

COMMUNICATIONS WITH THE DIVISION OF CORPORATION FINANCE'S OFFICE OF CHIEF ACCOUNTANT (CF-OCA)

(Last updated: 8/25/2017)

CF-OCA performs the following functions that may result in communications with companies and their advisors:

- Acts on behalf of the Commission to grant relief under Rule 3-13 of Regulation S-X. The staff has authority, where consistent with investor protection, to permit registrants to omit, or substitute for, required financial statements. Requests for this relief should be submitted by email. Call (202) 551-3111 and ask for the appropriate person listed below to discuss questions about potential relief:

Rule 3-05 – Patrick Gilmore

Article 11 – Todd Hardiman

Rules 3-09 and 4-08(g) – Christy Adams

Rules 3-10 and 3-16 – Tricia Armelin

Rule 3-14 – Jessica Barberich

- Answers interpretive request letters and provides informal interpretive advice about the form and content of financial statements and other financial information required to be included in Commission filings. Requests for interpretive letters should be submitted by email. Requests for informal interpretive advice should be submitted by online form or by calling (202) 551-3400. While the statements made by the staff on the telephone are intended to be helpful to the persons making the inquiries, they are not binding due to their informal nature.
- Helps identify and explain the applicable rules, regulations, forms, and guidance that affect the form and content of financial statements and other financial information required to be included in Commission filings. Requests for this assistance should be submitted by online form or by calling (202) 551-3400.

2065 Acquisition of Selected Parts of an Entity may Result in Less than Full Financial Statements.

(Last updated: 8/25/2017)

NOTE to SECTION 2065

S-X 3-05 applies to the acquisition of selected parts of an entity when that acquisition represents the acquisition of a “business” as defined in S-X 11-01(d) and the business acquired does not represent a predecessor of the registrant.

Except for acquisitions of certain oil and gas properties discussed in Section 2065.11, requests to substitute statements of assets acquired and liabilities assumed and statements of revenues and direct expenses (abbreviated financial statements) in lieu of full financial statements or carve-out financial statements should be directed to CF-OCA prior to filing. In addition, requests to provide abbreviated financial statements for an acquired business identified as a predecessor of the registrant should be directed to CF-OCA prior to filing.

- 2065.1 **Acquire Substantially All of an Entity** - If the registrant acquires or succeeds to substantially all of the entity's key operating assets, full audited financial statements of the entity are presumed to be necessary in order to provide investors with the complete and comprehensive financial history of the acquired business. In these circumstances, elimination of specified assets and liabilities not acquired or assumed by the registrant is depicted in pro forma financial statements presenting the effects of the acquisition.
- 2065.2 **Acquire Less than Substantially All of an Entity** - In some circumstances, a registrant does not acquire or succeed to substantially all of the assets and liabilities of another entity. For example, the selling entity may retain significant operating assets, or significant operating assets that comprised the seller may be operated by an entity other than the registrant. In these circumstances, financial statements of the larger entity of which the acquired business was a part may not be informative. In that case, audited financial statements usually should be presented for the acquired component business, excluding the continuing operations retained by the larger entity. Registrants should evaluate their facts and circumstances to determine whether to apply the guidance in Section 2065.3 (carve-out financial statements) or in Sections 2065.4 through Section 2065.12 (abbreviated financial statements).
- 2065.3 **Carve-out Financial Statements - Applicability** - The staff will accept carve-out financial statements if it is impracticable to prepare the full financial statements required by Regulation S-X, and explanation of that impracticability is included in the filing. Carve-out financial statements may be appropriate when the acquired business represents a discrete activity of the selling entity for which assets and liabilities are specifically identifiable and a reasonable basis exists to allocate items that are not specifically identifiable to the acquired business, such as debt and indirect expenses not directly involved in the revenue producing activity. Carve-out financial statements should reflect all assets and liabilities of the acquired business even if they are not acquired/assumed as part of the acquisition. The staff would expect carve-out financial statements to comply with the guidance in SAB Topic 1B.1.
- 2065.4 **Abbreviated Financial Statements – Statements of Assets Acquired and Liabilities Assumed and Statements of Revenues and Direct Expenses – Applicability** – The staff

may allow audited statements of assets acquired and liabilities assumed and statements of revenues and direct expenses (abbreviated financial statements) if it is impracticable to prepare the full financial statements required by Regulation S-X. For example, it may be impracticable to prepare full financial statements in an acquisition of a product line where the acquired product line is not a stand-alone entity; separate, audited financial statements of the product line have never been prepared; and the seller has not maintained the distinct and separate accounts necessary to present the full financial statements of the product line. Except for acquisitions of certain oil and gas properties discussed in Section 2065.11, requests to substitute abbreviated financial statements in lieu of full financial statements or carve-out financial statements should be directed to CF-OCA prior to filing.

2065.5 **Abbreviated Financial Statements – Statements of Assets Acquired and Liabilities Assumed – General Requirements** – Present a statement of assets acquired and liabilities assumed as of the end of each period required to be provided under S-X 3-05, not just as of the end of the most recent period, on the basis of seller’s historical GAAP carrying value. If the registrant is unable to obtain statements of assets acquired and liabilities assumed prepared on the basis of seller’s historical GAAP carrying value for each of the reporting dates required by S-X 3-05 (or, if applicable, S-X 8-04), CF-OCA will consider a registrant’s request to present a statement of assets acquired and liabilities assumed prepared on the basis of the allocation of the registrant’s purchase price as of the acquisition date. Registrants would still need to present the statement of revenues and direct expenses for the periods indicated by S-X 3-05 and S-X 8-04, as applicable.

2065.6 **Abbreviated Financial Statements – Statement of Revenues and Direct Expenses - General Requirements** -The staff would expect the statement of revenues and direct expenses to exclude only those costs not directly involved in the revenue producing activity, such as corporate overhead, interest and taxes. **All** costs directly associated with producing revenues reflected in the statement, including, but not limited to **all** related costs of sales and other selling, general and administrative, distribution, marketing, and research and development costs, must be included in the statement. The statement should include a reasonable allocation of expenses incurred by the seller on behalf of the business sold. The reasons for omitting any historical corporate overhead, interest, or tax expense should be explained in a note to the statements. If the type and historical amounts of these omitted expenses are known or reasonably available on an unaudited basis, they should be disclosed in an unaudited footnote. An explanation of the impracticability of preparing the full financial statements required by Regulation S-X should be provided. Also, the notes should describe how the financial statements presented are not indicative of the financial condition or results of operations of the acquired business going forward because of the omission of various operating expenses.

NOTE to SECTION 2065.6

If granted, the accommodation from CF-OCA to present abbreviated financial statements is premised on the registrant’s ability to identify all costs directly associated with producing revenues of the acquired product line.

2065.7 [Reserved]

2065.8 **Cash Flows** - When abbreviated financial statements are presented, preparation of full

statements of cash flows may not be practicable. However, registrants are required to provide information about the business's operating, investing and financing cash flows, to the extent available, in the notes to the financial statements or in unaudited supplemental disclosures.

2065.9 Abbreviated Financial Statements – Statements of Assets Acquired and Liabilities Assumed and Statements of Revenues and Direct Expenses - Calculating Significance -

Registrants should compute all three S-X 3-05 significance tests as written. For the asset test, this will require comparing the book value of the assets acquired to the registrant's total assets. For the income test this will require comparing the excess/deficiency of revenue over direct expenses to the registrant's pre-tax earnings. Historically, some registrants have requested to adjust the S-X 1-02(w) income test denominator (i.e., the registrant's pre-tax earnings) to exclude costs not directly involved in the registrant's revenue producing activity, such as corporate overhead, interest and taxes, when those costs are excluded from the numerator used to calculate income test significance. While such a calculation may help facilitate a registrant's analysis of whether the application of the S-X 3-05 income test produces anomalous results, such a calculation should not be done in lieu of the income test specified in S-X 3-05. If a registrant's management believes the application of the S-X 3-05 tests as written produces anomalous results, CF-OCA will, upon receipt of the registrant's written request and supporting analysis, consider a registrant's request to waive one or more of the periods specified by S-X 3-05. In making this request, registrants should evaluate all relevant facts and circumstances in determining what number of periods are necessary for an investor's understanding of the acquired business. Generally, CF-OCA will not waive all audited periods required by S-X 3-05.

2065.10 Pro Forma Financial Statements and Forward-Looking Disclosures – S-X Article 11 applies to the acquisition of selected parts of an entity.

Pro Forma Condensed Balance Sheet Guidance – If the historical financial statements of the acquired business are full financial statements (see Section 2065.1), the pro forma balance sheet should include adjustments to remove assets and liabilities that were not acquired or assumed provided the criteria described in Section 3220.3 are met.

Pro Forma Condensed Income Statement Guidance - The pro forma condensed income statement should comply with the criteria at Section 3230.4 and should not include forward-looking information. If the historical financial statements of the acquired business are abbreviated financial statements, the pro forma footnotes should explain how the pro forma condensed income statements are not indicative of the acquired business's operations going forward because of the changes in the business and the omission of various operating expenses.

Forward-Looking Information - If the registrant includes forward-looking information, it should clearly be identified as forward-looking rather than as pro forma. If the forward-looking information is in the form of an S-X 11-03 forecast, the pro forma condensed income statements may be omitted (see Section 3510). If the forward-looking information provided is not in the form of an S-X 11-03 forecast, it should nonetheless disclose how revenues and operating efficiencies may vary given the assumptions underlying the forward-looking information as if the business had been acquired at the beginning of the periods presented.

2065.11 **Unique Considerations for Acquisitions of Oil and Gas Properties – General** – An acquisition of an interest in a producing oil or natural gas property is considered by the staff to be the acquisition of a business pursuant to S-X 11-01(d) for which pre-acquisition financial statements are required if significant. If the property acquired represents substantially all of the selling entity’s key operating assets, see Section 2065.1. If the property acquired represents less than substantially all of the selling entity’s key operating assets, the registrant should provide the carve-out financial statements described in Section 2065.3, except that the staff will accept (i.e. pre-clearance with CF-OCA is not required) the abbreviated financial statements described in Sections 2065.4 through 2065.8 and in Section 2065.12 if the following three circumstances exist:

- The interest in the acquired oil or natural gas property constitutes only a portion of the assets of the seller and is not a segment or division of an entity or contained in a separate legal entity.
- Separate financial statements for the acquired business have not previously been prepared, and the seller has not maintained the distinct and separate accounts necessary to present the full financial statements or full carve-out financial statements of the property.
- It is impracticable to prepare the full financial statements required by Regulation S-X.

If abbreviated financial statements are provided, significance should be calculated in accordance with Section 2065.9.

2065.12 **Unique Considerations for Acquisitions of Oil and Gas Properties – Additional Guidance** – Registrants that present abbreviated financial statements in the circumstances described in Section 2065.11:

- May omit the statement of assets acquired and liabilities assumed if the business acquired consists solely of interest(s) in one or more oil or natural gas properties (e.g. working interests, net profit interests, etc.).
- Should include in the statement of revenues and direct expenses, income statement effects of all derivative contracts related to the property that existed during the historical financial statement periods presented if the registrant acquires or assumes any derivative contracts related to the acquired oil and natural gas property.
- Should furnish the supplementary disclosures described in ASC 932-235-50-3 through 50-11 and ASC 932-235-50-29 through 50-36 for each full year of operations presented for the acquired property. If prior year reserve studies were not made, the staff will not object to computing the reserves for prior years using only production and new discovery quantities and valuation, in which case there will be no “revision of prior estimates” amounts. Registrants may develop these disclosures based on a reserve study for the most recent year, computing the changes backward. If disclosures are developed in this manner, the method of computation should be disclosed in a footnote.

- Should consider the guidance in Section 2065.10 regarding pro forma financial statements and forward-looking disclosures.

10220.1 **Number of Years of Registrant Financial Statements to be Presented**

a. Initial Public Offering of Common Equity Securities

An EGC is not required to present more than two years of audited financial statements in a Securities Act registration statement for an initial public offering of its common equity securities.

Foreign private issuers that file using IFRS as issued by the IASB may need a third balance sheet in certain circumstances. See Section 10320.

b. Initial Public Offering of Debt Securities

An EGC must present three years of audited financial statements in its initial public offering of debt securities, unless Section 10220.1c applies.

c. Securities Act Registration Statements Filed Subsequent to the Initial Public Offering of Common Equity Securities

An EGC is not required, in subsequent filings, to include audited financial statements for any periods prior to the earliest audited period presented in connection with its initial public offering of common equity securities.

d. Exchange Act Registration Statements

EGC Exchange Act registration statements require the presentation of three years of financial statements unless the company qualifies as a smaller reporting company.

e. Annual Report on Form 10-K or 20-F

For an EGC that is not a smaller reporting company, three years of audited financial statements are required to be included in its Form 10-K or Form 20-F.

f. Omission of Financial Information for Historical Periods

See the Division of Corporation Finance's C&DI's for Securities Act Forms, Question 101.04. Note that Question 101.05 addresses similar matters for non-EGC issuers. (Last updated 8/25/2017)

10220.5 **Financial Statements of Entities Other than the Registrant and Pro Forma Financial Information**

(Last updated: 11/9/2016)

- a. If the significance tests result in a requirement to present three years of financial statements for entities other than the registrant, such as acquired businesses under Rule 3-05, acquired real estate operations under Rule 3-14 or equity method investees under Rule 3-09, an operating company EGC may present two years of financial statements for these other entities in the registration statement for its initial public offering of common equity securities.
- b. If an operating company EGC voluntarily presents a third year of its financial statements in its initial public offering of common equity securities, it may limit the financial statements of these other entities to two years instead of three in that registration statement.
- c. See the Division of Corporation Finance's C&DIs for the FAST Act, Question 2 for guidance regarding the omission of financial statements of other entities. *(Last updated 8/25/2017)*