

[Securities Regulation Daily Wrap Up, TOP STORY—SEC proposes to amend Reg S-X disclosures on acquisitions and disposition of businesses, \(May 3, 2019\)](#)

Securities Regulation Daily Wrap Up

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The proposed amendments to Regulation S-X and related rules and forms are the result of the SEC's ongoing comprehensive evaluation of disclosure requirements.

The SEC has proposed amendments to rules and forms to improve disclosure requirements for financial statements relating to acquisitions and dispositions of businesses, including real estate operations and investment companies. The goal is to give investors better financial information about acquired and disposed businesses and give companies more timely access to capital, as well as reduce the complexity and cost of preparing disclosures (*Amendments to Financial Disclosures about Acquired and Disposed Businesses*, [Release No. 33-10635](#), May 3, 2019).

"The proposed rules are, first and foremost, intended to ensure that investors receive the financial information necessary to understand the potential effects of significant acquisitions or dispositions," said Chairman Jay Clayton.

In a [statement](#), Commissioner Robert Jackson said the rules do need to be updated, but he is concerned that the proposal treats mergers as an "unalloyed good," even though mergers come with both benefits and costs. Jackson urged commenters to weigh in with detailed ideas on how to improve the proposal and allow investors to hold executives accountable, especially for mergers that harm investors over the long run.

"Some acquisitions create important efficiencies; others allow managers to build empires and extract value from investors. Our disclosure rules should give investors the tools to tell the difference," said Jackson.

Existing requirements. As explained in a [fact sheet](#), under Rule 3-05 of Regulation S-X, a registrant that acquires a significant business other than a real estate operation must provide separate audited annual and unaudited interim pre-acquisition financial statements of that business. Rule 3-14 of Regulation S-X addresses disclosures related to acquisition of a significant real estate operation. In addition, Article 11 of Regulation S-X requires registrants to file unaudited pro forma financial information relating to the acquisition or disposition.

Rule 3-05 applies to registrants that are registered investment companies and business development companies. However, investment company registrants differ from non-investment company registrants in significant ways, including that they mainly 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. As a result, it is often unclear how to apply reporting requirements to acquired funds.

Proposed changes. The proposed amendments would:

- Revise the investment test and the income test regarding significance, expand the use of pro forma financial information in measuring significance, and conform the significance threshold and tests for a disposed business;
- Reduce the time period that financial statements of the acquired business must cover from the three most recent fiscal years to two;
- Allow the omission of certain expenses for certain acquisitions of a component of an entity;
- Clarify when financial statements and pro forma financial information are required;

- Allow the use in certain circumstances of, or reconciliation to, International Financial Reporting Standards;
- No longer require separate acquired business financial statements once the business has been included in the registrant's post-acquisition financial statements for a complete fiscal year;
- 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 pro forma financial information requirements to improve content and relevance, specifically, disclosure of "Transaction Accounting Adjustments," reflecting the accounting for the transaction; and "Management's Adjustments," reflecting reasonably estimable synergies and transaction effects;
- Make corresponding changes to the smaller reporting company requirements in Article 8 of Regulation S-X;
- Add a definition of significant subsidiary that is tailored for investment companies; and
- Add a new Rule 6-11 and amend Form N-14 to cover financial reporting for fund acquisitions by investment companies and business development companies.

The comment period will run for 60 days after publication in the *Federal Register*.

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