

Press Release

SEC Adopts Amendments to Improve Financial Disclosures about Acquisitions and Dispositions of Businesses

FOR IMMEDIATE RELEASE
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Washington D.C., May 21, 2020 —The Securities and Exchange Commission today announced that it has voted to adopt amendments to its rules and forms to improve for investors the financial information about acquired or disposed businesses, facilitate more timely access to capital, and reduce the complexity and costs to prepare the disclosure. The amendments will update our rules which have not been comprehensively addressed since their adoption, some over 30 years ago.

"This action, which is designed to enhance the quality of information that investors receive while eliminating unnecessary costs and burdens, will benefit investors, registrants and the market more generally," said Chairman Jay Clayton. "I want to thank the staff for their outstanding efforts to bring their years of experience to modernizing these rules."

The amendments to the rules and forms are intended to assist registrants 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, including real estate operations and investment companies.

The amendments will be effective on Jan. 1, 2021, but voluntary compliance will be permitted in advance of the effective date.

FACT SHEET

Amendments to Financial Disclosures About Acquired and Disposed Businesses May 21, 2020

Action

The Securities and Exchange Commission today announced that it has adopted amendments to the financial disclosure requirements in Regulation S-X for acquisitions and dispositions of businesses, including real estate operations, in Rules 3-05, 3-14, 8-04, 8-05, 8-06, and Article 11, as well as in other related rules and forms. In conjunction with these changes, the Commission also amended the significance tests in the "significant subsidiary" definition in Rule 1-02(w), Securities Act Rule 405, and Exchange Act Rule 12b-2 to improve their application and to assist registrants in making more meaningful determinations of whether a subsidiary or an acquired or disposed business is significant. In addition, to address the unique attributes of investment companies and business development companies, the Commission adopted new requirements regarding fund acquisitions specific to registered investment companies and business development companies.

Background

When a registrant acquires a significant business, other than a real estate operation, Rule 3-05 of Regulation S-X generally requires a registrant to provide separate audited annual and unaudited interim pre-acquisition financial statements of that business. 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.

Article 11 of Regulation S-X also requires registrants to file unaudited pro forma financial information relating to the acquisition or disposition. Pro forma financial information typically includes a pro forma balance sheet and pro forma income statements based on the historical financial statements of the registrant and the acquired or disposed

business, including adjustments to show how the acquisition or disposition might have affected those financial statements.

Rule 3-05 also applies to registrants that are registered investment companies and business development companies. Investment company registrants differ from non-investment company registrants in that they principally invest for returns from capital appreciation and/or investment income, are required to recognize changes in value to their portfolio investments each reporting period, and generally do not consolidate entities they control or use equity method accounting. Due to the nature of registered investment companies and business development companies, under the current rules it is often unclear how to apply these reporting requirements to acquired funds.

Highlights

The final amendments will, among other things:

- 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;
- permit the use of, or reconciliation to, International Financial Reporting Standards as issued by the International Accounting Standards Board in certain circumstances;
- 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;
 - special provisions for blind pool offerings; 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;

- amend the definition of “significant subsidiary” to provide a definition that is specifically tailored for investment companies; and
- add new Rule 6-11 and amend Form N-14 to cover financial reporting for fund acquisitions by investment companies and business development companies.

What’s Next?

The amendments will be effective Jan. 1, 2021. However, voluntary compliance with the final amendments will be permitted in advance of the effective date.

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