

November 22, 2019

Vanessa Countryman  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-0609

**Re: Amendments to Financial Disclosures about Acquired and Disposed Businesses  
File Number S7-05-19**

Dear Ms. Countryman:

CFA Institute<sup>1</sup> is pleased to provide you with our perspectives on areas for consideration in conjunction with the Securities and Exchange Commission's (SEC's or Commission's) initiative to improve financial disclosures about acquired and disposed businesses, [\*Amendments to Financial Disclosures About Acquired and Disposed Businesses\*](#), (hereafter referred to as the "Proposal"). ***Our comments are principally focused on the proposed changes to Article 11, Pro Forma Financial Information of Regulation S-X.***

As an overall matter, we are strongly in favor of making changes to pro forma information so that it is more useful to investors. ***The existing pro forma financial statements are so reflective of the past that frequently they are of limited use to investors, as they do not include any forward-looking information.*** Therefore, we strongly support the Commission's efforts to improve the content of pro forma information by including more forward-looking information. At the same time, we offer some other suggestions to further improve this information for investors. Most importantly, ***we believe that for the improvements in this area to be truly transformational, the information needs to be made available to investors on a more accelerated basis, to a date much closer to when the deal is announced to the public. This is when investors are actually making decisions about the deal, and therefore, when this information is most decision-useful to them.*** Accordingly, we strongly encourage the SEC to consider this suggestion.

We elaborate on these points below, and also provide our views on other aspects of the Proposal, such as the proposed changes to the significance tests and requirements regarding the financial information that is required for acquisitions.

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<sup>1</sup> CFA Institute is a global, not-for-profit professional association of nearly 171,400 investment analysts, advisers, portfolio managers, and other investment professionals in 165 countries, of whom more than 164,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 154-member societies in 77 countries and territories.

***Management's Adjustments:***

***Inclusion Will Improve the Usefulness of Pro Forma Information to Investors***

From our perspective, investors are primarily interested in understanding how a company will look going forward and in assessing its future prospects. Therefore, historical earnings and historical earnings per share in an equity offering are less relevant to investors than estimations of future performance. Thus, the current limitations in the pro forma rules on significant planned changes by the acquirer, such as workforce reductions, facility closings, and the like, actually hinder, rather than help, the investor. Pro forma information provided by financial institutions, for example, is virtually meaningless to investors because of its backward look on interest rates and the inability to reflect significant planned changes by the acquirer. In fact, we observe that many companies explicitly acknowledge that the pro forma financial statements are of limited use as they exclude the effects of management actions or other events that do not meet the “factually supportable” criterion.

***Thus, we strongly support the proposed changes to the content of pro forma information to include Management's Adjustments that reflect reasonably estimable synergies and other transaction effects that have occurred or are reasonably expected to occur.*** We believe this additional requirement to include forward-looking information that gives effect to the synergies and other transaction effects identified by management in determining to consummate or integrate the transaction will prove decision-useful to investors. We believe this change would prove useful to investors as it is grounded in the information that is provided to investors in connection with “marketing the deal” to the public and that is furnished to the SEC connection with Regulation FD. In fact, we believe that Management's Adjustments should be consistent with, if not reconciled to, management projections provided to its board and shareholders, or the projections provided to financial advisors for purposes of rendering fairness opinions.

This is the information that is actually being used by investors in making investment decisions, and thus is more relevant to them. Providing more information regarding management's plans for the combined entity, including synergies and other operational changes, will further enable investors to understand how the transaction will impact the acquiror and will provide them with the information they need to form their own estimations of the combined entity's going forward prospects.

Because this information is typically already prepared by management in marketing the deal to the public and presented to the board of directors, we believe that it should be readily available to registrants and will not place an undue burden on them in providing it as part of the pro forma results. We are also of the view that because these synergies and cost reductions are often relied upon by management and the board in making their decision to engage in a transaction, it is in no way “premature” to disclose these estimates in the pro forma information to investors. Where confidentiality is a concern, such as providing information regarding planned plant closings that might impact employee retention or morale, this can be addressed by disclosing planned cost savings or revenue increases in the aggregate.

***Management's Adjustments:***

***Investors Recognize They Evolve Over Time & Will Not Be Confused***

Of course, we are aware that Management's Adjustments may evolve over time, as the acquiror becomes more familiar with the acquiree's business and as integration plans evolve. Estimates by their nature are highly uncertain and based on imperfect information; as more information is obtained, these estimates will improve. ***We believe that changes in estimates are a normal part of the process, and disclosure of these changes will not be confusing to investors, but rather will prove useful to them in understanding the progression of the transaction over time.*** Accordingly, we believe that these changes in estimates should be incorporated into the pro forma information whenever it is required to be provided – for example, in a Form S4/proxy statement seeking approval of the transaction, in the subsequent Form 8-K filing, and in connection with other financing transactions to fund the acquisition.

If registrants are concerned regarding potential liability of disclosing these types of Management Adjustments, either because they contain forward-looking information, or because they will change over time, we would not be opposed to the Commission providing a safe harbor for such information similar to that found in the Private Securities Litigation Reform Act's safe harbor rule (15 U.S.C. § 78u-5(c)). In short, we believe it is preferable to provide investors with more relevant information that is subject to a safe harbor than to provide what is currently perceived today as largely irrelevant information without a safe harbor.

***Pro Forma Financial Information:***

***Objective Should be Clearly Articulated***

More generally, we believe that the SEC should clarify the objective of pro forma information, as we believe this will prove useful in resolving many questions and concerns that arise in practice with providing this information. In our view, the purpose of pro forma information is to demonstrate how historical results would change based on the transaction; we do not consider it to be a projection (or commitment), but an estimation, of the company's future results. Investors are interested in the earnings pattern of the acquired business, the changes in assets values that will be recognized on the acquisition, and how these and other impacts (synergies) will impact the earnings pattern into the future. The purpose of pro forma information should be to attempt to paint this picture for investors.

Clearly articulating the objective of providing pro forma information will also prove useful in determining how registrants, auditors, underwriters, and even the SEC itself should address questions that arise in practice regarding what should or should not be included in the information provided. For example, some of the issues that are discussed below would be more easily answered if the objective of providing pro forma information were clearly set forth by the SEC.

***Management's Adjustments:***

***Include Non-recurring Costs and Near- and Long-term Synergies***

We acknowledge the fact that in many acquisitions, incremental costs are incurred short term, which may lead to cost savings or increased revenues over the longer term. For example, actions such as closing facilities, terminating or renegotiating leases and laying off employees may lead to synergies in the long-term but typically entail increased costs in the near term as severance and other breakage obligations are incurred.

***We believe it is important to include such non-recurring charges in the pro forma information***, as we believe it is critical to illustrating how historical results would change based on the transaction. Given the Commission's goal to make pro forma financial information more meaningful for investors, we believe it would be a disservice to exclude this information on the grounds that it is not indicative of future performance, as investors are clearly interested in receiving information on costs associated with a planned transaction.

At the same time, ***we acknowledge that it would not be appropriate to depict only the near-term effects (i.e., increased up-front costs to achieve synergies) without also reflecting management's estimate of the synergies that may be achieved in later years as a result.*** (As a side note, we do not believe that the term "synergies" has to be formally defined, as the term is used widely in practice; we believe it encompasses cost, revenue and capital synergies.) Determining how to present such longer-term revenue synergies in the pro forma information could prove challenging, and will clearly require judgment. Accordingly, rather than mandate a one-size fits all approach, ***we agree with the SEC's Proposal to provide management the flexibility to provide information regarding the full anticipated run-rate savings and synergies, along with their anticipated timing for realization, as footnotes to the pro forma financial statements.*** This would provide for a complete picture for investors and would allow them to factor this information into their own estimates regarding the planned transaction.

***We also concur with the SEC's requirement for management to disclose any material uncertainties regarding the anticipated synergies.*** We believe that as a general matter, management can indicate the level of confidence in the accuracy and attainability of the forecasted information in narrative disclosure that accompanies the pro forma schedules.

***Finally, we believe that more clarity could be achieved by aligning the SEC and GAAP pro forma rules.*** The differences that exist today between these two sets of rules are understood only by a small cadre of accounting and legal professionals and prove confusing, at best, to the wider investment community. We see no compelling reason to preserve these two different regimes and urge the SEC to work with FASB on conforming the requirements.

***Pro Forma Financial Information:  
Can Be Dramatically Improved by Providing Information on A More Accelerated Basis***

While we support the changes to the content of the pro forma information, we believe that in order for these changes to be truly transformational, the pro forma information needs to be made available on a more accelerated basis to investors.

Currently, the pro forma information is provided substantially after the announcement of – and market reaction to – an acquisition by a registrant. From this we can safely conclude that pricing decisions are made by investors long before pro forma information is available to investors and after it would be most decision relevant.

The reality is that under the current rules, by the time the information is provided to investors, it is already stale, and therefore of limited use. ***Essentially the pro forma information provided today is an “accounting exercise.” Therefore, for the SEC to make pro forma information more relevant to, and effective for, investors, the SEC should accelerate the timing of the pro forma information to a date closer to when the deal is announced to the public.*** For example, we note that the timeline for filing pro forma financial information for a significant disposition is four business days, without the automatic 71 calendar-day extension permitted for providing pro forma financial information for an acquisition. We believe that the timeline for filing pro forma information for acquisitions should be aligned to that for significant dispositions, that is, four business days after the occurrence of the event.

We acknowledge the fact that in certain cases it may be difficult to comply with this requirement; we respectfully submit that extending the deadline for filing pro forma financial to a maximum of 30 days would appropriately balance registrants’ compliance burden with the imperative of providing timely disclosure to the market.

***Proforma Financial Information:  
Auditors’ Comfort Letters Should Not Pose an Impediment to Improving***

We are aware that underwriters typically request a registrant’s auditor to provide comfort on the pro forma financial information in certain circumstances. It is our understanding that the procedures required for auditors to provide negative assurance to underwriters on comfort letters are fairly limited in nature, consisting of: 1) enquiring of management as to the basis of its determination for the pro forma adjustments and as to the compliance of the pro forma financial information with the requirements of Rule 11-02 of Regulation S-X, and 2) checking the arithmetic accuracy of the application of those adjustments to the historical amounts. ***We do not believe that the proposed changes would materially impact the auditors’ responsibilities in this regard.***

However, if the SEC or PCAOB determines that this change to the pro forma rules would require additional rule-making for auditors (i.e., an amendment to AS 6101, *Letters for Underwriters and Certain Other Requesting Parties*), one possible interim approach would be to require that Management’s Adjustments be segregated from the traditional pro forma information and be accompanied by appropriate disclosures, so that auditors could exclude Management’s Adjustments from their comfort letters. We believe that

this would allow whatever rulemaking is required to progress without delaying the timely finalization of the SEC's Proposal and without resulting in any disruption to the capital markets.

***Proposed Changes to Significance Tests: Income Test  
Revise to Capture Either Revenues or Income***

The SEC is proposing to revise the Income and Investment significance tests set forth in Rule 1-02(w) so that they result in more meaningful significance determinations. The proposed changes to the Income Test would require that, where the registrant and its subsidiaries consolidated and the tested subsidiary have recurring annual revenue, the tested subsidiary must meet both the new revenue component and the net income component; a registrant would use the lower of the revenue component and the net income component to determine the number of periods for which financial statements under Rule 3-05 are required.

The Proposal also provides that where a registrant or tested subsidiary does not have recurring annual revenues, the revenue component is less likely to produce a meaningful assessment and therefore only the net income component would apply. The Income Test would also be revised to use the average of the absolute value of net income when the existing 10% threshold in Computational Note 2 to Rule 1-02(w) is met and the proposed revenue component of the Income Test does not apply.

However, we note that oftentimes, registrants acquire companies with little or no income from continuing operations, primarily because the target company has significant revenue streams. ***We do not believe that the revisions to the Income Test would adequately capture significance in these situations. Accordingly, rather than revising the Income Test to require that the registrant exceed both revenue and net income components when the registrant and the tested subsidiary have recurring annual revenue, we believe that the Income Test should be revised to require that the tested subsidiary exceed either the revenue or net income components when the registrant and the tested subsidiary have recurring annual revenue.*** We believe this change would more accurately determine whether a business is significant to the registrant and would capture situations in which a registrant acquires a company with strong revenues and immaterial income.

***Proposed Changes to Significance Tests: Investment Test  
Incorporating Market Value Will Align the Test More with Economic Value***

We support the Proposal to change to the Investment Test to compare the registrant's investment in and advances to the acquired business to the aggregate worldwide market value of the registrant's voting and non-voting common equity ("AWMV") rather than to the registrant's total assets. We believe this change makes sense because the test will now compare the purchase price of the acquired business, which is primarily a fair value measure under US GAAP, to the fair value of the registrant's business, and will thus capture the significance of an investment from an economic value perspective, which is the primary focus of investors. In addition, we agree with the Commission's reasoning that in the current business environment in which intangible assets play a greater role in

determining the value of an investment or acquisition, but which are not always reflected at fair value in the financial statements, a test that focuses on the fair value of the investment will prove more meaningful to investors.

*While we acknowledge the fact that this change could result in less disclosure about acquisitions made by companies whose market value is significantly different from their book value, we believe the solution to this is not to remain with the existing test, because that test, by comparing a fair value (purchase price) to a historical value (registrant's assets), is essentially an "apples to oranges" comparison.* Rather, the natural solution to the concern about less disclosure in instances where there is a large disparity between a registrant's book value and market value is to **lower the threshold at which significance is defined in these circumstances**, or to supplement the Investment Test with another test.

In addition, we would not object to using an average AWMV to limit the impact of market fluctuations on the test, such as a 30- or 60-day average, over a period ending on or shortly prior to the announcement of the transaction.

#### ***Comments on Other Changes Proposed:***

##### ***Number of Periods Presented & Abbreviated Financials***

*We do not object to the Proposal to reduce the maximum number of years of acquired company historical financial statements (Rule 3-05 financial statements) from three years to two years.* As noted above, investors are primarily interested in forward-looking information rather than historical information, so we do not object to the loss of the third prior year of historical information.

In addition, we have questions regarding the proposed changes that would permit the use of abbreviated financial statements where the business acquired is not a separate entity, segment or division. The distinctions between these definitions are highly accounting-driven and may be lost on many investors. ***Accordingly, it is more important to investors to understand how these abbreviated financial statements will be contextualized and integrated into the pro forma information.*** As mentioned above, investors are interested in understanding how an acquired business will impact the registrant's business. Thus, ***we believe that if abbreviated information is provided, registrants should be required to indicate how the information is integrated into the pro forma information. In addition, it is not clear to us what type of auditor assurance will be provided on this information.*** We respectfully request the Commission to address these questions before finalizing this aspect of the Proposal.

#### ***Conclusion***

In closing, we believe that making pro forma information more useful to investors is a worthwhile use of the SEC's time. While there are many minor points that could be further deliberated debated regarding the proposed changes, we believe the Proposal has sufficient clarity that it could be finalized as is, and we encourage the SEC to do so.

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We would welcome an opportunity to meet with the to discuss our comments and perspectives. If you or your staff have questions or seek further elaboration of our views, please contact please contact me at + [REDACTED] or by email at [REDACTED]

Sincerely,

*/s/ Sandra J. Peters*

Sandra J. Peters, CPA, CFA  
Senior Head, Global Financial Reporting Policy  
CFA Institute

cc:

The Honorable Jay Clayton, Chairman, U.S. Securities and Exchange Commission  
The Honorable Commissioner Robert J. Jackson, Jr., U.S. Securities and Exchange Commission  
The Honorable Commissioner Hester M. Peirce, U.S. Securities and Exchange Commission  
The Honorable Commissioner Elad L. Roisman, U.S. Securities and Exchange Commission  
The Honorable Commissioner Allison Herren Lee, U.S. Securities and Exchange Commission

Mr. William H. Hinman, Director,  
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Mr. Sagar Teotia, Chief Accountant, U.S. Securities and Exchange Commission

Mr. Rick Fleming, Investor Advocate, U.S. Securities and Exchange Commission