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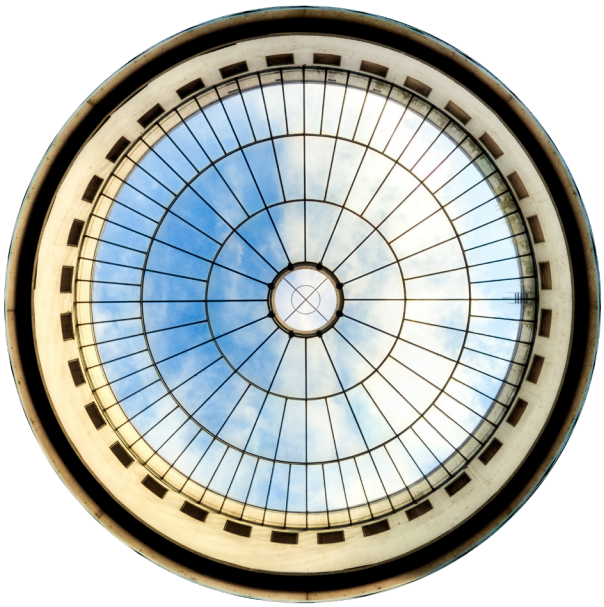

In This Issue

SEC Proposes Improvements to Disclosures for Business Acquisitions and Dispositions

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Introduction

On May 3, 2019, the SEC issued a proposed rule[1] that would amend the financial statement requirements for acquisitions and dispositions of businesses, including real estate operations, and related pro forma financial information. These changes are intended to improve the information investors receive regarding acquired or disposed businesses, reduce complexity and costs of preparing the required disclosures, and facilitate timely access to capital.

The proposed amendments include changes to improve the disclosure requirements for (1) acquired or to be acquired businesses in SEC Regulation S-X, Rule 3-05;[2] (2) real estate operations in SEC Regulation S-X, Rule 3-14;[3] and (3) pro forma financial information in SEC Regulation S-X, Article 11,[4] as well as modifications to the significance tests in SEC Regulation S-X, Rule 1-02(w).[5] In addition, the proposed rule includes amendments to financial disclosures specific to smaller reporting companies[6] (SRCs) and investment companies.[7]

[1] SEC Proposed Rule Release No. 33-10635, *Amendments to Financial Disclosures About Acquired and Disposed Businesses*.
[2] SEC Regulation S-X, Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired."
[3] SEC Regulation S-X, Rule 3-14, "Special Instructions for Real Estate Operations to Be Acquired."
[4] SEC Regulation S-X, Article 11, "Pro Forma Financial Information."
[5] SEC Regulation S-X, Rule 1-02(w), "Definitions of Terms Used in Regulation S-X: Significant Subsidiary."
[6] SRCs, as defined in SEC Regulation S-K, Item 10(f)(1), "General: Smaller Reporting Companies," and issuers relying on SEC Regulation A (collectively referred to as SRCs) should refer to the discussion in the Smaller Reporting Companies section for a summary of how the proposed rule would affect them.
[7] Investment companies registered under the Investment Company Act and business development companies (collectively referred to as investment companies) should refer to the discussion in the Investment Companies section for a summary of how the proposed rule would affect them.

Background and Key Provisions of the Proposed Rule

"[T]he proposed rule amendments . . . eliminate unnecessary costs and burdens of the current rules . . . while at the same time improving the disclosures investors receive." — SEC Chairman Jay Clayton

Rule 3-05 requires registrants, including entities undertaking an initial public offering (IPO), to file the separate preacquisition financial statements for a significant acquired or to be acquired business (acquiree). Similarly, Rule 3-14 may require a registrant to provide preacquisition financial statements for a significant acquired or to be acquired real estate operation (real estate acquiree). The financial statement periods required to be filed are based on the significance levels determined after performing the applicable significance tests in Rule 1-02(w) (i.e., the investment, asset, and income tests). Further, Article 11 requires a registrant to provide pro forma financial information depicting the impact of a significant acquisition or disposition. These disclosures can be important to investors because an acquisition or disposition will generally affect a registrant's financial condition, results of operations, liquidity, and future prospects.

As described in further detail below, key items in the proposed rule would:

- Change the investment test to use aggregate worldwide market value of common equity of the registrant.
- Change the income test to use the lower of (1) income from continuing operations after taxes or (2) revenue.
- Reduce acquiree annual financial statement periods required to a maximum of the two most recent fiscal years.
- Result in fewer circumstances requiring acquiree financial statements for an IPO and for individually insignificant acquirees.
- Permit use of abbreviated financial statements for an acquiree in certain circumstances without a request for SEC staff permission.
- Allow the use of, or reconciliation to, IFRS® Standards as issued by the International Accounting Standards Board (IASB®) (IFRS-IASB) in certain circumstances.
- Amend the pro forma financial information disclosures to require adjustments and certain disclosures for (1) "Transaction Accounting Adjustments" and (2) "Management's Adjustments" (e.g., reasonably estimable synergies and other impacts of the acquisition).
- Align certain requirements for a real estate acquiree with those in Rule 3-05.
- Raise the significance threshold for reporting dispositions of a business from 10 percent to 20 percent to conform the threshold with that of a significant acquisition.
- Make other changes specific to SRCs and investment companies.

While the changes summarized above may be significant for some registrants, many elements of Rule 3-05 would be retained under the proposed rule. Although the significance tests would be modified, the proposed rule would retain certain bright line significance thresholds. The proposed rule explains that bright line tests may allow registrants to evaluate significance more quickly than a model based on judgment would. In addition, the proposed rule would maintain the current definition of a business for SEC reporting purposes. This definition, which is outlined in SEC Regulation S-X, Rule 11-01(d),[8] focuses on the continuity of operations, including revenue-producing activities, before and after the acquisition and is different from the definition in ASC 805[9] or IFRS 3.[10] The proposed rule states that "because the definitions serve different purposes, we have not proposed to conform our rules with the applicable accounting standards." Further, some of the proposed changes may only codify current SEC staff practice or interpretation and thus may not result in a significant change in practice. For more information on Rules 3-05 and 3-14 as well as on Article 11, see Deloitte's *A Roadmap to SEC Reporting Considerations for Business Combinations*.

[8] SEC Regulation S-X, Rule 11-01, "Presentation Requirements."
[9] ASC 805, *Business Combinations*.
[10] IFRS 3, *Business Combinations*.

Connecting the Dots

Although the proposed rule may reduce the financial statement requirements under Rule 3-05 (e.g., by eliminating a third year of acquiree financial statements), it does not extend to (1) target companies included in a proxy statement or registration statement on Form S-4 or (2) a company that is considered the predecessor[11] of a registrant.

Measuring Significance

As noted above, a registrant must perform the following three tests to determine the significance of an acquiree: the investment test, the asset test, and the income test. The test that results in the highest significance level is used to determine whether an acquisition is significant and the financial statement periods that must be presented. These tests are also used to evaluate significance in other circumstances, such as the disposition of a business (see the Disposition of a Business section). The proposed rule would amend the investment and income test but would not modify the asset test.

Connecting the Dots

The significance tests outlined in Rule 1-02(w) are used throughout the SEC's disclosure requirements and regulations, and the proposed rule would retain the consistent application of the significance tests. Thus, the changes described above would also apply when a registrant is evaluating equity method investments for significance to determine the financial statements or financial information required in accordance with SEC Regulation S-X, Rule 3-09,[12] or SEC Regulation S-X, Rule 4-08(g).[13] For more information on Rules 3-09 and 4-08(g), see Deloitte's *A Roadmap to SEC Reporting Considerations for Equity Method Investees*.

Changes to the Investment Test

The investment test currently compares (1) the investment in the acquiree (generally the consideration transferred as measured in accordance with the applicable accounting standards[14]) with (2) the total assets of the registrant as of the end of the most recently completed fiscal year. The proposed rule acknowledges that the current test represents a measure that compares a fair value amount (i.e., consideration transferred) with an amount that often may reflect historical cost (i.e., total assets). The proposed rule would modify the test to compare (1) the investment in the acquiree with (2) the aggregate worldwide market value of the registrant's common equity as of the last business day of the registrant's most recently completed fiscal year as of or before the date of acquisition. If the registrant has no aggregate worldwide market value, the current test would be retained.

Changes to the Income Test

The current income test consists of a single component that is based on income from continuing operations before income taxes (pretax income). This test can often result in a high level of significance if a registrant has breakeven or near breakeven income or loss, and it can also result in the requirement of financial statements that may not be material to investors. To reduce anomalous results that can occur under the income test, the proposed income test would consist of two components: the income component and the revenue component. The registrant would consider both components when evaluating significance and, if it finds the

[11] See paragraph 1170.1 of the SEC Financial Reporting Manual (FRM).
[12] SEC Regulation S-X, Rule 3-09, "Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons."
[13] SEC Regulation S-X, Rule 4-08(g), "General Notes to Financial Statements: Summarized Financial Information of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons."
[14] ASC 805 governs the measurement of consideration transferred unless the registrant is a foreign private issuer (FPI) that reports in accordance with IFRS-IASB, in which case IFRS 3 should be used.

results of both to be significant, would use the lower of the two components to determine the number of periods for which acquiree financial statements are required. Under the proposed test:

- The income component would be determined by comparing the absolute value of the income or loss from continuing operations after income taxes of the acquiree with that of the registrant.
- If both the registrant and the acquiree have recurring annual revenue, the revenue component would be calculated by comparing the registrant's share of the revenue of the acquiree with the registrant's revenue.

The proposed rule would also change the calculation of a registrant's average net income for the last five fiscal years, as currently contemplated in the computational notes to Rule 1-02(w). The proposed rule would require a registrant to use absolute values to calculate its average net income for the last five fiscal years, when applicable. This differs from the existing guidance in paragraph 2015.8 of the FRM, which indicates that "zero" should be used for any loss years in computing the average. This proposed calculation is expected to make the average income test more reflective of relative significance and may increase the registrant's average income for those registrants that have reported losses during the last five fiscal years. However, income averaging would not be available for the income component of the income test if the registrant and the acquiree have recurring annual revenue.

Acquiree Financial Statements

The proposed rule would allow, among other items, a registrant to (1) present fewer acquiree financial statement periods, (2) present acquiree financial statements in fewer circumstances, (3) use abbreviated financial statements without requesting SEC staff permission, and (4) use, or reconcile to, IFRS-IASB in certain circumstances:

Fewer Acquiree Financial Statement Periods Required

- *Changes in annual periods presented* — Currently, Rule 3-05 requires the presentation of three[15] years of audited financial statements of the acquiree when the results of any of the three significance tests exceed 50 percent. Under the proposed rule, the requirement to file the third year of audited financial statements would be eliminated; therefore, the maximum financial statement periods required for an acquiree would be two[16] years.
- *Changes in interim periods presented* — The proposed rule would eliminate the requirement to provide financial statements for the comparative prior-year interim period when only one year of audited acquiree financial statements are required (i.e., when the result of a significance test is greater than 20 percent, but none of the significance test results are greater than 40 percent).

Connecting the Dots

While the SEC rules do not require interim periods of an acquiree to be reviewed by an independent auditor, a review is often performed at the request of management of the registrant. For the auditor to complete a review of the current period, prior-year equivalent amounts may still need to be prepared.

[15] Under the existing requirements, (1) the third year of financial statements is not required if the acquiree reported less than $100 million in revenue during its most recent fiscal year and (2) when three years of financial statements are required, the balance sheet for the third year may be omitted.

[16] Under the existing requirements, emerging growth companies may omit the third year of any required acquiree financial statements during their IPO of common equity securities or for Form 8-K filings before the earlier of the filing or the filing deadline of their first Form 10-K. In addition, SRCs are not required to present more than two years of acquiree financial statements. Therefore, the proposed rule would align the maximum acquiree financial statement periods to be presented for all registrants.

Fewer Circumstances Requiring Acquiree Financial Statements

- *Reduced acquiree financial statements in an IPO* — Under the proposed rule, acquiree financial statements would not be required once the registrant's audited financial statements reflect the operating results of the acquiree for a "complete fiscal year." This may offer significant relief to companies undertaking an IPO since they would no longer be required to evaluate acquisitions that occurred before the most recently completed fiscal year.

Connecting the Dots

The proposed rule clarifies that the operations of the acquiree would need to be reflected in the audited financial statements of the registrant for a complete fiscal year, or all 12 months of the registrant's most recently completed fiscal year. Therefore, SEC Regulation S-X, Rule 3-06,[17] which permits the filing of financial statements for a period of 9 to 12 months to satisfy a one-year requirement, could not be applied by analogy. Further, the 12-month requirement could not be reduced by preacquisition historical financial statements that may be provided as currently contemplated in paragraph 2030.4 of the FRM.

- *Changes to disclosure requirements for individually insignificant acquisitions*[18] — The proposed rule would remove the requirement to provide separate financial statements for any individually insignificant acquiree and require financial statements only for acquirees whose results on any significance test exceed 20 percent and for which separate financial statements are not yet required to be filed.[19] However, pro forma financial information would be required to reflect the aggregate effects of all such acquired businesses, even if preacquisition financial statements for such businesses would not be required. In a manner consistent with current requirements, this applies only to registration statements and proxy statements.

Connecting the Dots

Although the proposed rule would eliminate the requirement to provide separate financial statements for any individually insignificant acquirees, a registrant would still be required to obtain sufficient historical financial information about all of its individually insignificant acquirees to prepare the required pro forma financial information. In addition, if that information is derived from financial records that have not been subject to audit or review procedures, it may affect the level of comfort that could be provided to underwriters by auditors in conjunction with a securities offering.

Use of Abbreviated Financial Statements Without a Request for SEC Staff Permission

Historically, the SEC staff has permitted, through its delegated authority under SEC Regulation S-X, Rule 3-13[20] (also referred to as a waiver request), registrants to present audited financial statements of assets acquired and liabilities assumed and statements of revenues and expenses (excluding corporate overhead, interest, and taxes), referred to as abbreviated financial statements, when it acquires net assets that constitute a business and certain criteria are met. The proposed rule would permit registrants to present such abbreviated financial statements for an acquiree without seeking permission from the SEC staff when certain conditions are met. The proposed rule identifies conditions that are generally consistent with

[17] SEC Regulation S-X, Rule 3-06, "Financial Statements Covering a Period of Nine to Twelve Months."
[18] See paragraph 2035.2 of the FRM for the definition of individually insignificant acquisitions, which does not change in the proposed rule. Also see Section 1.9 of Deloitte's *A Roadmap to SEC Reporting Considerations for Business Combinations*.
[19] The proposed rule may accelerate reporting of historical financial statements for these acquirees in certain registration statements and proxy statements.
[20] SEC Regulation S-X, Rule 3-13, "Filing of Other Financial Statements in Certain Cases."

the criteria the SEC staff applies when evaluating a waiver request as outlined in Section 2065 of the FRM.

Use of, or Reconciliation to, IFRS-IASB in Certain Circumstances

Existing rules distinguish between a foreign acquiree[21] that meets the definition of a foreign business[22] and one that meets the definition of an FPI.[23] Under the existing requirements, only a foreign business acquiree is permitted to present IFRS-IASB financial statements without reconciliation. The proposed rule would allow a registrant to present the financial statements of a foreign acquiree that does not meet the definition of a foreign business in accordance with IFRS-IASB without reconciliation to U.S. GAAP if the foreign acquiree would qualify to use IFRS-IASB if it were a registrant (i.e., it would meet the FPI definition).

Connecting the Dots

Although the proposed rule would increase the instances in which a registrant may provide financial statements of a foreign acquiree prepared in accordance with IFRS-IASB, without reconciliation, the pro forma financial information reflecting the acquiree must nonetheless be presented in accordance with the basis of presentation of the registrant. That is, a registrant that prepares its financial statements in accordance with U.S. GAAP and presents IFRS-IASB financial statements for a foreign acquiree must obtain sufficient historical financial information about the acquiree under U.S. GAAP to comply with the pro forma requirements of the registrant.

The proposed rule would also allow FPIs that prepare their financial statements in accordance with IFRS-IASB to reconcile[24] home-country GAAP foreign acquiree financial statements to IFRS-IASB, rather than to U.S. GAAP as required under the existing requirements, when the foreign acquiree meets the definition of a foreign business.

Pro Forma Financial Information

Pro forma financial information is generally required when separate financial statements are provided under Rule 3-05 or Rule 3-14 for a significant acquiree or real estate acquiree, respectively, or when there is a significant disposition of a business. The objective of pro forma financial information is to enable investors to understand and evaluate the impact of a transaction, such as the acquisition or disposition of a business, by showing how that transaction (or group of transactions) might have affected the registrant's historical financial position and results of operations had the transaction occurred at an earlier date.

Under current requirements in Article 11, pro forma financial information is generally presented in columnar form, with separate columns for the historical financial information, pro forma adjustments, and pro forma results. The historical financial statements are adjusted for charges, credits, and related tax impacts that are (1) directly attributable to the transaction, (2) factually supportable, and (3) with respect to the statement of comprehensive income, expected to have a recurring impact. The proposed rule would significantly change the requirements for preparing pro forma financial information regarding the (1) nature of the adjustments and (2) presentation and disclosure requirements.

Nature of the Adjustments

The proposed rule would replace the three criteria noted above with two categories of adjustments depicting only (1) the accounting for the transaction, referred to as transaction

[21] Refers to an acquired or to be acquired business that is not incorporated in the United States.
[22] See paragraph 6110.4 of the FRM.
[23] See paragraph 6110.2 of the FRM.
[24] Such reconciliation is generally required if the significance of the foreign acquiree exceeds 30 percent.

accounting adjustments, and (2) reasonably estimable synergies and other effects of the transaction, referred to as management's adjustments.

- *Transaction accounting adjustments* — These adjustments would be limited to those that reflect the accounting for the transaction in accordance with U.S. GAAP or IFRS-IASB, as applicable. They may include, among other items, recognition of goodwill and intangible assets and adjustments of assets and liabilities to fair value on the balance sheet, as well as the related impacts on the statement of comprehensive income.
- *Management's adjustments* — These adjustments would be limited to synergies and other effects of the transaction that (1) are reasonably estimable and (2) have occurred or are reasonably expected to occur. Such adjustments may include, among others, closing facilities, discontinuing product lines, terminating employees,[25] and modifying existing contractual arrangements. Such disclosures are intended to provide investors with insight into the effects of the transaction and management's plans, including any uncertainties.

Connecting the Dots

Under the existing requirements, adjustments that reflect synergies or other actions taken or expected to be taken by management generally do not qualify as pro forma adjustments because they do not meet the "factually supportable" or "directly attributable" criteria. Under the proposed rule, management's adjustments, which may include forward-looking information,[26] would be required if the new conditions above are met. This may affect the level of comfort that could be provided to underwriters by auditors in conjunction with a securities offering.

Presentation and Disclosure Requirements

To enable investors to understand the accounting impact of the transaction separate from the impact of management's plans, the proposed rule would require separate columns for the transaction accounting adjustments and the management's adjustments as well as subtotals and earnings per share following each group of adjustments. For example, pro forma financial information for a significant acquisition may include:

- The registrant's historical financial information.
- The acquiree's historical financial information.
- Transaction accounting adjustments.
- A subtotal (reflecting the combination of the above items, including earnings per share information).
- Management's adjustments.
- The pro forma total (reflecting the combination of all items above (other than the previous subtotal), including earnings per share information).

The proposed rule would also require certain disclosures to aid investors in evaluating management's adjustments. Such disclosures would include:

- A description of the adjustments and any related uncertainties.
- Material assumptions, methods of calculation, and the expected timing for completion.

[25] When depicting a disposition, transaction accounting adjustments may reflect only adjustments to compensation expense for employees that have been or will be transferred or terminated as of the disposition date. Other compensation adjustments may be reflected as management's adjustments if the requirements for such adjustments are met.

[26] The proposed rule would revise Article 11 so that any forward-looking information supplied is expressly covered by the safe harbor rule.

- Qualitative information necessary to provide a fair and balanced presentation. Such disclosure would also encompass synergies or other transaction adjustments that are not reasonably estimable and therefore are excluded from the pro forma financial information.
- The reportable segments, products, services, and processes involved; material resources required; and anticipated timing, if known.

Real Estate Operations

Companies in the real estate industry apply Rule 3-14 to report the acquisition or probable acquisition of a real estate operation (real estate acquiree). Although Rule 3-14 has historically differed from Rule 3-05, the SEC staff indicated in the proposed rule that there are no unique industry considerations that justified treating real estate acquirees differently from others. Therefore, the proposed rule includes a number of changes to substantially align Rule 3-14 with Rule 3-05 in an effort to reduce complexity while retaining certain industry-specific disclosures. The proposed rule also includes a number of changes to Rule 3-14, many of which codify positions that the SEC staff has historically applied and that were standard industry practice and therefore are not discussed below. Some of the key changes in the proposed rule that affect the requirements for real estate acquirees are summarized below. The proposed rule would:

- Increase the significance threshold from 10 percent to 20 percent for an individual real estate acquiree.
- Increase the significance threshold from 10 percent to 50 percent for the aggregate impact of certain consummated and probable real estate acquisitions for which financial statements are (1) not required or (2) not yet required (individually insignificant real estate acquirees) and align the proposed disclosure requirements with those in Rule 3-05 as described in the Changes to disclosure requirements for individually insignificant acquisitions discussion. For example, a registrant would not be required to provide separate financial statements for any individually insignificant real estate acquiree; however, pro forma financial information would be required to reflect the aggregate effects of all such real estate acquirees. This applies only for registration statements and proxy statements.
- Reduce the three-year annual financial statement requirement for real estate acquirees from related parties to one year and not differentiate the number of periods on the basis of whether the seller is a related party.
- No longer require financial statements of a real estate acquiree in registration statements and proxy statements once it is reflected in the registrant's financial statements for a complete fiscal year (see the Reduced acquiree financial statements in an IPO discussion for a summary of the analogous provision in Rule 3-05).
- Permit the filing of financial statements covering a period of 9 to 12 months to satisfy the one-year requirement for a real estate acquiree, in a manner consistent with Rule 3-06.
- Specify the use of a "modified investment test"[27] for the assessment of the significance of a real estate acquiree. The test would compare the registrant's investment in the real estate operation, including any debt secured by the real properties that is assumed by the registrant, with total assets as of the most recently completed fiscal year. This modified test is consistent with current practice; however, it differs from the proposed investment test for Rule 3-05.

[27] The proposed modified investment test would also be used to measure the significance of a disposition of real estate operations. Unlike acquisitions of real estate operations, which apply only the modified investment test to measure significance, a registrant would also have to consider the asset and income tests when evaluating whether a disposition of real estate operations is significant.

- Conform the requirements related to acquisitions of foreign real estate operations in Rule 3-14 with the analogous provisions in Rule 3-05 (see the Use of, or Reconciliation to, IFRS-IASB in Certain Circumstances section).
- Not differentiate between a real estate acquiree with a triple-net lease and one without. Therefore, the proposed rule clarifies that it is more appropriate for a registrant to provide financial statements of a real estate acquiree than it is for the registrant to provide the financial statements of the lessee or guarantor of the lease, which is the current practice.[28]
- Codify existing SEC staff practice for blind pool offerings, which is to calculate the significance of a real estate acquiree as set forth in paragraphs 2325.3 and 2325.5 of the FRM and, in certain circumstances, allow the use of pro forma total assets.

For an overview of the current requirements in Rule 3-14, see Chapter 2 of Deloitte's *A Roadmap to SEC Reporting Considerations for Business Combinations*.

Disposition of a Business

Article 11 currently requires pro forma financial information for the disposition or probable disposition of a business when it exceeds the 10 percent significance level on the basis of any of the three significance tests noted above. The proposed rule would raise the significance threshold from 10 percent to 20 percent and align the investment and income test to be consistent with the revised tests for a business acquisition. Therefore, for the investment test, a registrant would compare the fair value of consideration received with the aggregate worldwide market value of the registrant (or, if there is no market value, compare the carrying value of the disposed business with the total assets of the registrant). This differs from the current investment test, which compares the greater of (1) the carrying value of the disposed business or (2) the fair value of consideration received with the registrant's total assets. Similarly, under the proposed rule, the registrant would consider both the income component and the revenue component of the income test and compare after-tax income from continuing operations and revenue of the disposed business with those of the registrant.

Connecting the Dots

Although the proposed rule would increase the significance threshold for the disposal of a business to 20 percent, it would not modify the threshold for reporting the acquisition or disposition of a significant amount of assets that do not constitute a business. Form 8-K, Item 2.01, continues to require disclosure, including pro forma financial information, for asset acquisitions and dispositions for cases in which significance exceeds 10 percent.

Smaller Reporting Companies

The proposed rule includes corresponding changes to the requirements for SRCs. Although SEC Regulation S-X, Article 8,[29] currently requires financial statements and pro forma financial information for acquirees, it does not provide the same level of detailed guidance as Rule 3-05 and Article 11. Although SRCs could continue to prepare acquiree financial statements in accordance with Article 8 (e.g., the form and content requirements), the proposed rule would specifically refer to the requirements in Rules 3-05 and 3-14 for other requirements. Similar changes were proposed for pro forma financial information, which would refer to Article 11 for the presentation and disclosure requirements (except for the condensed format allowed for SRCs). Given the alignment with Article 11, the proposed rule would result in changes to the types of adjustments to be made and may affect the periods to be presented.

[28] See Section 2340 of the FRM for current guidance regarding properties subject to triple-net leases.
[29] SEC Regulation S-X, Article 8, "Financial Statements of Smaller Reporting Companies."

Investment Companies

Under current regulations, investment companies follow the same general requirements of Rule 3-05 and Article 11 as do other registrants. However, because of the unique characteristics of investment companies, it is often unclear how to apply these rules.

The proposed rule would also add SEC Regulation S-X, Rule 6-11,[30] and Rule 1-02(w)(2), which, among other things, provide investment company–specific significance tests: (1) the investment test, which would focus on the value of the total investments, and (2) the income test, which would use measures commonly included in the investment company's financial statements such as changes in net assets from operations.[31] In addition, the proposed rule would (1) make certain revisions to the significance thresholds that may reduce the need to provide financial statements and (2) limit the audited financial statement periods required for an acquired fund to one year and the most recent interim period. Further, the proposed rule would allow the use of U.S. GAAP financial statements for an acquired private fund supplemented by schedules that comply with SEC Regulation S-X, Article 12[32] (including a detailed schedule of investments), rather than financial statements that comply with the provisions of Regulation S-X. Regarding pro forma financial information for a fund acquisition, the proposed rule would replace the current requirement with a requirement to provide certain supplemental information.

Requests for Comment

The SEC is interested in feedback from investors, companies, and other market participants on the proposed rule and does not require a specific format for the submission of comments. The proposed rule includes 98 numbered requests for comment. Some commenters may choose to present their views in a narrative format without any reference to specific questions posed by the SEC, and others may choose to answer all, or only some, of the specific requests for comment. Any format is acceptable, and the SEC encourages all types of feedback. Comments can be submitted through the SEC's Web site and are due 60 days after publication of the proposed rule in the *Federal Register*. Any comments submitted will be posted to the SEC's Web site.

Looking Ahead

The proposed rule continues the SEC's ongoing effort to facilitate capital formation and improve disclosure effectiveness. The proposed rule takes into consideration feedback received from the SEC's September 2015 request for comment[33] on the effectiveness of financial disclosures about entities other than the registrant.

Still on the SEC's agenda, among other items, are proposed changes to the definitions of an accelerated filer and large accelerated filer. These definitions affect, among other matters, the deadlines for certain periodic reports as well as whether a registrant is required to obtain auditor attestation on the effectiveness of its internal control over financial reporting. The SEC is expected to propose changes in the near future. Stay tuned for further developments.

[30] SEC Regulation S-X, Rule 6-11, "Financial Statements of Funds Acquired or to Be Acquired."
[31] The proposed rule refers to including, for example, any net realized gains and losses and net change in unrealized gains and losses.
[32] SEC Regulation S-X, Article 12, "Form and Content of Schedules."
[33] SEC Release No. 33-9929, *Request for Comment on the Effectiveness of Financial Disclosures About Entities Other Than the Registrant*.

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