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Technical Line

Applying the SEC's requirements for significant acquired businesses

Registrants may be required to file separate pre-acquisition financial statements and pro forma information for acquired or to-be acquired businesses.

What you need to know

- Rule 3-05 of Regulation S-X generally requires a registrant to provide separate audited annual and unaudited interim pre-acquisition financial statements of a significant business that it acquired or will acquire.
- To determine the significance of an acquired or to-be-acquired business, the registrant performs "significant subsidiary" tests under Rule 1-02(w) of Regulation S-X (i.e., the asset test, the investment test and the income test).
- The periods for which a registrant is required to present financial statements are based on the significant subsidiary test resulting in the highest level of significance (e.g., a maximum of two years of audited financial statements and the latest unaudited year-to-date interim period for an acquired business exceeding 40% significance).
- Rule 3-05 financial statements must be filed on Form 8-K, certain Securities Act registration statements and in proxy statements, and be accompanied by pro forma financial information.
- This publication has been updated throughout to incorporate additional SEC staff guidance, including guidance issued since our initial publication, along with additional illustrations and expanded discussions on selected topics.

Overview

Audited financial statements of significant acquired businesses must be reported in reports on Form 8-K and proxy statements required by the Securities Exchange Act of 1934 (Exchange Act) and in certain filings required by the Securities Act of 1933 (Securities Act) (e.g., Forms S-1 and S-3). However, the number of years of audited financial statements that must be presented

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generally depends on the significance of the acquired business. Rule 3-05, *Financial statements of businesses acquired or to be acquired* (Rule 3-05), under Regulation S-X describes the Securities and Exchange Commission (SEC) requirements for registrants to provide audited financial statements of acquired or to be acquired businesses.

The SEC rules that went into effect 1 January 2021 for calendar-year registrants changed the significance tests that registrants use to determine the information they need to disclose, the periods that must be included in the financial statements and the form of pro forma financial information that must be included in certain SEC filings.

This publication discusses the requirements and has been updated to include SEC staff guidance issued after 2020 and additional illustrations of how to apply these requirements, among other things.

When using this publication, a registrant should refer to the rules in Regulation S-X (i.e., Rule 1-02(w) for significance testing, Rule 3-05 for financial statement requirements, and Rules 11-01 and 11-02 for pro forma requirements), as well as Rule 11-01(d) for determining whether a business has been acquired.

While registrants may also want to refer to chapters 2 and 3 of the SEC's Division of Corporation Finance Financial Reporting Manual, they should confirm the relevance of any guidance labeled as updated before 21 May 2020, which is when the SEC amended the rules.

Rule 3-14, *Special instructions for financial statements of real estate operations acquired or to be acquired*, includes the financial statement requirements for acquired operating real estate properties, which are summarized in our Technical Line, ***How to apply the amended S-X Rule 3-14 to real estate acquisitions***.

Contents

1 Definition of a business

To determine whether Rule 3-05 applies, a registrant must first determine whether the assets and liabilities it is acquiring meet the SEC's definition of a business in Rule 11-01(d) of Regulation S-X.

Acquired assets and liabilities that do not meet the SEC's definition of a business are not subject to the reporting requirements of S-X Rule 3-05 or S-X Article 11, even if they meet the US GAAP definition of a business under Accounting Standards Codification (ASC) 805, *Business Combinations*. (See our Financial reporting developments (FRD) publication, ***Business combinations***.)

Under Rule 11-01(d), the general principle for identifying a business is that there must be continuity of the entity's operations before and after the transaction, and the pre-acquisition financial information about the acquired business is, therefore, material to an understanding of the registrant's operations after the transaction.

There is a presumption that a separate entity, subsidiary, division or a working interest in an oil and gas property is a business. Rule 3-05 also defines as a business an investment accounted for using the equity method (including when the fair value option has been elected).

The SEC staff's analysis of whether a business is being acquired focuses primarily on the continuity of operations before and after a transaction.

Other components of a selling entity, such as a product line, may also be considered a business for SEC reporting purposes. When evaluating whether such a component is a business, registrants should consider both of the following criteria:

- Whether the nature of the revenue-producing activity of the component generally will remain the same as before the transaction
- Whether any of the following attributes remain with the component after the transaction:
  - Customer base
  - Employee base
  - Market distribution system
  - Operating rights
  - Physical facilities
  - Production techniques
  - Sales force
  - Trade names

The SEC staff has emphasized that the analysis of whether an acquired entity is a business focuses primarily on the continuity of operations before and after the acquisition. However, registrants must use judgment to evaluate the above criteria among other facts and circumstances.

Illustration 1 — Definition of a business

Registrant A is acquiring certain assets related to Product X from Company B. No employees will move from Company B to Registrant A, and the transaction involves only the internally generated intangible assets (e.g., brand name, manufacturing know-how) and inventory related to Product X. Product X is not a separate entity, subsidiary or division of Company B. After the acquisition, Registrant A will sell Product X to Company B's customers.

Because the nature of the revenue-producing activity associated with Product X will remain the same after the acquisition and multiple attributes listed in S-X Article 11 will remain with Product X, Registrant A concludes that the transaction involves a business. Refer to section 6.4, *Acquiring a component of a seller*, for a discussion of the financial statement requirements for components such as Product X.

How we see it

If a registrant believes that it may be able to overcome the presumption that a separate entity, subsidiary, division or a working interest in an oil and gas property is a business or is uncertain whether the criteria in S-X Rule 11-01(d) have been met, we recommend that the registrant contact the SEC staff to discuss whether a business has, in fact, been acquired. When the answer is unclear, it may also be helpful to consider whether the information conveyed in Rule 3-05 financial statements would be useful to investors.

2 Significance

A registrant that determines that it has acquired a business is required to provide Rule 3-05 financial statements and pro formas if the business exceeds 20% significance to the registrant. Significance is expressed as a percentage, and it is measured using the asset test, the investment test and the income test described in S-X Rule 1-02(w) to compare the acquired business with the registrant. The results of the tests cannot be rounded, and the registrant uses the highest result of the three tests to determine its reporting requirements.

In most cases, significance is determined using amounts that appear in the registrant's most recent annual pre-acquisition audited financial statements filed with the SEC and amounts in the financial statements of the acquired business for the same fiscal year. In certain cases, registrants may need to obtain more recent financial statements of the acquired business than those they will present to comply with Rule 3-05 to test significance. Although the acquired business's financial statements do not need to be audited to be used in the significance tests, the acquired business may need to accelerate the preparation of its latest annual financial statements to comply with Rule 3-05.

When a registrant acquires a business with a different fiscal year end, the registrant must test significance using the acquired business's pre-acquisition financial statements for the most recent fiscal year that would have been required if the business were a reporting company with the same filer status as the registrant. Thus, the registrant should not conform the fiscal year ends when testing significance. For example, if a calendar year-end registrant acquires an October year-end company on 30 May 20X3, it should compare the acquired company's financial statements for the year ended 31 October 20X2 with its audited annual financial statements for the year ended 31 December 20X2.

If the registrant or acquired business has been in existence for less than one year, the registrant or acquiree should not annualize its historical financial statements.

Further, financial statements used by both the registrant and the acquired business to measure significance must be prepared in accordance with the same comprehensive basis of accounting. For example, a registrant that files its financial statements with the SEC in accordance with US GAAP should determine significance using amounts reported under US GAAP for both the registrant and the acquired business even if the acquired business is based in another country and already has financial statements available using different accounting standards (e.g., IFRS as issued by the International Accounting Standards Board (IFRS-IASB)).

Also refer to section 2.4, S*ignificance tests — special circumstances*.

How we see it

When the registrant and the acquired business use different comprehensive bases of accounting (e.g., the registrant reports under US GAAP and the acquired business reports under IFRS), registrants may not need to fully convert the acquired business's reporting basis to their reporting basis to test significance if they have an understanding of the differences, how the differences might impact the test and how close the percentages calculated are to the thresholds in the rule.

Generally, each business acquired or to be acquired is evaluated individually. However, a group of related businesses must be evaluated together as a single acquisition. Businesses are deemed to be related if they are under common control or management, the acquisition of one business is conditional on the acquisition of the other business, or each acquisition is conditioned on a single common event. For example, if Registrant A acquires Companies B and C, and both Companies B and C were wholly owned by the same private equity company, Companies B and C would be evaluated as a single acquisition when performing the significance tests since they were under common control immediately before the acquisition.

To perform the tests for the group as a whole, a registrant must aggregate the amounts for each business, and the highest result represents the significance of the group. That is, if the significance of the group exceeds 20% for at least one test, Rule 3-05 financial statements and pro formas are required for each of the related businesses, even if the significance of one or more of them is 20% or less for all three tests. In addition, as discussed in section 3.2.3, *Individually insignificant acquisitions*, a registrant must consider the aggregate significance of acquisitions that are not individually significant for Rule 3-05 reporting requirements when filing registration and proxy statements.

How we see it

Registrants may submit requests to the Office of the Chief Accountant of the SEC's Division of Corporation Finance (CF-OCA) for relief from the requirement to prepare Rule 3-05 financial statements if (1) the results of their significance tests are anomalous and would lead to filing acquiree financial statements for periods beyond those reasonably necessary to inform investors or (2) if the preparation of Rule 3-05 financial statements would impose an unreasonable burden on the registrant (e.g., the effort and costs of preparing financial statements significantly outweighs any benefit to investors).

The CF-OCA staff may exercise its delegated authority under Rule 3-13 of Regulation S-X to waive some or all of the required acquiree financial statements or permit other financial statements to be substituted, as long as the staff deems it to be consistent with investor protection.

2.1 Asset test

A registrant performs the asset test by comparing its proportionate share of the acquired business's total assets to its consolidated total assets. For the purpose of performing the asset test, intercompany transactions between the registrant and the acquired business should be eliminated in the same manner they would be if the acquired business had been consolidated. The assets of the acquired business should not be reduced for any assets not acquired by a registrant (e.g., working capital items).

Illustration 2 — Asset test

Registrant A acquires 80% of Company B on 15 May 20X3. The most recent fiscal year end of both companies is 31 December 20X2, and each company's total assets reflect intercompany eliminations:

Registrant A:	$5 million
Company B:	$2 million

Asset test calculation:

80% of Company B's total assets:	$	1.6 million
Divided by Registrant A's total assets:	$	5 million

Significance = 32%

2.2 Investment test

A registrant that does not have WWMV should use its total assets to perform the investment test.

When performing the investment test, a registrant compares its investments in and advances to the acquired business to the aggregate worldwide market value of the registrant's voting and non-voting common equity (WWMV), or the registrant's total assets if WWMV is not available (i.e., when common equity is not publicly traded, as is the case for a company conducting an initial public offering (IPO)). However, a registrant must use its WWMV in the investment test if the WWMV is available when the test is being performed, even if the entity was not publicly traded as of the most recent pre-acquisition fiscal year end (i.e., the annual financial statement period used for the asset and income tests).

The term "investments in the acquired business" refers to the fair value of the consideration transferred for a business, adjusted to exclude the carrying value of any assets transferred by the registrant to the acquired business that will remain with the registrant after the acquisition.

Contingent consideration is included in the consideration transferred if it is recognized at fair value at the acquisition date for an acquisition that meets the definition of a business combination in ASC 805. Transaction costs are excluded because they are expensed as incurred under that guidance.

The WWMV is determined by averaging the aggregated worldwide market value calculated daily using the shares outstanding on the last five trading days of the month ended before the earlier of the registrant's announcement of the transaction or the date of the acquisition agreement. Classes of common equity that are not publicly traded are excluded from WWMV, including shares that are exchangeable or convertible into classes of common equity that are publicly traded.

Illustration 3 — Investment test

Registrant A acquires Company B on 15 September 20X2 for $20 million in cash. Under the agreement, Registrant A will pay the owners of Company B an additional $5 million (fair value is $3 million) if the business achieves certain post-acquisition performance targets. Registrant A also incurred transaction costs of $1 million. Registrant A and Company B agreed to the transaction on 28 February 20X2, and it was announced on 1 March 20X2. Registrant A has 10 million shares of outstanding publicly traded Class A common stock and 10 million shares of Class B stock that is not publicly traded but is convertible into common stock.

Investment test calculation:

Cash purchase price:	$ 20 million
Fair value of contingent consideration:	$ 3 million
Consideration transferred:	$ 23 million

Divided by average WWMV of only the Class A shares for each of the last five trading days of January (month ended before date of agreement on 28 February):

- 26 January daily average of $10.00 x 10 million shares = $100 million
- 27 January daily average of $10.50 x 10 million shares = $105 million
- 28 January daily average of $10.80 x 10 million shares = $108 million
- 29 January daily average of $11.00 x 10 million shares = $110 million
- 30 January daily average of $11.50 x 10 million shares = $115 million

WWMV = $107.6 million

Significance = 21%

When a registrant acquires assets and liabilities that do not meet the definition of a business under ASC 805 (i.e., an asset acquisition under US GAAP), it typically recognizes contingent consideration upon acquisition only if payment is probable and reasonably estimable. However, contingent consideration for these transactions should be included in the investment test, unless the likelihood of payment is remote. In addition, transaction costs are typically capitalized and included in the numerator of the investment test.

Illustration 4 — Investment test — acquired business is not a business under ASC 805

Registrant A acquires AssetCo, a business under S-X Rule 11-01(d), for $30 million. The transaction does not qualify as a business combination under ASC 805 and will be accounted for as an asset acquisition under US GAAP. Registrant A will also pay an additional $4 million to the owner of AssetCo if the business achieves certain post-acquisition performance targets during the first two years. Registrant A determined that $3 million of the contingent consideration is reasonably likely to be paid, and the likelihood of the remaining $1 million being paid is remote. Registrant A also incurred $1 million of transaction costs, and its WWMV was $100 million.

Investment test calculation:

Cash purchase price:	$ 30 million
Contingent consideration (more than remote):	$ 3 million
Transaction costs:	$ 1 million
Consideration transferred:	$ 34 million
Divided by Registrant A's WWMV	$ 100 million

Significance = 34%

How we see it

A lengthy period of time (e.g., a year or more) may elapse between the date used to calculate WWMV (i.e., when based on the registrant's announcement of the transaction) and the acquisition closing date (i.e., when the consideration transferred is determined). If a registrant believes that the mechanics of the investment test require providing Rule 3-05 financial statements and pro formas for a significant business that are not necessary for investors to make informed decisions, it should contact the SEC staff to discuss potential relief under S-X Rule 3-13.

2.2.1 Combinations of businesses or entities under common control accounted for in a manner similar to a pooling of interests (added April 2023)

For combinations of businesses or entities under common control that will be accounted for in a manner similar to a pooling of interests (e.g., reorganization of entities under common control), the investment test is performed by (1) comparing the net book value of the acquired entity to the registrant's consolidated total assets, and (2) comparing the number of common shares exchanged or to be exchanged by the registrant to its total common shares outstanding at the date the combination is initiated.

If the significance of the acquired business exceeds 20% under either of these tests, Rule 3-05 financial statements and pro formas are required. See section 3.1 for Form 8-K filing requirements and section 3.2 for registration statement and proxy statement filing requirements.

Illustration 5 — Investment test — reorganization of entities under common control

On 9 June 20X3, Registrant merged with commonly controlled Company A. The merger will be accounted for in a manner similar to a pooling of interests. Registrant exchanged 100 shares of its common stock for all of the outstanding shares of Company A. Registrant had 800 shares of common stock outstanding at the date the combination was initiated. At 31 December 20X2, Registrant had total assets of $1,000 and Company A had a net book value of $300.

Investment test calculation:

Company A net book value:	$ 300
Registrant total assets:	$ 1,000

Significance = 30%

Registrant shares exchanged:	100
Registrant total common shares outstanding at initiation date:	800

Significance = 12.5%

Registrant must file a Form 8-K by 15 June 20X3 to report the acquisition and an amendment by 25 August 20X3 (71 days later) that includes (1) audited financial statements of Company A as of and for the year-ended 31 December 20X2, and (2) unaudited interim financial statements of Company A as of and for the three months ended 31 March 20X3. Because this transaction will be accounted for in a manner similar to a pooling of interests, a pro forma income statement is required for (1) each of the three years ending 31 December 20X2, and (2) the three months ended 31 March 20X3. A pro forma balance sheet also is required as of 31 March 20X3.

2.3 Income test

A registrant needs to calculate both an income component and a revenue component (if applicable) for the income test. The income component compares the registrant's proportionate share of the acquired business's pretax income or loss from continuing operations, net of amounts attributable to any noncontrolling interest, to that of the registrant. A registrant or an acquired business may need to make adjustments, as reflected in the illustration below, to pretax income shown in the statement of comprehensive income to arrive at the amount used in the test.

The revenue component compares the registrant's proportionate share of the acquired business's most recent annual consolidated revenue from continuing operations to that of the registrant. If the registrant acquires 100% of another entity, it uses 100% of the entity's consolidated revenue in the significance test.

Intercompany transactions between the registrant and the acquired business should be eliminated from pretax income and revenue in the same manner they would if the acquired business had been consolidated.

Significance is measured using the lower result of the two components, but the revenue component of the test can only be used when the acquired business and the registrant both had material revenue during each of their past two fiscal years. The SEC staff has indicated that the determination of material revenue should be based on separate considerations of materiality for the registrant and the acquired business (i.e., the point isn't to compare the revenue of the registrant with that of the acquired business).

The staff has also clarified that when a registrant or acquiree is a successor to a predecessor company, the registrant should consider revenue for the full relevant period without regard to the separation of the predecessor and successor periods.

A registrant can average its income for the income component of the test only when the revenue component does not apply.

Illustration 6 — Income test

Registrant A acquires 60% of Company B on 15 May 20X2. Registrant A records income from an investment that it accounts for using the equity method. Registrant A also has a consolidated but not wholly owned subsidiary, and it allocates a portion of its income to the noncontrolling interest in the subsidiary. Company B does not have any investments or a noncontrolling interest. Neither company has had any discontinued operations, and both had material revenue. Both companies have calendar year ends.

Selected items from Registrant A's 20X1 statement of comprehensive income (in millions):

Revenue	$ 100
Income before income taxes	$ 10
Income taxes	$ 3
Income after taxes	$ 7
Income from investee (net of $1 million tax)	$ 2
Net income	$ 9
Net income attributable to noncontrolling interest (net of $1 million tax)	($ 3)
Net income attributable to Registrant A	$ 6

Selected items from Company B's 20X1 statement of comprehensive income (in millions)

Revenue	$ 19
Income before income taxes	$ 5

<u>Income test calculation:</u>

Income component:

60% of Company B's income before income taxes:	$ 3
Divided by Registrant A's adjusted income before taxes:	
Income before taxes	$ 10
Plus pretax income from investee	$ 3
Less pretax income allocated to noncontrolling interest	($ 4)
Registrant's adjusted income before taxes	$ 9

Income component significance = 33%

Revenue component:

60% of Company B's revenue:	$ 11.4
Divided by Registrant A's revenue:	$ 100

Revenue component significance = 11%.

Significance under the income test is 11%, the lower result of the two components.

When the revenue component is not available, a registrant averages its income from the last five fiscal years. If the registrant's income used for the income component is at least 10% lower than its calculated average income, the registrant uses the average. If a loss was recorded in any year, it uses the absolute value.

If the registrant has less than five years of audited financial statements on the same basis of accounting, the SEC staff will not allow income averaging. For instance, the registrant may have experienced a change in basis of accounting due to emerging from bankruptcy or succeeding to the reporting obligations of another reporting entity less than five years before the last audited balance sheet used for the S-X 1-02(w) significance tests.

When registrants have five years of audited financial statements that include two or more different bases of accounting, the SEC staff will consider a relief request by the registrant to perform the significance test using pro forma amounts determined in accordance with S-X Article 11 as if the predecessor had been acquired at the beginning of the fiscal year being measured. The SEC staff generally believes that combining the historical results of the successor and predecessor (within one year or within the five-year average) without Article 11 pro forma adjustments is not an appropriate surrogate for the significance test.

The income of the acquired business cannot be averaged.

Illustration 7 — Income averaging when the revenue component is not available

Assume the same facts as in Illustration 6, except that Company B did not have material revenue during fiscal year 20X0, and the registrant recorded the income and loss before taxes shown below for the four years before 20X1.

Income average calculation:

20X1:	$ 9 million
20X0:	($ 10 million)*
20X9:	$ 11.5 million
20X8:	$ 13 million
20X7:	$ 14 million
Total	$ 57.5 million
Average over five years:	$ 11.5 million

* Use absolute value in this calculation.

Registrant A's 20X1 income of $9 million is at least 10% lower than $11.5 million, so the income component is calculated by dividing Company B's income before taxes of $3 million by Registrant A's average income of $11.5 million.

Income component significance = 26%

If a registrant is allowed to present abbreviated financial statements (refer to section 6.4.2, *Abbreviated financial statements*), the income component should be calculated using the acquired business's revenue less direct expenses.

How we see it

Over the past year, the SEC staff has sought more details in its filing reviews about how registrants concluded that separate 3-05 financial statements and pro formas were not required. The SEC staff may also review publicly available information, other than SEC filings, to identify any completed acquisitions for which the registrant didn't file separate financial statements or pro formas.

Registrants should consider maintaining contemporaneous documentation of significance tests performed and their analysis of Rule 3-05 and Article 11 requirements, particularly when they conclude that an acquisition is not significant.

2.4 Significance tests — special circumstances

2.4.1 Calculating significance when the Form 10-K is filed subsequent to an acquisition

As discussed above, a registrant generally measures significance using its pre-acquisition consolidated financial statements as of the end of the most recently completed audited fiscal year required to be filed with the SEC. However, a registrant can choose which fiscal year of its financial statements to use when it files a new annual report on Form 10-K after completing the acquisition of a business but before the Rule 3-05 financial statements and pro formas would be required to be filed in a Form 8-K (see separate discussion below about Form 8-K filing requirements and due dates). In this situation, if the registrant elects to use the new annual report on Form 10-K, it may either use amounts from the same newly completed period of the acquired business or continue to use the amounts from the prior period.

Illustration 8 — Financial statements used to perform the significance tests

Registrant A is a calendar year-end accelerated filer that completed the acquisition of Company B on 28 February 20X3. Company B is significant to Registrant A when using Registrant A's most recent audited annual financial statements on file at consummation (i.e., the 20X1 financial statements) and Company B's annual financial statements for the same period. As a result, Registrant A filed an Item 2.01 Form 8-K on 4 March and must file an Item 9.01 Form 8-K on 14 May (i.e., 71 days after 4 March) with Rule 3-05 financial statements and pro formas.

On 16 March 20X3, Registrant A files its 20X2 annual report and performs the significance tests again using its 20X2 financial statements and the 20X1 financial statements for Company B. Company B is no longer significant, and Registrant A does not need to file the Item 9.01 Form 8-K.

A registrant also has a choice of which fiscal year of its financial statements to use for significance when the most recently filed financial statements are not yet due at the time of the acquisition. For example, if calendar-year Registrant B voluntarily files its 20X2 annual report on Form 10-K early on 1 February 20X3 and acquires Company C on 5 February 20X3, Registrant B has the option to test significance using either its 20X2 or 20X1 financial statements.

2.4.2 Registrant financial statements used to determine significance in an IPO (added April 2023)

In connection with an IPO, a registrant should use the most recent pre-acquisition financial statements included in the registration statement to determine the significance of an acquisition. That is, the registrant cannot use financial statements for an earlier period even if the financial statements would have been required at the time of the acquisition had the company been reporting under the Exchange Act.

Illustration 9 — Measuring significance in an IPO

Calendar-year Company A files an IPO registration statement on 28 February 20X3 that includes its audited financial statements as of 31 December 20X2 and 20X1 and for each of the three years in the period ended 31 December 20X2. Company A acquired Company B on 5 February 20X2 so it must use its financial statements as of and for the year ended 31 December 20X1 to determine significance because those are the most recent pre-acquisition financial statements included in the registration statement.

2.4.3 *Using pro forma financial information to calculate significance*

A registrant can measure significance using information contained in pro formas that reflect significant business acquisitions and dispositions consummated after its latest fiscal year end if the required Rule 3-05 financial statements and pro formas have already been filed in a Form 8-K or a registration statement. However, the pro forma balance sheet used for the asset test (and investment test, if WWMV is not available) must be as of the end of the registrant's most recent fiscal year, even if that balance sheet was not included in the previously filed pro formas.

Pro formas used to test significance must include all significant acquisitions and dispositions completed since the beginning of the fiscal year and should exclude any transactions that were included in filed pro formas but were not required to be. If the registrant chooses to compute significance using pro formas, it must do so for all three tests and continue to do so until it files its next annual report on Form 10-K.

Rule 11-01(b)(3)(i)(B) requires that pro formas used to test significance only include transaction accounting adjustments for the acquisitions and dispositions included (e.g., excludes offering proceeds). However, we understand that the SEC staff would not object to a registrant also including transaction accounting adjustments for related transactions, other than offering proceeds, that are considered material under S-X 11-01(a)(8) and presented as part of the pro forma financial presentation on file (as further described in our publication, ***Pro form financial information: A guide for applying Article 11 of Regulation S-X***).

A company conducting an IPO can use pro formas to test significance.

A company conducting an IPO can use pro formas to test significance, including pro formas that are included in a draft registration statement (DRS) under the SEC's confidential filing process. However, the first publicly filed registration statement will also need to include the pro formas (and related Rule 3-05 financial statements). If any changes occurred between the draft submission and the public filing, a company should reassess the significance of any acquisitions it tested using the pro formas in the DRS. For example, if a company conducting an IPO acquired two significant businesses after its latest fiscal year end, it would need to file a registration statement (e.g., a DRS), including the Rule 3-05 financial statements and pro formas, for the first acquisition in order to use the pro formas to perform the significance tests for its second acquisition.

Illustration 10 — Using pro forma financial information filed in a Form 8-K to measure significance

Registrant A has a calendar year end and acquires Company B on 20 May 20X3. On 3 August 20X3, Registrant A files a Form 8-K that includes Rule 3-05 financial statements for Company B and pro formas reflecting the transaction. The pro formas include a balance sheet as of 31 March 20X3 and income statements for the year ended 31 December 20X2 and the three months ended 31 March 20X3.

On 15 September 20X3, Registrant A acquires Company C and can test its significance using its previously filed pro forma income statement for the year ended 31 December 20X2 and a pro forma balance sheet at 31 December 20X2 that must be prepared separately by Registrant A solely for testing significance.

Illustration 11 — Using pro forma financial information filed in a DRS to measure significance

Company A is a calendar-year emerging growth company (EGC) preparing for an IPO in 20X3 and has completed two acquisitions (Target B and Target C) since its most recently completed fiscal year (e.g., 12/31/20X2). Company A intents to submit its Form S-1 DRS in July 20X3, which will include its audited financial statements for the two years ended 31 December 20X2 and unaudited interim financial statements for periods ended 31 March 20X3 and 20X2. Company A also expects to file publicly in December 20X3 and have its registration statement declared effective in January 20X4.

The following table summarizes key assumptions and dates:

Event	Date	Significance based on FY22 audited financial statements
Company A acquires Target B	2/15/20X3	25%
Company A acquires Target C	4/15/20X3	22%
Initial confidential submission (DRS)	7/1/20X3	n/a

Based on the fact pattern, if Company A includes in the DRS (and the publicly filed Form S-1 in December 20X3) the S-X Rule 3-05 financial statements and pro forma financial information for Target B, it may use the pro forma financial information that reflects the acquisition of Target B in the DRS to test the significance of Target C.

2.4.4 *Calculating significance when a consolidated subsidiary acquires a business (added April 2023)*

A registrant may have a consolidated subsidiary that acquires a business. If the subsidiary is not a registrant, the acquired business's financial statements should be compared with the registrant's audited financial statements. However, if the subsidiary is also a registrant, both the registrant and the subsidiary are required to test the significance of the acquired business.

Further, when a non-registrant subsidiary that is not wholly owned acquires a business (e.g., a registrant consolidates a 60%-owned private operating company, which acquires 100% of an unrelated business), the SEC staff has indicated the following with respect to performing the three significance tests:

- When performing the asset test and calculating the revenue component of the income test, 100% of the acquired business's assets and revenue from continuing operations should be used in the numerator, and 100% of the registrant's assets and revenue should be used in the denominator. That is, the registrant's 60% ownership of the operating company does not affect these calculations.

- For the investment test, if the registrant does not have an aggregate worldwide market value of its voting and non-voting common equity, it is required to use total assets in the denominator. In this case, the registrant should use 100% of the registrant's assets, and the numerator should reflect 100% of the consideration transferred by the operating company.

- For the income component of the income test, the numerator should reflect only 60% of the acquired business's pretax income/loss (i.e., income/loss attributable to controlling interest). The denominator should be the registrant's pretax income/loss attributable from continuing operations and attributable to the controlling interest, which also excludes pretax income/loss attributable to noncontrolling interests.

How we see it

If a registrant believes that the mechanics of the asset test and the revenue component of the income test in this scenario will not result in useful information provided to investors, it should contact the SEC staff to discuss the application of the significance tests.

2.4.5 *Calculating significance of an acquisition after a reverse acquisition (added April 2023)*

The SEC staff has indicated that if an acquisition is made after a transaction accounted for as a reverse acquisition of the registrant but before the audited financial statements for the fiscal year in which the reverse acquisition occurred are filed and the audited financial statements for the accounting acquirer have been filed with the SEC, significance should be measured against the accounting acquirer's (i.e., legal acquiree) financial statements.

Illustration 12 — Calculating significance of an acquisition after a reverse acquisition

On 1 April 20X3, Registrant Z, a non-accelerated filer, acquired Company A, a nonpublic company, in a transaction to be accounted for as a reverse acquisition. Therefore, Company A is the accounting acquirer, and Registrant Z is the accounting acquiree. Both Registrant Z and Company A have calendar year ends. On 6 April 20X3, Registrant Z filed an Item 2.01 Form 8-K that included audited financial statements of Company A as of 31 December 20X2 and 20X1 and for each of the three years in the period ended 31 December 20X2.

On 7 October 20X3, Registrant Z acquired Company B. In this case, the significance of Company B should be measured against the 31 December 20X2 audited financial statements of Company A, the accounting acquirer.

If the financial statements of Company A are not filed prior to the acquisition of Company B (e.g., during the 71-day Form 8-K extension period), significance should be measured against the 31 December 20X2 audited financial statements of Registrant Z (legal acquirer).

2.4.6 *Impact of discontinued operations on significance calculations (added April 2023)*

The SEC staff has indicated that once a registrant files financial statements retrospectively adjusted for a discontinued operation (i.e., recasted financial statements), the registrant should use them to determine significance only for (1) probable acquisitions as of the date of the registration statement or proxy statement, (2) calculating the aggregate effect of all individually insignificant businesses or (3) businesses acquired after the recasted financial statements have been filed.

For individual acquisitions consummated on or before the filing of the recasted financial statements, registrants may measure significance using either (1) the financial statements filed before the recasted financial statements, generally those in the registrant's previous SEC annual report or (2) the recasted financial statements for the most recently completed fiscal year. A registrant must consistently use the financial statements it chooses (i.e., either (1) or (2)) to measure significance of all individual acquisitions completed on or before the filing date of the recasted financial statements.

Illustration 13 — Measuring significance with discontinued operations
Calendar-year Registrant Z, an accelerated filer, acquired Company A on 8 March 20X3 and acquired Company B on 22 September 20X3. In April 20X3, Registrant Z disposed of a component that was reported as a discontinued operation in Registrant Z's 30 June 20X3 Form 10-Q. On 26 August 20X3, Registrant Z filed a registration statement that incorporated by reference its 30 June 20X3 Form 10-Q and an Item 8.01 Form 8-K that reflected its recasted financial statements as of 31 December 20X2 and 20X1 and for each of the three years in the period ended 31 December 20X2. Because the acquisition of Company A was consummated before the recasted financial statements were filed, significance should be measured using the financial statements in Registrant Z's 31 December 20X2 Form 10-K. However, because the acquisition of Company B was consummated after the recasted financial statements were filed, significance may be measured using either the financial statements in the Form 10-K or the recasted financial statements.

2.4.7 Calculating significance for an exchange transaction (added April 2023)

A registrant and another party each may contribute businesses to a Newco (or joint venture), receiving in exchange an equity interest in the combined company. In this transaction, the registrant is giving the other party an interest in a formerly consolidated business in exchange for an equity interest in the other party's business. Dispositions and acquisitions effected through exchange transactions each need to be reported as indicated in Instruction 2 to Item 2.01 of Form 8-K. Item 2.01 specifies separate thresholds for determining when each transaction is significant. The significance of the disposition and acquisition should be evaluated separately in determining whether pro forma information about the disposition (and receipt of an equity investment) is required, and whether audited financial statements of the business contributed by the other party are required, in which case pro forma information related to the acquisition also would be required.

Significance of the disposition should be calculated based on the net disposed percentage of the business contributed to the joint venture (that is, total equity transferred net of the equity interest retained). The net disposed percentage of the pretax earnings (losses), revenues and total assets of the disposed business would be compared to the corresponding amounts in the registrant's annual financial statements on file before the disposition.

If the net portion of the disposed business exceeds 20% under any of the significance tests, the disposition is considered significant and pro forma financial information must be furnished to reflect the effects of the disposition of a controlling interest in the business.

As discussed above, the acquisition of an interest in a business to be accounted for using the equity method is deemed an acquisition of a business. Therefore, if the interest in the joint venture will be accounted for using the equity method, financial statements of the business or businesses contributed by the other party are required under S-X Rule 3-05 or S-X Rule 3-14 if that business exceeds 20% significance.

In this situation, all three significance tests should be based on the acquired percentage of the other party's business compared to the registrant's historical financial statements (without adjustment for the related disposition of the business contributed by the registrant to the joint venture). Regardless of whether the transaction is accounted for at fair value, the investment test should be based on the fair value of the consideration given up or the consideration received, whichever is more reliably determinable.

Illustration 14 — Measuring significance in an exchange transaction

On 15 July 20X3, calendar-year Registrant Z contributes Division A-1 to a joint venture in exchange for a 50% ownership interest. On that date, Company B contributes Division B-1 to the same joint venture in exchange for a 50% ownership interest. Company B also has a calendar year end.

To determine its reporting requirements, Registrant Z must calculate the significance of the disposition of Division A-1 and the acquisition of a 50% interest in Division B-1 separately. Below is pertinent financial information of Registrant Z, Division A-1, and Division B-1. Assume that the fair value of Division B-1 is more reliably determinable than the fair value of Division A-1, and that the revenue component of the income test was higher than the income component.

	Pre-tax Income excluding Noncontrolling Interest	Average WWMV	Total Assets	Book Value of Net Assets	Fair Value of Net Assets
Registrant Z	$1,000	$15,000	$10,000	N/A	N/A
Division A-1	$250	N/A	$4,100	$800	$1,200
Division B-1	$220	N/A	$4,200	$1,100	$1,500

Significance of disposition of Division A-1:

Income Test: ($250 x 50%) / $1,000 = 12.5%

Asset Test: ($4,100 x 50%) / $10,000 = 20.5%

Investment Test: ($1,500 x 50%) / $15,000 = 5.0%

Because the significance of the disposition of Division A-1 exceeds 20%, Registrant Z must report the disposition under Item 2.01 of Form 8-K and furnish Article 11 pro forma financial information under Item 9.01 of Form 8-K within four business days of the disposal. For purposes of calculating the investment test, the fair value of Division B-1 was used because it was concluded to be more reliably determinable than the fair value of Division A-1.

Significance of acquisition of Division B-1:

Because the significance of the acquisition of Division B-1 exceeds 20% based on the asset test, Registrant Z must report the acquisition under Item 2.01 of Form 8-K and furnish (1) audited financial statements of Division B-1 as of and for the year ended 31 December 20X2, (2) unaudited interim financial statements of Division B-1 as of and for the three months ended 31 March 20X3 and statements of income and cash flows for the corresponding interim period of the prior fiscal year, and (3) related pro forma financial information.

In this example, the pro forma financial information would reflect both the disposition of a net 50% interest in Division A-1 and the acquisition of a 50% interest in Division B-1 through the joint venture interest.

Ordinarily, pro forma financial information depicting a significant disposition must be filed within four business days of the disposition. However, if reporting both the disposition and the acquisition are required by Form 8-K, a registrant may be unable to present a pro forma income statement depicting the joint venture formation because financial statements of the business contributed by the other party are not available. In this case, the acquired business financial statements and related pro forma financial information need not be filed until 71 days after the original Item 2.01 Form 8-K due date.

The initial Form 8-K reporting the transaction should include a narrative description of the effects of the disposition, quantified to the extent practicable. The amended Form 8-K should include complete pro forma information depicting the effects of the exchange of interests and the audited financial statements of the acquired business.

The acquisition or disposition of securities (e.g., common stock) is deemed to be the indirect acquisition or disposition of the assets represented by such securities if it results in the acquisition or disposition of control, as indicated in general Instruction 3 to Item 2.01 of Form 8-K. Therefore, one might conclude that if the investment in the joint venture will not be consolidated by the registrant, the registrant has not acquired (indirectly) the assets of the joint venture and no Item 2.01 Form 8-K would be required. However, the SEC staff has not interpreted the instruction in this manner for the formation of joint ventures and generally will require the registrant to file an Item 2.01 Form 8-K and appropriate Item 9.01 information if either the registrant's disposition or proportionate acquisition is significant.

2.4.8 Calculating significance for an acquisition by a shell company after a forward acquisition (added April 2023)

When a shell company registrant (or registrant with minimal operating activity) acquires a business after it has previously acquired an entity deemed to be the shell registrant's predecessor (but not accounted for as a reverse acquisition or recapitalization), the SEC staff has indicated that significance should be measured using the historical financial statements of the shell company registrant.

Illustration 15 — Acquisition by a shell company after a forward acquisition

Calendar-year shell Registrant Z was incorporated on 19 October 20X1 and has had no activity since its date of inception.

On 18 August 20X3, shell Registrant Z acquired for cash Company A, that was deemed its predecessor. The transaction was not accounted for as a reverse acquisition or recapitalization.

On 22 August 20X3, shell Registrant Z filed a Form 8-K containing (1) Company A's audited financial statements as of 31 December 20X2 and 20X1 and for each of the three years in the period ended 31 December 31 20X2, (2) its unaudited interim financial statements as of and for the six months ended 30 June 20X3 and 20X2, (3) related pro forma financial information, and (4) all of the information required by Item 2.01(f) of Form 8-K (i.e., disclosure consistent with a Form 10 Exchange Act registration). On 15 September 20X3, shell Registrant Z acquired Company B, a calendar-year company.

Significance must be determined by comparing the most recent annual pre-acquisition audited financial statements of Company B (i.e., 31 December 20X2) to shell Registrant Z's most recent annual pre-acquisition audited financial statements (i.e., 31 December 20X2), not the 20X2 financial statements of the predecessor (i.e., Company A) filed in the Form 8-K.

2.4.9 Calculating significance for a step acquisition (added April 2023)

The SEC staff has indicated that when a registrant increases its investment in an entity relative to the prior year, significance should be based on the additional interest acquired, as opposed to the cumulative interest to date. However, the significance of step acquisitions that are part of a single plan to be completed within a 12-month period should be aggregated.

The SEC staff also has indicated that when a registrant increases its investment in an entity that is already consolidated, financial statements of that subsidiary ordinarily are not required. However, significance still must be calculated to determine whether pro forma financial information for the acquisition of the noncontrolling interest will be required in a Form 8-K.

Illustration 16 — Acquisition of additional interest in a consolidated subsidiary

Calendar-year Registrant Z acquired a 60% interest in Company A on 15 May 20X1. On 12 June 20X3, Registrant Z acquired the remaining 40% interest in Company A for cash consideration of $150. At 31 December 20X2, Registrant Z had total assets of $500, a WWMV of $600, and pretax income from continuing operations of $1,000. At 31 December 20X2, Company A had total assets of $300 and pretax income from continuing operations of $800. There were no intercompany transactions between Registrant Z and Company A, and the revenue component of the income test was higher than the income component.

The significance tests for the acquisition of the additional 40% equity interest would be computed as follows:

Investment test:

Cost of additional 40% interest:	$ 150
Registrant Z's WWMV:	$ 600
Significance = 25%	

Asset test:

Registrant Z's additional share of Company A's assets (40% * 300):	$ 120
Registrant Z total assets:	$ 500
Significance = 24%	

Income test:

Registrant Z's additional share of Company A's pre-tax income (40% * 800):	$ 320
Registrant Z's pre-tax income attributable to controlling interests:	$ 1,000
Significance = 32%	

Even though the acquisition of the remaining noncontrolling interest exceeds 20% significance, Registrant Z need not provide Company A's audited financial statements on Form 8-K because Company A previously has been consolidated by Registrant Z. However, Registrant Z must report on Form 8-K by 16 June 20X3 (i.e., within four business days of the acquisition date) pro forma financial information. If the pro forma impact of the transaction only affects the amounts attributable to non-controlling interests, the SEC staff typically accepts a more abbreviated or narrative presentation.

2.4.10 Calculating significance for a "put-together" transaction (added April 2023)

SEC Staff Accounting Bulletin (SAB) Topic 2.A.8 addresses when two or more businesses combine in a single business combination just prior to or contemporaneously with an IPO. The SEC staff believes that the combination of two or more businesses should be accounted for in accordance with ASC 805. Therefore, even when no combining company's shareholders obtain more than 50% of the combined company's outstanding shares, one of the combining companies must be identified as the accounting acquirer.

The SEC staff has indicated that significance in a "put-together" transaction should be measured against the accounting acquirer, regardless of whether the accounting acquirer is a newly formed entity (Newco).

If there are three or more entities involved in a put-together transaction, all of the non-accounting acquirer businesses are considered related under S-X Rule 3-05(a)(3), and they must be treated as a single acquisition for purposes of measuring significance against the accounting acquirer.

If a new acquisition occurs after a put-together IPO but before the filing of the registrant's first Form 10-K, the SEC staff has indicated that the registrant should measure significance using the audited financial statements of the accounting acquirer for the most recent fiscal year included in the IPO registration statement. However, the registrant may also use pro formas filed in its IPO registration statement to test significance.

If a new acquisition occurs after the filing of the registrant's first Form 10-K, the SEC staff has indicated that the registrant should measure significance using the audited financial statements of the registrant for the most recent fiscal year in the Form 10-K.

In some cases, such as when the IPO occurs close to the registrant's fiscal year end, the registrant's financial statements presented in Form 10-K only may include operations for a very short period of time. Upon written request and depending on the proximity of the put-together transaction to the balance sheet date, the SEC staff will consider whether relief from the literal application of S-X Rule 3-05 is appropriate. For example, a registrant may request to use pro forma results as the basis for determining significance.

2.4.11 Determining significance using abbreviated and carve-out financial statements (added April 2023)

If a registrant is allowed to present abbreviated Rule 3-05 financial statements (see section 6.4.2), the abbreviated financial statements can be used to test significance. For example, the income component of the income test would compare the acquired business's revenue less direct expenses with the registrant's income or loss from continuing operations before taxes, net of amounts attributable to any noncontrolling interest. Financial statements of the business component that reflect cost allocations required or permitted by SAB Topic 1.B (carve-out financial statements) may be used in determining the significance of the business under the income test (see section 6.4.1).

3 Filing Rule 3-05 financial statements

Rule 3-05 financial statements must be filed on Form 8-K, in certain Securities Act registration statements and proxy statements as described below. The pro formas must accompany these financial statements and are addressed in section 7, *Pro forma financial information*.

3.1 Form 8-K

A registrant must report the acquisition of a significant business under Item 2.01, *Completion of Acquisition or Disposition of Assets*, of Form 8-K by the fourth business day after consummation. However, if the acquisition occurs within four business days of filing a Form 10-Q or Form 10-K, the acquisition may be initially reported in that periodic report.

The registrant also must file Rule 3-05 financial statements and pro formas under Item 9.01, *Financial Statements and Exhibits*, of Form 8-K by the 71st calendar day after the Item 2.01 due date. If the Rule 3-05 financial statements and pro formas are not included in the initial Form 8-K, the registrant must state in the initial report that it will file them within 71 days. If either of these due dates occurs on a weekend or a holiday, a registrant can file on the next business day.

General Instruction A of Form 8-K allows a registrant to skip filing an Item 9.01 Form 8-K containing Rule 3-05 financial statements and pro formas if the registrant already included the information in a registration statement, and the information in the Form 8-K would be "substantially the same" as what is presented in that registration statement. This instruction generally allows registrants to skip filing an Item 9.01 Form 8-K if the Rule 3-05 financial statements it would need to provide in the Form 8-K would need only one additional interim quarter based on the financial statement age requirements discussed below. However, registrants will need to file an Item 9.01 Form 8-K if they previously filed third-quarter financial information of an acquired business and the Form 8-K requires audited financial statements for the latest annual period.

3.1.1 Consolidation of a legal entity (added April 2023)

Instruction 2 to Item 2.01 of Form 8-K includes consolidations in the definition of acquisitions. Accordingly, when a registrant consolidates a legal entity (including a variable interest entity or a voting interest entity pursuant to ASC 810, *Consolidations*), the registrant should consider whether the initial consolidation represents a significant business acquisition that should be reported under Item 2.01 of Form 8-K, even though the registrant might have issued no consideration.

If the entity meets the SEC's definition of a business and its significance exceeds 20%, the registrant must report the consolidation as an acquisition under Item 2.01 of Form 8-K and file Rule 3-05 financial statements and pro formas under Item 9.01 of Form 8-K as discussed above. If the entity is not a business, the consolidation should be reported as an asset acquisition under Item 2.01 of Form 8-K if its significance exceeds 10%.

Similarly, a registrant also should consider whether it has a Form 8-K reporting obligation for the disposal of a significant business or assets when an entity is deconsolidated.

3.1.2 Voluntary reporting (added April 2023)

Registrants may voluntarily file a Form 8-K to report a business acquisition when the level of significance does not exceed 20%. In that case, the acquisition should be reported under Item 8.01, *Other Events*, of Form 8-K, rather than under Items 2.01 and 9.01 of Form 8-K.

Rule 3-05 financial statements and pro formas are not required when a registrant voluntarily reports a business acquisition under Item 8.01 of Form 8-K. However, this information may be required in a registration statement if the aggregate significance of individually insignificant acquisitions acquired since the registrant's most recent audited balance sheet date exceeds 50% (see section 3.2.3) or the aggregate significance of a group of related acquired businesses exceeds 20% (see section 2).

3.1.3 *Related businesses (added April 2023)*

In contrast to registration and proxy statements, Form 8-K is not required to report acquisitions of individually insignificant businesses, unless such businesses are related businesses and are significant in the aggregate. Related businesses are treated as if they are a single business for the purpose of Form 8-K, and aggregate significance will increase as the businesses are acquired if the acquisitions are not consummated at the same time.

Separate or combined financial statements (depending on the application of ASC 810) of the related businesses must be reported on Form 8-K once the cumulative significance exceeds 20% and may need to be updated in additional Form 8-K filings.

Illustration 17 — Reporting acquisition of significant related businesses on Form 8-K

Registrant Z acquired calendar-year Companies A, B and C on various dates in 20X2. The acquisition of each business was conditioned on a single common event. Companies A, B and C are not under common control or management. Because the acquisition of each business was conditioned on a single common event, Companies A, B and C are related businesses.

Below is a summary of the Form 8-K filing requirements.

					Rule 3-05 Financial statements	
Company	Acquisition Date	Individual significance	Cumulative significance	Form 8-K required?	Audited annual	Unaudited interim
A	3/25/20X2	18%	18%	No	N/A	N/A
B	5/13/20X2	14%	32%	Yes	A - 20X1 B - 20X1	A - N/A B - 3/31/20X2
C	6/18/20X2	19%	51%	Yes	A** - 20X1, 20X0 B** - 20X1, 20X0 C - 20X1, 20X0	A - N/A B* - 3/31/20X2, 3/31/20X1 C - 3/31/20X2, 3/31/20X1

* A comparative interim period is not required for Company B when cumulative significance is 32%. However, once cumulative significance rises above 40%, the comparative period is required.

** Audited financial statements for one year are required for Companies A and B when cumulative significance is 32%. However, once cumulative significance rises above 40%, two years of audited financial statements are required.

3.2 Registration and proxy statements

In registration statements (except as provided otherwise for filings on Forms S-4 or F-4) or proxy statements (except for merger proxies), a registrant must also provide Rule 3-05 financial statements and pro formas. However, the requirements and due dates are different from those for Form 8-K, and a registrant may need to provide disclosures about additional acquired businesses.

See sections 3.3 and 3.4 for a discussion of financial statement requirements of merger proxy statements and registration statements on Forms S-4 or F-4, respectively.

3.2.1 *Completed individual acquisitions*

Rule 3-05 financial statements and pro formas must be included in a registration statement for a significant business that has already been acquired unless all of the following conditions are met:

- The business is 50% significant or less.

- The registration statement is filed or declared effective no more than 74 days after consummation (interpreted as one day before the Item 9.01 Form 8-K due date).
- The financial statements have not already been filed by the registrant.

Rule 3-05 financial statements and pro formas for a completed acquisition that is more than 20% significant but no more than 50% significant may be omitted from a registration statement that is filed or becomes effective within 70 calendar days of the Item 2.01 Form 8-K due date. However, the registrant is still required to file Rule 3-05 financial statements and pro formas in an Item 9.01 Form 8-K by the 71st day.

Illustration 18 — Omitting an acquired business that is 50% or less significant
On Monday, 4 March 20X3, Registrant A completes the acquisition of Company B (30% significant). The Item 2.01 Form 8-K is due on 8 March, and the Item 9.01 Form 8-K is due on 19 May. Through 18 May, Registrant A can file or have a registration statement declared effective without Rule 3-05 financial statements and pro formas that reflect the acquisition of Company B.

Rule 3-05 financial statements and pro formas are always required in registration statements for completed and probable acquisitions of businesses that are more than 50% significant.

Rule 3-05 financial statements and pro formas for a completed acquisition that is more than 50% significant must always be included in a registration statement, unless the results of the acquired business have been included in a registrant's post-acquisition results for 12 months as described further below. These requirements also apply to offerings conducted under a shelf registration statement on Form S-3 (shelf offering) that is already effective. However, the following securities offerings may proceed under an effective registration statement even though financial statements of the acquired business have not yet been filed: (1) offerings or sale of securities upon the conversion of outstanding convertible securities or upon the exercise of outstanding warrants or rights, (2) dividend or interest reinvestment plans, (3) employee benefit plans, (4) secondary offerings and (5) sales of securities pursuant to Rule 144.

Before conducting a shelf offering, a registrant must also consider whether a completed acquisition of a business that is 50% or less significant, for which Rule 3-05 financial statements and pro formas have not been filed, represents a "fundamental change" in accordance with Rule 512 of Regulation S-K. If the acquisition represents a fundamental change, the financial statements and pro formas must be filed before the registrant conducts the offering. While such acquisitions are rarely determined to be a fundamental change, the determination is a legal matter that a registrant should discuss with its legal counsel.

3.2.2 *Probable acquisitions*

In a registration statement or a proxy statement, Rule 3-05 financial statements and pro formas may be required for a business that has not yet been acquired if the acquisition is "probable." While the SEC has not provided guidance about when an acquisition is probable, the general practice is to consider an acquisition probable when a public announcement is made by the registrant or when a binding agreement between the parties is in place. This usually occurs when the major provisions of the acquisition transaction have been agreed to in writing (i.e., a definitive agreement). Additionally, the SEC staff generally considers acquisitions to be probable if they are conditioned only upon obtaining financing or approval by shareholders or regulators. A registrant should consider all the relevant facts and circumstances because the intent of requiring financial information related to probable acquisitions is to capture situations where the registrant's financial statements alone would not provide investors with adequate financial information with which to make an investment decision.

Rule 3-05 financial statements (e.g., two most recent fiscal years and most recent year-to-date interim period with a comparative prior period) and pro formas are always required in registration statements for probable acquisitions of businesses that are more than 50% significant. A probable acquisition that is deemed to be a fundamental change also triggers a requirement to file the information before conducting a shelf offering.

3.2.3 Individually insignificant acquisitions

Registrants must also consider the aggregate significance of acquisitions that do not individually trigger a requirement to include Rule 3-05 financial statements and pro formas in a registration statement or proxy statement. These include:

- Acquisitions consummated after the registrant's most recent audited balance sheet date that are 20% or less significant
- Probable acquisitions that are 50% or less significant
- Completed acquisitions that are more than 20% but not more than 50% significant for which Rule 3-05 financial statements and pro formas are not yet required because the filing or effective date of the registration statement (or proxy statement mailing date) falls within 74 days of consummation

If a registration statement is filed or becomes effective or a proxy statement is mailed after year end but before the date that annual audited financial statements must be filed, individually insignificant acquisitions acquired since the previous year end through the filing/effective/mailing date must be aggregated (along with acquisitions that were probable in this period).

For example, if a registration statement became effective on 29 January 20X3 and the 31 December 20X2 Form 10-K was filed on 27 February 20X3, the registrant would be required to aggregate insignificant completed and probable acquisitions for the period 1 January 20X2 through 29 January 20X3.

If the aggregate significance of these acquisitions exceeds 50% for any of the three tests, the rules require a registrant to include in a registration statement pro formas that depict the aggregate effect of all individually insignificant acquisitions in all material respects. Rule 3-05 financial statements (covering the most recent fiscal year and interim period) for any of these acquisitions that exceed 20% must also be included.

To calculate the aggregate significance for each test, a registrant generally treats the businesses acquired or being acquired as if they are a single business. For the asset and investment tests, the registrant simply adds together the individual significance test results of each business. For the income test, the registrant uses the same approach for each component of the test (i.e., revenue and income) if all businesses being aggregated reported income (or if all business being aggregated reported losses), and the lower result of the two components is the aggregate significance. The revenue component can only be used if both the registrant and the aggregated businesses (together as if they are a single business) had material revenue during the past two fiscal years.

However, if some of the businesses being aggregated reported income during their most recent fiscal year, two calculations are necessary. Aggregate significance under both the revenue and income components is calculated separately for the businesses that reported income and for those that reported losses. That is, a registrant must aggregate businesses acquired or being acquired into two separate groups: an income group and a loss group.

In addition, the revenue component may apply to one group but not the other. For example, if the income group had material combined revenue for the most recently completed fiscal year and the preceding fiscal year in the aggregate, the revenue component of the income test for this income group is based on the aggregate revenues.

If the loss group did not have material combined revenues for either the recently completed fiscal year or the preceding fiscal year or both, the revenue component of the income test will not apply to the loss group. If the significance of either group exceeds 50%, the disclosure requirements apply to all of the businesses tested (i.e., both the businesses in the income group and the loss group).

Individual businesses in a group of related businesses are treated as a single business and are not separated based on whether they reported income or losses.

A registrant may also need to do more than just add the results used in the original significance tests. If either a registrant or an acquired business has more recent pre-acquisition financial statements available at the time of filing or effectiveness of a registration statement, significance must be recalculated.

Illustration 19 shows an example of a significance test that would need to be recalculated, and Illustration 20 and 21 show how the results of the significance tests are aggregated.

Illustration 19 — Recalculating significance

On 31 January 20X2, Registrant A completed the acquisition of Company B (19% significant) and filed a registration statement on 15 June 20X2. The most recent annual financial statements available at consummation (and used to calculate significance for Form 8-K reporting) were for 20X0 for both Registrant A and Company B.

Registrant A must recalculate the significance of Company B when evaluating individually insignificant acquisitions for its registration statement because the most recent annual pre-acquisition financial statements available at the filing date for both Registrant A and Company B were for 20X1.

Illustration 20 — Individually insignificant acquisitions when all businesses reported income

In 20X2, calendar-year Registrant A completed the acquisition of three businesses, Company B, Company C and Company D, on 15 January, 20 May and 1 November, respectively. On 1 December 20X2, Registrant A enters into a definitive agreement to acquire Company E. Registrant A files a registration statement on 15 December 20X2.

Companies B, C, D and E are unrelated and have calendar year ends. None of them recorded pretax losses in their most recent fiscal year. Registrant A and Company E had material revenue during the last two fiscal years, and the remaining businesses did not. However, Registrant A concluded that the acquired and to-be-acquired companies, when evaluated together as if they were a single entity, did have material revenue during the past two years.

Calculation of aggregate significance:

	Company B	Company C	Company D	Company E	Aggregate significance
Asset test	2%	19%	8%	14%	43%
Investment test	3%	15%	5%	15%	38%
Income test					
Revenue component	N/A	N/A	N/A	30%	30%
Income component	2%	15%	21%	27%	65%
Individual significance	3%	19%	21%	27%	–

Aggregate significance is 30% using the revenue component of the income test and the other two tests are below 50%. As a result, Registrant A has no obligation to provide any Rule 3-05 financial statements or pro formas in its registration statement. If aggregate significance were above 50%, Registrant A would need to include in its registration statement Rule 3-05 financial statements covering at least the most recent fiscal year and interim period for individually significant Companies D and E and pro formas that show the material effects of all the acquisitions.

Illustration 21 — Individually insignificant acquisitions when some businesses reported income and some reported losses

In 20X2, calendar-year Registrant A completed the acquisition of four businesses, Company B, Company C, Company D and Company E, on 15 January, 20 May, 1 November, 15 November, respectively. On 1 December 20X2, Registrant A enters into a definitive agreement to acquire Company F. Registrant A files a registration statement on 22 December 20X2, and its pretax income from continuing operations attributable to controlling interests was $100 million for the year ended 31 December 20X1.

Companies B, C, D, E and F are unrelated and have calendar year ends. Companies B, C and D had pretax losses, while Companies E and F had pretax income.

To perform the income test, Registrant A aggerates the businesses acquired and being acquired into an income group and loss group. In addition, Registrant A and Company E and Company F in the aggregate had material revenue during the last two fiscal years, while Companies B, C and D did not.

Calculation of aggregate significance:

	Co B	Co C	Co D	Aggregate significance for loss group	Co E	Co F	Aggregate significance for income group
Asset test	10%	19%	8%	37%	13%	14%	27%
Investment test	18%	15%	5%	38%	19%	15%	34%
Income test							
Revenue component	N/A	N/A	N/A	N/A	15%	30%	45%
Income component	16%	15%	21%	52%	28%	27%	55%
Individual significance	18%	19%	21%	–	19%	27%	–

Since the aggregate significance of the loss group is greater than 50% (i.e., 52%) using the income component of the income test, Registrant A is required to include in its registration statement Rule 3-05 financial statements covering at least the most recent fiscal year and interim period for individually significant Companies D and F and pro formas that show the material effects of all the acquisitions (companies B, C, D, E and F).

How we see it

Because the requirement to provide pro formas that reflect individually insignificant acquisitions is qualified by materiality (i.e., in all material respects), we believe that a registrant can make judgments regarding which acquisitions to include. For example, Registrant A in Illustration 20 might conclude that including Company B is not necessary to show the material effects of all the transactions.

There may be instances of pro formas depicting the financial information of businesses that have not had their historical financial statements audited or reviewed. In this situation, a registrant should work closely with its auditor to determine what additional procedures the auditor may need to perform to provide negative assurance on the pro formas in a comfort letter.

When conducting a shelf offering, a registrant must consider whether individually insignificant acquisitions aggregate to constitute a fundamental change.

When conducting a shelf offering, a registrant must consider whether individually insignificant acquisitions in the aggregate constitute a fundamental change. To make this determination, a registrant should consider the individually insignificant acquisitions that occurred after the effective date of the shelf registration statement, combined with individually insignificant acquisitions that occurred after the most recent audited balance sheet in the shelf registration statement but before its filing or effective date. If a fundamental change occurred, Rule 3-05 financial statements of the businesses that are more than 20% significant and pro formas that show the material effects of all the individually insignificant acquisitions must be filed prior to conducting the offering.

3.2.4 Acquired business included in registrant's post-acquisition audited financial statements

Rule 3-05 financial statements and pro formas may be omitted from a registration statement for a business that is more than 20% significant but not more than 40% significant if the business has been included in the registrant's audited results for at least nine months. The financial statements and pro formas may be omitted for a business that exceeds 40% significance, but only if the business has been included in the registrant's audited results for a full fiscal year.

Illustration 22 — Acquired business included in post-acquisition audited results

On 31 March 20X2, Company A, a calendar-year company, acquired Company B, a calendar-year company, and concluded that it is 25% significant. On 5 April 20X3, Company A files an initial registration statement on a Form S-1, and its 20X2 audited financial statements include the results of Company B for nine months. The registration statement does not need to include Rule 3-05 financial statements or pro formas that reflect Company B.

However, if Company B were 45% significant, Company A would need to include Rule 3-05 financial statements of Company B for 20X1 and 20X0 and pro formas, because it would not have included Company B in its audited results for a full fiscal year.

To meet the conditions for omission, a registrant cannot include audited financial statements of the acquired business for a pre-acquisition stub period during the year of acquisition. That is, Company A in Illustration 22 could not use the audited results of Company B (45% significant) for the first quarter of 20X2 and combine them with its post-acquisition results to arrive at the full fiscal year necessary to omit the required Rule 3-05 financial statements.

In addition, the rules do not contemplate using post-acquisition audited results to reduce the number of audited periods required.

How we see it

Registrants that don't qualify for omission may want to contact the SEC staff to discuss potential relief. For example, it may not be necessary to provide Rule 3-05 financial statements and pro formas when a 25% significant business is included in a registrant's post-acquisition results for nearly nine months (e.g., if the period is short of nine months by just a few days).

In addition, it may satisfy investors and be more cost-effective for a registrant to provide audited financial statements of a stub period during the year of acquisition rather than for another full year. For example, the Company A in Illustration 22 could ask the SEC staff if it could provide audited financial statements of Company B (45% significant) for the first quarter of 20X2 and all of 20X1 rather than for fiscal years 20X1 and 20X0. See discussion below for further details on the periods required to be presented in Rule 3-05 financial statements.

3.2.5 Second-tier acquisitions (added April 2023)

Rule 3-05 does not address whether separate Rule 3-05 financial statements are required for recent acquisitions made by an acquiree (i.e., a "second-tier" acquisition). The SEC staff has indicated that neither are required, unless their omission would render the acquiree's financial statements misleading or substantially incomplete.

3.3 Merger proxy statements (added April 2023)

Depending on state laws and the articles of incorporation, a registrant often needs shareholder approval for merger and consolidation transactions. Item 14 of Schedule 14A requires financial statements of the registrant, and any respective acquisition target, to be included in the proxy statement, if action is to be taken with respect to any transaction involving:

- The merger or consolidation of the registrant into or with any other company or of any other company into or with the registrant
- The acquisition by the registrant, or any of its security holders, of securities of another company
- The acquisition by the registrant of any other business or its assets
- The sale or other transfer of all or any substantial part of the assets of the registrant
- The liquidation or dissolution of the registrant

The requirements for financial statements of acquisition targets in a merger proxy statement are similar to those in a Form S-4 filing (see section 3.4). In the following circumstances, Instructions 2 through 4 of Item 14 provide relief with respect to the financial statement requirements of the acquirer and/or the target:

- If the transaction is a cash merger or third-party cash tender offer, the acquirer's financial statements are not required, unless the information is material to an informed voting decision (e.g., the target's shareholders are voting and financing is not assured).

Additionally, if only the shareholders of the target are voting, financial statements of the target are not required. However, if the transaction is a going-private transaction, financial statements of the target must be provided.

- If the transaction includes the offer of securities exempt from registration under the Securities Act or includes a combination of exempt securities and cash to the target's shareholders, and only the shareholders of the acquirer are voting, the acquirers financial statements are not required (unless the information is material to an informed voting decision).
- If only the shareholders of the target are voting, financial statements of the target are not required, and financial statements of the acquirer are generally required regardless of whether the acquirer is a reporting or non-reporting company. However, financial statements of the target must be provided if the transaction is a going-private or a roll-up transaction.
- Financial statements for either the acquirer or the target are not required if the vote only involves the acquirer's merger and one or more of its wholly owned subsidiaries.

However, depending on the target's significance to the registrant, the target's audited financial statements still may be required to be filed in a Form 8-K upon consummation of the acquisition.

If the consideration to be issued in the business combination includes registered securities, registrants must comply with the financial statement requirements of Form S-4 or Form F-4, respectively (see section 3.4).

3.3.1 Acquired business financial statements of registrant and/or target (added April 2023)

In addition to the financial statements of the target, Item 14 of Schedule 14A requires Rule 3-05 financial statements with respect to transactions other than those on which action is being taken. Specifically, the proxy materials must include financial statements of acquired or to-be-acquired businesses of (1) the registrant, if the financial statements of the registrant are required in the proxy statement, or (2) a reporting target, if the financial statements of the reporting target are required in the proxy statement.

When a reporting target company is permitted to omit its financial information from its proxy materials, the SEC staff has indicated that the reporting target still should furnish the financial statements and related pro forma financial information required by Rule 3-05 and Article 11 in its proxy materials if that financial information previously has not been filed (e.g., the proxy mailing date falls within the 71-day Form 8-K extension). The SEC staff believes that this information would be material to an informed voting decision.

The SEC staff also has indicated that the same analysis applies to the omission of financial information about the acquirer when only the acquirer's security holders are voting. That is, the acquirer still should furnish the financial statements and related pro forma financial information required by S-X Rule 3-05 and Article 11 in its proxy materials if that financial information previously has not been filed, regardless of whether the acquirer omits its own audited financial statements from its proxy materials when allowed.

When the acquirer's financial statements are required in an all-cash transaction (e.g., because the target's shareholders are voting and financing is not assured), the SEC staff has indicated that the proxy materials must include financial statements required by Rule 3-05 and related pro forma financial information. However, if only the target's shareholders are voting, the SEC staff has indicated that it may grant relief with respect to the acquirer's Rule 3-05 financial statements that previously have not been filed when those financial statements are not material in assessing the acquirer's financial ability to satisfy the terms of the transaction.

3.4 Registration statements on Forms S-4 and F-4 (added April 2023)

If a merger requires the registrant to exchange its securities for the securities or assets of another company, the securities to be issued usually are registered under the Securities Act using Forms S-4 and F-4. In these situations, the proxy statement becomes the basis for the prospectus, and some additional information is added. Thus, the registration statement is "wrapped around" the proxy statement (i.e., the joint statement will serve as the proxy statement and the prospectus relating to the offer of the securities).

The financial statement requirements of a target on Form S-4 are separate from the financial statement requirements of completed and probable business combinations under Rule 3-05. Generally, financial statements of the target must be provided, regardless of the target's level of significance. The financial statement requirements of the target are summarized in Items 15, 16 and 17 of Forms S-4 and F-4 and depend on, among other things, whether the target is a reporting company or a non-reporting company as discussed further below.

In addition to the financial statements of the target, Form S-4 also requires Rule 3-05 financial statements with respect to other acquisition transactions of the registrant or the target. Specifically, the Form S-4 must include financial statements of acquired or to-be-acquired businesses of (1) the registrant, (2) a reporting target and (3) a non-reporting target when the acquirer's shareholders are voting and omission of the Rule 3-05 financial statements would render the non-reporting target's financial statements misleading or substantially incomplete.

The SEC staff has indicated that the Form S-4 must include pro forma financial information prepared in accordance with Article 11 of Regulation S-X only if the proposed acquisition is significant under Rule 3-05.

3.4.1 Target is a reporting company (added April 2023)

If the target is a reporting company (regardless of whether the acquirer's shareholders are voting), Item 17(a) of Form S-4 requires the Form S-4 to include the following S-X compliant financial statements of the target:

- Audited balance sheets as of the two most recent fiscal years
- Audited statements of comprehensive income, changes in stockholders' equity and cash flows for each of the three most recent fiscal years (two most recent fiscal years for a target smaller reporting company (SRC) or an EGC prior to filing its first Form 10-K)
- Unaudited interim information as recent as that required by Form 10-Q for the target, except that interim information need only include cumulative year to date interim information for the current fiscal year and corresponding interim period of the prior fiscal year

3.4.2 Target is a non-reporting company (added April 2023)

Under Item 17(b) of Form S-4, when a non-reporting target is being acquired in a stock merger or stock tender offer transaction, the annual financial statement requirements of the target depend on (1) whether the acquirer's security holders are voting on the transaction and (2) the significance of the non-reporting target to the acquirer.

Furthermore, the audit requirement depends on whether the Form S-4 will be used to register securities for resale to the public by any person who is deemed an underwriter. Outside legal counsel generally assists registrants in determining whether there will be resales by persons deemed to be underwriters.

3.4.2.1 Non-reporting target and acquirer's security holders are voting

If the acquirer's security holders are voting on the transaction, the annual financial statements of the non-reporting target would be required as if the target was issuing an annual report to shareholders under Rules 14a-3(b)(1) and (b)(2) (i.e., for three years, unless the target would qualify as an SRC, in which case two years).

If the Form S-4 will be used to register securities for resale to the public by any person who is deemed an underwriter within the meaning of Exchange Act Rule 145(c), the financial statements of the non-reporting target must be audited only for the periods required under Rule 3-05. Otherwise, financial statements of the non-reporting target must be audited for the latest fiscal year only to the extent practicable, and the financial statements for years prior to the most recent fiscal year need not be audited if they were not previously audited. In these circumstances, if the target exceeds 40% significance, the SEC staff may require representation from the registrant's legal counsel that the Form S-4 will not be used for resale by underwriters.

However, because the registrant still needs to report the acquisition and file Rule 3-05 financial statements for the target on a Form 8-K after consummation of the acquisition (see section 3.1), registrants should consider obtaining audited financial statements of the target for the periods that ultimately will be required based on its significance.

In order to determine whether an audit is practicable, the SEC staff believes that the registrant must weigh the feasibility and expense of the audit against the usefulness of the audit to the target's security holders. If the target is not closely held by insiders (e.g., more than 15 shareholders), the SEC staff ordinarily will require an audit of the most recent year's financial statements.

3.4.2.2 Non-reporting target and acquirer's security holders are not voting

If the acquirer's security holders are not voting on the transaction, and the non-reporting target is not in excess of 20% significant to the acquirer, no financial information (including interim financial statements, pro forma information, or financial statement schedules) for the target company is required. However, registrants will continue to have the obligation under Rule 3-05 to evaluate individually insignificant acquisitions in the aggregate, including the insignificant target when acquired in connection with any subsequent registration statement.

If the acquirer's security holders are not voting on the transaction, but the non-reporting target is in excess of 20% significant to the acquirer, annual financial statements of the target for the most recent fiscal year are required in the Form S-4. In addition, if the target has provided its security holders' GAAP financial statements for either or both of the two fiscal years prior to the most recent fiscal year, financial statements for those years are required as well. Further, if the Form S-4 will be used to register securities for resale to the public by any person who is deemed an underwriter within the meaning of Exchange Act Rule 145(c), the financial statements of the non-reporting target must be audited for the periods required under Rule 3-05. Otherwise, financial statements of the non-reporting target for the latest fiscal year must be audited only to the extent practicable and the financial statements for the two years prior to the most recent fiscal year need not be audited if they were not previously audited. However, in these circumstances, if the target exceeds 40% significance, the SEC staff may require representation from the registrant's legal counsel that the Form S-4 will not be used for resale by underwriters. In addition, the registrant will continue to have the obligation to provide audited financial statements of the target in a Form 8-K upon consummation of the acquisition for the periods required under S-X Rule 3-05 based on the significance of the target company.

3.5 Inability to comply with Rule 3-05 (added April 2023)

If a registrant is unable to provide the audited financial statements and pro forma financial information of a significant acquired business as required by Items 2.01 and 9.01 of Form 8-K, the Form 8-K would be considered deficient and, therefore, not filed in a timely manner for purposes of Form S-3 eligibility.

Until the registrant has filed audited financial statements including the operations of the acquired business for the required periods, registration statements under the Securities Act and post-effective amendments to registration statements may not be declared effective without the required Rule 3-05 financial statements and pro formas.

In addition, the offering restrictions described in section 3.2.1 apply.

How we see it

To avoid the consequences of not being able to comply with Rule 3-05, registrants should make sure they have the right to use or obtain any prior financial statements or accounting records of the acquired business. We recommend that purchase agreements state that the registrant will have access to the acquired business's financial statements and accounting records and that its audited financial statements are compliant with the SEC requirements for acquiree financial statements (see section 6).

Such considerations may be applicable for an insignificant acquisition since financial statement requirements under Rule 3-05 may be applicable at a later date when individually insignificant acquisitions become material in the aggregate.

4 Content of Rule 3-05 financial statements

A registrant that needs to present Rule 3-05 financial statements of a significant acquired business must then determine how many years of audited statements are required, how recent the financial statements must be and which unaudited interim statements are required, if any. A registrant also must comply with most of the form and content requirements of Regulation S-X.

4.1 Annual audited and unaudited interim periods

The number of audited years and unaudited interim periods that must be presented in the Rule 3-05 financial statements is determined by the significance level of the acquired business:

Significance level	Annual and interim periods
Exceeds 20% but not 40%	Most recent fiscal year and most recent year-to-date interim period
Exceeds 40%	Two most recent fiscal years and most recent year-to-date interim period with a comparative prior period

As discussed above, Rule 3-05 financial statements for individually insignificant acquisitions only need to cover the most recent fiscal year and year-to-date interim period. In addition, the periods required may be shorter if the acquired business only existed for part of those periods.

Rule 3-06 of Regulation S-X allows an audited period to cover a period from nine to 12 months and still count as a full year when only one year of Rule 3-05 financial statements is required or when two years are required and the other year presented is a full fiscal year.

Illustration 23 — Audited period covering nine months

Calendar-year Registrant A acquires Company B on 1 January 20X3. Company B has a calendar year end and is significant at the 45% level. Therefore, Registrant A's Form 8-K must include two years of audited financial statements of Company B and the most recent year-to-date interim period with a comparative prior period.

Instead of providing (1) audited financial statements of Company B as of and for the two years ended 31 December 20X1, and (2) interim financial statements as of and for the nine months ended 30 September 20X2 and statements of income and cash flows for the corresponding interim period of the prior fiscal year, Registrant A may provide audited balance sheets as of 30 September 20X2 and 31 December 20X1, and audited statements of income and cash flows for the year ended 31 December 20X1 and nine months ended 30 September 20X2.

Note: If Registrant A files a registration statement in April 20X3, it must provide audited financial statements for the year ended 31 December 20X2. It would not be appropriate to provide unaudited interim financial statements for the fourth quarter.

In accordance with S-X Rule 3-05(b)(4)(iv), a separate audited balance sheet of the acquired business is not required if the date of a registrant's audited annual balance sheet is after consummation of the acquisition.

In addition, the SEC staff does not consider the filing of acquired business financial statements with other governmental agencies (e.g., Office of the Comptroller of the Currency, Office of Thrift Supervision) to be "filed" for purposes of Rule 3-05.

5 Age of Rule 3-05 financial statements

5.1 General requirements

To determine which annual and interim periods to include in Rule 3-05 financial statements, a registrant considers how recent the financial statements must be. The so-called age requirements for the financial statements depend primarily on whether they are filed in a Form 8-K or registration statement/proxy statement, the consummation date, the acquired business's filer status and its fiscal year end.

Generally, the most recent balance sheet in Rule 3-05 financial statements can be no more than 134 days old (129 for an acquired business that is an accelerated or large accelerated filer) on the earlier of the filing or due date of the initial Item 2.01 Form 8-K or on the filing and effective date of a registration statement or date the proxy statement is mailed. Rule 3-05 financial statements can be older when an acquired business just passed its fiscal year end as discussed further below.

These age requirements generally apply to both acquired businesses and registrants. When a registrant acquires another public company, the financial statements of the acquired business can be incorporated by reference from the timely filed annual report on Form 10-K and quarterly report on Form 10-Q of the acquired business.

5.2 Form 8-K

The most recent balance sheet for Form 8-K must be no older than 134 or 129 days when the registrant initially reports the transaction under Item 2.01, depending on the filer status of the acquired business. However, Rule 3-05 financial statements for an acquired business's third quarter can be used in Form 8-K if the Item 2.01 was filed no later than:

- 89 days after fiscal year end, if the business is a non-accelerated filer (including acquired businesses that are not public companies)
- 74 days after fiscal year end for an accelerated filer
- 59 days after fiscal year end for a large accelerated filer

A Form 8-K that would be due on a weekend or federal holiday is due the next business day.

The following illustration shows how the Form 8-K age requirements would change, depending on the acquired business's filing status.

Illustration 24 — Age of Rule 3-05 financial statements in Form 8-K

Assume that Registrant A acquires Company B on 25 March 20X3 and determines that Company B is 25% significant. The table below shows how the age requirements for Rule 3-05 financial statements would change, depending on Company B's filing status.

- The first column shows that, as a non-accelerated filer, Company B's third-quarter financial statements can be used because the Item 2.01 Form 8-K is filed within 89 days after its fiscal year end.
- The second column shows how the answer changes if Company B is an accelerated filer because the Item 2.01 Form 8-K is filed more than 74 days after its fiscal year end.

In calculating the dates, we assumed that both companies have calendar year ends and all dates presented are neither holidays nor weekends.

	Non-accelerated	Accelerated
Consummation	25 March 20X3	25 March 20X3
89 or 74 days after Company B's year end	30 March 20X3	15 March 20X3
Item 2.01 filing	29 March 20X3	29 March 20X3
Annual period required	20X1	20X2**
Interim period required	30 September 20X2*	None

* The financial statements of Company B (as a non-accelerated filer) might need to be updated if Registrant A files a subsequent registration statement.

** A registration statement would not trigger an update to Company B (as an accelerated filer) because Company B's 20X2 financial statements are the most recent pre-acquisition financial statements that could be provided.

5.3 Registration and proxy statements

The age requirements for financial statements of significant acquired businesses are generally the same as they are for registrants.

Rule 3-05 financial statements provided in a registration statement must adhere to the same general age requirements as for Form 8-K, but age is determined using the filing and effective dates, and the requirements for updating the third quarter are different. The age determinations for registration statements can result in a registrant updating the Rule 3-05 financial statements after filing them in a Form 8-K or between the filing and effective dates of a registration statement.

Under Rule 3-12(b) of Regulation S-X, Rule 3-05 financial statements for the third quarter can be used in all cases when the filing of a registration statement or the effective date is no later than 45 days after the acquired business's year end.

If the filing or effective date is more than 45 days but less than 90 days after year end, the acquired business's third-quarter financial statements can be used for the same number of days as under Form 8-K (89, 74 or 59 days after the acquired business's fiscal year end, depending on its filer status) if the **registrant** meets all of the following conditions in S-X Rule 3-01(c):

- Files annual, quarterly and other reports under Sections 13 or 15(d) of the Exchange Act, and all reports have been filed
- Expects to report income attributable to the registrant after taxes for the fiscal year just ended
- Reported income attributable to the registrant after taxes for one of the two fiscal years preceding the year just ended

The first condition above prevents companies conducting IPOs (except for SRCs) from relying on the third-quarter financial statements in this situation.

If the filing or effective date is 90 days or more after the acquired business's year end, the Rule 3-05 financial statements must be updated for that year. If audited Rule 3-05 financial statements for the recently completed fiscal year are available, a registrant must provide them even if the age requirements described above allow it to rely on third-quarter statements.

Illustration 25— Age of Rule 3-05 financial statements in a registration statement
Assume that Registrant A determines that the acquisition of Company B, a private company that is 25% significant, is probable and files a registration statement on 20 February 20X3 that becomes effective on 31 March. Both companies are calendar year-end companies, and all dates presented are neither holidays nor weekends. Registrant A has met the conditions of S-X Rule 3-01(c) because it has filed all of its Exchange Act reports, reported income in 20X1 and expects to report income again in 20X2. In its registration statement filed on 20 February 20X3, Registrant A can include Rule 3-05 financial statements of Company B for 20X1 along with interim financial statements for the nine months ended 30 September 20X2 because the filing date is within 89 days after Company B's fiscal year end, and Registrant A has met the conditions of S-X Rule 3-01(c). However, Registrant A must update Company B's audited financial statements to include 20X2 if its registration statement becomes effective more than 89 days after Company B's fiscal year end.

How we see it

In limited circumstances, if the registrant does not meet the conditions of S-X Rule 3-01(c), it may be required to include audited financial statements of the acquired business as of a date more recent than the financial statements of the registrant.

If the registrant believes that providing updated audited financial statements of the acquired business would impose an unreasonable burden under the circumstances, the registrant may submit a pre-filing letter seeking relief from the SEC staff, as long as the acquired business's financial statements are updated on an unaudited basis through either the registrant's latest balance sheet date or the acquired business's year end.

Illustration 26 — Application of S-X 3-01(c) resulting in Rule 3-05 financial statements more current than the registrant
A non-S-X Rule 3-01(c) eligible Registrant acquires Company A, a non-accelerated filer, on 15 January 20X3. Company A has a 30 November year end and is significant at the 55% level. If the effective date of Registrant's registration statement is 3 February 20X3, the most recent audited financial statements of Registrant included the registration statement would be as of and for the year end 31 December 20X1. Unless a waiver is obtained from the SEC staff, the registration statement must include Rule 3-05 financial statements of Company A as of and for the years ended 30 November 20X2 and 20X1, because 3 February 20X3 is more than 45 days after Company A's year end, and Registrant does not meet the conditions of S-X Rule 3-01(c).

6 Regulation S-X presentation requirements

The financial statement requirements for significant acquired businesses or probable acquisitions of significant businesses are generally the same as those required for registrants. That is, Rule 3-05 financial statements must comply with S-X Article 3, which requires balance sheets, statements of comprehensive income, statements of changes in stockholders' equity, statements of cash flows and the footnote disclosures described in S-X Rule 4-08. The balance sheets and statements of comprehensive income must also be classified in accordance with S-X Rules 5-02 and 5-03, respectively.

However, a separate audited balance sheet of an acquired business is not required if the acquisition occurred before the date of a registrant's most recent audited annual balance sheet filed with the SEC, and interim financial statements can use the exceptions provided to registrants in S-X Article 10, and the schedules required by S-X Article 12 are not required.

6.1 Accounting principles

An acquired business that is not a registrant but has its financial statements included in a registrant's SEC filing because it is a significant acquired business meets the definition of a public business entity (PBE) in US GAAP, for purposes of the filing.

Therefore, an acquired business cannot elect in its Rule 3-05 financial statements to use the accounting alternatives developed by the Private Company Council (PCC). As a result, an acquired business that previously used PCC accounting alternatives would need to retrospectively unwind that accounting. For example, an acquired business that previously elected to amortize goodwill would need to retrospectively adopt ASC 350, *Intangibles — Goodwill and Other*, to remove the amortization and perform impairment tests before its financial statements could be used in an SEC filing.

In addition, an acquired business would generally be expected to apply new accounting standards consistent with the timing for PBEs that are not SEC filers.

How we see it

Registrants should carefully consider the transition provisions of new accounting standards because transition provisions can vary. If an acquired business fails to adopt a standard on time, the SEC may consider the filing that includes the Rule 3-05 financial statements to be deficient.

An acquired business that is not already a public company is also exempt from providing certain disclosures. Examples include segment information under ASC 280, earnings per share (EPS) information under ASC 260, and certain disclosures about pensions and other postretirement benefits under ASC 715.

As discussed in section 2, *Significance*, related businesses must be treated as a single acquisition. However, even though the related businesses are combined for purposes of determining significance, the financial statements of the related businesses, if required, may only be presented on a combined basis if the criteria specified in ASC 810, *Consolidation* (i.e., common management or common control), are met. Otherwise, separate audited financial statements must be provided for each business.

6.2 Audit requirements and interim reviews

Auditor's reports for acquired businesses that are not registrants must refer to the standards issued by the American Institute of Certified Public Accountants (AICPA). In addition, auditors of acquired businesses that are not registrants only need to comply with the AICPA independence rules and do not need to be independent under SEC or Public Company Accounting Oversight Board (PCAOB) rules.

Although there is no requirement for an auditor to perform interim review procedures over an acquired businesses' interim financial statements, such a review is often performed when a comfort letter is being issued by the auditor. An auditor also will perform certain procedures over interim financial information when the information accompanies the annual financial statements and the auditor is performing post-report review procedures.

6.3 Financial statements of foreign acquired businesses

S-X Rule 3-05(c) allows a domestic registrant to provide Rule 3-05 financial statements of an acquired business that qualifies as a foreign business (as defined in 1-02(l) of Regulation S-X) prepared in accordance with IFRS-IASB without reconciliation to US GAAP. If the acquired foreign business's financial statements are prepared using home-country GAAP, that fact must be disclosed in the auditor's report (or in a reasonably prominent headnote before the financial statements), and a description of the material variations between home-country and US GAAP must be provided. In addition, reconciliations to US GAAP that comply with Item 17 of Form 20-F must be provided if the significance of the foreign business exceeds 30%. A registrant can also rely on the age requirements in Item 8 of Form 20-F for the Rule 3-05 financial statements rather than the age requirements described above.

Additionally, the SEC staff allows financial statements of acquired businesses that meet the definition of a foreign business to be prepared under International Financial Reporting Standards for Small and Medium-sized Entities (IFRS for SMEs), published by the IASB in July 2009, with reconciliation to US GAAP. The SEC staff would not accept financial statements prepared under IFRS for SMEs for predecessors of issuers.

If a business acquired by a domestic registrant is not a foreign business but would qualify as a foreign private issuer (as defined in Regulation C, Rule 405 and Exchange Act Rule 3b-4) if it were a registrant, Rule 3-05(d) allows that the financial statements prepared using IFRS-IASB would also satisfy Rule 3-05. However, the reconciliations to US GAAP required when home-country GAAP is used must comply with Item 18 of Form 20-F and must be provided regardless of significance. In addition, Item 18 requires the inclusion of all US GAAP and Regulation S-X disclosures that apply to acquired businesses. The age requirements in Item 8 of Form 20-F do not apply, but a registrant can contact the SEC staff to ask for permission to rely on them.

If a registrant is a foreign private issuer, the financial statements of an acquired business that qualifies as a foreign business or would qualify as a foreign private issuer can be reconciled to either US GAAP or IFRS-IASB under Item 17 of Form 20-F if home-country GAAP is used to prepare the financial statements.

The financial statements prepared in accordance with this section may be presented in the reporting currency of the registrant or that which the acquired business normally uses to prepare its financial statements.

The accommodations described in this section are not available to acquired businesses that are deemed predecessors.

In some situations, such as when only one year of Rule 3-05 financial statements is required, a complete set of financial statements (as defined in IFRS-IASB) would not be required by SEC rules. A single year of Rule 3-05 financial statements prepared in accordance with IFRS-IASB would receive a qualified auditor's opinion due to the lack of a comparative period as required by IFRS-IASB, but the SEC staff does not object to the inclusion of auditor's reports that are qualified solely for this reason.

How we see it

Acquiring a business based in a foreign country can be complex because the SEC only partially conformed the reporting requirements for a foreign business as defined by S-X Rule 1-02(l) and a business that would qualify as a foreign private issuer. As result, the first step when acquiring such a business is to determine whether it qualifies under these terms. Once that is determined, a registrant should determine what financial statements might already be available and evaluate how best to meet the requirements that apply to the type of business acquired.

Further, registrants that have audited financial statements available for a foreign target may still need to obtain a re-audit under the AICPA or PCAOB auditing standards if those financial statements were previously audited using international or other non-US auditing standards.

6.4 Acquiring a component of a seller

When a registrant acquires "substantially all" of a seller, the SEC staff expects the registrant to provide full financial statements of the selling entity. In these cases, the SEC staff believes that full audited financial statements of the seller are necessary to provide investors with a complete financial history of the acquired business, and any assets and liabilities that are not acquired or assumed would be removed as part of the pro forma presentation.

In these situations, any adjustments relating to specific assets and liabilities not acquired or assumed by the registrant would be reflected in the Article 11 pro forma financial statements.

However, when a registrant does not acquire substantially all of a seller (e.g., it acquires a subsidiary, division, product line), the SEC staff has said it will not accept full financial statements of the selling entity because they wouldn't provide useful information about the acquired business and could be misleading. In these cases, registrants should provide either carve-out or abbreviated financial statements, depending on the facts and circumstances.

6.4.1 Carve-out financial statements

Carve-out financial statements are typically provided when a registrant acquires less than substantially all of a seller, but the transaction does not meet the conditions described below to present abbreviated financial statements. The SEC has not provided specific guidance regarding when carve-out financial statements should be provided or how to prepare them. Refer to our ***Guide to preparing carve-out financial statements*** for additional information.

6.4.2 Abbreviated financial statements

If certain conditions are met, the registrant may provide audited abbreviated financial statements (i.e., statements of assets acquired and liabilities assumed and direct revenues and expenses) of an acquired business. This often occurs when the registrant acquires a product line or contract that will be integrated into its business.

Under Rule 3-05(e), registrants can provide abbreviated financial statements of an acquired business when all the following conditions are met:

- The total assets and total revenue (after intercompany eliminations) of the acquired business constitute no more than 20% of the total assets and total revenue of the seller for the most recently completed fiscal year.

- The acquired business was not a separate entity, subsidiary, operating segment (as defined by US GAAP or IFRS-IASB) or division during the periods for which financial statements are required.
- Separate financial statements for the business have not previously been prepared, the seller has not maintained the separate accounts necessary to present full financial statements of the business, and it is impracticable to prepare such financial statements.

Abbreviated financial statements must include substantially all expenses incurred by or on behalf of the acquired business during the pre-acquisition financial statement periods presented, including costs of sales or services, selling, distribution, marketing, general and administrative, depreciation, amortization, and research and development expenses. Corporate overhead allocations, interest expense for debt that will not be assumed by the registrant and income tax expense can normally be excluded.

The notes to the abbreviated financial statements must identify the omitted expenses, explain the reason for the omission and disclose the impracticability of preparing financial statements that include the omitted expenses. A registrant must also disclose that the statements are not indicative of the future financial condition or operating results of the acquired business. In addition, a statement of cash flows is not required when abbreviated financial statements are presented. However, registrants must provide in the notes to the financial statements information about the operating, investing and financing cash flows of the acquired business to the extent it is available.

A statement of cash flows is not required in abbreviated financial statements.

Illustration 27 — Product line

Registrant acquired the XYZ product line from Company A, which included the customer base, trademarks and operating rights specific to that product line. However, because Registrant has its own production facility and sales force, it did not acquire the manufacturing facility, employee base or sales force of the XYZ product line. In addition, Registrant acquired certain accounts receivable and inventory specific to the XYZ product line.

Registrant concluded that the acquisition of the XYZ product line met the definition of a business pursuant to S-X Article 11-01(d) and all qualifying conditions specified in S-X Rule 3-05(e)(1). Therefore, it may present a statement of assets acquired and liabilities assumed and a statement of direct revenues and expenses.

Although Registrant did not acquire the manufacturing facility or sales force of the XYZ product line, the SEC staff would require that the historical production and selling costs be reflected in the statement of direct revenues and expenses because these costs are directly attributable to the revenue producing activity.

Rule 3-05(f) also allows a registrant to present abbreviated financial statements of an acquired business engaged in oil- and gas-producing activities, which must include certain industry-specific disclosures specified in ASC 932, *Extractive Activities — Oil and Gas*.

How we see it

While registrants do not have to request SEC staff permission to provide abbreviated financial statements if the conditions described above are met, there may be other situations in which abbreviated financial statements would provide sufficient disclosure for investors, even though the conditions have not been met.

Registrants that believe this is the case should consider contacting the SEC staff and requesting permission to provide abbreviated financial statements.

7 Pro forma financial information

7.1 Overview

Generally, pro formas are required in Form 8-K, registration statements and proxy statements for significant acquisitions and disposals. Pro formas for an acquired business combine the pre-acquisition historical financial information of the registrant and the acquired business to show how the balance sheet and results would have looked if the transaction had occurred earlier. This helps investors consider the expected effect on a registrant's financial statements of a recent or probable acquisition.

Article 11 of Regulation S-X, *Pro forma financial information*, describes the requirements for registrants to provide pro formas.

While registrants can provide projections of future performance in lieu of pro forma income statements if the projections comply with the requirements of Regulation S-X Rule 11-03, projections are rarely provided.

Pro formas that comply with the requirements of Article 11 of Regulation S-X must accompany Rule 3-05 financial statements of acquired businesses. Pro formas can reflect acquisitions of businesses for which Rule 3-05 financial statements are not required, such as individually insignificant businesses reported in a registration statement or acquisitions that occurred earlier than one required to be reported on Form 8-K.

How we see it

Companies that make more than one significant acquisition in any given year have to file a Form 8-K for every significant acquisition, and they should consider reflecting all of the significant acquisitions that have already occurred in pro formas included in each Form 8-K they file. The rules don't require that treatment, but companies typically do this to more easily comply with registration statement requirement as well as it being encouraged by the SEC staff.

7.2 Required statements in pro forma financial information

7.2.1 General

A registrant's pro formas for an acquired business typically include an introductory section, the most recent condensed balance sheet, condensed statements of comprehensive income for its most recent annual and year-to-date interim period and explanatory notes. Pro forma statements of other comprehensive income, cash flows or shareholders' equity are not required.

The pro forma financial statements are presented in columnar form with separate columns depicting the historical financial information of the registrant, the historical financial information of the businesses that have been acquired or disposed of (if applicable), the pro forma adjustments and a total or combined column.

Pro forma adjustments may include transaction accounting adjustments to show how a transaction would have affected the historical financial information of the registrant and/or autonomous entity adjustments to show what a new registrant that was part of another entity would have looked like as a standalone entity (e.g., in a spin-off transaction). A registrant can also elect to present management's adjustments that provide supplemental forward-looking information.

The age of the pro forma balance sheet and income statements are determined at the earlier of the filing or due date of the initial Item 2.01 Form 8-K related to the acquisition or disposal and at the filing and effective date of a registration statement (or mailing date of a proxy statement).

When amending an existing registration statement (i.e., post-effective amendment) or filing a new one, a registrant may need to update previously filed pro forma information (e.g., filed on Form 8-K). The pro forma income statements must be kept current in new or amended registration statements until the registrant is able to omit the historical financial statements of the acquired business required by Rule 3- 05 from the registration statement. The pro forma balance sheet must also be updated until the transaction is reflected in the registrant's latest balance sheet filed with the SEC.

7.2.2 *Pro forma balance sheet*

A registrant must include a pro forma condensed balance sheet as of the end of the most recent annual or interim period filed or required to be filed by S-X Rule 3-01. Generally, the historical balance sheet of the acquired business included in the presentation should be as of the same date unless the business has a different fiscal year end.

If the transaction is already reflected in the registrant's latest balance sheet, a pro forma balance sheet is not required. For example, a pro forma balance sheet reflecting a significant acquisition or disposal that closed during the first quarter is not required when a registrant incorporates its first-quarter Form 10-Q by reference into a registration statement.

The pro forma balance sheet can be condensed by combining items that are less than 10% of total assets with others.

Pro formas must be updated if the registrant must update its financial statements to comply with the age requirements in S-X Rule 3-12.

7.2.3 *Pro forma income statements*

Pro forma income statements are required for the registrant's most recent fiscal year and any subsequent year-to-date interim period filed or required to be filed by S-X Rule 3-02. Generally, the historical income statements of the acquired business must be for the same periods unless the business has a different fiscal year end, in which case specific rules apply.

An income statement for the corresponding interim period of the preceding fiscal year is optional. Once the acquired business has been reflected in a registrant's results for an entire period required to be presented in the pro formas, that period should not be presented. In addition, a registrant is able to omit the pro formas related to an acquisition if it can omit the separate financial statements required by S-X Rules 3-05, as discussed in section 3.

S-X Rule 11-02(c)(2) prohibits a registrant from presenting more than one annual period of pro forma results of operations for an acquired business unless the transaction is accounted for as a reorganization of entities under common control under ASC 805 or discontinued operations are not yet reflected in the historical financial statements. In that case, pro forma income statements are required for all annual periods presented in the registrant's financial statements.

Registrants present the pro forma income statements through income (loss) from continuing operations attributable to the registrant. Discontinued operations are excluded. Registrants can also elect to present an allocation of the income or loss to noncontrolling interests. In addition, any income statement caption that is less than 15% of average net income attributable to the registrant for the most recent three fiscal years can be combined with others.

A registrant also must disclose, on the face of the pro forma income statement, basic and diluted earnings per share from continuing operations attributable to the registrant and the number of shares used in the computation, on both a historical and pro forma basis, giving effect only to the pro forma transaction accounting adjustments.

7.3 Additional pro forma guidance and considerations (added April 2023)

Refer to our publication ***Pro form financial information: A guide for applying Article 11 of Regulation S-X*** for additional guidance and considerations when applying the pro forma rules, including various examples of pro forma adjustments and disclosures.

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