

SEC AMENDS ACQUIRED BUSINESS FINANCIAL STATEMENT REQUIREMENTS

May 22, 2020

On May 21, 2020 the Securities and Exchange Commission adopted a number of amendments intended to reduce the complexity of financial disclosures required for business acquisitions and dispositions by U.S. public companies. These amendments will, among other things, (i) revise the requirements for financial statements and pro forma financial information for acquired businesses, (ii) revise the tests used to determine significance of acquisitions and dispositions, and (iii) for certain acquisitions of a component of a business, allow financial statements to omit certain expenses. The amendments are effective January 1, 2021, but registrants may voluntarily comply with the rules as amended prior to the effective date.

When a registrant acquires a business that is “significant,” other than a real estate operation, Rule 3-05 of Regulation S-X generally requires a registrant to provide separate audited financial statements of that business and pro forma financial information under Article 11 of Regulation S-X. The number of years of financial information that must be provided depends on the relative significance of the acquisition to the registrant. Similarly, Rule 3-14 of Regulation S-X addresses the unique nature of real estate operations and requires a registrant that has acquired a significant real estate operation to file financial statements with respect to such acquired operation.

The significance of an acquisition or disposition is based on an Investment Test, an Asset Test, and an Income Test. The amendments revise the Investment Test to compare a registrant’s investments in and advances to the acquired or disposed business to the registrant’s aggregate worldwide market value, rather than the registrant’s total assets. The amendments add a revenue component to the Income Test in order to avoid the anomalous results under the existing rules for registrants with marginal net income or loss in a recent fiscal year. Under the existing rules, such registrants were required under the existing rules to provide financial statements for small acquisitions that may not have been material to investors. The amendments also expand the ability to use pro forma financial information reflecting prior acquisitions for purposes of calculating significance.

Under the existing rules, financial statements for an acquired business for up to three prior years may be required, depending on the significance of the acquisition. The amendments require no more than two years of financial statements for an acquired business. Additionally, the

amendments remove the requirement for separate financial statements in registration statements once the acquired business has been included in the registrant's post-acquisition financial statements for nine months or a complete fiscal year, depending on significance of the acquired business.

Where a registrant is acquiring a component of an entity that is a business as defined in Rule 11-01(d) of Regulation S-X, such as a product line that is not a separate entity, the existing rules allow the registrant to provide abbreviated financial statements of the acquired business. Specifically, the amendments permit the abbreviated financial statements to exclude certain expenses previously required to be included.

The amendments eliminate the potential requirement under the existing rules to provide financial statements for individually insignificant acquisitions when the aggregate significance of individually insignificant acquisitions is over 50%, but expand the requirement to provide pro forma financial information depicting the aggregate effect in all material respects.

The amendments also substantially revise the requirements for financial statements of real estate operations under Rule 3-14 of Regulation S-X to more closely with the requirements for business acquisitions generally. Under the existing rules, the significance tests and period for which financial statements are required for acquisitions of real estate operations differ in a number of respects as compared to business acquisitions.

The amendments also change pro forma financial information requirements to, among other things, permit "Management Adjustments" depicting synergies and dis-synergies if, in management's opinion, such adjustments would enhance an understanding of the pro forma effects of the transaction and certain conditions related to the basis and the form of presentation are met.

We plan to provide a more detailed analysis of the amendments in a future client bulletin.

RELATED PRACTICE AREAS

- Securities & Corporate Governance

MEET THE TEAM



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