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July 29, 2019

Office of the Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Proposed Rule, “Amendments to Financial Disclosures about Acquired and Disposed Businesses,” File No. S7-05-19

Dear Office of the Secretary:

Crowe LLP appreciates the opportunity to provide input on the Securities and Exchange Commission (“SEC” or “Commission”) proposed rule, “*Amendments to Financial Disclosures about Acquired and Disposed Businesses*” (“Proposal” or “Proposed Rule”). We support the SEC’s efforts to explore avenues to reduce the administrative burden on reporting companies while at the same time seeking to maintain or enhance investor protection.

Current rules covering disclosure related to the acquisitions and dispositions of businesses can create undue burden on issuers and auditors. We support the objective of the Proposed Rule and believe it will achieve its goal of reducing unnecessary compliance burdens while maintaining important investor protections. However, certain aspects of the rule might be improved or clarified, which are outlined below.

Significance Tests

Investment Test

The Proposed Rule suggests revising the denominator of the investment test¹ to the registrant’s aggregate worldwide market capitalization (that is, the market value of all voting and non-voting common equity) as of the last business day of its most recently completed fiscal year. The Proposal notes using market capitalization would “align the [i]nvestment [t]est more closely with the economic significance of the acquisition to the registrant.” Conceptually, using market capitalization is more indicative of the relative significance of an acquisition for investors in the registrant because the numerator of the investment test has historically been on a fair value basis (that is, typically the fair value of the purchase consideration), but the denominator uses historical cost.

We recommend the Commission consider whether a date closer to the acquisition date provides a more meaningful significance measure. For example, a registrant might have significant intervening events that materially impacted its market capitalization. Such events could impact a registrant’s market capitalization both positively or negatively. For events that negatively impact a registrant’s market capitalization, registrants might conclude an acquisition is not significant under the Proposed Rule when, in fact, had a later date been used to calculate market capitalization, the acquisition would be significant. In such a scenario, investor protection would be compromised. In contrast, if significant positive events have impacted the registrant’s market capitalization post-year-end, an acquisition might trigger significance using year-end market capitalization even though it would not trigger significance using current market capitalization. We recommend the Commission

¹ See Rule 1-02(w) of Regulation S-X.

consider whether the registrant's market capitalization as of its most recent quarter end or immediately prior to the announcement of the acquisition is more likely to conceptually reflect the significance of the acquisition to investors.

Income Test

The Proposed Rule recommends both the numerator and the denominator of the income test² use after-tax net income instead of pre-tax income under the current test. Many registrants in certain industries are not subject to income tax at the entity level (that is, the registrant is a pass-through entity). Similarly, in many cases, an acquired business is a pass-through entity. In situations where either the registrant or the acquired entity is subject to income taxes but the other is not, or one entity has recorded a full valuation allowance against deferred income taxes but the other has not, the results of the income test will be skewed under the proposed income test. The current income test using pre-tax income has not created significant issues in practice with respect to the comparability of the measure between the registrant and the acquired business, and we suggest continuing to use pre-tax income in any revised test. Should the Commission elect to finalize the Proposed Rule using after-tax net income, we encourage revising the rule to provide clarity on how to apply the rule in situations where application of the income test results in using financial information that is not comparable (that is, comparing an after-tax figure to a pre-tax figure).

The Proposed Rule also suggests adding a second prong to the income test when both the registrant and the acquired entity have "recurring annual revenue." The Proposed Rule does not appear to define "recurring annual revenue," and practitioners might have different views as to the meaning of "recurring." Providing a definition or clarifying guidance would reduce the possibility of diversity in practice when applying the proposed income test.

Abbreviated Financial Statements

Historically, when a registrant acquires less than substantially all of the assets and liabilities of another entity, the staff accepts either "carve-out" financial statement or "abbreviated financial statements," depending on specific facts and circumstances, when it is impracticable to prepare full financial statements required by Regulation S-X. Under current practice, registrants submit to CF-OCA pre-filing requests to present abbreviated financial statements, when applicable. The Proposed Rule seeks to codify existing staff practices with respect to abbreviated financial statements and indicates the staff will accept, without pre-clearance, audited statements of assets acquired and liabilities assumed, and statements of revenues and expenses (exclusive of corporate overhead, interest and income tax expenses) in lieu of full financial statements required by Regulation S-X, when certain criteria are met. However, it is unclear whether and how the Proposed Rule impacts "carve-out" financial statements.

Existing staff guidance in the Division of Corporation Finance's Financial Reporting Manual³ ("FRM") indicates the staff "will accept carve-out financial statements if it is impracticable to prepare the full financial statements required by Regulation S-X, and explanation of that impracticability is included in the filing." The criteria that would allow abbreviated financial statements under the Proposed Rule could be read to overlap with the staff's interpretive guidance on when "carve-out" financial statements are appropriate (for example, both appear to apply when a registrant acquires less than substantially all of a business), but the Proposed Rule does not appear to mention or provide clarity on whether "carve-out" or "abbreviated" financial statements are appropriate.

We encourage the Commission to consider whether it would be useful for any final rule to more specifically describe the different scenarios when "carve-out" or "abbreviated" financial statements would be appropriate as well as provide further clarity on certain criteria such as when the acquired business "was not a separate entity, subsidiary, segment, or division." For example, it is unclear whether the acquisition of multiple segments

² Ibid.

³ <https://www.sec.gov/corpfin/cf-manual>

of another entity in a single transaction would qualify for abbreviated financial statements under the criteria set forth in the Proposed Rule.

Registration Statements

Historical Financial Statements of Acquired Businesses

Under the Proposed Rule, a registrant can omit financial statements of a significant acquisition once the post-acquisition results are included in the registrant's financial statements for a complete fiscal year. The Proposed Rule clarifies a registrant is not allowed to utilize the nine month equivalent to a full fiscal year accommodation in current Rule 3-06 of Regulation S-X for this purpose. Under current Rule 3-05, historical financial statements of an acquired business that meets the lowest level of significance (that is, one year) can be omitted when the acquired business has been included in its post-acquisition audited results for at least 9 months. We suggest the Commission maintain this application of Rule 3-06. To supplement the required financial statements, the Commission could also consider whether it would be appropriate to modify the Proposed Rule to require disclosure of any material information impacting any pre-acquisition period that would otherwise be required absent the use of Rule 3-06.

Investment Test

The Proposed Rule only allows a registrant to use, in the denominator of the proposed investment test, the aggregate worldwide market value of its common equity "when available," which would exclude an initial public offering (IPO). Consistent with today's practice of estimating public float at the anticipated offering date to determine whether an IPO prospect qualifies for smaller reporting company⁴ status, we recommend an IPO prospect should be allowed to estimate its worldwide market capitalization at the anticipated offering date for the denominator of the proposed investment test to foster the consistent application of the test.

Pro Forma Financial Information

Management's Adjustments

The Proposed Rule introduces a new required category of pro forma adjustment under Article 11 of Regulation S-X called Management's Adjustments ("MAs") that would depict "synergies and other transaction effects identified by management in determining to consummate or integrate the transaction for which pro forma effect is being given." The Proposed Rule also provides examples of MAs including "closing facilities, discontinuing product lines, terminating employees, and executing new or modifying existing agreements that are both reasonably estimable and have occurred or are reasonably expected to occur."

The Proposed Rule is not clear whether the examples of MAs is a complete list or whether there are additional MAs that might be acceptable. Specifically, practitioners could interpret the concept of synergies and other effects considered by management in consummating or integrating the transaction more broadly than intended in the Proposed Rule. In particular, management might have considered a full forecast of the integrated acquisition in its decision making process, and it is unclear whether such a forecast is contemplated in the definition of MAs or would instead be encompassed in current Rule 11-03 of Regulation S-X. We encourage the Commission to provide more clarity and guidance on what represents appropriate MAs.

We also suggest further clarification of certain terms used in the context of MAs. For example, what amount of precision implies the MA is "reasonably estimable," what time horizon implies an MA is "reasonably likely to occur," and what disclosure is required for a "fair and balanced" presentation.

⁴ Item 10(f)(1) of Regulation S-K.

US GAAP Disclosures

Financial Accounting Standards Board (“FASB”) Accounting Standards Codification Topic 805 (“Topic 805”) requires certain pro forma disclosures when a business combination has occurred; however, Topic 805 provides limited guidance on the preparation of those disclosures. Practitioners typically analogize to Article 11 of Regulation S-X in areas where Topic 805 is silent. Prior to the issuance of any final rule, we recommend the Commission coordinate with FASB to determine if any changes to Topic 805 are in the interest of investors to promote consistency and comparability between registrant disclosures, particularly during any transition period when some Topic 805 disclosures might have been prepared using analogies to the current Article 11 and other Topic 805 disclosures might have been prepared using analogies to the Proposed Rule, once it is effective.

Independence

Proposed Rules 3-05, Rule 3-14 and Rule 6-11 would require financial statements “prepared and audited in accordance with this regulation” (that is, Rule 2-01 of Regulation S-X if the business is a registrant) or, alternatively if the business is not a registrant, the applicable independence standards. We recommend that the Commission clarify the meaning of “applicable independence standards” in the final rules given the various independence standards that might apply to a business that is not a registrant.

Comfort Letters

While we acknowledge comfort letter considerations are not directly contemplated in the Proposed Rule, the Proposed Rule could impact auditors’ ability to provide comfort on certain disclosures, which might negatively impact capital formation. As part of their due diligence process in a securities offering, underwriters typically request the auditor provide a comfort letter, and auditors follow Public Company Accounting Oversight Board (“PCAOB”) Auditing Standard 6101 (“AS 6101”): *Letters for Underwriters and Certain Other Requesting Parties*.

Paragraph 42 of AS 6101 refers to the current Rule 11-02 of Regulation S-X, which does not include MAs. The Proposed Rule will significantly change the manner of presenting pro forma financial information; in particular with respect to MAs, which are more subjective than adjustments currently permitted under Rule 11-02. In addition, the Proposed Rule would require registrants in certain circumstances to provide pro forma financial information depicting the aggregate effects of all individually insignificant businesses (that is, no historical financial statements of the acquired businesses are required in certain circumstances, even though pro forma financial information is required). Paragraph 42 of AS 6101 does not allow auditors to provide negative assurance on pro forma information unless an auditor has performed an audit of the annual financial statements, or an AS 4105 review of the interim financial statements, of all of the individual constituent entities to which the pro forma adjustments were applied. We encourage the SEC to coordinate with the PCAOB to 1) determine if any changes to AS 6101 are required in light of the significant proposed changes to pro forma financial information; and 2) determine appropriate transition guidance if changes are required to avoid any unintended detriments to capital formation.

Updates to Staff Interpretative Guidance

We recommend the staff undertake a comprehensive review of its interpretive guidance (for example, the FRM, Compliance and Disclosure Interpretations, etc.), and provide any updates to the staff’s interpretive guidance concurrent with the issuance of any final rule.

Closing

We thank the SEC for providing the opportunity to express our views on questions raised in the Request. Please contact Mark Shannon at 202-779-9921 or Brad Davidson at 317-706-2635 to answer any questions that the staff may have regarding the views expressed in this letter.

Sincerely,

Crowe LLP

Crowe LLP