the fiscal year information and the subsequent interim period). Furthermore, paragraph 3330.2 of the FRM states, “Additional quantitative and narrative disclosure about gross profit, selling and marketing expenses, and operating income of any period excluded from or included more than once may be necessary to inform readers about the effects of unusual charges or adjustment in the omitted or double-counted period.”

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14 The number of months included for the acquiree's historical operations will generally match the number of months included for the registrant's historical operations. It is generally not appropriate, for example, to include 11 months of historical operations for the acquiree if 12 months of the registrant's operations are included in the pro forma income statement. Postacquisition results of the acquiree that are included in the historical results of the registrant being adjusted are an exception.

15 For other required disclosures in pro forma financial statements, see Section 3.3.1.1.
Example

- Registrant R, a calendar-year-end company, acquired Company B on August 1, 20X9. Company B is an SEC registrant with an August 31 year-end.
- Registrant R determines that the acquisition of B is significant such that B's separate financial statements and pro forma financial information for the business combination must be filed on a Form 8-K.
- Assume that B is significant at the 25 percent level and therefore that the Form 8-K will include historical financial statements of B for the year ended August 31, 20X8, and for the nine months ended May 31, 20X9 and May 31, 20X8.
- Because of the timing of the filing of the initial Form 8-K (i.e., before R has filed its June 30, 20X9, interim financial statements), R determines that the pro forma financial information (based on its fiscal year-end) must include a pro forma balance sheet as of March 31, 20X9, and pro forma income statements for the year ended December 31, 20X8, and three-month period ended March 31, 20X9.

The pro forma balance sheet as of March 31, 20X9, should include B's historical balance sheet as of May 31, 20X9, since this is B's most recent balance sheet filed with the SEC.

A pro forma income statement is required for the year ended December 31, 20X8, and may combine the following:
- Registrant R's historical income statement information for the year ended December 31, 20X8.
- Company B's historical income statement information for the 12-month period ended November 30, 20X8.\(^\text{17}\)

Company B's results for its 12-month period are derived by adding the results of the three-month period ended November 30, 20X8, to its income statement for the year ended August 31, 20X8, and subtracting the results of the three-month period ended November 30, 20X7.

A pro forma income statement is also required for the subsequent interim period ended March 31, 20X9, and may combine the following:
- Registrant R's historical income statement information for the three-month period ended March 31, 20X9.

Regarding the different fiscal year-ends of the entities involved, the notes to the pro forma financial information should disclose the periods combined. In addition, the notes should disclose B's sales or revenues and income for December 1, 20X8, to February 28, 20X9, because this period is excluded from B's historical information in both the annual and interim pro forma income statements. Furthermore, the registrant should consider whether additional quantitative and narrative disclosures about gross profit, selling and marketing expenses, and operating income for the excluded period are necessary to provide readers with information if there are unusual charges or adjustments in the excluded period.

\(^{16}\) See the Q&As in Section 1.11 for further discussion of SEC reporting considerations regarding the age of financial statements for an acquired or to be acquired business in SEC filings.

\(^{17}\) Another 12-month period of B's that ends within 93 days of R's year-end may be presented instead. In this example, the 12-month period ended November 30, 20X8, was used because it corresponds to B's quarter-end. However, the registrant has other options as long as the period selected is within 93 days and the number of months is the same as those presented for the registrant.
3.3.2.3 Pro Forma Financial Statement Presentation When the Registrant’s Fiscal Year Is Less Than 12 Months

Q&A Regulation S-X: Rule 11-02(c)-3
In certain circumstances, such as when there is a change in the registrant’s fiscal year-end, a registrant’s most recent fiscal year may be for a period that is less than 12 months. When a registrant changes its fiscal year-end, it may file a transition report on Form 10-K with audited financial statements for a transition period that is less than 12 months.

Question
For what periods should a registrant prepare pro forma financial information for a significant consummated or probable business combination when its most recent fiscal year is less than 12 months because its year-end has changed?

Answer
It depends. The determination of the periods for which pro forma financial information should be presented when the registrant’s most recent fiscal year is less than 12 months depends on the length of the transition period.

Transition Period Is Nine Months or More

Article 11 generally requires that pro forma income statements be presented for the latest fiscal year and subsequent interim period. Rule 3-06 indicates that “the filing of [historical] financial statements covering a period of 9 to 12 months shall be deemed to satisfy a requirement for filing financial statements for a period of 1 year” in certain circumstances. These circumstances include, but are not limited to, when a registrant changes its fiscal year-end. When a registrant changes its fiscal year and the change results in a period of nine months or more, the registrant may also rely on the guidance provided in Rule 3-06 to satisfy the requirement of preparing a pro forma income statement for the latest year. Therefore, the pro forma income statement for the most recent fiscal year may combine the registrant’s historical operations for the transition period with the historical financial operations of the acquired business for the same number of months. See paragraph 3230.1 of the FRM for more information.

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18 A transition report must be filed for all transition periods except those of one month or less. A registrant should file a transition report on Form 10-K for transition periods that are six months or more. For a transition period shorter than six months but longer than one month, a registrant can file a transition report on either Form 10-K or Form 10-Q. See Section 1360 of the FRM for additional guidance.

19 See Section 3.3.1.2 for the periods to be presented in pro forma financial information.

20 Refer to Section 3.3.2.2 regarding combining entities with different fiscal year-ends, which notes that the historical operations of the acquired company must be included in the pro forma financial statements for the same number of months as the registrant’s operations.
Example 1

- Registrant R, a large accelerated filer, changes its fiscal year-end from March 31, 20X8, to December 31, 20X8.
- Registrant R files a transition report on Form 10-K, which includes audited financial statements for the nine-month transition period ended December 31, 20X8, along with the other required financial statements.
- On March 1, 20X9, R acquires Company B, a calendar-year-end company.
- Since the business combination is significant to R, R must file a Form 8-K with the required separate financial statements of B and pro forma financial information for the business combination.
- Because of the timing of the filing of the initial Form 8-K, R must file a pro forma balance sheet as of December 31, 20X8, and a pro forma income statement for the year ended December 31, 20X8, in the Form 8-K.

**Pro Forma Balance Sheet**

Registrant R would satisfy the pro forma balance sheet requirement by combining R’s historical balance sheet as of December 31, 20X8, with B’s historical balance sheet as of December 31, 20X8.

**Pro Forma Income Statement**

Registrant R may satisfy the pro forma income statement requirement by combining R’s income statement for the nine months ended December 31, 20X8, with B’s income statement for the nine months ended December 31, 20X8 (which could be derived by subtracting the results for the three-month period ended March 31, 20X8, from those for the fiscal year ended December 31, 20X8). Since the transition period is nine months or more, the registrant can rely on the guidance in Rule 3-06 to satisfy the requirement to present a pro forma income statement for the most recent fiscal year.

In this example, a pro forma income statement is not required for any interim period because the acquisition was consummated during the first quarter.

**Transition Period Is Less Than Nine Months**

At the April 2004 AICPA SEC Regulations Committee joint meeting with the SEC staff, the SEC staff indicated that when a registrant changes its fiscal year-end and the transition period is less than nine months, the registrant can satisfy the requirement to include a pro forma income statement for the most recent fiscal year by including either of the following:

- A pro forma income statement for the “most recent fiscal year” based on the transition period of the registrant, supplemented as necessary by the addition of earlier periods sufficient to provide 9 to 12 months of historical financial information for the registrant.
- A pro forma income statement for the transition period in addition to a pro forma income statement for the registrant’s most recently completed full fiscal year (i.e., the period immediately preceding the transition period).

In either case, if the registrant and the acquired company have different fiscal year-ends, the financial information for the acquired business included in the pro forma financial statements should be for a period that ends within 93 days of the registrant’s period. In addition, the acquired company’s operating results must be for the same number of months presented for the registrant.21

21 See Section 3.3.2.2 for guidance regarding combining entities with different fiscal year-ends.
Example 2

- Registrant R, a large accelerated filer, changed its fiscal year-end from June 30, 20X8, to December 31, 20X8.
- Registrant R filed a transition report on Form 10-K that included financial statements for the six-month transition period ended December 31, 20X8, and the three years ended June 30, 20X8.
- On March 1, 20X9, R acquired Company B, a calendar-year-end large accelerated filer.
- Since the business combination is significant to R, R must file a Form 8-K with the required separate financial statements of B and pro forma financial information for the business combination.
- Because of the timing of the filing of the initial Form 8-K, R must file a pro forma balance sheet as of December 31, 20X8, and a pro forma income statement for the year ended December 31, 20X8, in the Form 8-K.

**Pro Forma Balance Sheet**

Registrant R would satisfy the pro forma balance sheet requirement by combining R's historical balance sheet as of December 31, 20X8, with B's historical balance sheet as of December 31, 20X8.

**Pro Forma Income Statement**

Registrant R may satisfy the pro forma income statement requirement for the most recent fiscal year by combining either of the following:

- Registrant R's income statement for the 12 months ended December 31, 20X8 (derived by adding the six-month transition period ended December 31, 20X8, to R's three-month periods ended March 31 and June 30, 20X8), and B's income statement for its fiscal year ended December 31, 20X8.
- Registrant R's transition-period income statement for the six months ended December 31, 20X8, and B's income statement for the six months ended December 31, 20X8. In addition, since the six-month transition period would not satisfy the requirements for a period of one year in accordance with Rule 3-06, R would also be required to file a pro forma income statement that combines R's income statement for its previous fiscal year ended June 30, 20X8, with B's income statement for the 12 months ended June 30, 20X8 (derived by adding the results for the six-month period ended June 30, 20X8, to B's income statement for the year ended December 31, 20X7, and subtracting the results of the six-month period ended June 30, 20X7).

In this example, a pro forma income statement is not required for any interim period after December 31, 20X8, because the acquisition was consummated during the first quarter.

3.3.2.4 Reflecting Multiple Transactions in Pro Forma Financial Information

Q&A Regulation S-X: Rule 11-02(b)-4

In certain circumstances, pro forma financial information may need to reflect multiple transactions that have occurred (and/or whose occurrence is probable) during a period so that investors receive adequate information about transactions that are material individually or in the aggregate.

Examples of scenarios in which multiple transactions may need to be presented in pro forma financial information include the following:
• When a registrant consummates, or it is probable that it will consummate, a second significant acquisition after it previously reported a significant acquisition during the most recent fiscal year or interim period.\textsuperscript{22}

• When an acquired company or probable acquiree previously acquired a significant entity of its own during the most recent fiscal year and that information would be material to an understanding of the registrant or a vote on the transaction.\textsuperscript{23}

\textbf{Question}

How should multiple transactions be reflected in pro forma financial information?

\textbf{Answer}

It depends. \textit{Article 11} generally allows a registrant certain options for presenting pro forma financial information for multiple transactions. However, as noted below, in certain circumstances, depending on the transaction and nature of the filing, a transaction must be disclosed separately from other unrelated transactions, such as when shareholders are being asked to vote on a particular transaction. A registrant should consider the most appropriate presentation for pro forma information when multiple transactions have occurred (and/or their occurrence is probable) during the periods presented and such transactions are not already reflected in the historical financial statements.

Depending on the facts and circumstances, a registrant may present pro forma financial information for multiple transactions in one of the following ways:

• On a combined basis (i.e., in a single column) in a single set of pro forma financial statements.

• On a disaggregated basis (i.e., in multiple columns) in a single set of pro forma financial statements.

• In multiple sets of pro forma financial statements.

\textbf{Paragraph 3240.6} of the FRM provides the following guidance on when a registrant should present pro forma financial information separately for multiple transactions:

Pro forma information for a particular acquisition or other transaction usually should be presented separately from pro forma information for unrelated transactions for which pro forma information may be required if:

a. The proceeds of an offering will be used to fund that acquisition,

b. Shareholders are being asked to vote on that acquisition or other transaction, or

c. A Form 8-K is required to be filed for that acquisition or transaction.

Other transactions appropriate for inclusion in a pro forma presentation should be accumulated in a separate column. Otherwise, if consummation of more than one transaction has occurred or is probable, pro forma information may be presented on either a combined or separate basis. If combined, footnote explanation should disaggregate the various transactions in a reasonable fashion.

As noted above, when shareholder approval or other action is required, a registrant should present the pro forma effects of the transaction to be voted or acted on separately from other transactions that are not contingent on the transaction to be voted on. To accomplish this,

\textsuperscript{22} See the \textit{highlights} of the July 2017 CAQ SEC Regulations Committee joint meeting with the SEC staff. Pro forma information in a Securities Act registration statement should reflect all relevant transactions. The SEC staff has indicated that it encourages registrants to show both transactions in the second pro forma presentation provided in a Form 8-K since such disclosure is more comprehensive.

\textsuperscript{23} See \textit{paragraph 3110.2} of the FRM.
a registrant may present the pro forma effects of other significant transactions as additional
columns or in separate pro forma financial statements. For example, a significant business
combination that occurred before the transaction being voted on could be presented in a
separate column or in a separate set of pro forma financial statements, both of which would
adjust the historical financial statements. The pro forma “as adjusted” amounts would then carry
forward into the pro forma financial statements presented reflecting the transaction to be voted
on by the shareholders.

The following example demonstrates some of the options available to a registrant that is
presenting multiple transactions in pro forma financial information.

Example

Assume the following:

- On May 1, 20X9, Registrant R, a calendar-year-end company, files a proxy statement to solicit
  shareholder approval for the acquisition of Company B.
- In separate transactions during 20X9, R consummates two significant business combinations
  and appropriately files a Form 8-K for each transaction that includes the separate financial
  statements of each entity and the required pro forma financial information. Registrant R
- In the proxy statement, pro forma financial information as of and for the year ended December
  31, 20X8, will give effect to the consummated acquisitions of C and D as well as the proposed
  acquisition of B that requires shareholder approval.

Because shareholders must vote for the acquisition of B, the registrant must present pro forma
financial information for this transaction separately from the two consummated business
combinations. Registrant R may present a single set of pro forma financial statements as of and for the
year ended December 31, 20X8, on a disaggregated basis, with separate columns for the following:

- Registrant R historical financial information.
- Company C historical financial information.
- Company D historical financial information.
- Pro forma adjustments for the acquisition of C and D.
- A pro forma “as adjusted” column reflecting the pro forma results before the proposed
  business combination requiring shareholder approval.
- Company B historical financial information.
- Pro forma adjustments for the proposed acquisition of B.
- Pro forma combined results.

Note that R could alternatively combine the historical financial results of the two consummated
business combinations (C and D) into one column. In this case, R should provide a footnote in the
pro forma financial information to adequately disaggregate the financial information for the two
acquisitions. As another option, R could include a separate set of pro forma financial statements
for the acquisition of C and D and then carry forward those pro forma results as the starting point
for the pro forma financial statements presented that reflects the acquisition of B to be voted on by
shareholders.
3.3.3 Updating Requirements

3.3.3.1 Updating Pro Forma Financial Information in a Registration Statement or Proxy Statement for a Significant Business Combination

Q&A Regulation S-X: Rule 11-02(b)-5

Question
When would a registrant be required to update pro forma financial information that was previously filed for a significant business combination?

Answer
A registrant may need to update pro forma financial information when it subsequently files (or amends) a registration or proxy statement. A registrant may be required to update the pro forma financial information even when Rule 3-05 does not require the historical financial statements of the acquiree to be updated.24

Pro Forma Balance Sheet
A pro forma balance sheet should be presented as of the most recent balance sheet date of the registrant included in the registration or proxy statement unless the transaction is already reflected in the historical balance sheet.25 Accordingly, an updated pro forma balance sheet would only be required if the historical balance sheet of the registrant included in the registration or proxy statement does not reflect the consummated business combination.

Pro Forma Income Statement
Pro forma income statements should generally be presented for the most recent fiscal year and interim period of the registrant included in the registration or proxy statement unless the business combination is already reflected in the historical income statement for the entire period.26 The updated pro forma income statement information in the registration or proxy statement should include historical financial information for the acquiree up to the date of acquisition. The pro forma income statement should be updated to reflect the results of the acquiree for the entire period presented (annual and interim if applicable).

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24 See the Q&As in Section 1.11 for further discussion of SEC reporting considerations regarding the age of financial statements for an acquired or to be acquired business in SEC filings.

25 See Section 3.3.1.2 regarding the periods to be presented in pro forma financial information.

26 See footnote 25.
Example

- On December 2, 20X8, Registrant R, a calendar-year-end company, files a registration statement on Form S-3.
- The registration statement includes R's (1) historical audited financial statements as of December 31, 20X7 and 20X6 and for the three years ended December 31, 20X7, and (2) unaudited interim financial statements as of September 30, 20X8, and for the nine-month periods ended September 30, 20X8, and 20X7.
- On March 15, 20X8, R acquires Company B, a calendar-year-end accelerated filer.
- On March 19, 20X8, R files an initial Form 8-K announcing the acquisition of B.
- Assume that B is significant at the 30 percent level.
- On May 28, 20X8, R files a Form 8-K/A with the required audited separate financial statements of B for the year ended December 31, 20X7, and pro forma financial information as of and for the year ended December 31, 20X7.

In the registration statement filed on December 2, 20X8, R would incorporate by reference the Form 8-K filed on March 19, 20X8, and Form 8-K/A filed on May 28, 20X8.

Registrant R must update its historical financial statements in the registration statement in accordance with Rule 3-12. However, the separate financial statements of B are not required to be updated because the acquisition occurred on March 15, 20X8. 27

To comply with Rules 3-12 and 11-02(c) in the registration statement, R must update the pro forma financial information previously filed in the Form 8-K. Since the business combination is already reflected in R's historical balance sheet as of September 30, 20X8, an updated pro forma balance sheet is not required. However, R would be required to provide an updated pro forma income statement for the nine-month period ended September 30, 20X8, because the transaction is not reflected in the historical income statement for the entire period. As a result, R's income statement for the nine-month period ended September 30, 20X8, would be combined with B's income statement results from January 1, 20X8, through the acquisition date (March 15, 20X8).

For currently effective registration statements (e.g., an existing Form S-3) upon which a registrant wishes to draw down or issue securities, a registrant may use a prospectus supplement. Paragraph 2045.3 of the FRM indicates that “a domestic registrant has no specific obligation to update the prospectus except as stipulated by 1933 Act Section 10(a)(3) and S-K 512(a) with respect to any fundamental change.” As a result, a registrant is not required to update the pro forma financial information that was previously filed unless there has been a fundamental change. It is the responsibility of management, in consultation with SEC legal counsel, to determine what constitutes a fundamental change. 28

3.3.3.2 Updating Pro Forma Financial Information in a Form 8-K for a Significant Business Combination Previously Filed in a Registration or Proxy Statement

Q&A Regulation S-X: Rule 11-02(c)-4

A registrant may have previously filed a registration or proxy statement that included (1) separate historical financial statements of a probable acquisition (the acquiree) as required under Rule 3-05 and (2) pro forma financial information required under Article 11. Upon consummation of the business combination, the registrant must comply with the applicable Form 8-K filing requirement to report the significant business combination. 29

27 In accordance with paragraph 2045.9 of the FRM, “financial statements of an acquired business need not be updated if the omitted period is less than a complete quarter. However, disclosure of significant events occurring during the omitted interim period may be necessary.”

28 See also Section 1.11.2, which addresses whether updated separate financial statements of an acquiree under Rule 3-05 are required when there is a prospectus supplement.

29 See Section 1.4.1 regarding filings that require financial statements of a significant business acquisition or probable business acquisition.
**Question**

When a registrant has previously filed a registration or proxy statement that included the acquiree’s separate financial statements and pro forma financial information and is ready to report the consummation of this significant business combination on Form 8-K, must the registrant include pro forma financial information in the Form 8-K?

**Answer**

It depends. **General Instruction B.3 of Form 8-K** states, in part:

If the registrant previously has reported substantially the same information as required by this form, the registrant need not make an additional report of the information on this form.

Further, **paragraph 2045.16** of the FRM states, in part:

Financial statements of an acquiree are not required in Form 8-K if they were previously filed by the registrant. Examples of when previously filed acquiree financial statements will not be deemed “substantially the same” pursuant to this instruction include:

- the previously filed acquiree financial statements would not satisfy the required age of financial statements in the Form 8-K because operating results for two or more interim quarters are omitted. . . .
- the previously filed acquiree financial statements are interim financial statements and the Form 8-K requires filing of updated audited annual financial statements of the acquiree. . . .
- the previously filed acquiree financial statements were prepared in accordance with the requirements for smaller reporting companies in S-X Article 8, but the registrant is not a smaller reporting company.

**Example 1**

- Registrant R, a calendar-year-end company, entered into an agreement to purchase Company B, also a calendar-year-end company. On June 1, 20X8, R filed a registration statement on Form S-4 to register the securities being offered to the shareholders of B.
- The financial statement requirements for the Form S-4 were determined to be both R’s and B’s separate historical audited financial statements as of December 31, 20X7, and 20X6 and for the three years ended December 31, 20X7, and unaudited interim financial statements as of March 31, 20X8, and for the three-month periods ended March 31, 20X8, and 20X7.
- The Form S-4 also included a pro forma balance sheet as of March 31, 20X8, and pro forma income statements for the year ended December 31, 20X7, and the three-month period ended March 31, 20X8.
- The transaction was consummated on October 1, 20X8, and a Form 8-K reporting the acquisition was filed in a timely manner.

Because of the age of financial statement requirements\(^{30}\) and the fact that the transaction was consummated on October 1, 20X8, separate interim financial information of B would normally be required through June 30, 20X8, in the Form 8-K. However, **paragraph 2045.16** of the FRM indicates that the separate interim financial information of B previously filed in the registration statement is deemed to be substantially the same because the omitted period of B (i.e., April 1, 20X8, through June 30, 20X8) is less than two quarters. In the absence of significant events, updated interim financial information of B would not be required in the Form 8-K. Since the separate financial statements of B are not required, pro forma financial information for the business combination is not required.

\(^{30}\) Refer to **Section 1.11.1** for further information.
Example 1 (continued)

Note, however, that if the acquisition was consummated on December 1, 20X8, updated interim and pro forma financial information of B would be required in the Form 8-K to satisfy the age of financial statement requirements. Otherwise, operating results for two or more interim quarters would be omitted (i.e., June 30, 20X8, and September 30, 20X8), and therefore, the previously filed financial statements of B in the Form S-4 will not be deemed to be substantially the same for the filing of the Form 8-K.

Example 2

- Registrant R, a calendar-year-end company, enters into an agreement to acquire Company B, also a calendar-year-end company. On December 15, 20X8, R files a registration statement on Form S-4 to register the securities being offered to the shareholders of B.
- The financial statement requirements for the Form S-4 are determined to be both R’s and B’s separate historical audited financial statements as of December 31, 20X7, and 20X6, and for the three years ended December 31, 20X7, and unaudited interim financial statements as of September 30, 20X8, and for the nine-month periods ended September 30, 20X8, and 20X7.
- The Form S-4 also included a pro forma balance sheet as of September 30, 20X8, and pro forma income statements for the year ended December 31, 20X7, and the nine-month period ended September 30, 20X8.
- The transaction was consummated on April 1, 20X9, and a Form 8-K reporting the acquisition was filed in a timely manner.

Updated audited financial statements of B for the year ended December 31, 20X8, must be included in the Form 8-K. Registrant R must also include updated pro forma financial information as of and for the year ended December 31, 20X8, in the Form 8-K. Otherwise, audited annual financial statements would be omitted and, therefore, the previously filed financial statements of B in the Form S-4 would not be deemed to be substantially the same for the filing of the Form 8-K.

3.4 Preparing Pro Forma Adjustments

3.4.1 Basic Principles

3.4.1.1 General Principles of Pro Forma Adjustments

Q&A Regulation S-X: Rule 11-02(b)-2

The objective of pro forma financial information is to provide investors with information about the continuing impact of a transaction (or group of transactions) by illustrating how it would have affected the registrant’s historical financial statements had the transaction been consummated as of an earlier date. Pro forma financial information is generally presented in columnar form, with separate columns for historical financial information, pro forma adjustments, and pro forma results.

Question

What are the general principles of pro forma adjustments?

Answer

To achieve the objective of pro forma financial information, the pro forma balance sheet and pro forma income statements should begin with the registrant’s historical financial statements. For a business combination, the next column would be the acquiree’s historical financial statements.
The historical financial statements are then adjusted for material charges, credits, and related tax effects that are (1) directly attributable to the transaction and (2) factually supportable. The SEC staff has indicated that for an adjustment to be considered “factually supportable,” the registrant should have reliable, documented evidence (e.g., an executed agreement or consummated transaction). A determination that an adjustment is factually supportable is not based on the ability to estimate or reliably measure it.\(^{31}\) Adjustments to the pro forma income statement have one further attribute: they must be expected to have a continuing impact on the registrant, as further discussed below.

These pro forma adjustments, which are presented as a separate column on the face of the pro forma balance sheet and pro forma income statements, should contain references to notes that clearly explain the assumptions involved and other relevant information for each adjustment. As noted in paragraph 3240.7 of the FRM, pro forma adjustments should generally be shown gross rather than net so that the reader can understand the nature and amount of each adjustment. Alternatively, a more detailed explanation of the components of the adjustments may be presented in the notes to the pro forma statements.

**Pro Forma Balance Sheet**

Rule 11-02(b)(6) and paragraphs 3220.2, 3220.3, and 3250.1 of the FRM provide guidance on adjustments associated with the pro forma balance sheet. Pro forma adjustments related to the pro forma balance sheet should assume that the transaction occurred as of the date of the most recent balance sheet and “should give effect to events that are directly attributable to each specific transaction and factually supportable.”\(^{32}\) The pro forma balance sheet adjustments should include all items that have a continuing impact as well as those that are nonrecurring.

**Pro Forma Income Statement**

Rule 11-02(b)(6) and paragraphs 3230.3, 3230.4, and 3250.1 of the FRM provide guidance on adjustments associated with the pro forma income statement. Pro forma adjustments included in the pro forma income statement should assume that the transaction occurred at the beginning of the fiscal year presented and was carried forward to any interim period, if applicable.\(^ {33} \) Pro forma income statement adjustments should include those that are “(a) directly attributable to each specific transaction, (b) factually supportable, and (c) expected to have a continuing impact” (e.g., ongoing adjustments that will be included in the registrant’s income, such as amortization of intangible assets, depreciation expense, and interest expense).

An important distinction between adjustments to the pro forma balance sheet and those to the pro forma income statement is whether the adjustment is recurring. The pro forma balance sheet should include adjustments that are both recurring and nonrecurring, while the pro forma income statement should only include adjustments that have a continuing impact. Since the requirement to have a continuing impact applies only to the pro forma income statement, the same item may be treated differently on the pro forma balance sheet than it is in the pro forma income statement. For example, the pro forma income statement may include a pro forma adjustment to remove acquisition-related costs already reflected in the historical income statement but would not include a pro forma adjustment to record similar costs that are anticipated but have not yet been incurred. Although these costs are directly attributable to the acquisition, because they are nonrecurring, they would not be considered to have a continuing impact and therefore should not be reflected in the pro forma totals for the income statement.

\(^{31}\) For more information, see Deloitte’s December 14, 2011, *Heads Up*.

\(^{32}\) For more information, see *Section 3.4.1.3*.

\(^{33}\) See footnote 32.
Conversely, any accrued acquisition-related costs in the historical balance sheet would not be reversed as a pro forma adjustment in the pro forma balance sheet. A pro forma adjustment would be recorded to accrue for any additional anticipated acquisition-related costs that are not included in the historical balance sheet, provided that the amount was factually supportable. Any acquisition-related costs reflected in either the registrant's or the acquiree's historical financial statements for other unrelated acquisitions would not be eliminated from the pro forma income statement since such costs would not be directly attributable to the transaction. See paragraph 3250.1(c) of the FRM for further discussion of transaction costs in business combination transactions.

This guidance also applies to gains or losses resulting from a transaction (i.e., directly attributable to the transaction), such as a bargain purchase gain in a business combination (see ASC 805-30-50-1) or a sale of an asset or business. If a gain or loss is (1) directly attributable to the transaction and (2) factually supportable, it should be reflected in the pro forma balance sheet (as a debit or credit to retained earnings) even when the gain or loss is nonrecurring. However, such gains or losses should not be included in the pro forma income statement since they would not have a continuing impact. Therefore, if the gain or loss is not recorded in the historical financial statements, it should not be included as an adjustment in the pro forma income statement. See also Section 3.4.3.1.

Material nonrecurring amounts should be separately disclosed in a note to the pro forma financial statements. See Regulation S-X, Rule 11-02(b)(5).

In arriving at the pro forma results, a registrant generally should not eliminate infrequent or nonrecurring items that are already included in the underlying historical financial statements of either the registrant or the other combining entity (such as a previous restructuring or impairment charge) unless the item is (1) directly attributable to the transaction and (2) not expected to have a continuing impact.34

Because the pro forma balance sheet and pro forma income statement assume that the transaction occurred on different dates (i.e., most recent balance sheet date vs. beginning of the fiscal year presented for the pro forma income statement), and because of the difference in whether nonrecurring adjustments are included, the adjustments reflected in the pro forma balance sheet will not necessarily reconcile with the adjustments in the pro forma income statement.

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34 For more information, see paragraph 3230.4 of the FRM.
3.4.1.2 Tax Effect of Pro Forma Adjustments

Q&A Regulation S-X: Rule 11-02(b)-3

Question
What tax rate should be applied to pro forma adjustments?

Answer
Generally, the statutory rate should be applied to pro forma adjustments.

Instruction 7 of Rule 11-02(b) provides the following guidance on how to tax-effect pro forma adjustments:

Tax effects, if any, of pro forma adjustments normally should be calculated at the statutory rate in effect during the periods for which pro forma condensed statements of comprehensive income are presented and should be reflected as a separate pro forma adjustment. [Emphasis added]

In addition, Section 3270 of the FRM indicates that “[i]f taxes are not calculated on that basis, or if unusual effects of loss carryforwards or other aspects of tax accounting are depicted, an explanation should be provided in a note to the pro forma financial statements.” Section 3270 of the FRM also states that “[c]ompanies are allowed to use different rates if they are factually supportable[35] and disclosed.”

3.4.1.3 Pro Forma Balance Sheet and Pro Forma Income Statement Adjustments

Q&A Regulation S-X: Rule 11-02(b)(6)-1

Question
What date should be used for pro forma balance sheet and pro forma income statement adjustments?

Answer
Rule 11-02(b)(6) notes that the date used for pro forma balance sheet adjustments is different from the date used for pro forma income statement adjustments.

Pro Forma Balance Sheet Adjustments
The pro forma balance sheet adjustments are computed as if the transaction was consummated at the end of the most recent (i.e., annual or interim) balance sheet date included in the filing.

Pro Forma Income Statement Adjustments
As indicated in paragraph 3230.3 of the FRM, pro forma income statement adjustments are computed as if the transaction was consummated at the beginning of the fiscal year presented and are carried forward through the interim period, if applicable. In other words, the adjustments are computed as if the transaction occurred at the beginning of the earliest fiscal year presented.

[35] See Section 3.4.1.1 for a discussion of what may constitute a factually supportable pro forma adjustment.
Example

- Registrant A, a calendar-year-end company, files a registration statement on December 28, 20X8.
- Registrant A's historical audited financial statements as of December 31, 20X7, and 20X6, and for the three years ended December 31, 20X7, and unaudited interim financial statements as of September 30, 20X8, and for the nine-month periods ended September 30, 20X8, and 20X7, are included in the registration statement.
- Registrant A acquired Company B on October 5, 20X8, in a business combination.
- Registrant A determines that the acquisition of B is significant such that B's separate financial statements and pro forma financial information for the business combination must be included in the filing.

Registrant A will be required to include a pro forma balance sheet as of September 30, 20X8, in the registration statement. The acquisition of B should be accounted for as if it occurred on September 30, 20X8, for purposes of the pro forma balance sheet.

Registrant A is required to include a pro forma income statement for the year ended December 31, 20X7, and for the nine-month period ended September 30, 20X8, in the registration statement. The acquisition of B should be accounted for as if it occurred on January 1, 20X7, for purposes of the pro forma income statement for both the year ended December 31, 20X7, and the interim nine-month period ended September 30, 20X8.

3.4.1.4 Circumstances Permitting Pro Forma Adjustments for Proceeds From an Offering

Q&A Regulation S-X: Rule 11-02(b)(6)-9

Question

Can a registrant present pro forma adjustments for the receipt or application of proceeds to be received from an offering of securities?

Answer

It depends. As discussed in Section 3.4.1.1, which addresses the general principles of pro forma adjustments, such adjustments must be factually supportable and directly attributable to the transaction. The SEC staff has indicated that proceeds from an offering of securities can only be considered factually supportable in limited circumstances. In the absence of such circumstances, the proceeds should not be considered factually supportable regardless of whether it may be probable that they will occur. Paragraph 3320.1 of the FRM specifies that pro forma financial information may not reflect the receipt or application of proceeds from an offering of securities, except in the following circumstances:

- To the extent that a firm commitment has been received from an underwriter.
- To the extent of the minimum amount “in a best-efforts minimum/maximum offering” of securities.
- “In a best-efforts all-or-none offering” of securities.
- Certain situations involving “savings and loan conversions.”

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36 In a best-efforts minimum/maximum offering, the underwriters must sell the minimum number of securities offered if any securities are sold. The underwriters are required to use their best efforts to sell the maximum number of securities.

37 A best-efforts all-or-none offering is an offering in which the entire issue (a predetermined number) must be sold or the securities will be withdrawn from distribution. In an all-or-none offering, no sale is considered final until the issuer has determined that the entire issue has been distributed.
Example

- Registrant A enters into an agreement to acquire Company B.
- Registrant A expects to finance the acquisition by using cash already on hand and cash proceeds obtained from the issuance of new debt and equity securities.
- Registrant A is filing a new registration statement to register the debt and equity securities expected to be issued.
- Registrant A determines that the acquisition of B is both probable and significant such that B’s separate financial statements and pro forma financial information for the business combination are required in the registration statement.38

Depending on the agreement with the underwriter to the registration statement, the following scenarios may be appropriate:

- To the extent that the registration statement contains a firm commitment from the underwriter, the entire amount of proceeds expected to be received can be included as a pro forma adjustment.
- In a best-efforts minimum/maximum arrangement, pro forma adjustments may be included for the minimum amount of proceeds. A registrant should also disclose the likely source of any additional amounts needed to fund the acquisition price (e.g., bank debt) and should indicate whether any additional proceeds received, up to the maximum amount, would be used to fund the purchase.
- In a best-efforts all-or-none arrangement, pro forma adjustments may be included for the entire amount of proceeds expected, since no securities will be sold unless all the securities are sold.

3.4.2 Pro Forma Adjustments and Disclosures in a Business Combination

3.4.2.1 Research and Development Expenses of an Acquired Business

Q&A Regulation S-X: Rule 11-02(b)(5)-1A

Question

How should a registrant reflect the historical R&D expenses of an acquired business in pro forma financial information?

Answer

ASC 805 requires a registrant to capitalize acquired in-process research and development (IPR&D) and does not permit the immediate write-off of such amounts. An acquired business may have historically incurred R&D expenses that relate to projects for which the registrant has capitalized as IPR&D as part of the purchase price allocation. As indicated in the note to paragraph 3250.1(g) of the FRM, no adjustment should be made to eliminate any preacquisition R&D expenses historically incurred by the acquired business. Further, the April 2008 CAQ SEC Regulations Committee joint meeting with the SEC staff states that it is not appropriate to eliminate any historical R&D expenses since these costs “(1) are not directly related to the acquisition, and (2) do not have a continuing impact.”

38 See Section 3.2.1 for additional information about SEC filings in which pro forma information is required.
3.4.2.2 Presenting Expected Costs Associated With Exit or Disposal Activities (Restructuring Costs)

Q&A Regulation S-X: Rule 11-02(b)(6)-2A

Question

May a registrant present expected restructuring costs as pro forma adjustments?

Answer

It depends. ASC 805 prohibits an acquirer from recognizing restructuring costs as liabilities assumed in an acquisition unless the acquirer meets the recognition criteria in ASC 420-10-25-1 as of the acquisition date. In most business combinations, the acquirer will not be able to meet those criteria as of the acquisition date and will therefore not be able to recognize a liability assumed for restructuring costs in the business combination accounting.

As part of a business combination, a registrant may commit to a plan to dispose of a revenue-producing activity. A registrant may include pro forma adjustments to depict the recurring effects of exiting revenue-producing activities if they are directly attributable to the transaction and factually supportable. Paragraph 3250.1(d) of the FRM clarifies that “[o]nly revenues and costs specifically identifiable with that revenue-producing activity may be included in the pro forma adjustments. Allocations of corporate costs should not be adjusted for the disposition.”

Adjusting pro forma results to depict the recurring effects of exiting revenue-producing activities is consistent with the requirement to provide pro forma information depicting material dispositions. As discussed in paragraph 3120.1 of the FRM, a significant disposition (or significant probable disposition) may require the presentation of pro forma information, unless the disposition is already recognized in the historical financial statements.

For example, if either the registrant or its acquiree expects to dispose of certain operations in order for regulatory approval to be granted, the disposal should be reflected in the pro forma financial information to the extent that the operations are identifiable. If operations to be disposed of are not presently identifiable with any reasonable certainty, the contingency and reasonably possible impact on the pro forma financial information should be disclosed in the footnotes to the pro forma financial information. See paragraph 3250.1(l) of the FRM for more information.

However, other actions taken by management in a business combination may not qualify as pro forma adjustments. Rule 11-02(b)(6) allows pro forma income statement adjustments that are (1) “directly attributable to the transaction,” (2) “expected to have a continuing impact on the registrant,” and (3) are “factually supportable.” Costs associated with exit or disposal activities in connection with a business combination, including costs to terminate employees, infrequently qualify as pro forma adjustments because they are often too uncertain to meet the “factually supportable” criterion. Paragraph 3250.1(e) of the FRM states:

Termination of employees and closing facilities are typical actions taken in connection with business combinations to eliminate costs perceived by management as redundant. The timing and effects of these actions are generally too uncertain to meet the S-X Article 11 criteria for pro forma adjustments. Management’s estimate of how these actions (and other business integration activities not specifically associated with the disposition of a business) are expected to impact the operations and liquidity of the newly combined companies going forward should be discussed in MD&A and in supplemental information clearly identified as forward-looking information.
Example

- Registrant A acquired Company B.
- Registrant A determines that the acquisition of B is significant such that B's separate financial statements and pro forma financial information for the business combination are required.
- Management of A has determined that upon completion of the transaction, B's CEO and vice president (VP) of sales will not continue to be employed after the acquisition.

The determination of whether A should reflect the cost savings associated with the termination of B's CEO and VP of sales in the pro forma income statement requires careful consideration of the specific facts and circumstances.

Registrant A may consider whether the cost savings from the termination of B's CEO should be adjusted in the pro forma income statement, because A would not need two CEOs and this may be a redundant cost. In addition, A should consider whether the elimination of this CEO's position would have resulted in a negative impact on revenues or an increase in other costs. For example, the creation of a new management position to help support the expanded organization could indicate that the costs associated with B's CEO position are not truly redundant. It may be more difficult to support adjusting the salary of the VP of sales from the pro forma income statement. The VP of sales most likely had a direct impact on the level of sales recorded by B, and removal of this person's salary may also be expected to have a direct impact on the level of sales.

In determining whether any employee-related expense can be deducted, it is important for A to demonstrate that the cost being removed is clearly redundant and that future sales, profits, or other items will not be negatively affected. If the criteria in Rule 11-02(b)(6) (e.g., adjustments are factually supportable) are not met, a pro forma adjustment would not be permitted.

3.4.2.3 Consideration Transferred Disclosures

Q&A Regulation S-X: Rule 11-02(b)(6)-3A

Question

What footnote disclosures should a registrant present in the pro forma financial statements regarding consideration transferred (or purchase price) and the fair value of the assets acquired and liabilities assumed?

Answer

Pro forma financial information should include disclosure of the following items regarding the consideration transferred and the fair value of the assets acquired and liabilities assumed:

- A schedule showing the calculation of the consideration transferred.
- The fair value of the identifiable assets acquired and liabilities assumed.
- Whether the initial accounting for the business combination is preliminary or provisional.

Calculation of the Consideration Transferred

Paragraph 3250.1(f) of the FRM states that a registrant must disclose “a schedule showing the calculation of the [consideration transferred] (including the value assigned to non-cash portions) . . . in a note, if not otherwise reasonably apparent.” For example, it would not be sufficient to merely disclose the number of shares to be issued to consummate the acquisition, since such disclosure would not clearly indicate the value assigned to those shares.

39 For other required pro forma financial statement disclosures, see Section 3.3.1.1.
Example 1

- Registrant A acquired Company B on February 1, 20X9.
- Registrant A determines that the acquisition of B is significant such that B’s separate financial statements and pro forma financial information for the business combination are required.

Registrant A discloses the following:

Registrant A acquired B by paying cash of $800 and issuing 200 shares of common stock with fair value of $1 per share on XX date for total consideration transferred of $1,000.

Under ASC 805, registrants should disclose the nature and fair value of all consideration transferred during the business combination, which may include cash, shares to be issued, or both. Incremental transaction costs should not be included in the calculation of consideration transferred.

The note to paragraph 3250.1(f) of the FRM further states:

Under SFAS 141(R) [ASC 805], registrants should use the most recent stock price at the time of filing for determining the value of stock to be issued in a transaction that has not yet [been] consummated. In addition, the notes to the pro forma balance sheet should include a disclosure of the date at which the stock price was determined and a sensitivity analysis for the range of possible outcomes based upon percentage increases and decreases in the recent stock price. The appropriate percentages should be reasonable in light of acquirer’s volatility.

Fair Value of Assets Acquired and Liabilities Assumed

Paragraph 3250.1(g) of the FRM indicates that the registrant should allocate the purchase price to specifically identifiable tangible and intangible assets (e.g., customer lists, contracts acquired, trademarks, patents, and IPR&D) and liabilities. The purchase price should generally not, for example, be allocated solely to goodwill. The purchase price allocation can be presented in either a tabular or narrative format, although a tabular presentation is generally easier to follow.

Thus, under ASC 805, a registrant must disclose the acquisition-date fair value (or for business combinations not yet consummated, the registrant’s best estimate of fair value) assigned to assets acquired and liabilities assumed, including goodwill.

In addition, the registrant must disclose, in a note to the pro forma financial statements, the expected useful lives or amortization periods of significant assets acquired and the effect, if material, of amortization that is not straight line for the five years after the acquisition. (For more information about disclosures regarding expected useful lives or amortization periods, see Section 3.4.2.5.)

Below is an example of pro forma financial statement footnote disclosure regarding the consideration transferred and the acquisition-date fair value of specifically identifiable tangible and intangible assets acquired and liabilities assumed. For business combinations not yet consummated (i.e., probable business combinations), the amount of consideration transferred and the best estimate of the fair value of assets acquired and liabilities assumed may only be preliminary and not yet final; the registrant should disclose this fact. See additional discussion in When the Consideration Transferred or Determination of Fair Value Is Preliminary below.
Example 2

- Registrant A acquired Company B by paying cash of $800 and issuing 200 shares of A's common stock with fair value of $200 (using the end-of-day price of such shares on February 1, 20X9, the acquisition date).
- The pro forma financial statements reflect the following acquisition-date fair value of tangible assets, liabilities, and other intangible assets (the final allocation may result in a different allocation for tangible and intangible assets from that presented in these pro forma financial statements):

<table>
<thead>
<tr>
<th>Assets Acquired/Liabilities Assumed</th>
<th>Book Value</th>
<th>Fair Value Increment</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Receivables</td>
<td>$ 400</td>
<td></td>
<td>$ 400</td>
</tr>
<tr>
<td>Inventory</td>
<td>300</td>
<td>$ 50</td>
<td>350</td>
</tr>
<tr>
<td>Property, plant, and equipment (PP&amp;E)</td>
<td>700</td>
<td>100</td>
<td>800</td>
</tr>
<tr>
<td>Current liabilities</td>
<td>(600)</td>
<td></td>
<td>(600)</td>
</tr>
<tr>
<td>Net book value</td>
<td>$ 800</td>
<td></td>
<td>$ 950</td>
</tr>
<tr>
<td>Consideration given</td>
<td></td>
<td></td>
<td>$ 1,000</td>
</tr>
<tr>
<td>Excess of consideration transferred over identifiable assets acquired and liabilities assumed (goodwill)</td>
<td></td>
<td></td>
<td>$ 50</td>
</tr>
</tbody>
</table>

Purchased PP&E is being depreciated on a straight-line basis over its weighted-average remaining useful life of approximately five years.

When the Consideration Transferred or Determination of Fair Value Is Preliminary

If a registrant's estimate of the fair value of assets acquired and liabilities assumed, or the amount of consideration transferred, is not final (including probable business combinations) at the time the pro forma financial statements are prepared, a registrant's disclosure should be sufficient to allow the reader to understand the potential impact and the areas that are subject to change. Paragraph 3250.1(g) of the FRM states, in part, “If the allocation is preliminary/provisional, significant liabilities and tangible and intangible assets likely to be recognized should be identified and uncertainties regarding the effects of amortization periods assigned to the assets should be highlighted.”

When preparing pro forma financial statements, a registrant should also consider whether it is necessary to disclose any additional range of possible results. Paragraph 3240.5(b) of the FRM suggests that it may be necessary to provide a sensitivity analysis for a change in a variable that may produce different results. Paragraph 3240.5(b) of the FRM provides the following example:

A registrant files a proxy statement requesting shareholder approval of an acquisition. The registrant will issue a certain number of common shares in the acquisition, the number of which will be determined by a formula such that the total dollar amount of the acquisition is subject to change. The registrant may present the pro forma effects of the acquisition using a purchase price [consideration transferred] calculated as if the acquisition was consummated at the date of filing (by using the most current trading price of the common shares). If the range of possible outcomes may have a material impact on the amount of goodwill to be recorded in the financial statements, the registrant should disclose the impact on the balance sheet of increases or decreases in the common share trading price.
3.4.2.4 Disclosures Relating to Contingent Consideration

Q&A Regulation S-X: Rule 11-02(b)(6)-4A
An acquisition agreement may include contingent consideration, which is the obligation to transfer additional assets or equity interests to the former owners of an acquired business if specified future events occur or conditions are met. Occasionally, however, contingent consideration may also represent the right to the return of previously transferred consideration if specified conditions are met. ASC 805 requires that contingent consideration be recognized and measured at fair value as of the acquisition date.

Question
What should a registrant disclose in the footnotes to the pro forma financial statements when an acquisition agreement includes contingent consideration?

Answer
ASC 805 requires an acquirer to recognize the fair value of contingent consideration as of the acquisition date as part of the consideration transferred; thus, it will be included as part of the total purchase price. Accordingly, the notes to the pro forma financial statements should disclose the terms of the contingent consideration, how management determined the fair value, and the potential impact on future earnings. Refer to paragraph 3250.1(i) of the FRM. (For more information about consideration transferred disclosures, see Section 3.4.2.3.)

3.4.2.5 Disclosure of Expected Useful Lives or Amortization Periods of Significant Assets Acquired

Q&A Regulation S-X: Rule 11-02(b)(6)-5

Question
What footnote disclosures should a registrant present in the pro forma financial statements regarding expected useful lives or amortization periods of significant assets acquired?

Answer
For a business combination, pro forma adjustments to the income statement will typically include, among other items, adjustments to historical amortization and depreciation amounts of acquired assets on the basis of the allocation of the purchase price. (For more information about purchase price disclosures, see Section 3.4.2.3.)

Paragraph 3250.1(j) of the FRM states, “The expected useful lives or amortization periods of significant assets acquired in a purchase business combination, including identified intangibles, should be disclosed in a note to the pro forma financial statements.” In addition, any uncertainties regarding the effects of amortization periods assigned to the acquired assets should be highlighted. When the amortization method for purchase price adjustments of acquired assets is something other than a straight-line method, the effect on operating results for the five years after the acquisition should be disclosed in a note, if material.
3.4.2.6 Conforming Accounting Principles of the Acquired Business to Those of the Registrant (Acquiring Business)

Q&A Regulation S-X: Rule 11-02(b)(6)-6

Question
When a registrant intends to conform the accounting principles of an acquired business to its own, are pro forma adjustments required?

Answer
Generally, yes. However, a registrant should only make conforming adjustments when presenting such information would be compliant with GAAP (see below for further discussion regarding the adoption of new accounting principles that have not yet been adopted by an acquired business).

When a registrant acquires a business whose accounting principles are different from its own, the registrant generally needs to adjust the pro forma financial statements when conforming the accounting. Paragraph 3230.4(c)(3) of the FRM indicates that when conforming changes are made to accounting principles adopted by a registrant, the “[p]ro forma information should consistently apply the . . . accounting principles to all periods presented.”

Example 1

Conforming an Accounting Principle
- Registrant A acquired Company B.
- Registrant A determines that the acquisition of B is significant such that B's separate financial statements and pro forma financial information for the business combination are required.
- Registrant A accounts for taxes collected on behalf of governmental authorities for revenue-producing activities with customers on a gross basis, while B reports similar taxes on a net basis.
- As a result of the acquisition, A will conform B's method of accounting to the gross basis to be consistent with A's historical financial statement presentation.

An adjustment to the pro forma income statement will be necessary to reflect the conformed accounting method.

The above guidance would also include circumstances in which a registrant has adopted a new accounting principle (regardless of whether the election was voluntary or to reflect a new standard) that has not yet been adopted by an acquired business or adopted as of a different date. In such circumstances, pro forma financial statements should be adjusted to conform the accounting policies of the acquired business as if it had adopted the accounting principle at the same time and under the same transition method as the registrant. As indicated in paragraph 3250.1(m) of the FRM:

If a registrant adopts a new accounting standard as of a different date and/or under a different transition method than a significant acquired business, the registrant must conform the date and method of adoption of the acquired business to its own in its pro forma financial information. The staff will consider requests for relief from this requirement.

However, pro forma adjustments reflecting conforming changes for recently adopted accounting principles should only be made if pro forma information reflecting the adoption is required under the applicable GAAP transition provisions (i.e., by either ASC 250 or the new standard). As indicated in paragraph 3250.1(n) of the FRM, a registrant does not need to apply the new
accounting principle in the pro forma financial information “for periods prior to adoption until it has reflected the new standard in the historical financial statements for those periods.”

**Example 2**

**Conforming the Adoption of an Accounting Principle**

- Registrant A acquired Company B on August 30, 20X9.
- Registrant A and B both have calendar fiscal year-ends.
- As a result of the acquisition, A must file a pro forma balance sheet and income statement for the interim six-month period ended June 30, 20X9, and a pro forma income statement for the year ended December 31, 20X8.
- To be consistent with A's accounting principles, the interim pro forma information should be adjusted to reflect B's adoption of the new accounting principle on January 1, 20X9. However, information for the year ended December 31, 20X8, should not be adjusted to reflect the new accounting principle because it was adopted on a prospective basis.
- Assume the same facts as above, except that on January 1, 20X9, A adopted a new accounting principle in its interim financial statements retrospectively but has not yet revised its financial statements for the prior annual periods. In this case, only the 20X9 interim pro forma information needs to reflect the adoption of the new standard to conform B's accounting principle to A's.

**3.4.2.7 Pro Forma Adjustment Considerations for New Contractual Arrangements**

Q&A Regulation S-X: Rule 11-02(b)(6)-7

**Question**

Should a registrant adjust the pro forma financial statements for new contractual arrangements (e.g., compensation or management agreements) entered into as part of a business combination or a spin-off of a subsidiary?

**Answer**

Generally, yes. The pro forma financial statements should generally be adjusted for the effects of new contractual arrangements that are related to a business combination or a spin-off of a subsidiary. Section 3280 of the FRM states that the “effects of new major distribution, cost sharing, or management agreements, and compensation or benefit plans may be reflected only if amounts are factually supportable, directly attributable to the transaction, and expected to have a continuing impact on the statement of operations.” A registrant should include pro forma adjustments when, as noted in paragraph 3250.1(b) of the FRM, new management or compensation agreements are entered into in conjunction, or concurrently, with the acquisition agreement. The terms of the agreements should be finalized before pro forma adjustments are made; otherwise, the adjustment may not meet the “factually supportable” criterion. See Section 3.4.1.1 for a discussion of what may constitute a factually supportable pro forma adjustment.

Section 3280 of the FRM provides the following example:

In connection with a spin-off of a subsidiary, a formal management agreement between a registrant or target subsidiary and its parent that provides for payments intended to cover administrative costs incurred by the parent on behalf of the subsidiary may be terminated or modified. If a new agreement

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40 For more information about general principles of pro forma adjustments, see Section 3.3.1.1.
is executed with different terms or the old agreement is terminated and no new agreement is entered into because the subsidiary or its new parent will now perform the activities covered by the previous management agreement, pro forma adjustment for the contractually modified fee may be made.

3.4.2.8 Pro Forma Adjustments for the Effects of Financing Arrangements

Q&A Regulation S-X: Rule 11-02(b)(6)-8

Question

Should a registrant give effect to a debt financing in pro forma financial information?

Answer

Generally, yes. Pro forma financial information should begin with the historical financial statements of the registrant (and, if applicable, other entities such as businesses acquired) and show the pro forma adjustments necessary to reflect the effects of the transaction, such as adjustments to interest expense arising from the debt financing. Paragraph 3260.1 of the FRM states that adjustments reflecting the debt financing “[g]enerally should be based on either the current interest rate or the interest rate for which the registrant has a commitment.” The registrant should disclose the “effect on income of a 1/8 percent variance in interest rates” if the actual interest rate used in the pro forma financial statements could vary, such as with variable-rate debt.

Paragraph 3260.2 of the FRM further states:

Although use of current or committed interest rates is appropriate in most cases, careful consideration should be given to the facts and circumstances specific to each presentation to determine whether the interest rate used is reasonable. Certain limited circumstances may warrant the use of an interest rate other than the current or committed rate. In some instances, the staff believes that the registrant should use the interest rates that were prevailing during the period covered by the pro forma information.

For example: If a registrant purchases a business whose assets comprise variable rate interest earning assets financed by variable rate debt, it may be inappropriate to use current interest rates for purposes of computing pro forma interest expense if historical income amounts related to interest earning assets are reflected using interest rates significantly different from current or committed rates.

When a rate other than the current or committed rate is used, prominent disclosure of the basis of presentation and the anticipated effects of the current interest rate environment should appear in the introduction to the pro forma financial statements and wherever pro forma information is provided.

Pro forma adjustments to remove the historical balance sheet and income statement effects of any replaced/revised debt structures and to recognize any significant changes to deferred debt offering costs on the pro forma balance sheet should also be considered in the preparation of pro forma information.
3.4.3 Special Issues in the Preparation of Pro Forma Financial Information

3.4.3.1 Gains and Losses Directly Attributable to a Transaction

Q&A Regulation S-X: Rule 11-02(b)(5)-2

Question

Should a registrant include pro forma income statement adjustments for gains and losses that are directly attributable to a transaction but that are nonrecurring?

Answer

No. As discussed in Rule 11-02(b)(6), paragraph 3230.4 of the FRM, and Section 3.4.1.1, the pro forma income statement adjustments should include adjustments that are (1) “directly attributable to each specific transaction,” (2) “factually supportable,” and (3) “expected to have a continuing impact.”

On the basis of these general principles of pro forma financial statements, nonrecurring gains and losses, even if they are factually supportable and directly attributable to the transaction, should not be included as adjustments to the pro forma income statement. However, paragraph 3310.2 of the FRM indicates that such gains and losses should be included as adjustments to pro forma retained earnings on the pro forma balance sheet, along with appropriate disclosure in the related footnotes, regardless of whether the adjustment is recurring or nonrecurring. This is because the general principles of pro forma adjustments require that adjustments to the pro forma balance sheet include both adjustments that have a continuing impact and nonrecurring adjustments. If the pro forma financial information includes a period after the consummation of the acquisition, it would be appropriate to eliminate such gains or losses as an adjustment to the pro forma income statement only.

In addition, this stipulation is consistent with Rule 11-02(b)(5), which states, in part:

Material nonrecurring charges or credits and related tax effects which result directly from the transaction and which will be included in the income of the registrant within the 12 months succeeding the transaction shall be disclosed separately. It should be clearly indicated that such charges or credits were not considered in the pro forma condensed statement of comprehensive income.

3.4.3.2 Interest Income on Proceeds Received in a Transaction

Q&A Regulation S-X: Rule 11-02(b)(6)-10

Question

Can a registrant present pro forma adjustments related to interest earned on proceeds received from an offering of securities or from the sale of assets?

Answer

No. Section 3310.1 of the FRM indicates that it is generally not appropriate to make pro forma adjustments to reflect “interest income from the use of proceeds from an offering” or sale of assets. However, such adjustments could be disclosed in the footnotes to the pro forma financial statements.
Appendix A — Selected Regulation S-X Rules and SAB Topic 1.J

Selected Regulation S-X rules and SAB Topic 1.J (SAB 80) are reproduced below for reference.

SEC Regulation S-X, Rules 1-02(l) and 1-02(w)

§210.1-02 Definitions of terms used in Regulation S-X (17 CFR part 210).

(l) Foreign business. A business that is majority owned by persons who are not citizens or residents of the United States and is not organized under the laws of the United States or any state thereof, and either:

(1) More than 50 percent of its assets are located outside the United States; or

(2) The majority of its executive officers and directors are not United States citizens or residents.

(w) Significant subsidiary. The term significant subsidiary means a subsidiary, including its subsidiaries, which meets any of the following conditions:

(1) The registrant's and its other subsidiaries' investments in and advances to the subsidiary exceed 10 percent of the total assets of the registrant and its subsidiaries consolidated as of the end of the most recently completed fiscal year (for a proposed combination between entities under common control, this condition is also met when the number of common shares exchanged or to be exchanged by the registrant exceeds 10 percent of its total common shares outstanding at the date the combination is initiated); or

(2) The registrant's and its other subsidiaries' proportionate share of the total assets (after intercompany eliminations) of the subsidiary exceeds 10 percent of the total assets of the registrants and its subsidiaries consolidated as of the end of the most recently completed fiscal year; or

(3) The registrant's and its other subsidiaries' equity in the income from continuing operations before income taxes of the subsidiary exclusive of amounts attributable to any noncontrolling interests exceeds 10 percent of such income of the registrant and its subsidiaries consolidated for the most recently completed fiscal year.

Note to paragraph (w):
A registrant that files its financial statements in accordance with or provides a reconciliation to U.S. Generally Accepted Accounting Principles shall make the prescribed tests using amounts determined under U.S. Generally Accepted Accounting Principles. A foreign private issuer that files its financial statements in accordance with IFRS as issued by the IASB shall make the prescribed tests using amounts determined under IFRS as issued by the IASB.
Appendix A — Selected Regulation S-X Rules and SAB Topic 1.J

SEC Regulation S-X, Rules 1-02(l) and 1-02(w) (continued)

**Computational note 1 to paragraph (w)(3):**
For purposes of making the prescribed income test the following guidance should be applied:

1. When a loss exclusive of amounts attributable to any noncontrolling interests has been incurred by either the parent and its subsidiaries consolidated or the tested subsidiary, but not both, the equity in the income or loss of the tested subsidiary exclusive of amounts attributable to any noncontrolling interests should be excluded from such income of the registrant and its subsidiaries consolidated for purposes of the computation.

2. If income of the registrant and its subsidiaries consolidated exclusive of amounts attributable to any noncontrolling interests for the most recent fiscal year is at least 10 percent lower than the average of the income for the last five fiscal years, such average income should be substituted for purposes of the computation. Any loss years should be omitted for purposes of computing average income.

3. Where the test involves combined entities, as in the case of determining whether summarized financial data should be presented, entities reporting losses shall not be aggregated with entities reporting income.

SEC Regulation S-X, Rule 3-01

§210.3-01 Consolidated balance sheets.

(a) There shall be filed, for the registrant and its subsidiaries consolidated, audited balance sheets as of the end of each of the two most recent fiscal years. If the registrant has been in existence for less than one fiscal year, there shall be filed an audited balance sheet as of a date within 135 days of the date of filing the registration statement.

(b) If the filing, other than a filing on Form 10-K or Form 10, is made within 45 days after the end of the registrant’s fiscal year and audited financial statements for the most recent fiscal year are not available, the balance sheets may be as of the end of the two preceding fiscal years and the filing shall include an additional balance sheet as of an interim date at least as current as the end of the registrant’s third fiscal quarter of the most recently completed fiscal year.

(c) The instruction in paragraph (b) of this section is also applicable to filings, other than on Form 10-K or Form 10, made after 45 days but within the number of days of the end of the registrant’s fiscal year specified in paragraph (i) of this section: Provided, that the following conditions are met:

1. The registrant files annual, quarterly and other reports pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 and all reports due have been filed;

2. For the most recent fiscal year for which audited financial statements are not yet available the registrant reasonably and in good faith expects to report income attributable to the registrant, after taxes; and

3. For at least one of the two fiscal years immediately preceding the most recent fiscal year the registrant reported income attributable to the registrant, after taxes.

(d) For filings made after 45 days but within the number of days of the end of the registrant’s fiscal year specified in paragraph (i) of this section where the conditions set forth in paragraph (c) of this section are not met, the filing must include the audited balance sheets required by paragraph (a) of this section.

(e) For filings made after the number of days specified in paragraph (i)(2) of this section, the filing shall also include a balance sheet as of an interim date within the following number of days of the date of filing:

1. 130 days for large accelerated filers and accelerated filers (as defined in §240.12b-2 of this chapter); and

2. 135 days for all other registrants.
SEC Regulation S-X, Rule 3-01 (continued)

(f) Any interim balance sheet provided in accordance with the requirements of this section may be unaudited and need not be presented in greater detail than is required by §210.10-01. Notwithstanding the requirements of this section, the most recent interim balance sheet included in a filing shall be at least as current as the most recent balance sheet filed with the Commission on Form 10-Q.

(g) For filings by registered management investment companies, the requirements of §210.3-18 shall apply in lieu of the requirements of this section.

(h) Any foreign private issuer, other than a registered management investment company or an employee plan, may file the financial statements required by Item 8.A of Form 20-F (§249.220 of this chapter) in lieu of the financial statements specified in this rule.

(i)(1) For purposes of paragraphs (c) and (d) of this section, the number of days shall be:

(i) 60 days (75 days for fiscal years ending before December 15, 2006) for large accelerated filers (as defined in §240.12b-2 of this chapter);

(ii) 75 days for accelerated filers (as defined in §240.12b-2 of this chapter); and

(iii) 90 days for all other registrants.

(2) For purposes of paragraph (e) of this section, the number of days shall be:

(i) 129 days subsequent to the end of the registrant's most recent fiscal year for large accelerated filers and accelerated filers (as defined in §240.12b-2 of this chapter); and

(ii) 134 days subsequent to the end of the registrant's most recent fiscal year for all other registrants.


SEC Regulation S-X, Rule 3-02

§210.3-02 Consolidated statements of comprehensive income and cash flows.

(a) There shall be filed, for the registrant and its subsidiaries consolidated and for its predecessors, audited statements of comprehensive income and cash flows for each of the three fiscal years preceding the date of the most recent audited balance sheet being filed or such shorter period as the registrant (including predecessors) has been in existence. A registrant that is an emerging growth company, as defined in §230.405 of this chapter (Rule 405 of the Securities Act) or §240.12b-2 of this chapter (Rule 12b-2 of the Exchange Act), may, in a Securities Act registration statement for the initial public offering of the emerging growth company's equity securities, provide audited statements of comprehensive income and cash flows for each of the two fiscal years preceding the date of the most recent audited balance sheet (or such shorter period as the registrant has been in existence).

(b) In addition, for any interim period between the latest audited balance sheet and the date of the most recent interim balance sheet being filed, and for the corresponding period of the preceding fiscal year, statements of comprehensive income and cash flows shall be provided. Such interim financial statements may be unaudited and need not be presented in greater detail than is required by §210.10-01.

(c) For filings by registered management investment companies, the requirements of §210.3-18 shall apply in lieu of the requirements of this section.

(d) Any foreign private issuer, other than a registered management investment company or an employee plan, may file the financial statements required by Item 8.A of Form 20-F (§249.220 of this chapter) in lieu of the financial statements specified in this rule.

**SEC Regulation S-X, Rule 3-05**

§210.3-05 Financial statements of businesses acquired or to be acquired.

(a) **Financial statements required.** (1) Financial statements prepared and audited in accordance with this regulation should be furnished for the periods specified in paragraph (b) below if any of the following conditions exist:

(i) A business combination has occurred or is probable (for purposes of this section, this encompasses the acquisition of an interest in a business accounted for by the equity method); or

(ii) Consummation of a combination between entities under common control is probable.

(2) For purposes of determining whether the provisions of this rule apply, the determination of whether a business has been acquired should be made in accordance with the guidance set forth in §210.11-01(d).

(3) Acquisitions of a group of related businesses that are probable or that have occurred subsequent to the latest fiscal year-end for which audited financial statements of the registrant have been filed shall be treated under this section as if they are a single business combination. The required financial statements of related businesses may be presented on a combined basis for any periods they are under common control or management. For purposes of this section, businesses shall be deemed to be related if:

(i) They are under common control or management;

(ii) The acquisition of one business is conditional on the acquisition of each other business; or

(iii) Each acquisition is conditioned on a single common event.

(4) This rule shall not apply to a business which is totally held by the registrant prior to consummation of the transaction.

(b) **Periods to be presented.** (1) If securities are being registered to be offered to the security holders of the business to be acquired, the financial statements specified in §§210.3-01 and 210.3-02 shall be furnished for the business to be acquired, except as provided otherwise for filings on Form N-14, S-4 or F-4 (§239.23, §239.25 or §239.34 of this chapter). The financial statements covering fiscal years shall be audited except as provided in Item 14 of Schedule 14A (§240.14a-101 of this chapter) with respect to certain proxy statements or in registration statements filed on Forms N-14, S-4 or F-4 (§239.23, §239.25 or §239.34 of this chapter).

(2) In all cases not specified in paragraph (b)(1) of this section, financial statements of the business acquired or to be acquired shall be filed for the periods specified in this paragraph (b)(2) or such shorter period as the business has been in existence. The periods for which such financial statements are to be filed shall be determined using the conditions specified in the definition of significant subsidiary in §210.1-02(w) as follows:

(i) If none of the conditions exceeds 20 percent, financial statements are not required. However, if the aggregate impact of the individually insignificant businesses acquired since the date of the most recent audited balance sheet filed for the registrant exceeds 50%, financial statements covering at least the substantial majority of the businesses acquired shall be furnished. Such financial statements shall be for at least the most recent fiscal year and any interim periods specified in §§210.3-01 and 210.3-02.

(ii) If any of the conditions exceeds 20 percent, but none exceed 40 percent, financial statements shall be furnished for at least the most recent fiscal year and any interim periods specified in §§210.3-01 and 210.3-02.

(iii) If any of the conditions exceeds 40 percent, but none exceed 50 percent, financial statements shall be furnished for at least the two most recent fiscal years and any interim periods specified in §§210.3-01 and 210.3-02.

(iv) If any of the conditions exceed 50 percent, the full financial statements specified in §§210.3-01 and 210.3-02 shall be furnished. However, financial statements for the earliest of the three fiscal years required may be omitted if net revenues reported by the acquired business in its most recent fiscal year are less than $100 million.\(^1\)

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\(^1\) See footnote 55.
SEC Regulation S-X, Rule 3-05 (continued)

(3) The determination shall be made by comparing the most recent annual financial statements of each such business, or group of related businesses on a combined basis, to the registrant's most recent annual consolidated financial statements filed at or prior to the date of acquisition. However, if the registrant made a significant acquisition subsequent to the latest fiscal year-end and filed a report on Form 8-K (§249.308 of this chapter) which included audited financial statements of such acquired business for the periods required by this section and the pro forma financial information required by §210.11, such determination may be made by using pro forma amounts for the latest fiscal year in the report on Form 8-K (§249.308 of this chapter) rather than by using the historical amounts of the registrant. The tests may not be made by “annualizing” data.

(4) Financial statements required for the periods specified in paragraph (b)(2) of this section may be omitted to the extent specified as follows:

(i) Registration statements not subject to the provisions of §230.419 of this chapter (Regulation C) and proxy statements need not include separate financial statements of the acquired or to be acquired business if it does not exceed any of the conditions of significance in the definition of significant subsidiary in §210.1-02 at the 50 percent level, and either:

(A) The consummation of the acquisition has not yet occurred; or

(B) The date of the final prospectus or prospectus supplement relating to an offering as filed with the Commission pursuant to §230.424(b) of this chapter, or mailing date in the case of a proxy statement, is no more than 74 days after consummation of the business combination, and the financial statements have not previously been filed by the registrant.

(ii) An issuer, other than a foreign private issuer required to file reports on Form 6-K, that omits from its initial registration statement financial statements of a recently consummated business combination pursuant to paragraph (b)(4)(i) of this section shall furnish those financial statements and any pro forma information specified by Article 11 of this chapter under cover of Form 8-K (§249.308 of this chapter) no later than 75 days after consummation of the acquisition.

(iii) Separate financial statements of the acquired business need not be presented once the operating results of the acquired business have been reflected in the audited consolidated financial statements of the registrant for a complete fiscal year unless such financial statements have not been previously filed or unless the acquired business is of such significance to the registrant that omission of such financial statements would materially impair an investor's ability to understand the historical financial results of the registrant. For example, if, at the date of acquisition, the acquired business met at least one of the conditions in the definition of significant subsidiary in §210.1-02 at the 80 percent level, the statements of comprehensive income of the acquired business should normally continue to be furnished for such periods prior to the purchase as may be necessary when added to the time for which audited statements of comprehensive income after the purchase are filed to cover the equivalent of the period specified in §210.3-02.

(iv) A separate audited balance sheet of the acquired business is not required when the registrant's most recent audited balance sheet required by §210.3-01 is for a date after the date the acquisition was consummated.

(c) Financial statements of foreign business. If the business acquired or to be acquired is a foreign business, financial statements of the business meeting the requirements of Item 17 of Form 20-F (§249.220f of this chapter) will satisfy this section.

SEC Regulation S-X, Rule 3-06

§210.3-06 Financial statements covering a period of nine to twelve months.

Except with respect to registered investment companies, the filing of financial statements covering a period of 9 to 12 months shall be deemed to satisfy a requirement for filing financial statements for a period of 1 year where:

(a) The issuer has changed its fiscal year;

(b) The issuer has made a significant business acquisition for which financial statements are required under §210.3-05 of this chapter and the financial statements covering the interim period pertain to the business being acquired; or

(c) The Commission so permits pursuant to §210.3-13 of this chapter.

Where there is a requirement for filing financial statements for a time period exceeding one year but not exceeding three consecutive years (with not more than 12 months included in any period reported upon), the filing of financial statements covering a period of nine to 12 months shall satisfy a filing requirement of financial statements for one year of that time period only if the conditions described in either paragraph (a), (b), or (c) of this section exist and financial statements are filed that cover the full fiscal year or years for all other years in the time period.

[54 FR 10315, Mar. 13, 1989]

SEC Regulation S-X, Rule 3-12

§210.3-12 Age of financial statements at effective date of registration statement or at mailing date of proxy statement.

(a) If the financial statements in a filing are as of a date the number of days specified in paragraph (g) of this section or more before the date the filing is expected to become effective, or proposed mailing date in the case of a proxy statement, the financial statements shall be updated, except as specified in the following paragraphs, with a balance sheet as of an interim date within the number of days specified in paragraph (g) of this section and with statements of comprehensive income and cash flows for the interim period between the end of the most recent fiscal year and the date of the interim balance sheet provided and for the corresponding period of the preceding fiscal year. Such interim financial statements may be unaudited and need not be presented in greater detail than is required by §210.10-01. Notwithstanding the above requirements, the most recent interim financial statements shall be at least as current as the most recent financial statements filed with the Commission on Form 10-Q.

(b) Where the anticipated effective date of a filing, or in the case of a proxy statement the proposed mailing date, falls within the number of days subsequent to the end of the fiscal year specified in paragraph (g) of this section, the filing need not include financial statements more current than as of the end of the third fiscal quarter of the most recently completed fiscal year unless the audited financial statements for such fiscal year are available or unless the anticipated effective date or proposed mailing date falls after 45 days subsequent to the end of the fiscal year and the registrant does not meet the conditions prescribed under paragraph (c) of §210.3-01. If the anticipated effective date or proposed mailing date falls after 45 days subsequent to the end of the fiscal year and the registrant does not meet the conditions prescribed under paragraph (c) of §210.3-01, the filing must include audited financial statements for the most recently completed fiscal year.

(c) Where a filing is made near the end of a fiscal year and audited financial statements for that fiscal year are not included in the filing, the filing shall be updated with such audited financial statements if they become available prior to the anticipated effective date, or proposed mailing date in the case of a proxy statement.

(d) The age of the registrant's most recent audited financial statements included in a registration statement filed under the Securities Act of 1933 or filed on Form 10 (17 CFR 249.210) under the Securities Exchange Act of 1934 shall not be more than one year and 45 days old at the date the registration statement becomes effective if the registration statement relates to the security of an issuer that was not subject, immediately before the time of filing the registration statement, to the reporting requirements of section 13 or 15(d) of the Securities Exchange Act of 1934.
SEC Regulation S-X, Rule 3-12 (continued)

(e) For filings by registered management investment companies, the requirements of §210.3-18 shall apply in lieu of the requirements of this section.

(f) Any foreign private issuer may file financial statements whose age is specified in Item 8.A of Form 20-F (§249.220f of this chapter). Financial statements of a foreign business which are furnished pursuant to §210.3-05 or §210.3-09 because it is an acquired business or a 50 percent or less owned person may be of the age specified in Item 8.A of Form 20-F.

(g)(1) For purposes of paragraph (a) of this section, the number of days shall be:

(i) 130 days for large accelerated filers and accelerated filers (as defined in §240.12b-2 of this chapter); and

(ii) 135 days for all other registrants.

(2) For purposes of paragraph (b) of this section, the number of days shall be:

(i) 60 days (75 days for fiscal years ending before December 15, 2006) for large accelerated filers (as defined in §240.12b-2 of this chapter);

(ii) 75 days for accelerated filers (as defined in §240.12b-2 of this chapter); and

(iii) 90 days for all other registrants.

[45 FR 62687, Sept. 25, 1980]

SEC Regulation S-X, Rule 3-13

§210.3-13 Filing of other financial statements in certain cases.

The Commission may, upon the informal written request of the registrant, and where consistent with the protection of investors, permit the omission of one or more of the financial statements herein required or the filing in substitution therefor of appropriate statements of comparable character. The Commission may also by informal written notice require the filing of other financial statements in addition to, or in substitution for, the statements herein required in any case where such statements are necessary or appropriate for an adequate presentation of the financial condition of any person whose financial statements are required, or whose statements are otherwise necessary for the protection of investors.

SEC Regulation S-X, Rule 3-14

§210.3-14 Special instructions for real estate operations to be acquired.

(a) If, during the period for which statements of comprehensive income are required, the registrant has acquired one or more properties which in the aggregate are significant, or since the date of the latest balance sheet required has acquired or proposes to acquire one or more properties which in the aggregate are significant, the following shall be furnished with respect to such properties:

(1) Audited income statements (not including earnings per unit) for the three most recent fiscal years, which shall exclude items not comparable to the proposed future operations of the property such as mortgage interest, leasehold rental, depreciation, corporate expenses and Federal and state income taxes: Provided, however, That such audited statements need be presented for only the most recent fiscal year if
SEC Regulation S-X, Rule 3-14 (continued)

(i) The property is not acquired from a related party;

(ii) Material factors considered by the registrant in assessing the property are described with specificity in the filing with regard to the property, including sources of revenue (including, but not limited to, competition in the rental market, comparative rents, occupancy rates) and expense (including, but not limited to, utility rates, ad valorem tax rates, maintenance expenses, capital improvements anticipated); and

(iii) The registrant indicates in the appropriate filing that, after reasonable inquiry, the registrant is not aware of any material factors relating to that specific property other than those discussed in response to paragraph (a)(1)(ii) of this section that would cause the reported financial information not to be necessarily indicative of future operating results.

Note 1 to paragraph (a)(1):
The discussion of material factors considered should be combined with that required by Item 15 of Form S-11.

(2) If the property is to be operated by the registrant, there shall be furnished a statement showing the estimated taxable operating results of the registrant based on the most recent twelve month period including such adjustments as can be factually supported. If the property is to be acquired subject to a net lease the estimated taxable operating results shall be based on the rent to be paid for the first year of the lease. In either case, the estimated amount of cash to be made available by operations shall be shown. There shall be stated in an introductory paragraph the principal assumptions which have been made in preparing the statements of estimated taxable operating results and cash to be made available by operations.

(3) If appropriate under the circumstances, there shall be given in tabular form for a limited number of years the estimated cash distribution per unit showing the portion thereof reportable as taxable income and the portion representing a return of capital together with an explanation of annual variations, if any. If taxable net income per unit will become greater than the cash available for distribution per unit, that fact and approximate year of occurrence shall be stated, if significant.

(b) Information required by this section is not required to be included in a filing on Form 10-K.


SEC Regulation S-X, Article 11

Pro Forma Financial Information

Source: Sections 210.11-01 through 210.11-03 appear at 47 FR 29837, July 9, 1982, unless otherwise noted.

§210.11-01 Presentation requirements.

(a) Pro forma financial information shall be furnished when any of the following conditions exist:

(1) During the most recent fiscal year or subsequent interim period for which a balance sheet is required by §210.3-01, a significant business combination has occurred (for purposes of these rules, this encompasses the acquisition of an interest in a business accounted for by the equity method);

(2) After the date of the most recent balance sheet filed pursuant to §210.3-01, consummation of a significant business combination or a combination of entities under common control has occurred or is probable;

(3) Securities being registered by the registrant are to be offered to the security holders of a significant business to be acquired or the proceeds from the offered securities will be applied directly or indirectly to the purchase of a specific significant business;

(4) The disposition of a significant portion of a business either by sale, abandonment or distribution to shareholders by means of a spin-off, split-up or split-off has occurred or is probable and such disposition is not fully reflected in the financial statements of the registrant included in the filing;
SEC Regulation S-X, Article 11 (continued)

(5) During the most recent fiscal year or subsequent interim period for which a balance sheet is required by §210.3-01, the registrant has acquired one or more real estate operations or properties which in the aggregate are significant, or since the date of the most recent balance sheet filed pursuant to that section the registrant has acquired or proposes to acquire one or more operations or properties which in the aggregate are significant.

(6) Pro forma financial information required by §229.914 is required to be provided in connection with a roll-up transaction as defined in §229.901(c).

(7) The registrant previously was a part of another entity and such presentation is necessary to reflect operations and financial position of the registrant as an autonomous entity; or

(8) Consummation of other events or transactions has occurred or is probable for which disclosure of pro forma financial information would be material to investors.

(b) A business combination or disposition of a business shall be considered significant if:

(1) A comparison of the most recent annual financial statements of the business acquired or to be acquired and the registrant's most recent annual consolidated financial statements filed at or prior to the date of acquisition indicates that the business would be a significant subsidiary pursuant to the conditions specified in §210.1-02(w), substituting 20 percent for 10 percent each place it appears therein; or

(2) The business to be disposed of meets the conditions of a significant subsidiary in §210.1-02(w).

(c) The pro forma effects of a business combination need not be presented pursuant to this section if separate financial statements of the acquired business are not included in the filing.

(d) For purposes of this rule, the term business should be evaluated in light of the facts and circumstances involved and whether there is sufficient continuity of the acquired entity's operations prior to and after the transactions so that disclosure of prior financial information is material to an understanding of future operations. A presumption exists that a separate entity, a subsidiary, or a division is a business. However, a lesser component of an entity may also constitute a business. Among the facts and circumstances which should be considered in evaluating whether an acquisition of a lesser component of an entity constitutes a business are the following:

(1) Whether the nature of the revenue-producing activity of the component will remain generally the same as before the transaction; or

(2) Whether any of the following attributes remain with the component after the transaction:

(i) Physical facilities,

(ii) Employee base,

(iii) Market distribution system,

(iv) Sales force,

(v) Customer base,

(vi) Operating rights,

(vii) Production techniques, or

(viii) Trade names.

(e) This rule does not apply to transactions between a parent company and its totally held subsidiary.

**SEC Regulation S-X, Article 11 (continued)**

**§210.11-02 Preparation requirements.**

(a) **Objective.** Pro forma financial information should provide investors with information about the continuing impact of a particular transaction by showing how it might have affected historical financial statements if the transaction had been consummated at an earlier time. Such statements should assist investors in analyzing the future prospects of the registrant because they illustrate the possible scope of the change in the registrant's historical financial position and results of operations caused by the transaction.

(b) **Form and content.** (1) Pro forma financial information shall consist of a pro forma condensed balance sheet, pro forma condensed statements of comprehensive income, and accompanying explanatory notes. In certain circumstances (i.e., where a limited number of pro forma adjustments are required and those adjustments are easily understood), a narrative description of the pro forma effects of the transaction may be furnished in lieu of the statements described herein.

(2) The pro forma financial information shall be accompanied by an introductory paragraph which briefly sets forth a description of (i) the transaction, (ii) the entities involved, and (iii) the periods for which the pro forma information is presented. In addition, an explanation of what the pro forma presentation shows shall be set forth.

(3) The pro forma condensed financial information need only include major captions (i.e., the numbered captions) prescribed by the applicable sections of part 210 of this chapter (Regulation S-X). Where any major balance sheet caption is less than 10 percent of total assets, the caption may be combined with others. When any major statement of comprehensive income caption is less than 15 percent of average net income attributable to the registrant for the most recent three fiscal years, the caption may be combined with others.

(4) Pro forma statements shall ordinarily be in columnar form showing condensed historical statements, pro forma adjustments, and the pro forma results.

(5) The pro forma condensed statement of comprehensive income shall disclose income (loss) from continuing operations before nonrecurring charges or credits directly attributable to the transaction. Material nonrecurring charges or credits and related tax effects which result directly from the transaction and which will be included in the income of the registrant within the 12 months succeeding the transaction shall be disclosed separately. It should be clearly indicated that such charges or credits were not considered in the pro forma condensed statement of comprehensive income. If the transaction for which pro forma financial information is presented relates to the disposition of a business, the pro forma results should give effect to the disposition and be presented under an appropriate caption.

(6) Pro forma adjustments related to the pro forma condensed statement of comprehensive income shall be computed assuming the transaction was consummated at the beginning of the fiscal year presented and shall include adjustments which give effect to events that are directly attributable to the transaction, expected to have a continuing impact on the registrant, and factually supportable. Pro forma adjustments related to the pro forma condensed balance sheet shall be computed assuming the transaction was consummated at the end of the most recent period for which a balance sheet is required by §210.3-01 and shall include adjustments which give effect to events that are directly attributable to the transaction and factually supportable regardless of whether they have a continuing impact or are nonrecurring. All adjustments should be referenced to notes which clearly explain the assumptions involved.

(7) Historical primary and fully diluted per share data based on continuing operations (or net income if the registrant does not report discontinued operations) for the registrant, and primary and fully diluted pro forma per share data based on continuing operations before nonrecurring charges or credits directly attributable to the transaction shall be presented on the face of the pro forma condensed statement of comprehensive income together with the number of shares used to compute such per share data. For transactions involving the issuance of securities, the number of shares used in the calculation of the pro forma per share data should be based on the weighted average number of shares outstanding during the period adjusted to give effect to shares subsequently issued or assumed to be issued had the particular transaction or event taken place at the beginning of the period presented. If a convertible security is being issued in the transaction, consideration should be given to the possible dilution of the pro forma per share data.
(8) If the transaction is structured in such a manner that significantly different results may occur, additional pro forma presentations shall be made which give effect to the range of possible results.

**Instruction 1 to paragraph (b).** The historical statement of comprehensive income used in the pro forma financial information shall not report discontinued operations. If the historical statement of comprehensive income includes such items, only the portion of the statement of comprehensive income through “income from continuing operations” (or the appropriate modification thereof) should be used in preparing pro forma results.

**Instruction 2 to paragraph (b).** For a business combination, pro forma adjustments for the statement of comprehensive income shall include amortization, depreciation and other adjustments based on the allocated purchase price of net assets acquired. In some transactions, such as in financial institution acquisitions, the purchase adjustments may include significant discounts of the historical cost of the acquired assets to their fair value at the acquisition date. When such adjustments will result in a significant effect on earnings (losses) in periods immediately subsequent to the acquisition which will be progressively eliminated over a relatively short period, the effect of the purchase adjustments on reported results of operations for each of the next five years should be disclosed in a note.

**Instruction 3 to paragraph (b).** For a disposition transaction, the pro forma financial information shall begin with the historical financial statements of the existing entity and show the deletion of the business to be divested along with the pro forma adjustments necessary to arrive at the remainder of the existing entity. For example, pro forma adjustments would include adjustments of interest expense arising from revised debt structures and expenses which will be or have been incurred on behalf of the business to be divested such as advertising costs, executive salaries and other costs.

**Instruction 4 to paragraph (b).** For entities which were previously a component of another entity, pro forma adjustments should include adjustments similar in nature to those referred to in Instruction 3 above. Adjustments may also be necessary when charges for corporate overhead, interest, or income taxes have been allocated to the entity on a basis other than one deemed reasonable by management.

**Instruction 5 to paragraph (b).** Adjustments to reflect the acquisition of real estate operations or properties for the pro forma statement of comprehensive income shall include a depreciation charge based on the new accounting basis for the assets, interest financing on any additional or refinanced debt, and other appropriate adjustments that can be factually supported. See also Instruction 4 to this paragraph (b).

**Instruction 6 to paragraph (b).** When consummation of more than one transaction has occurred or is probable during a fiscal year, the pro forma financial information may be presented on a combined basis; however, in some circumstances (e.g., depending upon the combination of probable and consummated transactions, and the nature of the filing) it may be more useful to present the pro forma financial information on a disaggregated basis even though some or all of the transactions would not meet the tests of significance individually. For combined presentations, a note should explain the various transactions and disclose the maximum variances in the pro forma financial information which would occur for any of the possible combinations. If the pro forma financial information is presented in a proxy or information statement for purposes of obtaining shareholder approval of one of the transactions, the effects of that transaction must be clearly set forth.

**Instruction 7 to paragraph (b).** Tax effects, if any, of pro forma adjustments normally should be calculated at the statutory rate in effect during the periods for which pro forma condensed statements of comprehensive income are presented and should be reflected as a separate pro forma adjustment.

(c) **Periods to be presented.** (1) A pro forma condensed balance sheet as of the end of the most recent period for which a consolidated balance sheet of the registrant is required by §210.3-01 shall be filed unless the transaction is already reflected in such balance sheet.

(2)(i) Pro forma condensed statements of comprehensive income shall be filed for only the most recent fiscal year and for the period from the most recent fiscal year end to the most recent interim date for which a balance sheet is required. A pro forma condensed statement of comprehensive income may be filed for the corresponding interim period of the preceding fiscal year. A pro forma condensed statement of comprehensive income shall not be filed when the historical statement of comprehensive income reflects the transaction for the entire period.
(ii) For combinations between entities under common control, the pro forma statements of comprehensive income (which are in effect a restatement of the historical statements of comprehensive income as if the combination had been consummated) shall be filed for all periods for which historical statements of comprehensive income of the registrant are required.

(3) Pro forma condensed statements of comprehensive income shall be presented using the registrant's fiscal year end. If the most recent fiscal year end of any other entity involved in the transaction differs from the registrant's most recent fiscal year end by more than 93 days, the other entity's statement of comprehensive income shall be brought up to within 93 days of the registrant's most recent fiscal year end, if practicable. This updating could be accomplished by adding subsequent interim period results to the most recent fiscal year-end information and deducting the comparable preceding year interim period results. Disclosure shall be made of the periods combined and of the sales or revenues and income for any periods which were excluded from or included more than once in the condensed pro forma statements of comprehensive income (e.g., an interim period that is included both as part of the fiscal year and the subsequent interim period). For investment companies subject to §§210.6-01 through 210.6-10, the periods covered by the pro forma statements must be the same.

(4) Whenever unusual events enter into the determination of the results shown for the most recently completed fiscal year, the effect of such unusual events should be disclosed and consideration should be given to presenting a pro forma condensed statement of comprehensive income for the most recent twelve-month period in addition to those required in paragraph (c)(2)(i) of this section if the most recent twelve-month period is more representative of normal operations.


§210.11-03 Presentation of financial forecast.

(a) A financial forecast may be filed in lieu of the pro forma condensed statements of comprehensive income required by §210.11-02(b)(1).

(1) The financial forecast shall cover a period of at least 12 months from the latest of (i) the most recent balance sheet included in the filing or (ii) the consummation date or estimated consummation date of the transaction.

(2) The forecasted statement of comprehensive income shall be presented in the same degree of detail as the pro forma condensed statement of comprehensive income required by §210.11-02(b)(3).

(3) Assumptions particularly relevant to the transaction and effects thereof should be clearly set forth.

(4) Historical condensed financial information of the registrant and the business acquired or to be acquired, if any, shall be presented for at least a recent 12 month period in parallel columns with the financial forecast.

(b) Such financial forecast shall be presented in accordance with the guidelines established by the American Institute of Certified Public Accountants.

(c) Forecasted earnings per share data shall be substituted for pro forma per share data.

(d) This rule does not permit the filing of a financial forecast in lieu of pro forma information required by generally accepted accounting principles.

[47 FR 29837, July 9, 1982, as amended at 83 FR 50208, Oct. 4, 2018]
SEC Staff Accounting Bulletin Topic 1.J (SAB 80)

J. Application of Rule 3-05 in Initial Public Offerings

Facts: Rule 3-05 of Regulation S-X establishes the financial statement requirements for businesses acquired or to be acquired. If required, financial statements must be provided for one, two or three years depending upon the relative significance of the acquired entity as determined by the application of Rule 1-02(w) of Regulation S-X. The calculations required for these tests are applied by comparison of the financial data of the registrant and acquiree(s) for the fiscal years most recently completed prior to the acquisition. The staff has recognized that these tests literally applied in some initial public offerings may require financial statements for an acquired entity which may not be significant to investors because the registrant has had substantial growth in assets and earnings in recent years.18

Question: How should Rules 3-05 and 1-02(w) of Regulation S-X be applied in determining the periods for which financial statements of acquirees are required to be included in registration statements for initial public offerings?

Interpretive Response: It is the staff's view that initial public offerings involving businesses that have been built by the aggregation of discrete businesses that remain substantially intact after acquisition19 were not contemplated during the drafting of Rule 3-05 and that the significance of an acquired entity in such situations may be better measured in relation to the size of the registrant at the time the registration statement is filed, rather than its size at the time the acquisition was made. Therefore, for a first time registrant, the staff has indicated that in applying the significance tests in Rule 3-05, the three tests in Rule 1-02(w) generally can be measured against the combined entities, including those to be acquired, which comprise the registrant at the time the registration statement is filed. The staff's policy is intended to ensure that the registration statement will include not less than three, two and one year(s) of audited financial statements for not less than 60%, 80% and 90%, respectively, of the constituent businesses that will comprise the registrant on an ongoing basis. In all circumstances, the audited financial statements of the registrant are required for three years, or since its inception if less than three years. The requirement to provide the audited financial statements of a constituent business in the registration statement is satisfied for the post-acquisition period by including the entity's results in the audited consolidated financial statements of the registrant. If additional periods are required, the entity's separate audited financial statements for the immediate pre-acquisition period(s) should be presented.20

In order for the pre-acquisition audited financial statements of an acquiree to be omitted from the registration statement, the following conditions must be met:

a. the combined significance of businesses acquired or to be acquired for which audited financial statements cover a period of less than 9 months21 may not exceed 10%;

b. the combined significance of businesses acquired or to be acquired for which audited financial statements cover a period of less than 21 months may not exceed 20%; and

c. the combined significance of businesses acquired or to be acquired for which audited financial statements cover a period of less than 33 months may not exceed 40%.

Combined significance is the total, for all included companies, of each individual company's highest level of significance computed under the three tests of significance. The significance tests should be applied to pro forma financial statements of the registrant, prepared in a manner consistent with Article 11 of Regulation S-X. The pro forma balance sheet should be as of the date of the registrant's latest balance sheet included in the registration statement, and should give effect to businesses acquired subsequent to the end of the latest year or to be acquired as if they had been acquired on that date. The pro forma statement of operations should be for the registrant's most recent fiscal year included in the registration statement and should give effect to all acquisitions consummated during and subsequent to the end of the year and probable acquisitions as if they had been consummated at the beginning of that fiscal year.

The three tests specified in Rule 1-02(w) should be made in comparison to the registrant's pro forma consolidated assets and pretax income from continuing operations. The assets and pretax income of the acquired businesses which are being evaluated for significance should reflect any new cost basis arising from purchase accounting.
Example: On February 20, 20X9 Registrant files Form S-1 containing its audited consolidated financial statements as of and for the three years ended December 31, 20X8. Acquisitions since inception have been:

<table>
<thead>
<tr>
<th>Acquiree</th>
<th>Fiscal Year End</th>
<th>Date of Acquisition</th>
<th>Highest Significance at Acquisition</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>3/31</td>
<td>1/1/x7</td>
<td>60%</td>
</tr>
<tr>
<td>B</td>
<td>7/31</td>
<td>4/1/x7</td>
<td>45%</td>
</tr>
<tr>
<td>C</td>
<td>9/30</td>
<td>9/1/x7</td>
<td>40%</td>
</tr>
<tr>
<td>D</td>
<td>12/31</td>
<td>2/1/x8</td>
<td>21%</td>
</tr>
<tr>
<td>E</td>
<td>3/31</td>
<td>11/1/x8</td>
<td>11%</td>
</tr>
<tr>
<td>F</td>
<td>12/31</td>
<td>To be acquired</td>
<td>11%</td>
</tr>
</tbody>
</table>

The following table reflects the application of the significance tests to the combined financial information at the time the registration statement is filed.

<table>
<thead>
<tr>
<th>Component Entity</th>
<th>Significance of</th>
<th></th>
<th></th>
<th>Highest Level of Significance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Assets</td>
<td>Earnings</td>
<td>Investment</td>
<td></td>
</tr>
<tr>
<td>A</td>
<td>12%</td>
<td>23%</td>
<td>12%</td>
<td>23%</td>
</tr>
<tr>
<td>B</td>
<td>10%</td>
<td>21%</td>
<td>10%</td>
<td>21%</td>
</tr>
<tr>
<td>C</td>
<td>21%</td>
<td>3%</td>
<td>4%</td>
<td>21%</td>
</tr>
<tr>
<td>D</td>
<td>10%</td>
<td>5%</td>
<td>13%</td>
<td>13%</td>
</tr>
<tr>
<td>E</td>
<td>4%</td>
<td>9% loss</td>
<td>3%</td>
<td>9%</td>
</tr>
<tr>
<td>F</td>
<td>2%</td>
<td>11%</td>
<td>6%</td>
<td>11%</td>
</tr>
</tbody>
</table>

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

Year 2 (preceding fiscal year) — Financial statements for E and F may be omitted since their combined significance is 20% and no other combination can be formed with E which would not exceed 20%.

Year 3 (second preceding fiscal year) — Financial statements for D, E and F may be omitted since the combined significance of these entities is 33%\(^2\) and no other combination can be formed with E and F which would not exceed 40%.
The financial statement requirements must be satisfied by filing separate pre-acquisition audited financial statements for each entity that was not included in the consolidated financial statements for the periods set forth above. The following table illustrates the requirements for this example.

<table>
<thead>
<tr>
<th>Component Entity</th>
<th>Date of Acquisition</th>
<th>Minimum Financial Statement Requirement</th>
<th>Period in Consolidated Financial Statements (months)</th>
<th>Separate Pre-Acquisition Audited Financial Statement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Registrant</td>
<td>N/A</td>
<td>33</td>
<td>36</td>
<td>—</td>
</tr>
<tr>
<td>A</td>
<td>1/1/x7</td>
<td>33</td>
<td>24</td>
<td>9</td>
</tr>
<tr>
<td>B</td>
<td>4/1/x7</td>
<td>33</td>
<td>21</td>
<td>12(^{22})</td>
</tr>
<tr>
<td>C</td>
<td>9/1/x7</td>
<td>33</td>
<td>16</td>
<td>17</td>
</tr>
<tr>
<td>D</td>
<td>2/1/x8</td>
<td>21</td>
<td>11</td>
<td>10</td>
</tr>
<tr>
<td>E</td>
<td>11/1/x8</td>
<td>—</td>
<td>2</td>
<td>—</td>
</tr>
<tr>
<td>F</td>
<td>To be acquired</td>
<td>9</td>
<td>—</td>
<td>9</td>
</tr>
</tbody>
</table>

18 An acquisition which was relatively significant in the earliest year for which a registrant is required to file financial statements may be insignificant to its latest fiscal year due to internal growth and/or subsequent acquisitions. Literally applied, Rules 3-05 and 1-02(w) might still require separate financial statements for the now insignificant acquisition.

19 For example, nursing homes, hospitals or cable TV systems. This interpretation would not apply to businesses for which the relative significance of one portion of the business to the total business may be altered by post-acquisition decisions as to the allocation of incoming orders between plants or locations. This bulletin does not address all possible cases in which similar relief may be appropriate but, rather, attempts to describe a general framework within which administrative policy has been established. In other distinguishable situations, registrants may request relief as appropriate to their individual facts and circumstances.

20 If audited pre-acquisition financial statements of a business are necessary pursuant to the alternative tests described here, the interim period following that entity's latest pre-acquisition fiscal year end but prior to its acquisition by the registrant generally would be required to be audited.

21 As a matter of policy the staff accepts financial statements for periods of not less than 9, 21 and 33 consecutive months (not more than 12 months may be included in any period reported on) as substantial compliance with requirements for financial statements for 1, 2 and 3 years, respectively.

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

23 The audited pre-acquisition period need not correspond to the acquiree’s pre-acquisition fiscal year. However, audited periods must not be for periods in excess of 12 months.
Appendix B — Template for Request to Provide Statements of Assets Acquired and Liabilities Assumed and Revenues and Direct Expenses

This template may be used for additional guidance in preparing a request to the CF-OCA\(^1\) to present abbreviated financial statements. There are unique considerations for acquisitions of oil and gas properties, and registrants should consider the guidance in paragraphs 2065.11 and 2065.12 of the FRM before preparing a request to the CF-OCA to present abbreviated financial statements. This template is only a guide and should be tailored to a registrant’s specific facts and circumstances.

Company’s Letterhead

[Insert date]

Mr./Ms. [Insert Name]
[Title of above CF-OCA official]
Securities and Exchange Commission
Division of Corporation Finance
100 F Street, N.E.
Washington, DC 20549
E-mail: dcaoletters@sec.gov

Re: Request to provide Statements of Assets Acquired and Liabilities Assumed and Revenues and Direct Expenses for [insert name, “Acquiree”] to satisfy the financial statement requirements of Rule 3-05 of Regulation S-X in the Company’s anticipated Form 8-K filing.

Dear [Insert Name]:

The Company, a publicly-held corporation, is a [describe nature of operations] company in the United States. As of and for the year ended [insert date], the Company had total assets of [$x] million, shareholders’ equity of [$x] million, net revenue of [$x] million, and net income of [$x] million. [Provide necessary background information on Company.]

On [insert date], Company entered into an Asset Exchange Agreement with [insert name, “Owner”] to purchase Acquiree. We expect to consummate this acquisition in the [insert timeframe].

\(^1\) For a list of whom to contact on the SEC staff for topics such as Regulation S-X, Rule 3-05, see the Communications With the Division of Corporation Finance’s Office of Chief Accountant (CF-OCA) section of the FRM.
We plan to file a Form 8-K within four (4) business days subsequent to consummation of the acquisition of Acquiree. We anticipate the level of significance of Acquiree will be [insert significance level]. Accordingly, we will be required to include in the Form 8-K, audited financial statements of Acquiree for [insert financial statement periods required] pursuant to the requirements of Rule 3-05 of Regulation S-X. We plan to include these financial statements in the initial Form 8-K if the statements are available, or in an amendment to Form 8-K, within 71 calendar days from the due date of the initial Form 8-K.

The purpose of this letter is to seek the staff’s concurrence with our proposed presentation of Acquiree financial statements which will be included in the Form 8-K, in satisfaction of the requirements of Rule 3-05 of Regulation S-X.

We propose to provide audited combined statements of assets acquired and liabilities assumed of Acquiree as of [insert dates], and audited combined statements of revenue and direct expenses of Acquiree for the [insert date]. In addition, we will provide unaudited financial statements of Acquiree for the interim periods [insert date] to comply with Rule 3-12 of Regulation S-X as of the filing date. We believe this proposed presentation is the most relevant and meaningful financial statement presentation for investors and other users of the financial information. The basis for our conclusion is summarized in the following section.

**Statements of Assets Acquired and Liabilities Assumed and Statements of Revenues and Direct Expenses**

[Provide background information for Acquiree operations. Specifically, describe how Acquiree’s operations relate/compare to Owner’s operations. In addition, disclose the purchase price paid for Acquiree.] It is impracticable to prepare full financial statements in accordance with Regulation S-X due to the following reasons:

- Acquiree has not been accounted for as a separate entity, subsidiary or division of Owner’s business.
- Owner did not manage Acquiree as a stand-alone business.
- Stand-alone financial statements of Acquiree have never previously been prepared.
- Owner does not have sufficient financial information about Acquiree. Owner has never allocated certain corporate expenses to Acquiree, including interest expense, corporate overhead expenses and income taxes. We understand that this information is not otherwise readily available and any allocation would be subjective and may not be relevant due to differences in corporate structures between Owner and the Company.

On the basis of the foregoing, we cannot compile complete balance sheet and income statement information for Acquiree. Furthermore, because we cannot compile complete balance sheet and income statement information, we also cannot prepare a statement of cash flows for Acquiree.

We request your concurrence with our proposal to present the following financial information relating to Acquiree in satisfaction of the requirements of Rule 3-05 of Regulation S-X:

- Statements of Revenues and Direct Expenses for Acquiree for the [insert date] pursuant to the requirements of Rule 3-05 of Regulation S-X. These statements will include revenues, less expenses, directly attributable to Acquiree. Direct expenses include sales and marketing, depreciation and other administrative costs directly associated with the revenue producing activities of Acquiree, and would exclude only costs that are not directly involved in the revenue producing activity, such as corporate overhead, interest, and taxes.
• Statements of Assets Acquired and Liabilities Assumed as of [insert dates], pursuant to the requirements of Rule 3-05 of Regulation S-X. This Statement will consist only of the assets acquired and liabilities assumed. Pursuant to the Asset Exchange Agreement, the Company will only acquire [describe assets acquired]. No other assets or liabilities will be acquired or assumed by the Company.

• Unaudited financial statements (as defined above) for the interim periods [insert date] to comply with Rule 3-12 of Regulation S-X.

• To the extent available, we will provide selected cash flow information about operating, investing, and financing cash flows relating to the Acquiree in the notes to the financial statements.

• In the notes to Acquiree financial statements, we will disclose (1) management’s assertion that the allocation method used is reasonable; (2) the basis of presentation, including the nature of the omitted expenses and the reasons for their omission; (3) an explanation of the impracticability of providing full financial statements; and (4) that the financial statements presented are not indicative of financial condition or results of operations of the acquiree because operating expenses have been omitted.

**Conclusion**

We believe the presentation of the abbreviated financial information described above would provide investors with all of the information material to their understanding of our acquisition of Acquiree.

Please contact me at [insert phone number and e-mail address] to discuss any additional information you may need in order to conclude on this issue. Thank you for your consideration of this matter.

Sincerely,

[Insert Name]
Chief Financial Officer
Appendix C — Summary of Requirements Before and After Adoption of the May 2020 Final Rule

The table below summarizes requirements that affect a registrant’s disclosures before and after adoption of the SEC’s May 2020 final rule related to the acquisition of a business in accordance with Regulation S-X, Rules 3-05 and 11-01. Note that the table does not address acquisitions of real estate operations or acquisitions by business development companies, investment companies, or SRCs. In addition, it should be read in conjunction with Deloitte’s June 2, 2020, Heads Up, which further describes changes as a result of the final rule and defines certain key terms.

The requirements in the “Before Amendments” column are reflected in the guidance throughout this Roadmap. The requirements in the “Final Rule” column will be incorporated into the Roadmap in future updates.

<table>
<thead>
<tr>
<th></th>
<th>Before Amendments</th>
<th>Final Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Significance Tests</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment test for</td>
<td>The investment test compares (1) the investment in the acquiree with (2) the</td>
<td>The investment test compares (1) the investment in the acquiree with (2)</td>
</tr>
<tr>
<td>business acquisitions</td>
<td><strong>total assets</strong> of the registrant.</td>
<td>the aggregate worldwide market value of the registrant’s common equity. If</td>
</tr>
<tr>
<td></td>
<td></td>
<td>there is no aggregate worldwide market value of the registrant’s common</td>
</tr>
<tr>
<td></td>
<td></td>
<td>equity, the test uses the registrant’s total assets.</td>
</tr>
</tbody>
</table>
### Significance Tests (continued)

<table>
<thead>
<tr>
<th></th>
<th>Before Amendments</th>
<th>Final Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income test</strong></td>
<td>The income test consists of a single component based on financial information for the most recent fiscal year:</td>
<td>The income test consists of two components based on financial information for the most recent fiscal year:</td>
</tr>
<tr>
<td></td>
<td>• <em>Income component</em> — Compares the absolute values of the acquiree's pretax income or loss with the registrant's pretax income or loss.</td>
<td>• <em>Income component</em> — Compares the absolute values of the acquiree's pretax income or loss with the registrant's pretax income or loss.</td>
</tr>
<tr>
<td></td>
<td>• <em>Revenue component</em> — Compares the acquiree's revenues with the registrant's revenues.</td>
<td>• <em>Revenue component</em> — Compares the acquiree's revenues with the registrant's revenues.</td>
</tr>
</tbody>
</table>

A registrant must consider both components when evaluating significance, and only if it finds the results of both to be significant, uses the lower of the two components to determine the number of periods for which acquiree financial statements must be presented.

The revenue component does not apply if either the registrant or acquiree did not have material revenue for the two most recently completed fiscal years.

In the calculation of a registrant's average net income for the last five fiscal years, "zero" must be used for any loss years in the computation of the average.

In the calculation of a registrant's average net income for the last five fiscal years, **absolute values** must be used in the computation of the average. However, income averaging would only be available for the income component of the income test if the registrant is not able to apply the revenue component.

### Acquiree Financial Statements

<table>
<thead>
<tr>
<th>Periods required — annual</th>
<th>On the basis of the highest level of significance, registrants must provide audited annual financial statements for the following number of years:</th>
<th>On the basis of the highest level of significance, registrants must provide audited annual financial statements for the following number of years:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• <em>Significance exceeds 50 percent</em> — <strong>Three years.</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• <em>Significance exceeds 40 percent but not 50 percent</em> — <strong>Two years.</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• <em>Significance exceeds 20 percent but not 40 percent</em> — <strong>One year.</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• <em>Significance exceeds 40 percent</em> — <strong>Two years.</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td>• <em>Significance exceeds 20 percent but not 40 percent</em> — <strong>One year.</strong></td>
<td></td>
</tr>
</tbody>
</table>
(Table continued)

<table>
<thead>
<tr>
<th>Acquiree Financial Statements (continued)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Periods required — interim</strong></td>
</tr>
<tr>
<td>Unaudited interim financial statements for the most recent interim period and the <strong>comparative prior-year interim period</strong> are required for all levels of significance.</td>
</tr>
<tr>
<td>• Significance exceeds 40 percent — The most recent interim period and the <strong>comparative prior-year interim period</strong>.</td>
</tr>
<tr>
<td>• Significance exceeds 20 percent but not 40 percent — The most recent interim period (the <strong>comparative prior-year interim period is not required</strong>).</td>
</tr>
</tbody>
</table>

**Registration statements for IPOs**

Registrants must evaluate significance for **all** acquirees during (1) the **latest three fiscal years** (or the **latest two fiscal years** for emerging growth companies and SRCs) and (2) any subsequent interim period through the date the initial registration statement is declared effective.

Audited financial statements are required for the number of years indicated by the significance tests. Preacquisition, postacquisition, or a combination of preacquisition and postacquisition audited results may satisfy the financial statement requirement.

Registrants must evaluate significance for **all** acquirees during (1) the **latest fiscal year** and (2) any subsequent interim period through the date the initial registration statement is declared effective.

Audited preacquisition financial statements are required for the number of years indicated by the significance tests unless the registrant’s audited financial statements reflect the operating results of the acquiree for:

• Nine months if any of the results of the significance tests are greater than 20 percent but none are greater than 40 percent.

• A complete fiscal year if the results of any of the significance tests are greater than 40 percent.

**Individually insignificant acquisitions**

When filing a registration or proxy statement and the aggregate significance of all individually insignificant acquisitions exceed 50 percent, a registrant must provide:

• Financial statements for the **substantial majority** of individually insignificant acquisitions.

• Pro forma financial information to reflect the aggregate effects of the **substantial majority** of individually insignificant acquisitions.

When filing a registration or proxy statement and the aggregate significance of all individually insignificant acquisitions exceed 50 percent, a registrant must provide:

• Financial statements only for acquirees that exceed 20 percent **significance** and have not yet been filed.

• Pro forma financial information to reflect the aggregate effects of all **individually insignificant** acquisitions.
Appendix C — Summary of Requirements Before and After Adoption of the May 2020 Final Rule

<table>
<thead>
<tr>
<th>Acquiree Financial Statements (continued)</th>
<th>Before Amendments</th>
<th>Final Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abbreviated financial statements</td>
<td>A registrant must seek SEC staff permission to use abbreviated financial statements if it acquires net assets that constitute a business.</td>
<td>A registrant may use abbreviated financial statements without requesting SEC staff permission if it acquires net assets that constitute a business that (1) represent 20 percent or less of the seller’s revenue and assets and (2) meet certain other criteria.</td>
</tr>
<tr>
<td>Use of IFRS-IASB financial statements, without reconciliation to U.S. GAAP</td>
<td>A registrant is permitted to present IFRS-IASB financial statements, without reconciliation to U.S. GAAP, if it acquires a significant foreign acquiree that meets the definition of a foreign business.</td>
<td>A registrant is permitted to present IFRS-IASB financial statements, without reconciliation to U.S. GAAP, if it acquires a significant foreign acquiree that meets the definition of a foreign business or would meet the definition of an FPI if it were a registrant.</td>
</tr>
<tr>
<td>Reconciliation requirements for acquiree home-country GAAP financial statements</td>
<td>FPIs that prepare their financial statements in accordance with IFRS-IASB must reconcile home-country GAAP financial statements of a foreign acquiree to U.S. GAAP even when the foreign acquiree meets the definition of a foreign business or would meet the definition of an FPI if it were a registrant.</td>
<td>FPIs that prepare their financial statements in accordance with IFRS-IASB may reconcile home-country GAAP financial statements of a foreign acquiree to IFRS-IASB if the foreign acquiree meets the definition of a foreign business or would meet the definition of an FPI if it were a registrant.</td>
</tr>
</tbody>
</table>

**Pro Forma Financial Information**

<table>
<thead>
<tr>
<th>Pro forma adjustments</th>
<th>Adjustments must be:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Directly attributable to the transaction.</td>
</tr>
<tr>
<td></td>
<td>• Factually supportable.</td>
</tr>
<tr>
<td></td>
<td>• For the statement of comprehensive income, expected to have a continuing impact.</td>
</tr>
</tbody>
</table>

**Transaction accounting adjustments** — These adjustments must reflect the transaction in accordance with U.S. GAAP or IFRS-IASB, as applicable.

**Autonomous entity adjustments** — If the registrant was previously part of another entity, these adjustments must reflect the registrant’s financial condition and results of operations as if it were a separate stand-alone entity.

**Management’s adjustments (optional)** — These adjustments may reflect synergies and dis-synergies of acquisitions and dispositions when certain criteria are met.
(Table continued)

<table>
<thead>
<tr>
<th>Pro Forma Financial Information (continued)</th>
<th>Before Amendments</th>
<th>Final Rule</th>
</tr>
</thead>
<tbody>
<tr>
<td>Presentation</td>
<td>Separate columns are presented for the:</td>
<td>Separate columns are presented for the:</td>
</tr>
<tr>
<td></td>
<td>• Registrant.</td>
<td>• Registrant.</td>
</tr>
<tr>
<td></td>
<td>• Acquiree.</td>
<td>• Acquiree.</td>
</tr>
<tr>
<td></td>
<td>• Pro forma adjustments.</td>
<td>• Transaction accounting adjustments.</td>
</tr>
<tr>
<td></td>
<td>• Pro forma total.</td>
<td>• Autonomous entity adjustments.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Pro forma total.</td>
</tr>
<tr>
<td>Management's adjustments, if presented, may not be reflected on the face of the pro forma financial statements but should be included in the explanatory notes in the form of a reconciliation.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


Appendix D — Titles of Standards and Other Literature

SEC Literature

Codified Financial Reporting Releases
Section 506.02(a)(ii), “Preparation Requirements”
Section 506.02(c)(ii), “Business to Be Acquired and Other Transactions Not Yet Consummated”

Final Rules
No. 33-8567, First-Time Application of International Financial Reporting Standards
No. 33-10513, Amendments to Smaller Reporting Company Definition
No. 33-10762, Financial Disclosures About Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant’s Securities

FRM
Topic 1, “Registrant’s Financial Statements”
Topic 2, “Other Financial Statements Required”
Topic 3, “Pro Forma Financial Information (Regulation S-X Article 11)”
Topic 4, “Independent Accountants’ Involvement”
Topic 5, “Smaller Reporting Companies”
Topic 6, “Foreign Private Issuers & Foreign Businesses”
Topic 7, “Related Party Matters”
Topic 10, “Emerging Growth Companies”
Topic 12, “Reverse Acquisitions and Reverse Recapitalizations”
Topic 13, “Effects of Subsequent Events on Financial Statements Required in Filings”

Industry Guide
No. 5, “Preparation of Registration Statements Relating to Interests in Real Estate Limited Partnerships”
Interpretive Release
No. 34-49708, Commission Guidance Regarding the Public Company Accounting Oversight Board’s Auditing and Related Professional Practice Standard No. 1

Regulation S-K
Item 512, “Undertakings”
Item 901, “Definitions”

Regulation S-X
Rule 1-02, “Definitions of Terms Used in Regulation S-X (17 CFR part 210)”
  • Rule 1-02(l), “Foreign Business”
  • Rule 1-02(u), “Related Parties”
  • Rule 1-02(w), “Significant Subsidiary”

Rule 2-02, “Accountants’ Reports and Attestation Reports”

Rule 2-05, “Examination of Financial Statements by More Than One Accountant”

Rule 3-01, “Consolidated Balance Sheets”

Rule 3-02, “Consolidated Statements of Comprehensive Income and Cash Flows”

Rule 3-04, “Changes in Stockholders’ Equity and Noncontrolling Interests”

Rule 3-05, “Financial Statements of Businesses Acquired or to Be Acquired”
  • Rule 3-05(a), “Financial Statements Required”
  • Rule 3-05(b), “Periods to Be Presented”
  • Rule 3-05(c), “Financial Statements of Foreign Business”

Rule 3-06, “Financial Statements Covering a Period of Nine to Twelve Months”

Rule 3-09, “Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons”

Rule 3-10, “Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered”

Rule 3-12, “Age of Financial Statements at Effective Date of Registration Statement or at Mailing Date of Proxy Statement”

Rule 3-13, “Filing of Other Financial Statements in Certain Cases”

Rule 3-14, “Special Instructions for Real Estate Operations to Be Acquired”

Rule 3-16, “Financial Statements of Affiliates Whose Securities Collateralize an Issue Registered or Being Registered”

Rule 3-18, “Special Provisions as to Registered Management Investment Companies and Companies Required to Be Registered as Management Investment Companies”

Rule 4-08, “General Notes to the Financial Statements”
  • Rule 4-08(g), “Summarized Financial Information of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons”
Article 5, “Commercial and Industrial Companies”
  • Rule 5-02, “Balance Sheets”
  • Rule 5-03, “Statements of Comprehensive Income”

Article 8, “Financial Statements of Smaller Reporting Companies”
  • Rule 8-03, “Interim Financial Statements”
  • Rule 8-04, “Financial Statements of Businesses Acquired or to Be Acquired”

Article 10, “Interim Financial Statements”

Article 11, “Pro Forma Financial Information”
  • Rule 11-01, “Presentation Requirements”
  • Rule 11-02, “Preparation Requirements”
    ◦ Rule 11-02(b), “Form and Content”
    ◦ Rule 11-02(c), “Periods to Be Presented”

Article 12, “Form and Content of Schedules: For Certain Real Estate Companies”
  • Rule 12-28, “Real Estate and Accumulated Depreciation”

Article 13, “Financial and Non-Financial Disclosures for Certain Securities Registered or Being Registered”
  • Rule 13-01, “Guarantors and Issuers of Guaranteed Securities Registered or Being Registered”
  • Rule 13-02, “Affiliates Whose Securities Collateralize Securities Registered or Being Registered”

SAB Topics


No. 1.J (SAB 80), “Application of Rule 3-05 in Initial Public Offerings”


Securities Act of 1933

Rule 145(c), “Reclassification of Securities, Mergers, Consolidations and Acquisitions of Assets; Persons and Parties Deemed to Be Underwriters”

Rule 405, “Definition of Terms”

Rule 415, “Delayed or Continuous Offering and Sale of Securities”

Rule 424, “Filing of Prospectuses, Number of Copies”

Rule 462(b), “Immediate Effectiveness of Certain Registration Statements and Post-Effective Amendments”

Section 10, “Information Required in Prospectus”

Securities Exchange Act of 1934

Rule 12b-2, “Definitions”

Rule 13e-3, “Going Private Transactions by Certain Issuers or Their Affiliates”
Section 3, “Definitions and Application of Title”
Section 10, “Regulation of the Use of Manipulative and Deceptive Devices”
Section 12, “Registration Requirements for Securities”
Section 12(b), “Procedure for Registration; Information”
Section 13, “Periodical and Other Reports”
Section 15(d), “Registration and Regulation of Brokers and Dealers; Supplementary and Periodic Information”

**AICPA Literature**

**Professional Standards**

AU-C Section 700, “Forming an Opinion and Reporting on Financial Statements”

AU-C Section 805, “Special Considerations — Audits of Single Financial Statement and Specific Elements, Accounts, or Items of a Financial Statement”

**FASB Literature**

**ASC Topics**

ASC 205, *Presentation of Financial Statements*
ASC 220, *Income Statement — Reporting Comprehensive Income*
ASC 250, *Accounting Changes and Error Corrections*
ASC 260, *Earnings per Share*
ASC 280, *Segment Reporting*
ASC 323, *Investments — Equity Method and Joint Ventures*
ASC 420, *Exit or Disposal Cost Obligations*
ASC 450, *Contingencies*
ASC 715, *Compensation — Retirement Benefits*
ASC 805, *Business Combinations*
ASC 810, *Consolidation*
ASC 825, *Financial Instruments*
ASC 850, *Related Party Disclosures*
ASC 855, *Subsequent Events*

**ASUs**

ASU 2013-12, *Definition of a Public Business Entity — An Addition to the Master Glossary*

ASU 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*
ASU 2017-13, Revenue Recognition (Topic 605), Revenue From Contracts With Customers (Topic 606), Leases (Topic 840), and Leases (Topic 842): Amendments to SEC Paragraphs Pursuant to the Staff Announcement at the July 20, 2017 EITF Meeting and Rescission of Prior SEC Staff Announcements and Observer Comments (SEC Update)

ASU 2019-10, Financial Instruments — Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates

ASU 2020-02, Financial Instruments — Credit Losses (Topic 326) and Leases (Topic 842): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02, Leases (Topic 842)

IFRS Literature
IFRS 1, First-Time Adoption of International Financial Reporting Standards

PCAOB Literature
Rule 1001, “Definitions of Terms Employed in Rules”

Superseded Literature

EITF Issue
Topic D-86, “Issuance of Financial Statements”

FASB Statement
No. 141(R), Business Combinations

AICPA Accounting Research Bulletin (ARB)
No. 51, Consolidated Financial Statements
## Appendix E — Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AICPA</td>
<td>American Institute of Certified Public Accountants</td>
</tr>
<tr>
<td>ARB</td>
<td>FASB Accounting Research Bulletin</td>
</tr>
<tr>
<td>ASC</td>
<td>FASB Accounting Standards Codification</td>
</tr>
<tr>
<td>ASU</td>
<td>FASB Accounting Standards Update</td>
</tr>
<tr>
<td>C&amp;DI</td>
<td>SEC Compliance and Disclosure Interpretation</td>
</tr>
<tr>
<td>CAQ</td>
<td>Center for Audit Quality</td>
</tr>
<tr>
<td>CARES Act</td>
<td>Coronavirus Aid, Relief, and Economic Security Act</td>
</tr>
<tr>
<td>CEO</td>
<td>chief executive officer</td>
</tr>
<tr>
<td>CF-OCA</td>
<td>SEC Division of Corporation Finance, Office of the Chief Accountant</td>
</tr>
<tr>
<td>CFR</td>
<td>Code of Federal Regulations</td>
</tr>
<tr>
<td>EGC</td>
<td>emerging growth company</td>
</tr>
<tr>
<td>EITF</td>
<td>FASB Emerging Issues Task Force</td>
</tr>
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<td>FASB</td>
<td>Financial Accounting Standards Board</td>
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<td>FAST Act</td>
<td>Fixing America’s Surface Transportation Act</td>
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<td>FR</td>
<td>Federal Register</td>
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<tr>
<td>GAAP</td>
<td>generally accepted accounting principles</td>
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<td>GAAS</td>
<td>generally accepted auditing standards</td>
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<td>IASB</td>
<td>International Accounting Standards Board</td>
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<tr>
<td>IFRS</td>
<td>International Financial Reporting Standard</td>
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<td>IPO</td>
<td>initial public offering</td>
</tr>
<tr>
<td>IPR&amp;D</td>
<td>in-process research and development</td>
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<td>JOBS Act</td>
<td>Jumpstart Our Business Startups Act</td>
</tr>
<tr>
<td>LLC</td>
<td>limited liability corporation</td>
</tr>
<tr>
<td>MD&amp;A</td>
<td>Management’s Discussion and Analysis</td>
</tr>
<tr>
<td>MLP</td>
<td>master limited partnership</td>
</tr>
<tr>
<td>PBE</td>
<td>public business entity</td>
</tr>
<tr>
<td>PCAOB</td>
<td>Public Company Accounting Oversight Board</td>
</tr>
<tr>
<td>PP&amp;E</td>
<td>property, plant, and equipment</td>
</tr>
<tr>
<td>Q&amp;A</td>
<td>question and answer</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>research and development</td>
</tr>
<tr>
<td>REIT</td>
<td>real estate investment trust</td>
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<tr>
<td>SAB</td>
<td>SEC Staff Accounting Bulletin</td>
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<td>SAS</td>
<td>Statement on Auditing Standards</td>
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<td>SEC</td>
<td>Securities and Exchange Commission</td>
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<tr>
<td>SFAS</td>
<td>Statement of Financial Accounting Standards</td>
</tr>
<tr>
<td>SPAC</td>
<td>special-purpose acquisition company</td>
</tr>
<tr>
<td>SRC</td>
<td>smaller reporting company</td>
</tr>
<tr>
<td>VP</td>
<td>vice president</td>
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</table>