

SEC Regulations Committee
October 11, 2007 - Joint Meeting with SEC Staff
SEC Offices – Washington DC

Discussion Document A

Topic: Assessing the Age of Financial Statement Requirements Relating to an Acquired/To Be Acquired Business When the Registrant and the Acquiree Have Different Fiscal Year-Ends

Issue: How should a registrant determine its eligibility under Rule 3-01(c) of Regulation S-X for purposes of evaluating financial statement updating requirements relating to a significant acquired/to be acquired business with a fiscal year-end that differs from the registrant's fiscal year-end?

Background: The historical financial statements of a significant acquired/to be acquired business included in a new or amended registration statement do not need to include audited financial statements for the acquiree's most recently completed fiscal year if the registration statement is filed (or becomes effective) on or before the 45th day after the acquiree's fiscal year-end. The SEC Staff Training Manual also indicates (at page 2-20) that the registration statement does not need to include the acquiree's audited financial statements for its most recently completed fiscal year if the registration statement is filed (or becomes effective) after 45 days but within 90 days of the acquiree's fiscal year end and the registrant meets the eligibility requirements under Rule 3-01(c) of Regulation S-X.

Note: The reference to 90 days above assumes the acquiree is either a private company or a non-accelerated filer. If the acquiree is an accelerated filer or a large accelerated filer, the reference would be changed to 75 days or 60 days, respectively.

The eligibility criteria set forth in Rule 3-01(c) are as follows:

1. The registrant files annual, quarterly and other reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 and all reports due have been filed;
2. For the most recent fiscal year for which audited financial statements are not yet available the registrant reasonably and in good faith expects to report income, after taxes but before extraordinary items and cumulative effect of a change in accounting principle; and
3. For at least one of the two fiscal years immediately preceding the most recent fiscal year the registrant reported income, after taxes but before extraordinary items and cumulative effect of a change in accounting principle.

Consider the following example:

Company X is a calendar year-end SEC registrant and has filed all reports due pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Company X purchased Business B (a private company with a March 31 fiscal year-end) on April 15, 2007 in an all-cash transaction. Company X has determined that Business B is significant at the 80% level.

Company X intends to file a new registration statement on Form S-3 on May 21, 2007. Business B's audited financial statements for the year-ended March 31, 2007 will not be available at the date the Form S-3 is intended to be filed.

Question: How should Company X evaluate criteria #2 and #3 of Rule 3-01(c) for purposes of determining whether the Form S-3 must include/incorporate by reference audited financial statements of Business B for its fiscal year-ended March 31, 2007?

View A: Company X's eligibility under Rule 3-01(c) should be measured by reference to its most recently completed fiscal year (without regard to whether the audited financial statements for that year have been issued) and the two preceding fiscal years. Since Company X's most recently completed fiscal year-end is the year ended December 31, 2006, Company X should use its actual income after taxes but before extraordinary items and cumulative effect of a change in accounting principle for the year ended December 31, 2006 for purposes of evaluating criterion #2. Company X should use its actual income after taxes but before extraordinary items and cumulative effect of a change in accounting principle for the years ended December 31, 2005 and 2004 for purposes of evaluating criterion #3.

View B: Company X's eligibility under Rule 3-01(c) should be based on the financial statements for the next fiscal year for which financial statements will be issued (as well as the two preceding fiscal years). Since the year-ending December 31, 2007 is the next fiscal year for which financial statements have not yet been issued, Company X should use its best estimate of its projected income after taxes but before extraordinary items and cumulative effect of a change in accounting principle for the year ending December 31, 2007 for purposes of evaluating criterion #2. Company X should use its actual income after taxes but before extraordinary items and cumulative effect of a change in accounting principle for the years ended December 31, 2006 and 2005 for purposes of evaluating criterion #3.

View C: Since Company X has filed its audited financial statements for its most recently completed fiscal year, the tests for criteria #2 and #3 should be made by reference to Business B's financial information. Business B should use its expected income after taxes but before extraordinary items and cumulative effect of a change in accounting principle for the year ended March 31, 2007 for purposes of evaluating criterion #2. Business B should use its actual income after taxes but before extraordinary items and cumulative effect of a change in accounting principle for the years ended March 31, 2006 and 2005 for purposes of evaluating criterion #3.

View D: Since Company X has filed its financial statements for the most recent fiscal year, the tests in Rule 3-01(c) are no longer applicable and therefore Business B's financial statements must always be updated to include audited financial statements for its year ended March 31, 2007. As indicated in the SEC Staff Training Manual, if the registrant believes the requirement to provide audited financial statements more current than the audited financial statements of the registrant, registrants could seek relief from the audit requirement since this method of evaluation would require audited financial statements of the target that are more recent than the audited financial statements of the registrant.

Committee Recommendation: The Committee supports View A. The Committee believes the most recently completed fiscal year of the registrant should be the starting point of the analysis without regard to whether those financial statements have been issued. The Committee believes this model would avoid the need for the registrant to project its income for a significant amount of time.

SEC Staff Response: The staff supports View A.