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November 23, 2015

Mr. Brent Fields
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

Re: File Reference No. S7-20-15*, Request for Comment on the Effectiveness of Financial Disclosures About Entities Other Than the Registrant*

Dear Mr. Fields:

Deloitte & Touche LLP is pleased to respond to the request for public comment ("request for comment") from the Securities and Exchange Commission (SEC or the "Commission") regarding the financial disclosure requirements in Regulation S-X ("S-X") for certain entities other than a registrant, which is related to the Commission's disclosure effectiveness initiative to improve the disclosure requirements for the benefit of investors and public companies.

OVERALL COMMENTS

We support the Commission's objective of improving its disclosure requirements to enhance the information provided to investors and promote efficiency, competition, and capital formation. In general, transparent disclosures benefit all market participants and, most importantly, stand to help investors make informed investment decisions.

We believe that the SEC's request for comment is consistent with the objective of its disclosure effectiveness initiative, which is to ensure that a registrant's required disclosures are clear, concise, and focused on matters that are both material to investors and specific to the registrant. We agree that effective disclosures emphasize matters that the registrant believes to be the most relevant and material to investors. In addition, we support the Commission's efforts to improve disclosures by seeking input from both investors and registrants, including (1) how investors use the disclosures in making investment decisions and (2) the challenges that registrants face in preparing and providing the required disclosures.

In response to the Commission's request for comment, we considered potential changes to the disclosure requirements in S-X that could enhance the information provided to investors and promote efficiency, competition, and capital formation. Our comments presented herein are based on our experiences as auditors, the work we do with our clients, and the challenges we understand our clients face when preparing and providing these required disclosures. In addition to discussing how various disclosures could be reduced or eliminated, we propose alternative disclosures that may be more useful

and concise for investors and consider the costs and benefits associated with preparing such disclosures. We encourage the Commission to continue outreach to investors to ensure that appropriate consideration is given to understanding how well the respective disclosure requirements are informing investors and how investors use the disclosures to make investment and voting decisions.

EXECUTIVE SUMMARY

Regarding the SEC's determination of whether to change the financial reporting disclosure requirements in S-X, including those raised in the request for comment, we encourage the Commission to consider how any potential changes would (1) improve the quality and usefulness of financial information provided to investors, (2) highlight meaningful information about registrants' business activities, and (3) address the challenges that registrants may face when preparing the required disclosures. On the basis of our experiences and our work with preparers, and for the reasons discussed in more detail in this letter, we offer the Commission the following considerations:[1]

- *S-X Rule 1-02(w): Significant subsidiary* — The Commission should consider:
    - A principles-based framework to evaluate significance.
    - If the current bright-line model is retained, (1) additional or alternative measures to determine significance (e.g., revenues, fair value) and (2) whether more than one test should be required to exceed a bright-line threshold before a registrant concludes that a subsidiary is significant.
- *S-X Rule 3-05: Financial statements of businesses acquired or to be acquired and related requirements* — The Commission should consider:
    - Permitting the use of audited financial statements for material nonpublic acquired businesses that are (1) prepared in accordance with U.S. GAAP but not in accordance with certain S-X disclosure requirements and other public-company considerations, (2) prepared in accordance with private-company alternatives under U.S. GAAP, or (3) audited in accordance with International Standards on Auditing (ISAs) for certain foreign acquired entities.
    - Permitting registrants in certain circumstances to provide abbreviated financial statements without first requesting permission from the SEC.
    - Whether the audited financial statements currently required for individually insignificant acquisitions provide meaningful information to investors.
    - Developing a framework for evaluating whether financial statements for all related businesses are required.
    - Whether registrants may provide no more than two (rather than three) years of audited financial statements of an acquired or to be acquired business.

[1] We have identified a number of recommendations and suggestions regarding the disclosure requirements in Regulation S-X for certain entities other than a registrant. Each recommendation may be considered independently of the others; therefore, some recommendations may not be necessary if others are adopted. In addition, as possible amendments to Regulation S-X are evaluated, the Commission should consider the benefit of addressing possible proposed rule changes by topic and not as one single project.

- Whether differences in the updating requirements under the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act") are appropriate.
- Whether financial statements of "major significance" must be provided if previously filed.
- Whether SEC Staff Accounting Bulletin (SAB) Topic 1.J (SAB 80) should be revised.
- Whether the reconciliation requirements for certain acquired businesses of foreign private issuers (FPIs) should be revised.
- Revisions to S-X Rule 3-14 to align them with certain aspects of S-X Rule 3-05.

- *S-X Article 11: Pro forma financial information* — The Commission should consider:
  - Aligning the form and content of the pro forma financial information prepared under the SEC rules with that of the pro forma financial information prepared under U.S GAAP while retaining the differences in the definition of a business.
  - Modifying the interpretation of a pro forma adjustment that is "factually supportable" to permit certain flexibility in its application.
  - Permitting a two-column approach for different types of pro forma adjustments if the Commission chooses to retain the concepts of the current interpretations of allowable pro forma adjustments.
  - Permitting the presentation of pro forma financial information for additional fiscal years.
  - Input from investors and other financial statement users on whether the market would demand greater auditor involvement with pro forma financial information than what exists under current practice.
- *S-X Rules 3-09 and 4-08(g): Separate financial statements and summarized financial information of subsidiaries not consolidated and 50 percent or less owned persons*[2] —The Commission should consider whether:
  - Summarized financial information should be provided for each individually significant equity method investment.
  - Enhanced disclosures may be permitted in lieu of separate financial statements of the investee in certain circumstances.
  - Unaudited financial statements of the investee are needed in periods in which the investee is not significant.
  - A registrant should still be required to provide summarized financial information about a significant investee for interim periods when the investee has had no significant changes since the end of the registrant's most recent fiscal year.

[2] S-X Rules 3-09 and 4-08(g) apply to subsidiaries not consolidated and 50 percent or less owned persons. Because the request for comment focuses primarily on the requirements that apply to 50 percent or less owned persons accounted for under the equity method of accounting, such entities are the focus of our comments (unless otherwise noted). These are referred to herein as "equity method investments" or "investee(s)."

- A registrant should still be required to recompute the significance of an investee by using historical financial statements that have been retrospectively adjusted to give effect to a discontinued operation or change in accounting principle.
- The requirement to provide investee financial statements in the year of disposal is necessary for investors.
- Certain investments in partnerships or limited liability corporations are intended to be within the scope of S-X Rules 3-09 and 4-08(g), and, if so, whether an alternative framework should be used to evaluate significance.
- Financial statements of certain investees may be audited in accordance with ISAs.
- The reconciliation requirements for certain investees of FPIs should be revised.
- Given the requirement to report all investments at fair value, investment companies[3] should be allowed to (1) use alternative measures to determine significance (e.g., the investment income test) and (2) provide alternative disclosures in lieu of separate financial statements and summarized financial information for their investees.

- *S-X Rule 3-10: Financial statements of guarantors and issuers of guaranteed securities registered or being registered* — The Commission should consider:
  - Whether, in lieu of the current condensed consolidating financial information (the "consolidating information"), summarized financial statement information in the notes to the parent company's financial statements should be required for (1) issuers separately and combined guarantor subsidiaries separately, (2) the issuers and guarantors on a combined basis, or (3) just the guarantor subsidiaries; or whether only information about the balance sheet, including net assets and liquidity available to satisfy the guarantee, would be sufficient.
  - If consolidating information is retained, providing significant implementation guidance on its preparation and presentation.
  - Expanding instances in which narrative disclosures would be permitted.
  - Requiring interim reporting for subsidiary issuers and subsidiary guarantors only if material changes to the subsidiary issuers/guarantors have occurred since the end of the registrant's most recent fiscal year.
  - Permitting a registrant to cease filing certain disclosures when it suspends its reporting obligation under the Exchange Act.
  - Revising the significance test, disclosure requirements, and audit requirements applicable to recently acquired subsidiary issuers and guarantors.
- *S-X Rule 3-16: Financial statements of affiliates whose securities collateralize an issue registered or being registered* — The Commission should consider whether:

[3] As defined under the Investment Company Act of 1940.

- To allow summarized financial information for affiliates whose securities constitute a substantial portion of the collateral[4] ("significant affiliates") in lieu of full financial statements.
- Registrants should be allowed to use other indicators of significance besides market value when calculating the "substantial portion of the collateral" given the challenges of performing the market value calculation.
- Using the outstanding principal balance in the "substantial portion of the collateral" test results in the provision of meaningful financial statements when the balance declines over time.
- Interim information is necessary for significant affiliates in certain registration statements.
- Significant affiliates whose securities constitute a substantial portion of the collateral should continue to provide financial statements of other entities under S-X Rules 3-05 and 3-09.

In addition, we offer the Commission considerations regarding other requirements — specifically, those related to XBRL tagging in other entities' financial statements.

We further discuss all of the above recommendations and provide additional suggestions for consideration in the sections below.

POTENTIAL AMENDMENTS TO S-X

S-X Rule 1-02(w): Significant Subsidiary[5]

The significance tests described in S-X Rule 1-02(w), which employ bright-line percentage thresholds to a limited set of financial statement measures, are used by registrants in complying with various SEC requirements, including (1) S-X Rules 3-05, 3-09, and 4-08(g) and (2) Item 2.01 of Form 8-K. For example, registrants must apply these significance tests when evaluating whether they are required to provide separate financial statements of (1) an acquired business under Rule 3-05 or (2) subsidiaries not consolidated and 50 percent or less owned persons under Rule 3-09.

Principles-Based Framework

We believe that replacing the current bright-line significance tests with a principles-based framework, or revising the current tests as suggested below, could result in improved quality and usefulness of the financial information provided by registrants related to certain other entities under S-X Rules 3-05 and 3-09.

As discussed below, we believe that as a result of certain limitations in the mechanical tests as

[4] The affiliate's portion of the collateral is determined by comparing (1) the highest amount among the aggregate principal amount, par value, book value, and market value of the affiliate's securities with (2) the principal amount of the securities registered or being registered. If the affiliate's portion under this test equals or exceeds 20 percent for any fiscal year presented by the registrant, S-X Rule 3-16 financial statements are required.

[5] The recommendations in this section are not intended to apply to investment companies, which are separately addressed in this letter.

currently prescribed under S-X Rule 1-02(w), registrants may be required to provide financial information for entities when such information may not be meaningful. A principles-based framework would allow a registrant to exercise judgment in evaluating various quantitative and qualitative factors when no one indicator is necessarily determinative. That is, such a framework would allow a registrant to apply judgment and conclude, upon considering all facts and circumstances, whether an acquired business or equity method investment is material to the registrant's financial statements as a whole.

We prefer a principles-based framework because even if the mechanical tests are refined, the tests may still lead registrants to conclude that (1) financial statements are required when they may not be relevant to investors or (2) financial statements are not required when they may, in fact, be relevant to investors. The success of a principles-based framework depends on the development of a rigorous framework that can be consistently applied so that registrants with similar facts would be expected to reach a similar conclusion. In addition, its success depends on the willingness of other stakeholders to respect and accept reasonable judgments. While we acknowledge that a principles-based approach may introduce uncertainty about whether the application of such judgments will be respected, we believe that it would result in the provision of information that is more meaningful, relevant, and useful to investors than that provided under the current bright-line tests.

In addition to the existing tests described in S-X Rule 1-02(w), quantitative and qualitative factors for a rigorous principles-based framework could include:

- Revenue.
- Operating income.
- Cash flows.
- EBITDA (or other relevant non-GAAP measures).
- Pro forma results.
- Net book value.
- Fair value of the tested subsidiary relative to the registrant's market capitalization (if readily determinable).
- Key industry metrics (e.g., number of branches for a bank, number of beds for a hospital, square footage of a manufacturing plant).
- Number of employees.
- Impact on the entity's reportable segments.
- Factors/information specifically used by management when it evaluates the business acquisition during the due diligence process and determines the purchase price.
- Other indicators deemed relevant in the registrant's specific circumstances.

A judgment framework would permit registrants to determine the materiality of an acquired business or equity method investment in the context of the "surrounding circumstances" and the "total mix" of information. While the "total mix" of information may include allowing the results of bright-line tests to be used as a "rule of thumb" in the first step of a materiality assessment, it would also include other

qualitative factors and the factual circumstances related to the acquired business or the equity method investment in question. That is, the registrant would consider both quantitative and qualitative factors in assessing the significance of the acquired business or equity method investment to the registrant's financial statements. This is consistent with the approach used in SAB Topic 1.M, under which qualitative and quantitative factors are considered.

Significance Tests

If the Commission retains a bright-line percentage thresholds model, we suggest that it consider introducing mechanical tests to be used in addition, or as alternatives, to those currently prescribed by S-X Rule 1-02(w). Further, to help minimize instances in which anomalous outcomes result in the provision of financial statements that may not be meaningful, the Commission could require more than one of the tests to exceed a bright-line percentage threshold when used to measure significance. Specifically, we offer the following suggestions:

- *Income test under S-X Rule 1-02(w)* — The literal application of the income test can be difficult and may result in the provision of financial statements that are not meaningful or relevant to investors, particularly when the registrant performing the test has near-break-even results. In light of this, we suggest that the Commission consider allowing registrants to use the following tests in addition, or as alternatives, to the income test as currently defined:
    - *Revenues* — Compare the registrant's proportionate share of net revenues of the acquired entity with the registrant's consolidated net revenues for the most recently completed fiscal year.
    - *Pro forma revenues* — When pro forma financial information has been filed for the most recent fiscal year-end under S-X Article 11, compare the registrant's proportionate share of pro forma net revenues of the acquired entity with the registrant's pro forma net revenue for the most recently completed fiscal year.

  In our experience, and as the Commission noted in its request for comment, many of the prefiling letters to the Commission requesting relief under S-X Rules 3-05 and 3-09 have been related to income tests that yielded anomalous results. We believe that the suggested measures we have outlined are strong indicators of significance and may help (1) avoid many outcomes that lead to the provision of immaterial financial statements and (2) eliminate a number of prefiling requests.

  If the Commission retains the income test as currently defined in S-X Rule 1-02(w), it should consider the following modifications to the rule's computational note (2) related to average income,[6]

[6] The second computational note in S-X Rule 1-02(w) indicates that if the registrant's income for the most recent fiscal year is 10 percent or more lower than the average of the registrant's income for the last five fiscal years, the average income of the registrant should be used for the computation. This computational note also applies if the registrant reported a loss rather than income.

which could also reduce the incidence of anomalous outcomes and the provision of financial statements that may not be meaningful:

- Allow the exclusion of loss years from the calculation of average income (e.g., four years of profitability would be divided by 4, not 5).[7]
- Allow registrants to use average income for the acquired business or equity method investee when calculating the numerator.[8]
- For loss years, consider allowing registrants to include the absolute value in their calculation of average income.

- *Asset and investment tests under S-X Rule 1-02(w)* — The existing asset and investment tests are based on carrying values, which may not consider the economic substance of the acquired business or equity method investment. Further, the mechanics of the calculation of the investment test compare a fair value metric (consideration transferred under U.S. GAAP or IFRSs,[9] as appropriate) with a carrying value metric (total assets), and such a comparison may not provide a meaningful evaluation of significance. To address these issues in circumstances in which fair value is readily available, we suggest that the Commission consider, as an addition or alternative to the investment and asset tests as currently defined, a fair value test under which the following metrics would be used to compare the fair value of the registrant's investment in the tested entity with 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 fair value is not readily available, the carrying value of the registrant's total assets would be permitted.
  - For an equity method investment calculation under S-X Rules 3-09 and 4-08(g), the numerator should represent the fair value of the equity method investment. If the fair value of the investee is not readily available, the investment test as currently described in S-X Rule 1-02(w) could be retained.
  - For an acquisition calculated under S-X Rule 3-05, the numerator should continue to represent the fair value of the consideration transferred (i.e., the consideration transferred under U.S. GAAP or IFRSs, as appropriate).

[7] Paragraph 2015.8 of the SEC Financial Reporting Manual (FRM) indicates that when a registrant computes its average income for the last five fiscal years, it should assign loss years a value of zero to compute the numerator for this average, but the denominator should be 5.

[8] Paragraph 2015.8 of the FRM indicates that the acquiree's income may not be averaged.

[9] For purposes of this letter, references to IFRSs are within the context of the English language version of IFRSs as published by the IASB unless otherwise noted.

S-X Rule 3-05: Financial Statements of Businesses Acquired or to Be Acquired and Related Requirements

Disclosures about a business acquisition allow current and prospective investors to evaluate an acquisition's potential future impact on the registrant's financial condition, results of operations, liquidity, and future prospects. However, as the Commission pointed out in its request for comment, some of the current financial statement information required under S-X Rule 3-05 may have limitations as a predictor of an acquired business's impact on the combined entity after the acquisition. In light of this, we offer the following considerations for improving requirements related to the financial statements of businesses acquired or to be acquired and the related pro forma disclosures:

- When a registrant acquires a nonpublic business that is significant, financial statements that are otherwise available, or that are prepared solely for compliance with Rule 3-05, are required to include enhanced accounting and financial disclosures that may require (1) compliance with certain S-X disclosures and other public-company considerations, (2) elimination of private-company accounting alternatives,[10] or (3) audits in accordance with U.S. generally accepted auditing standards (GAAS) even when a business is a foreign entity.[11] The Commission should consider whether the benefits of requiring financial statements to include these enhanced accounting and disclosures outweigh the incremental costs and potential delays to the closing of a transaction. For example, we suggest that the Commission consider allowing, in certain circumstances, the following items (which are currently not permitted) to satisfy the financial statement requirements in S-X Rule 3-05:
    - *U.S. GAAP financial statements that are not compliant with Regulation S-X* — Financial statements of the acquired business are generally required to be the same as if the acquired company were a registrant[12] and therefore must comply with the disclosures prescribed in S-X (e.g., the form and content requirements in S-X Articles 4 and 5), SEC staff accounting positions expressed in Staff Accounting Bulletins, and EITF observer comments. The Commission should consider whether these incremental accounting treatments and disclosures are necessary when such financial statements would not otherwise need to be filed on a recurring basis.
    - *Private-company alternatives under U.S. GAAP* — We encourage the Commission to consider allowing private-company alternatives in historical financial statements provided under S-X Rule 3-05. The existing requirement to eliminate the effects of any previously elected private-company alternatives may be less relevant in historical financial statements of the acquiree that are not filed on a recurring basis. The effects of the private-company alternatives would continue to be eliminated in the pro forma financial statements in accordance with S-X Article 11.

[10] Under FASB Accounting Standards Update No. 2013-12, *Definition of a Public Business Entity — An Addition to the Master Glossary*, the definition of a public business entity (PBE) includes entities that are "required by the [SEC] to file or furnish financial statements, or [do] file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing)." PBEs are not permitted to adopt private-company accounting alternatives. Accordingly, the effects of any previously elected private-company accounting alternatives would have to be eliminated from the historical financial statements of an entity whose financial statements are included in the SEC filing of a registrant.

[11] In accordance with Instruction 2 to Item 8.A.2 of Form 20-F, the required financial statements must be audited in accordance with U.S. GAAS.

[12] See paragraph 2005.1 of the FRM.

- *IFRS or home-country GAAP financial statements audited in accordance with ISAs —* If an acquired business is a foreign entity, we suggest that the Commission consider allowing financial statements audited in accordance with ISAs to comply with the requirements of S-X Rule 3-05. ISAs are high-quality auditing standards that are widely accepted worldwide and largely converged with AICPA standards. The Commission should consider whether auditing the financial statements under U.S. GAAS provides an incremental benefit.

- When a registrant acquires less than substantially all of an entity, it may be impracticable to prepare full financial statements of the acquired business. In these circumstances, a registrant may request permission to provide abbreviated financial statements of the acquired business, which consist of audited statements of assets acquired and liabilities assumed and statements of revenues and direct expenses in lieu of full financial statements.[13] We suggest that the Commission develop specific criteria for evaluating whether a registrant may present abbreviated financial statements without first requesting permission from the SEC staff. This approach may provide efficiencies for both preparers and the SEC staff and would be consistent with current practice in certain industries (e.g., practice related to oil and gas properties[14] and real estate operations to be acquired[15]).

- In a registration or proxy statement, a registrant may be required to provide separate audited financial statements for certain individually insignificant acquisitions when the aggregate impact of such acquisitions exceeds 50 percent.[16] We suggest that the Commission consider whether these financial statements provide meaningful information to investors given that they are deemed insignificant for reporting under the Exchange Act on a Form 8-K at the time they are acquired. This requirement can be challenging to implement since the aggregate significance tests are complex and result in a selection of certain (but not all) entities to achieve a substantial majority.[17] In addition, it may prove difficult for users to ascertain the relevance of the various sets of financial statements that are provided. Further, registrants may find it challenging to obtain such financial statements for a future registration statement when the financial statements were initially determined not to be necessary at the time of the acquisition.

- The acquisition of businesses that are related must be evaluated as if they are a single business combination.[18] When evaluating significance of related businesses, a registrant must aggregate the financial measures used in the significance tests described in S-X Rule 1-02(w). If any one of the aggregate significance tests exceeds a significance threshold, the financial statements of each related business must be presented, even if one or more of the related businesses are de minimis. We suggest that the Commission develop a framework that would allow a registrant to provide only those financial statements that would be material to an investment decision. This may reduce the

[13] See paragraph 2065.4 of the FRM.
[14] See paragraphs 2065.1 and 2015.2 of the FRM.
[15] See paragraph 2330.1 of the FRM.
[16] S-X Rule 3-05(b)(2)(i) states that if the aggregate impact of individually insignificant businesses acquired since the date of the most recent audited balance sheet filed for the registrant exceeds 50 percent, financial statements covering at least the substantial majority of the businesses acquired should be furnished.
[17] See paragraph 2035.3 of the FRM.
[18] See S-X Rule 3-05(a)(3).

need for registrants to incur the costs and effort of obtaining separate audited financial statements of related businesses that are insignificant and therefore unlikely to be relevant to users.

- A registrant must file up to three years of the acquired business's preacquisition audited annual financial statements on the basis of the results of the significance tests prescribed in S-X Rule 1-02(w).[19] Preacquisition financial statements beyond two years may be less relevant and useful to an assessment of the impact of an acquisition on a registrant's financial condition, results of operations, liquidity, and future prospects. Once an acquired business has been determined to be significant, we suggest that the Commission consider allowing the registrant to provide no more than two years of audited annual preacquisition financial statements when it is determined that a third year of historical results is not material.
- Currently, the financial statement periods for which information is required in the Form 8-K are based on the date the initial Form 8-K is filed.[20] However, if a registrant subsequently files a registration statement, it may be required to update the financial statements of the acquired business to a more current period.[21] The Commission should consider whether differences in the requirements to update under the Exchange Act and the Securities Act are appropriate or whether consistent rules would be preferred. If consistency is desired, the Commission may consider whether the requirement to provide updated financial statement information under both the Exchange Act and the Securities Act may be appropriate in certain circumstances (e.g., when there was a material intervening event, trend, or uncertainty in an omitted period).
- A registrant may need to continue to include previously filed financial statements of an acquired business in subsequent registration statements if the acquisition is of "major significance."[22] We suggest that the Commission consider eliminating this requirement since investors continue to have access to those previously filed financial statements via EDGAR and such access did not exist when the requirement was adopted. In addition, eliminating the requirement will reduce the need for a registrant to obtain a consent of the independent accountants of the acquired business when a subsequent registration statement is filed.
- SAB 80 provides an alternative method of measuring significance for initial public offerings when a registrant has been built by the aggregation of discrete businesses that will remain substantially intact after the acquisition. SAB 80 allows first-time issuers to consider the significance of businesses recently acquired or to be acquired on the basis of the pro forma financial information for the registrant's most recently completed fiscal year. The calculations described in SAB 80 are complex and may or may not result in reduced financial statement periods required under Rule 3-05 for the registrant's acquirees. Consequently, SAB 80 is rarely applied in practice. We recommend that the Commission consider revising SAB 80 to reduce its complexity and ensure that

[19] See S-X Rule 3-05(b)(4).
[20] See paragraphs 2045.13 and 2045.15 of the FRM.
[21] See paragraph 2045.10 of the FRM.
[22] S-X Rule 3-05(b)(4)(iii) states that if "the acquired business met at least one of the conditions in the definition of significant subsidiary in [S-X Rule 1-02(w)] at the 80 percent level, the income statements of the acquired business should normally continue to be furnished for such periods prior to the purchase as may be necessary when added to the time for which audited income statements after the purchase are filed to cover the equivalent of the period specified in [S-X Rule 3-02]." Paragraph 2040.2 of the FRM provides further interpretation of "major significance" and "previously filed acquiree financial statements."

its application is consistent with its intent of providing financial statements that are meaningful to investors.

- Registrants that are FPIs and prepare their financial statements in accordance with IFRSs are not required to present their financial information under U.S. GAAP.[23] However, in certain circumstances, those FPIs may be required to provide financial statements of a significant acquired business that include a reconciliation to U.S. GAAP. For example, a significant acquired business that does not meet the definition of a foreign business[24] is required to provide a reconciliation to U.S. GAAP[25] even though the registrant is not required to present U.S. GAAP information. The Commission should consider whether such a reconciliation requirement provides meaningful information given that it is inconsistent with the basis of the registrant's financial statements. Alternatively, the Commission should consider whether financial statements of a significant acquired business prepared in accordance with IFRSs or with a reconciliation from home-country GAAP to IFRSs would be more meaningful since the reconciliation would be prepared on a basis that is consistent with the financial statements of the registrant.
- We suggest that the Commission consider any revisions to S-X Rule 3-14 concurrently with changes to S-X Rule 3-05. When the SEC amended S-X Rule 3-05 in 1996, it indicated that it would "consider revision of [S-X] Rule 3-14 in the context of its evaluation of a more comprehensive disclosure scheme."[26] The lack of consistency between S-X Rules 3-05 and 3-14 has resulted in unnecessary complexity and confusion and has required significant SEC staff interpretive guidance. We believe that the Commission should consider whether the requirements in S-X Rules 3-05 and 3-14 have similar objectives and, if so, whether the following aspects of S-X Rule 3-05 should be aligned when an acquisition of real estate operations is evaluated under S-X Rule 3-14:
    - The applicability of S-X Rule 3-06 (i.e., whether periods of 9 to 12 months satisfy the requirement to provide one year of financial statements).
    - The use of post-acquisition results to reduce the periods required.
    - The significance thresholds (i.e., 20 percent versus 10 percent).
    - The requirements related to the mathematical majority of individually insignificant acquisitions.
    - The ability to use the grace period to provide financial statements of significant acquisitions in a new registration statement regardless of whether the acquisitions are in a blind pool offering during their distribution period.

[23] See Section 6310 of the FRM.
[24] See S-X Rule 1-02(l).
[25] See paragraph 6410.9 of the FRM.
[26] SEC Release No. 33-7355, *Streamlining Disclosure Requirements Relating to Significant Business Acquisitions.*

S-X Article 11: Pro Forma Financial Information

The financial statements of a significant acquired business are typically filed in a Form 8-K along with the pro forma financial information described in S-X Article 11 ("pro forma information"). This pro forma information includes adjustments that provide investors with information about the continuing impact of a particular transaction by showing how the acquisition might have affected the registrant's financial statements had it occurred at an earlier time. While pro forma disclosures are also required under U.S. GAAP[27] to enable investors to understand the "nature and financial effect of a business combination," such disclosures are significantly less detailed than those required by the SEC rules. In addition, the periods presented under U.S. GAAP differ from those prescribed in S-X Article 11, and certain items (i.e., nonrecurring charges and earnings measures) are presented differently. We offer the following suggestions to improve the consistency and usefulness of pro forma information:

- As noted above, given the differences between the pro forma requirements in U.S. GAAP and those in S-X Article 11, we encourage the Commission to work with the FASB to consider aligning the form and content of the pro forma financial information provided under the SEC rules with that of the pro forma information prepared under U.S. GAAP. This would allow for efficiencies and consistencies in both the preparation and analysis of pro forma disclosures provided for acquired businesses.
- While we believe that the SEC and FASB should consider working together to align the form and content of the pro forma financial information required under their respective guidance, there may be valid reasons to maintain the differences in how a business is defined under S-X Rule 11-01(d) and applicable U.S. GAAP. The definitions under the SEC's and FASB's respective guidance have different purposes; and the definition in S-X Rule 11-01(d), which is intended to determine circumstances in which historical financial statements would be material to an understanding of future operations, appears to appropriately consider the continuity of operations as well as the nature of the revenue-producing activities and other attributes after a material acquisition.

We understand that the pro forma financial information described in S-X Article 11 is widely desired and may be highly relevant; however, the usefulness of pro forma information could be improved given the limitations in the pro forma rules. While the pro forma information provided under S-X Article 11 helps demonstrate how the accounting for an acquisition might have affected the registrant's historical financial statements had the transaction been consummated at an earlier time, this information has limitations on predicting the future impact of the transaction, including those based on the nature of allowable pro forma adjustments and the comparability of periods presented. We offer the following additional suggestions to improve the overall usefulness of the pro forma information:

- Pro forma adjustments related to the pro forma condensed income statement must include adjustments that give effect to events that are (1) directly attributable to the transaction, (2) expected to have a continuing impact on the issuer, and (3) factually supportable.[28] We recommend that the Commission consider modifying the interpretation of a pro forma adjustment that is "factually supportable" to (1) be more clearly defined and easier to understand and (2) permit certain flexibility in its application if appropriate guidance could be developed regarding what is considered permissible. For example, under certain circumstances, adjustments for cost savings and expected

[27] See FASB Accounting Standards Codification (ASC) Topic 805, *Business Combinations*.
[28] See S-X Rule 11-02(b)(6).

future synergies could be permitted if transparent disclosures about the adjustments and underlying estimates are provided.

- If the Commission chooses to retain the concepts of the current interpretations of allowable pro forma adjustments, a two-column approach could be considered. The first column could include adjustments that have been traditionally accepted under the current model. A second column could be introduced to allow for adjustments that have not been typically viewed as acceptable adjustments since they do not meet the factually supportable criteria (e.g., cost savings, synergies). This approach would preserve the consistency and reliability of the pro forma presentation that currently exists and allow financial statement users to separately evaluate the nature of adjustments that may be more useful and relevant.
- We recommend that the Commission consider providing an option to present pro forma information for additional fiscal years as desired.[29] This option would allow registrants to present comparative pro forma results that may better demonstrate future trends expected from the acquisition and could also facilitate comparative analysis in Management's Discussion and Analysis.
- While the Commission does not currently require auditors to perform procedures over pro forma financial information, auditors already have some involvement with pro forma financial information. When Article 11 pro forma financial information is included in the same document as the financial statements on which an auditor has reported, as may be the case for an Item 2.01 Form 8-K or a registration statement, the auditor carries out its responsibilities as required by professional standards. Underwriters typically request the auditor's involvement as part of the underwriters' due diligence responsibilities. In the case of securities offerings, a registrant's auditor is generally requested to provide negative assurance in a comfort letter on (1) the application of pro forma adjustments to historical amounts in the compilation of pro forma financial information and (2) whether the pro forma financial information complies as to form in all material respects with the applicable accounting requirements of Article 11. PCAOB AU Section 634, *Letters for Underwriters and Certain Other Requesting Parties*, does not allow the auditor to provide this level of comfort unless the historical financial statements that serve as the basis for the pro forma financial information have been reviewed or audited. In other situations, auditors perform procedures and report findings in a comfort letter. While we do not sense a need for greater auditor involvement with pro forma financial information, we believe that investors and other financial statement users have the best insight to provide input on whether the market would demand greater auditor involvement than what exists under current practice.

S-X Rules 3-09 and 4-08(g): Separate Financial Statements and Summarized Financial Information of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons

To ensure that investors receive relevant financial information about a registrant's significant activities, S-X Rules 3-09 and 4-08(g) require registrants that have significant equity method investees ("investees") to provide certain financial information about the investees in their filings with the SEC. The amount of information a registrant must present depends on the investee's significance, which the registrant determines

[29] S-X Rule 11-02(c)(2) indicates that pro forma income statements should be presented "for only the most recent fiscal year and for the period from the most recent fiscal year end to the most recent interim date for which a balance sheet is required" by S-X Rule 3-01. S-X Rule 11-02(c)(2) also permits, but does not require, a pro forma presentation "for the comparative interim period of the previous fiscal year."

by performing the applicable significant-subsidiary tests. Depending on the outcome of the significance tests, a registrant may be required to provide (1) separate audited and/or unaudited annual financial statements for each individually significant investee under S-X- Rule 3-09 and/or (2) summarized financial information, on an aggregate basis, for all investees under S-X Rule 4-08(g).[30] Different requirements must be considered for a registrant's interim financial statements as well.

As the SEC acknowledged in its request for comment, financial statements provided under S-X Rule 3-09 have certain limitations, particularly when entities prepare such information by using U.S. GAAP, fiscal year-ends, or reporting currencies that differ from those employed by the registrant. Similarly, the aggregate presentation of summarized financial information may limit an investor's ability to determine the impact that an individual investee may have on the registrant's financial statements. We suggest that the Commission consider the following regarding the financial information that registrants provide about their investees:

- To improve the usefulness of the summarized financial information currently required by S-X Rule 4-08(g), the Commission should consider requiring summarized financial information only for each individually significant investee. The current requirement to present only aggregate summarized information for all investees may not result in the most useful information given that the presentation may combine (1) investees that recorded losses with investees that recorded income and (2) immaterial investees with material investees. Alternatively, if the Commission believes that aggregate information remains useful, we recommend separate summarized financial information for (1) each individually significant investee and (2) the aggregate of all individually insignificant investees.[31]
- Although separate financial statements of equity method investees that are of major significance may still be necessary, the Commission may further consider whether enhanced disclosures could be presented in lieu of the separate audited financial statements of the investees in certain circumstances when the investee is significant. For example, the Commission could consider narrowing the circumstances in which separate financial statements would be required by S-X Rule 3-09, and the investor could rely on enhanced summarized financial information for each individually significant investee to provide relevant and useful information about its investees. Such enhanced summarized information could include the information required under S-X Rule 1-02(bb),[32] other material expense items, and statement of cash flow information such as totals for operating, investing, and financing activities.

[30] S-X Rule 3-09 requires a registrant to provide separate audited financial statements of an individual equity method investment if the investment is more than 20 percent significant on the basis of either the investment test or the income test. Rule 4-08(g), which addresses summarized financial information of subsidiaries not consolidated and 50 percent or less owned persons ("summarized financial information"), requires a registrant to provide summarized financial information if either an individual equity method investment or an aggregated group of investments is more than 10 percent significant on the basis of the investment test, income test, or asset test.

[31] FPIs that prepare their financial statements in accordance with IFRSs are not required to comply with S-X Rule 4-08(g). If the Commission contemplates substantive changes to S-X Rule 4-08(g) to provide for enhanced disclosures, it should consider an alternative approach to ensure that FPIs that prepare their financial statements in accordance with IFRSs provide disclosures consistent with those provided by domestic companies. For example, it should consider whether to make changes to Form 20-F or include revisions in S-X Rule 3-09 that would apply to FPIs.

[32] S-X Rule 1-02(bb) indicates that summarized financial information includes (1) current assets, noncurrent assets, current liabilities, noncurrent liabilities, and, when applicable, redeemable preferred stocks and noncontrolling interest; and (2) net

- If an investee is significant in a given year, the registrant must provide the investee's financial statements for the same dates as those of the registrant;[33] however, financial statements for the periods in which the investee was not significant may be unaudited. While these financial statements may be presented as unaudited, the cost and effort to prepare them and ensure compliance with S-X can be significant. We suggest that the Commission consider whether the presentation of unaudited financial statements for the years in which the investee is not significant provides meaningful information to investors.
- The Commission should consider whether the requirement for registrants to provide summarized financial information about significant equity method investments in their interim financial statements[34] continues to provide material information, particularly when no significant changes to the investees have occurred since the most recent fiscal year. S-X Article 10, currently permits a registrant to apply judgment and omit details of accounts that have not changed significantly since the registrant's most recently completed fiscal year.[35] Accordingly, we suggest that the Commission consider whether a similar approach would be appropriate regarding the need for a registrant to present summarized financial information about its investees for the interim reporting periods.
- If a registrant has a discontinued operation or a retrospectively applied change in accounting principle in the current year, it must recompute the significance of its investees for each of the two preceding fiscal years presented in its Form 10-K by using the retrospectively revised financial statements.[36] We suggest that the Commission consider whether such reassessment leads to the provision of meaningful disclosures given that it creates challenges for registrants to obtain audited and unaudited financial statements that previously were not required.
- If, in the current year, a registrant disposes of a significant investee (or an interest in a significant investee such that the registrant stops using the equity method of accounting), S-X Rule 3-09 requires the registrant to continue providing audited financial statements (or unaudited financial statements if the investee has become insignificant for the current year but was significant in the previous years) through the disposal date.[37] Upon disposal of its investment, the registrant moves from a position of significant influence to one of no influence (or minimal influence, if the registrant reduces its interest such that it stops using the equity method of accounting) and may be unable to obtain the investee's financial statements. We suggest that the Commission consider whether such financial statements are useful or relevant to users given that the registrant either no longer retains an interest in the investee or reduces its interest such that it stops using the equity method of accounting. We also understand that there are challenges in obtaining the investee's

sales or gross revenues, gross profit (or, alternatively, costs and expenses applicable to net sales or gross revenues), income or loss from continuing operations before extraordinary items and cumulative effect of a change in accounting principle, net income or loss, and net income or loss attributable to the entity.

[33] S-X Rule 3-09(b)(2) requires that an investee's separate financial statements include two years of balance sheets and three years of statements of operations, statements of stockholders' equity, and cash flow statements for the investee even if it was not significant in the earliest two years.

[34] See S-X Rule 10-01(b)(1).

[35] S-X Article 10 states, in part, that "footnote disclosure which would substantially duplicate the disclosure contained in the most recent annual report to security holders or latest audited financial statements, such as a statement of significant accounting policies and practices [and] details of accounts which have not changed significantly in amount or composition since the end of the most recently completed fiscal year, . . . may be omitted."

[36] See paragraph 2410.8 of the FRM.

[37] See paragraph 2405.4 of the FRM.

financial statements through the unique disposal date that may not otherwise align with the investee's reporting period. If the Commission retains the requirement for financial statements in the year of disposal, the Commission should consider (1) allowing the presentation of a full year or quarterly period closest to the disposal date rather than through the unique disposal date or (2) permitting a presentation of summarized financial information for the investee in accordance with Rule 4-08(g).

- Certain investments in partnerships, limited liability corporations, or unincorporated joint ventures may be accounted for under the equity method of accounting even when the registrant's ownership interest is very low (i.e., 3–5 percent).[38] We understand that the low ownership interest in these investees can limit a registrant's ability to solicit the preparation and publication of the investee's financials statements and/or summarized financial information in accordance with these requirements. We suggest that the Commission consider whether these investments are intended to be within the scope of S-X Rules 3-09 and 4-08(g) and, if so, whether a different framework should be provided to determine whether financial statements for these low-interest investees are meaningful for investors.
- If an investee is a foreign entity, its financial statements may be audited in accordance with ISAs, which, under current SEC rules, do not satisfy the requirements of S-X Rule 3-09.[39] As we did similarly with respect to financial statements under S-X Rule 3-05, we suggest that the Commission consider allowing the use of financial statements audited in accordance with ISAs when the audit report does not need to refer to the standards of the PCAOB.[40] ISAs are high-quality auditing standards that are widely accepted worldwide and largely converged with AICPA standards. The Commission should consider whether auditing the financial statements under U.S. GAAS provides an incremental benefit.
- FPIs that prepare their financial statements in accordance with IFRSs are not required to present their financial information under U.S. GAAP.[41] However, in certain circumstances, those FPIs may be required to provide financial statements of a significant investee that include a reconciliation to U.S. GAAP. For example, a significant investee that does not meet the definition of a foreign business is required to provide a reconciliation to U.S. GAAP[42] even though the registrant is not required to present U.S. GAAP information. As we did similarly with respect to financial statements under S-X Rule 3-05, we suggest that the Commission consider whether such a reconciliation requirement results in the provision of meaningful information given that the reconciliation to U.S. GAAP is inconsistent with the basis for the registrant's financial statements. Alternatively, the Commission should consider whether financial statements of a

[38] ASC 323-30 requires the use of the equity method unless the investor's interest is "so minor" that the limited partner may have virtually no influence over partnership operating and financial policies. In EITF Topic No. D-46, "Accounting for Limited Partnership Investments," the SEC acknowledged that in practice, investments in limited partnerships of more than 3–5 percent have generally been viewed as more than minor and thus are subject to the equity method. Because profits and losses are allocated to individual partner accounts, the partner's share of earnings is allocated for income tax purposes, and the nature of partnership interests usually gives rise to some degree of influence (stated or unstated), it is presumed that either consolidation or the equity method should be used to account for all partnership interests. The approach under ASC 323-30 de-emphasizes significant influence and requires the equity method of accounting because it enables noncontrolling investors to reflect the underlying nature of their investments.

[39] See footnote 11.

[40] See paragraph 4110.5 of the FRM, footnotes 3 and 5.

[41] See Section 6310 of the FRM.

[42] See paragraph 6410.9 of the FRM.

significant investee prepared in accordance with IFRSs or with a reconciliation from home-country GAAP to IFRSs would be more meaningful given that the reconciliation would be prepared on a basis that is consistent with the financial statements of the registrant.

Application of S-X Rules 3-09 and 4-08(g) to Investment Companies

We understand that until several years ago, investment companies and business development companies (together referred to as "investment companies" for purposes of this section) prepared financial statements and periodic filings as if the reporting requirements of S-X Rules 3-09 and 4-08(g) were not applicable. However, we recognize that the SEC staff has more recently indicated that investment companies are not exempt from those rules. With this in mind, we offer the following considerations to improve disclosure requirements related to investment companies:

- *Significance tests under S-X Rule 1-02(w)* —As noted in the S-X Rule 1-02(w): Significant Subsidiary section above, current application of the income test may yield anomalous results and is even more pronounced for investment companies. For example, net income reported in the statement of operations includes the periodic changes in the fair value of investments in addition to the interest income generated by the portfolio investments ("investees"). Consequently, determining the significance of investees under the current income test may result in significantly different outcomes from quarter to quarter. Such differences, in turn, may yield inconsistent information about these investees and may also distort which investments are, in fact, significant.

  To address this concern, we suggest that the Commission consider replacing the income test with an investment income test. Under this revised test, the investment income earned[43] by the registrant from its investee (numerator) would be compared with the total investment income earned by the registrant (denominator). For investment companies, investment income may be a more meaningful measure that could lead to a more consistent determination of significance under S-X Rules 3-09 and 4-08(g).

- *Disclosure requirements* —When an investee is significant under S-X Rule 1-02(w), the investment company must currently provide historical financial statements or selected financial information of the investee, which may not be meaningful to how the investment company manages its investment. The investment company is required to report all investments at fair value, and the investee's historical balance sheet information does not correlate to the fair values recorded by the investment company. Further, the results of the investee's net income (or a share thereof) are not included in the investment company's statements of operations. We therefore suggest that the Commission consider whether alternative disclosures about the investee, as suggested below, would result in a more meaningful presentation than the historical financial information of the investee that is currently required.

  For example, ASC 820, *Fair Value Measurement*, requires that for investments accounted for at fair value, entities must disclose the valuation techniques and inputs used to develop fair value measurement of assets.[44] However, ASC 820 generally requires disclosure of these techniques in the

[43] For purposes of this discussion, investment income includes interest income, dividend income, structuring fees, and other income constituting an investment company's investment income in accordance with the accounting and reporting requirements for investment companies (ASC 946 and S-X Rule 6-07).
[44] See ASC 820-10-50-2.

aggregate. Given the significance of (1) the valuation of an investment portfolio, (2) the techniques used to value items in the investment portfolio, and (3) income generated by the investment portfolio of an investment company, the Commission should consider requiring investment companies to disclose the following in lieu of the historical information currently required under S-X Rules 3-09 and 4-08(g) for each significant investee:[45]

- Valuation techniques and inputs used to develop fair value measurements.
- Income earned during the reporting period.

Further, if the investee is an investment company,[46] a registrant could also provide a schedule that includes the investee's significant underlying portfolio holdings. We believe that these disclosures may be better aligned with the fair value reporting framework used by investment companies and can be derived from information that is readily available.

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

Issuers of registered securities that are guaranteed and guarantors of registered securities must provide separate annual and interim financial statements for each subsidiary issuer and subsidiary guarantor ("issuer/guarantor") so that investors can evaluate their likelihood of payment. However, issuers/guarantors that meet certain conditions may provide disclosures in the parent company's annual and interim consolidated financial statements ("alternative disclosures") in lieu of full financial statements of each issuer/guarantor. The alternative disclosures, whose form and content is determined on the basis of additional conditions, are presented in a footnote to the financial statements and can represent (1) narrative disclosure about the issuer/guarantors or (2) consolidating information.

Because of the complexities and limited guidance available regarding the preparation of consolidating information, compliance with S-X Rule 3-10 is challenging, time-consuming, and costly for preparers. In addition, this information is lengthy and may not be meaningful or understood by users of the financial statements. While the prescribed alternative disclosures provide relief from filing multiple sets of financial statements and Exchange Act periodic reports, preparation of the detailed and unique consolidating information still presents various challenges. Further, debt agreements are often structured to either meet or avoid the requirements of S-X Rule 3-10 and may not result in a guarantor structure that is most beneficial to registrants and security holders. Accordingly, we suggest that the Commission consider the following input on the usefulness of the alternative disclosures and suggestions for improving them:

- The general rule in S-X Rule 3-10(a) requires, in part, that "every guarantor of a registered security must file the financial statements required for a registrant"; however, if certain conditions specified in S-X Rule 3-10 are met, registrants may provide consolidating information that presents information about the guarantors separately from information about the issuer and the nonguarantors. Given that the general rule would only require separate financial statements of issuers and guarantors, we suggest that the Commission consider whether an investor would have sufficient information for evaluating the likelihood of payment if a registrant provides separate summarized financial information related only to (1) the issuers separately and the combined

[45] We suggest that the Commission consider similar significance calculations and disclosure requirements for registrants that elect to account for their investees at fair value as permitted by ASC 825, *Financial Instruments*.
[46] See footnote 3.

guarantor subsidiaries separately, (2) the issuers and guarantors on a combined basis, or (3) the guarantor subsidiaries. Such disclosures could be presented in the notes to the parent company's financial statements that include all major captions of the balance sheet, income statement, and cash flow statement at a level of detail similar to what must be shown separately in interim financial statements under S-X Article 10. Alternatively, we suggest that the Commission consider whether only information about the balance sheet of the issuer(s) and combined guarantors (or just the guarantors), including net assets and the liquidity available to satisfy the guarantee, would be sufficient for investors to evaluate the likelihood of payment since we understand that such information may often be the only information provided about issuers and guarantors in a private placement transaction regardless of the existence of registration rights.

- If the concept of consolidating information is retained, we recommend that the Commission consider providing significant implementation guidance to help eliminate complexity and reduce the number of errors in presenting the information. For example, it would be helpful if the Commission provided guidance on (1) presenting intercompany transactions in the balance sheet (current versus noncurrent assets, liabilities, or equity classification), (2) presenting intercompany transactions in the cash flow statement (operating, investing, or financing cash flows and gross versus net presentation), (3) allocating costs and expenses to the various subsidiary columns, (4) allocating income tax expense to the various subsidiary columns, and (5) applying the equity method of accounting to nonguarantors and other subsidiaries when such method is required.
- Under certain circumstances specified in S-X Rule 3-10, registrants are permitted to present narrative disclosures in the notes to the financial statements in lieu of consolidating information. We suggest that the Commission consider expanding the instances in which the narrative disclosures would be permitted. It could do so by broadening the circumstances in which (1) a nonguarantor subsidiary is considered minor[47] and (2) the parent is considered to have no independent assets or operations.[48]
- We suggest that the Commission consider whether the interim reporting requirement to provide consolidating information results in the presentation of material information, particularly when no significant changes to the subsidiary issuer/guarantors have occurred since the most recent fiscal year. S-X Article 10 currently permits a registrant to apply judgment and omit details of accounts that have not changed significantly since the registrant's most recently completed fiscal year.[49] The Commission should consider whether a similar approach would be appropriate regarding the need to present the consolidating information for the interim reporting periods.
- A registrant that provides separate financial statements under S-X Rule 3-10(a) may cease complying with S-X Rule 3-10 once it files Form 15 to suspend its reporting obligations under the Exchange Act. However, if the registrant was eligible to present consolidating information

[47] S-X Rule 3-10(h)(6) states that 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 3% of the parent company's corresponding consolidated amount" (emphasis added).

[48] Under S-X Rule 3-10(c), (e), and (f), narrative disclosure is permitted when, among other requirements, the parent company has no independent assets or operations. S-X Rule 3-10 (h)(5) further indicates that a "parent company has *no independent assets or operations* 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 3% of the [parent company's] corresponding consolidated amount" (emphasis added).

[49] See footnote 35.

and elected to do so (i.e., did not provide separate financial statements of its subsidiary issuer/guarantor), it must continue to provide consolidating information for as long as the debt is outstanding.[50] We suggest that the Commission consider permitting a registrant to cease filing alternative disclosures when it files Form 15 and suspends its reporting obligations under the Exchange Act since the existing requirement appears to create an inconsistency and potentially burdens registrants that meet the criteria for presenting the alternative disclosures.

- Under S-X Rule 3-10(g), a registrant may be required to provide separate financial statements of a recently acquired subsidiary issuer/guarantor if the issuer/guarantor is significant.[51] A registrant must evaluate whether it is subject to this requirement, which is separate and distinct from the requirement to evaluate under S-X Rule 3-05. We offer the following considerations related to S-X Rule 3-10(g):
    - We suggest that the Commission consider whether the requirement to provide separate financial statements of recently acquired subsidiary issuers/guarantors remains appropriate given that the information provided for these subsidiaries is more detailed than the information required for the other subsidiary issuers/guarantors. Currently, the consolidating information for existing subsidiary issuers/guarantors is provided (1) at a level of detail consistent with that of condensed financial statements provided under S-X Article 10 and (2) without detailed footnotes. The Commission should consider whether the presentation of information about a recently acquired subsidiary issuer/guarantor in a manner generally consistent with the level of information accepted for other issuers/guarantors (i.e., summarized financial information or balance sheet information, as recommended above) may be sufficient to allow investors to evaluate its historical results.
    - If the requirement to provide separate audited financial statements for recently acquired subsidiary issuers/guarantors is retained, the Commission should consider whether the current significance test should be modified. To determine significance under S-X Rule 3-10(g), a registrant must compare the subsidiary's net book value or purchase price (whichever is greater) with the principal amount of the securities being registered. As a result of applying this test, registrants are often required to provide financial statements that are not material to the overall guarantor structure, particularly when a company only desires to raise a small amount of capital. We therefore suggest that the Commission consider whether an alternative test for evaluating the significance of a recently acquired subsidiary issuer/guarantor would be more appropriate. For example, a registrant may be better able to measure the significance of a recently

[50] At the March 12, 2002, CAQ SEC Regulations Committee joint meeting with the SEC staff ("joint meeting"), the SEC staff indicated that a parent company should continue to provide condensed consolidating financial information for as long as the debt is outstanding. The staff's conclusion was based the SEC's final rule *Financial Statements and Periodic Reports for Related Issuers and Guarantors*. At the June 20, 2006, joint meeting, the SEC staff expressed its belief that since the final rule refers only to circumstances in which modified (i.e., condensed consolidating) financial information is presented, the concept of "as long as the debt is outstanding" applies only when a registrant provides modified financial information. Therefore, if the parent company previously provided separate financial statements of the subsidiary issuer or guarantor, the parent company's obligation to comply with the reporting requirements in S-X Rule 3-10 would end as a result of its filing of Form 15.

[51] On the basis of S-X Rule 3-10(g)(1)(ii), a subsidiary is considered significant if its net book value or purchase price, whichever is greater, is 20 percent or more of the principal amount of the securities being registered.

acquired subsidiary issuer/guarantor by comparing the greater of the subsidiary's net book value or purchase price with the combined financial information of the guarantor subsidiaries rather than with the principal amount of the securities being registered.

- If the requirement to provide separate financial statements of recently acquired subsidiary issuers/guarantors is retained, we suggest that the Commission consider whether the required financial statements must be audited by a public accounting firm registered with the PCAOB and in accordance with the PCAOB's standards.[52] We understand that the Commission may grant relief from those auditing requirements, particularly in circumstances in which the financial statements were also presented under S-X Rule 3-05.[53] Nevertheless, we recommend that the Commission consider whether all registrants that are required to provide financial statements for recently acquired subsidiary issuers/guarantors should be allowed to do so without obtaining a PCAOB opinion.

S-X Rule 3-16: Financial Statements of Affiliates Whose Securities Collateralize an Issue Registered or Being Registered

In connection with the issuance of a registered class of securities, a registrant may pledge the capital stock of one or more of its subsidiaries as collateral to debt holders in the event that the registrant defaults on its debt payments. In such circumstances, a registrant would need to consider the requirements of S-X Rule 3-16 and may be required to file separate annual and interim financial statements for each affiliate[54] whose securities constitute a substantial portion of the collateral for any class of securities registered or being registered ("S-X Rule 3-16 financial statements"). These financial statements are intended to help current and prospective investors evaluate the affiliate's ability to satisfy its commitment in the event of default; in practice, however, agreements are often structured to avoid or limit these disclosures by reducing the amount of collateral the investor might otherwise receive in the event of default. To help the Commission make the information provided under S-X Rule 3-16 more useful to investors, we offer the following considerations and suggestions:

- We suggest that the Commission consider whether providing summarized financial information, rather than full financial statements, for each affiliate whose securities constitute a substantial portion of the collateral ("significant affiliate") would be sufficient to enable the investor to evaluate an affiliate's ability to satisfy its commitment in the event of default. For example, the notes to the registrant's financial statements could include for each significant affiliate (or the significant affiliates on a combined basis) all major captions of the balance sheet, income statement, and cash flow statements at a level of detail similar to what is required to be shown separately in interim financial statements under S-X Article 10. A simplified disclosure requirement under S-X Rule 3-16 may increase the use of collateralizations and narrow the

[52] See paragraph 4110.7 of the FRM.
[53] Paragraph 4110.5 of the FRM indicates that financial statements of nonissuer entities that are filed to satisfy S-X Rule 3-05 are not required to be audited under the PCAOB's standards.
[54] S-X Rule 1-02(b) states that an "affiliate of, or a person affiliated with, a specific person is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified." In practice, such an affiliate is almost always a consolidated subsidiary of the registrant, although the two are technically different.

circumstances in which the amount of collateral that the investor might otherwise receive in the event of a default is limited or reduced.

- Currently, a registrant determines an affiliate's portion of the collateral by comparing, among other items, the market value[55] of the affiliate's securities with the principal amount of the securities registered or being registered. This aspect of the calculation can be time-consuming and difficult to apply, particularly if multiple affiliates are not publicly traded. We suggest that the Commission consider whether other indicators of significance besides market value may be appropriate given the challenges of performing the market value calculation.
- The "substantial portion of the collateral" test must be performed at the time of effectiveness of a registration statement and subsequently as of the end of each fiscal year. The denominator of the test is based on the outstanding principal balance of the registered debt. If the principal balance is being reduced over time, the significance of the tested affiliates will tend to increase over time, thus potentially requiring more S-X Rule 3-16 financial statements as the principal obligation is reduced. We suggest that the Commission consider whether use of the outstanding principal balance over time results in the provision of meaningful financial statements.
- Interim financial statements of a significant affiliate are required in certain registration statements; however, they are not required in subsequent Forms 10-Q.[56] Given that interim information is unnecessary in periods following the registration statement, we suggest that the Commission consider whether providing such interim information in the registration statement is meaningful to investors since such information would not be provided in future periods.
- S-X Rule 3-16 requires the same financial statements of an affiliate that would be filed if the affiliate were a registrant. Accordingly, a significant affiliate may also be required to provide financial statements of (1) acquired businesses under S-X Rule 3-05 and (2) equity method investees under S-X Rule 3-09 with respect to that affiliate.[57] We suggest that the Commission consider whether the requirement to provide these additional financial statements provides meaningful and relevant information for evaluating the affiliate's ability to satisfy its commitment in the event of default.

OTHER REQUIREMENTS — CONSIDERATION OF XBRL TAGGING IN OTHER ENTITIES' FINANCIAL STATEMENTS

The SEC's final rule *Interactive Data to Improve Financial Reporting*[58] states that its XBRL tagging requirements "are intended not only to make financial information easier for investors to analyze, but also to assist in automating regulatory filings and business information processing. Interactive data [have] the potential to increase the speed, accuracy and usability of financial disclosure, and eventually reduce costs." In light of this, we suggest that when the Commission evaluates whether to continue excluding financial statements provided under S-X Rules 3-05 and 3-09 from the scope of its XBRL tagging requirements, it should consider (1) whether the XBRL data have broad utility, particularly when the

[55] In the note to paragraph 2610.1 of the FRM, the SEC staff clarifies that within the context of S-X Rule 3-16, the term "market value" should be interpreted as fair value regardless of whether the securities that serve as collateral are traded on an exchange or in an over-the-counter market.
[56] See paragraph 2620.2 of the FRM.
[57] See paragraph 2630.4 of the FRM.
[58] SEC Release Nos. 33-9002, 34-59324, 39-2461, and IC-28609.

financial statements are not expected to be filed on a recurring basis; (2) whether significant costs outweigh the benefits of the data, particularly when the financial statements provided are those of private companies that may not have XBRL tagging processes in place or experience with XBRL tagging; and (3) whether registrants have sufficient knowledge of the financial reporting of other entities to adequately tag those entities' financial statements.

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We appreciate the opportunity to provide our perspectives on these important topics. If you have any questions or would like to discuss these issues further, please contact Christine Davine at [redacted] or Tom Omberg at [redacted].

Sincerely,

Deloitte & Touche LLP

cc: Mary Jo White, SEC Chairman
Luis A. Aguilar, SEC Commissioner
Michael S. Piwowar, SEC Commissioner
Kara M. Stein, SEC Commissioner
Keith Higgins, Director, Division of Corporation Finance
Mark Kronforst, Chief Accountant, Division of Corporation Finance
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