



## Target and Pro Forma Financial Statement Requirements for Significant Acquisitions

US reporting companies that are planning or have completed a significant acquisition of a business may be required to file separate target financial statements and related pro forma financial statements under Rule 3-05 and Article 11 of Regulation S-X. The specific SEC rules and financial reporting obligations triggered by a significant acquisition can be quite complex, requiring careful evaluation by an acquiring company. These rules may also impact the ability of registrants to access the capital markets in a timely fashion, affecting the ability to offer securities in a registered offering, the proceeds of which would be used to fund the acquisition or to register securities to be used as consideration for the acquisition.

This note discusses the SEC's financial reporting and disclosure requirements triggered by a company's significant business acquisition. We outline key concepts and practice points helpful in determining if an acquisition is significant, which financial statements of the target are required to be included in the registrant's SEC filing or offering document, what related pro forma financial information is required, when and how these target and pro forma financial statements are to be filed or updated, and relevant market practice considerations.

### Overview

In general, Rule 3-05 requires the filing of separate pre-acquisition, or historical, financial statements when the acquisition of a significant business has occurred or is probable. This means that the acquiring company must obtain separate audited annual and unaudited interim pre-acquisition financial statements of the target or business it acquires if such business or acquisition is "significant" to the acquiring company. "Significance" is determined and measured by applying three significance tests prescribed by the SEC rules. The more significant an acquisition is, the more onerous the requirements relating to financial information of the target (*e.g.*, years of historical annual audited financial statements). In addition, a registrant must also present pro forma financial statements that give effect to the acquisition, in compliance with Article 11. As a general rule, the registrant must file these target and pro forma financial statements within 75 days after an acquisition is consummated, with a Current Report on Form 8-K. However, a registrant that registers or offers securities may need to provide these financial statements much earlier and include these in the relevant SEC filing or offering document; for instance, in its registration statement, prospectus supplement or merger proxy statement, as applicable. Furthermore, while these rules technically only apply to SEC filings and registered offerings, market practice has evolved such that practitioners, in general, substantially adhere to them in the context of exempt offerings.

Rule 3-05 and Article 11 of Regulation S-X should be read and understood in conjunction with "Topic 2: Other Financial Statements Required" and "Topic 3: Pro Forma Financial Information" of the Financial Reporting Manual ("FRM") of the SEC's Division of Corporation Finance ("Corp Fin").

### Threshold Questions

In determining whether Rule 3-05 financial statements will be required in connection with an acquisition, the first order of business is to ask two threshold questions: (1) Do the assets and liabilities acquired or to be acquired by the registrant constitute a "business?" and (2) Has the transaction been consummated or is it "probable?"

#### *Is the Target a "Business"?*

The SEC prescribes a "facts and circumstances" analysis to determine whether an acquisition constitutes the acquisition of a "business," rather than of just assets.<sup>1</sup> The focus of the inquiry is whether there is sufficient continuity of operations so that disclosure of prior financial information is material to an understanding of future operations. There is a presumption in Rule 11-01(d) of Regulation S-X that a separate entity, subsidiary or division is a "business" for Rule 3-05 purposes. However, a lesser component of an entity, such as a product line, also may be considered a business. In evaluating whether a component of an entity can be considered a business, Rule 11-01(d) requires registrants to consider (1) whether the nature of the revenue-producing activity of the component will remain generally the same as before the transaction and (2) whether the facilities, employee base,

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<sup>1</sup> See Rules 3-05 (a)(2) and 11-01(d). All rule references in this note are to Regulation S-X unless otherwise indicated.

distribution system, sales force, customer base, operating rights, production techniques or trade name of the component will remain with the component after the transaction.

Moreover, the SEC rules treat a group of related businesses as a single business for these purposes. Under Rule 3-05(a)(3), businesses shall be deemed to be related if they are under common control or management or their acquisitions are dependent on each other or a single common event or condition.<sup>2</sup> Finally, FRM paragraph 2010.1 cautions that what constitutes a “business” for SEC reporting purposes (e.g., the Rule 11-01(d) definition applicable to a Rule 3-05 analysis) may be different from what constitutes a “business” for accounting purposes (e.g., under US GAAP).

#### **Is the Transaction “Probable”?**

Rule 3-05 applies not only when an acquisition has been consummated (e.g., the business combination has closed), but also when an acquisition is “probable.” The term “probable” is not defined in Rule 3-05. However, FRM paragraph 2005.4 provides that the assessment of “probability” requires consideration of all available facts and that an acquisition is probable where the registrant’s financial statements alone would not provide adequate financial information to make an investment decision. In practice, the factors that may be considered to determine whether an acquisition is “probable” include the following: (i) a signed definitive agreement; (ii) a binding letter of intent; (iii) approval from the board of directors or shareholders of the seller and target companies; (iv) submission of transaction terms to regulatory authorities for approval; (v) receipt of required third-party approvals or consents material to the transaction; (vi) incurrence of financial penalties if acquisition is not consummated; and (vii) a public announcement of the acquisition.

If the acquisition by the registrant is an acquisition of a “business” and such acquisition has been consummated or is probable, then the next query to be made in order to determine whether target financial statements are required is whether such acquisition is significant.

#### **Significance Tests: Is the Acquisition “Significant?”**

Registrants measure significance by using each of the three tests prescribed under the SEC rule: the asset test, investment test and income test. These tests are based on the definition of a “significant subsidiary” under Rule 1-02(w) except that, for Rule 3-05 purposes, the 10% minimum threshold in Rule 1-02(w) is replaced by a 20% minimum threshold. For Rule 3-05 purposes, an acquisition is considered “significant” if it exceeds 20% on any of the three tests. The significance tests compare features of the acquired business (i.e., acquisition purchase price, the target’s assets and pre-tax income) to the registrant buyer, and measure these relationships as a percentage. These tests are illustrated in the table below. Per FRM paragraph 2015.2, as a rule, one should use and compare the most recent pre-acquisition annual financial statements of the target with the registrant buyer’s most recent pre-acquisition consolidated annual audited financial statements, to perform these tests.

**Table 1: Significance Tests**

Investment Test	Asset Test	Income Test
$\frac{\text{Purchase Price}}{\text{Buyer's Total Assets}}$	$\frac{\text{Target's Total Assets}}{\text{Buyer's Total Assets}}$	$\frac{\text{Target's Pre-Tax Income}}{\text{Buyer's Pre-Tax Income}}$

- **Investment Test.** An acquisition is significant if the buyer’s investments in the target exceed 20% of the buyer’s total assets as of the end of the buyer’s most recent fiscal year.

In performing the investment test, FRM paragraph 2015.5 states that the “GAAP purchase price” of the acquired business should be compared to the registrant’s consolidated total assets, and that the term “GAAP purchase price” here refers to the “consideration transferred” as defined in the applicable accounting standard (e.g., under SFAS 141R and IFRS 3).

- **Asset Test.** An acquisition is significant if the buyer’s share of the total assets of the target exceeds 20% of the buyer’s total assets as of the end of the buyer’s most recent fiscal year.
- **Income Test.** An acquisition is significant if the buyer’s share of “pre-tax income” from continuing operations of the target exceeds 20% of the buyer’s pre-tax income for the most recent fiscal year.

<sup>2</sup> See also FRM Section 2015.12.



“Pre-tax income” refers to income from continuing operations before income taxes, extraordinary items and cumulative effect of a change in accounting principle, exclusive of amounts attributable to any noncontrolling interests. Per FRM paragraph 2015.9, if either the buyer or the target reported a pre-tax loss while the other reported a pre-tax income, then the absolute values must be used for purposes of the income test calculation.

After applying the three significance tests summarized above, the highest resulting percentage from among them will govern and will be used as the significance level for the acquisition.

### Practical Reminders When Performing Significance Tests

Below are a few practical points to take into account when carrying out the significance tests.

- *No Alternative Tests.* FRM paragraph 2020.1 provides that the Staff of Corp Fin (“Staff”) will not accept alternative significance tests, in order to achieve consistent application and fair treatment across all registrants and industries. If after performing the required significance tests a registrant believes that the tests specify periods beyond those reasonably necessary to inform investors, it may make a written request to the Office of the Chief Accountant of Corp Fin to waive one or more years of financial statements.
- *Do Not Include Target in Denominator.* FRM paragraph 2015.1 provides that the acquired business is not considered part of the registrant’s denominator in determining significance.
- *Use Annual Financial Statements; Exception.* As a rule, when performing the significance tests, use the annual pre-acquisition financial statements of both the target and the registrant buyer. However, where the registrant has completed a previous significant acquisition for which it has previously filed target and pro forma financial statements in a Form 8-K, then the registrant may evaluate significance (for the subsequent acquisition and target) by using the registrant’s pro forma financial information (that gave effect to the prior significant acquisition) rather than the historical pre-acquisition financial statements.
- *Using Buyer’s Five-Year Average Pre-Tax Income for Income Test.* If the registrant’s pre-tax income for the most recent fiscal year is 10% or lower than its average pre-tax income for the last five fiscal years, then such average pre-tax income of the registrant should be used to perform the income test. See FRM paragraph 2015.8 and the second computational note to Rule 1-02(w). In computing this five-year average, loss years (where a registrant reported a pre-tax loss instead of pre-tax income) should be assigned a value of zero, but the denominator should be “5.”
- *No Rounding.* FRM paragraph 2015.3 provides that the results of the significance tests should not be rounded.

### Significance Levels and Rule 3-05 Historical Financial Statements Required

Depending on the significance of the acquisition, the registrant must produce one to three years of the target’s audited historical financial statements and, in all cases, unaudited interim financial statements for the last interim period and for the corresponding interim period of the prior year.

Table 2 below summarizes the required target financial statements corresponding to a significance level of a **completed** acquisition.

**Table 2: Periods of Required Target Financial Statements for Completed Acquisitions**

Significance Level (Individual acquisition or multiple acquisitions of related businesses)	Required Historical Financial Statements of the Target
At or below 20% significance	No separate financial statements needed
Exceeds 20% significance but less than or equal to 40%	<ul style="list-style-type: none"> <li>• Audited financial statements for the <u>most recent</u> fiscal year</li> <li>• Unaudited interim financial statements for latest completed period that precedes the acquisition, and for the corresponding interim period of the prior year</li> </ul>
Exceeds 40% significance but less than or equal to	<ul style="list-style-type: none"> <li>• Audited financial statements for the <u>two</u></li> </ul>



Significance Level (Individual acquisition or multiple acquisitions of related businesses)	Required Historical Financial Statements of the Target
50%	<p><u>most recent</u> fiscal years</p> <ul style="list-style-type: none"> <li>• Unaudited interim financial statements for the latest completed period that precedes the acquisition, and for corresponding interim period of the prior year</li> </ul>
Exceeds 50% significance	<ul style="list-style-type: none"> <li>• Audited financial statements for the <u>three most recent</u> fiscal years</li> <li>• Unaudited interim financial statements for the latest completed period that precedes the acquisition, and for corresponding interim period of the prior year <ul style="list-style-type: none"> <li>○ Exception: If target had net revenues below \$100 million in its most recent fiscal year, the audited financials for the earliest of the three fiscal years may be omitted</li> <li>○ Exception: If registrant is an emerging growth company (EGC), it may present, in its initial registration statement, only two years of audited financial statements of the target</li> </ul> </li> </ul>

As discussed in more detail below, notwithstanding the chart above, no financial statements need to be filed *yet* if the acquired business does not exceed the 50% significance level and the acquirer is in the 74-day grace period. An acquirer is within the 74-day grace period if the date of the final prospectus for the offering is no more than 74 days after the acquisition is completed and the financial statements of the acquired business have not yet been filed. However, in many instances, it may be advisable to file the financial statements earlier in order to complete a financing.

With respect to a **probable** acquisition (as opposed to a completed acquisition), historical financial statements described in the row immediately above are only required if such acquisition exceeds the 50% significance level.

Target financial statements are not required if the significance level is at or below the 50% significance level and the acquisition has not yet been completed.

Note that the chart sets out general rules only, and there are a number of exceptions and considerations that may apply depending on the particular filing or offering document, level of significance or timing. Before we discuss some of these particular SEC filings however, we first take a look at the pro forma financial statements required under Article 11, as these would need to be presented as well to accompany the required Rule 3-05 target historical financial statements.

### Pro Forma Financial Information

As a rule, where a significant recent or probable acquisition triggers the need for Rule 3-05 target historical financial statements, then pro forma financial information that gives effect to the acquisition is also required to be presented under Article 11 of Regulation S-X. Article 11 pro forma financial information is intended to provide investors with information about the continuing impact of a particular transaction by showing how the transaction might have affected historical financial statements if the transaction had been consummated at an earlier time. The pro forma financial statements are intended to assist investors in analyzing the future prospects of the registrant by illustrating the possible scope of the change in the registrant's financial position and results of operations caused by the transaction.<sup>3</sup>

<sup>3</sup> See Rule 11-02(a).



Rule 11-02(b) provides that pro forma financial information should consist of a pro forma condensed balance sheet, pro forma condensed statements of income and accompanying explanatory notes. In particular, Rule 11-02(d) requires:

- a pro forma condensed balance sheet as of the end of the most recent period for which a consolidated balance sheet of the acquirer is required, unless the transaction is already reflected in that balance sheet; and
- pro forma condensed income statements for the acquirer's most recently completed fiscal year and the most recent interim period, unless the historical income statement reflects the transaction for the entire period.

The pro forma financial information should be accompanied by an introductory paragraph briefly setting forth a description of (i) the transaction, (ii) the entities involved and (iii) the periods for which the pro forma information is presented. Pro forma financial information should be presented in columnar form, with separate columns presenting historical results, pro forma adjustments and pro forma results. With respect to adjustments:

- Pro forma adjustments related to the pro forma condensed balance sheet should be computed assuming the transaction was consummated on the date of the latest balance sheet included in the filing. Adjustments should give effect to events that are directly attributable to each specific transaction and factually supportable. Adjustments should include those items that have a continuing impact and also those that are nonrecurring.
- Pro forma adjustments related to the pro forma condensed income statement should be computed assuming the transaction was consummated at the beginning of the fiscal year presented and carried forward through any interim period presented. Adjustments should give effect to events that are (i) directly attributable to the transaction, (ii) expected to have a continuing impact on the registrant and (iii) factually supportable.

#### **Target and Pro Forma Financial Statements Required in SEC Filings**

In connection with a significant completed or probable acquisition, a registrant may be required to include Rule 3-05 historical financial statements and Article 11 pro forma financial statements in different SEC filings, including in a Form 8-K, registration statements, prospectus supplements and proxy materials for a business combination. We discuss these in more detail below. Note that in all instances, the target's financial statements must satisfy the usual age of financial statements requirements or "staleness" deadlines which, in turn, depend on the target's filer status.

#### **Requirements Under Form 8-K**

A significant acquisition usually triggers the requirement to file a Form 8-K at three different periods: (1) a *signing* 8-K to be filed after the acquisition agreement is signed; (2) a *closing* 8-K to be filed after the acquisition closes; and (3) a *Form 8-K/A* to be filed within approximately 75 days of the closing of the acquisition.

- *Signing 8-K.* Item 1.01 of Form 8-K requires a registrant to disclose in a Form 8-K its entry into a material definitive agreement not made in the ordinary course of business. The Form 8-K should be filed within four business days from the signing of such agreement and should disclose, among other things, the date of the agreement, identity of the parties and a brief description of the material terms and conditions of the agreement. No financial statements (either target or pro forma) are required to be included in this 8-K.
- *Closing 8-K.* Item 2.01 of Form 8-K requires a registrant to disclose in a Form 8-K that it has completed the acquisition of a significant amount of assets, otherwise than in the ordinary course of business. The Form 8-K should be filed within four business days from the closing of the acquisition and should disclose, among other things, the date of completion of the acquisition, a brief description of the assets involved, the identity of the parties and the nature and amount of consideration given or received. As a general rule, no financial statements (either target or pro forma) are required to be included in this 8-K.
- *Form 8-K/A.* Items 9.01(a) and (b) of Form 8-K require the registrant to file the required Rule 3-05 historical target financial statements and Article 11 pro forma financial information, either in the Closing 8-K described above or in an amendment to such Closing 8-K, not later than 71 calendar days after the required filing date of the Closing 8-K (approximately 75 days from the completion of the acquisition). Note that for purposes of applying the staleness rules to the financial statements filed in the Form 8-K/A, FRM paragraph 2045.13 provides that the age of such financial statements should be determined by reference to the filing date of the Form 8-K initially reporting consummation of the acquisition. This means that the target financial statements included in the Form 8-K/A would be deemed current if they would have met the permitted age requirements on the filing date of the Closing 8-K.



As previously mentioned, as a general rule, a reporting company that has completed a significant acquisition must file these target and pro forma financial statements within 75 days after the acquisition is consummated on a Form 8-K/A. However, a registrant that registers or offers securities may need to provide these financial statements much earlier, and include them in the relevant SEC filing or offering document.

### **Registration Statements other than those on Form S-4**

#### *When Required*

In general, a registrant is required to file target and pro forma financial statements of a significant business acquisition that was completed 75 or more days before a registration statement is filed or declared effective. Such financial statements are also required if an acquisition is probable and exceeds the 50% significance level. The financial statements can be included in the registration statement itself or incorporated therein by reference—for instance, from the previously filed Form 8-K/A that contains the target and pro forma financial statements.

#### *When Not Required*

No target or pro forma financial statements are required if the business acquisition does not exceed the 50% significance level, and either: (1) the acquisition is probable or has not yet been completed or (2) the acquisition was completed less than 75 days before the registration is filed or declared effective (stated otherwise, the date of the final prospectus or the prospectus supplement filed with the SEC is no more than 74 days from the consummation of the acquisition), and the financial statements of the acquired business have not yet been filed.

#### *Special Rules When Significance Exceeds 50%*

FRM paragraph 2050.5 provides that if significance exceeds 50% and the financial statements of the acquired business have not yet been filed, then new registration statements and post-effective amendments to such registration statements will not be declared effective. In this scenario, at the more than 50% significance level, a registrant will need to file the required target and pro forma financial statements in the new registration statement or an amendment to an existing one, even if such acquisition is only probable or has closed only within the past 74 days. FRM paragraph 2060 provides a flowchart overview of Rule 3-05. This flowchart illustrates when target financial statements are required in a registration statement for an acquisition that has occurred or is probable.

### **Considerations Applicable to Shelf Takedowns and Prospectus Supplements**

A registrant may utilize a prospectus supplement to effect a takedown of securities under an existing, currently effective registration statement. However, a registrant must be mindful of certain rules under Rule 3-05 that may impact its ability to utilize an existing, effective shelf registration statement for a takedown.

FRM paragraph 2045.3 provides that offerings pursuant to effective registration statements cannot proceed if the significance of an acquisition exceeds 50% and financial statements have not been filed. FRM paragraph 2050.3<sup>4</sup> further provides that if the significance exceeds 50% and the financial statements of the acquired business have not been filed, registrants should not make offerings pursuant to effective registration statements, or pursuant to Rule 506 of Regulation D if any purchasers are not accredited investors until the required audited financial statements are filed. As an exception however, the following offerings and sales of securities may proceed during the grace period notwithstanding that the financial statements of the acquired business have not been filed:

- offerings or sales of securities upon the conversion of outstanding convertible securities or upon the exercise of outstanding warrants or rights;
- dividend or interest reinvestment plans;
- employee benefit plans;
- transactions involving secondary offerings; and
- sales of securities pursuant to Rule 144.

<sup>4</sup> See similar requirement in the Instruction to Item 9.01 of Form 8-K.



The Staff has clarified that FRM paragraphs 2045.3 and 2050.3 above only apply to completed business acquisitions. They do not apply to probable business acquisitions, unless management determines that such probable business acquisition constitutes a “fundamental change.”

FRM paragraph 2045.3 provides that in general, after the effectiveness of a registration statement, a domestic registrant has no specific obligation to update the prospectus (*e.g.*, by filing an amendment to the prospectus or a prospectus supplement) except as stipulated by Section 10(a)(3) of the Securities Act and Item 512(a) of Regulation S-K with respect to any “fundamental change.” If an acquisition would be significant under Rule 3-05, management should consider whether the probability of consummation of the transaction would represent a fundamental change to its business. It is the responsibility of management to determine what constitutes a fundamental change. The registrant should also consider whether individually insignificant acquisitions occurring subsequent to effectiveness, when combined with individually insignificant acquisitions that occurred after the most recent audited balance sheet in the registration statement but prior to effectiveness, may be of such significance in the aggregate that an amendment is necessary.

#### **Registration Statement on Form S-4**

A registrant may prepare a registration statement on Form S-4 in order to register securities to be offered to the security holders of a business to be acquired. FRM paragraph 2200.3 provides that in general, the determination of the number of periods for which target company financial statements need be included in a Form S-4 should be made by reference to the requirements of Form S-4, not S-X 3-05. The financial statement and audit requirements for Form S-4 filings may be different from the Rule 3-05 requirements outlined above, depending on a number of facts and circumstances. These factors include among others, (1) whether the registrant’s shareholders are required to vote on the potential acquisition and (2) whether the target is an SEC reporting entity. In particular, as FRM paragraph 2200.1 illustrates:

- the target company financial statement periods to present depend on whether: (i) target is a reporting company; (ii) target is a non-reporting company and the issuer’s shareholders are voting; (iii) target is a non-reporting company and the issuer’s shareholders are not voting; (iv) target is a smaller reporting company; (v) acquirer is an EGC; or (vi) acquirer is a shell company.
- the need to audit target company financial statements depends on whether (i) target is a reporting company or (ii) target is a non-reporting company (irrespective of whether the issuer’s shareholders are voting).

For instance, where the issuer’s shareholders are required to vote on the transaction and the target is an SEC reporting entity, the following target financial statements would be required, *regardless of significance* under Rule 3-05: (i) balance sheets as of the two most recent fiscal years (audited); (ii) statements of operations, comprehensive income, cash flows and changes in shareholders’ equity for the three most recent fiscal years (audited); (iii) required interim information (unaudited), if applicable; and (iv) financial statements of the target’s significant acquired or to be acquired business under Rule 3-05.

As another example, if the target is a reporting company, all target company fiscal years presented must be audited, whether or not the issuer’s shareholders are voting.<sup>5</sup>

#### **Merger Proxy Statement**

FRM paragraph 1140.3 provides that the requirement for acquirer and target financial statements in a merger proxy statement depends on whose proxies are solicited and the nature of the consideration. If the consideration to be issued in the business combinations includes registered securities, the registrant must comply with the financial statement requirements of Form S-4 described above. The following table, which is derived from the table found in FRM paragraph 1140.3, outlines when financial statements are required for transactions that do not involve registered securities.

<sup>5</sup> See also FRM paragraph 2200.6.



**Table 3: When Financial Statements are Required for Merger Proxy Statements**

Solicited Shareholders	Consideration	Financial Statements
Acquirer Only	Cash only	<ul style="list-style-type: none"> <li>Financial statements of the target are required.</li> <li>Financial statements of the acquirer are not required unless they are material to an informed voting decision.</li> <li>Pro forma financial information is required if it is material to a voting decision.</li> </ul>
Acquirer Only	Exempt securities only or a combination of exempt securities and cash	<ul style="list-style-type: none"> <li>Financial statements of the target are not required unless it is a going private transaction.</li> <li>Financial statements of the acquirer are not required unless they are material to an informed voting decision.</li> <li>No pro forma information is required.</li> </ul>
Target Only	Cash only	<ul style="list-style-type: none"> <li>Financial statements of the target are not required unless it is a going private or a roll-up transaction.</li> <li>Financial statements of the acquirer are generally required.</li> <li>Pro forma financial information is required, if material.</li> </ul>
Target Only	Exempt securities only or a combination of exempt securities and cash	<ul style="list-style-type: none"> <li>Financial statements of the target are required.</li> <li>Financial statements of the acquirer are not required unless they are material to an informed voting decision.</li> <li>Pro forma financial information is required if it is material to a voting decision.</li> </ul>
Acquirer and Target	Cash only	<ul style="list-style-type: none"> <li>Financial statements of the target are required.</li> <li>Financial statements of the acquirer are generally required.</li> <li>Pro forma financial information is required, if material.</li> </ul>
Acquirer and Target	Exempt securities only or a combination of exempt securities and cash	<ul style="list-style-type: none"> <li>Financial statements of the target are required.</li> <li>Financial statements of the acquirer are not required unless they are material to an informed voting decision.</li> <li>Pro forma financial information is required if it is material to a voting decision.</li> </ul>

**Exempt Offerings – Rule 144A Transactions and Offering Memoranda**

The target and pro forma financial statement requirements under Rule 3-05 and Article 11 also become relevant in Rule 144A offerings, as a result of market convention. While these SEC requirements do not technically apply to Rule 144A offerings, it has become standard practice for practitioners to substantially adhere to these requirements as much as possible in their exempt offerings. Initial purchasers and QIBs have come to expect that the financial disclosures in a Rule 144A offering memorandum; in particular, the inclusion of target and pro forma financial statements in connection with a significant acquisition, would in all material respects be consistent with the needed financial disclosures in a registration statement. This is particularly the case where security holders have been granted registration rights or an A/B exchange offer would follow a Rule 144A notes offering, since in these situations, compliance with the SEC requirements will then apply, at the back-end, to the registered offering. Inclusion of such financial statements in the Rule 144A offering memorandum assists the issuer and financial intermediaries in presenting investors with full and fair disclosure about the issuer's financial condition and results of operations, and mitigates possible claims from investors that the offering document contained material misstatements or material omissions.

Since the SEC rules under Rule 3-05 and Article 11 do not technically apply to Rule 144A offerings, practitioners are afforded a certain degree of flexibility in a Rule 144A deal. For instance, it is not uncommon for practitioners to decide that two years of target audited financial statements would suffice, instead of three years that may be required by the SEC rules, if such omission does not materially alter the total mix of information available to investors. Marketing considerations also come into play. For instance, in the case of a probable significant acquisition that exceeds 20% significance but not 40% significance, it is not uncommon for practitioners to decide to include target and pro forma financial statements in the offering memorandum, notwithstanding that



these would not be required to be included in a registration statement since the significance has not exceeded the 50% significance level applicable to probable acquisitions.

### Rule 3-13 Waiver Requests

Finally, registrants that wish to seek relief from complying with Rule 3-05 and Article 11 financial statement requirements should remember and consider making Rule 13-3 waiver requests. Rule 3-13 of Regulation S-X allows the SEC, upon the informal request of a registrant and where consistent with investor protection, to permit the omission of financial statements otherwise required by the SEC rules or their substitution by financial statements of a comparable character.

Note that in July 2017, SEC Chair Jay Clayton stated that under Rule 3-13, issuers can request modifications to their financial reporting requirements in certain circumstances where disclosures are burdensome to generate, but may not be material to the total mix of information available to investors. Chair Clayton encouraged companies to consider whether such modifications may be helpful in connection with their capital raising activities and assured them that Staff is placing a high priority on responding with timely guidance. Echoing Mr. Clayton's earlier remarks, then Corp Fin Chief Accountant Mark Kronforst also remarked in November 2017 that Rule 3-13 is intended to facilitate capital information, and allows companies to be granted relief where consistent with investor protection. Mr. Kronforst said the SEC staff is encouraging companies with reporting problems to come to them and that, under a pilot program, the SEC staff usually responds within five days from the date of request.

### Conclusion

A significant business acquisition represents an important event in the life cycle of a registrant. Because a significant acquisition oftentimes results in significant changes to a registrant's financial position, results of operations and future prospects, the SEC rules require registrants to include in their filings and disclose to investors historical financial statements of the target and pro forma financial statements giving effect to the acquisition under Rule 3-05 and Article 11. Understanding these rules is essential for registrants to discharge their reporting obligations and to carry out any contemplated securities offerings in a timely fashion. While this note provides an overview of the financial statement requirements under Rule 3-05 and Article 11, it is important to remember that the SEC's financial reporting and disclosure requirements triggered by a company's significant business acquisition are technical in nature and are subject to many exceptions and special cases. Registrants should therefore carefully review the rules, evaluate the applicable facts and circumstances, and work with counsel and auditors in carrying out their significance analysis and financial reporting presentations.

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**On point.**

