

INSIGHTS

SEC Adopts Amendments to Improve Financial Disclosures related to Acquisitions and Dispositions of Businesses, Update “Significant Subsidiary” Test

May 22, 2020

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On May 21, 2020, the Securities and Exchange Commission adopted amendments to the rules that govern the financial disclosures registrants must make upon the acquisition or disposition of certain businesses. The Commission also amended the definition of “significant subsidiary” in Rule 1-02(w) of Regulation S-X, Rule 405 under the Securities Act of 1933 and Rule 12b-2 under the Securities Exchange Act of 1934 (together, the “Significance Rules”) to update the significance test in each rule. The amendments become effective on January 1, 2021, but filers are permitted to voluntarily comply with the new rules before the effective date.

The Commission’s final rule adopting these amendments can be found [here](#).

Pre-Amendment Rules

Generally, when a registrant acquires a “significant” business, Rule 3-05 of Regulation S-X requires the disclosure of pre-acquisition historical audited annual and unaudited interim financial statements of the acquired business. If the target business is of major significance to the registrant, the registrant must provide financial information covering a longer period of time than would otherwise be required if the acquired business were of less significance to the registrant.

Similarly, Article 11 of Regulation S-X requires registrants to file pro forma financial information relating to significant acquisitions and dispositions. Such pro forma financials typically include a pro forma balance sheet and pro forma income statements based on the historical financial statements of the registrant and the acquired or disposed business.

Amendments

The amended rules will make the following changes, among others:

- Amend the significance tests, as defined in the Significance Rules, to:

- Revise the “investment test” to compare (i) the registrant’s investments in and advances to the acquired or disposed business to (ii) the registrant’s aggregate worldwide market value;
 - Add a revenue component to the “income test”;
 - Expand the use of pro forma financial information in measuring significance; and
 - Where applicable, conform the threshold and tests for significance for disposed businesses to those used for acquired businesses.
- Shorten the required look-back period for the financial statements of the acquired business to cover no more than the two most recent fiscal years.
 - Allow registrants to eliminate separate financial statements of the acquired business after the acquired business has been included in the registrant’s post-acquisition financial statements for either nine months or one complete fiscal year, depending on the significance of the business.
 - Modify the required disclosure for the aggregate effect of acquisitions for which financial statements are not required or are not yet required by eliminating historical financial statements for non-significant businesses and expand pro forma financial information to depict the aggregate effect of acquisitions in all material respects.
 - Permit registrants to provide abbreviated financial statements for certain acquired oil and gas producing businesses for which separate financial statements do not exist.
 - Permit the use of, or reconciliation to, International Financial Reporting Standards in certain circumstances.
 - Clarify Rule 3-14 of Regulation S-X, which governs real estate operations, with regard to:
 - Determining significance;
 - The need for interim income statements; and
 - The scope of the rule’s requirements.

Please contact a member of your Bracewell team or any of the authors of this alert with questions regarding these amendments.