

SEC Adopts Changes to Financial Disclosures Regarding Acquisitions and Dispositions of Businesses

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The SEC has **adopted amendments** to rules and forms designed to assist public companies in “making more meaningful determinations of whether a subsidiary or an acquired or disposed business is significant, and improve the financial disclosure requirements applicable to acquisitions and dispositions of businesses.” The amendments will be effective on January 1, 2021, however voluntary compliance will be permitted in advance of the effective date.

The SEC Fact Sheet announcing these amendments listed, in part, the following highlights:

- update the significance tests in Rule 1.02(w), Securities Act Rule 405 and Exchange Act Rule 12b-2 by :
 - revising the investment test to compare the registrant’s investments in, and advances to, the acquired or disposed business to the registrant’s aggregate worldwide market value if available;
 - revising the income test by adding a revenue component;
 - expanding the use of pro forma financial information in measuring significance; and
 - conforming, to the extent applicable, the significance threshold and tests for disposed businesses to those used for acquired businesses;
- modify and enhance the required disclosure for the aggregate effect of acquisitions for which financial statements are not required or are not yet required by eliminating historical financial statements for insignificant businesses and expanding the pro forma financial information to depict the aggregate effect in all material respects;
- require the financial statements of the acquired business to cover no more than the two most recent fiscal years;
- permit disclosure of financial statements that omit certain expenses for certain acquisitions of a component of an entity;
- no longer require separate acquired business financial statements once the business has been included in the registrant’s post-acquisition financial statements for nine months or a complete fiscal year, depending on significance;
- align Rule 3-14 with Rule 3-05 where no unique industry considerations exist;

- clarify the application of Rule 3-14 regarding:
 - the determination of significance;
 - the need for interim income statements; and
 - the scope of the rule’s requirements;
- amend the pro forma financial information requirements to improve the content and relevance of such information; more specifically, the revised pro forma adjustment criteria will provide for:
 - “Transaction Accounting Adjustments” reflecting only the application of required accounting to the transaction;
 - “Autonomous Entity Adjustments” reflecting the operations and financial position of the registrant as an autonomous entity if the registrant was previously part of another entity; and
 - optional “Management’s Adjustments” depicting synergies and dis-synergies of the acquisitions and dispositions for which pro forma effect is being given 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;
- make corresponding changes to the smaller reporting company requirements in Article 8 of Regulation S-X, which will also apply to issuers relying on Regulation A.

The following is a more detailed discussion of some of these highlights:

Significance Tests

- **Investment Test.** This revised test will now compare the acquiring company’s investment in and advances to the target with the aggregate market value of the acquiring company’s common equity, if available, using the average aggregate worldwide market value calculated daily for the last five trading days of the company’s most recently completed month ending prior to the earlier of the announcement date or the date of the agreement. If the acquiring company does not have common equity with aggregate worldwide market value, the current investment test using the acquiring company’s total assets will continue to be used.
- **Income Test.** This revised test adds a new revenue component comparing an acquiring company’s proportionate share of the consolidated total revenue of the target with the consolidated total revenue of the acquiring company for the most recently completed fiscal year. If the companies involved each had recurring annual revenue, both the new revenue component and the existing net income component must be met with the lower of the two used to determine the number of periods for which financial statements are required. If either company did not have material revenue in each of the two most recently completed fiscal years, the new revenue component will not be applicable.

Testing Significance with Pro Forma Financial Information

The final rules expand the circumstances in which pro forma financial information may be used for significance testing by allowing significance to be measured using filed pro forma financial information that depicts only significant acquisitions and dispositions consummated under certain circumstances.

Audited Financial Statements of the Acquired Business

The final rules reduce the requirement of audited financial statements for an acquired business from three to two years. Only the most recent interim period must be provided if the significance test exceeds 20% but not 40% rather than also including the comparative interim period. Since the amendments did not make any changes to Form S-4 or Form F-4, there may be some circumstances when the registrant may still be required to include two or three years of target financial statements even though they would not be required to include as many years in a Form 8-K or another form of registration statement.

Financial Statements for Component Acquisitions, Including Oil and Gas Production

The revised rules permit the acquiring company to file abbreviated financials of a target that is a component of an entity such as a product line or line of business that exclude corporate overhead, interest, and income tax expenses from the audited financial statements of the target if certain conditions are satisfied. The target financial statements must include certain industry-specific disclosures under ASC Topic 932, which may be presented as unaudited supplemental information for each fiscal year of operations presented for the target that include significant oil and gas producing activities. When substantially all of the target's revenue is from oil and gas activities, the amendments allow the target financial statements to consist only of audited statements of revenue and expenses that exclude depreciation, depletion and amortization, corporate overhead, income tax, and interest expenses.

Individually Insignificant Acquisitions

Acquiring companies will still be required to provide pro forma financial information depicting the aggregate effect of individually insignificant businesses acquired since the date of the most recent audited financial statements that exceed the significance test by more than 50%, but historical financial statements will only be required to cover the targets whose individual significance exceeds 20% rather than a substantial majority of the businesses acquired.

Significance of Business Dispositions

The final amendments raised the significance threshold for pro forma financial information for a disposed business from 10% to 20% to conform this significance test with the same test for acquired businesses.

Smaller Reporting Companies and Regulation A

Rule 8-05 of Regulation S-X has been revised to require the pro forma financial information by smaller reporting companies to substantially comply with the amendments to Article 11. Rule 8-04 of Regulation S-X now directs registrants to Rule 3-05 for the requirements related to the target's financial statements, other than the form and content requirements of Rules 8-02 and 8-03 of Regulation S-X. The revisions to Rule 8-05 apply to issuers relying on Regulation A.

Other Amendments

The final amendments include other rules affecting, among other topics, financial statements of real estate operations and disclosures about acquisitions specific to investment companies that are not described in this Alert.

For questions regarding filing requirements for acquisitions and dispositions or any other SEC guidance, please contact your GableGotwals attorney or a member of our [Corporate & Securities team](#).



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