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Alerts & Publications

SEC Adopts Amendments Related to Financial Disclosures for Acquisitions and Dispositions

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On May 20, 2020, the Securities and Exchange Commission (SEC) adopted amendments related to financial statement disclosure requirements applicable to acquisitions and dispositions of businesses, including real estate operations. The SEC had proposed amendments to the rules in May 2019. Companies are required to apply the final amendments to acquisitions or dispositions that are probable or consummated following the company's fiscal year beginning after December 31, 2020, but voluntary early compliance is permitted.

The final adopting release is available here. The changes include:

- changing the investment test used to determine significance to compare a company's investment in the target to the "aggregate worldwide market value" of the company's equity (rather than total assets), when available;
- changing the income test used to determine significance to add a revenue component that compares the target's revenue to the company's revenue, and allowing the company to use the lower of the revenue and net income components to measure significance;
- increasing the significance threshold for dispositions from 10% to 20%;
- requiring only two (instead of three) years of historical financial statements for an acquired business, including for acquisitions that exceed 50% significance;
- creating a new method for presenting pro forma financial information that:
  - requires the use of "Transaction Accounting Adjustments" to reflect the accounting for the transaction,
  - requires the use of "Autonomous Entity Adjustments" to reflect the operations and financial position of the registrant as an autonomous entity when the registrant was previously part of another entity, and
  - permits the use of "Management's Adjustments" to reflect the effect of synergies and dis-synergies of the transaction 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 form of presentation are met; adjustments would enhance an understanding of the pro forma effects of the transaction, and certain conditions related to the basis and form of presentation are met;

- permitting the use of abbreviated financial statements of assets acquired and liabilities assumed (instead of a balance sheet) and statements of revenues and expenses (instead of a statement of income) if the registrant acquires a "business" (as defined in Rule 11-01(d)) that is not a separate entity, operating segment, or division and meets certain qualifying and presentation conditions;
- permitting companies to omit separate target financial statements in registration statements and proxy statements once the target has been included in the company's post-acquisition financial statements for nine months (for businesses that exceed 20% but not 40% significance) or one year (for businesses that exceed 40% significance);
- permitting companies that acquire a target that is not a "foreign business" but that would qualify as a "foreign private issuer" if it were a registrant to prepare target financial statements in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) without reconciliation to U.S. GAAP;
- permitting the reconciliation to IFRS-IASB rather than U.S. GAAP of a target's financial statements prepared in home country GAAP if the acquirer is a "foreign private issuer" that prepares IFRS-IASB financial statements and the target (i) is a "foreign business" or (ii) is not a "foreign business" but would qualify as a "foreign private issuer" if it were a SEC registrant;
- removing the requirement to include historical financial statements for at least the "substantial majority" of "individually insignificant businesses," requiring pro forma financial information if the aggregate impact of businesses (including real estate operations) acquired or to be acquired since the date of the most recent audited balance sheet for which financial statements are not required exceeds 50%, and only requiring historical financial statements of a business if the individual significance exceeds 20%;
- codifying SEC staff guidance to permit the use of pro forma financial statements to measure significance by allowing companies to use pro forma financial statements depicting significant acquisitions or dispositions subsequent to the latest fiscal year end to measure significance, provided that required financial or pro forma financial information for those transactions has been filed, but requiring a company that chooses to use pro forma financial statements to measure significance to include only "Transaction Adjustments;"
- directing smaller reporting companies to Rule 3-05 for requirements relating to financial statements of businesses acquired or to be acquired (other than for form and content, which will continue to be prepared pursuant to Rules 8-02 and 8-03); and
- aligning the financial statement requirements for acquisition of real estate operations under Rule 3-14 to 3-05 (where no unique industry considerations exist), including, among other things, to increase the

significance threshold from 10% to 20% and defining “real estate operations.”

Appendix A (available **here**) summarizes the more significant changes.

The changes would primarily impact Rule 3-05, Rule 3-14 and Article 11 of Regulation S-X and related rules and forms. The release also adds new Rule 6-11 of Regulation S-X and amendments to Form N-14 to specifically govern financial reporting for acquisitions involving investment companies.

This memorandum is a summary for general information and discussion only and may be considered an advertisement for certain purposes. It is not a full analysis of the matters presented, may not be relied upon as legal advice, and does not purport to represent the views of our clients or the Firm. John-Paul Motley, an O’Melveny partner licensed to practice law in California, Shelly Heyduk, an O’Melveny partner licensed to practice law in California, Robert Plesnarski, an O’Melveny partner licensed to practice law in the District of Columbia, and Su Lian Lu, an O'Melveny senior counsel licensed to practice law in California, contributed to the content of this newsletter. The views expressed in this newsletter are the views of the authors except as otherwise noted.