REITS

SEC Financial Statement Requirements: A Primer for Publicly-Traded REITs

By Michael H. Friedman

This primer introduces key financial statement reporting obligations under Securities and Exchange Commission (SEC) rules applicable to acquisitions and dispositions undertaken by publicly-traded real estate investment trusts (REITs). These rules are contained primarily in Regulation S-X (Form and Content of and Requirement for Financial Statements) as well as in registration statements filed under the Securities Act of 1933, as amended (the 1933 Act) and reports filed under the Securities Exchange Act of 1934, as amended (the 1934 Act).[1]

SEC rules seek to assure the full, fair and timely disclosure of information material to investment decisions in securities of a company subject to SEC reporting obligations (commonly referred to as a public company and referred to in this primer as a registrant). A registrant's acquisition or disposition of a business may be material to the registrant's future operations, from both quantitative and qualitative perspectives.

Accordingly, if a registrant enters into an agreement to make an acquisition or disposition that is material to the registrant, then the registrant must make appropriate disclosures.[2] Generally, if the acquisition or disposition qualifies as "significant" under SEC rules, then the closing of the acquisition or disposition will be a separate disclosure trigger, which may require the filing by the registrant of historical financial statements of the subject business and pro forma financial information. The rules that govern the timing and scope of required financial statements and pro forma financial information are context-specific and depend on, for example, whether the registrant intends to file a registration statement or to offer securities prior to, or shortly after, the closing of the acquisition or disposition.

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Whenever a registrant acquires a business that meets quantitative significance thresholds, the registrant must file historical financial statements of the acquired business and pro forma financial information (based on historical financial statements of the registrant and subject business) that gives effect to the acquisition as if the acquisition had occurred, generally, as of the start of the registrant's most recently completed fiscal year.[3] Similarly, whenever a registrant disposes of a business (or a portion of a business) that meets significant thresholds, the registrant must file pro forma financial information that gives effect to the disposition, although separate historical financial statements of the disposed business would not be required.[4]

Is the Subject of an Acquisition or Disposition a Business?

A threshold question for any acquisition or disposition is whether the subject of the acquisition or disposition is a *business* or involves assets that do not constitute a business. In contrast to the acquisition or disposition of a significant business, the acquisition or disposition of a significant amount of assets that do not constitute a business (or a significant portion of a business) will not trigger obligations to file financial statements or pro forma financial information, although, as noted below, an acquisition or disposition of a significant amount of assets will need to be reported on a Form 8-K.[5]

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To determine whether the subject of an acquisition or disposition constitutes a business, rather than (mere) assets, registrants must look to Rule 11-01(d) of Regulation S-X. Rule 11-01(d) calls for a facts-and-circumstances focus on the acquired or disposed "operations" and an evaluation of whether there is a sufficient continuity of the operations prior to and after the transactions "so that disclosure of prior financial information is material to an understanding of future operations."

A presumption exists that a separate entity, a subsidiary, or a division is a business. However, a lesser component of an entity may also constitute a business.[6] For example, the acquisition of a large parcel of vacant land would be the acquisition of assets but not a business. If the land were, however, part of the operations of an acquired golf course or medical office building, then the acquired operations would be a business. Similarly, an acquisition of land on which an office building, warehouse or apartment complex is situated would be the acquisition of a business comprised of real estate operations. As discussed below, "real estate operations" are a subcategory of, or special form of, a business.

Generally, if the subject of the acquisition or disposition does not constitute a business (or a significant portion of a business) but involves a significant amount of assets, then, unless the acquisition or disposition falls within an "ordinary course of business" exception, the registrant must report the acquisition or disposition under Item 2.01 of Form 8-K within four business days of the closing of the acquisition or disposition.[7] However, in cases that do not involve a business, there would be no historical financial statements required to be filed for the assets acquired or disposed. In May 2020, the SEC revised its rules to clarify, consistent with historical practice, that the "ordinary course of business" exception does not apply to the acquisition or disposition of a significant amount of assets that constitute a real estate operation. Therefore, consistent with historical practice, purchases and dispositions of real estate facilities that constitute a real estate operation by a REIT, even if part of an established pattern or regular course of activity, will, if the significance test in Item 2.01 is met, trigger a reporting obligation under Item 2.01 of Form 8-K.[8]

In contrast to the acquisition or disposition of a significant amount of assets that do not constitute a business, the acquisition of a significant business will require the registrant to file historical financial statements of the acquired business and pro forma financial information that gives effect to the acquisition; and a disposition of a significant business (or a significant portion of a business) will require the registrant to file pro forma financial information.

Real Estate Operations As Subset of Business

Real estate operations are a subcategory, or special form of, a business and, therefore, acquisitions and dispositions of real estate operations generally are subject to the same financial reporting obligations applicable to acquisitions and dispositions of a business. However, in the case of *acquisitions* of real estate operations, the required financial statements are governed by Rule 3-14 of Regulation S-X, rather than by Rule 3-05, which generally applies to acquisitions of businesses. Rule 3-14 financial statements are abbreviated because they exclude historical items that are not comparable to future operations of the acquired real estate operation such as mortgage interest, depreciation, and corporate expense.[9]

The SEC uses the term "real estate operation" to mean a business that generates substantially all of its revenues through the leasing of real property.[10] Sometimes, an acquired business consists substantially of real estate operations but also includes operations that constitute a business but do not qualify as real estate operations.

Consider, for example, an acquisition of a portfolio of properties, comprised largely of multifamily properties (that is, real estate operations) and a relatively small hotel (a business that does not qualify as real estate operations). In addition to quantitative factors bearing on the relative significance of the non-qualifying operations, qualitative factors may be

relevant, such as whether the non-qualifying operations will, upon their acquisition, be classified on the purchaser's balance sheet as held for sale. In these situations, the Staff of the Commission should be consulted.[11]

The Multiple Roles of "Significant" and "Significant Subsidiary"

Once a determination has been made that the subject of an acquisition or disposition involves a business and a further determination has been made that the business constitutes real estate operations, then the next question is whether the business qualifies as a "significant subsidiary."

Several SEC rules (for example, Rule 1-02(w) of Regulation S-X, Rule 405 under the 1933 Act and Rule 12b-2 under the 1934 Act) define (consistently) the terms "significant" or "significant subsidiary" and the term "significant subsidiary" are used in various SEC rules and forms, including Form S-3, Form S-4, Schedule 14A, Forms 10-K and 10-Q, and Items 101, 103 and 601 of Regulation S-K. For purposes of financial statement requirements, the starting point is the definition of "significant subsidiary" in Rule 1-02(w) of Regulation S-X, which sets forth three tests for determining significance: (1) an investment test, (2) an asset test, and (3) an income test. In the case of *acquisitions* of real estate operations, only the investment test applies.[12]

For purposes of several SEC rules and forms, each of the three significance tests is keyed to a 10 percent numerical threshold. In other words, if a subsidiary is significant at the 10 percent level under any of the three tests, then the subsidiary is a "significant subsidiary." However, in the context of a significance determination for acquisitions or dispositions of a business, 20 percent is substituted for 10 percent. Moreover, if significance exceeds 50 percent, then additional considerations come into play.[13] In addition, aggregation of individually insignificant acquisitions may be required for purposes of the percentage thresholds; and acquisitions that are probable but have not yet occurred may, in some situations, trigger the need to file financial statements prior to closing of the acquisition(s). These situations are addressed below.

The acquisition of a business (as distinct from the entry into an agreement to acquire a business) triggers financial statements if the subject business meets specified *significance thresholds*. Probable acquisitions of a business, including businesses subject to purchase agreements, may also trigger financial statements. The timing requirements for the financial statements depend on (1) the significance to the purchaser of the subject business, (2) whether the acquisition (viewed individually or in aggregate with other recent acquisitions) has closed or is probable, and (3) whether the purchaser is filing a registration statement, a transactional proxy statement or a prospectus supplement under an effective shelf registration statement prior to the general deadline for the filing of the financial statements for acquisitions.[14]

In the case of acquisitions (but not in the case of dispositions) of real estate operations, significance is determined solely under the investment test. The investment test computes significance based on the ratio of the registrant's and its other subsidiaries' investments in, and advances to, the tested subsidiary to the aggregate worldwide market value of the registrant's voting and non-voting common equity.[15]

However, if the registrant has no such worldwide market value (that is, because the equity is not publicly-traded) then the denominator in the investment test would be the total assets of the registrant and its subsidiaries consolidated as of the fiscal year-end. Note that, in the case of a REIT that is structured as an umbrella partnership REIT (UPREIT) that owns its assets and conducts its operations solely through a subsidiary partnership that is itself a registrant but without worldwide market value (that is, because the units of the subsidiary partnership are not publicly-traded), use of total assets in the denominator of the investment test may be required absent relief from the Staff of the SEC.

Note that, under Rule 3-14(b)(2)(ii), when the investment test is based on total assets, rather than the aggregate worldwide market value of the

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registrant's equity, any assumed debt secured by the subject real property must be included in the "investments" in amount. The numerator in the investment test must also include the fair value of any contingent consideration if fair value is required to be recognized by the registrant under GAAP. If fair value is not so required, then *all* of the contingent consideration (other than any portion for which the likelihood of payment is remote) must be included as part of the numerator.[16]

In specified circumstances, pro forma information for recently completed transactions may be used to test significance.[17] Specifically, under Rule 11-01(b)(3) of Regulation S-X, a registrant may measure significance using *filed* pro forma financial information that depicts *only* significant acquisitions and dispositions completed after the latest fiscal year-end if the registrant has filed Rule 3-14 financial statements for each such acquisition and pro forma financial information required by Article 11 for each such acquisition and/or disposition, with the caveat that the pro forma financial information may include only "Transaction Accounting Adjustments" (that is, adjustments required by GAAP or, if applicable, the standards specified by the International Accounting Standards Board) and may not include adjustments for synergies, dis-synergies or other so-called Management's Adjustments.

Timing Triggers

No financial statements are required if significance does not exceed 20 percent. Closing of an acquisition above the 20 percent significance level triggers an obligation to report the acquisition within four business days under Item 2.01 of Form 8-K and to amend the Form 8-K within approximately 75 days of the closing date to include the required financial statements and related pro forma information.[18]

Notwithstanding the general time period within which to file the required financial statements, the financial statements must have been filed before the registrant may file a registration statement or transactional proxy statement if the acquisition has closed or is probable and significance is at or above the 50 percent level. Aggregation requirements for individually insignificant completed acquisitions will also trigger financial statements in advance of the general deadline if significance is at the 50 percent level and the registrant files a registration statements or transactional proxy statement. In addition, an offering of securities under an effective shelf registration statement will require the filing of financial statements in advance of the general deadline if significance is at or above the 50 percent level.[19]

If the aggregate impact of completed and probable real estate acquisitions since the date of the most recent audited balance sheet exceeds 50 percent but financial statements are not yet required (that is, either because the acquisitions, individually, do not reach the 20 percent significance level or because the 75 day filing deadline has not yet arrived), then (per Rule 3-14(b)(2)(i)(C)) pro forma financial information will be required in a registration statement and such pro forma information must depict the aggregate impact of all of the completed and probable acquisitions in all material respects and, in addition, historical financial statements for each completed or probable acquisition that is significant at the 20 percent level must also be provided.

Thus, aggregation testing is important for purposes of both completed and probable acquisitions—whether or not they are individually insignificant—for purposes of the 50 percent threshold. If the 50 percent level is met, then, although pro forma information must reflect all such completed and probable acquisitions, historical financial statements would be limited to only those acquisitions that are significant at or above the 20 percent threshold.[20]

Specific Financial Statements for Business Acquisitions

As discussed above, the specific timing and filing triggers for financial statements and pro forma financial information are a function of several circumstances, notably: (1) circumstances when significance

exceeds 50 percent; (2) circumstances when *aggregation* of multiple unrelated acquisitions brings significance above applicable percentage thresholds; (3) circumstances when the registrant is filing a new registration statement or transactional proxy statement; (4) circumstances when the registrant is offering securities under an already effective shelf registration statement; and (5) circumstances when one or more of the acquisitions or dispositions have been completed and/or are probable.[21]

Financial statements and pro forma financial information for an acquired business may need to be updated based on staleness considerations applicable to registration statements, transactional proxy statements, and offerings under effective registration statements. Other factors, such as refinements to purchase price allocations and changes in financial statements subsequent to the initial filing of the financial statements, may require updating of the financial statements and pro forma financial information originally filed.

For example, if target financial statements and pro forma information through the second fiscal quarter are included in a registration statement and the transaction closes in the fourth quarter, then the financial statements and pro forma financial information that are required to be filed after the transaction closes (whether pursuant to Item 2.01 of Form 8-K or for purposes of registration statements, transactional proxy statements and offerings under effective shelf registration statements) will need to be updated.[22] Apart from the passage of time, other changes may also require pro forma information to be updated such as changes to the number of outstanding shares of stock of the registrant.

Generally, financial statements for acquired real estate operations cease to be required to be included in registration statements and transactional proxy statements after the operations have been reflected in filed post-acquisition financial statements of the purchaser for a complete fiscal year. As a practical matter, the cessation will obviate the need for consents of accountants that audited the applicable financial statements in future registration statements.[23]

Additional Considerations

Even if the financial statements of a completed or probable acquisition are not required at the time of an offering of securities by the registrant, the registrant and its counsel and the underwriters and their counsel might determine to file the financial statements prior to the offering because they view the financial statements and related pro forma information as material or important to an effective offering. The handling of this issue, including as to accountant consents and comfort letters, should be addressed at the outset of offering preparations.[24]

Dispositions

As discussed above, the disposition of a significant business triggers an obligation to report the disposition within four business days under Item 2.01 of Form 8-K. For dispositions, in contrast to acquisitions, the required financial information, consisting solely of pro forma financial information to reflect the disposition, must be included in the Form 8-K filed by the four-business-day due date (that is, the 75-day window available for financial information for significant acquisitions does not apply). Also, in contrast to significance testing for acquisitions, significance testing for dispositions is measured under each of the investment, income and assets tests.

Pro Forma Financial Information

Article 11 of Regulation S-X governs the specific pro forma financial information that must be provided. Specifically, Rule 11-01(a) and Rule 11-01(b) set forth triggering conditions and related significance thresholds for pro forma information. Rule 11-02 governs the form and content of financial information. In particular, Rule 11-02(a)(6) mandates "Transaction Accounting Adjustments" and, if applicable, "Autonomous Entity Adjustments." Rule 1102(a)(7) permits "Management's Adjustments" that depict synergies and dis-synergies, subject to specified limitations keyed to reliability of the

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adjustments and a fair presentation.[25] As noted earlier, only Transaction Accounting Adjustments are permitted under Rule 11-01(b)(3) when pro forma amounts are used for significance determinations.

Internal Control over Financial Reporting

When a registrant is planning for a business acquisition, it must be mindful of its obligations to maintain effective internal control over financial reporting. The Staff of the SEC has recognized that acquisitions completed towards the end of a fiscal year can present challenges for registrants. In its Frequently Asked Questions (FAQs) on "Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports," the Staff has stated:

> [W]e would typically expect management's report on internal control over financial reporting to include controls at all consolidated entities. However, we acknowledge that it might not always be possible to conduct an assessment of an acquired business's internal control over financial reporting in the period between the consummation date and the date of management's assessment. In such instances, we would not object to management referring in the report to a discussion in the registrant's Form 10-K or 10-KSB regarding the scope of the assessment and to such disclosure noting that management excluded the acquired business from management's report on internal control over financial reporting. If such a reference is made, however, management must identify the acquired business excluded and indicate the significance of the acquired business to the registrant's consolidated financial statements. Notwithstanding management's exclusion of an acquired business's internal controls from its annual assessment, a registrant must disclose any material change to its internal control over financial reporting due to the acquisition pursuant to Exchange Act Rule 13a-15(d) or 15d15(d), whichever applies (also refer to the last two sentences in the answer to question 7). In addition, the period in which management may omit an assessment of an acquired business's internal control over financial reporting from its assessment of the registrant's internal control may not extend beyond one year from the date of acquisition, nor may such assessment be omitted from more than one annual management report on internal control over financial reporting.[26]

The subject of internal control over financial reporting also arises in REIT participations in joint ventures, including joint ventures accounted for under the equity method. Here again, in the FAQs, the Staff has provided guidance:

> The accounts of an equity method investee are not consolidated on a line-by-line basis in the financial statements of the investor, and as such, controls over the recording of transactions into the investee's accounts are not part of the registrant's internal control structure. However, the registrant must have controls over the recording of amounts related to its investment that are recorded in the consolidated financial statements. Accordingly, a registrant would have to consider, among other things, the controls over: the selection of accounting methods for its investments, the recognition of equity method earnings and losses, its investment account balance, etc. For example, a registrant might require that, at least annually, its equity method investees provide audited financial statements as a control over the recognition of equity method earnings and losses. However, nothing precludes a registrant from evaluating the control over financial reporting of an equity method investment, and there may be

circumstances where it is not only appropriate but also may be the most effective form of evaluation. For purposes of applying this guidance, we make no distinction between those equity method investments for which the registrant is required to file audited financial statements pursuant to Rule 3-09 of Regulation S-X and those where no such requirement is triggered.[27]

Form 10-K and Listing of Significant Subsidiaries

Item 601 of Regulation S-K specifies the exhibits that must be attached to (or incorporated by reference into) the annual report on Form 10-K. One of the exhibits is a list of subsidiaries, with the notable caveat that particular subsidiaries may be omitted if the omitted subsidiaries, taken in the aggregate as a single subsidiary, would not constitute a "significant subsidiary" as of the end of the fiscal year under Rule 1-02(w) of Regulation S-X. In this context, significance is linked to 10 percent not 20 percent. In addition, unlike for testing of significance for acquisitions of real estate operations, where only the investment test is used, significance for the exhibit listed is based on each of the investment, income and asset tests.

Moreover, Rule 1-02(w)(1)(i)(C), rather than Rules 1-02(w)(1)(i)(A) and 1-02(w)(1)(i)(B), applies to the investment test outside of the acquisition and disposition context, and specifies that, outside of the acquisition and disposition context, significance under the investment test is computed as the ratio of investments in, and advances to, the tested subsidiary to the total assets of the registrant and its subsidiaries consolidated as of the fiscal year-end. Therefore, in this context, aggregate worldwide market value of the registrant's equity plays no role.

Joint Ventures

Joint ventures take many forms but generally involve a collaboration, through a tax-efficient structure, between two or three partners/members to carry-out a specific project or series of projects. In the context of REITs, joint ventures would commonly be formed to develop or acquire, and own, operate, and eventually sell, real estate operations. A threshold question for the registrant is whether it must consolidate the joint venture or, alternatively, account for its interest in the venture through the equity method, or otherwise. GAAP provides the analytic framework for the consolidation analysis.[28]

Even if a joint venture is not consolidated in the registrant's financial statements, then, under Rule 3-09 of Regulation S-X, the registrant will be required to provide separate financial statements for the joint venture if the joint venture meets any of the three significance tests in Rule 1-02. Note too that significant asset concentrations between formally separate entities may need to be aggregated, with the result that audited combined statements of the multiple entities would be required.[29]

Conclusion

As should be clear, the regulation of financial statements and pro forma financial information in connection with acquisitions (including acquisitions or formations of joint ventures) and dispositions present complex considerations, and the aim of this primer has been to introduce some of the more salient of such considerations.

Notes

1. Financial statement considerations play a role in many contexts apart from acquisitions and dispositions. For example, many offerings of public debt by REITs involve subsidiary and parent guarantees. Each guaranty is itself a separate security and the issuer of the guaranty (the guarantor) must consider whether its publicly-offered guaranty will qualify for an exemption not only from the registration requirements under the 1933 Act, but also from separate financial statement requirements. See Rule 3-10 of Regulation S-X (Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered).

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2. Additional disclosure considerations arise when stockholders of the registrant are asked to vote to approve a specific acquisition or disposition, and these additional considerations are contained in the SEC's proxy regulations, including those applicable to Registration Statements on Form S4.
3. Per Rule 11-02(c) of Regulation S-X, the required pro forma financial information must include a pro forma condensed balance sheet of the registrant as of the end of the most recent period for which a consolidated balance sheet is required and pro forma condensed statements of comprehensive income for the most recent fiscal year and from the most recent fiscal year-end through the date of any required interim balance sheet. The essential objective of the pro forma information, including required and optional adjustments, is to depict how the transaction might have affected the registrant's historical financial statements had the transaction occurred at an earlier time.
4. If, of course, the disposed business was significant to the buyer, then financial statements for the business would be required for the buyer, if the buyer is also a registrant.
5. In addition to financial statement considerations for acquisitions and dispositions, registrants must be mindful of obligations linked to "material contracts" (as defined in Rule 601 of Regulation S-K), such as contracts that call for the acquisition or disposition of property, plant or equipment for consideration exceeding 15 pecent of the registrant's consolidated *fixed* assets. Also, in many cases, an agreement that provides for acquisitions or dispositions of a significant amount of assets or a significant business will qualify as a "material definitive agreement" and thus trigger a filing obligation under Item 1.01 of Form 8-K.
6. *See* Rule 11-01(d) of Regulation S-X, which also lists eight attributes that should be considered as party of the analysis of a "business."
7. If the contract calling for the acquisition or disposition is a material contract, then, as noted earlier, a report under Item 1.01 of Form 8-K would be required within four business days of entry into the contract. Also, a separate rule applies to the determination of significance in the case of acquisitions and dispositions of assets. Specifically, an acquisition or disposition of assets is deemed to involve a significant amount of assets if "the registrant's and its other subsidiaries' equity in the net book value of the assets, or the amount paid or received for the assets, exceeds 10 percent of the total assets of the registrant and its consolidated subsidiaries." See Instruction 4 to Item 2.01 of Form 8-K.
8. *See* footnote 240 of SEC Release No. 33-10786 (Amendments to Financial Disclosures about Acquired and Disposed Businesses) (hereafter referred to as the 2020 Release): "While Item 2.01 currently only requires that significant acquisitions and dispositions be reported if they are not in the ordinary course of business, in practice registrants provide Item 2.01 disclosure for acquisitions [or dispositions] of significant real estate operations regardless of whether the acquisition or disposition was in the ordinary course of business." Item 2.01 of Form 8-K, as revised in May 2020, now expressly reflects this historical practice.
9. *See* Rule 3-14(a)(2) of Regulation S-X, which makes clear that the acquisition of real estate operations also covers the acquisition of an interest in real estate under the equity method or, as applicable, the fair value option.
10. The Financial Reporting Manual, or FRM, of the Division of Corporation Finance has not yet been updated to reflect the "substantially all" formulation used in Rule 3-14 of Regulation S-X. See 2305.2 of the FRM, which states that "real estate operations" refers to properties that generate revenues *solely* through leasing. However, the Commission did not interpret the (now replaced) "solely" requirement to "preclude a property that includes a limited amount of non-leasing revenues (like property management or other services related to leasing)" from applying Rule 3-14. See discussion in the 2020 Release around note 244.
11. As stated in 2305.2 of the FRM: real estate operations, for purposes of Rule 3-14 financial statements, exclude "properties that generate revenues from operations other than leasing real property, such as nursing homes, hotels, motels, golf courses, auto dealerships, and equipment rental operations, which are more susceptible to variations in costs and revenues over shorter periods due to market and managerial factors." Note too that acquisitions of real estate subject to triple net leases are generally subject to Rule 3-14. However, when

a registrant has multiple real estate operations that have been triple net leased to a single tenant, financial statements of the tenant may be needed based on the overall significance of the tenant's credit to investors of the registrant: "When a registrant has triple net leased one or more real estate properties to a single lessee/tenant (including in the capacity as co-lessee or guarantor), and such properties represent a 'significant' portion of the registrant's assets, an investor may need to consider the lessee's financial statements or other financial information in order to evaluate the risk to the registrant from this asset concentration. An asset concentration is generally considered 'significant' if it exceeds 20 percent of the registrant's assets as of its most recent balance sheet." 2340 of the FRM.

12. As noted earlier, a separate rule applies to determine significance in the context of asset acquisitions and dispositions.
13. In the case of Rule 3-05 financial statements, significance above 40 percent has independent relevance, but there is no such independent relevance in the context of Rule 3-14 financial statements.
14. By "general deadline" for acquisition-related financial statements, I mean the 71st day after the due date for the Form 8-K that reports, under Item 2.01, the closing of the acquisition. As a practical matter, the general deadline is approximately 75 days after the closing of the transaction. See Item 9.01(a)(3) of Form 8-K. The 71-day grace period is inapplicable to pro forma information for significant dispositions.
15. The aggregate worldwide market value of the common equity is computed based on a trailing five-trading day average as of the end of the most recently completed month before the earlier of the public announcement date of the transaction and the date of entry into the acquisition or disposition agreement. See Rule 1-02(w)(1)(i)(A)(3) of Regulation S-X. In and around footnotes 29 and 54 of the 2020 Release, the SEC explains its reasoning for use of a current fair value metric (if available) in the investment test (as represented by equity market value) rather than use of the historical book value of assets.
16. Special computation rules may be applicable for the investment test for a registrant conducting a continuous offering over an extended period of time. See Rule 11-01(b)(4) of Regulation S-X. In addition, blind pool offerings are subject to special consideration. These considerations are discussed in the 2020 Release and at Item 20.D. of Industry Guide 5, Disclosure Guidance: Topic No. 6—Staff Observations Regarding Disclosures of Non-Traded Real Estate Investment Trusts. See too 2325 of the FRM ("Blind Pool"). As noted in the 2020 Release: "The undertakings include use of sticker supplements related to certain significant properties that will be acquired and post-effective amendments." The undertakings in Industry Guide 5 and continuous offerings by non-traded REITs are beyond the scope of this primer.
17. If a registrant uses pro forma information to measure significance, then it must continue to do so until the registrant's next Form 10-K. See Rule 11-01(b)(3)(i)(B)(2) of Regulation S-X.
18. As discussed below, aggregation of separate acquisitions is relevant in the context of registration statements, transactional proxy statements and offerings under an effective shelf registration statement. However, if acquisitions are unrelated to each other, then aggregation of such unrelated acquisitions is not required for purposes of reporting obligations under Item 2.01 of Form 8-K. Instruction 4 to Item 2.01 of Form 8-K states in part: "The aggregate impact of acquired businesses are not required to be reported pursuant to this Item 2.01 unless they are related businesses . . . and are significant in the aggregate."
19. The rules also require disclosure in prospectuses if the aggregate impact of businesses acquired or to be acquired since the date of the most recent audited balance sheet filed for the registrant, for which financial statements are either not required by Rule 3-14(b)(2)(i) or are not yet required based on Rule 3-14(b)(3)(i), exceeds 50 percent for any condition. As stated in the 2020 Release: "In this way, the amendments clarify that 'individually insignificant businesses' include: (a) Any acquisition consummated after the registrant's audited balance sheet date whose significance does not exceed 20 percent; (b) Any probable acquisition whose significance does not exceed 50 percent; and (c) Any consummated acquisition whose significance exceeds 20 percent, but does not exceed 50 percent, for

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which financial statements are not yet required by Rule 3-05(b)(4) [and Rule 3-14(b)(3)] because of the 75-day filing period."

20. Needless to say, apart from "technical" financial statement considerations, the registrant and underwriters will want to address the imperative of assuring that all material information, which may include financial information, has been included, directly or through incorporation by reference, in the offering prospectus. Moreover, if pro forma financial information must be filed without underlying audited financial statements, then comfort letter considerations should be addressed at the outset with both the applicable accounting firm and the underwriters. In the 2020 Release, the Commission recognizes that PCAOB rules applicable to comfort letters restrict accountants from providing negative assurance in comfort letters on pro forma adjustments to historical amounts unless the accountants have, among other things, performed an audit of the subject annual financial statements and, as applicable, a SAS No. 71 review of interim financial statements. See AS 6101 (Letters for Underwriters and Certain Other Requesting Parties) of the PCAOB rules. Be that as it may, the Commission stated in the 2020 Release: "[W]e acknowledge concerns expressed as to whether accountants will be able to provide negative assurance to underwriters on the combined pro forma financial information where historical financial statements included in the pro forma financial information for individually insignificant acquisitions have not been reviewed or audited. We recognize that, in some circumstances, accountants may need to perform additional work to be able to provide negative assurance. We also observe that the 'reasonable investigation' and 'reasonable care' provisions of Sections 11 and 12 of the Securities Act are also fact specific and depend on a variety of factors. Whether steps taken to provide the required disclosures satisfy 'reasonable investigation' or 'reasonable care,' or whether additional work is needed to provide negative assurance, should be determined by accountants and their clients based on facts and circumstances. Although accountants and their clients may need to take additional steps in certain circumstances, we believe those concerns are outweighed by the need to improve the usefulness of information provided to investors when the aggregate impact of the specified acquired or to be acquired businesses exceed 50 percent, rather than requiring audited financial statements that are not necessary to reasonably inform investors or pro forma financial information that is materially incomplete in its depiction of the aggregate impact."

21. One area that is not as clear as it might be is whether takes-downs under an effective shelf registration statement may proceed without regard to the 50 percent significance level if the subject transactions are probable. We believe, insofar as takedowns under an effective shelf registration statement are concerned, the 50 percent significance threshold is not applicable to probable acquisitions. However, if a completed acquisition exceeds 50 percent, then no takedown off the shelf may be made before the historical financial statements and pro forma financial information have been filed. See "SEC Committee Regulation Highlights—October 21, 2015" available on the website of the Center for Audit Quality, SEC Regulations Committee Highlights—October 21, 2015 | The Center for Audit Quality (thecaq.org). Section IV of the October 2015 Meeting Highlights states: "The Committee asked the staff to confirm that the guidance in FRM 2045.3 and 2050.3, which indicates that financial statements of an acquired business that is greater than 50 percent significant are required to be filed prior to offering securities pursuant to an effective registration statement (except in certain limited types of offerings specified in FRM 2050.3), does not apply to a probable business acquisition unless management determines that the probable business acquisition constitutes a fundamental change. The staff confirmed that the 'bright line' guidance only applies to completed acquisitions." Nevertheless, in such situations, and being mindful of the caveat linked to "fundamental change," it would be prudent to confirm applicability of this position with the Staff before relying on it. Moreover, the flexibility allowed by this position may be illusory in contexts where the offering participants conclude (based on general disclosure considerations) that an offering should not proceed when a probable acquisition exceeds significance at the 50 percent level until financial statements and pro forma financial information have been filed.

22. *See* too Item 11 of Form S-3, which provides for inclusion in the prospectus (directly or through incorporation by reference) for financial statements and financial information for significant acquisitions and dispositions.
23. In limited circumstances, Rule 3-06 and Rule 3-14 of Regulation S-X permit financial statements covering a period of nine months to be considered to satisfy the requirement for a complete fiscal year and, therefore, in such circumstances, separate financial statements of an acquired business would cease to be required once the acquired business has been reflected in the registrant's filed post-acquisition financial statements covering a period of nine months. Where Rule 3-05 financial statements (rather than Rule 3-14 financial statements) apply, availability of the flexibility afforded by Rule 3-06 will generally not apply to acquisitions that exceed significance at the 40 percent level, but the 40 percent limit for Rule 3-05 financial statements is inapplicable to Rule 3-14 financial statements.
24. *See* too Rule 4-01(a) of Regulation S-X, which requires that information with respect to any financial statements must include all material information necessary to make the required statements not misleading.
25. Registrants should, of course, review with their accountants and underwriters inclusion of Management's Adjustments in pro forma financial information, particularly in light of heightened liability for information in a registration statement.
26. These FAQs are accessible as part of the SEC's Compliance and Disclosure Interpretations (CD&Is) under "Sarbanes-Oxley Act."
27. *See* Q&A No. 2 of the above-referenced FAQs.
28. *See* Consolidation Topic, codified in Section 810 in FASB's Accounting Standards Codification.
29. An additional consideration relative to joint ventures is Section 4-08(g) of Regulation S-X, which governs summarized financial information for subsidiaries not consolidated and 50 percent or less-owned persons.

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