

SEC Amends Financial Disclosures about Acquired and Disposed Businesses

On May 21, 2020, the SEC issued final rules that amend the financial disclosure requirements of Regulation S-X for acquired and disposed businesses. The SEC also amended the significance tests for a “significant subsidiary” in certain SEC rules. The amendments are part of the SEC’s ongoing *Disclosure Effectiveness Initiative* and follow similar [proposed amendments](#) from May 2019. The amendments are intended to enhance the financial information about acquired and disposed businesses for investors, facilitate access to capital and reduce the complexity and cost associated with the related disclosures. The amendments are effective at the beginning of a registrant’s fiscal year beginning after December 31, 2020. However, early application is permitted if the amendments are applied in their entirety.

When a registrant acquires a significant business, the registrant is required to provide separate audited annual and unaudited interim pre-acquisition financial statements of the acquired business based on the significance of the entity acquired to the business of the registrant (see S-X Rules 1-02 (w), 3-05 and 3-14 (real estate operations)) and unaudited pro forma financial information (see Article 11).

Some of the significant amendments compared to the current requirements are as follows:

Topic	New Guidance	Current Guidance
Measuring the significance of an acquired business	<ul style="list-style-type: none"> • Revise the investment test to compare the registrant’s investment in and advances to the acquired business to the registrant’s “average aggregate worldwide market value.” (The current investment test would continue to apply to registrants with no publicly traded common equity). • Revise the income test to: <ul style="list-style-type: none"> ○ Use the lower of income from continuing operations before taxes or revenue, when revenue is applicable ○ Use the absolute values for loss years in the income averaging calculation 	<ul style="list-style-type: none"> • The investment test compares the registrant’s investment in and advances to the acquired business to the carrying value of the registrant’s total assets • The income test is based solely on income from continuing operations before taxes and often produces anomalous results under certain circumstances (for example, when the acquired business has a large loss and the registrant has minimal income). The income averaging calculation uses “zero” for loss years.

Topic	New Guidance	Current Guidance
Measuring the significance of a disposed business	<ul style="list-style-type: none"> Conform the significance tests for a disposed business with those of an acquired business (where applicable) and raise the significance threshold to 20% 	<ul style="list-style-type: none"> A disposed business is considered significant using a 10% threshold under S-X Rule 1-02(w)
Financial statement requirements for a significant acquired business	<ul style="list-style-type: none"> Limit the required historical annual financial statements for an acquired business to two years even when significance exceeds 50% Remove the requirement to provide the comparative prior period interim financial statements when significance is less than 40% Remove the requirement for separate financial statements of a significant acquired business in a registration or proxy statement once the business has been included in the registrant's financial statements for nine months or a complete fiscal year, depending on the significance Permit the use of abbreviated financial statements if certain requirements are met 	<ul style="list-style-type: none"> Three years of historical annual financial statements are generally required for an acquired business if significance exceeds 50% The comparative prior period interim financial statements are required when significance thresholds are met Financial statements of a significant acquired business are generally required to be provided in a registration statement or proxy statement when they have not been previously filed or the acquired business is of major significance Requests to provide abbreviated financial statements in lieu of full or carve-out financial statements must be cleared by the SEC staff prior to filing (except for certain acquisitions that include significant oil and gas producing activities)
Financial statement requirements for individually insignificant businesses	<ul style="list-style-type: none"> Revise the disclosure requirements for "individually insignificant businesses" that are significant in the aggregate to disclose the impact of all acquired businesses in pro forma financial information, but only require historical financial statements for those that are more than 20% significant 	<ul style="list-style-type: none"> Historical financial statements (and the related pro forma financial information) are required for a substantial majority of individually insignificant but significant in the aggregate businesses
Financial statement requirements for acquired real estate operations	<ul style="list-style-type: none"> Generally align S-X Rule 3-14 with S-X Rule 3-05 (which includes eliminating the requirement for three years of financial statements for acquisitions from related parties and revising S-X Rule 3-06 to allow a period of nine to twelve months to satisfy the requirement to provide one year of financial statements for an acquired/to be acquired real estate operation) 	<ul style="list-style-type: none"> The significance thresholds and financial statement requirements (including timing) differ under S-X Rule 3-14 for acquired real estate operations and S-X Rule 3-05 for acquired businesses

Topic	New Guidance	Current Guidance
Pro forma financial statements presented in accordance with S-X Article 11	<ul style="list-style-type: none"> • Revise to include the following categories of pro forma adjustments: <ul style="list-style-type: none"> ○ Require “Transaction Accounting Adjustments” (to reflect required accounting for the transaction) and “Autonomous Entity Adjustments” (to reflect the operations and financial position of registrant as an autonomous entity, if previously part of another entity), and ○ Permit, but not require, “Management’s Adjustments” in certain circumstances (to reflect certain synergies and other effects of transaction to acquire the business within the pro forma financial statements) 	<ul style="list-style-type: none"> • Pro forma adjustments are limited to those adjustments directly attributable to the transaction, factually supportable, and as it relates to the income statement, expected to have a continuing impact. Synergies and other actions taken or to be taken by management to integrate the acquired business after consummation of the transaction may not be reflected, although a discussion of such facts is allowed with transparent disclosure

The amendments also include updates to:

- Expand the use of pro forma financial information to measure significance;
- Clarify when historical financial statements and pro forma financial information are required within S-X Rule 3-05 and Article 11;
- Make corresponding changes to the requirements for smaller reporting companies;
- Permit the use of, or reconciliation to, IFRS as issued by the IASB in the financial statements of an acquired business in certain circumstances;
- Define a significant subsidiary tailored to investment companies; and
- Address financial reporting for fund acquisitions by business development companies and investment companies.

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