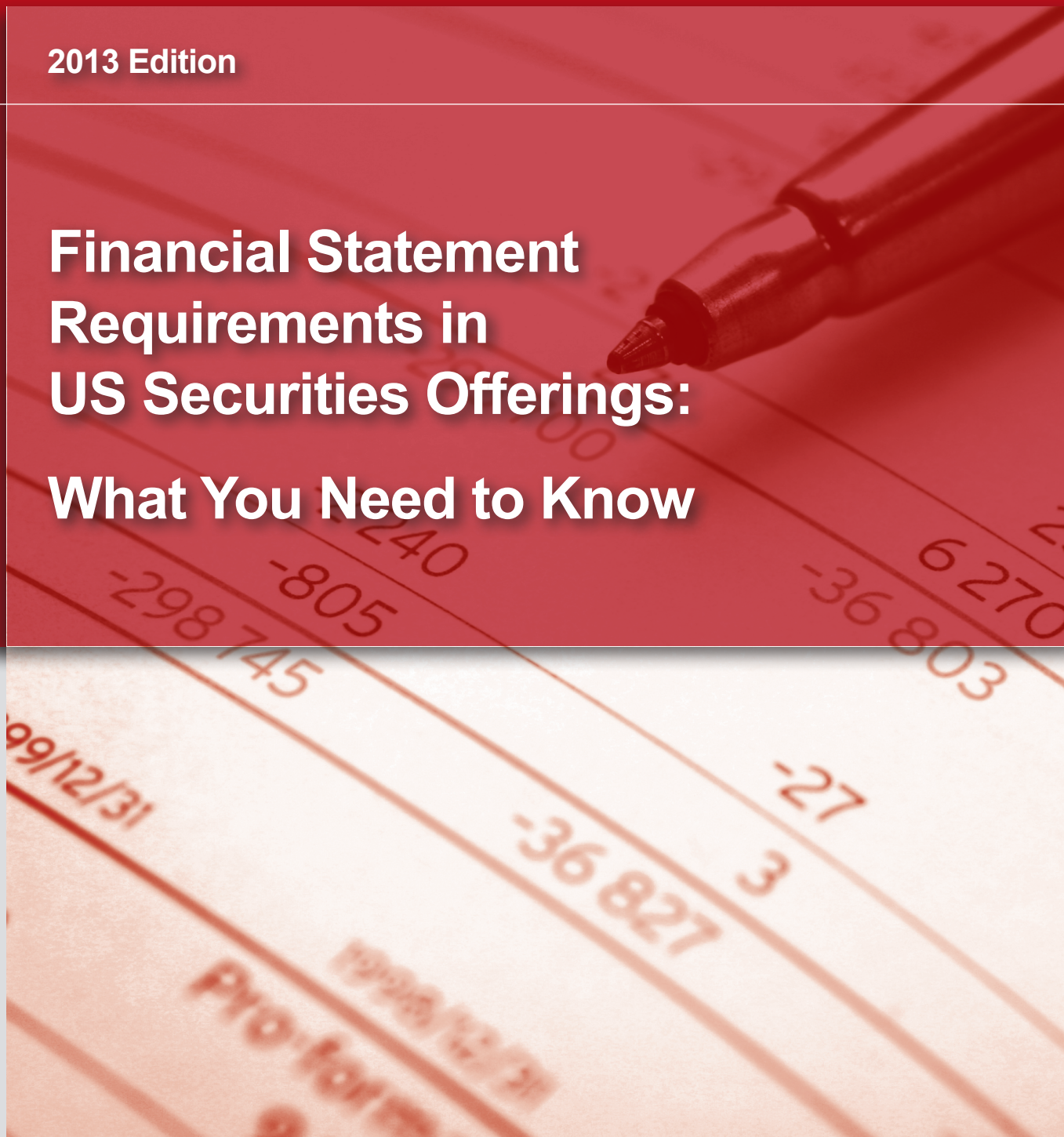


LATHAM & WATKINS LLP



2013 Edition

# Financial Statement Requirements in US Securities Offerings: What You Need to Know





# FINANCIAL STATEMENT REQUIREMENTS IN US SECURITIES OFFERINGS: WHAT YOU NEED TO KNOW

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# TABLE OF CONTENTS

<b>Introduction</b>	<b>1</b>
<b>The Basics</b>	<b>1</b>
Background to Financial Statement Requirements	1
What Financial Statements Must Be Included in Public Offerings?	1
When Does Financial Information Go “Stale?”	3
When Do Financial Statements Go Stale in 2013?	6
When Do Financial Statements Go Stale in 2014?	7
MD&A	8
<b>Additional Financial Information for Certain Specific Situations</b>	<b>8</b>
Recent and Probable Acquisitions	8
<i>Pro Forma</i> Financial Information	12
Discontinued Operations and Other GAAP Retrospective Revisions	13
Guarantor Financial Statements	14
Secured Offerings	17
Investments Accounted for Under the Equity Method	17
Segment Reporting	18
Supplemental Schedules for Certain Transactions	19
Industry Guides	19
Quantitative and Qualitative Disclosure About Market Risk	20
<b>Some Related Issues</b>	<b>20</b>
Additional Financial Information That Is Typically Included	20
Non-GAAP Financial Measures	21
Form 8-K Filing Requirements in Connection With Significant Acquisitions or Dispositions	23
Internal Control Over Financial Reporting	24
Interactive Data	24
<b>Special Considerations in Rule 144A Transactions and for Foreign Private Issuers</b>	<b>24</b>
Rule 144A Transactions	24
Special Rules Applicable to Foreign Private Issuers and Acquired Foreign Businesses	25
<b>Conclusion</b>	<b>26</b>
<b>Endnotes</b>	<b>27</b>

# FINANCIAL STATEMENT REQUIREMENTS IN US SECURITIES OFFERINGS: WHAT YOU NEED TO KNOW

2013 Edition

## Introduction

The most frequently asked question at all-hands meetings for a securities offering is "What financial statements will be needed?" The question seems simple enough. But the answer is rarely straightforward.

This User's Guide is designed to provide a roadmap to help navigate the financial statement requirements of the federal securities laws. We focus on the requirements for public offerings, including offerings by emerging growth companies (EGCs) under the JOBS Act.<sup>1</sup> We also summarize briefly the practices in the Rule 144A market, as well as the special rules applicable to "foreign private issuers."<sup>2</sup>

To make the discussion below easier to follow, we have provided examples using actual dates. These dates are based on a company with a December 31 fiscal year end.

## The Basics

### Background to Financial Statement Requirements

Public securities offerings registered with the US Securities and Exchange Commission (the SEC) under the US Securities Act of 1933 (the Securities Act) require the filing of a registration statement with the SEC and the distribution of a prospectus in connection with the offering. The registration statement and prospectus must contain certain financial statements and other financial information regarding the issuer's financial condition and results of operations.

The Securities Act and the related rules and regulations detail the disclosure requirements through the use of "forms" (for example, Forms S-1 and S-3). These forms, in turn, specify the information that must be disclosed under Regulation S-K (S-K) and Regulation S-X (S-X). To simplify, S-K largely deals with textual disclosure, and S-X with financial statement form and content.

### What Financial Statements Must Be Included in Public Offerings?

The following tables summarize the scope of the basic financial statement requirements for all registered offerings.<sup>3</sup> Note that much of the basic information can be incorporated by reference for issuers eligible to use Form S-3,<sup>4</sup> and for certain issuers filing a registration statement on Form S-1 or Form S-11.<sup>5</sup> Issuers who are eligible for incorporation by reference will want to consult their underwriters before electing to incorporate all required financial information by reference. For marketing purposes, it is often desirable to include the financial information directly in the printed offering document.

## The Basic Requirements for Public Offerings

<b>Annual Audited Financial Statements</b> <sup>6</sup>	<ul style="list-style-type: none"><li>• Balance sheets:<ul style="list-style-type: none"><li>• audited balance sheets as of the end of the two most recent fiscal years.<sup>7</sup></li><li>• if the issuer has been in existence less than one year, an audited balance sheet as of a date within 135 days of the date of filing the registration statement.<sup>8</sup></li></ul></li><li>• Income, cash flow and equity statements:<ul style="list-style-type: none"><li>• audited income statements, statements of comprehensive income, statements of cash flows and stockholders' equity covering each of the three most recent fiscal years, or for the life of the issuer (and its predecessors), if shorter.<sup>9</sup></li></ul></li><li>• Under certain circumstances, audited financial information may cover nine, 10 or 11 months rather than a full fiscal year for one of the required years.<sup>10</sup></li><li>• Audited financial statements for an issuer must be accompanied by an audit report issued by accountants that are registered with the Public Company Accounting Oversight Board (the PCAOB) under auditing standards promulgated by the PCAOB.<sup>11</sup></li></ul>
<b>Interim Unaudited Financial Statements</b>	<ul style="list-style-type: none"><li>• Balance sheet:<ul style="list-style-type: none"><li>• an interim unaudited balance sheet as of the end of the most recent three-, six- or nine-month period following the most recent audited balance sheet.<sup>13</sup></li></ul></li><li>• Income statements:<ul style="list-style-type: none"><li>• interim unaudited statements of income, comprehensive income, cash flows, and stockholders' equity for any stub period covered by an interim balance sheet, together with statements of income and cash flows for the corresponding three-, six- or nine-month stub period of the prior year.<sup>14</sup></li></ul></li></ul>
<b>Acquired Company Financial Information and <i>Pro Forma</i> Financial Information – S-X Rule 3-05 and S-X Article 11</b> <sup>19</sup>	<ul style="list-style-type: none"><li>• Depending on the size of the acquisition and its significance to the issuer (which is measured in various ways – not all of them intuitive), audited acquired company annual financial statements for the most recent one, two or three fiscal years, plus appropriate unaudited interim financial statements, under S-X Rule 3-05, which we discuss in more detail below.</li><li>• Where acquired company financial statements are included in a registration statement (and in certain other instances) <i>pro forma</i> financial information under S-X Article 11, which we discuss in more detail below, must also be included.</li></ul>
<b>Selected Financial Information – S-K Item 301</b> <sup>16</sup>	<ul style="list-style-type: none"><li>• Selected income statement and balance sheet data for each of the last five fiscal years (or for the life of the issuer and its predecessors, if shorter)<sup>17</sup> and any interim period included in the financial statements (together with comparative information for the corresponding interim period of the prior year).<sup>18</sup></li><li>• The purpose of the selected financial data is to highlight certain significant trends in the registrant's financial condition and results of operations, and must include:<ul style="list-style-type: none"><li>• net sales or operating revenues;</li><li>• income (loss) from continuing operations;</li><li>• income (loss) from continuing operations per common share;</li><li>• total assets;</li><li>• long-term obligations and redeemable preferred stock; and</li><li>• cash dividends declared per common share.<sup>19</sup></li></ul></li><li>• The selected financial data may also include any additional items that would enhance an understanding of the issuer's financial condition and results of operations.<sup>20</sup></li></ul>

## The Basic Requirements for Public Offerings

<p><b>EGC Offerings</b></p>	<ul style="list-style-type: none"> <li>• In order to qualify as an EGC a company must have annual revenue for its most recently completed fiscal year of less than \$1.0 billion.<sup>21</sup> EGC status is generally unavailable to any issuer that priced its US IPO on or before December 8, 2011.</li> <li>• An EGC may conduct its initial public equity offering using two years, rather than three years, of audited financial statements and as few as two years, rather than five years, of selected financial data.<sup>22</sup> After its IPO, an EGC phases into full compliance by adding one additional year of financial statements in each future year until it presents the traditional three years of audited financial statements plus two years of selected financial data.<sup>23</sup> The required MD&amp;A would cover only the years for which audited financial statements are provided.<sup>24</sup> If debt securities are being registered, a ratio of earnings to fixed charges for each of the last five fiscal years and for the latest interim period presented.<sup>25</sup></li> <li>• After the initial determination of EGC status, a company will remain an EGC until the earliest of:             <ul style="list-style-type: none"> <li>• the last day of any fiscal year in which the company earns \$1.0 billion or more in revenue;</li> <li>• the date when the company qualifies as a “large accelerated filer,” with at least \$700 million in public equity float;</li> <li>• the last day of the fiscal year ending after the fifth anniversary of the IPO pricing date; or</li> <li>• the date of issuance, in any three-year period, of more than \$1.0 billion in non-convertible debt securities.<sup>26</sup></li> </ul> </li> </ul>
<p><b>Ratio of Earnings to Fixed Charges for Debt – S-K Item 503(d)<sup>27</sup></b></p>	<ul style="list-style-type: none"> <li>• If debt securities are being registered, a ratio of earnings to fixed charges for each of the last five fiscal years and for the latest interim period presented.<sup>28</sup></li> <li>• For preferred securities, a ratio of combined fixed charges and preference dividends to earnings.<sup>29</sup></li> <li>• If the proceeds from the sale of debt or preferred equity will be used to repay outstanding debt or to retire other securities and the change in the ratio would be 10 percent or greater, a <i>pro forma</i> ratio for the most recent fiscal year and the latest interim period presented.<sup>30</sup></li> </ul>
<p><b>Supplementary Financial Information – S-K Item 302</b></p>	<ul style="list-style-type: none"> <li>• For issuers that have registered securities under Section 12(b) or 12(g) of the US Securities Exchange Act of 1934 (the Exchange Act) – generally, equity securities listed on the NYSE or quoted on Nasdaq – certain additional unaudited selected financial data for each full quarter within the two most recent fiscal years and any subsequent interim period for which financial statements are included.<sup>31</sup> This information is not required for IPO prospectuses.</li> </ul>

### When Does Financial Information Go “Stale?”

Understanding the timing requirements for the provision of financial statements is almost as critical as understanding the scope of the financial information required. The determination of when financial statements go “stale” is sure to come up at the all-hands meeting and planning to have the necessary financial information prepared on time is an essential part of the offering process. Among other considerations, the SEC Staff has a policy against commencing review of a filing unless the financial statements in the filing comply with the staleness rules on the filing date.<sup>32</sup>



These rules vary for different categories of issuers. In particular, the rules distinguish between large accelerated filers, accelerated filers, initial filers, loss corporations and delinquent filers. For these purposes:

- A **large accelerated filer** is an issuer that, as of the end of its fiscal year:<sup>33</sup>
  - has an aggregate worldwide market value of voting and non-voting common equity held by non-affiliates (public float) of \$700 million or more (measured as of the last business day of its most recently completed second fiscal quarter);
  - has been subject to SEC reporting under the Exchange Act for a period of at least twelve calendar months;
  - has filed at least one annual report under the Exchange Act with the SEC; and
  - is not eligible to use the requirements for smaller reporting companies in Regulation S-K.<sup>34</sup>
- An **accelerated filer** is an issuer meeting the same conditions, except that it has a public float of \$75 million or more, but less than \$700 million (measured as of the last business day of its most recently completed second fiscal quarter).<sup>35</sup>
- An **initial filer** is generally a company that was not subject to the SEC's reporting requirements prior to filing the registration statement (*i.e.*, a first-time filer, an IPO filer or a voluntary filer) and is not an "all other filer" as indicated in the charts below.<sup>36</sup>
- A **loss corporation** is a company that does not expect to report positive income after taxes but before extraordinary items and the cumulative effect of a change in accounting principle for the most recently ended fiscal year and for at least one of the two prior fiscal years.<sup>37</sup>
- A **delinquent filer** is a company that is subject to the SEC's reporting requirements, but has not filed all reports that are due.<sup>38</sup>

The following tables summarize financial statement staleness requirements, measured by the number of days between the effective date of the registration statement (or, by analogy, the pricing date of a Rule 144A offering if the underwriter desires to mirror SEC requirements) and the date of the financial statements in the filing.<sup>39</sup> For any of the time frames noted below, if the last day before the financial statements go stale is a Saturday, Sunday or US federal holiday, Securities Act Rule 417 allows the filing to be made on the next business day, thereby effectively postponing the staleness date.

### Staleness of Financial Statements

For first and second quarter financial statements, "staleness" means the point in the year when the quarterly financial statements become so old that the issuer needs to include the subsequent quarter's financial statements. By contrast, for third quarter financial statements, "staleness" means the point in the year when the third quarter financial statements become so old that the issuer needs to include *annual* audited financial statements.

The dates below are based on a December 31 fiscal year end in a year that is not a leap year, and do not reflect a permitted extension to the next business day where staleness days would otherwise fall on a weekend or US federal holiday.



## Staleness of Financial Statements

### When do 1<sup>st</sup> Quarter Financial Statements Go Stale?

- *Large Accelerated Filers and Accelerated Filers:* First quarter financial statements go stale at the close of business on August 7 (the gap between the date of effectiveness of the registration statement and the date of the first quarter financial statements in the filing may not be more than 129 days).<sup>40</sup> In other words, the registration statement cannot be declared effective after August 7 unless it includes second quarter financial statements.
- *All Other Filers:* First quarter financial statements go stale at the close of business on August 12 (the gap between the date of effectiveness of the registration statement and the date of the financial statements in the filing may not be more than 134 days).<sup>41</sup>
- Whenever updated interim financial statements are included, an interim income statement and statement of cash flows must be included for the corresponding period of the prior year.<sup>42</sup>

### When do 2nd Quarter Financial Statements Go Stale?

- *Large Accelerated Filers and Accelerated Filers:* Second quarter interim financial statements go stale at the close of business on November 6 (the gap between the date of effectiveness of the registration statement and the date of the second quarter financial statements in the filing may not be more than 129 days).<sup>43</sup>
- *All Other Filers:* Second quarter interim financial statements go stale at the close of business on November 11 (the gap between the date of effectiveness of the registration statement and the date of the second quarter financial statements in the filing may not be more than 134 days).<sup>44</sup>
- Whenever updated interim financial statements are included, an interim income statement and statement of cash flows must be included for the corresponding period of the prior year.<sup>45</sup>

### When do 3rd Quarter Financial Statements Go Stale?

- *Initial Filers, Loss Corporations and Delinquent Filers:*<sup>46</sup> Third quarter interim financial statements go stale at the close of business on February 14 (updated annual audited financial statements must be included when the gap between the date of effectiveness of the registration statement and the date of the prior year's audited financial statements is more than one year and 45 days). In other words, it is not possible for an IPO registration statement to become effective after February 14 of a year until audited financial statements have been provided for the just ended fiscal year. Note that a large accelerated filer or an accelerated filer that is a loss corporation or a delinquent filer would be subject to the February 14 deadline (and not the March 1/March 16 deadlines mentioned below).
- *Large Accelerated Filers:* Third quarter interim financial statements go stale at the close of business on March 1\* (updated annual audited financial statements must be included when the gap between the date of effectiveness of the registration statement and the date of the fiscal year end is more than 60 days).<sup>47</sup>
- *Accelerated Filers:* Third quarter interim financial statements go stale at the close of business on March 16\* (updated annual audited financial statements must be included when the gap between the date of effectiveness of the registration statement and the date of the fiscal year end is more than 75 days).<sup>48</sup>
- *All Other Filers:* Third quarter interim financial statements go stale at the close of business on March 31\* (updated annual audited financial statements must be included when the gap between the date of effectiveness of the registration statement and the date of the fiscal year end is more than 90 days).<sup>49</sup>

\*In leap years, these deadlines occur one day prior to these dates (*i.e.*, February 29, March 15 and March 30, respectively).

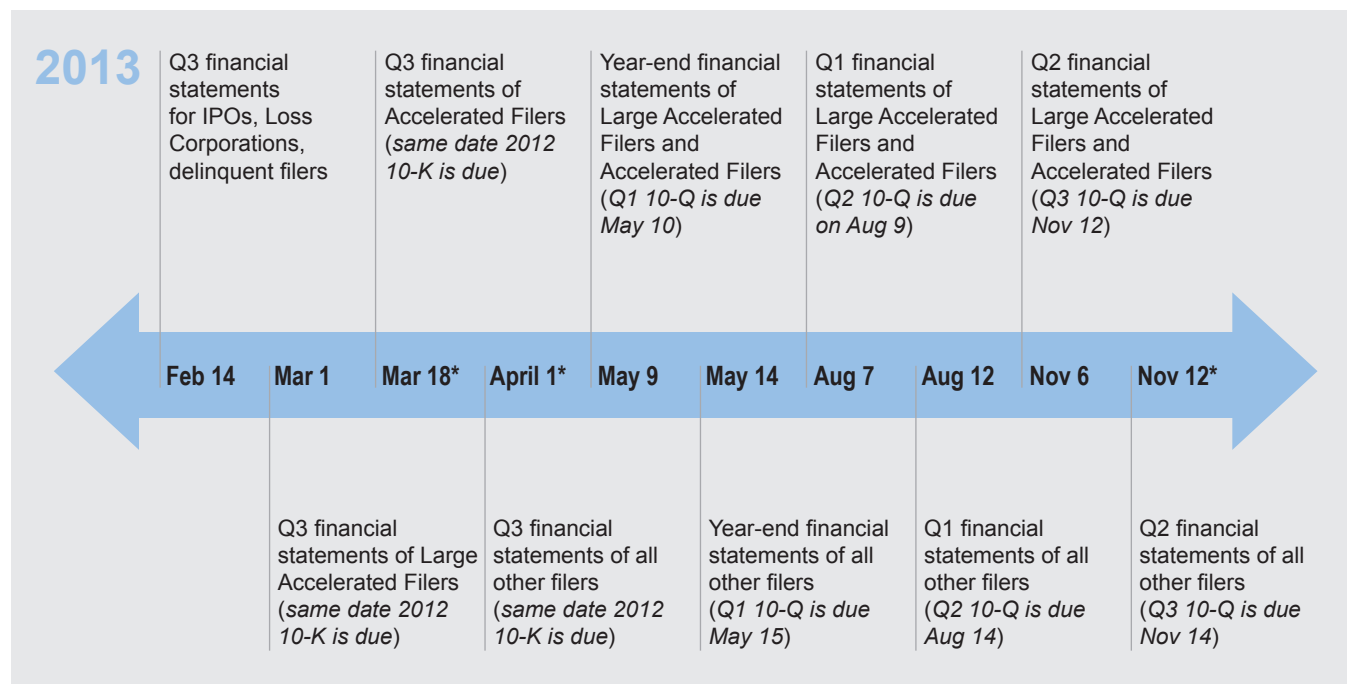
### When do Year-End Financial Statements Go Stale?

- *Large Accelerated Filers and Accelerated Filers:* Year-end audited financial statements go stale at the close of business on May 9\* (the gap between the date of effectiveness of the registration statement and the date of the year-end financial statements in the filing may not be more than 129 days).<sup>50</sup> In other words, the registration statement cannot be declared effective after May 9 unless it includes first quarter financial statements.
- *All Other Filers:* Year-end audited financial statements go stale at the close of business on May 14\* (the gap between the date of effectiveness of the registration statement and the date of the yearend financial statements in the filing may not be more than 134 days).<sup>51</sup>

\*In leap years, these deadlines occur one day prior to these dates (*i.e.*, May 8 and May 13, respectively).

## When Do Financial Statements Go Stale in 2013?

At the close of business on the following dates (for issuers with a fiscal year ended **December 31, 2012**):



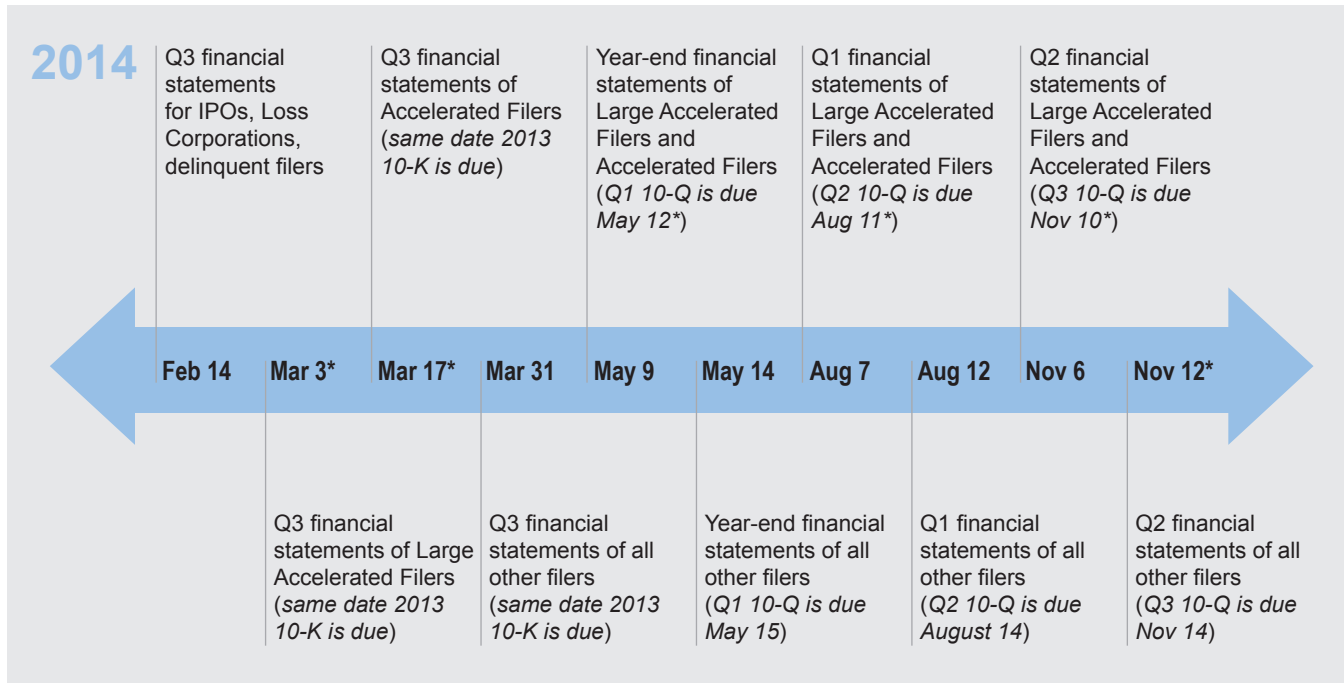
\*These dates reflect a permitted extension to the next business day where dates would have otherwise occurred on a weekend or US federal holiday.

*Special accommodation for timely filers: Staleness dates do not correspond exactly with the Form 10-Q filing deadlines because the 10-Q deadlines run from the end of the most recently ended quarter, whereas the staleness dates run from the end of the preceding quarter. However, the SEC Staff generally provides an accommodation for repeat issuers that have been timely filers for the past 12 months by allowing their registration statements to become effective during the gap period between the staleness dates shown above and the nearest 10-Q filing deadline, absent unusual circumstances. As a result, for most repeat issuers, the effective staleness date is the same as the 10-Q filing deadline.*

*Note that the most recent interim financial information filed with the SEC must always be included in a registration statement.*

## When Do Financial Statements Go Stale in 2014?

At the close of business on the following dates (for issuers with a fiscal year ended **December 31, 2013**):



\* These dates reflect a permitted extension to the next business day where dates would have otherwise occurred on a weekend or US federal holiday.

*Special accommodation for timely filers: Staleness dates do not correspond exactly with the Form 10-Q filing deadlines because the 10-Q deadlines run from the end of the most recently ended quarter, whereas the staleness dates run from the end of the preceding quarter. However, the SEC Staff generally provides an accommodation for repeat issuers that have been timely filers for the past 12 months by allowing their registration statements to become effective during the gap period between the staleness dates shown above and the nearest 10-Q filing deadline, absent unusual circumstances. As a result, for most repeat issuers, the effective staleness date is the same as the 10-Q filing deadline.*

*Note that the most recent interim financial information filed with the SEC must always be included in a registration statement.*

## MD&A

Registration statements must contain or incorporate by reference a “management’s discussion and analysis” section (the MD&A).<sup>52</sup> The requirements for the MD&A are set out in S-K Item 303.

The purpose of the MD&A is to provide investors with the information necessary to understand an issuer’s financial condition, changes in financial condition and results of operations.<sup>53</sup> It is the place where management interprets the financial statements for investors. A well-written MD&A will focus on trends and uncertainties in the marketplace and will identify the key “drivers” of the issuer’s results of operations. It will explain the issuer’s business as management sees it, from separately discussing each segment’s performance to the business as a whole. It will also identify and discuss the key metrics that management uses to evaluate the business’ performance and financial health. Many MD&A sections include a general discussion of the issuer’s future prospects under a subheading such as “Outlook,” and some issuers even go so far as to give specific guidance for the following quarter or the current or following fiscal year. Drafting the MD&A section of the disclosure requires close coordination among the issuer’s financial team, its accountants and counsel and can be a time-consuming exercise.

The SEC has steadily expanded the line-item disclosure requirements for the MD&A, adding specific requirements for off-balance sheet arrangements, long-term contractual obligations,<sup>54</sup> certain derivatives contracts and related-party transactions<sup>55</sup> as well as critical accounting policies.<sup>56</sup> For a recent explanation of the SEC’s view of required liquidity and capital resources disclosure, see the guidance release from September 2010,<sup>57</sup> and for a sweeping explanation of the purpose of MD&A disclosure, see the guidance release from December 2003.<sup>58</sup>

### Additional Financial Information for Certain Specific Situations

#### Recent and Probable Acquisitions

In addition to financial statements of the issuer, registration statements generally require inclusion of audited financial statements for a significant acquisition of a “business” that has taken place 75 days or more before the offering, or, in the case of the most material acquisitions, as soon as the acquisition becomes “probable.”<sup>59</sup> These requirements can be found in S-X Rule 3-05. In addition, where a material acquisition has occurred or is probable, *pro forma* financial information complying with S-X Article 11 for the most recent fiscal year and the most recent interim period will generally also be required in the registration statement.

#### What is a “Business?”

The SEC defines the term “business” to include an operating entity or business unit, but excludes machinery and other assets that do not generate a distinct profit or loss stream.<sup>60</sup> It is important to note that the definition of a business under US Generally Accepted Accounting Principles (US GAAP) (and potentially other GAAPs) differs from the SEC’s definition. Accordingly, an acquisition that is a business under US GAAP may not be one for SEC purposes, and vice versa.

#### What is “Probable?”

Evaluating whether a given transaction is probable involves looking at the facts and circumstances. The SEC Staff has taken the general view that an acquisition becomes probable at least upon the signing of a letter of intent,<sup>61</sup> and has also stated that an acquisition is probable “where registrant’s financial statements alone would not provide adequate financial information to make an investment decision.”<sup>62</sup>

## Significance Tests

Whether financial statements for recent and probable acquisitions must be included in the filing also depends upon the “significance” of the acquisition. Significance of an acquired business is evaluated under S-X Rule 3-05 based upon three criteria (which in turn are derived from S-X Rule 1-02(w)):

- the amount of the issuer’s investment in the acquired business compared to the issuer’s total assets;
- the issuer’s share of the total assets of the acquired business compared to the issuer’s total assets; and
- the issuer’s share of “pre-tax income”<sup>63</sup> from continuing operations of the acquired business compared to the issuer’s pre-tax income from continuing operations;

in each case, based on a comparison between the issuer’s and the target’s most recent annual audited financial statements. However, if the issuer has made a significant acquisition subsequent to its latest fiscal year end and filed a report on Form 8-K that included all of the financial statements for the periods required by S-X Rule 3-05 (or included those financial statements in a non-IPO registration statement), the test for a subsequent acquisition may, at the issuer’s option, be based upon the S-X Article 11 *pro forma* amounts for the issuer’s latest fiscal year included in the Form 8-K (or the registration statement) rather than the historical amounts for the latest fiscal year.<sup>64</sup>

Acquisitions of related businesses are treated as a single acquisition for purposes of the significance tests. Businesses are considered “related” if they are owned by a common seller or under common management, or where the acquisition of one business is conditioned upon the acquisition of each other business or a single common event.<sup>65</sup>

Generally:

- if the acquired business exceeds 20 percent of any of the three significance criteria, then one year of audited financial information is required, as well as the interim financial information that would be required under S-X Rules 3-01 and 3-02;<sup>66</sup>
- if the acquired business exceeds 40 percent of any of the three criteria, then two years of audited and the appropriate interim financial information are required;<sup>67</sup> and
- if the acquired business exceeds 50 percent (or if securities are being registered to be offered to the security holders of the acquired business), then three years of audited and the appropriate interim financial information are required—however, if the issuer is an EGC, then two years of audited financials for the acquired business may be presented in the EGC’s initial registration statement, regardless of whether the issuer presents two or three years of its own financial statements.<sup>68</sup>

## Financial Statements Required in Connection with Acquisitions

The following table summarizes the general rules for an acquisition that occurred more than 75 days before the offering.

Acquisition Scenario	Reporting Requirement
<b>Individual acquisition at or below the 20 percent significance level</b>	No requirement to include audited or interim financial statements.
<b>Individual acquisition (or multiple acquisitions of “related businesses,” as described above) in excess of the 20 percent significance level, but not above the 40 percent level</b>	Audited financial statements for the most recent fiscal year of the acquired business must be included. Unaudited interim financial statements may need to be included, depending on the time of year that the offering takes place.
<b>Multiple acquisitions of unrelated businesses below the 20 percent significance level individually, but aggregating in excess of the 50 percent level of significance</b>	Audited financial statements for the most recent fiscal year will be required for a substantial majority of the individually insignificant acquisitions. Unaudited interim financial statements may need to be included, depending on the time of year that the offering takes place.
<b>Individual acquisition (or multiple acquisitions of “related businesses,” as described above) in excess of the 40 percent significance level, but not above the 50 percent level</b>	Audited financial statements for the two most recent fiscal years of the acquired business must be included. Unaudited interim financial statements may need to be included, depending on the time of year that the offering takes place.
<b>Individual acquisition above the 50 percent significance level</b>	Audited financial statements for the three most recent fiscal years of the acquired business must be included (or, if the issuer is an EGC, in its initial registration statement audited financial statements for the two most recent fiscal years of the acquired business must be included). This requirement also applies to acquisitions of this size that have closed within the 75-day period prior to the offering or are “probable” at the time of the offering. However, audited financial statements for the earliest of the three fiscal years required may be omitted if net revenues reported by the acquired business in its most recent fiscal year are less than \$50 million. Unaudited interim financial statements may need to be included, depending on the time of year that the offering takes place.

#### Note that:

- The permitted age of financial statements of an acquired or soon-to-be acquired business is generally determined by looking to the “staleness” rules that apply to its financial statements (rather than the staleness rules applicable to the financial statements of the acquiring company).<sup>69</sup> In other words, you need to determine whether the acquired company is, for example, a large accelerated filer, an accelerated filer or an initial filer, and then analyze the dates on which its financial statements go stale under the rules summarized above.<sup>70</sup>
- Below the 50 percent significance level, no audited financial statements are required in the offering document for probable acquisitions or for completed acquisitions consummated up to 74 days before the date of the offering.<sup>71</sup> The commitment committees of some financing sources may, however, require at least a one year audit of the acquired company in this situation together with historical *pro forma* financial information, even if the 74-day grace period has not yet expired.
- When a “foreign business”<sup>72</sup> is acquired, S-X Rule 3-05(c) effectively allows for the inclusion of financial statements prepared in accordance with local home-country generally accepted accounting principles (local GAAP) or International Financial Reporting Standards (IFRS) other than the English-language version of IFRS as issued by the International Accounting Standards Board (IASB IFRS) *without reconciliation* to US GAAP when the acquired business is below the 30 percent level for all of the significance tests; at or above 30 percent, reconciliation to US GAAP must be included for the most recent two fiscal years and interim periods (although this reconciliation need only meet the requirements of Item 17, not Item 18, of Form 20-F).<sup>73</sup> No US GAAP reconciliation is required for the inclusion of financial statements of an acquired foreign business where that business uses IASB IFRS.<sup>74</sup>
- If the acquired company is not already an SEC reporting company, its financial statements need not be audited by a PCAOB-registered firm, and the audit report need not refer to PCAOB standards (*i.e.*, the audit can be conducted in accordance with US generally accepted auditing standards).<sup>75</sup>

#### Exceptions to the Financial Statement Requirements for Acquired Businesses

There are a number of exceptions to the requirement to provide separate financial statements of acquired businesses.

#### Exceptions to the Requirement to Provide Financial Statements of Acquired Businesses

- Separate financial statements for an acquired business do not need to be presented once the operating results of the acquired business have been included in the issuer’s audited consolidated financial statements for at least nine months unless the financial statements have not been previously filed by the issuer or unless the acquired business is of such significance to the issuer that omission of such financial statements “would materially impair an investor’s ability to understand the historical financial results of the registrant.”<sup>76</sup> Where the acquired business met at least one of the significance tests at the 80 percent level, the income statements of the acquired business should normally continue to be furnished.<sup>77</sup> This rule means that financial statements for major acquisitions at the highest level of materiality may be required for subsequent securities offerings, even those unrelated to the financing of the original acquisition.
- A single audited period of nine, 10 or 11 months may count as a year for an acquired business in certain circumstances.<sup>78</sup>



## Industry Roll-Ups and Operating Real Estate

Staff Accounting Bulletin No. 80 (SAB 80) provides a special interpretation of S-X Rule 3-05 for initial public offerings of businesses that have been built by the aggregation of discrete businesses that will remain substantially intact after acquisition (*i.e.*, industry rollups).<sup>79</sup> SAB 80 allows first-time issuers to consider the significance of businesses recently acquired or to be acquired based on the *pro forma* financial information for the issuer's most recently completed fiscal year. While compliance with this interpretation requires an application of SAB 80's guidance and examples on a case-by-case basis, the policy is to allow currently insignificant business acquisitions to be excluded from the financial statement requirements while still ensuring that the registration statement will include not less than three, two and one year(s) of financial statements for not less than 60 percent, 80 percent and 90 percent, respectively, of the constituent businesses of the issuer.<sup>80</sup>

The acquisition or probable acquisition of operating real estate property is subject to a different set of disclosure requirements under S-X Rule 3-14, which addresses income-producing real estate such as apartment houses and shopping malls. In comparison, where real estate is merely incidental to the service provided by a business, as for example in the case of a hotel, the regular S-X Rule 3-05 requirements would apply. S-X Rule 3-14(a) requires that audited income statements be provided for the three most recent fiscal years for any such acquisition or probable acquisition that would be "significant" (generally, that would account for 10 percent or more of the issuer's total assets as of the last fiscal year end prior to the acquisition). S-X Rule 3-14(a) also requires certain variations from the typical form of income statement and allows for only one year of income statements to be provided if the property is not acquired from a related party and certain additional textual disclosure is made.<sup>81</sup>

## MD&A For Acquisitions

Whenever historical financial statements of an acquired business (or probable acquisition) are included in the offering document, the registrant will need to consider whether a separate MD&A section discussing those financial statements is appropriate. Although there is no specific line item requiring that a second MD&A be included, it is not uncommon for registrants to interpret Securities Act Rule 408<sup>82</sup> to require a full discussion and analysis of the financial statements of an acquired business (or probable acquisition), particularly where it exceeds 50 percent on any of the three significance criteria discussed above

## Pro Forma Financial Information

As noted above, where a material acquisition has occurred or is probable that would trigger the need for acquired business financial statements under S-X Rule 3-05, *pro forma* financial information complying with S-X Article 11 must also be included. *Pro forma* financial information is intended to illustrate the continuing impact of a transaction, by showing how the specific transaction might have affected historical financial statements had it occurred at the beginning of the issuer's most recently completed fiscal year or the earliest period presented.

In particular, S-X Article 11 requires:<sup>83</sup>

- a condensed *pro forma* balance sheet<sup>84</sup> as of the end of the most recent period for which a consolidated balance sheet of the issuer is required, unless the transaction is already reflected in that balance sheet;<sup>85</sup> and
- a condensed *pro forma* income statement for the issuer's most recently completed fiscal year and the most recent interim period of the issuer, unless the historical income statement reflects the transaction for the entire period.<sup>87</sup>

S-X Article 11 also requires *pro forma* financial information in a number of other situations, such as:

- certain dispositions at a greater than 10% significance level (measured under the tests summarized above) that are not fully reflected in the financial statements of the issuer included in the prospectus;<sup>88</sup>
- acquisition of certain investments accounted for under the equity method;<sup>89</sup> and
- other events or transactions for which disclosure of *pro forma* financial information would be material to investors.<sup>90</sup>

S-X Article 11 provides extensive specific requirements for the content of *pro forma* financial information, including those set out in the following table.<sup>91</sup>

## Pro Forma Financial Information – Certain Key Content Requirements

### Content Requirements – S-X Rule 11-02

- *Pro forma* adjustments related to the *pro forma* condensed income statement must include adjustments which give effect to events that are:
  - directly attributable to the transaction;
  - expected to have a continuing impact on the issuer; and
  - factually supportable.<sup>92</sup>
- As a result, adjustments for expected future synergies and cost savings that are not expressly mandated by the acquisition documents will generally not be permitted.
- *Pro forma* condensed income statements should be presented using the issuer’s fiscal year end.<sup>93</sup> If the most recent fiscal year end of the acquired company differs from that of the issuer by more than 93 days, the acquired company’s fiscal year end should be brought up to within 93 days of the issuer’s fiscal year end (if practicable).<sup>94</sup>

Even if *pro forma* financial information for an acquired business is not required to be included in the prospectus, the underwriters may nevertheless request that *pro forma* financial information be included in the disclosure. This situation arises where the bankers want to show the higher “run rate” operating results of the combined companies for marketing reasons even though there is no specific requirement to do so.

### Discontinued Operations and Other GAAP Retrospective Revisions

As noted above, significant dispositions may require *pro forma* financial information under S-X Article 11. In addition, dispositions of a “component” of a company (for example, a segment, a reporting unit, a subsidiary or an asset group) may be reported as discontinued operations in the company’s financial statements, thereby triggering requirements under ASC 205-20 (former SFAS 144) for reclassification of prior period financial statements.<sup>95</sup>

If a disposition would be treated as a discontinued operation under GAAP, a key question is when prior period financial statements need to be recast to reflect the discontinued operation. In general, retrospective revision of pre-event financial statements is required in connection with an offering when the pre-event financial statements are reissued after post-event financial statements have been issued.<sup>96</sup>

The following table summarizes some common scenarios, assuming that a material discontinued operation has occurred after the end of a fiscal year (say, in the first fiscal quarter).

Scenario	Requirement
IPO/initial registration statement on Form S-1, S-4 or S-11	Revision of pre-event financial statements is required if post-event financial statements are needed for the offering. For example, if the offering takes place at a time when Q1 interim financial statements are required for the registration statement, retrospective revision of pre-event financial statements would be required. <sup>97</sup>
New/follow-on registration statement on Form S-3, S-1, S-4 or S-11 (including post-effective amendments to those forms) or proxy statement	<p>If post-event financial statements have already been filed, then both pre-event and post-event financial statements are needed for the offering and revision of pre-event financial statements is required.<sup>98</sup></p> <p>If post-event financial statements have not been filed, then filing audited revised pre-event financials is not required or allowed (although unaudited supplementary information may be provided or <i>pro forma</i> financial statements reflecting the discontinued operation may be needed).</p>

Scenario	Requirement
<b>Takedown from an effective shelf registration statement</b>	Pre-event financial statements in a shelf registration statement that was declared effective prior to the discontinued operation are not required to be retrospectively revised, <i>whether or not post-event financial statements have been filed</i> , unless there has been a “fundamental change.” <sup>99</sup>
<b>New registration statement on Form S-8</b>	Revision of pre-event financial statements is typically not required. <sup>100</sup>

Note that these same guidelines generally apply to other retrospectively applied revisions required by GAAP, such as changes in segments and accounting methods.

In addition:

- if annual financial statements have been recast to reflect discontinued operations, then a revised MD&A should be included to describe the events or circumstances that led to the discontinued operation, the material terms of that disposition, and the impact on the issuer’s operating results and business;<sup>101</sup> and
- the liquidity and capital resources section of MD&A should discuss whether the company’s liquidity is likely to be affected by the discontinued operations.<sup>102</sup>

### Guarantor Financial Statements

A guarantee of a security (such as a guarantee of a debt or preferred equity security) is itself a security that must be registered under the Securities Act, absent an applicable exemption. As a result, under S-X Rule 3-10(a), the general rule is that guarantors are required to present the same financial statements as the issuer of the guaranteed securities.<sup>103</sup> Fortunately, S-X Rules 3-10(b)-(f) contain a number of important exceptions that permit issuers to disclose financial information about guarantors in a condensed format using a footnote to their own financial statements.<sup>104</sup> Although the footnote approach can involve a fair amount of effort, it is far less burdensome than providing separate audited financial statements for every guarantor, which would be prohibitively expensive in many cases. S-X Rules 3-10(c), (e) and (f) go even further, dispensing with any additional information requirement for guarantors in the case of a parent company or subsidiary issuer where the parent company does not have independent assets or operations of its own and all of the direct and indirect non-guarantor subsidiaries are “minor”<sup>105</sup> (generally, less than three percent of the consolidated parent) and each guarantee is full and unconditional. A footnote US GAAP reconciliation is required when the parent’s consolidated financial statements are not prepared under US GAAP or IASB IFRS.<sup>106</sup> In the table below, we review the provisions of S-X Rule 3-10 as they apply to the following five common situations:

- parent company issuer of securities guaranteed by one or more subsidiaries;
- operating subsidiary issuer of securities guaranteed by parent company;
- finance subsidiary issuer of securities guaranteed by parent company;
- subsidiary issuer of securities guaranteed by parent company and one or more other subsidiaries of parent company; and
- recently acquired subsidiary issuer or subsidiary guarantor.

Guarantee Scenario	Financial Statement Requirements
<p>Parent company issuer of securities guaranteed by some or all of issuer’s subsidiaries, where:</p> <ul style="list-style-type: none"> <li>the subsidiary guarantors are 100 percent owned<sup>107</sup> by the parent company issuer;</li> <li>each guarantee is full – the amount of the guarantee may not be less than the underlying obligation;<sup>108</sup></li> <li>each guarantee is unconditional – holders must be able to take immediate action against the guarantor after a default on the underlying obligation; and</li> <li>the guarantees are joint and several (if there are multiple guarantors).<sup>109</sup></li> </ul>	<p>No separate financial statements for subsidiaries are required under S-X Rules 3-10(e) and (f) if the parent’s annual audited and interim unaudited financial statements are filed for the periods required, and those financial statements include a footnote (audited for the periods for which audited financial statements are required) with condensed, consolidating financial information<sup>110</sup> for each such period, with separate columns for:</p> <ul style="list-style-type: none"> <li>the parent company;</li> <li>the subsidiary guarantor (or subsidiary guarantors on a combined basis);</li> <li>any non-guarantor subsidiaries on a combined basis;<sup>111</sup></li> <li>consolidating adjustments; and</li> <li>total consolidated amounts.</li> </ul> <p>Note 2 to S-X Rule 3-10(e) and Note 1 to S-X Rule 3-10(f) allow a conditional exemption from providing this footnote if the parent company has no independent assets or operations, the non-guarantor subsidiaries are “minor” (generally, less than three percent of the consolidated parent) and there is a footnote to that effect in the parent financial statements that also notes that the guarantees are full and unconditional and joint and several. Under S-X Rule 3-10(h)(5), “a parent company has no independent assets or operations if each of its total assets, revenues, income from continuing operations before income taxes, and cash flows from operating activities (excluding amounts related to its investment in its consolidated subsidiaries) is less than three percent of the corresponding consolidated amount.”<sup>112</sup></p>
<p>Operating subsidiary<sup>113</sup> issuer of securities guaranteed by parent company, where:</p> <ul style="list-style-type: none"> <li>the operating subsidiary issuer is 100 percent owned by the parent company guarantor;</li> <li>the guarantee is full and unconditional; and</li> <li>no other subsidiary of the parent is a guarantor.</li> </ul>	<p>No separate financial statements for the operating subsidiary are required under S-X Rule 3-10(c) if the parent’s audited annual and unaudited interim financial statements are filed for the periods required and they include a footnote (audited for the periods for which audited financial statements are required) with condensed, consolidating financial information<sup>114</sup> for each such period, with separate columns for:</p> <ul style="list-style-type: none"> <li>the parent company;</li> <li>the operating subsidiary issuer;</li> <li>any non-guarantor subsidiaries on a combined basis;<sup>115</sup></li> <li>consolidating adjustments; and</li> <li>total consolidated amounts.</li> </ul> <p>Note 3 to S-X Rule 3-10(c) provides that this exception is also available if an operating subsidiary issuer meets these requirements except that the parent is a co-issuer with the subsidiary, rather than a guarantor.</p>

Guarantee Scenario	Financial Statement Requirements
<p>Finance subsidiary issuer of securities guaranteed by parent company, where:<sup>116</sup></p> <ul style="list-style-type: none"> <li>the finance subsidiary issuer is 100 percent owned by the parent company guarantor;</li> <li>the guarantee is full and unconditional; and</li> <li>no other subsidiary of the parent is a guarantor</li> </ul>	<p>No separate financial statements for the finance subsidiary are required under S-X Rule 3-10(b) if the parent's audited annual and unaudited interim financial statements are filed for the periods required and they include a footnote (audited for the periods for which audited financial statements are required) with:</p> <ul style="list-style-type: none"> <li>a statement that the finance subsidiary issuer is a 100 percent-owned finance subsidiary of the parent; and</li> <li>the parent has fully and unconditionally guaranteed the securities</li> </ul> <p>This exception is also available if a finance subsidiary issuer meets these requirements except that the parent is a co-issuer with the subsidiary, rather than a guarantor.<sup>117</sup></p>
<p>Operating or finance subsidiary issuer of securities guaranteed by parent company and one or more other subsidiaries of parent company, where:</p> <ul style="list-style-type: none"> <li>the issuer and all subsidiary guarantors are 100 percent owned by the parent company guarantor;</li> <li>the guarantees are full and unconditional; and</li> <li>the guarantees are joint and several.<sup>118</sup></li> </ul>	<p>No separate financial statements for subsidiaries are required under S-X Rule 3-10(d) if the parent's audited annual and unaudited interim financial statements are filed for the periods required and they include a footnote (audited for the periods for which audited financial statements are required) with condensed, consolidating financial information<sup>119</sup> for each such period, with separate columns for:</p> <ul style="list-style-type: none"> <li>the parent company;</li> <li>the subsidiary issuer;</li> <li>the guarantor subsidiaries on a combined basis;</li> <li>any non-guarantor subsidiaries on a combined basis;<sup>120</sup></li> <li>consolidating adjustments; and</li> <li>total consolidated amounts.</li> </ul> <p>This exception is also available if a subsidiary issuer meets these requirements except that the subsidiary is not a joint and several guarantor. In that case, the condensed consolidating financial information should include a separate column for the subsidiary.<sup>121</sup></p>
<p>Recently acquired subsidiary issuer or subsidiary guarantor, where:</p> <ul style="list-style-type: none"> <li>the subsidiary has not been included in the audited consolidated results of the parent company for at least nine months of the most recent fiscal year;<sup>122</sup> and</li> <li>the purchase price or net book value (as of the most recent fiscal year end prior to the acquisition),<sup>123</sup> whichever is greater, of the subsidiary (or group of subsidiaries that were related prior to the acquisition) is 20 percent or more of the principal amount of the securities being registered.</li> </ul>	<p>Separate financial statements are required under S-X Rule 3-10(g) for each such subsidiary, including:</p> <ul style="list-style-type: none"> <li>audited financial statements for the subsidiary's most recent fiscal year prior to the acquisition; and</li> <li>unaudited financial statements for any required interim periods.<sup>125</sup></li> </ul> <p>These requirements apply even if (i) the recently acquired subsidiary would otherwise be eligible for the use of condensed consolidating footnote presentation<sup>126</sup> or (ii) S-X Rule 3-05 would not require financial statements. In addition, note that the auditors of the recently acquired subsidiary must be PCAOB registered and the audit report must refer to PCAOB standards, even in the case of a newly acquired entity that is not an SEC reporting company (<i>i.e.</i>, where S-X Rule 3-05 would otherwise permit use of a non-PCAOB registered auditor).<sup>127</sup></p>

## Secured Offerings

S-X Rule 3-16 generally requires separate audited and interim financial statements for an issuer's affiliate if the securities of that affiliate are pledged as collateral for the offering and those securities constitute a "substantial portion" of the collateral for the securities being registered.<sup>128</sup> Securities of the affiliate are deemed to constitute a "substantial portion" of the collateral if the aggregate principal amount, par value, or book value of the pledged securities (as carried by the issuer), or the market value of the pledged securities, whichever is the greatest, equals 20 percent or more of the principal amount of the securities that are being secured.<sup>129</sup>

If this test is met, the affiliate must file the same financial statements that it would be required to file if it were the issuer.<sup>130</sup> However, the affiliate's financial statements do not need to be filed if they are otherwise separately included (which may be through incorporation by reference, if incorporation is otherwise permitted). This very burdensome requirement to produce separate audited financial statements for large subsidiaries if their stock is pledged to secure a bond deal often makes it uneconomical to secure publicly offered bonds with stock pledges.

## Investments Accounted for Under the Equity Method

S-X Rule 3-09 generally requires the inclusion of separate audited financial statements for significant investments that are accounted for under the equity method.<sup>131</sup> S-X Rule 3-09 applies whether the investee is held by an issuer, a subsidiary or another investee.<sup>132</sup> Note that if the investee is not already an SEC reporting company, its financial statements need not be audited by a PCAOB-registered firm, and the audit report need not refer to PCAOB standards (although in some circumstances, such as when the principal auditor of the issuer is making reference in its report to the investee auditor's report, the audit must be carried out in accordance with PCAOB standards).<sup>133</sup>

For investees, significance is evaluated under S-X Rule 1-02(w) based on the following two criteria:<sup>134</sup>

- whether the amount of the issuer's (and its other subsidiaries') investment in and advances to the investee exceeds 20 percent of the total assets of the issuer and its subsidiaries on a consolidated basis as of the end of the most recently completed fiscal year (Test 1);<sup>135</sup> and
- whether the equity of the issuer (and its other subsidiaries) in the pre-tax income from continuing operations of the equity investee exceeds 20 percent of such income of the issuer and its subsidiaries on a consolidated basis for the most recently completed fiscal year (Test 2).<sup>136</sup>

If either of the above tests is met, separate financial statements of the investee must be filed. Insofar as practicable, those financial statements must be as of the same dates and for the same periods as the required audited annual financial statements of the issuer, but need only be audited for those fiscal years in which either Test 1 or Test 2 is met at or above the 20 percent level.<sup>138</sup> Regardless of whether it presents two or three years of its own financial statements, in its initial registration statement an EGC may present two years of investee financial statements.<sup>139</sup>

US GAAP permits the use of the "fair value option" for certain investments that would otherwise be accounted for under the equity method. If an issuer elects the fair value option, Test 2 above is altered to compare the change in fair value of the investee (as reflected in the issuer's financial statements) to the issuer's consolidated pre-tax income for the most recently completed fiscal year.

For equity investees that meet any of the three S-X Rule 1-02(w) criteria at the greater than 10 percent but not more than the 20 percent significance level, S-X Rule 4-08(g) requires the presentation of summary financial information as described by S-X Rule 1-02(bb).<sup>140</sup>

Financial statements of equity investees that are presented under local GAAP or non-IASB IFRS to comply with S-X Rule 3-09 do not have to be reconciled to US GAAP unless either of the Test 1 or Test 2 criteria is greater than 30 percent (calculated on a US GAAP basis).<sup>141</sup> That reconciliation may be done under the less comprehensive requirements of Item 17 of Form 20-F rather than Item 18.<sup>142</sup> A description of the differences in accounting methods is required, however, regardless of the significance levels.<sup>143</sup> Equity investees using IASB IFRS do not need to include a reconciliation.<sup>144</sup>



Summary financial information for a foreign business provided under S-X Rule 4-08(g) must be presented under the same GAAP used by the issuer. For example, a US company would report summarized information for a foreign investee under US GAAP no matter what basis of accounting is used by the foreign investee to prepare its own financial statements.<sup>145</sup>

## Segment Reporting

In addition to all the consolidated financial information required to be included in an offering document, companies that are engaged in more than one line of business or operate in more than one geographic area may also be required to include separate revenues and operating data for each of their business lines or geographic areas. This requirement is a function of whether the company's business comprises more than one operating segment, as defined by US GAAP. S-X Rule 3-03(e) and S-K Item 101(b) require certain financial reporting and textual disclosure for each operating segment.<sup>146</sup> FASB Accounting Standards Codification 280, "Segment Reporting" (ASC 280), provides detailed guidance for when a component of a larger enterprise constitutes an operating segment and how its discrete financial information must be reported.

Generally, an operating segment is a component of a larger enterprise:

- that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same enterprise);
- whose operating results are regularly reviewed by the enterprise's chief operating decision maker<sup>147</sup> to make decisions about resources to be allocated to the segment and assess its performance; and
- for which discrete financial information is available.

The aim of segment reporting is to align public financial reporting with a company's internal reporting in order to permit financial analysts and the public to see the overall enterprise the same way management sees it. The most critical factor in determining whether an issuer has more than one operating segment is how management runs its business.<sup>148</sup> Whether an issuer can aggregate operating segments is highly fact-specific and depends on factors such as economic similarity, the similarity of the products or services sold, the nature of the production process, customer type, distribution methods, and the regulatory environment for the business. The determination is very subjective and is often the subject of much discussion with the company's accountants and, through the SEC comment process, with the SEC Staff.

Once a segment has been identified, the issuer must provide information about the segment if it meets any of the following 10 percent thresholds:

- its reported revenue (including both sales to external customers and inter-segment sales) is 10 percent or more of the combined revenue (internal and external) of all reported operating segments;
- the absolute amount of its reported profit or loss is 10 percent or more of the greater, in absolute amount, of (i) the combined profit of all operating segments that did not report a loss or (ii) the combined loss of all operating segments that did report a loss; or
- its assets are 10 percent or more of the combined assets of all operating segments.<sup>149</sup>

A company with more than one segment (or aggregated segments) in excess of any of these thresholds must disclose for each such segment the revenues from external customers, a measure of profit or loss<sup>150</sup> and the total assets attributable to that segment, as well as a reconciliation to the corresponding consolidated amounts. Additional information on items such as equity investments and capital expenditures may be required under ASC 280 if such amounts are reviewed by the company on a segment basis. For interim periods, disclosure must include a measure of profit or loss for each segment, reconciliations and material changes to total assets. Financial disclosure for segments will typically be included in the financial statements and be cross-referenced as part of a discussion on operating segments in MD&A. The effect of these requirements is to force disclosure of profitability by segment, which many issuers are reluctant to do for competitive reasons.



The identification and reporting of financial information for operating segments will be critical in the offering process, as the time to prepare such information, the effect on textual disclosure and the impact on enterprise valuation may all be significant. The need for segment reporting is always considered carefully when a company is issuing securities for the first time. However, the issue should be revisited whenever the company has entered into new business lines or if management has begun to analyze its business in a new way that may impact the original segment analysis. Because the guidance of ASC 280 is complex and its application very fact-specific, it is important to begin an early dialogue with the accountants when there may be segment reporting issues.

### Supplemental Schedules for Certain Transactions

S-X Rule 5-04 requires a number of supplemental schedules for particular industries and circumstances.<sup>151</sup> Each schedule contains additional financial information that must be audited and provided, typically including:

- *Schedule I - Condensed Financial Information of Registrant (known as "parent-only" financial statements):* requires condensed balance sheets and statements of income and cash flows on a non-consolidated basis as of the end of the latest fiscal year if the amount of restricted net assets of subsidiaries exceeds 25 percent of the issuer's consolidated assets. "Restricted net assets" are the issuer's proportionate share of net assets of consolidated subsidiaries (after intercompany eliminations) which as of the end of the most recent fiscal year may not be transferred to the parent company by subsidiaries in the form of loans, advances or cash dividends without the consent of a third party (*i.e.*, lender, regulatory agency, foreign government, etc.).<sup>152</sup>
- *Schedule II - Valuation and Qualifying Accounts:* requires an analysis of each valuation and qualifying account (*e.g.*, allowance for doubtful accounts, allowance for obsolescence).
- *Schedule III - Real Estate and Accumulated Depreciation:* requires real estate operating and investment companies to disclose certain financial details regarding each of their properties.
- *Schedule IV - Mortgage Loans on Real Estate:* requires real estate operating and investment companies to disclose details of each mortgage loan which accounts for three percent or more of the carrying value of all of the issuer's mortgages.
- *Schedule V - Supplemental Information Concerning Property-Casualty Insurance Operations:* requires disclosure as to liabilities on property-casualty insurance claims if the issuer, its subsidiaries or 50 percent-or-less owned equity basis investees have such liabilities. However, the schedule may be omitted if reserves for unpaid property-casualty claims and claims adjustment expenses did not, in the aggregate, exceed 50 percent of common stockholders' equity of the issuer and its consolidated subsidiaries as of the beginning of the fiscal year.

Note that issuers in specific industries may have schedule requirements that vary from those listed above. In addition, an issuer may provide the schedule information separately or in the notes to the audited financial statements.

### Industry Guides

S-K Item 801 sets out five industry "guides" requiring enhanced disclosure of financial and operational metrics for issuers in certain industries:<sup>153</sup>

- *Guide 3 - Statistical Disclosure by Bank Holding Companies:* requires disclosure of analyses of interest earnings, investment and loan portfolios, loan loss experience, deposit types, returns on equity and assets, and short-term deposits.
- *Guide 4 - Prospectuses Relating to Interests in Oil and Gas Programs:* requires enhanced disclosure relating to the offering terms and participation in costs and revenues among investors and others, as well as a ten-year financial summary of any drilling programs by the issuer and its associates, including recovery on investment for investors in those programs.
- *Guide 5 - Preparation of Registration Statements Relating to Interests in Real Estate Limited Partnerships:* requires a summary of the financial performance of any other real estate investment programs sponsored by the general partner and its affiliates.

- *Guide 6 – Disclosure Concerning Unpaid Claims and Claim Adjustment Expenses of Property- Casualty Insurance Underwriters:* requires disclosure of details of reserves and historical claim data if reserves for unpaid property casualty claims and claim adjustment expenses of the issuer, its consolidated and unconsolidated subsidiaries and equity investees exceed 50 percent of the common stockholders' equity of the issuer and its consolidated subsidiaries.
- *Guide 7 – Description of Property by Issuers Engaged or to be Engaged in Significant Mining Operations:* requires disclosure of information relating to each of the mines, plants and other significant properties owned or operated (or intended to be owned or operated) by the issuer, including location of the property, brief description of the title, claim or lease to the property, a history of previous operations, and a description of the present condition and operations on the property.

In addition, as part of its 2008 Interpretive Release modernizing oil and gas reporting, former Guide 2 was removed from Item 801 and largely recodified in S-K Item 1200. S-K Item 1200 requires enhanced disclosure of oil and gas reserves (including from non-traditional sources), the company's progress in converting proved undeveloped reserves into proved developed reserves, technologies used establishing reserves, the company's internal controls over reserves estimates, disclosure based on geographic area (as defined). Required disclosure also includes information regarding proved undeveloped reserves; oil and gas production; drilling and other exploratory and development activities; present activities; delivery commitments; and oil and gas properties, wells, operations and acreage. Finally, disclosure of probable and possible reserves and oil and gas reserves' sensitivity to price is optional under S-K Item 1200.<sup>154</sup>

Compiling the information required by these industry guides and S-K Item 1200 may be a significant undertaking, and the issuer's financial and operating management should consult with its professional advisors early in the process if an industry guide applies to the offering.

### **Quantitative and Qualitative Disclosure About Market Risk**

S-K Item 305 sets out various specific requirements for quantitative and qualitative disclosure about market risk sensitive instruments (such as derivatives). This disclosure can be significant for companies with substantial trading portfolios or that engage in extensive hedging.

## **Some Related Issues**

### **Additional Financial Information That Is Typically Included**

In addition to the formal requirements of Regulations S-K and S-X, it is customary to include certain other information in the offering document that may be material or convenient for investors in considering the financial condition of the issuer. The three most common examples are described below.

#### **Summary Financial Data**

A page of summary financial data is routinely included in the "summary box" in the offering document. Although there are no specific line item requirements for this key marketing page, it usually contains an income statement, balance sheet, and other financial data for the last three to five fiscal years and the most recent interim period (as well as the comparable interim period in the prior year) comparable to that required on the "Selected Financial Data" page that appears later in the disclosure document. Where appropriate from either a disclosure or marketing perspective, additional operational metrics are also included in the summary under a heading such as "Other Financial Data." These metrics will vary with the type of issuer and will be selected based on the criteria that management and the investment community monitor to evaluate performance or liquidity. Typical examples include comparable store sales data for a retailer, capital expenditures for a manufacturer and subscriber numbers for a cable television company.

## Recent Financial Results

If a significant amount of time has passed since the most recent financial statements included in the offering document, it may be appropriate to include a summary of the quarter in progress (or recently ended) in the “summary box” even before full financial statements for that quarter are required. Examples of “recent results” disclosures are most common after a quarter is completed but before financial statements for that quarter have become available. The issuer and the underwriters will want to tell the market as soon as possible about any positive improvement in operating trends at the conclusion of a good quarter. If the recent results are negative, on the other hand, recent results disclosure may be advisable to avoid any negative surprises for investors when the full quarterly numbers become available. For example, the issuer may be aware that its sales are trending down in the current quarter, or that significant charges will be taken in connection with an acquisition after it closes. Even if Wall Street analysts may be anticipating such an event, it is preferable to disclose this information in the offering document itself. At the “road show” meetings, prospective investors will be asking about the results for a quarter just or almost completed and presenting information in the offering document will facilitate a discussion of these results.<sup>155</sup>

## Recent Developments

To the extent material, the likely consequences of material recent developments may also be disclosed in the “summary box” or the MD&A section of the disclosure. For example, it is customary to discuss a material recent or proposed acquisition, whether or not audited financial statements of the acquired or to-be-acquired business are required to be presented. This practice will often result in a “Recent Developments” paragraph in the summary and a discussion of the impact of the pending or recently completed transaction on margins, debt levels, etc., in a section of the MD&A labeled “Overview,” “Impact of the Acquisition” or a similar title. The textual disclosure may also include a discussion of any special charges or anticipated synergies expected to result from the acquisition or other pending event.

## Non-GAAP Financial Measures

Many issuers choose to disclose measures of financial performance or liquidity that, while derived from GAAP figures presented in a company's financial statements, are not themselves calculated in accordance with GAAP. EBITDA is perhaps the best-known (and most widely used) non-GAAP financial measure.

The SEC's rules (adopted in response to Section 401(b) of the Sarbanes-Oxley Act) limit the use of non-GAAP financial measures in various ways. First Regulation G applies to any public disclosure of non-GAAP financial measures. Second, Item 10(e) of Regulation S-K layers on additional requirements for disclosures in Securities Act and Exchange Act filings (and earnings releases furnished to the SEC under Item 2.02 of Form 8-K).<sup>157</sup>

## Regulation G

A non-GAAP financial measure under Regulation G is broadly defined as a numerical measure of financial performance that excludes (or includes) amounts that are otherwise included (or excluded) in the comparable measure calculated and presented in the financial statements under GAAP.<sup>158</sup>

The term “non-GAAP financial measure” carves out certain items including:

- operating measures and ratios or statistical measures calculated using financial measures determined in accordance with (1) GAAP (e.g., GAAP sales per square foot and operating margin calculated by dividing GAAP revenues into GAAP operating income) or (2) measures that are not themselves non-GAAP financial measures;<sup>159</sup> or
- financial measures required to be disclosed by GAAP, SEC rules or an applicable system of regulation of a government, governmental authority, or a self-regulatory organization (e.g., segment measures required by ASC 280).<sup>160</sup>

Under Regulation G, if a public company discloses a non-GAAP financial measure, it must:<sup>161</sup>

- present the most directly comparable financial measure calculated in accordance with GAAP; and
- quantitatively reconcile the differences between the non-GAAP financial measure and the most directly comparable GAAP financial measure.<sup>162</sup>

In addition, Regulation G contains an anti-fraud prohibition – that is, an issuer may not make any non-GAAP financial measure public if the measure contains a material misstatement or omission.<sup>163</sup>

### **S-K Item 10(e)**

For purposes of Item 10(e), the term “non-GAAP financial measures” has the same meaning as under Regulation G. Under Item 10(e), if a public company includes a non-GAAP financial measure in an SEC filing (or an earnings release furnished under Form 8-K Item 2.02) it must also include:<sup>165</sup>

- a presentation, with equal or greater prominence, of the most directly comparable GAAP financial measure;
- a quantitative reconciliation of the differences between the non-GAAP financial measure and the most directly comparable GAAP financial measure;<sup>166</sup>
- a statement why management believes the non-GAAP financial measure provides useful information for investors; and
- to the extent material, a statement of the additional purposes for which management uses the non-GAAP financial measure.<sup>167</sup>

Furthermore, Item 10(e) prohibits in SEC filings (but not an earnings release furnished under Form 8-K Item 2.02), among other things:<sup>168</sup>

- non-GAAP measures of liquidity that exclude items requiring cash settlement, other than EBIT and EBITDA;
- non-GAAP measures of performance that eliminate or smooth items characterized as non-recurring, unusual, or infrequent when it is reasonably likely that a similar charge or gain will recur within two years, or there was a similar charge or gain within the prior two years;
- the presentation of non-GAAP financial measures on the face of the financial statements, in the accompanying notes, or on the face of any *pro forma* financial information required to be disclosed by Article 11 of Regulation S-X; and
- using a name for non-GAAP financial measures that is the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures.

### **Updated SEC Staff Guidance**

The SEC Staff updated its guidance in 2010 regarding the use of non-GAAP financial measures. The updated guidance, contained in newly issued compliance and disclosure interpretations (C&DI), supersedes the Staff’s prior guidance on this topic issued in 2003.<sup>169</sup>

Highlights of the updated guidance include the following:

- Item 10(e) does not prevent a company from disclosing a non-GAAP financial performance measure (such as Adjusted EBITDA) that eliminates the impact of recurring items, so long as the company clearly discloses the reasons for eliminating the recurring items in the non-GAAP financial measure and does not suggest that the items are non-recurring or infrequent if, in fact, they may recur or have occurred.<sup>170</sup>
- Management does not have to use a non-GAAP financial measure in managing its business in order to present it.<sup>171</sup> However, Item 10(e) requires a statement disclosing why management believes the non-GAAP financial measure provides useful information for investors and, to the extent material, a statement of the additional purposes for which management uses the non-GAAP financial measure (if any).

- Item 10(e) specifically identifies EBIT and EBITDA as acceptable non-GAAP financial measures. The SEC views the term “earnings” to cover net income as presented in the statement of operations under GAAP. If a company calculates the measures in a different way, it must change the title (to for example, Adjusted EBITDA).<sup>172</sup>
- Item 10(e) applies to free-writing prospectuses included in or incorporated by reference into a registration statement or other filing under the Exchange Act, but does not apply to other free-writing prospectuses.<sup>173</sup>
- Item 10(e) does not allow companies to present per share cash flow measures (or similar per share non-GAAP liquidity measures).<sup>174</sup> On the other hand, non-GAAP per share *performance* measures may be permissible.
- The SEC will not accept presentation of a non-GAAP income statement as part of the reconciliation of a non-GAAP financial measure to the most comparable GAAP measure, because undue prominence may be attached to the non-GAAP financial measure.<sup>175</sup>

### Form 8-K Filing Requirements in Connection With Significant Acquisitions or Dispositions

Completion of the acquisition or disposition of a “significant amount of assets” other than in the ordinary course of business must be disclosed under Item 2.01 of Form 8-K, and in turn may trigger the requirement for financial statements of the target under Item 9.01 of Form 8-K. Instruction 4 to Item 2.01 provides that an acquisition or disposition is deemed to involve a significant amount of assets if:

- the company’s and its other subsidiaries’ equity in the net book value of the assets or the amount paid or received for the assets upon such acquisition or disposition exceeded 10% of the total assets of the registrant and its consolidated subsidiaries; or
- it involved a “business” that is “significant.”

Acquisitions and disposition of a business have different reporting thresholds. A “significant” acquisition of a business for these purposes is one meeting the definition of a “significant subsidiary” under S-X Rule 1-02(w) above the 20% level.<sup>176</sup>

If a completed acquisition of a business results in Item 2.01 disclosure, Item 9.01 of Form 8-K comes into play. That item requires a company to file separate audited financial statements of the acquired business under S-X Rule 3-05, based on the significance of the acquisition. In other words, if an acquisition is significant above a 20% percent level, financial statements of the acquired business need to be provided. Similarly, if S-X Rule 3-05 financial statements are needed then S-X Article 11 *pro forma* financial information will be required (and conversely, if no S-X Rule 3-05 financials are needed, then no S-X Article 11 financials will generally be required).<sup>177</sup> Item 9.01(a) provides that the required financial information may be filed with the initial Form 8-K or by amendment to that 8-K not later than 71 calendar days after the due date for the initial Form 8-K (*i.e.*, four business days after the occurrence of the event).

The situation is different for dispositions. First, dispositions have a lower threshold than acquisitions. A “significant” disposition is one where the business would be a “significant subsidiary” under S-X Rule 1-02(w) - that means significant to a 10% level, not the 20% level for acquisitions.<sup>178</sup>

Second, unlike in the case of acquisitions, there is no link between the need for S-X Rule 3-05 financial statements and S-X Article 11 *pro forma* financial information. S-X Rule 3-05 does not apply to dispositions, but you may nonetheless need S-X Article 11 *pro forma* financial information. For example, in the case of a disposition that is significant at a 12% level, *pro forma* financial information would be required notwithstanding that there are no required financial statements.

Third, you have to file the *pro forma* financial information required in an Item 9.01 Form 8-K more quickly in the case of dispositions, because if S-X Article 11 *pro forma* financial information is required, you do not get the benefit of the 71-day extension under Item 9.01(a) of Form 8-K.<sup>179</sup> In other words, you have four business days to prepare and file your *pro forma* financial information (rather than four business days plus 71 additional calendar days).

## Internal Control Over Financial Reporting

An IPO will involve close scrutiny of a company's internal control over financial reporting. Once a company is public, Section 404(a) of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley) requires an assessment by management of the issuer's internal control over financial reporting, while Section 404(b) requires an attestation report of the issuer's independent auditors on management's assessment. Compliance with Section 404 can be a major undertaking for a newly public company, although the SEC has adopted rules to allow an IPO issuer to wait until its second annual report to provide management's Section 404(a) assessment and its auditor's Section 404(b) attestation.<sup>180</sup>

Issuers that are "large accelerated filers" or "accelerated filers" must comply with both Section 404(a) and Section 404(b)<sup>181</sup> management's assessment of internal control over financial reporting and the Section 404(b) independent auditor's attestation report in annual reports filed on Form 10-K with the SEC. By contrast, issuers that are neither large accelerated filers nor accelerated filers are required only to provide management's assessment of internal control under Section 404(a).<sup>182</sup> An EGC is not required to provide the Section 404(b) independent auditor's attestation report for as long as it qualifies as an EGC.<sup>183</sup>

If an entire annual report is incorporated by reference into a registration statement (as is the case with a registration statement on Form S-3), the Section 404 reports and disclosures will also be part of the registration statement.

## Interactive Data

The SEC has adopted rules that require public companies and foreign private issuers that prepare their financial statements in accordance with US GAAP or IASB IFRS to supplement their filed financial statements with financial statements formatted in eXtensible Business Reporting Language (XBRL).<sup>184</sup> XBRL is a form of electronic communication whose main feature includes interactive electronic tagging of both financial and non-financial data.

A previously non-reporting company is not required to include XBRL financial statements in its initial Securities Act registration statement (*i.e.*, an IPO on Form S-1 or an initial exchange offer on Form S-4).<sup>185</sup> It will begin including XBRL financial statements with the first Form 10-Q (or annual report on Form 20-F) it files as a reporting company.<sup>186</sup> Once having provided its first XBRL financial statements, the company would include XBRL financial statements in a subsequent Securities Act registration statement, but only if it includes a price or price range (and not if it merely incorporates financial statements by reference).<sup>187</sup> This means, for example, that XBRL financial statements are not needed in a base registration statement for a shelf offering.

## Special Considerations in Rule 144A Transactions and for Foreign Private Issuers

### Rule 144A Transactions

The disclosure document in a Rule 144A offering is typically modeled after a public offering prospectus. This holds true for financial statement requirements as well – although the line item disclosure rules of the Securities Act do not strictly apply to private offerings under Rule 144A, it has become standard practice to follow these rules as if they applied to Rule 144A offerings, with only limited exceptions. In many situations, the commitment committees of the major financing sources will insist on including financial disclosure in the Rule 144A offering circular that is in all material respects consistent with the financial statement requirements that would apply to a registration statement filed with the SEC. Rule 144A offerings are typically sold off the desk to buyers who expect substantially the same level of disclosure that they would receive in a public deal. Additionally, in the case of a Rule 144A offering with registration rights, the Rule 144A circular will be followed by a registered exchange offer prospectus and the buyers of the offered securities will thereby receive full Securities Act disclosure after the closing. Therefore, Rule 144A offering circulars typically follow the public offering rules described above in all material respects.

It is not uncommon, however, for a working group on a Rule 144A deal to decide to dispense with a particular financial statement requirement if the group determines that that particular item will not materially alter the total mix of information provided, or if there is another way to disclose the item that the S-X requirement



is targeting. After all, Rule 144A(d)(4)'s information requirement is very modest and calls only for "the issuer's most recent balance sheet and profit and loss and retained earnings statements, and similar financial statements for such part of the two preceding fiscal years as the issuer has been in operation (the financial statements should be audited to the extent reasonably available)." A more flexible approach can also be justified by the fact that the liability standards of Sections 11 and 12 of the Securities Act do not apply to Rule 144A deals. Although Rule 10b-5 does apply to Rule 144A offerings, it is more difficult for disgruntled purchasers to demonstrate the requisite *scienter* required to establish a valid 10b-5 claim.<sup>188</sup> As a result, it is not uncommon to provide only two years of audits in a Rule 144A transaction where a registration statement would require three years. This is true for the issuer and for material acquired businesses. We have seen this decision taken in a number of deals, particularly where the issuer is already in its third or fourth fiscal quarter, since the third year of audits will likely be completed in the natural course before the exchange offer registration statement is required to be filed. Other working groups have elected to exclude some of the finer elements of the financial information requirements where they have determined that such additional information would not materially alter the total mix of information presented. Examples include some of the details of the required guarantor footnotes described above, the separate financial statements of subsidiaries in secured deals and some of the details of executive compensation. Although the industry custom is to follow the public offering rules as if they applied to the 144A deal, there is no requirement in Rule 144A to do so and some working groups will conclude that not every detail of the information called for in a registration statement is required to present 144A investors with full and fair disclosure.

As the full impact of Sarbanes-Oxley has made itself felt upon the private equity community and smaller public companies (for whom a few extra million dollars of administrative expenses are material), we have seen a rise in "144A-for-life" debt financings. These transactions are identical to regular Rule 144A offerings, except that they do not offer bond investors any registration rights and they do not require the bond issuers to become or remain voluntary filers of Exchange Act reports. Because these offerings will not be followed by a registered exchange offer prospectus that is fully compliant with S-X, some deal teams are concluding that "144A-for-life" disclosure documents can more freely dispense with non-core S-X requirements than would be the case in a Rule 144A offering with registration rights. There is no clear consensus among practitioners at this time as to whether, or to what extent, such additional flexibility is appropriate.

### **Special Rules Applicable to Foreign Private Issuers and Acquired Foreign Businesses**

The financial statement requirements for foreign private issuers differ in a number of significant ways from those of domestic US issuers. These requirements, discussed extensively in our companion publication "Financial Statements in US Securities Offerings: What Non-US Issuers Need to Know," are summarized briefly below:

#### **Ability to Use US GAAP, IFRS or Local GAAP**

US domestic companies must file financial statements with the SEC in accordance with US GAAP.<sup>189</sup> The financial statements of foreign private issuers, however, may be prepared using US GAAP, IFRS or local GAAP.<sup>190</sup> In the case of foreign private issuers that use IASB IFRS, no reconciliation to US GAAP is needed.<sup>191</sup> By contrast, if local GAAP or non-IASB IFRS is used, the consolidated financial statements (both annual and interim) must include a note reconciliation to US GAAP.<sup>192</sup>

#### **Quarterly Reporting Not Required; Current Reporting on Form 8-K Not Required**

Unlike domestic US issuers, foreign private issuers are not required to file quarterly reports (including quarterly financial information) on Form 10-Q.<sup>193</sup> They also are not required to use Form 8-K for current reports, and instead furnish (not file) Form 6-K with the SEC.<sup>194</sup> Some foreign private issuers, however, choose (or are required by contract) to file the same forms with the SEC that domestic US issuers use. In that case, they must comply with the requirements of the forms for domestic issuers (and would file quarterly reports on Form 10-Q and current reports on Form 8-K, in addition to annual reports on Form 10-K).<sup>195</sup>



### Financial Information Goes Stale More Slowly

The SEC's rules also allow a foreign private issuer's registration statement to contain financial information that is of an earlier date than that allowed for domestic US issuers. In particular, foreign private issuers can omit interim unaudited financial statements if a registration statement becomes effective less than nine months after the end of the last audited fiscal year (unless the issuer has already published more current interim financial information).<sup>196</sup> After that time, a foreign private issuer must provide interim unaudited financial statements (which may be unaudited) covering at least the first six months of the fiscal year, together with comparative financial statements for the same period in the prior year.<sup>197</sup>

### Ability to Submit IPO Registration Statements Confidentially

Certain foreign private issuers that are registering for the first time with the SEC may submit draft registration statements on a confidential basis to the SEC Staff. In particular, a foreign private issuer may submit its IPO registration statement on a confidential basis if it:

- qualifies as an EGC;
- is listed or is concurrently listing its securities on a non-US securities exchange – *i.e.*, a foreign private issuer that is not solely listing in the United States;
- is being privatized by a foreign government; or
- can "demonstrate that the public filing of an initial registration statement would conflict with the law of an applicable foreign jurisdiction."<sup>198</sup>

By contrast, domestic US issuers that are not EGCs must file registration statements publicly.

### Conclusion

Knowing what financial statements will be required to complete a particular financing and when they go "stale" is a critical step in planning a financing. This User's Guide is designed to provide a roadmap to the answers to those questions in the typical cases that we face every day, but is of course not a substitute for reading the rules and regulations we have summarized. In any particular case, securities counsel and the auditors will need to be consulted to confirm your analysis.

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## Endnotes

- <sup>1</sup> The JOBS Act created a new category of issuer, called an emerging growth company (EGC). EGCs benefit from a various accommodations designed to make the initial public offering (IPO) process more attractive and to ease the transition from private to public company.
- <sup>2</sup> For a detailed discussion of these rules, see our companion publication “Financial Statements in US Securities Offerings: What Non-US Issuers Need to Know.”
- A foreign private issuer is any issuer (other than a foreign government) incorporated or organized under the laws of a jurisdiction outside the United States, unless (1) more than 50 percent of its outstanding voting securities are directly or indirectly owned by US residents and (2) either (A) the majority of its executive officers or directors are US citizens or residents, (B) more than 50 percent of its assets are located in the United States or (C) its business is principally administered in the United States. See Rule 405 under the Securities Act of 1933, as amended (the Securities Act); Rule 3b-4 under the US Securities Exchange Act of 1934, as amended (the Exchange Act).
- <sup>3</sup> The financial statement requirements discussed in this User’s Guide also apply to spin-offs registered on Form 10 for the distribution of shares of a subsidiary to the existing shareholders of a public company. However, we do not cover financial statements in M&A transactions. When securities are registered on Form S-4 or F-4 in connection with a stock-for-stock acquisition, different requirements might apply.
- <sup>4</sup> Generally, Form S-3 may be used by an issuer to sell securities (provided that the issuer has at least \$75 million of common equity outstanding held by non-affiliates) if the issuer has been subject to the Exchange Act reporting requirements and timely filed all Exchange Act reports for the 12 months prior to registration, and if neither the issuer nor its subsidiaries have had any material defaults on a payment related to a dividend, sinking fund, indebtedness, or rentals under long-term leases.
- See Form S-3, General Instructions.
- <sup>5</sup> In particular, Form S-1 allows an issuer to incorporate information by reference from its previously filed Exchange Act reports if the issuer:
- is required to file Exchange Act reports;
  - has filed all required materials under the Exchange Act during the prior 12 months;
  - has filed an annual report for its most recently completed fiscal year;
  - is not a blank check issuer, shell company or penny stock issuer; and
  - makes its Exchange Act reports readily available on its website (including by way of a hyperlink to the reports).
- See Form S-1 General Instructions.
- <sup>6</sup> The requirements of Regulation S-X (S-X) Rule 3-01 are imported into both Form S-1 and Form S-3. See Form S-1, Item 11(e) (noting financial statements must be included meeting the requirements of S-X generally); see also Form S-3, Item 12(a) (noting the registrant’s latest annual report on Form 10-K must be incorporated by reference; in turn, Form 10-K, Item 8 specifies that financial statements must be included meeting the requirements of S-X, with certain exceptions).
- <sup>7</sup> See S-X Rule 3-01(a). If the filing is made on or before February 14 (*i.e.*, within 45 days after the end of the prior fiscal year), and audited financial statements for the most recent year are not available, the balance sheet may be as of the end of the two preceding fiscal years. See S-X Rule 3-01(b). In this case, the filing must include an additional balance sheet as of an interim date at least as current as the end of the issuer’s third fiscal quarter of its most recently completed fiscal year. *Id.* Under certain circumstances, this approach may be taken if the filing is made after 45 days but within 90 days of the end of the issuer’s fiscal year. See S-X Rule 3-01(c). In any event, interim balance sheets need not be audited. See S-X Rule 3-01(f).
- <sup>8</sup> See S-X Rule 3-01(a). Financial information of a registrant’s predecessor is required for all periods prior to the registrant’s existence, with no lapse in audited periods or omission of other information required about the registrant. SEC Division of Corporation Finance, *Financial Reporting Manual*, Section 1170 [*Financial Reporting Manual*]. The term “predecessor” is broadly defined. See Securities Act Rule 405.
- <sup>9</sup> See S-X Rule 3-02(a) (income and cash flow statements); see also S-X Rule 3-04 (stockholders’ equity).
- <sup>10</sup> See S-X Rule 3-06. Under this rule, the SEC will accept financial statements for periods of not less than nine, 21 and 33 consecutive months as substantial compliance with the requirement to provide financial statements for one, two and three years, respectively. In particular, whenever audited financial statements are required for a period of one, two or three years, a single audited period of nine to 12 months may count as a year if:
- the issuer has changed its fiscal year during the period;
  - the issuer has made a significant business acquisition for which financial statements are required under S-X Rule 3-05 and the financial statements covering the interim period pertain to the business being acquired; or
  - the SEC grants permission to do so under S-X Rule 3-13, provided that financial statements are filed that cover the full fiscal year or years for all other years in the time period.
- See *id.* Note, however, that this permission is rarely granted.

- <sup>11</sup> See *Financial Reporting Manual*, Section 4110.5 (accounting firm must be PCAOB registered and auditor's report must refer to PCAOB standards); Section 4110.1 (citing PCAOB Rule 2100, which requires each firm to register with the PCAOB that prepares or issues any audit report with respect to any issuer, or plays a substantial role in the preparation of furnishing of an audit report with respect to any issuer).
- <sup>12</sup> See *Financial Reporting Manual*, Section 4130.1 (audit reports that refer to PCAOB standards must comply with both the SEC's and PCAOB's independence rules).
- <sup>13</sup> See S-X Rules 3-01(c), 3-01(e) and 3-01(f). If the filing is made on or before February 14 (*i.e.*, within 45 days after the end of the prior fiscal year), and audited financial statements for the most recent year are not available, then an interim unaudited balance sheet must be included as of the previous September 30 (*i.e.*, as of the end of the most recently completed third quarter). See S-X Rule 3-01(b).
- <sup>14</sup> See S-X Rule 3-02(b). Note that the statement of stockholders' equity may be provided in the notes to the financial statements. See *Financial Reporting Manual*, Section 1120.
- <sup>15</sup> See Form S-1, Item 11(e) (financial statements must be included meeting the requirements of S-X generally); see also Form S-3, Item 11(b)(i) (financial information under S-X Rule 3-05 must be included if not incorporated by reference under Form S-3, Item 12(a)).
- <sup>16</sup> See Form S-1, Item 11(f) (information required by Regulation S-K Item 301 must be included). This requirement is satisfied in Form S-3 registration statements via incorporation by reference of the Form 10-K (requiring S-K Item 301 information pursuant to Part II, Item 6).
- <sup>17</sup> See S-K Item 301(a). Note that selected income statement and balance sheet data for additional fiscal years must be included if needed to keep the information from being misleading. See S-K Item 301(b).
- <sup>18</sup> See S-K Item 301, Instruction 4.
- <sup>19</sup> See S-K Item 301, Instructions 1 and 2.
- <sup>20</sup> See S-K Item 301, Instruction 2.
- <sup>21</sup> See JOBS Act Sections 101(a) and (b) (adding new Securities Act Section 2(a)(19) and Exchange Act Section 3(a)(80)).
- <sup>22</sup> See JOBS Act Section 102(b)(1) (adding new Securities Act Section 7(a)(2)).
- <sup>23</sup> See JOBS Act Section 102(b)(2) (modifying Exchange Act Section 13(a)).
- <sup>24</sup> See JOBS Act Section 102(b)(3) (modifying Regulation S-K, Item 303(a)).
- <sup>25</sup> See S-K Item 503(d).
- <sup>26</sup> EGC status will ordinarily terminate on the last day of a fiscal year. However, the issuance in any three-year period of more than \$1.0 billion in non-convertible debt securities would cause an issuer to lose its EGC status immediately.
- <sup>27</sup> See Form S-1, Item 3 (information under S-K Item 503 must be included); see also Form S-3 Item 3 (noting the same).
- <sup>28</sup> See S-K Item 503(d).
- <sup>29</sup> See *id.*
- <sup>30</sup> See *id.*
- <sup>31</sup> This requirement includes quarterly supplementary financial information, or each of the following line items:
- net sales;
  - gross profit (net sales less costs and expenses associated directly with or allocated to products sold or services rendered);
  - income (loss) before extraordinary items and cumulative effect of a change in accounting;
  - per share data based upon such income (loss); and
  - net income (loss).
- See S-K Item 302(a). This information is typically incorporated by reference rather than presented in the offering document, when permitted.
- <sup>32</sup> See *Financial Reporting Manual*, Section 1210.
- <sup>33</sup> See Exchange Act Rule 12b-2(2).
- <sup>34</sup> We do not discuss the requirements applicable generally to "smaller reporting companies" under the SEC's rules. For a discussion of these requirements, see *Final Rule: Smaller Reporting Company Regulatory Relief and Simplification*, Release No. 33-8876 (December 19, 2007). A smaller reporting company for these purposes generally means an issuer that is not an investment company, an asset-backed issuer or a majority-owned subsidiary of a parent that is not a smaller reporting company and that:
- had a public float of less than \$75 million as of the last business day of its most recently completed second fiscal quarter;
  - in the case of an initial registration statement, had a public float of less than \$75 million as of a date within 30 days of filing the registration statement; or
  - in the case of an issuer with a public float of zero, had annual revenues of less than \$50 million during the most recently completed fiscal year for which audited financial statements are available.
- S-K, Item 10(f)(1).
- <sup>35</sup> See Exchange Act Rule 12b-2(2).
- <sup>36</sup> See S-X Rule 3-12(d).

<sup>37</sup> See S-X Rule 3-01(c).

<sup>38</sup> See *id.*

<sup>39</sup> The rules regarding staleness of the required financial statements for foreign private issuers vary a great deal from those applicable to US domestic issuers. Generally speaking, the financial statements for US domestic issuers go stale at a much faster rate.

<sup>40</sup> See S-X Rules 3-12(a), 3-12(g)(1)(i).

<sup>41</sup> See S-X Rules 3-12(a), 3-12(g)(1)(ii).

<sup>42</sup> See S-X Rule 3-12(a).

<sup>43</sup> See S-X Rules 3-12(a), 3-12(g)(1)(i).

<sup>44</sup> See S-X Rules 3-12(a), 3-12(g)(1)(ii).

<sup>45</sup> See S-X Rule 3-12(a).

<sup>46</sup> See S-X Rule 3-12(b) (loss corporations and non-current filers); S-X Rule 3-12(d) (initial filers). This rule also applies to initial registrations under the Exchange Act on Form 10 for issuers not previously subject to Exchange Act reporting.

<sup>47</sup> See S-X Rules 3-12(b), 3-12(g)(2)(i).

<sup>48</sup> See S-X Rules 3-12(b), 3-12(g)(2)(ii).

<sup>49</sup> See S-X Rules 3-12(b), 3-12(g)(2)(iii).

<sup>50</sup> See S-X Rules 3-12(a), 3-12(g)(1)(i).

<sup>51</sup> See S-X Rules 3-12(a), 3-12(g)(1)(ii).

<sup>52</sup> See Form S-1, Item 11(h); Form S-3, Item 12(a)(1).

<sup>53</sup> See S-K Item 303(a).

<sup>54</sup> See *Final Rule: Disclosure in Management's Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations*, Release No. 33-8182 (Jan. 28, 2003).

<sup>55</sup> See *Other Orders and Notices: Commission Statement about Management's Discussion and Analysis of Financial Condition and Results of Operations*, Release No. 33-8056 (Jan. 22, 2002).

<sup>56</sup> See *Proposed Rule: Disclosure in Management's Discussion and Analysis about the Application of Critical Accounting Policies*, Release No. 33-8098 (May 10, 2002); see also *Other Orders and Notices: Cautionary Advice Regarding Disclosure About Critical Accounting Policies*, Release No. 33-8040 (Dec. 12, 2001).

<sup>57</sup> See *Interpretive Release: Commission Guidance on Presentation of Liquidity and Capital Resources Disclosure in Management's Discussion and Analysis*, Release No. 33-0144 (Sept. 17, 2010).

<sup>58</sup> See *Interpretive Release: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*, Release No. 33-8350 (Dec. 19, 2003).

<sup>59</sup> See Form S-1, Item 11(e); see also Form S-3, Item 11(b)(i). This requirement does not apply to annual reports. See Form 10-K, Item 8 Paragraph 1. Also, when securities are registered on Form S-4 or F-4 in connection with a stock-for-stock acquisition, somewhat different requirements apply for the financial statements of the company being acquired.

<sup>60</sup> See S-X Rule 11-01(d). The question whether an acquisition is of a "business" should be evaluated in light of the facts and circumstances involved and whether there is sufficient continuity of the acquired entity's operations prior to and after the transactions so that disclosure of prior financial information is material to an understanding of future operations. A presumption exists that a separate entity, a subsidiary, or a division is a business. However, a lesser component of an entity may also constitute a business. Among the facts and circumstances to consider in evaluating whether an acquisition of a lesser component of an entity constitutes a business are:

- whether the nature of the revenue-producing activity of the component will remain generally the same as before the transaction; or
- whether any of the following attributes remain with the component after the transaction: (i) physical facilities, (ii) employee base, (iii) market distribution system, (iv) sales force, (v) customer base, (vi) operating rights, (vii) production techniques or (viii) trade names.

See *id.*

<sup>61</sup> However, a different conclusion may be reached depending upon the customary practice for an industry or a particular issuer. For example, an issuer may be submitting a letter of intent as one of many parties in a bidding process, or a rollup entity may routinely sign letters of intent to further its due diligence investigations of multiple potential targets, but with the acquisition of only a minority of those companies becoming probable.

<sup>62</sup> See *Financial Reporting Manual*, Section 2005.4.

<sup>63</sup> By "pre-tax income" we mean the income from continuing operations before income taxes, extraordinary items and cumulative effect of a change in accounting principle. See S-X Rule 1-02(w)(3). If the acquired business had a net loss, then the absolute value of the negative amount is generally used for the test. See *Financial Reporting Manual*, Section 2015.9.

<sup>64</sup> See S-X Rule 3-05(b)(3). The tests may not be made by "annualizing" data. *Id.*

<sup>65</sup> See S-X Rule 3-05(a)(3) (governing whether businesses are "related"); S-X Rule 11-01(d) (governing whether an acquisition involves a "business").

<sup>66</sup> See generally S-X Rule 3-05(b)(2)(ii).

<sup>67</sup> See S-X Rule 3-05(b)(2)(iii).

<sup>68</sup> See S-X Rule 3-05(b)(2)(iv) (50 percent test); S-X Rule 3-05(b)(1) (registration of securities to be offered to security holders of acquired business); *The Center for Audit Quality SEC Regulations Committee Highlights* (Mar. 19, 2013) (EGC may include only two years of financial statements of the Rule 3-05 acquiree, even in situations where an EGC voluntarily provides a third year of financial statements).

<sup>69</sup> See S-X Rule 3-05(a)(1) (financial statements of acquired businesses must be prepared and audited in accordance with S-X).

<sup>70</sup> Although the staleness date for an acquired company's financial statements is determined based on the status of the acquired company (e.g., as an accelerated or non-accelerated filer), an interesting wrinkle may emerge where the acquiring company is on a faster track than the acquired company. In that fact pattern, the separate requirement to include *pro forma* financial information under Article 11 of Regulation S-X can effectively accelerate the need for the acquired company's financial information. The acquiring company will need to produce financial statements for the acquired business if the acquiring company wants to go to market with "LTM" *pro forma* financials after the date on which its own year-end financials are due but before the due date for the acquired company's financials.

<sup>71</sup> See S-X Rule 3-05(b)(4)(i). The date of an offering will be deemed to be the date of the final prospectus or prospectus supplement filed pursuant to Rule 424(b). See *id.* By analogy, the pricing date would be the date of an offering in a Rule 144A transaction.

<sup>72</sup> "Foreign business" is defined in S-X Rule 1-02(l) as a business that is majority owned by persons who are not citizens or residents of the United States and is not organized under US law, and either:

- more than 50 percent of its assets are located outside the United States; or
- the majority of its executive officers or directors are not US citizens or residents.

In determining the majority ownership of a business, the SEC Staff will consider the ultimate parent entity that would consolidate the business under US GAAP (or IFRS for IASB IFRS issuers) and the parent's controlling shareholders. See *Financial Reporting Manual*, Section 6110.4. The implication of this is that a non-US subsidiary of a US company would likely not be considered a "foreign business."

<sup>73</sup> See S-X Rule 3-05(c) (financial statements of an acquired non-US business can meet Item 17 of Form 20-F); Form 20-F, Item 17(c)(v) (financial statements of an acquired business may omit reconciliation below the 30% significance level).

<sup>74</sup> See Form 20-F, Item 17(c)(2)(v).

<sup>75</sup> See *Financial Reporting Manual*, Section 4110.5.

<sup>76</sup> The nine-month requirement reflects the interplay between S-X Rule 3-05(b)(4)(iii) and S-X Rule 3-06. Note that each month in the nine-month period must be covered by an audit.

<sup>77</sup> See S-X Rule 3-05(b)(4)(iii). In certain situations the SEC Staff will apply a 70 percent significance test. See *Financial Reporting Manual*, Section 2040.2.

<sup>78</sup> See S-X Rule 3-06.

<sup>79</sup> SAB 80 was recodified, with slight modifications in *SEC Staff Accounting Bulletin: Codification of Staff Accounting Bulletins*, Topic 1.J. For a discussion of SAB 80, see generally *Financial Reporting Manual*, Section 2070.

<sup>80</sup> *Id.* In order for the pre-acquisition statements of an acquiree to be omitted from the registration statement, each of the following conditions must be met:

- the combined significance of businesses acquired or to be acquired for which audited financial statements cover a period of less than nine months may not exceed 10 percent;
- the combined significance of businesses acquired or to be acquired for which audited financial statements cover a period of less than 21 months may not exceed 20 percent; and
- the combined significance of businesses acquired or to be acquired for which audited financial statements cover a period of less than 33 months may not exceed 40 percent.

Combined significance is the total, for all included companies, of each individual company's highest level of significance under the three tests of significance (investment, assets and pre-tax income). For a serial acquirer going public, the application of SAB 80 is likely to allow for the exclusion of financial statements for an increasing number of acquired companies for each period prior to the IPO. See *id.*

<sup>81</sup> See S-X Rule 3-14(a). The additional disclosure includes (i) material factors considered by the issuer in assessing the property, including sources of revenue (including, but not limited to, competition in the rental market, comparative rents, occupancy rates) and expense (including, but not limited to, utility rates, *ad valorem* tax rates, maintenance expenses and capital improvements anticipated) and (ii) an indication that, after reasonable inquiry, the issuer is not aware of any material factors relating to the property other than those discussed in (i) that would cause the reported financial information not to be necessarily indicative of future operating results. See S-X Rule 3-14(a)(1).

<sup>82</sup> Securities Act Rule 408 states that "In addition to the information expressly required to be included in a registration statement, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading."

<sup>83</sup> See S-X Rule 11-01(a)(1) (noting *pro forma* financial information required for a "significant" business acquisition); S-X Rule 11-01(b)(1) (noting a "significant" acquisition means an acquisition above the 20 percent significance level); S-X Rule 11-01(c) (noting no *pro forma* financial information is needed if separate financial statements of the acquired business are not included).



- <sup>84</sup> See S-X Rule 11-02(b)(1).
- <sup>85</sup> See S-X Rule 11-02(c)(1). The *pro forma* condensed balance sheet should be prepared as if the transaction had occurred on the date of the latest historical balance sheet. See S-X Rule 11-02(b)(6).
- <sup>86</sup> See S-X Rule 11-02(b)(1).
- <sup>87</sup> See S-X Rule 11-02(c)(2)(i). The *pro forma* condensed income statements should be prepared as if the transaction had taken place at the beginning of the latest fiscal year included in the filing. See S-X Rule 11-02(b)(6).
- <sup>88</sup> See S-X Rule 11-01(a)(4). A “significant” disposition for these purposes is one where the business would be a “significant subsidiary” under S-X Rule 1-02(w).
- <sup>89</sup> See S-X Rule 11-01(a)(1) and *Financial Reporting Manual*, Section 3110.1.
- <sup>90</sup> See S-X Rule 11-01(a)(8).
- <sup>91</sup> See generally S-X Rule 11-02.
- <sup>92</sup> See S-X Rule 11-02(b)(6).
- <sup>93</sup> See S-X Rule 11-02(c)(3).
- <sup>94</sup> See *id.* This updating could be accomplished by adding subsequent interim period results to the most recent fiscal yearend information and deducting the comparable preceding year interim period results. See *id.* Another common approach is to use the acquired company’s most recent quarterly information.
- <sup>95</sup> See generally ASC 205-20; *Financial Reporting Manual*, Section 13200. The FASB recently issued for exposure a proposed Accounting Standards Update (ASU), *Presentation of Financial Statements (Topic 205), Reporting Discontinued Operations*. The ASU proposes a revised definition of discontinued operations and additional financial statement disclosures. In the proposed ASU, a discontinued operation would be either: (i) a component of an entity or a group of components of an entity that represents a separate major line of business or major geographical area of operations that either has been disposed of or is part of a single coordinated plan to be classified as held for sale or (ii) a business that, on acquisition, meets all of the criteria to be classified as held for sale.
- <sup>96</sup> See *Financial Reporting Manual*, Section 13100.
- <sup>97</sup> See *Financial Reporting Manual*, Section 13110.1.
- <sup>98</sup> See *Financial Reporting Manual*, Section 13110.2; Form S-3 Item 11(b)(ii).
- <sup>99</sup> See *Financial Reporting Manual*, Section 13110.2; Item 512(a) of Regulation S-K.
- <sup>100</sup> See Securities Act Forms Compliance & Disclosure Interpretation (C&DIs) Question 126.40 (“The fact that financial statements eventually will be retroactively restated does not necessarily mean that there are ‘material changes in the registrant’s affairs,’ thereby requiring the financial statements to be restated for inclusion, or incorporation by reference, in a Form S-8.”).
- <sup>101</sup> See *Financial Reporting Manual*, Section 9830.1.
- <sup>102</sup> See *Financial Reporting Manual*, Section 9210.6.b.
- <sup>103</sup> See S-X Rule 3-10(a). In the case of a foreign private issuer, these will be the financial statements required by Item 8.A of Form 20-F. See S-X Rule 3-10(a)(3). Note that S-X Rule 3-10 typically does not apply to credit enhancements that are not guarantees. However, in certain cases the financial condition of the party providing the credit enhancement could be material to investors and subject to disclosure. See *Final Rule: Financial Statements and Periodic Reports for Related Issuers and Guarantors*, Release No. 33-7878 at FN 50 (Aug. 15, 2000) [*Guarantors Release*].
- <sup>104</sup> The modified financial information permitted by S-X Rules 3-10(b)-(f) is available only for guaranteed debt and debt-like instruments. See *Guarantors Release* at Section III.A.4.b. Substance is determinative, and the characteristics that identify a guaranteed security as debt or debt-like for these purposes are: (i) the issuer has a contractual obligation to pay a fixed sum at a fixed time and (ii) where the obligation to make such payments is cumulative, a set amount of interest must be paid. See *id.*
- <sup>105</sup> Under S-X Rule 3-10(h)(6), a subsidiary is “minor” if each of its total assets, stockholders’ equity, revenues, income from continuing operations before income taxes, and cash flows from operating activities is less than three percent of the parent company’s corresponding consolidated amount. See also *Financial Reporting Manual* Note to Section 2515.3 (minor definition applies to both direct and indirect subsidiaries of the parent; non-guarantor subsidiaries that are more than minor prevent the use of the narrative approach, whether owned directly by parent or indirectly through another subsidiary).
- <sup>106</sup> See S-X Rule 3-10(i)(12). The reconciliation may be based on Item 17 of Form 20-F. See *id.*
- <sup>107</sup> Under S-X Rule 3-10(h)(1), a subsidiary is 100 percent owned if all of its outstanding voting shares are owned, directly or indirectly, by its parent company. The term “voting shares” includes all rights, other than as affected by events of default, to vote for election of directors, and the sum of all interests in an unincorporated person. See S-X Rule 1-02(z). Convertible securities and options to buy voting shares would typically be considered voting shares. Note that this standard is different from the definition of “wholly-owned subsidiary” under S-X Rule 1-02(aa), which is “a subsidiary substantially all of whose outstanding voting shares are owned by its parent and/or the parent’s other wholly owned subsidiaries.”
- <sup>108</sup> The Latham & Watkins standard form indenture includes a “savings clause” to limit the guarantee to the extent necessary for the guarantee not to constitute a fraudulent conveyance under insolvency laws. This exception does not vitiate the “full and unconditional” nature of the guarantee in the view of the SEC. Guarantees may also have different subordination terms than the guaranteed security.

<sup>109</sup> Note 3 to S-X Rule 3-10(f) provides that if any of the subsidiary guarantees is not joint and several with the guarantees of the other subsidiaries, then each subsidiary guarantor whose guarantee is not joint and several need not include separate financial statements, but the condensed consolidating financial information must include a separate column for each subsidiary guarantor whose guarantee is not joint and several.

<sup>110</sup> S-X Rule 3-10(i) provides guidance for the preparation of the condensed consolidating financial information in the footnote.

<sup>111</sup> The column for non-guarantor subsidiaries may be omitted if the parent has independent assets or operations and the non-guarantor subsidiaries are minor. See Note 3 to S-X Rule 3-10(e); see also Note 2 to S-X Rule 3-10(f).

<sup>112</sup> S-X Rule 3-10(h)(5).

<sup>113</sup> A subsidiary is an operating subsidiary if it is not a "finance subsidiary." See S-X Rule 3-10(h)(8). In turn, a subsidiary is a finance subsidiary "if it has no assets, operations, revenues or cash flows other than those related to the issuance, administration and repayment of the security being registered and any other securities guaranteed by its parent company." S-X Rule 3-10(h)(7).

<sup>114</sup> Note 1 to S-X Rule 3-10(c) allows a conditional exemption from providing the footnote if the parent company has no independent assets or operations, the guarantee is full and unconditional, the non-guarantor subsidiaries are minor, and there is a footnote to this effect in the parent's financial statements.

<sup>115</sup> The column for non-guarantor subsidiaries may be omitted if the parent has independent assets or operations and the non-guarantor subsidiaries are minor. See Note 2 to S-X Rule 3-10(c).

<sup>116</sup> As noted above, a subsidiary is a finance subsidiary "if it has no assets, operations, revenues or cash flows other than those related to the issuance, administration and repayment of the security being registered and any other securities guaranteed by its parent company." S-X Rule 3-10(h)(7).

<sup>117</sup> See Note to S-X Rule 3-10(b).

<sup>118</sup> Pursuant to Note 4 to S-X Rule 3-10(d), if any of the subsidiary guarantees is not joint and several with the guarantees of the parent company or the guarantees of the parent company and the other subsidiaries, each subsidiary guarantor whose guarantee is not joint and several need not include separate financial statements, but the condensed consolidating financial information must include a separate column for each subsidiary guarantor whose guarantee is not joint and several.

<sup>119</sup> For a finance subsidiary only, instead of providing this condensed consolidating financial information, the parent company's financial statements may include a footnote stating (if true) that the parent company has no independent assets or operations, the issuer is a 100 percent-owned finance subsidiary, the parent company and all of the parent company's subsidiaries other than the issuer have guaranteed the securities, and the guarantees are full and unconditional and joint and several. See Note 5 to S-X Rule 3-10(d).

<sup>120</sup> The column for non-guarantor subsidiaries may be omitted if the non-guarantor subsidiaries are minor.

<sup>121</sup> See Instruction 4 to S-X Rule 3-10(d).

<sup>122</sup> See S-X Rule 3-10(g)(1)(i).

<sup>123</sup> See Instruction 1 to S-X Rule 3-10(g)(1).

<sup>124</sup> See Instruction 3 to S-X Rule 3-10(g)(1).

<sup>125</sup> The audited and unaudited financial statements must comply with all aspects of S-X except for the filing of supporting schedules. See S-X Rule 3-10(g)(2)(ii). If the subsidiary is a foreign business, financial statements of the subsidiary meeting the requirements of Item 17 of Form 20-F will suffice. See *id.*

<sup>126</sup> See S-X Rule 3-10(g)(1).

<sup>127</sup> See *Financial Reporting Manual*, Section 4110.5.

<sup>128</sup> See *Financial Reporting Manual*, Section 2600.1.

<sup>129</sup> See S-X Rule 3-16.

<sup>130</sup> See *Financial Reporting Manual*, Section 2600.2.

<sup>131</sup> See ASC 323, *Investments - Equity Method and Joint Venture*; see also *Financial Reporting Manual*, Section 5210.

<sup>132</sup> See SAB 103, Topic 6.K.4.

<sup>133</sup> See *Financial Reporting Manual*, Section 4110.5.

<sup>134</sup> See S-X Rule 3-09(a).

<sup>135</sup> Note this test is derived from S-X Rule 1-02(w)(1).

<sup>136</sup> Note this test is derived from S-X Rule 1-02(w)(3).

<sup>137</sup> See S-X Rule 3-09(a).

<sup>138</sup> See S-X Rule 3-09(b).

<sup>139</sup> *The Center for Audit Quality SEC Regulations Committee Highlights* (Mar. 19, 2013) (EGC may include only two years of financial statements of the Rule 3-09 investee, even in situations where an EGC voluntarily provides a third year of financial statements).

<sup>140</sup> See generally S-X Rule 408(g).

<sup>141</sup> See Form 20-F, Item 17(c)(vi).



<sup>142</sup> See S-X Rule 3-09(d).

<sup>143</sup> See Form 20-F, Item 17(c).

<sup>144</sup> See *id.*

<sup>145</sup> See *Financial Reporting Manual*, Note to Section 6410.6.

<sup>146</sup> See S-X Rule 3-03(e); see also S-K Item 101(b).

<sup>147</sup> ASC 280 uses the term “chief operating decision maker” to identify a function rather than a specific person; the “chief operating decision maker” could be the CEO, CFO, or a group of senior managers, depending upon the circumstances.

<sup>148</sup> In practice there are a great variety of ways in which management may view its business and there is no one right answer within a given industry.

<sup>149</sup> See ASC 280-10-50-12 (quantitative thresholds).

<sup>150</sup> Under ASC 280, the details provided in reporting a “measure of profit or loss” depends upon the information that is actually reviewed by the chief operating decision maker and may include revenues from external vs. internal customers, interest revenue and expenses, depreciation and amortization, and extraordinary items, among others.

<sup>151</sup> See generally S-X Rule 5-04(c).

<sup>152</sup> Where restrictions on the amount of funds that may be loaned or advanced differ from the amount restricted as to transfer in the form of cash dividends, the amount least restrictive to the subsidiary may be used. Redeemable preferred stocks and noncontrolling interests are deducted in computing net assets for purposes of this test.

<sup>153</sup> See generally S-K Item 801.

<sup>154</sup> See *Interpretive Release: Modernization of Oil and Gas Reporting*, Release No. 33-8995 (Dec. 31, 2008). Notably, these amendments apply to registration statements filed on or after January 1, 2010 and for annual reports on Forms 10-K and 20-F for fiscal years ending on or after December 31, 2009. *Id.* at 95.

<sup>155</sup> Regulation FD prohibits discussing material information with prospective investors unless it has been made public. Some companies will issue a “recent results” press release ahead of schedule in order to allow for the inclusion of these results in the offering document and a “road show” discussion of these results with prospective investors. See Regulation FD Rule 100.

<sup>156</sup> See Regulation G, Rule 100(a).

<sup>157</sup> See Form 8-K, Item 2.02, Instruction 2 (requirements of Regulation S-K Item 10(e)(1)(i) apply to Item 2.02 disclosures).

<sup>158</sup> See Regulation G at Rule 101(a)(1).

<sup>159</sup> See *id.* at Rule 101(a)(2).

<sup>160</sup> See *id.* at Rule 101(a)(3).

<sup>161</sup> See *id.* at Rule 100(a).

<sup>162</sup> See *id.* at Rule 100(a)(2). In the case of forward-looking non-GAAP measures, a quantitative reconciliation need only be provided to the extent available without unreasonable efforts. *Id.*

<sup>163</sup> See *id.* at Rule 100(b).

<sup>164</sup> See Regulation S-K, Items 10(e)(2), 10(e)(4) and 10(e)(5).

<sup>165</sup> See *id.* at Item 10(e)(1)(i).

<sup>166</sup> See *id.* at Item 10(e)(1)(i)(B).

<sup>167</sup> See *id.* at Item 10(e)(1)(i).

<sup>168</sup> See *id.* at Item 10(e)(1)(ii).

<sup>169</sup> See SEC Office of the Chief Accountant, Division of Corporation Finance, Frequently Asked Questions Regarding the Use of Non-GAAP Financial Measures (June 13, 2003); Latham & Watkins Client Alert, Adjusted EBITDA is Out of the Shadows as Staff Updates Non-GAAP Interpretations (Feb. 22, 2010).

<sup>170</sup> See C&DI 102.03.

<sup>171</sup> C&DI 102.04.

<sup>172</sup> C&DI 103.01.

<sup>173</sup> C&DI 102.08.

<sup>174</sup> C&DI 102.05.

<sup>175</sup> C&DI 102.10.

<sup>176</sup> See S-X Rule 11-01(b).

<sup>177</sup> See S-X Rules 11-01(a)(1), 11-01(b)(1), 11-01(c).

<sup>178</sup> See S-X Rule 11-01(b).

<sup>179</sup> See Form 8-K Item 9.01(b).

- <sup>180</sup> See S-K Item 308, Instruction 1 (providing a “transition period” for “newly public companies” pursuant to which the management’s assessment and the auditor’s attestation is not required until the company “either had been required to file an annual report pursuant to section 13(a) or 15(d) of the Exchange Act for the prior fiscal year or had filed an annual report with the Commission for the prior fiscal year”); see also *Final Rule: Internal Control over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers and Newly Public Companies*, Release No. 33-8760 (Dec. 15, 2006) (adopting the transition period codified in S-K Item 308 Instruction 1).
- <sup>181</sup> See S-K Items 308 (a) and (b). Under Exchange Act Rule 12b-2, a “large accelerated filer” is an issuer that, as of the end of its fiscal year:
- has an aggregate worldwide market value of voting and non-voting common equity held by nonaffiliates (market capitalization) of \$700 million or more (measured as of the last business day of the issuer’s most recently completed second fiscal quarter);
  - has been subject to SEC reporting under the Exchange Act for a period of at least twelve calendar months;
  - has filed at least one annual report under the Exchange Act with the SEC; and
  - is not eligible to use the requirements for smaller reporting companies in Regulation S-K.
- In addition, under Exchange Act Rule 12b-2, an “accelerated filer” is an issuer meeting the same conditions, except that it has a market capitalization of \$75 million or more but less than \$700 million (measured as of the last business day of its most recently completed second fiscal quarter).
- In general, the primary determinant for “smaller reporting company” eligibility is whether the company has less than \$75 million in public float or, in the case of issuers with a public float of zero (e.g., companies with no common equity outstanding or no market price for their outstanding common equity), revenue of less than \$50 million in the last fiscal year. See *Final Rule: Smaller Reporting Company Regulatory Relief and Simplification*, Release No. 33-8876 (Dec. 19, 2007).
- <sup>182</sup> See *Final Rule: Internal Control over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers*, Release No. 33-9142 (Sept. 21, 2010). This rule implemented Section 989G of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which added Section 404(c) to Sarbanes-Oxley. Under Section 404(c), the requirements of Section 404(b) do not apply to any audit report prepared for an issuer that is neither an accelerated filer nor a large accelerated filer.
- <sup>183</sup> JOBS Act Section 103 (revising Sarbanes-Oxley Section 404(b)); JOBS Act Section 101(a) and (b) (adding new Securities Act Section 2(a)(19) and Exchange Act Section 3(a)(80)).
- <sup>184</sup> See *Final Rule: Interactive Data to Improve Financial Reporting*, Release No. 33-9002 (Jan. 30, 2009).
- <sup>185</sup> See S-K Item 601(b)(101)(i).
- <sup>186</sup> *Id.*
- <sup>187</sup> *Id.*
- <sup>188</sup> Under the relevant Rule 10b-5 case law, a plaintiff must show more than a simple misstatement or omission. A showing of *scienter* or recklessness is also required to establish liability.
- <sup>189</sup> See S-X Rule 4-01(a)(1) (financial statements not prepared in accordance with “generally accepted accounting principles” are presumed to be misleading or inaccurate); *Financial Reporting Manual*, Section 1410 (S-X and US GAAP must be followed by domestic issuers).
- <sup>190</sup> S-X Rule 4-01(a)(2).
- <sup>191</sup> *Final Rule: Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Accounting Standards Without Reconciliation to US GAAP*, Release No. 33-8879 (Dec. 21, 2007). Note that the accounting policy footnote must state compliance with IASB IFRS and the auditor’s report must opine on IASB IFRS. *Financial Reporting Manual*, Section 6310.2.
- <sup>192</sup> See Form 20-F, Items 17(c), 18.
- <sup>193</sup> Exchange Act Rule 13a-13(b)(2).
- <sup>194</sup> Exchange Act Rule 13a-11(b); see also Exchange Act Rule 13a-16(c) (reports on Form 6-K are furnished, not filed).
- <sup>195</sup> See Exchange Act Rule 13a-16(a)(3); see also *Financial Reporting Manual*, Section 6120.1 (same).
- <sup>196</sup> See Form 20-F, Item 8(a)(5); *Financial Reporting Manual*, Sections 6220.1, 6220.6.
- <sup>197</sup> See Form 20-F, Item 8(a)(5).
- <sup>198</sup> See Staff of the Division of Corporation Finance, *Non-Public Submissions from Foreign Private Issuers* (Dec. 8, 2011, updated May 30, 2012).



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