The Association of Accountants and Financial Professionals in Business

July 31, 2019

Ms. Vanessa A. Countryman
Secretary, Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

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

Dear Ms. Countryman:

The Financial Reporting Committee (FRC or Committee) of the Institute of Management Accountants (IMA) is writing to share its views on the Securities and Exchange Commission's (SEC or Commission) Proposed Rule − *Amendments to Financial Disclosures about Acquired and Disposed Businesses* (Proposal).

The IMA is a global association representing over 130,000 accountants and finance team professionals. Our members work inside organizations of various sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities, and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The Committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics, and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals, and other documents issued by domestic and international agencies and organizations. Additional information on the FRC can be found at www.imanet.org (About IMA, Advocacy, Financial Reporting Committee).

Overall, we support the SEC's efforts to simplify and make more meaningful the requirements for registrants to file audited financial statements of acquired businesses, and pro forma financial information related to significant acquisitions and dispositions (financial disclosures about acquired and disposed businesses). Members of our Committee have observed that the existing financial disclosure requirements about acquired and disposed businesses regularly apply to transactions which are not significant from either the registrant's or users' perspectives. In these circumstances, we are aware that registrants regularly request and receive financial disclosure waivers from the SEC staff. Additionally, when financial disclosures are provided, pro forma financial information may not be particularly useful to users of financial statements due to the existing limitations on the nature of the allowed adjustments.

In this regard, we believe the Proposal properly focuses on both the definition of a significant acquisition (disposition), and what financial information should be provided for both significant and insignificant acquisitions (dispositions). We believe the revised significance tests, the simplified and reduced requirements for audited annual and unaudited interim financial statements and the introduction of management adjustments to pro forma financial information will all result in improvements to the relevance and quality of the information filed by the registrants.

However, we have the following recommendations that we believe are consistent with the SEC's intent in issuing the Proposal and would improve the Proposal.

1. For the investment test, we recommend the SEC change the proposed approach to use the acquirer's enterprise value instead of market value of common stock or, in the absence of a readily-determinable market value of common stock, total assets. While for certain registrants the market value of common stock will exceed (in some cases significantly) the registrant's total assets, there are many registrants (particularly those with significant debt and/or preferred stock) where the market value of common stock is less than the registrant's total assets. The approach to the investment test in the Proposal could lead to a conclusion that an acquired business is significant when the opposite conclusion would be reached using the registrant's total assets. Because the revision to the investment test appears to be motivated by an attempt to compare the consideration paid for the acquired business (fair value) to an appropriate measure of the fair value of the registrant, we believe using the registrant's enterprise value represents a more appropriate means of achieving that result. We recognize that there is currently no single definition of enterprise value.

   However, we believe the SEC could adopt a definition for purposes of the investment test. We believe the enterprise value should include the registrant's common and preferred stock, as well as its debt (including finance lease obligations). While our proposed approach would require a registrant to estimate the fair value of any non-traded debt and preferred stock, we believe registrants are used to making fair value estimates (for example, in assessing a goodwill impairment and in disclosing the fair value of financial instruments). If the judgment involved in making those fair value estimates is acceptable for inclusion in financial statements filed with the SEC, that judgment should also be acceptable to determine whether an acquired business is significant under the investment test. If the SEC agrees to the use of enterprise value (however the SEC decides to define that term for purposes of the test), we recommend that a registrant be permitted to use either (1) the carrying amount of debt and/or preferred stock without a readily-determinable fair value in the test provided the registrant does not have any reason to believe that the fair value would be lower than the carrying amount, or (2) the carrying amount of debt, preferred stock and the residual equity (i.e., the amounts attributable to common stock).

2. For both the investment and the asset tests, we recommend permitting registrants to use the most recent annual *or* interim period-end date for purposes of performing the test. For example, with this recommended change, a calendar year-end company closing an acquisition towards the end of the year would be permitted to use the unaudited data as of September 30 of that year. Many newly registered companies experience rapid growth. We have observed examples where an acquisition that would have been material shortly after the prior year-end is no longer material, when it occurs towards the end of the following year. The ability to use the registrant's most recent interim period-end date for significance tests would help reduce circumstances where a registrant is required to provide financial statements for an acquisition that is not significant at the date the acquisition is consummated.

3. With respect to the income test, we recommend the SEC further streamline and simplify the use of the average method based on the most recent five years of operations. In our experience,

registrants tend to overlook when the average method should be used instead of the actual net income (loss). As a result, a registrant may reach incorrect conclusions regarding significance of the specific acquisitions. While the proposed amendments will make the application of the average method more reasonable by using the absolute values of the net loss, the rules as to when the method should be used remain complicated and are not intuitive. One possible simplification is to set the denominator as the higher of the actual net income (loss) or the average net income (loss) of the registrant over a five-year period in all circumstances. For any loss years, the absolute value of the loss would be used.

4. The income test for investment companies as drafted is not clear. The Proposal would require the acquirer to use the sum of the absolute values of investment income, net realized gains and losses on investments and the net change in unrealized gains and losses of the tested subsidiary in the numerator, but the denominator is the absolute value of the acquirer's change in net assets resulting from operations, rather than the absolute value of the components that make up the change in net assets from operations. The basis for determining the denominator seems different than the basis for determining the numerator and could lead to similar operating results between the acquired investment company and the acquirer being treated differently in the significance calculation. For example, if both the acquired investment company and the acquirer have a net realized loss on investments, the absolute value of the acquired investment company's net realized loss would be added to its investment income, but the acquirer's net realized loss would reduce the change in net assets from operations, resulting in a denominator that is lower than it would be if the calculation of the denominator were the same as the calculation of the numerator.

5. In the proposed requirements for financial statements of acquired net assets that constitute a business (Section II, A.3 of the Proposal), registrants would be permitted to exclude corporate overhead, interest and income tax expense if they meet certain requirements. Although this may be implied, we recommend the SEC also permit registrants to exclude any remaining amounts classified as other income or other expense, subject to the same or similar requirements. Examples of such items include investment income, foreign exchange gains and losses, and gains and losses from remeasurement of financial instruments carried at fair value. Collecting such information related to a set of acquired net assets could be just as impractical as the effort related to corporate overhead, interest expense and income taxes.

6. In the pro forma financial information, while we expect that management adjustments will result in more meaningful information, we anticipate there will be circumstances where additional adjustments would be helpful for users of the financial statements. For example, assume the acquired business had one product line that was underperforming to such an extent that the acquired business recorded an impairment loss during the interim period preceding the acquisition date. Upon acquisition, the registrant initiates a restructuring of the impaired product line. Under the Proposal, the pro forma financial information for the fiscal year preceding the acquisition date would include management adjustments for the restructuring, as if it had occurred at the beginning of that fiscal year. However, the impairment loss recorded by the acquired business would remain in the historical interim period. The resulting presentation in the pro forma financial information is inconsistent with what would have happened if the acquisition had been consummated as of the beginning of the annual period presented. In our view, we believe the impairment loss should be

reversed through a management adjustment, but it is not clear under the Proposal that such an adjustment would be appropriate. We recommend the SEC clarify that a management adjustment in such a circumstance would be appropriate.

It is hard to design a set of rules that would contemplate all potential circumstances confronted by registrants. We believe a reasonable approach could be to allow management discretion in determining the period in which management adjustments would be recorded. Additionally, it may also be appropriate to reflect in management adjustments a change in the timing of certain actual events, if making such changes is consistent with the nature of other management adjustments. For example, if the acquired business lost a major customer during the interim period preceding the acquisition date, it would seem appropriate to reflect a management adjustment to eliminate revenues from that customer in the pro forma financial information for the fiscal year preceding the acquisition date. However, as with the example above, it is not clear that such an adjustment would be permitted under the Proposal. To maintain integrity of the pro forma financial information, an overall objective could be added to the requirements – to present the information that is most indicative of what the financial performance would have looked like had the acquisition been consummated on the first day of the annual period presented.

7. We also recommend the SEC clarify how the pro forma financial information should be presented if there is an overlap between transaction accounting and management adjustments. For example, if an acquired business is expected to provide synergies or cost savings to a market participant, the fair value of intangible assets of the acquired business that benefit from those synergies or cost savings will be greater as a result. That increased fair value will result in an increased amortization expense in the acquirer's pro forma income statement. Presumably, these amounts would be part of the pro forma adjustments in the transaction accounting column. However, there would also be management adjustments to the historical income statement information of the acquired business to reflect the reduction in costs, to the extent the entity's actual or expected actions align with those of the market participant. Accordingly, there would be adjustments in each column that are based on the same factors, when synergies/cost savings are the same between the entity and the market participant. It would be helpful if the SEC would clarify whether that result is consistent with its views on determining management adjustments.

8. We recommend the SEC treat contingent consideration relating to milestones and royalties determined based on the usage of purchased or licensed intellectual property in the same manner as sales-based contingent consideration for purposes of determining the fair value of contingent consideration used in the significance test. In certain contracts, royalties are assessed on the licensee or purchaser usage of the intellectual property, instead of sales. We do not believe the treatment of royalties for purposes of the significance tests should vary depending on the underlying driver for the royalty amounts. Further, we recommend that the SEC permit registrants to determine significance using the fair value of the contingent consideration arrangement, even if that amount is not recognized in accounting for the acquisition. In an acquisition that qualifies as an asset acquisition under US GAAP (but is a business acquisition under the SEC rules), the fair value of the contingent consideration is usually not recorded. However, entities may have estimates of fair value of contingent consideration available to them. Being able to use such estimates for purposes of the significance test would help avoid classifying certain acquisitions as significant,

for example, when there is a wide range of possible outcomes in the eventual amount of contingent consideration that may be owed.

9. When a product line is acquired, we support the concept that registrants should be permitted to file abbreviated financial statements for such product lines, including statements of revenues and direct expenses (cost of revenues). This would be consistent with the result obtained today through SEC waivers. We agree that such abbreviated financial statements should be audited and filed within the customary 75-day filing window, along with the relevant Article 11 pro forma financial information. In our experience, presentation of a statement of revenues and direct expenses is appropriate when a full income statement of the acquired business is not available because the product line was not a separate entity within the seller and is not practical to prepare. A full income statement in that circumstance could also be misleading as it might include charges from the previous parent that are different from the costs that will be incurred under the acquiror. For example, if various expenses incurred within the division that encompasses the acquired product line are shared, allocation of such expenses to the acquired product line may not be available, practical or meaningful. In these circumstances, omission of this information (with relevant disclosures) would be appropriate.

In addition to our comments above, we recommend the Commission evaluate whether financial statement users derive a significant benefit from registrants filing historical audited financial statements of acquired businesses as part of Form 8-K. However, we do not recommend the Commission delay issuing the Proposal until it has completed that evaluation. Typically, such financial statements are filed approximately 75 days after the acquisition has closed. Because shareholders of the acquirer do not vote on such acquisitions, it is not clear what benefit they receive from the historical audited financial statements of the acquired business. If the acquired business does not already have audited historical financial statements, as occurs in many acquisitions, the need to prepare financial statements and have those financial statements audited imposes a significant effort and cost on both the acquirer and the acquired business. As the audited historical financial statements of the acquired business are usually not filed until after the close of the acquisition, the effort and cost of producing audited financial statements of the acquired business may not be commensurate with the benefit derived by users. In those circumstances, we believe the needs of financial statement users are better served through pro forma financial information as that information allows them to understand management's assessment of the expected impact of the acquired business on the registrant. This would facilitate users holding management accountable for acquisitions that subsequently do not meet expectations. We believe the proposed changes to the contents of pro forma financial information, and specifically management adjustments, will enhance the usefulness of such information because, unlike the audited historical financial statements of the acquired business, the pro forma financial information under the Proposal will provide users information about the expected performance of the acquired business following the acquisition. For example, pro forma adjustments may reflect integration and/or restructuring efforts, which are often significant, that result in the post-closing financial results of the acquired business with little in common with the historical financial results. For clarity, we still believe historical financial statements are important in a registration statement (Form S-1, S-3, S-4) or proxy as it is part of the information users would consider in deciding how to vote on the issues presented by the acquirer.

Certain industries are not represented on our Committee. As a result, our comments do not relate to the proposed changes that are specific to real estate, oil and gas, and, apart from one comment above, investment companies.

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We would be pleased to discuss our comments with the SEC staff at their convenience.

Sincerely,

Nancy J. Schroeder, CPA
Chair, Financial Reporting Committee
Institute of Management Accountants
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