

SEC Regulations Committee
April 9, 2008 - Joint Meeting with SEC Staff
SEC Offices – Washington DC

NOTICE: The Center for Audit Quality (CAQ) SEC Regulations Committee meets periodically with the staff of the SEC to discuss emerging technical accounting and reporting issues relating to SEC rules and regulations. The purpose of the following discussion document is to summarize the issues discussed at the meetings. This discussion document has not been considered and acted on by senior technical committees of the CAQ or AICPA, or by the Financial Accounting Standards Board, and does not represent an official position of these organizations.

In addition, this discussion document is not an authoritative position or an interpretation issued by the SEC or its Staff. This discussion document was not transcribed by the SEC and has not been considered or acted upon by the SEC or its Staff. Accordingly, this discussion document does not constitute an official statement of the views of the Commission or of the Staff of the Commission.

Discussion Document A

Topic: Impacts of FAS 141R and 160 on existing SEC filing and disclosure requirements

FASB Statement No. 141 (revised 2007) (FAS 141R), *Business Combinations*, and FASB Statement No. 160, *Noncontrolling Interest in Consolidated Financial Statements* (FAS 160), have numerous implications to existing SEC filing and disclosure requirements. Despite the 2009 effective dates, public companies would benefit from timely clarity as to the implications to filing requirements.

What process and timing does the SEC staff anticipate to address these questions? How can the Committee facilitate timely resolution and communication of these questions?

This Discussion Document addresses the following issues that the Committee has tentatively identified:

1. **Treatment of transaction costs in the S-X significance tests for an acquired business (Rule 3-05)**
 2. **Treatment of contingent consideration in the S-X significance tests for an acquired business (Rule 3-05)**
 3. **Performing the income significance test under Rule 3-09 of Regulation S-X when a registrant obtains control over an investee that was previously eligible to be accounted for under the equity method**
 4. **Presentation of Minority Interest in Consolidated Financial Statements under Article 5 of Regulation S-X Upon Adoption of FAS 160**
 5. **Acquired Business and Pro Forma Financial Statement Requirements When Control is Obtained Through Events Other than Transactions after Adoption of FAS 141R**
 6. **Presenting R&D Expenses in Pro Forma Income Statements After Adoption of FAS 141R**
 7. **Information Required in Registration Statements When There Are Retrospective Adjustments to Provisional Amounts after Adoption of FAS 141R**
-
1. **Treatment of transaction costs in the S-X significance tests for an acquired business (Rule 3-05)**

Section I.D.1 in Topic Two of the SEC Staff Training Manual (STM) interprets the investment test of significance for Rule 3-05 purposes (Regulation S-X, Rule 1-02(w)). That section indicates that a registrant should compare the total U.S. GAAP purchase price of the acquiree with the registrant's preacquisition consolidated assets. It further

states that the investment includes the “costs of acquisition that will be allocated to the assets and liabilities acquired” (e.g., legal, accounting and banking fees).

Statement 141R does not refer to a “purchase price”. Instead, it indicates that:

- The acquirer should recognize and measure the acquisition date fair value of the assets acquired and liabilities assumed.
- Goodwill is calculated as the difference between the acquisition date fair value of the **consideration transferred** (plus the fair value of any noncontrolling interest in the acquiree and, in a business combination achieved in stages, the fair value of the acquirer’s previously held interest in the acquiree) and the fair value of the assets acquired and liabilities assumed.¹
- Paragraph 59 of Statement 141R indicates that “the acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received”. That is, acquisition-related costs shall not be included in the consideration transferred.

Question: When performing the investment test of significance after the effective date of Statement 141R, would a registrant include transaction costs in the numerator of the investment test?

Committee Recommendation:

The Committee believes that while the numerator was previously defined as “purchase price” which included transaction costs (as per APB 16/FAS 141), under FAS 141R the definition of the numerator should be the “fair value of consideration transferred to the selling shareholders” which will exclude transaction costs. The Committee also recommends that the Staff Training Manual be updated for this change in definition.

SEC Staff Response:

The staff agrees that the numerator should be the fair value of the consideration transferred, which would include the fair value of contingent consideration, but exclude transaction costs.

2. Treatment of contingent consideration in the S-X significance tests for an acquired business (Rule 3-05)

[Note, the Committee and the SEC staff previously discussed this question. See Discussion Document G from September 2004 (http://thecaq.aicpa.org/NR/rdonlyres/14F4CABC-D560-426A-AF6A-3C78419CA00A/0/2004_0913_highlights.pdf).]

Under Statement 141, contingent consideration is generally not recorded at acquisition since it is often not determinable. At the September 13, 2004, AICPA SEC Regulations Committee Joint Meeting with the SEC Staff, the SEC staff stated “if the likelihood of payment is more than remote, the registrant should include the gross amount of the contingent consideration in the investment test.” The SEC staff also said that they would reconsider their view if the FASB adopted revisions to Statement 141 (that were being planned at that time).

Statement 141R requires that a registrant record any asset or liability resulting from a contingent consideration arrangement at its acquisition date fair value as part of the consideration transferred. The likelihood of payment of the contingent consideration is considered in the determination of its fair value.

¹ See paragraph 35 of 141(R). Emphasis added.

Question 1: After the effective date of Statement 141R, because the acquisition date fair value of contingent consideration will be included in the consideration transferred, should it be included in the numerator of the investment test of significance?

Committee Recommendation:

The Committee believes that after the adoption of SFAS 141R the definition of the numerator should be the "fair value of consideration transferred to the selling shareholders", including the fair value of contingent consideration. The Committee also recommends that the Staff Training Manual be updated for this change in definition.

Staff Response:

The staff agrees that the numerator should be the fair value of the consideration transferred, which would include the fair value of contingent consideration, but exclude transaction costs.

Question 2: SFAS 141R permits a measurement period which can extend for a year from the date of acquisition and may result in an adjustment of the provisional amounts recognized for the business combination. One such provisional amount is the fair value of contingent consideration. After the effective date of Statement 141R, under what circumstances, if any, does significance have to be re-measured if the preliminary estimate of fair value of contingent consideration changes?

Committee Recommendation:

Significance need not be remeasured when the preliminary estimate of the fair value of contingent consideration changes as long as a good faith estimate was made at the time of acquisition. Historically, significance has not been remeasured for changes in purchase price (e.g., subsequent arbitration regarding disputes in the amount of the purchase price).

SEC Staff Response:

The staff agrees with the Committee Recommendation.

3. **Performing the income significance test under Rule 3-09 of Regulation S-X when a registrant obtains control over an investee that was previously eligible to be accounted for under the equity method.**

Question: When a registrant gains control over an investee that was previously eligible to be accounted for under the equity method, should the registrant include any gain or loss attributable to the remeasurement of the pre-existing equity interest in the numerator of the "income" significance test under Rule 3-09 of Regulation S-X?

Background: Under FAS 141R, when an acquirer obtains control over an entity in a business combination that is achieved in stages (sometimes referred to as a "step acquisition"), the acquirer must remeasure its previous equity interest in the acquiree at fair value on the date control is obtained. The acquirer must recognize any gain or loss from this remeasurement in earnings. This gain or loss from remeasurement of the pre-existing equity interest is commonly referred to as a "holding" gain or loss.

Consider the following example:

Company X is a calendar year-end SEC registrant. In 2002, Company X purchased 35% of Investee A's common stock. Company X accounts for its investment in Investee A using the equity method of accounting.

Company X properly performed the significance tests required by Rule 3-09 of Regulation S-X for each period in which it held its investment in Investee A. Investee A was properly determined to be "insignificant" in each period.

On November 1, 2009, Company X acquired the remaining 65% of Investee A's common stock. In connection with the acquisition of the remaining outstanding common stock, Company X obtained control over Investee A. Accordingly, under FAS 141R, Company X was required to remeasure its prior 35% equity interest at the acquisition-date fair value and to record any resulting gain or loss in earnings. Based on this remeasurement, Company X recorded a \$10 million holding gain in its 2009 income statement.

Should Company X include the \$10 million holding gain in the numerator of the "income test" when considering whether its investment in Investee A was significant (under Rule 3-09) for the period January 1, 2009 through October 31, 2009 (i.e., the portion of the year during which Investee A was recorded under the equity method)?

View A: No. The \$10 million holding gain was only recognized because Company X obtained control over Investee A. Accordingly, the \$10 million gain should be "attributed" to the period in which Investee A is a consolidated subsidiary--and therefore excluded from the numerator of the income test for purposes of evaluating whether Investee A was "significant" during the period in which it was accounted for under the equity method (January 1, 2008 through October 31, 2008).

View B: Yes. The \$10 million gain is attributable to the period of time during which Company X accounted for Investee A using the equity method (i.e., it is a holding gain). Accordingly, the numerator of the income test should include the holding gain.

View C: No. Since Investee A was reflected as a consolidated subsidiary as of the end of 2008, Company X would not be required to perform any significance tests with respect to Investee A for 2008 (i.e., Rule 3-09 would not require an assessment of the income test for January 1, 2008 through October 31, 2008--the period during which Company X accounted for its investment in Investee A under the equity method).

Committee Recommendation: The Committee supports View A.

Prior to the effective date of FAS 141R, the types of holding gains and losses contemplated above were not typically recorded. Accordingly, this issue would likely not have arisen. At the June 2005 meeting, the SEC staff and the Committee discussed the opposite situation--a fact pattern in which a registrant's interest in a consolidated subsidiary changed to the extent that the registrant discontinued consolidation accounting and began to report the prior subsidiary using the equity method of accounting.

The question under consideration at the June 2005 meeting was how the registrant should perform the income test with respect to the entity under Rule 3-09 of Regulation S-X. In connection with that discussion, the SEC staff agreed that the registrant should calculate the income test based on the registrant's equity in the investee's pretax earnings for the period of the fiscal year in which it was accounted for by the equity method. However, the staff also indicated that "any gain or loss related to changes in ownership of the subsidiary/investee should [also] be included in the significance test."

The Committee believes the distinguishing factor between the treatment of the holding gain/loss due to remeasurement upon acquisition of control and the gain or loss on disposition (discussed in June 2005), is that in the acquisition situation, the entity has become a consolidated subsidiary and, accordingly, investors are receiving financial statements of the registrant which include the subsidiary on a fully consolidated basis (from the date control is acquired).

SEC Staff Response:

The staff supports View A. The staff noted that registrants should also consider the applicability of Rule 3-05 in this situation.

4. Presentation of Minority Interest in Consolidated Financial Statements under Article 5 of Regulation S-X Upon Adoption of FAS 160

Background:

Article 5 of Regulation S-X states that the purpose of the rule is “to indicate the various line items, which if applicable, and except as otherwise permitted by the Commission” should be presented in the financial statements. Specifically:

1. Rule 5.02 identifies “minority interests in consolidated subsidiaries” as a line item that should appear on the face of the balance sheets, and
2. Rule 5.03 identifies “minority interest in income of consolidated subsidiaries” as a line item that should appear on the face of the income statement.

While Article 5 does not expressly state the order in which line items should be presented on the financial statements, the organization of the line items listed in both Rule 5.02 and Rule 5.03 imply a specific placement. For example, the balance sheet line item “minority interests in consolidated subsidiaries” is listed in Rule 5.02 after long-term debt and before redeemable preferred stock. This has led to presenting minority interests outside of equity, typically between long-term debt and shareholders’ equity. The income statement line item “minority interest in income of consolidated subsidiaries” is listed in Rule 5.03 after “income and loss before income taxes and other appropriate items” and before “income or loss from continuing operations.” This suggests that minority interest in income or loss of consolidated subsidiaries must be included in the determination of income or loss from continuing operations.

Under Statement of Financial Accounting Standards No. 160, “*Noncontrolling Interests in Consolidated Financial Statements*”, (FAS 160), GAAP will require that minority interest (to be referred to as “noncontrolling interests”) be presented as (i) a separate line item outside of shareholders’ equity but within total equity on the consolidated statement of financial position, (ii) as a separate line item, net of tax, below net income on the consolidated income statement and (iii) as a separate line item, net of tax, below comprehensive income on the consolidated statement of comprehensive income.

Question:

Upon adoption of FAS 160, how should minority (noncontrolling) interests be presented in financial statements that are required to comply with Article 5 of Regulation S-X?

[Note: The scope of this question is limited to the presentation requirements of Rules 5.02 and 5.03 of Article 5 in Regulation S-X. It is not intended to address any disclosure or computation requirements of Regulations S-X or S-K. For example, it does not address the disclosure requirements of Rule 5.02(27) related to the amount represented by preferred stock and the applicable dividend requirements for any minority interests or Rule 4.08(g) and 1.02 (bb) [Summarized Financial Information] of Regulation S-X. It also does not address computational requirements that involve equity, net assets or minority interests in consolidated subsidiaries, such as (i) Rule 3-05 [Financial Statements of Businesses Acquired], Rule 3-09 [Financial Statements of Unconsolidated Subsidiaries and 50% or Less Owned Entities] and Schedule I in Rule 5.04 [Parent Company Financial Statements] of Regulation S-X or (ii) Item 503 [Ratio of Earnings to Fixed Charges] of Regulation S-K.]

Committee View:

The Committee believes that financial statements should comply with the presentation requirements of FAS 160 once that standard becomes effective. The Committee notes that the requirements of Article 5 related to minority (noncontrolling) interests could be confusing to preparers, auditors and investors and suggests that the Regulation be amended to conform to generally accepted accounting principles.

SEC Staff Response:

The staff agrees that registrants should follow the financial statement presentation requirements of FAS 160 once that standard becomes effective.

5. **Acquired Business and Pro Forma Financial Statement Requirements When Control is Obtained through Events Other than Transactions after Adoption of FAS 141R**

Issue: The scope of FAS 141R, *Business Combinations*, is broader than the scope of Statement 141. FAS 141R applies to situations in which control is acquired through events other than transactions, such as the lapse of contract rights. This Discussion Document addresses the questions of (1) whether acquisitions arising from events other than transactions are subject to the reporting requirements under Item 2.01 of Form 8-K and Rule 3-05 and Article 11 of Regulation S-X and (2) when such acquisitions should be viewed as probable for purposes of applying Rule 3-05 and Article 11.

Background: FAS 141R, in paragraph 3.e, defines a business combination as a transaction or other event in which an acquirer obtains control of one or more businesses. Thus a business combination can occur when one entity obtains control of another as a result of the expiration of rights held by others that had precluded consolidation, such as those described in EITF 96-16 and EITF 04-5.

Question 1: After a registrant adopts FAS 141R, if it acquires control of a business through events other than transactions, is such an event subject to the reporting requirements under Item 2.01 of Form 8-K and Rule 3-05 and Article 11 of Regulation S-X?

Discussion: The SEC staff and the Committee have discussed similar issues in the past. The discussions that are most relevant to this issue are those related to physician practice management companies (see Section XII of the minutes of the October 1996 meeting) and variable interest entities (see Discussion Document E from the September 2003 meeting). The Committee believes the approach of treating acquisitions that occur as a result of events, rather than transactions, as subject to the reporting requirements under Item 2.01 of Form 8-K and Rule 3-05 and Article 11 of Regulation S-X is consistent with current practice for businesses consolidated pursuant to EITF 97-2 and FIN 46R and seeks to confirm that the staff agrees with this view.

Committee Recommended Approach: Acquisitions that occur as a result of events, rather than transactions, are subject to the reporting requirements under Item 2.01 of Form 8-K and Rule 3-05 and Article 11 of Regulation S-X.

SEC Staff Response:

The staff believes the answer to Question 1 is yes. In Item 2.01 of Form 8-K the term *acquisition* includes every purchase, acquisition by lease, exchange, merger, consolidation, succession or other acquisition. In this fact pattern, obtaining control meets the definition of *acquisition*.

Question 2: A contract may state a date on which rights held by others that preclude consolidation will lapse. That date could be many years in the future. At what point should the business combination that will result from the lapse of those rights be considered probable for purposes of applying Rule 3-05 and Article 11 of Regulation S-X?

Discussion: Although expiration of the rights precluding consolidation may be probable, other conditions that would be necessary to result in a business combination at that time may be unknown, e.g., whether the registrant will still own the interests in the target that would give it control at that time. Also, providing acquired business financial statements

and pro forma information for an acquisition that is likely to occur at some date in the distant future may not be relevant to investors. Section 506.02.c.ii of the Codified Financial Reporting Releases provides guidance on this question and focuses on relevance. It states:

Guidance as to when consummation of a transaction is probable cannot be given because such a determination is dependent upon the facts and circumstances. In essence, however, consummation of a transaction is considered to be probable whenever the registrants' financial statements alone would not provide investors with adequate financial information with which to make an investment decision.

Committee Recommended Approach: The determination of whether an acquisition that will occur as a result of an event, rather than a transaction, is probable should be made based on the facts and circumstances and the relevance of the target's financial statements.

SEC Staff Response:

The determination as to whether an *acquisition*, as defined in Item 2.01 of Form 8-K, is probable should be made based on the facts and circumstances and the guidance included in Section 506.02.c.ii of the Codified Financial Reporting Release.

6. **Presenting R&D and Transaction Expenses in Pro Forma Income Statements After Adoption of FASB Statement 141R**

Issue: After a registrant adopts FASB Statement 141R, *Business Combinations*, it will capitalize acquired in-process research and development (IPR&D) and charge transaction costs to expense. This discussion document addresses the preparation of pro forma income statements after adoption of Statement 141R.

Background: After a registrant adopts FASB Statement 141R, it will no longer charge research and development assets acquired in a business combination to expense. Instead, it will record them at the acquisition date at fair value as an indefinite-lived intangible asset, as discussed in paragraph E11:

Tangible and intangible assets acquired in a business combination that are used in research and development activities are recognized and measured at fair value in accordance with FASB Statement No. 141 (revised 2007), *Business Combinations*, regardless of whether they have an alternative future use. After initial recognition, tangible assets acquired in a business combination that are used in research and development activities are accounted for in accordance with their nature. After initial recognition, intangible assets acquired in a business combination that are used in research and development activities are accounted for in accordance with FASB Statement No. 142, *Goodwill and Other Intangible Assets*, as amended.

The subsequent accounting will be as prescribed in paragraph E27:

Intangible assets acquired in a business combination that are used in research and development activities (regardless of whether they have an alternative future use) shall be considered *indefinite lived* until the completion or abandonment of the associated research and development efforts. During the period those assets are considered indefinite lived they shall not be amortized but shall be tested for impairment in accordance with paragraph 17. Once the research and development efforts are completed or abandoned, the entity shall determine the useful life of the assets based on the guidance in this Statement. Consistent with the guidance in paragraph 28 of Statement 144, intangible assets acquired in a business combination that have been temporarily idled shall not be accounted for as if abandoned.

The accounting for transaction costs is prescribed in paragraph 59:

Acquisition-related costs are costs the acquirer incurs to effect a business combination. Those costs include finder's fees; advisory, legal, accounting, valuation, and other professional or consulting fees; general administrative costs, including the costs of maintaining an internal acquisitions department; and costs of registering and issuing debt and equity securities. The acquirer shall account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities shall be recognized in accordance with other applicable GAAP.

Rule 11-02(b)(5) of Regulation S-X states that pro forma income statements should exclude the effects of nonrecurring charges or credits that are directly attributable to the transaction:

The pro forma condensed income statement shall disclose income (loss) from continuing operations before nonrecurring charges or credits directly attributable to the transaction. Material nonrecurring charges or credits and related tax effects which result directly from the transaction and which will be included in the income of the registrant within the 12 months succeeding the transaction shall be disclosed separately. It should be clearly indicated that such charges or credits were not considered in the pro forma condensed income statement.

At the April 2005 meeting, the SEC staff and the Committee discussed similar issues (see Discussion Document A). We discussed the treatment in pro forma income statements of (1) acquired IPR&D charges incurred by the acquirer and (2) incremental costs directly related to the acquisition that were incurred by the target and reflected as an expense in its historical financial statements. The SEC staff's views were as follows:

- Regarding IPR&D charges, the SEC staff commented that it would not object to a pro forma adjustment to remove such write-off from the Article 11 pro forma financial statements. (We understand that this was based on the view that the write-off is a non-recurring charge that results directly from the transaction.)
- Regarding transaction costs expensed by the target, the SEC staff commented that it would likely not object to a pro forma adjustment to remove such costs from the Article 11 pro forma financial statements. (The minutes do not state whether this was to avoid potential double counting of expenses, because the expenses are directly attributable to the acquisition and not the target's ongoing operations, or both.)

Question 1: After a registrant adopts Statement 141R, what adjustments should it make to a target's historical research and development expenses when it prepares pro forma income statements?

Discussion: Preacquisition R&D expenses incurred by the target might fall into three categories:

1. Projects to which no value was assigned by the acquirer
2. Projects to which value was assigned by the acquirer, but the amount assigned was less than the amount of the R&D expense incurred by the seller during the period(s) covered by the pro forma income statements (note that the periods for which preacquisition seller amounts are included vary depending on the point in the target's fiscal year in which the acquisition is made and whether the pro forma income statements cover a current acquisition or one that was made less recently, e.g., in the preceding fiscal year)
3. Projects to which the value assigned by the acquirer exceeded the amount of the R&D expense incurred by the seller during the period(s) covered by the pro forma income statements

It should be noted that the FASB did not change the accounting for R&D costs incurred outside of a business combination. Therefore, if an incomplete project is acquired, the

acquirer will reflect ongoing expenses related to completing that project in its postacquisition financial statements.

In addition, when pro forma income statements are being prepared sometime after the acquisition (e.g., the acquisition occurred in early 2009 and a pro forma income statement for the interim 2009 period or the year ended December 31, 2009 is to be included in a registration statement being filed later in 2009 or in 2010), it is possible that the R&D project may have been completed or abandoned. Thus, there might be situations where expenses related to the asset acquired in the business combination have been reflected in the acquirer's postacquisition financial statements, perhaps for the same fiscal period.

View A: No adjustments should be made to the amounts of R&D expense historically incurred by the target. As with other internally generated intangible assets that might be recognized in a purchase acquisition, it is not appropriate to eliminate any related historical costs incurred by the target because they (1) are not directly related to the acquisition, and (2) do not have a continuing impact.

View B: Adjustments should be made to eliminate R&D expense historically incurred by the target to the extent that the value assigned by the acquirer exceeds the amount of R&D expense incurred by the target for that project. This eliminates expenses from the pro forma income statements related to assets ultimately recognized at the acquisition date.

Committee Recommendation: The Committee supports View A.

SEC Staff Response:

The staff agrees with View A.

Question 2: After a registrant adopts Statement 141R, what adjustments should it make with respect to transaction expenses when it prepares pro forma income statements?

Committee Recommended Approach: Transaction expenses incurred by the acquirer and the target are nonrecurring charges or credits that are directly attributable to the transaction and that do not have a continuing impact. For this purpose, transaction costs must be both direct and incremental. Corporate overhead and the cost of a business development or M&A department are not considered incremental. Accordingly, adjustments should be made to exclude only nonrecurring direct and incremental costs from pro forma income from continuing operations to comply with Rule 11-02(b)(5) of Regulation S-X.

SEC Staff Response:

When preparing pro forma financial information under Article 11 of Regulation S-X for an acquisition accounted for under FAS 141R, the SEC staff observed that transaction costs might fall into three categories:

1. Direct, incremental costs of the specific acquisition which are not yet reflected in the historical financial statements of either the target or acquirer—for which no adjustment should be reflected in the pro forma income statement, but for which the pro forma balance sheet should reflect an adjustment (as the costs are non-recurring and directly related to the transaction)
2. Direct, incremental costs of the specific acquisition which are reflected in the historical financial statements of either the target or acquirer—for which an adjustment should remove those costs from the pro forma income statement (as a non-recurring charge directly related to the transaction)
3. Direct, incremental costs related to one or more other acquisitions that are reflected in the historical financial statements of either the target or acquirer—for which an adjustment should remove those costs from the pro

forma income statement only if pro forma effect is given to the other acquisition as well

The staff agreed that corporate overhead and the cost of a business development or M&A department are not considered incremental, and therefore, no adjustment should be made to the pro forma income statement to include them if they are not reflected in the historical financial statements or to exclude them if they are reflected in the historical financial statements.

7. **Information Required in Registration Statements When There Are Retrospective Adjustments to Provisional Amounts after Adoption of FASB Statement 141R**

Issue: After a registrant adopts FASB Statement 141R, *Business Combinations*, it will be required to retrospectively adjust the provisional amounts reflected in its financial statements as it completes its accounting for a business combination. This discussion document addresses the implications for registration statement filings when material amounts of such adjustments (1) are known but not reflected in any financial statements, or (2) have been recorded in the most recent interim financial statements but the acquisition occurred in the preceding fiscal year and the adjustments are not reflected in the annual financial statements to be presented or incorporated by reference in the registration statement.

Background: After a registrant adopts FASB Statement 141R, it will be required to retrospectively adjust the provisional amounts reflected in its financial statements as it completes its accounting for a business combination, as discussed in paragraph 51:

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognized at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts recognized as of that date. During the measurement period, the acquirer also shall recognize additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date that, if known, would have resulted in the recognition of those assets and liabilities as of that date.

The SEC staff and the Committee have discussed similar issues a number of times. Perhaps the discussions that are most relevant to this issue are the discussions of subsequently discontinued operations (see Discussion Document E from the March 2002 meeting) and financial information requirements in registration statements when there are retrospective accounting changes (see Discussion Document F from the June 2006 meeting).

Question 1: After a registrant adopts Statement 141R, if it determines that it must make a material retrospective adjustment to provisional amounts it previously reflected in its financial statements and this adjustment has not yet been reflected in any historical financial statements, what financial information regarding the effects of these adjustments on previously issued financial statements should be included or incorporated by reference in a registration statement?

Discussion: Paragraph 51 of Statement 141R does not contain provisions such as those in paragraph 43 of Statement 144, which precludes presenting a component as a discontinued operation when it is disposed of or classified as held for sale after the balance sheet date but before the financial statements are issued. Such adjustments are also not an accounting change for which the FASB has specified an effective date.

View A: Disclosure of the impending change is sufficient. This situation is analogous to an accounting change. When a registrant decides to make an accounting change and it

has not yet been reflected in any financial statements, disclosure that is consistent with SAB 74 is sufficient.

View B: Pro forma information depicting the accounting change is sufficient. Consistent with the treatment of retrospective changes related to discontinued operations (and reportable segments), the historical financial statements should not be revised until a company reports a period that reflects the retrospective adjustment.

View C: The registrant must provide or incorporate by reference revised financial statements reflecting the retrospective adjustment if the adjustment is material. (Although revised financial statements must be provided or incorporated by reference in the registration statement, because they did not contain errors when they were filed, it would be inappropriate to amend previously filed Exchange Act periodic reports (e.g., Forms 10-Q and 10-K).)

Committee Recommendation: The Committee supports View C.

SEC Staff Response:

The staff agrees with View C.

Question 2: After a registrant adopts Statement 141R, if it determines that it must make a material retrospective adjustment to provisional amounts it previously reflected in its financial statements and this adjustment has been reflected in subsequent interim historical financial statements but the acquisition occurred in the preceding fiscal year and the adjustments are not reflected in the annual financial statements, what financial information regarding the effects of these adjustments on previously issued financial statements should be included in a registration statement? Would the conclusion be different if the previously issued annual financial statements are incorporated by reference, rather than included?

Committee Recommended Approach: The Committee believes that a registrant in this situation should provide revised audited financial statements for the year of acquisition reflecting the adjustments. Note that the conclusion would not be different if the previously issued financial statements are incorporated by reference, rather than included. (Although revised financial statements must be provided or incorporated by reference in the registration statement, because they did not contain errors when they were filed, it would be inappropriate to amend previously filed Exchange Act periodic reports (e.g., Forms 10-Q and 10-K).)

SEC Staff Response:

The staff agrees with the Committee Recommended Approach.

