

SEC Regulations Committee
April 17, 2007 - Joint Meeting with SEC Staff
SEC Offices – Washington DC

Discussion Document D

Topic: Financial Statement Requirements in an IPO When a Merger of Entities Under Common Control Occurs at the Closing Date

Issue/Question: In an IPO involving a merger of entities under common control that will occur after effectiveness but no later than the closing of the IPO (or the date a similar transaction, such as a spin-off, is effected), is it acceptable to provide combined financial statements of the entities under common control in lieu of separate historical financial statements of the entities to be combined and pro forma financial statements?

Background: In speech at the December 2006 AICPA National Conference on Current SEC and PCAOB Developments, a staff member addressed accounting and reporting issues for an IPO that occurs in connection with a merger of entities under common control. The speech addressed the form and content of the financial statements required in the registration statement when a merger of such entities occurs (a) by the time of effectiveness of the IPO and (b) after effectiveness. The speech noted that it is appropriate to reflect the merger in the historical financial statements only if such a merger occurs by the time of effectiveness. If such a merger occurs after effectiveness (e.g., the merger occurs at the time of and as a condition to the closing of the IPO), the speech states that the separate historical financial statements of the entities to be combined should be presented, and the merger should be reflected only in pro forma financial statements.

The Committee's understanding is that in the past, when a merger of entities under common control was to occur at the time of closing of the IPO, in lieu of separate historical financial statements of the entities to be combined and pro forma financial statements, the staff has permitted registrants to present combined financial statements of the entities under common control. The Committee is aware of IPO registration statements where this was done.

We presume that this practice has been accepted in the past because, consistent with the guidance in paragraph 22 of ARB 51, it has been viewed as providing more useful information to investors. Combined financial statements could be viewed as more useful because:

- They are audited, whereas combined pro forma information is unaudited;
- They provide multiple combined balance sheets, rather than a combined pro forma balance sheet as of only the most recent date for which an historical balance sheet is included in the filing;
- They provide combined cash flows information, whereas pro forma financial statements do not report cash flows information; and
- They provide complete combined footnote disclosures.

In addition, using combined financial statements as the denominator for purposes of significance calculations pursuant to rules such as Rule 3-05 and Rule 3-09 is likely to better serve investors, because this approach is less likely to trigger the need for unnecessary information that should be filtered out of registration statements.

This issue also arises in initial registrations that do not involve a capital raising transaction, e.g., a spin-off where entities are contributed to the spinnee after the effective date of a Form 10 but before the time of the spin-off.

Committee Recommendation: If the controlling shareholder has complete discretion as to when and if the merger will take place and the merger will occur by the time of the closing, we believe the information needs of IPO investors (or investors that will receive shares of a spin-

off company) are the same, regardless of whether the merger occurs before effectiveness or at closing. Accordingly, we believe it is appropriate for a registrant to provide the same financial statements. (Of course, if the merger occurs after effectiveness, the financial statements would have to reflect the appropriate technical changes, i.e., be labelled "combined," rather than "consolidated," and report combined, rather than consolidated, equity accounts.)

Staff Response: The staff encourages registrants with this fact pattern to consult with the staff regarding the primary financial statement requirements in their particular facts and circumstances. The SEC staff also indicated that they would consider requests for relief to use combined financial amounts as the denominator for purposes of significance calculations in determining other financial statement requirements for the filing (e.g., Rules 3-05 and 3-09 of Regulation S-X).

