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Re: File Number S7-20-15
Request for Comment on the Effectiveness of Financial Disclosures about Entities Other than the Registrant

Dear Office of the Secretary,

Grant Thornton LLP appreciates the opportunity to comment on the Securities and Exchange Commission ("SEC" or "Commission") September 25, 2015 *Request for Comment on the Effectiveness of Financial Disclosures about Entities Other than the Registrant* ("Request for Comment"). We broadly support the Commission's efforts to enhance the effectiveness of public company disclosures and believe the Request for Comment is an important step in the process to clarify, enhance, and strengthen the quality of information available to public company shareholders and other stakeholders. We believe Regulation S-X ("S-X"), particularly as it relates to financial information provided about entities other than the registrant, is an ideal starting point, as reporting and disclosure in this area has not been the subject of Commission review in many years.

This letter summarizes the key points of our comments, with further details included in the accompanying Appendix, organized around the following topics:

- Definition of significant subsidiary, including specified significance tests (S-X Rule 1-02(w))
- Financial statements of businesses acquired or to be acquired and real estate operations (S-X Rules 3-05 and 3-14, respectively)
- Pro forma financial information (S-X Article 11)
- Separate financial statements and summarized financial information of equity method investees (S-X Rules 3-09 and 4-08(g), respectively)
- Cross-border transactions and foreign private issuer matters
- Financial statements of guarantors and issuers of guaranteed securities registered or being registered (S-X Rule 3-10)

While some of our comments are interrelated, we do encourage the Commission to consider individual rulemaking activities, such that smaller, but meaningful, changes can be made in specific areas without a comprehensive rulemaking effort. Additionally, we encourage the SEC to take this time to consider codifying those areas where the SEC staff frequently provides relief in a certain topical area. This could be accomplished by incorporating into any rule proposal stemming from this project or otherwise incorporated into existing vehicles for disseminating broad interpretive guidance to registrants.

Our comments reflect our views gained primarily from serving public companies as independent accountants, including interaction with the SEC staff in this capacity. We have focused our comments on areas where we have observed challenges in applying certain Regulation S-X rules pertaining to financial information of other entities, areas in which registrants frequently seek and obtain waivers from full compliance with a prescribed rule on the basis that the information is not material for understanding the operations and potential future outcomes of the registrant, and areas that seem overly prescriptive or inconsistent with other aspects of SEC reporting. Because understanding all points of view is critical to furthering the disclosure effectiveness project while maintaining the critical goal of investor protection, we encourage the Commission to continue its outreach to investors, registrants and other stakeholders as part of its request for feedback on the rules currently in place regarding financial information of other entities.

Executive Summary

In considering our thoughts and articulating them in this letter, we are keenly aware that the goal of the SEC's Disclosure Effectiveness initiative is not to reduce disclosure, but to make disclosure more effective and useful for investors and other stakeholders. With that as our guide, the main themes of our comments, detailed in the Appendix, are:

- Attention should be given to definition of *significant subsidiary* and the specified significance tests in S-X Rule 1-02(w) in order to reduce the number of anomalous results yielded by the current tests. We considered an alternative principles-based framework, and would support such a framework, but believe further outreach is needed before proceeding in this regard.
- The requirements regarding financial statements of an acquired business have not been significantly amended in nearly 20 years. Since that time, we have observed certain matters in applying the rules that have prevented or delayed completion of the acquisition of private company targets and delayed capital raise transactions. We have suggested modifications to the reporting requirements related to these transactions to streamline the process, while still providing investors with useful information in a timelier manner.
- We believe a significant amount of external focus is currently placed on pro forma financial information. Accordingly, we recommend permitting expanded disclosures, such as allowing more than one year of S-X Article 11 pro forma information.
- The reporting requirements for equity method investees under S-X Rules 3-09 and 4-08(g) should be re-evaluated, particularly in those situations involving business development companies, investments accounted for at fair value, and events that trigger a redetermination of significance.

- Consideration should be given to streamlining the reporting for guarantors and issuers that guarantee registered securities under S-X Rule 3-10 due to the unique challenges and extensive analysis surrounding the current disclosure model.

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We would be pleased to discuss our comments with you. If you have any questions, please contact Trent Gazzaway, National Managing Partner of Professional Standards, at [redacted] or [redacted].

Sincerely,

Grant Thornton LLP

Enc. Appendix: Comments Regarding Financial Disclosures about Entities Other than the Registrant

Appendix: Comments Regarding Financial Disclosures about Entities Other than the Registrant

Definition of Significant Subsidiary, including specified significance tests (S-X Rule 1-02(w))

Significant subsidiary, as defined in S-X Rule 1-02(w), serves as the foundation for many registrant disclosures throughout SEC rules and forms, including thresholds for determining when financial statements are required for entities other than the registrant, such as in S-X Rules 3-05 and 3-09. The three current tests in S-X Rule 1-02(w) are within a bright-line model, which has been in place for decades without significant revision. Due to the importance the thresholds in Rule 1-02(w) have on the presentation of financial statements of entities other than the registrant, we believe evaluation of this rule is a critical first step in any changes to Regulation S-X.

We evaluated the current bright-line model and an alternative principles-based framework, while keeping in mind that the definition in S-X Rule 1-02(w) is the backbone of many other disclosure requirements. We observe that the tests within the current bright-line model have some flaws which can yield anomalous results. There is no room in the current framework for management judgment, creating the need for companies to regularly seek waivers to omit financial statements that they believe are not material or relevant to investors.

Consideration of a principles-based framework

We believe there could be benefits to introducing judgment into the definition of significant subsidiary, whereby both quantitative and qualitative factors may be considered. While we do believe quantitative metrics are important and should be evaluated in all cases, it seems that the results of any one test may not be the sole indicator of a "significant" conclusion. We envisioned a framework whereby quantitative metrics are considered, but would also allow a registrant to consider a complete mix of information to make a judgment regarding what is material to evaluating the future prospects for the company. We believe this is consistent with the direction of other standard-setters, as well as the approach in SAB Topic 1.M, *Materiality*.

While a principles-based approach has merit, we also considered its challenges. It may be more difficult to apply. The results would not be as conclusive as a bright-line approach and therefore could be subject to after-the-fact critique. We believe this could have the undesired effect of causing registrants to frequently pre-clear their conclusions, which could increase the level of pre-filing written submissions to the SEC staff on this subject. Further, a principles-based framework could only yield a "yes" or "no" answer with respect to significance, such that it would not provide for tiers of reporting (such as one or two years of other entity financial statements). From a practical standpoint, this would completely change the environment in which we operate today and may raise significant concerns for stakeholders.

We are supportive of a principles-based framework and would encourage the SEC to further explore the practical application with registrants. However, in our deliberations, we could not get to an application of a principles-based framework that would adequately eliminate unease given the potential legal ramifications and implications to capital raise activity. Therefore, we focus our below comments on some modifications to the existing bright-line model that we believe may be more reflective of significance, and eliminate some of the anomalies with today's income test.

Considerations for the bright-line model

In considering the bright-line thresholds in S-X Rule 1-02(w), we note the following with respect to the current tests:

- Investment Test
  - Compares a fair value metric (example in an acquisition situation: consideration transferred under U.S. Generally Accepted Accounting Principles (U.S. GAAP) or International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS), as appropriate) to an historical, carrying value metric (total assets of the registrant) which may not provide a meaningful comparison.
- Asset Test
  - Based largely on historical cost or carrying values
- Income Test
  - Applying the test can be challenging, as evidenced by the multiple pages of interpretive guidance on this topic included in the SEC staff's Financial Reporting Manual ("FRM").
  - Is not intuitively suited for companies that account for unconsolidated subsidiaries using the fair value method.
  - Once calculated, this test often results in an indication of "significant" even if the registrant believes information about the underlying entity is not material to investors. This is particularly true when the registrant has near break-even results or when either entity has significant, unusual charges in the period tested (example: a one-time impairment charge).

Accordingly, we submit the following list of possible metrics to replace the current tests.

- Possible income statement tests:
  - Revenue: compare the registrant's proportionate share of net revenue of the tested entity to the registrant's consolidated net revenue for the most recently completed fiscal year, or
  - Operating income: compare the registrant's proportionate share of operating income of the tested entity to the registrant's consolidated operating income for the most recently completed fiscal year. While not currently specified as a line item on the income statement under S-X Rule 5-03 for commercial and industrial companies, the metric is frequently used and presented by registrants in their reporting.

In the case of an acquisition, consider permitting use of pro forma revenue or operating income in the denominator of the above tests, in order to measure against the combined entity for purposes of the calculation.

- Fair value: compare the fair value of the registrant's investment in the tested entity to the registrant's fair value.

- For the denominator, fair value amounts should be readily determinable for registrants with public equity outstanding. If a registrant does not have public equity outstanding and its fair value is not readily available, the carrying value of the registrant's total assets should be used in the denominator. In such circumstances, the carrying value of the registrant's investment would also be used in the numerator.
- For an equity method investment calculation under S-X Rule 3-09 or Rule 4-08(g), the numerator should represent the fair value of the equity method investment. Carrying value would be used if fair value is not readily available. In such circumstances, the carrying value of the registrant's total assets should be used in the denominator similar to the investment test today.
- For purposes of S-X Rule 3-05, the numerator should continue to represent the fair value of the consideration transferred (that is, the purchase price under U.S. GAAP or IFRS, as appropriate). Additionally, fair value of the registrant would be based on a date close to the acquisition date, given the fair value of the tested entity is at a more recent date than fiscal year-end.

Financial Statements of Businesses Acquired or to be Acquired and Real Estate Operations (S-X Rules 3-05 and 3-14, respectively)

Simplifying target financial statements

Number of periods

S-X Rule 3-05 generally requires three years of audited financial statements of a target entity when that entity is significant at the 50% or greater level. However, an emerging growth company (EGC) is permitted to provide only two years of audited financial statements for both itself and any acquired businesses in its initial public offering (IPO) registration statement. EGCs can be quite large, complex entities with multiple pre-IPO acquisitions. Further, we have observed other situations where S-X Rule 3-05 yields three years of required target financial statements, but for substantive reasons, the issuer does not believe three years of target financial statements would be material information to an investor. In these circumstances, the SEC staff has often granted relief from providing the third year. For these reasons, we question if there is significant value in the information contained in the third year's information and believe there may be merit to limiting disclosure under S-X Rule 3-05 to a maximum of two years of audited financial statements, except in cases of a reverse acquisition or when the target will be the reporting predecessor. We recommend the SEC revisit both the number of periods required for acquired business financial statements, as well as the significance thresholds at which the number of periods is triggered.

Abbreviated financial statements

In addition to financial statements of an entire acquired business, S-X Rule 3-05 applies to acquisitions of selected parts of an entity when that acquisition represents a "business" as defined in S-X Rule 11-01(d). When acquiring less than substantially all of an entity, issuers can provide a full set of financial statements for the portion acquired or carve-out financial statements. In many cases, fairly significant assumptions are made by the target entity to perform cost allocations, most of which were not contemporaneous.

The SEC staff does, in certain cases, permit a registrant to provide audited statements of assets acquired and liabilities assumed, and statements of revenues and direct expenses (abbreviated financial statements) in lieu of full or carve-out financial statements if it is impracticable to prepare the full financial statements required by Regulation S-X. Currently, except for acquisition of certain interests in producing oil and gas properties or real estate, registrants must make a written request to staff in the Division of Corporation Finance's Office of Chief Accountant to obtain such relief. In the oil and gas arena, FRM 2065.11 permits a registrant to file abbreviated financial statements without a written request, provided that the following three conditions are met:

1 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.

2 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.

3 It is impracticable to prepare the full financial statements required by Regulation S-X.

In our experience, the SEC staff has permitted registrants to file abbreviated financial statements in lieu of full financial statements across industries, provided the conditions described above are met.

Therefore, we recommend the SEC consider wider acceptance of abbreviated financial statements in all industries, provided that the three general conditions in FRM 2065.11 are met. Given that cost structures will change post-acquisition, the value of non-contemporaneous cost allocations seems questionable. Further, as is currently the practice, when abbreviated financial statements are permitted, disclosure would be provided regarding why it is impracticable to prepare full or carve-out financial statements of the acquired business and why such abbreviated statements provide meaningful information to investors.

Form and content

A registrant may acquire a privately held business whose historical financial statements have been prepared using Private Company Council (PCC) alternatives available in U.S. GAAP (such as goodwill amortization). The pre-acquisition financial statements filed with the SEC to satisfy the requirements of S-X Rule 3-05 must comply with the requirements of Regulation S-X, as well as SEC staff accounting positions. Additionally, any application of PCC alternatives would need to be retrospectively reversed for all periods presented in an SEC filing, since the acquired business qualifies as a public business entity (PBE) under U.S. GAAP at such time the statements are filed with the SEC to satisfy the issuer's obligation under S-X Rule 3-05. In cases where financial statements have already been prepared and audited for the acquired business, incremental cost and effort is required to revise the financial statements for purposes of inclusion in an SEC filing. This effort can delay the acquisition or otherwise influence the terms of closing, or worse, delay the timing in which investors receive the audited information for the significant acquisition.

We encourage the SEC to consider accepting PCC alternatives in S-X Rule 3-05 financial statements and further consider if the benefits outweigh the costs of requiring those pre-acquisition financial statements to comply with Regulation S-X. The adjustments to conform to public company accounting and reporting should be required by Regulation S-X or other SEC guidance to be fully reflected in the accompanying pro forma financial information. Given the acquired business will not have an ongoing, standalone public reporting requirement; the historical impact will be shown in pro forma; and the accounting policies post-acquisition will necessarily be conformed to that of the issuer, it seems that the goal of investor protection would be preserved without significant additional costs.

Areas of observed inconsistency in Securities Act and Exchange Act reporting

Individually insignificant acquisitions

When preparing to file a registration statement or proxy, issuers are required to evaluate individually insignificant acquisitions (primarily, those that were individually less than 20% significant) to determine if the acquisitions exceed 50% aggregate significance. This aggregate evaluation is not required for periodic and current reporting (on Forms 8-K, 10-Q, and 10-K). Therefore, unless capital raise activity is planned, it is difficult for an issuer to know at the close of an acquisition if financial statements of an individually insignificant acquisition will be required in the future. We recommend that the SEC consider whether there is utility to investors given that selection of which entities to present, if required, can be arbitrary and in many cases would be provided significantly after the close of the acquisition.

Probable acquisitions

There appears to be inconsistent treatment of probable acquisitions between Securities Act and Exchange Act filings and across various Securities Act offerings (that is, treatment in a new or amended registration statement versus a takedown using a prospectus supplement). For example, probable acquisitions are not required to be evaluated and reported for purposes of routine periodic reports, but are required to be evaluated in connection with a new Securities Act registration statement. We recommend that the SEC reconsider reporting requirements with respect to probable acquisitions by focusing on whether pro forma financial information depicting the acquisition may be sufficient or whether there is benefit to achieving symmetry between the Securities Act and Exchange Act reporting requirements.

Significance tests for acquired businesses in an IPO

Staff Accounting Bulletin No. 80 (SAB 80) was issued in 1988 in order to address application issues in S-X Rule 3-05 for companies undertaking an IPO that have grown through acquisition. SAB 80 is rarely applied given its complexity and the requirement that the issuer must have maintained those acquired entities substantially intact post-acquisition. Further adding to its complexity, the significance thresholds in the SAB do not align with those in S-X Rule 3-05 (as last amended in 1996). If the SEC amends S-X Rule 3-05, we recommend that changes to SAB 80 be incorporated into those revisions (and SAB 80 rescinded) – simplifying its application, aligning the thresholds and number of periods required with S-X Rule 3-05, and expanding the base of companies that may make use of the reporting accommodation.

S-X Rule 3-14

Given that S-X Rule 3-14, with respect to acquisitions of real estate operations, was not modified when the SEC amended S-X Rule 3-05 in 1996, we recommend the Commission consider changes to S-X Rule 3-14 concurrently with changes to S-X Rule 3-05. There are certain differences between S-X Rules 3-05 and 3-14 that seemingly could be eliminated and/or aligned. Specifically, we recommend that the SEC give consideration to the following in changing the reporting requirements under S-X Rule 3-14:

- The applicability of S-X Rule 3-06 (that is, periods of 9 to 12 months satisfy the requirement to provide one year of financial statements)
- The use of audited pre-acquisition and post-acquisition periods to satisfy the disclosure requirement
- The significance thresholds (that is, 20% vs. 10%)
- The requirements pertaining to individually insignificant acquisitions

Pro Forma Financial Information (S-X Article 11)

Pro forma financial information provides investors with disclosures concerning the effects of certain significant events on the registrant had the events occurred at an earlier date. We understand investors focus on pro forma disclosures and believe the SEC could potentially strengthen the usefulness of these disclosures by aligning them, in certain respects, with the disclosures required under U.S. GAAP; increasing the number of annual periods permitted for comparative purposes; and allowing other types of adjustments in the pro forma statements than those permitted under the current rules.

Definition of a Business

The objective in determining a business under S-X Rule 11-01(d) is to provide historical information concerning a transaction that is meaningful to an understanding of the effects on the registrant's future operations. Therefore, determining a business under S-X Article 11 rightly focuses on the continuity of the acquired entity's operations, specifically the nature of the revenue-producing activity. This objective, and determination of a business, are not aligned with U.S. GAAP, which focuses on certain inputs and outputs that exist *at* the date of acquisition. We believe it is appropriate to maintain the distinction between the determinations, as aligning the S-X Article 11 determination of a business to the U.S. GAAP definition could potentially result in the provision of pre-acquisition historical financial statements that do not provide meaningful information for understanding the effects on future operations (for example, acquisitions of cost centers that do not generate revenues). Should the SEC desire to align its definition of a business with U.S. GAAP, we suggest that the final determination be made after the FASB completes its current project clarifying the U.S. GAAP definition of a business.

Consistency with U.S. GAAP requirements

Nature of adjustments

Pro forma financial information is required under both U.S. GAAP (ASC 805-10-50-1) and S-X Article 11; yet there are differences between the two in preparation. For example:

- Nonrecurring adjustments – S-X Article 11 prohibits income statement adjustments for nonrecurring charges or credits directly attributable to a transaction. U.S. GAAP requires these adjustments.
- Different assumed transaction dates – S-X Article 11 requires adjustments related to a pro forma income statement to be computed assuming the transaction was consummated at the beginning of the fiscal year presented. In contrast, the assumed acquisition date used to compute pro forma operating results in accordance with U.S. GAAP is not revised as the financial statements are updated. These differences cause S-X Article 11 pro forma operating results that might initially agree with the U.S. GAAP pro forma operating results to move out of alignment as time passes.
- Different earnings measures – S-X Article 11 requires pro forma income from continuing operations and related pro forma per share amounts, and it prohibits showing pro forma amounts reflecting discontinued operations. U.S. GAAP simply requires a company to present pro forma "earnings" and does not specify which "earnings" measure is to be presented.

We recommend that the SEC and the FASB work collaboratively to establish more consistency between the pro forma presentation requirements.

Periods required/permitted

Today there exists a difference in the number of periods permitted for a pro forma income statement under S-X Rule 11-02 and that required under U.S. GAAP (ASC 805-10-50-2(h)). U.S. GAAP requires two years of pro forma income statement information when comparative financial statements are presented. But, S-X Rule 11-02(c)(2)(i) requires a pro forma income statement for only the most recent fiscal year and subsequent interim period for a business combination and does not permit prior full fiscal year pro forma income statements. In an effort to promote consistency and enhance a user's understanding of pro forma financial information, we recommend that the SEC permit registrants to provide pro forma income statements for the two latest fiscal years if they deem the information meaningful for investors.

Restrictions on pro forma adjustments

Under the existing framework, pro forma adjustments must meet certain criteria in order to be reflected on the face of the pro forma statement, one of which is the adjustment must be factually supportable. Registrants are permitted, though, to discuss in the footnotes to the pro forma statements the expected effects of actions to be taken by management as a result of the transaction. We recommend that the SEC consider whether this approach meets the objectives of pro forma information in balancing consistency, reliability, and usefulness of the information provided. As an alternative to the current model, the SEC might consider permitting these other types of adjustments stemming from the transaction in a column on the face of the pro forma statement separate and apart from the traditionally permitted types of adjustments.

Disposition Transactions

Under the existing rules, there is a disparity in reporting between significant disposition and significant acquisition transactions. Pro forma information is required for significant dispositions at a 10% threshold as compared to a 20% threshold for significant acquisitions.

Furthermore, the reporting of a significant disposition in an Item 2.01 Form 8-K requires the provision of pro forma financial information reflecting the disposition within a four business day period. We believe this disparity potentially creates confusion for preparers, and worse, as we have observed, delayed the close of transactions in order to prepare the required information on an accelerated reporting timeline.

We recommend that the Commission consider aligning the significance threshold related to dispositions with that of significant acquisitions, as well as extending the period to provide pro forma information for dispositions as it exists for significant acquisitions.

Separate Financial Statements and Summarized Financial Information of Equity Method Investees (S-X Rules 3-09 and 4-08(g), respectively)

ASC 323, *Investments – Equity Method and Joint Ventures*, sets forth the U.S. GAAP requirements for financial information of equity method investments or unconsolidated subsidiaries. Disclosures are triggered by management's assessment of materiality. The SEC has provided more specific, incremental disclosure requirements in S-X Rules 3-09 and 4-08(g) for public companies, including bright-line thresholds for significance. While we perceive value to the incremental disclosures and specific thresholds, there are some matters of practical application we would encourage the SEC to consider.

Significance levels and periods of required financial statements

When conducting outreach to other stakeholders, and in connection with any changes to S-X Rule 1-02(w) discussed previously, we recommend the SEC examine the thresholds by which full financial statements for purposes of S-X Rule 3-09 must be provided by the issuer/investor. Given comparability issues, such as differences in fiscal year ends, reporting currency and accounting policies, the financial statements may not be informative or useful for investors. Therefore, we question the value of providing a full set of investee financial statements for all periods required for the registrant, when significance reaches the 20% level for any given year. In many cases, a private company investee may not prepare a full set of S-X compliant financial statements, unless required to do so for production in the investor's annual report or registration statement. In a case where an investment did not trigger any level of significance in a prior year, but in the current year is slightly over 20%, three years of financial statements would generally be required for the investee. While only the years that are significant must be audited, the exercise of preparing multiple years of financial statements is not insignificant, especially when some of the periods are not considered material to an investor. If the 20% threshold is retained, we recommend the SEC reconsider the requirement to provide financial statements for all periods required for the registrant and perhaps instead include financial statements only for the period(s) in which the investee was deemed significant.

We also recommend that the SEC re-consider the practice of requiring a significance re-evaluation of prior periods in cases of a retroactive application of accounting principle (for matters such as a discontinued operation and adoption of a new accounting principle). Along the same lines as mentioned above, the issuer may not know that financial statements are needed for a prior period until significantly after that period has been filed. This creates difficulty in obtaining the financial statements of the investee and having those financial statements audited.

Application of S-X Rule 4-08(g)

The current requirements of S-X Rule 4-08(g) make it difficult to relate the summarized information back to the issuer's financial statements. Therefore, it would seem beneficial to consider segregating disclosures of unrelated entities and adding a reconciliation of the amounts back to the issuer's financial statements. We recommend outreach to registrants regarding disaggregation and reconciliation, as we have observed certain companies being reluctant to disaggregate private company investee information for fear of creating a competitive disadvantage for the investee. For example, given enough information about one investment, it may be possible for a competitor to calculate contract rates which could potentially be used against them in a contract bid/negotiation process. Further, for investments accounted for under the fair value option, the amounts would not easily be reconciled back to the operating results in the registrant's financial statements.

Investments accounted for under the fair value option

We also recommend that the SEC look more closely at the applicability of Rules 3-09 and 4-08(g) to investments accounted for under the fair value method as permitted by ASC 825, *Financial Instruments*. We understand the SEC staff believes the rules are applicable by analogy, and in practice has issued interpretive guidance that the current income test for measuring significance be based on the change in fair value. We recommend that for these types of investments, the SEC consider whether the objectives of the disclosures required by U.S. GAAP (in ASC 825 and ASC 323) are sufficient to allow elimination of S-X Rules 3-09 and 4-08(g) with respect to an investment carried at fair value, given that the financial statements of the underlying investment do not necessarily directly relate back to the operating results of the issuer. Alternatively, in lieu of providing separate financial statements under S-X Rule 3-09, we recommend the SEC consider requiring only the disclosures required by S-X Rule 4-08(g) with respect to such investments.

Interim reporting requirements

Although S-X Rules 3-09 and 4-08(g) do not apply to interim financial statements, S-X Article 10 requires summarized income statement information for equity method investees that meet the 20% significance threshold. We recommend the SEC consider guidance in S-X Rule 10-01(a)(5) to consider allowing registrants to focus the interim disclosures on significant changes in the results of operations or financial position of the equity method investees. Registrants could apply judgment and omit details of accounts that have not changed significantly in amount or composition since the end of the most recently completed fiscal year. This will enable registrants to focus the disclosures on changes and developments that they deem most relevant to investors.

Investment company considerations

Prior to the release of the Division of Investment Management Guidance Update, *Business Development Companies—Separate Financial Statements or Summarized Financial Information of Certain Subsidiaries*, in September 2013, Business Development Companies (BDCs) largely operated under the premise that S-X Rules 3-09 and 4-08(g) did not apply to them. This was primarily because the basis for those disclosures in U.S. GAAP (APB Opinion 18, *The Equity Method of Accounting for Investments in Common Stock*) did not apply to them.

BDCs are now regularly applying the disclosure requirements of S-X Rules 3-09 and 4-08(g). However, due to interpretive differences between the SEC's Divisions of Corporation Finance and Investment Management, the rules are not applied consistently for BDCs as with operating companies, which has created some confusion. We understand there may be a need for enhanced disclosures of unconsolidated subsidiaries, but we question whether this should be within the confines of S-X Rules 3-09 and 4-08(g). We encourage the SEC to consider whether any such disclosure requirements would be better placed in S-X Article 6 to address the unique considerations for investment companies, or addressed as an expansion of Schedule III - *Investments in and advances to affiliates* (S-X Rule 12-14).

Should the SEC determine to continue with application of S-X Rules 3-09 and 4-08(g) to BDCs, we recommend some attention be given to the functionality of the significance test for a BDC, as the change in fair value of the investment (current numerator of the income test) does not directly relate to the underlying financial statements of the investment. Accordingly, and as noted above with respect to fair value accounting in general, this can result in production of financial statements and disclosures that have limited direct relation to the issuer's consolidated financial statements and may not be as material for understanding the results of the issuer.

We further recommend that the significance test be recalibrated from an investor's perspective, given dividend return is the driver for most investors. A key measure for evaluating a BDC's performance is investment income; therefore, it seems that a significance test should be designed around this metric. We recommend the Commission consider a significance test based on investment income earned by a BDC from the investee (as the numerator) and the total consolidated investment income earned by the BDC (the denominator). We believe this change would result in a more accurate depiction of significance for a BDC and would result in more consistent results year over year.

Cross-border transactions and foreign private issuer (FPI) matters

Acquisitions

For a cross-border acquisition, IFRS financial statements may only be provided if the acquired business meets the definition of a *foreign business*, defined in S-X Rule 1-02(l). If the target is not a *foreign business*, the financial statements provided must be prepared in accordance with or reconciled to U.S. GAAP. It seems that if IFRS financial statements are available for a foreign company, even if it does not meet the strict definition of a *foreign business*, there is little benefit to requiring conversion to U.S. GAAP simply for the purpose of compliance with S-X Rule 3-05. Further, if the issuer itself reports to the SEC using IFRS for its consolidated financial statements, it seems logical that any reconciliation of home-country GAAP would be to IFRS. We recommend the SEC consider permitting financial statements of a foreign company, even if not meeting the strict definition of *foreign business*, be prepared in accordance with or reconciled to IFRS.

Additionally, we believe there is merit to the SEC considering accepting audits performed in accordance with International Standards on Auditing (ISAs) for audits of foreign companies. While not identical to U.S. generally accepted auditing standards as issued by the AICPA, they are generally converged with AICPA standards.

Finally, if the SEC proposes to amend the levels at which financial statements must be provided for an acquired business, we recommend consideration also be given to the threshold for which financial statements of an acquired foreign business prepared under home-country GAAP must be reconciled to U.S. GAAP (currently 30%, as noted in Form 20-F, Item 17(c)(2)(v)).

Disclosures about equity method investments

Following with our recommendations above with respect to cross-border acquisitions, we believe that FPIs that prepare financial statements in accordance with IFRS should provide financial statements for purposes of S-X Rule 3-09 that are prepared in accordance with, or reconciled to, IFRS, even when such investee is not a *foreign business*. This would provide meaningful information to investors and eliminate any potential confusion. We also believe that to the extent the principal auditor is not referring to the work of another auditor related to the significant equity method investee or that an audit report must otherwise refer to PCAOB standards, such audit of the investee could be conducted in accordance with ISAs.

Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered (S-X Rule 3-10)

The reporting relief available in certain circumstances under S-X Rule 3-10 in lieu of filing numerous individual Securities Act and Exchange Act reports that include multiple sets of financial statements, as we have observed, is often challenging and time-consuming for registrants. Preparation of the condensed consolidating financial information is done, in most cases, solely to prepare the required disclosures in the company's SEC filings. Registrants do not always maintain their books and records at a segregated level for each issuer, guarantor, non-guarantor or co-obligor. Preparation of the required information on a quarterly and annual basis is cumbersome, time-consuming, and involves detailed and expensive analysis. With this in mind, we have observed structuring of debt transactions to avoid the S-X Rule 3-10 reporting requirements.

We recommend that the SEC consider further streamlining the reporting requirements in a way that still provides meaningful information about the entities behind the guarantee. In this regard, input from preparers and users is extremely relevant in assisting the Commission in this streamlining process. Some items to consider include:

- If guarantees are full and unconditional, permit the registrant to present the required information for guarantors and issuers combined and non-guarantors separately.
- Consider permitting summarized financial information in lieu of full detailed condensed consolidating financial information. As previously noted, registrants do not necessarily maintain their books and records at this level of detail for each entity in its structure, and

often do not have cash flow information, parent investment in subsidiary, or intercompany accounts available without extensive analysis.

- Conform the quarterly reporting requirements with that as permitted in S-X Article 10 for updating for material changes.
- Modify the reporting required under S-X Rule 3-10(g) for recently acquired guarantors to mirror that required of other guarantors. If the SEC decides to retain the provision of separate financial statements for recently acquired guarantors, consider revising the significance determination to use the same metrics as previously discussed for acquired businesses. Furthermore, for a non-public recently acquired guarantor, do not require the financial statements to be prepared following public company form and content or require that they be audited following PCAOB standards.