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## Financial Statements Triggered by Acquisitions—When You Need Them

### A Practical Guide for US Public Companies, Part II

Significant acquisitions trigger specific financial statement requirements for the acquiring company. [Part I](#) of this publication covered determining if an acquisition is considered significant and what target and pro forma financial statements are required. In this Part II, we discuss when those financial statements need to be filed or updated and under what circumstances securities of the acquiring company can be offered before those financial statements are available. This is part of our series on [Financial Statement Triggers](#).

#### A Combination of SEC Rules and Market Practice

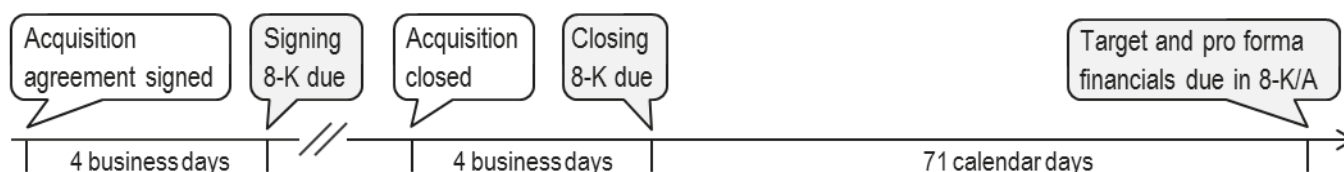
If the acquisition of a business is considered significant because it exceeds 20% on any one of the three significance tests, the SEC requires the acquiring company to file target and pro forma financial statements within approximately 75 days following the closing. If the acquiring company registers or offers securities, it may need to file such financial statements sooner. It may also have to update target and pro forma financial statements that it filed previously. While some of these requirements result from technical SEC financial statement rules, others are based on market practice and judgment calls about investors' expectations, materiality and legal risk.

#### Signing 8-K, Closing 8-K and 8-K/A

A significant acquisition by a US public company typically triggers an 8-K at three different times: (1) when the acquisition agreement is signed, (2) when the acquisition closes and (3) within approximately 75 days of closing to file required target and pro forma financial statements, unless they were previously filed in a registration or proxy statement.

- **Signing 8-K.** Specified trigger events require a US public company to file an 8-K within four business days to report the event and provide certain related information. One of the trigger events is a material agreement outside the ordinary course of business. An agreement for a significant acquisition will typically meet this test and thus trigger an 8-K due within four business days of signing. In addition, the acquiring company may want to announce the transaction promptly to avoid leaks and comply with the stock exchanges' "prompt release" policies with respect to material information. No target or pro forma financial statements are required at announcement, although the acquiring company may provide certain financial information to the market on a voluntary basis.
- **Closing 8-K.** The closing of a significant acquisition constitutes a separate 8-K trigger event, and the corresponding 8-K is due within four business days of the closing. If the acquisition does not involve a business or if it is not considered significant because it does not exceed 20% on any of the three tests it may still trigger a closing 8-K if the acquiring company's equity in the net book value of the assets acquired or the amount paid exceed 10% of the acquiring company's total assets. No financial statements are required in this situation.

- **8-K/A.** The closing of an acquisition with a significance level of more than 20% also triggers a requirement for the acquiring company to file target and pro forma financial statements within 71 days of the due date of the closing 8-K, or a total of four business days plus 71 calendar days after closing. They are filed in an 8-K/A amendment to the closing 8-K. The following chart illustrates the overall timeline of trigger events and filing deadlines.



- **Permitted age of financial statements backdated to filing date of closing 8-K.** Financial statements in the 8-K/A will generally be deemed current if they would have met the permitted age requirements on the filing date of the closing 8-K, rather than the filing date of the subsequent 8-K/A. As discussed in [Part I](#), the permitted age of target financial statements depends on the target filer status, and the pro forma financial statements need to cover the most recent fiscal year and interim period for which the acquiring company had already issued financial statements when it filed the closing 8-K. As an exception to this backdating, if a registration statement of the acquiring company becomes effective after the filing of the closing 8-K and before the 8-K/A is due, but omits target and pro forma financial statements in reliance on the SEC grace period described below, the permitted age of the financial statements in the 8-K/A is determined as of the effective date of the registration statement.
- **Option to retest significance if new 10-K is filed before 8-K/A.** If an acquisition closes after year-end but before the filing of the new 10-K, the acquiring company may reevaluate the significance of the acquisition based on the annual financial statements in the new 10-K if it is filed before the 8-K/A is due. If the acquisition is not significant on that basis, the 8-K/A with target and pro forma financial statements does not need to be filed.

## Registering or Offering Securities

As part of its ongoing reporting, a US public company generally does not need to file target or pro forma financial statements for a significant acquisition until the 8-K/A is due approximately 75 days after closing. However, these financial statements may be required sooner if the acquiring company is registering or offering securities.

- **SEC grace period.** In a registration statement of the acquiring company, the SEC's financial statement rules do not require previously unfiled target or pro forma financial statements for a significant acquisition that either (i) has not yet closed or (ii) closed only within the past 74 days prior to the effective date—unless significance exceeds 50%, as discussed below. The expiration of this grace period roughly coincides with when the 8-K/A is due approximately 75 days from closing. After signing or closing an acquisition at not more than 50% significance, the acquiring company may therefore remain able to file and go effective on a registration statement without target or pro forma financial statements until they are required to be filed in the 8-K/A.
- **Market practice.** Market practice for securities offerings often does not apply the SEC grace period. When offering securities after a significant acquisition has become probable or has closed, companies and underwriting banks typically decide to include target and pro forma financial statements in the offering document even when they would not yet be required in a registration statement. This is the case also in exempt debt offerings under

Rule 144A. The rationale for including target and pro forma financial statements before they are due relates to disclosure and liability considerations. Since the SEC has deemed those financial statements material enough to mandate their filing within 75 days of closing, they are viewed as potentially material to investors, and there is a concern that their omission could make the offering document misleading. If not included in the offering document, the financial statements will eventually be filed in the 8-K/A. If the price of the acquiring company's securities reacts negatively to that later disclosure, or if that is alleged, the offering document may, in hindsight, appear deficient without them. In addition to liability considerations, the underwriting banks may believe that providing this information to investors will help market the securities.

- **No SEC grace period if significance exceeds 50%.** If an acquisition exceeds 50% significance on any of the three tests, the SEC requires target and pro forma financial statements to be included in a new registration statement, or in an amendment to an existing one. This is the case even if the acquisition is only probable and has not yet closed or closed only within the past 74 days. For this purpose, an acquisition is aggregated with any acquisitions that do not exceed 20% significance but closed after the date of the most recent audited balance sheet and any acquisitions that are only probable or which only closed during the past 74 days. If financial statements are required due to this aggregation, they need to cover at least one fiscal year (and latest interim period) for a majority of the targets, calculated based on significance.
- **No takedown if significance exceeds 50%.** If the significance of an acquisition exceeds 50%, securities should not be offered under already effective registration statements unless target and pro forma financial statements are included, except for secondary offerings or the issuance of securities under outstanding convertible securities or warrants. The SEC staff recently clarified that this bright-line guidance applies only to completed acquisitions. Otherwise, effective registration statements technically need to be updated with financial statements for subsequent completed or probable acquisitions only if, individually or together with other post-balance sheet date acquisitions, they constitute a fundamental change. Market practice may include the financial statements even in the absence of a fundamental change based on the materiality considerations discussed above.
- **When is a significant acquisition “probable?”** Whether an acquisition has become probable enough to trigger the requirement for target and pro forma financial statements depends on the specific facts and circumstances. According to the SEC, an acquisition is considered probable when the acquiring company's financial statements alone would not provide investors with adequate financial information. This may be the case upon the signing of a definitive agreement or a non-binding letter of intent, depending on the likelihood of closing. Under the SEC's financial statement rules, the determination of probability technically matters only for acquisitions that, individually or in the aggregate, have more than 50% significance. As a practical matter, companies and underwriting banks will often not be comfortable offering securities without target and pro forma financial statements when an acquisition at any significance level in excess of 20% is pending or being negotiated.
- **Target and pro forma financials may need to be more current than for 8-K/A.** Target and pro forma financial statements required in a registration statement generally need to meet the same content, audit and age requirements as those filed in an 8-K/A, except that the age requirements are tested as of the effective date of the registration statement, rather than as of the filing date of the closing 8-K. In addition, if the acquiring company is a “loss corporation,” it cannot go effective on a registration statement that needs to include target and pro

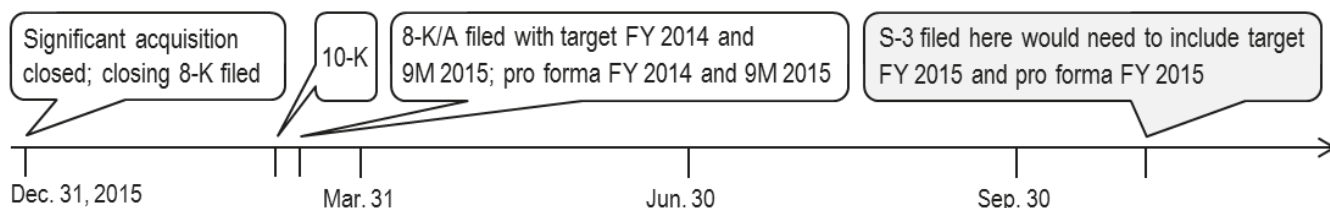
forma financial statements after the 45th day following the target’s fiscal year-end unless the target’s audited financial statements cover the target’s just completed fiscal year. Generally, a company is considered a loss corporation if it has reported a net loss for both of its two most recent fiscal years covered by its last 10-K or expects to report a net loss for its just completed fiscal year. See our [prior publication](#).

- **Financing cooperation covenants in acquisition agreements.** If the acquiring company wants to access the capital markets prior to the closing of an acquisition or shortly thereafter, it may require target and pro forma financial statements as well as cooperation from the target’s auditors in providing consents and comfort letters. Auditor consent and comfort procedures impose some burden on target resources because of the back-up documentation and representation letters required by the auditors. It is therefore important for the acquiring company to ensure the target’s cooperation through appropriate covenants in the acquisition agreement.

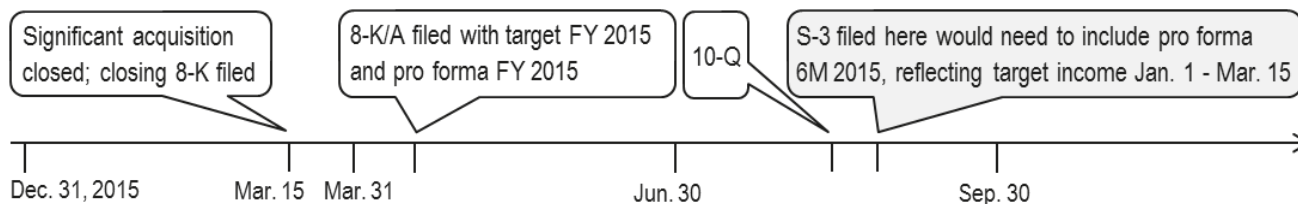
### Need to Update Previously Filed Financial Statements

Target and pro forma financial statements in an 8-K/A, although fully compliant when filed, may prove out of date if the acquiring company subsequently registers or offers securities. Below are a few common examples. All charts are based on acquisitions where both the acquiring company and the target have a calendar fiscal year.

- **No backdating to closing 8-K.** As described above, when filing the 8-K/A, the permitted age of the financial statements is determined by reference to the filing date of the closing 8-K. This backdating is not available in connection with registration statements. Previously filed financial statements may therefore need to be updated for another fiscal quarter, or even for a full audited fiscal year, as illustrated in the following chart.



- **Update pro formas for additional pre-acquisition target results.** Target financial statements do not need to be updated if the period that elapsed between the date of the most recent target financial statements in the 8-K/A and the closing of the acquisition represents less than a full fiscal quarter of the target. However, the pro forma income statement may need to be updated for the additional pre-acquisition target results, as illustrated below. This means that the target financial information reflected in the pro forma income statement may have to contain partial-quarter target financial information that is more recent than the most recent target financial statements.



- **Roll forward pro formas for additional quarters of acquiring company.** Pro forma financial statements may have to be updated even when there is no additional pre-acquisition target information simply because they must be as current as the most recent historical financial statements of the acquiring company included in the filing.

- **No update after target included in 10-K for nine months, except if of major significance.** Generally, previously filed target and pro forma financial statements do not need to be included in a registration statement, and therefore not updated, once the target is included in at least nine months of post-acquisition audited results of the acquiring company, unless the acquisition is of major significance. The SEC staff presumes major significance at levels of 70% or more and requires that the target be included in the acquiring company's audited results for between 21 and 33 months before inclusion and updating are no longer required. A pro forma income statement is not required once the target has been included in the acquiring company's audited results for a full fiscal year, but target financial statements may still need to be included, or updated, thereafter.

These updating requirements technically apply only when the acquiring company files or goes effective on a new registration statement, or amends an existing one. The requirements are not triggered when offering securities under an existing registration statement or in an exempt offering under Rule 144A, but companies and underwriting banks often treat an offering as similar to the filing of a new registration statement from a disclosure perspective. There is perhaps a bit more flexibility when it comes to updating previously filed target or pro forma financial statements because there is no concern that those financial statements will be filed in the 8-K/A, as would be the case in an offering that precedes the 8-K/A. However, in addition to liability concerns, banks will often want to include updated pro forma revenue, EBITDA and earnings metrics for marketing purposes. Obtaining auditor comfort on those updated metrics may be difficult without including the corresponding underlying target and pro forma financial statements. In addition, auditor comfort on pre-acquisition changes in the target's results may only be possible if more recent target financial statements are included. As a result, target and pro forma financial statements are often updated for subsequent offerings even where not technically required.

### **Offering Securities Without Target and Pro Forma Financial Statements**

Notwithstanding the market practice to include target and pro forma financial statements for significant acquisitions, in certain limited circumstances it may be possible to conclude that this additional financial information is not material to investors, and that an offering can proceed without it. Among the factors considered are the following:

- **Do the S-X significance tests reflect the true significance of the acquisition?** The SEC's three significance tests in Regulation S-X are, of necessity, somewhat arbitrary and may not always reflect the actual materiality of the acquisition or the target to the acquiring company. For example, if the fair value of a company's assets substantially exceeds its book value, the investment test will tend to overstate the transaction's significance. The same is true for the asset test if the book value of the target's assets is closer to fair value than is the case for the acquiring company. The income test can overstate the target's significance if the acquiring company is more leveraged or recently recorded a substantial one-time charge. Market participants may look to the target's contribution to revenue, operating income or EBITDA as a better gauge of its true significance.
- **How material is the omitted financial information?** Sometimes, an argument can be made that the omitted financial statements should not be material to investors. For example, early stage biotech companies trade less on their financial results, and more on the progress of their development pipeline. If the target company financial information is available to investors, pro forma financial information is sometimes viewed as adding little to that. The most significant pro forma adjustment that goes beyond math that investors could largely perform on their own is often purchase accounting. Although purchase accounting will tend to reduce near term earnings because

of the write-up of target inventory and intangibles, these are non-cash effects that investors may not necessarily view as material, especially if they are debt investors. However, it is possible that there are certain differences in the accounting policies of the acquiring company and the target which could affect revenue recognition or other metrics, and assessing the materiality of those differences may be difficult without preparing the corresponding pro forma adjustments. There is also the presumed materiality of pro forma information due to SEC rules and the consideration, discussed above, that the pro forma financial statements will eventually be filed in the 8-K/A.

- ***What other information about the target is available?*** In the absence of the full target and pro forma financial statements contemplated by the SEC's rules, there may be other information about the target that is available to investors of the acquiring company or that can be provided to them in the offering document. Perhaps certain summary financial information can be prepared and comforted. The acquiring company may have issued a press release about the acquisition or talked about it on an earnings call or at an investor conference and produced a slide presentation for this purpose that it furnished on an 8-K. These materials may contain certain headline financial information about the target, or management's projections on how the acquisition will affect the acquiring company's results. Although not all of it may be suitable for inclusion in an offering document, it is arguably part of the overall mix of information. While this context may be helpful, it also has its limits, and auditor comfort will often not be available for this information.
- ***What securities are being offered, to whom and by whom?*** Context matters. In offerings of debt securities, especially investment grade debt securities, there is somewhat more flexibility than in offerings of common stock or other equity securities. The Rule 144A debt market, where sales are limited to large and sophisticated institutional investors, offers additional leeway. Secondary sales of common stock after a significant acquisition has closed but before the 8-K/A with target and pro forma financial statements is filed can have their own dynamics. The acquiring company's common stock continues to trade without that information, and the underwriter is offering investors shares at a discount to the trading price. The selling stockholder may have no clear right to cause the acquiring company to file target and pro forma financial statements before they are due, although materiality considerations would still apply. This is different from an offering by the acquiring company itself to finance an acquisition. Bond investors will often expect information about pro forma EBITDA and leverage. Also note that bridge commitments require certain financial statements as a condition to funding.

Offering securities after a significant acquisition has been signed up or otherwise become probable without target and pro forma financial statements is still very much the exception, but may be possible in particular circumstances. These are ultimately decisions about the acceptable level of risk, and each situation will be different.

## Conclusion

Understanding the SEC rules and market practice for financial statements triggered by significant acquisitions is critical for planning and executing capital markets transactions. It is also important for negotiating acquisitions and related financing commitments. If the acquiring company wants to access the capital markets, or draw on a bridge financing, to finance the acquisition it may need target and pro forma financial statements much sooner than would be required by the SEC. As we mentioned previously, the rules governing the inclusion of target and pro forma financial statements are currently under review by the SEC. No date has yet been announced for when the SEC will propose potential changes to the existing significance tests and filing requirements.

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