



July 29, 2019

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

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

Submitted via rule-comments@sec.gov

Dear Ms. Countryman:

This letter is being submitted by Financial Executives International's (FEI) Committee on Corporate Reporting (CCR) in response to the Securities and Exchange Commission's (SEC or "the Commission") *Amendments to Financial Disclosures and Acquired and Disposed Businesses* ("the Amendments").

FEI is a leading international organization of more than 10,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives, and other senior-level financial executives. The Committee on Corporate Reporting (CCR) is a technical committee of FEI made up of 45 Chief Accounting Officers and Corporate Controllers from the Fortune 100 and other large public companies — representing approximately \$8.4 trillion in market capitalization. CCR reviews and responds to pronouncements, proposed rules and regulations, pending legislation, and other documents issued by domestic and international regulators and organizations such as the SEC, FASB, and PCAOB.

This letter represents the views of CCR and not necessarily the views of FEI or its members individually.

Executive Summary

As preparers of financial information, we commend and support the Commission for its efforts to improve the financial information and reporting requirements related to acquisitions and dispositions of businesses to facilitate more timely access to capital, reduce the complexity and costs to prepare the applicable disclosures, and focus financial statements on material and meaningful information. We appreciate the Commission's comprehensive evaluation of the disclosure requirements and its careful consideration of the feedback received in response to the 2015 Request for Comment on the Effectiveness of Financial Disclosures about Entities other than the Registrant.

Highlighted below are some of the key amendments that we support. We have also included for your consideration, certain recommendations and changes that we believe can further enhance the amendments as proposed. These recommendations include using pre-tax income in the Income Test and

removing the proposed requirement to include Management Adjustments in pro forma financial information. We have a number of concerns with the proposal to require Management Adjustments, which we have outlined below. While we agree with and appreciate most of the proposed Amendments, we feel that the Management Adjustments requirement could be challenging for preparers and may result in information that may be misleading and difficult for investors to interpret.

A. Proposed Amendments to Generally Applicable Financial Statement Requirements for Acquired Businesses

1. Significance Tests

We appreciate the Commission's efforts to revise the significance tests provided in Rule 1-02(w) to assist registrants in making more meaningful significance determinations. We support the changes to the Investment Test and the use of the aggregate worldwide market value of the registrant's voting and non-voting common equity, when available. We agree that the aggregate worldwide market value provides for better alignment of the Investment Test with the economic significance of the acquisition. The Commission also asks if the significance tests should take a qualitative approach rather than the current quantitative approach. We agree with the Commission's assessment that a qualitative approach would be time consuming during typically infrequent and time-intensive transactions. Therefore, we agree that the current quantitative, bright-line approach, including the proposed changes, would be less costly and encourage the Commission to retain the quantitative approach.

As it relates to the Income Test, we support the addition of the revenue component to reduce anomalous results that may occur by relying solely on income. We believe that the addition of the revenue component, when both the registrant and the tested subsidiary have recurring annual revenues, would not create significant additional costs because revenue is generally a readily available number. We support using the same threshold for the revenue component and the income component for the Income Test and believe that the threshold of 20% for both tests is an appropriate measure of significance. We have the following recommendation regarding the proposal to use after tax income for the Income Test.

We appreciate that the Commission's proposal to use after tax income as the basis for the Income Test is an attempt to simplify the test. However, we believe it is preferable to use pre-tax income because tax volatility may significantly influence results in ways that do not reflect the true significance of an entity to the registrant. One-time tax impacts due to foreign, federal, and/or state tax laws may impact both the registrant and the tested subsidiary differently and result in after tax income for the registrant and the tested subsidiary that are not comparable for the purposes of the significance test. For example, U.S. Tax Reform as part of the Tax Cuts and Jobs Act resulted in significant one-time tax charges and credits that impacted companies differently. Additionally, we understand that part of the reason for using after tax income is that it is more readily accessible. CCR members generally believe that pre-tax income is as easy

to provide as after tax income while also being more reliable and consistent. Therefore, we do not believe the benefits of using after tax income rather than pre-tax income outweigh the cost of using a less reliable measure of a company's economic income.

2. Audited Financial Statements for Significant Acquisitions

We support the proposed revision to Rule 3-05 regarding the number of years of audited financial statements required, depending on the relative significance of the acquired business. We agree that, at most, two years of pre-acquisition financial statements would be sufficient as older financial statements are less relevant in evaluating an acquisition. We also support the recommendations regarding comparative interim period financial statements, i.e. focusing on the most recent interim period rather than "any interim period" for acquisitions where a significance test exceeds 20% but not 40%. These changes will save significant cost and time for preparers while maintaining the value and information provided to investors.

3. Financial Statements for Net Assets that Constitute a Business

We support the Commission's proposal to permit the use of abbreviated financial statements when a registrant acquires a component of an entity that meets the definition of a business in Rule 11-01(d) but does not constitute a separate entity, subsidiary, or division. We also agree with the proposed conditions that would be required to use abbreviated financial statements as well as the form and content of the abbreviated financial statements.

B. Proposed Amendments Relating to Rule 3-05 Financial Statements Included in Registration Statements and Proxy Statements

1. Omission of Rule 3-05 Financial Statements for Businesses That Have Been Included in the Registrant's Financial Statements

We appreciate the Commission's efforts to reduce burden and preparation time of the required financial information and therefore support the proposal to no longer require Rule 3-05 Financial Statements in registration statements and proxy statements once the acquired business is reflected in filed post-acquisition registrant financial statements for a complete fiscal year.

2. Use of Pro Forma Financial Information to Measure Significance

We support the Commission's proposal to expand the circumstances in which a registrant can use pro forma financial information for significance testing and the conditions required to use pro forma financial statements. We also agree with the clarification that would allow registrants to not include the Management Adjustments when using the pro forma information to determine significance (see

comments below regarding the use of Management Adjustments in pro forma financial information). We agree that the amendments would provide registrants with the flexibility to more accurately determine the relative significance of an acquired or disposed business to the ongoing operations of the registrant.

3. Disclosure Requirements for Individually Insignificant Acquisitions

We support the proposed changes to the disclosure requirements for individually insignificant acquisitions. We agree with the Commission that the proposed amendments would both improve the information provided to investors and reduce burdens on registrants of providing audited historical financial statements for immaterial acquisitions.

D. Pro Forma Financial Information

1. Adjustment Criteria and Presentation Requirements

We agree with the proposal to replace the current pro forma adjustment criteria with simplified requirements to depict the applicable U.S. GAAP or IFRS-IASB with the Transaction Accounting Adjustment category which eliminates the inconsistencies under the current rules. The differences between U.S. GAAP or IFRS-IASB requirements and the current pro forma requirements in Article 11 are costly to prepare and create confusion for financial statement users. We also agree with the proposed disclosures in the explanatory notes that accompany the pro forma financial information to provide investors with additional information about the pro forma adjustments.

While we believe the ability to exercise judgment in providing balanced and forward-looking information to investors is important, we have concerns with forward-looking information being included in pro forma financial information through Management Adjustments. We understand that the intent of this requirement is to provide users with more information about the effects a transaction will have on a company and its operating results. We appreciate the Commission's efforts to create ways for companies to provide investors with this type of information. However, we have several concerns with using pro forma financial as the vehicle, including:

- Combining estimates of uncertain future events with the existing Article 11 Pro Forma financial information that is based on historical financial statements may be confusing or misleading for users. In particular, synergies will often unfold over a number of years, making it difficult to determine which amounts should be included in the Management Adjustments.
- The estimated amount, nature, and timing of synergies can often change and are therefore not well suited for presentation in a limited pro forma snapshot. For example, synergies tied to restructuring and divestment actions may take several years to complete before the benefits are fully realized.

- The requirement to include Management Adjustments could result in companies prematurely disclosing information about post-acquisition plans which could have adverse implications from a competitive standpoint or with respect to other stakeholders (e.g. employees).
- Preparing the Management Adjustments will likely be costly and operationally burdensome. In a large transaction companies could spend significant time and resource evaluating each potential synergy to determine if its effects are reasonably estimable and reasonably expected to occur, given the requirement to include all such effects. We also note that estimation/measurement of revenue synergies can be particularly complex.

Although we appreciate the intentions behind the Management Adjustments proposal, we believe the costs, complexities, and challenges significantly outweigh the potential benefits and recommend that the Commission should move forward without this provision in the rule.

If the Commission feels that it is important for preparers to provide additional information regarding synergies, we suggest that the Commission consider allowing a discussion of management's action plans, similar to the current MD&A disclosures for material restructuring plans (SAB Topic 5-P). Such a discussion could also be broadened to address acquisitions made for purposes other than synergies, for example, to acquire needed technologies. To the extent that these disclosures include projections, they would require the same Safe Harbor protections that are provided for MD&A forward-looking information.

Additionally, as it relates to the amendments to pro forma financial information we seek clarification from the Commission on the current pro forma adjustment requirements. The current rules allow companies to adjust additional events that are directly related to the transaction, for example adjusting for the effects of additional financing necessary to complete the acquisition. The proposal does not mention these allowable adjustments. We believe these adjustments are helpful to users and preparers. We suggest that the commission clarify in the final rule whether these types of adjustments will still be allowable under the proposed rule.

2. Significance and Business Dispositions

We appreciate the Commission's amendments related to dispositions. The 10% threshold provides little incremental benefit to stakeholders while requiring significant time and resources to prepare the required financial information. As such, we support the proposed increase from 10% to 20% in the significance threshold requiring a Form 8-K and pro forma financial information for disposed businesses. Additionally, we agree that the significance thresholds for acquisitions and dispositions should be aligned.

Conclusion



Committee on Corporate Reporting

Overall, we support the Commission's proposed amendments to improve the disclosure requirements for financial statement relating to acquisitions and dispositions of businesses except for the proposals to use after tax income for purposes of testing significance and to require Management Adjustments in the pro forma financial information. We appreciate the Commission's efforts and hope that you consider our additional recommendations. We stand ready to assist in continued dialogue on this topic.

Sincerely,

Prat Bhatt

Prat Bhatt
Chairman, Committee on Corporate Reporting
Financial Executives International

Cc: Russell G. Golden, Chairman, Financial Accounting Standards Board