SEC pro forma financial information

Handbook

US GAAP

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Contents

Navigating the complexities of SEC rules for pro forma financial statements

In May 2020, the Securities and Exchange Commission (SEC) modernized the pro forma rules in Regulation S-X Article 11, sharpening the focus so that pro forma adjustments primarily capture the required accounting for the transaction – referred to as 'transaction accounting adjustments'. Yet, putting these rules into practice can still feel like navigating a maze.

The SEC's rules distinguish between several categories of adjustments – each with its own detailed requirements. In addition to the transaction accounting adjustments that reflect the direct accounting for the event, companies may also need to include 'autonomous entity adjustments' for newly independent entities, as well as consider optional 'management's adjustments' that reflect expected synergies and dis-synergies.

This Handbook provides detailed guidance related to the SEC rules for pro forma financial statements. Using a Q&A format, it includes practical insights and examples to help you understand how the rules apply in real-world scenarios.

We hope you find this Handbook useful in understanding and applying these rules.

Timothy Brown and Erin McCloskey

Department of Professional Practice, KPMG LLP

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Timothy Brown

Wade Fanning

Erin McCloskey

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About this publication

This Handbook offers guidance on the filing and reporting requirements under the US federal securities laws for pro forma financial information. For companies undertaking significant transactions (e.g. acquisitions, dispositions, spinoffs) and filing registration statements, proxy materials or periodic reports that require pro forma financial statements, management should assess the specific pro forma information required.

This Handbook identifies the regulations requiring pro forma financial information and discusses their application. The information presented, including interpretations and guidance, reflects our understanding of current SEC staff positions and practices. However, this Handbook is not an SEC publication, nor has it been approved by the SEC.

Examples in this Handbook are included for illustrative purposes. Application of the rules related to pro forma financial information are subject to judgment. As such, there may be multiple ways to present pro forma financial information depending on the facts and circumstances of the matter triggering the requirement to include pro forma financial statements.

The rules and interpretations

References to various rules, regulations, forms and interpretative positions under US federal securities laws are included in this Handbook.

Some of the information included is based on informal discussions with the SEC staff or on SEC interpretative guidance found in the SEC Division of Corporation Finance's Financial Reporting Manual (FRM) and may be affected by future changes in staff positions. If you have questions about the guidance and other issues related to financial reporting requirements for pro forma financial information, please contact KPMG Department of Professional Practice.

In addition, certain Topics from the *FASB Accounting Standards Codification®* are referenced.

Organization of the text

Our commentary is referenced to the rules and to other literature, where applicable. The following are examples.

- S-X Rule 11-01(a) is Rule 11-01(a) of Regulation S-X
- S-K Item 504 is Item 504 of Regulation S-K
- SEC Rel 33-10786 is SEC Release No. 33-10786
- Form 8-K Item 2.01 (Instruction 4) is Instruction 4 to Item 2.01 of Form 8-K
- FRM 3160.1 is section 3160.1 of the Financial Reporting Manual (2026 ed) of the Division of Corporation Finance of the SEC

- Non-GAAP CFI 101.05 is Question 101.05 of Non-GAAP Financial Measures Corporation Finance Interpretations (formerly known as Compliance & Disclosure Interpretations)
- SAB Topic 1.B.2 is Staff Accounting Bulletin Topic 1.B.2
- Regs Comm 03/2002 is the March 2002 meeting of the Center for Audit Quality SEC Regulations Committee
- 20XX AICPA Conf is the respective year's AICPA Conference on Current SEC and PCAOB Developments
- 805-10-50-2(h) is paragraph 50-2(h) of Subtopic 805-10

Abbreviations

The following is a list of the abbreviations used in this publication.

'33 Act	Securities Act of 1933
'34 Act	Securities Exchange Act of 1934
AICPA	American Institute of Certified Public Accountants
CAQ	Center for Audit Quality
EGC	Emerging growth company
EPS	Earnings per share
FASB	Financial Accounting Standards Board
FPI	Foreign Private Issuer
FRM	SEC Financial Reporting Manual
GAAP	Generally accepted accounting principles
IASB	International Accounting Standards Board
IFRS® Accounting Standards-IASB	IFRS Accounting Standards as issued by the IASB
IPO	Initial public offering
IPR&D	In-process research and development
IRC	Internal Revenue Code
MD&A	Management's Discussion & Analysis
NCI	Noncontrolling interest
PCAOB	Public Company Accounting Oversight Board
PP&E	Property, plant and equipment
R&D	Research and development
SEC	US Securities and Exchange Commission
SPAC	Special purpose acquisition company
SRC	Smaller reporting company
VIE	Variable interest entity

1. Executive summary

Pro forma financial information is designed to help investors and other stakeholders understand the illustrative effect of a significant transaction on a company's historical financial statements. To this end, it presents adjusted historical financial information showing how the transaction might have affected the company's financial position and results of operations if it had occurred at an earlier date.

Though commonly associated with acquisitions, a registrant's obligation to file pro forma financial information is broader and extends to a variety of significant transactions including: reorganizations, dispositions, spinoffs, certain financing transactions, and other transactions where pro forma financial information would be material to users.

This Handbook provides comprehensive guidance on the preparation and presentation of pro forma financial information in accordance with US federal securities laws, primarily focusing on the requirements outlined in Regulation S-X Article 11. Understanding these requirements is critical for registrants undertaking significant transactions to ensure transparent financial reporting and inform investors.

This summary highlights the key aspects of preparing pro forma financial statements for various scenarios addressed in this Handbook.

Scope of pro forma rules

Article 11 requires pro forma information in two instances: (1) for 'specified' transactions (that have been consummated or, in limited circumstances, are probable), and (2) for 'other' transactions (either consummated or probable) for which pro forma information would be material to investors.

Specified transactions
Consummated or probable acquisition of a significant business[1], including equity method investments
Disposition or probable disposition of a significant business[1]
Combination of entities under common control
Roll-up transactions
Spinoff transactions
Note: 1. The pro forma requirements in Reg S-X Article 11 apply to significant acquisitions and dispositions of businesses, including real estate operations. Therefore, unless specifically indicated otherwise, where this Handbook refers to business transactions, the same principles apply to both acquisitions and dispositions, including those of real estate operations that are deemed significant. However, the significance threshold that triggers pro forma reporting for real estate operations differs from the threshold for other types of business transactions.

Other transactions (Examples)	
Acquisition, disposition, or exchange of significant assets outside the ordinary course of business	Changes in tax status (e.g. from a nontaxable to a taxable structure)
Emergence from bankruptcy	Changes in capitalization at the effectiveness or close of an IPO
Receipt and use of proceeds from a securities offering	Repayment or restructuring of existing indebtedness
Receipt and use of proceeds from a disposition	New or modified contracts that render historical financial statements no longer indicative of the ongoing entity – e.g. following a reorganization, change in tax-sharing or cost-sharing agreement
Declaring dividends after the balance sheet date	

Acquisitions and dispositions

Determining whether pro forma information is necessary for a business acquisition or disposition is discussed extensively in KPMG Handbook, SEC Business combinations. This section outlines the analysis and indicates where the SEC Business combinations Handbook provides the details.

Step 1: Determine whether a business has been acquired or disposed

Determining whether a *business* has been acquired or disposed is critical because the thresholds for when a transaction is significant (thereby requiring pro forma information) differ depending on whether the transaction involves a business versus assets. The SEC's definition of a business differs from the FASB's definition, so it is possible to reach a different conclusion about whether a transaction involves a business under Article 11 and Topic 805.

Step 1

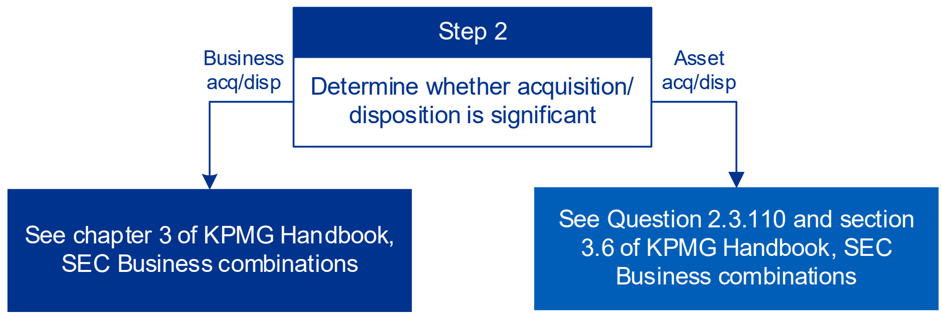
Determine whether a business has been acquired/disposed

SEC's definition of a business differs from FASB's definition (see section 2.2.10 of KPMG Handbook, SEC Business combinations)

Acquisition/disposition of real estate operations. To determine whether the acquisition/disposition of real estate is subject to the pro forma requirements, the registrant determines whether the real estate operation meets the definition of a business and generates substantially all of its revenues through leasing of real property. See section 8.2 of KPMG Handbook, SEC Business combinations.

Step 2: Determine whether the acquisition or disposition is significant

Generally, only significant acquisitions and dispositions trigger a pro forma filing requirement. However, insignificant transactions need to be aggregated with other transactions and tested for significance in certain circumstances.



Acquisition of real estate operations. The significance test for real estate operations differs from the significance test for other business acquisitions. See section 8.3 of KPMG Handbook, SEC Business combinations.

Step 3: Determine whether there is a pro forma filing requirement

Pro forma filing requirements exist for significant acquisitions/dispositions on Form 8-K, registration statements and proxy statements. The following table summarizes those requirements.

Type of filing	Acquisition of business (transaction consummated)	Disposition of business (transaction consummated)	Probable acquisition of business	Acquisition of individually insignificant businesses
Form 8-K filing	Acquired business is > 20% significant	Disposed of business is > 20% significant	N/A	N/A
Registrant is filing a registration or proxy statement	Up to 74 days and > 50% significant[1]	N/A	To be acquired business is > 50% significant	Acquisitions and probable acquisitions meeting certain criteria in the aggregate are > 50% significant
	75 or more days and > 20% significant[2]			

Notes:

1. This threshold applies if the registration statement is effective (or the mailing date of proxy materials is) within 74 days of the date the acquisition was consummated.

2.	This threshold applies if the registration statement is effective (or the mailing date of proxy materials is) more than 74 days from the date the acquisition was consummated.

Significant asset acquisitions and dispositions that are not in the ordinary course of business are also reported on a Form 8-K and require pro forma information. Such acquisitions or dispositions are considered significant if the assets at issue exceed 10% of consolidated net assets. However, because asset acquisitions and dispositions are not 'specified' transactions, pro forma information is required only if it would be material to investors.

Read more: chapter 2

Content of pro forma financial information and periods required

Key content requirements

The following diagram illustrates the elements of pro forma financial information.

Introductory paragraph (see section 3.2.10)

Pro forma balance sheet and income statement(s)			
Columnar presentation (see section 3.2.20):			
Historical financial statement balances	Transaction accounting adjustments (see section 3.3.20)	Autonomous entity adjustments, if applicable (see section 3.3.30)	Pro forma total
Income statement includes (see section 3.2.40): • EPS (basic and diluted) • Related share counts			Income statement includes (see section 3.2.40): • EPS (basic and diluted) • Related share counts

Explanatory notes
Management's adjustments, if elected (see section 3.4)

Columnar presentation

A columnar presentation is generally used whereby transaction accounting adjustments (and autonomous entity adjustments, if applicable) are 'layered on' to the historical financial statements via incremental columns. These adjustments reflect how the transaction or event giving rise to the need for pro forma financial statements might have affected the registrant's historical financial statements if it had occurred at an earlier date. A total 'Pro Forma' column is then presented.

- **Transaction accounting adjustments –** Required adjustments reflecting how the transaction – accounted for under US GAAP or IFRS® Accounting Standards as issued by the IASB (referred to in this Handbook as IFRS Accounting Standards-IASB) – would have affected the registrant's historical financial statements assuming the transaction had occurred earlier.

- **Autonomous entity adjustments –** Required, when applicable, to reflect the financial effect as if a carved out entity had operated on a stand-alone basis during the historical periods.

Registrants also have the option to disclose 'management's adjustments' in the explanatory notes. These adjustments are forward-looking adjustments used to illustrate expected synergies or dis-synergies from the transaction. They must meet certain criteria to be presented and cannot be included as part of the columnar totals (i.e. not presented on the face of the pro forma balance sheet or income statement but in the explanatory notes).

Required financial statements and periods

Generally, a registrant's pro forma financial information will consist of a condensed balance sheet and condensed income statement for the following periods.

- **Pro forma condensed balance sheet** as of the most recent annual or interim balance sheet filed or required under Reg S-X Rule 3-01 (unless the transaction is already reflected in that balance sheet).

- **Pro forma condensed income statement** for the most recent fiscal year and the most recent interim period (unless the historical income statement reflects the transaction for the entire period).

Although Article 11 refers to the 'pro forma condensed statements of comprehensive income', this statement's presentation stops at income or loss from continuing operations, even if discontinued operations were presented in the historical income statement. Accordingly, we refer to the 'pro forma income statement' throughout this Handbook. When a noncontrolling interest (NCI) exists, the allocation of income (loss) from continuing operations to the controlling interest is required.

Read more: chapter 3

Business combinations

Significant business acquisitions are the most common transactions that require pro forma financial information, which connects the financial effects of an acquired business to the registrant's audited historical statements in accordance with US GAAP or IFRS Accounting Standards-IASB.

Transaction accounting adjustments reflect the accounting for the significant business acquisition as required by GAAP. Key aspects of these adjustments often include those related to:

- **Purchase price allocation –** The allocation of consideration transferred to the acquired assets, liabilities and goodwill (if any).
- **Acquisition agreement specifics –** Adjustments mandated by the terms of the acquisition agreement or otherwise necessary to complete the acquisition.
- **Accounting policy alignment –** Harmonizing the accounting policies of the acquired business with those of the registrant.
- **Registrant-incurred transaction costs –** Specific costs incurred by the acquiring entity directly related to the transaction.

Transaction accounting adjustments are applied across various financial statement components.

- **Consideration transferred –** Disclosure in the pro forma notes details the purchase price components, particularly important when dealing with contingent amounts or unconsummated transactions.
- **Acquired assets and liabilities –** The assets acquired (including identifiable intangible assets and goodwill) and liabilities assumed are adjusted to their acquisition-date fair values. These adjustments affect the pro forma balance sheet and subsequently, the income statement (e.g. through depreciation/amortization of adjusted values).
- **Other material items –** This category covers gains and losses arising from the business combination (if any), specific acquirer-incurred transaction costs, adjustments to deferred tax assets (DTAs) and liabilities (DTLs) reflecting the fair value adjustments to assets and liabilities and valuation allowance effects, and compensation costs from pre-existing employment contracts or the merger agreement. Material adjustments outside these categories are presented separately.

Read more: chapter 4

Financing transactions

Pro forma financial information is required for certain financing transactions, with specific considerations for equity and debt offerings. Transaction accounting adjustments may be required for the anticipated receipt of cash (proceeds) from such offerings and for the intended use of those proceeds. The following table provides an overview of when and what transaction accounting adjustments are required in each case.

Equity offerings	Debt offerings
When are transaction accounting adjustments required?	
• The offering proceeds will be used for an appropriate specific corporate purpose; and • The offering is subject to a firm commitment.	• The offering proceeds will be used for an appropriate specific corporate purpose.
No pro forma adjustments are included if the proceeds will be used for activities that involve significant discretion, uncertainty or both.	

Equity offerings	Debt offerings
What transaction accounting adjustments are required when the above conditions are met?	
• The anticipated offering proceeds; and • The intended use of those proceeds.	• The anticipated offering proceeds; • The related interest expense associated with the new debt; and • The intended use of those proceeds.

Read more: chapter 5

Dispositions

Pro forma financial information may be required in the following instances involving 'significant' dispositions:

- disposition of a portion of a business is consummated;
- disposition of a portion of a business becomes probable; or
- disposition of a group of assets not in the ordinary course of business is consummated.

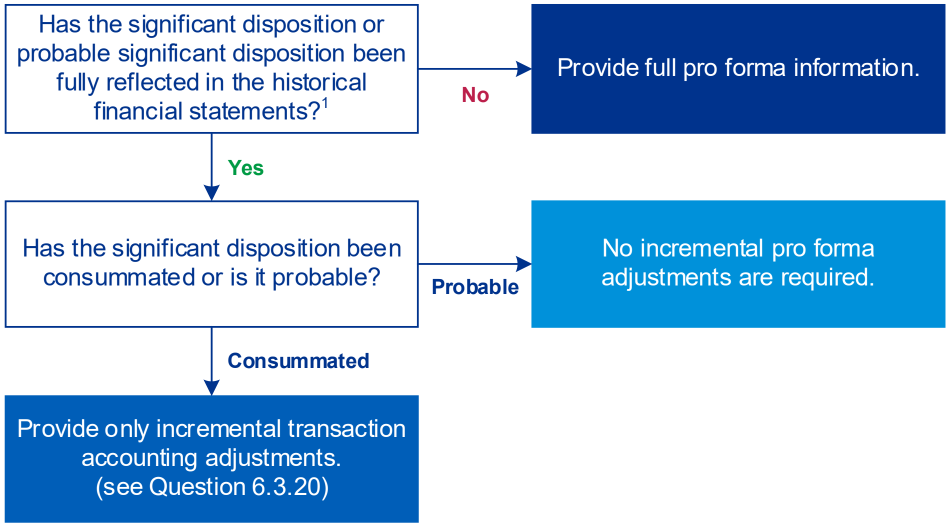
A disposition may be accomplished either by sale, abandonment or distribution to shareholders (e.g. spinoff, split-off). Significance is the attribute that triggers a pro forma requirement. Pro forma information is required not only for significant probable and consummated disposals that qualify as discontinued operations under Subtopic 205-20, but also other dispositions that are significant and/or would be material to an investor's understanding of the registrant even if they do not qualify as discontinued operations.

Type of transaction	Significance threshold	Pro forma requirement
Disposition of a business	Exceeds 20%	On Form 8-K (Item 9.01) within four business days of consummation
Probable disposition of a business	Exceeds 20%	In a registration statement or proxy statement
Disposition of a group of assets	Exceeds 10%	On Form 8-K (Item 9.01) within four business days of consummation if pro forma information would be material to investors

Summary of requirements

Pro forma financial information for dispositions illustrates the registrant's financial position and results of operations as if the disposed business had not been part of the entity for the periods presented.

It may be required in a Form 8-K, a registration statement or a proxy statement. The extent of pro forma financial information required in these instances depends on whether the disposal or probable disposal has already been reflected in the historical financial statements.



Note:

1. Full pro forma information is often required for a probable significant disposition. This is because a disposition is not fully reflected in the historical financial statements before it is consummated unless it is a discontinued operation.

The following are typical pro forma adjustments for dispositions.

Aspect of disposition	Pro forma adjustment	Notes
Consideration received	Reflect in pro forma balance sheet	Monetary and non-monetary consideration from the disposal
Disposed assets & liabilities	Eliminate from pro forma balance sheet	All assets and liabilities directly associated with the disposed business
Disposed operations	Eliminate from pro forma income statement	• Exclude revenues and expenses of the disposed business for periods presented • Conclude at income from continuing operations; do not present a separate 'Discontinued Operations' line item in the pro forma income statement, even if criteria are met
Related transactions	Evaluate for materiality; include if significant	Other probable or consummated transactions related to the disposition, if material to investors.

Read more: chapter 6

2. Circumstances requiring pro forma financial information

Detailed contents

2.1 How the Rules work

Article 11 requires pro forma information in two instances: (1) for 'specified' transactions (that have been consummated or, in limited circumstances, are probable), and (2) for 'other' transactions (either consummated or probable) for which pro forma information would be material to investors.

Specified transactions
Consummated or probable acquisition of a significant business[1], including equity method investments
Disposition or probable disposition of a significant business[1]
Combination of entities under common control
Roll-up transactions
Spinoff transactions
Note: 1. The pro forma requirements in Reg S-X Article 11 apply to significant acquisitions and dispositions of businesses, including real estate operations. Therefore, unless specifically indicated otherwise, where this Handbook refers to business transactions, the same principles apply to both acquisitions and dispositions, including those of real estate operations that are deemed significant. However, the significance threshold that triggers pro forma reporting for real estate operations differs from the threshold for other types of business transactions See section 2.3.50 for guidance on when an acquisition of real estate constitutes the acquisition of a significant real estate operation.

Other transactions (Examples)	
Acquisition, disposition, or exchange of significant assets outside the ordinary course of business	Changes in tax status (e.g. from a nontaxable to a taxable structure)
Emergence from bankruptcy	Changes in capitalization at the effectiveness or close of an IPO
Receipt and use of proceeds from a securities offering	Repayment or restructuring of existing indebtedness
Receipt and use of proceeds from a disposition	New or modified contracts that render historical financial statements no longer indicative of the ongoing entity – e.g. following a reorganization, change in tax-sharing or cost-sharing agreement
Declaring dividends after the balance sheet date	

Acquisitions and dispositions

Determining whether pro forma information is necessary for a business acquisition or disposition is discussed extensively in KPMG Handbook, SEC Business combinations. This section outlines the analysis and indicates where the SEC Business combinations Handbook provides the details.

Step 1: Determine whether a business has been acquired or disposed

Determining whether a business has been acquired or disposed is critical because the thresholds for when a transaction is significant (thereby requiring pro forma information) differ depending on whether the transaction involves a business versus assets. The SEC's definition of a business differs from the FASB's definition, so it is possible to reach a different conclusion about whether a transaction involves a business under Article 11 and Topic 805.

Acquisition/disposition of real estate operations. To determine whether the acquisition/disposition of real estate is subject to the pro forma requirements, the registrant determines whether the real estate operation meets the definition of a business and generates substantially all of its revenues through leasing of real property. See section 8.2 of KPMG Handbook, SEC Business combinations.

Step 2: Determine whether the acquisition or disposition is significant

Generally, only significant acquisitions and dispositions trigger a pro forma filing requirement. However, insignificant transactions need to be aggregated with other transactions and tested for significance in certain circumstances.

Acquisition of real estate operations. The significance test for real estate operations differs from the significance test for other business acquisitions. See section 8.3 of KPMG Handbook, SEC Business combinations.

Step 3: Determine whether there is a pro forma filing requirement

Pro forma filing requirements exist for significant acquisitions/dispositions on Form 8-K, registration statements and proxy statements. The following table summarizes those requirements.

Type of filing	Acquisition of business (transaction consummated)	Disposition of business (transaction consummated)	Probable acquisition of business	Acquisition of individually insignificant businesses
Form 8-K filing	Acquired business is > 20% significant	Disposed of business is > 20% significant	N/A	N/A
Registrant is filing a registration or proxy statement	Up to 74 days and > 50% significant[1] 75 or more days and > 20% significant[2]	N/A	To be acquired business is > 50% significant	Acquisitions and probable acquisitions meeting certain criteria in the aggregate are > 50% significant

Notes:

1. This threshold applies if the registration statement is effective (or the mailing date of proxy materials is) within 74 days of the date the acquisition was consummated.
2. This threshold applies if the registration statement is effective (or the mailing date of proxy materials is) more than 74 days from the date the acquisition was consummated.

Significant asset acquisitions and dispositions that are not in the ordinary course of business are also reported on a Form 8-K and require pro forma information. Such acquisitions or dispositions are considered significant if the assets at issue exceed 10% of consolidated net assets. However, because asset acquisitions and dispositions are not 'specified' transactions, pro forma information is required only if it would be material to investors.

2.2 When is pro forma financial information required?

2.2.10 Overview

Excerpt from Reg S-X Rule 11-01

Presentation requirements.

(a) Pro forma financial information must be filed when any of the following conditions exist:
   (1) During the most recent fiscal year or subsequent interim period for which a balance sheet is required by § 210.3-01, a significant business acquisition has occurred (for purposes of this section, this encompasses the acquisition of an interest in a business accounted for by the equity method);
   (2) After the date of the most recent balance sheet filed pursuant to § 210.3-01, consummation of a significant business acquisition or a combination of entities under common control has occurred or is probable;
   (3) Securities being registered by the registrant are to be offered to the security holders of a significant business to be acquired or the proceeds from the offered securities will be applied directly or indirectly to the purchase of a specific significant business;
   (4) The disposition of a significant portion of a business either by sale, abandonment or distribution to shareholders by means of a spin-off, split-up or split-off has occurred or is probable and such disposition is not fully reflected in the financial statements of the registrant included in the filing;
   (5) [Reserved]
   (6) Pro forma financial information required by § 229.914 of this chapter is required to be provided in connection with a roll-up transaction as defined in § 229.901(c) of this chapter;
   (7) The registrant previously was a part of another entity and such presentation is necessary to reflect operations and financial position of the registrant as an autonomous entity; or
   (8) Consummation of other transactions has occurred or is probable for which disclosure of pro forma financial information would be material to investors.

…

(c) The pro forma effects of a business acquisition need not be presented pursuant to this section if separate financial statements of the acquired business are not included in the filing, except where the aggregate impact of businesses acquired or to be acquired is significant as determined by § 210.3-05(b)(2)(iv) or § 210.3-14(b)(2)(i)(C).

Reg S-X Article 11 contains the SEC's pro forma requirements. It requires pro forma financial information in either of the following instances: [S-X Rule 11-01(a)]

- specified types of transactions have occurred (been consummated) or, in limited circumstances, are probable; or

- other types of transactions have been consummated or are probable, and for which the disclosure of pro forma financial information would be material to investors.

Pro forma financial information typically is provided via a Form 8-K (see section 2.2.20), a registration statement (see section 2.2.30) or a proxy statement (see section 2.2.40).

The following are the specific types of transactions that can trigger a pro forma filing requirement.

Types of transactions that ***can trigger*** a pro forma filing requirement
Consummated or probable acquisition of a significant business, including equity method investments (see section 2.3 and chapter 4)
Disposition or probable disposition of a significant business (see section 2.4)
Combination of entities under common control
Roll-up transactions
Spinoff transactions (see sections 2.4.30 and 6.4)

Examples of other transactions and events that typically require a pro forma filing, as such information would be material to investors, are identified in the following table. [S-X Rule 11-01(a)(8), SAB Topics 1.B.2 and 1.B.3, FRM 3160.1, FR 506.02]

Other transaction and events that ***typically require*** a pro forma filing
Acquisition, disposition or exchange of significant assets outside the ordinary course of business (see section 2.5)
Emergence from bankruptcy
Receipt and use of proceeds from a security offering (see chapter 5)
Receipt and use of proceeds from a disposition (see chapter 6)
Declaring dividends after the balance sheet date
Changes in tax status (e.g. from a nontaxable to a taxable structure)
Changes in capitalization at the effectiveness or close of an IPO
Repayment or restructuring of an existing indebtedness
New or modified contracts that render historical financial statements no longer indicative of the ongoing entity – e.g. following a reorganization, change in tax-sharing or cost-sharing agreement

Question 2.2.10 Are all registrants subject to the pro forma requirements?

Interpretive response: Yes. Prior to 2021, smaller reporting companies (SRCs) and real estate operations acquired (or to be acquired) were subject to unique rules that were similar but not identical to Reg S-X Rule 3-05 (requiring acquiree financial statements) and Article 11 (requiring pro forma financial information). However, presently they – along with all other registrants – are in the scope of

Rule 3-05 and Article 11 (or for SRCs Rules 8-04 and 8-05, which refer to Rule 3-05 and Article 11).

SRCs are allowed to condense pro forma financial information pursuant to Rule 8-03(a). [S-X Rule 8-05]

Rule 3-14 provides special instructions for financial statements of real estate operations acquired or to be acquired.

Question 2.2.20 Is pro forma information required for a significant business acquisition if Rule 3-05 financial statements are not required?

Interpretive response: Pro forma information is not required for an acquisition if Rule 3-05 financial statements are not required in the filing for the acquired business. However, pro forma financial information is required if the aggregate significance of individually insignificant business acquisitions exceeds 50% (see section 2.3.30). [S-X Rule 11-01(c), FRM 3110.4, FRM 3110.5]

Question 2.2.30 Is pro forma information required on Form 10-K or 10-Q?

Interpretive response: No. Forms 10-K and 10-Q do not require pro forma financial information under Article 11. [Form 10-K Part II Item 8, Form 10-Q Part I Item 1]

However, when a registrant provides comparative information (i.e. supplemental pro forma information), Topic 805 requires it to disclose, in its financial statement notes, the revenues and earnings of a combined entity as if the business combination occurred as of the beginning of the comparable prior annual reporting period. This requirement applies to both annual and interim periods. See section 13 of KPMG Handbook, Business combinations.

2.2.20 Form 8-K reporting of significant acquisitions and dispositions

A registrant's consummated significant acquisition or disposition of a business is disclosed on Form 8-K. Items 2.01 and 9.01 of Form 8-K provide the two basic filing requirements.

Item 2.01	Item 9.01	
The acquisition or disposition is disclosed on Form 8-K within four business days of consummation ('initial Form 8-K').	Acquiree financial statements (Rule 3-05 financial statements) and pro forma financial information are provided for the acquisition in the initial Form 8-K or within a specified time period after	Pro forma financial information is provided for the disposition in the initial Form 8-K.

Item 2.01	Item 9.01	
See Question 2.3.50 of KPMG Handbook, SEC Business combinations.	the initial Form 8-K ('amended Form 8-K' or 'Form 8-K/A').	
	See Question 2.2.40 for additional details.	

See section 2.5 for reporting requirements for asset acquisitions (i.e. acquisitions of net assets that do not constitute a business).

Question 2.2.40 When is pro forma financial information required to be filed on Form 8-K?

Interpretive response: Pro forma financial information is generally required to be filed within four business days of transaction's consummation. However, for a *significant business acquisition* that is reported on Item 2.01 within this four-business-day period, Item 9.01 allows registrants an additional 71 calendar days to provide the pro forma financial information and to file the Rule 3-05 (or Rule 3-14) financial statements; see Question 2.3.40 of KPMG Handbook, SEC Business combinations. This additional 71-day period is not available to shell companies, such as SPACs. The term '75-day filing period' used in this Handbook refers to the combination of these two periods. [Form 8-K Item 9.01 (Instruction)]

Extension not available for dispositions

The 71-calendar-day extension is not available for dispositions and pro forma financial information must be filed within four business days of a significant disposition except as noted in Question 2.2.50. [FRM 3120.2]

Question 2.2.50 When is pro forma financial information about an exchange transaction required to be filed?

Background: A registrant and another party may each contribute businesses to a joint venture in exchange for an equity method investment in the joint venture. The registrant's disposition of its controlling interest in the business, and its acquisition of the equity method investment in the joint venture are separately evaluated for significance and may need to be reported separately in a Form 8-K.

Interpretive response: It depends. Registrants must provide pro forma information for a significant disposition within four business days (see Question 2.2.40). If the consideration received includes a business and the necessary financial data for that business is unavailable within this timeframe, the SEC staff will accept a timely filed Form 8-K with a transaction description and quantifiable effects (if possible) filed within four business days. The registrant can then amend the Form 8-K within a 71-calendar-day extension to include the required pro forma financials and audited statements of the acquired business. [FRM 2930.8]

Question 2.2.60 May pro forma financial information be provided on a Form 10-K or 10-Q instead of a Form 8-K?

Interpretive response: Yes, if that Form 10-K or 10-Q is filed by the date the amended Form 8-K would otherwise have been due. Otherwise, Forms 10-K and 10-Q do not require the inclusion of pro forma information (see Question 2.2.30), and as such it is generally not included. [Form 10-K Item 9B, Form 10-Q Item 5]

2.2.30 Registration statements

All registration statements, except for Form S-8, require Article 11 pro forma financial information to be filed when a relevant transaction or event (as described in section 2.2.10) is either:

- probable of occurring (see section 2.3.40); or
- was consummated during the most recent fiscal year or after the date of the most recent balance sheet filed with the SEC.

While required for individually significant probable or consummated acquisitions, pro forma financial information in registration statements may also be required for individually insignificant acquisitions that are significant in the aggregate based on Reg S-X Rule 3-05. See Question 2.3.190 of KPMG Handbook, SEC Business combinations.

The following table outlines the pro forma requirements applicable to significant transactions in the most common domestic registration statements.

Domestic registration statement	Form Item	Is pro forma financial information required (when applicable)?
Form S-1	Item 11(e)	Yes
Form S-3	Item 11(b)(i)	Yes, in the prospectus; can also be incorporated by reference
Form S-4	Item 5	Yes, in the prospectus; can also be incorporated by reference for registrants that are eligible to file a Form S-3
	Item 10(b) and Item 12(c)	Yes, pro forma financial information unrelated to the securities being registered may be required under these Items
Form S-8	N/A	No
Form S-11	Item 27	Yes, in the prospectus
Form 10	Item 13	Yes

Because pro forma financial information about probable acquisitions must be included in registration statements (in addition to Rule 3-05 financial statements), a registrant may have to provide this information earlier than it would on a Form 8-K because the requirements of Items 2.01 and 9.01 of Form 8-K are triggered by the consummation date of the acquisition. Those Items do not require a registrant to file a Form 8-K for a probable acquisition regardless of its significance level.

Question 2.2.70 Does a registrant present pro forma financial information for a recently acquired business of the acquiree (i.e. a 'target's target')?

Interpretive response: Maybe. A registrant may acquire a significant business, sometimes referred to as 'a target', which had itself completed a significant acquisition shortly before the registrant acquired it (the 'target's target'). The registrant may need to include additional pro forma financial information to demonstrate how both acquisitions would have affected the registrant if they had been consummated on the first day of the registrant's annual pro forma income statement.

The SEC staff provides relief by not requiring financial statements of target's target unless their omission would make the target's financial statements misleading or substantially incomplete. [FRM 2905.5]

We believe a registrant should consider the following factors and exercise judgment in determining when to consider the effects of the target's target in its pro forma financial information:

- the size of the target's target in relation to the target based on the three significance tests of Reg S-X Rule 3-05;
- the timing of target's acquisition of its target, including the magnitude of pre-acquisition operations that would be omitted;
- the nature of the operations of the target's target; and
- whether the pro forma transaction accounting adjustments depicted provide an adequate understanding of the registrant or inform a vote on a transaction.

Example 2.2.10 Recently acquired business of acquiree

Scenario 1

On April 15, 20X9, Registrant acquires Target, which is significant to Registrant at approximately 55%. Previously, on November 15, 20X8, Target acquired Subsidiary, which was significant to Target at approximately 80%.

Given the significance of each acquisition, Registrant prepares its pro forma financial as if both Target and Subsidiary had been acquired on January 1, 20X8.

Scenario 2

Same timeline as in Scenario 1. Target is significant to Registrant at approximately 21%, and Subsidiary is significant to Target at approximately 21%. Neither Registrant nor Target has any outstanding debt; however, Subsidiary is highly leveraged with debt bearing interest at above-market rates and restrictive covenants.

Given Subsidiary's degree of leverage and length of the pre-acquisition period (10 months), Registrant prepares its pro forma financial information as if both Target and Subsidiary had been acquired on January 1, 20X8.

2.2.40 Proxy statements

Article 11 pro forma financial information may be required in Schedule 14A proxy statements.

Question 2.2.80 When is pro forma financial information required in Schedule 14A proxy statements?

Interpretive response: Item 13 of Schedule 14A requires pro forma financial information when shareholders are asked to vote on the issuance, modification or exchange of securities (pursuant to Items 11 or 12 of Schedule 14A). However, pro forma financial information is not required if it would "not be material for the exercise of prudent judgment concerning the action." Financial statements usually are considered material to this exercise if the action is the authorization or issuance of a material amount of senior securities or the authorization or issuance of securities related to a business combination. [Sch 14A (Instructions to Item 13), FRM 1140.2]

Item 14 of Schedule 14A may require pro forma financial information when shareholders are asked to vote on the registrant's proposal to:

- merge with another entity;
- acquire a business or assets of a business;
- sell substantial assets; or
- liquidate or dissolve.

The necessity of pro forma information under Item 14 in these situations depends on whose proxies are solicited (i.e. acquirer, target, or acquirer and target), the nature of the consideration and the materiality of the information. See Question 5.4.60 of KPMG Handbook, SEC Business combinations. [FRM 1140.3]

2.3 Significant consummated or probable business acquisitions

2.3.10 Overview

Acquisitions that qualify under the definition of 'significant business acquisition' in Reg S-X Article 11 include: [S-X Rule 11-01(a)(1)]

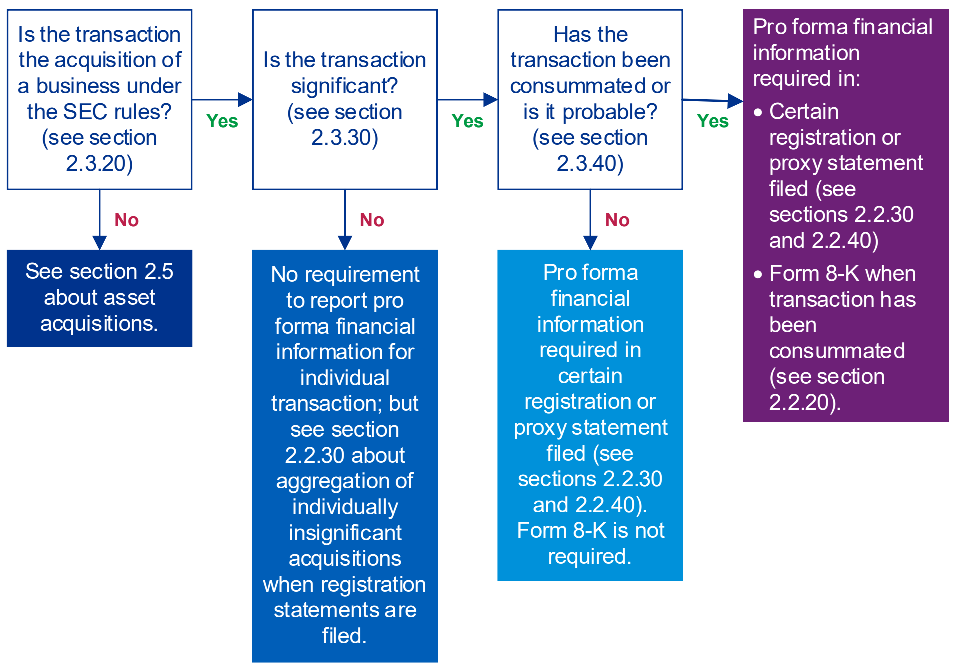
- any event that results in the registrant obtaining control over another entity (e.g. through either obtaining a controlling voting interest or becoming the primary beneficiary of a VIE), which is similar to the definition of a 'business combination' in Topic 805; and

- the purchase of a significant equity method investment accounted for under Topic 323.

Generally, if a registrant is required to file an acquiree's audited financial statements (Rule 3-05 financial statements), then pro forma financial information is also required under Article 11. The SEC staff believes providing Rule 3-05 financial statements without accompanying pro forma financial information can be misleading. [FRM 3110.5]

Conversely, pro forma effects of a business acquisition are not required if separate financial statements of the acquired business are not included unless the aggregate effect of businesses acquired or to be acquired is significant under Reg S-X Rule 3-05. [S-X Rule 11-01(c)]

The steps for evaluating whether Rule 3-05 financial statements and Article 11 pro forma financial information are required for a business acquisition are depicted as follows.



This section provides an overview of these steps, but the detailed requirements are explained in chapters 2 and 3 of KPMG Handbook, SEC Business combinations.

2.3.20 Determining whether a business has been acquired

Excerpt from Reg S-X Rule 11-01

Presentation requirements.

(d) For purposes of this rule, the term business should be evaluated in light of the facts and circumstances involved and whether there is sufficient continuity of the acquired entity's 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. Among the facts and circumstances which should be considered in evaluating whether an acquisition of a lesser component of an entity constitutes a business are the following:

(1) Whether the nature of the revenue-producing activity of the component will remain generally the same as before the transaction; or

(2) Whether any of the following attributes remain with the component after the transaction:
   - (i) Physical facilities,
   - (ii) Employee base,
   - (iii) Market distribution system,
   - (iv) Sales force,
   - (v) Customer base,
   - (vi) Operating rights,
   - (vii) Production techniques, or
   - (viii) Trade names.

Determining whether an acquisition or disposition is of a business or of assets is important because Reg S-X Article 11 provides quantitative thresholds to define a significant business for which pro forma financial information is required. There is a separate quantitative threshold to determine whether an asset acquisition or disposition is significant (see section 2.5).

Evaluating whether a transaction (e.g. acquisition, disposition) involves a business or assets requires judgment based on relevant facts and circumstances. Under Article 11, a transaction involves a business if there is sufficient continuity of the acquired entity's operations such that disclosure of prior financial information is material to an understanding of future operations. The SEC guidance assumes that a separate entity, subsidiary, division, working interest in an oil and gas property and an equity method investment are businesses. [S-X Rule 11-01(a)(1) and (d), FRM 2910.5]

Question 2.3.10 When is there sufficient continuity of operations in an acquisition or disposition?

Interpretive response: The SEC staff has stated its analysis of whether there is sufficient continuity of operations focuses primarily on whether the nature of the revenue-producing activity generally remains the same after the transaction. [FRM 2910.2 (note)]

While the SEC staff may presume the continuity of revenue-producing activities is an indicator of a business, the current or historical generation of revenue is not required for an acquired entity to represent a business. [FRM 2910.3]

To determine whether an acquiree is a business, see section 2.2 of the KPMG Handbook, SEC Business combinations.

2.3.30 Determining significance of a business acquisition

Excerpt from Reg S-X Rule 11-01

Presentation requirements.

(b) A business acquisition or disposition will be considered significant if:
- (1) The business acquisition meets:
  - (i) The definition of a significant subsidiary in § 210.1-02(w)(1), substituting 20 percent for 10 percent each place it appears therein; or
  - (ii) If the business is a real estate operation as defined in § 210.3-14(a)(2), the significant subsidiary condition in § 210.1-02(w)(1)(i) (i.e., the investment test condition), substituting 20 percent for 10 percent, as modified by the guidance in § 210.3-14(b)(2)(ii).
- (2) The business disposition, including a business that is a real estate operation as defined in § 210.3-14(a)(2), meets the definition of a significant subsidiary in § 210.1-02(w)(1), substituting 20 percent for 10 percent each place it appears therein.
- (3) The determination must be made, except as noted in paragraph (b)(4) of this section for the continuous offerings described therein, by using:
  - (i) For amounts derived from financial statements, the registrant's most recent annual consolidated financial statements required to be filed at or prior to the date of acquisition or disposition and the business's pre-acquisition or pre-disposition financial statements for the same fiscal year as the registrant or, if the fiscal years differ, the business's most recent fiscal year that would be required if the business had the same filer status as the registrant, however the determination may be made using:
    - (A) The financial statements for the business described in § 210.3-05(e) or (f) if the business meets the conditions for presenting those financial statements.
    - (B) Pro forma amounts for the registrant for the periods specified in § 210.11-01(b)(3) that only depict significant business acquisitions and dispositions consummated after the latest fiscal year-end for which the registrant's financial statements are required to be filed and only include Transaction Accounting Adjustments (see § 210.11-02(a)(6)(i)), provided that:
      - (1) The registrant has filed audited financial statements for any such acquired business for the periods required by § 210.3-05 or § 210.3-14 and the pro forma financial information required by §§ 210.11-01 through 210.11-02 for any such acquired or disposed business. The tests may not be made by "annualizing" data; and
      - (2) If a registrant has used pro forma amounts to determine significance of an acquisition or disposition, it must continue to use pro forma amounts to determine significance of acquisitions and dispositions through the filing date of its next annual report on Form 10-K (§

249.310 of this chapter) or Form 20-F (§ 249.220f of this chapter); or

(C) The registrant's annual consolidated financial statements, for the most recent fiscal year ended prior to the acquisition or disposition, that are included in the registrant's Form 10-K (§ 249.310 of this chapter) filed after the date of acquisition or disposition, but before the date financial statements and pro forma financial information for the acquisition or disposition would be required to be filed on Form 8-K (§ 249.308 of this chapter).

(ii) If the business is a related business (see § 210.3-05(a)(3)), combined pre-acquisition financial statements of the group of related businesses for the fiscal year specified in paragraph (b)(3)(i) of this section.

(4) When a registrant, including a real estate investment trust, conducts a continuous offering over an extended period of time and applies the Item 20.D. Undertakings of Industry Guide 5, the income test condition does not apply, and the determination must be made for the investment test condition, when it is based on the total assets of the registrant and its subsidiaries consolidated, and the asset test condition, if applicable, using the following for the registrant:

(i) During the distribution period, total assets as of the date of acquisition or disposition plus the proceeds (net of commissions) in good faith expected to be raised in the registered offering over the next 12 months, except that for acquisitions total assets must exclude the acquired business; and

(ii) After the distribution period ends and until the next Form 10-K is filed, total assets as of the date of acquisition or disposition, except that for acquisitions total assets must exclude the acquired business; and

(iii) After that next Form 10-K is filed, the guidance in paragraph (b)(3).

Pro forma financial information is required in certain filings for the transactions identified in section 2.2.10, including:

- consummated and probable significant business acquisitions; and
- consummated and probable dispositions of significant businesses.

A consummated business acquisition is considered significant if its significance exceeds 20%. Unlike the requirements for Rule 3-05 financial statements, the number of periods included in the pro forma financial information does not increase when significance surpasses 20%.

The significance thresholds are as follows.

	Significance (use the highest % from the 3 significance tests)	Pro forma financial statements
Consummated business acquisitions	Exceeds 20%	Yes, see chapter 3 for discussion of required content
Consummated and probable business disposals	Exceeds 20%	

	Significance (use the highest % from the 3 significance tests)	Pro forma financial statements
Probable business acquisition	Exceeds 50%	
Aggregation of individually insignificant business acquisitions	Exceeds 50%	

See chapter 3 of KPMG Handbook, SEC Business combinations, for guidance on how to determine the significance of consummated and probable acquisitions.

The table below lists transactions with more details available in other chapters of the KPMG Handbook, SEC Business combinations.

Scenario	Reference in KPMG Handbook, SEC Business combinations
Acquisition of real estate operations	Section 8.3
Blind pool offerings	Section 8.5.10
Reverse acquisitions	Section 3.7.10
Joint venture	Section 3.7.20
Step acquisitions	Section 2.4.30

Question 2.3.20 When is pro forma financial information required for an individually insignificant business acquisition?

Interpretive response: Article 11 pro forma financial information is not required for business acquisitions that are not individually significant. However, individually insignificant acquisitions are aggregated and tested for significance in the aggregate. If the aggregate significance exceeds 50%, a registrant is required to present pro forma financial information that depicts the aggregate effect of the acquired or to be acquired businesses that are included in the aggregate test in all material respects. [FRM 3110.4]

Aggregating individually insignificant acquisitions for the purpose of the 50% test is required only for registration statement filings and certain proxy materials. Form 8-K requires aggregating individually insignificant acquisitions only if they are related businesses and are, in the aggregate, significant. See Questions 2.3.70 and 2.3.190 of KPMG Handbook, SEC Business combinations. [Form 8-K Item 2.01 (Instruction 4)]

Question 2.3.30 May the pro forma financial information include a business acquisition that does not meet any of the prescribed significance thresholds?

Interpretive response: Yes, if the registrant believes this information would be meaningful to investors. However, the registrant and its counsel should consider whether including some insignificant transactions while excluding others would be misleading. For example, a registrant may not selectively include only business acquisitions that show favorable effects.

When a registrant elects to include insignificant acquisitions in its pro forma financial information, we believe it should define and document that determination so that its policy can be objectively applied to both current and future acquisitions and dispositions.

2.3.40 Determining the pro forma requirement

Reporting requirements differ between consummated and probable significant business acquisitions.

	Consummated	Probable
Report on Form 8-K (see section 2.2.20)	Yes	No
Report on registration and proxy statements (see sections 2.2.30 and 2.2.40)	Yes	Yes

Determining when a business acquisition has been consummated is usually straightforward based on a closing that involves the legal transfer of title to property or securities evidencing ownership. See Question 2.2.200 of KPMG Handbook, SEC Business combinations.

In contrast, determining when a business acquisition is probable requires judgment. To determine whether a potential acquisition is probable, see section 2.3 of KPMG Handbook, SEC Business combinations.

2.3.50 Acquisition of a significant real estate operation

While Reg S-X Rule 3-05 applies to general businesses and Reg S-X Rule 3-14 applies to real estate operations, the pro forma requirements in Reg S-X Article 11 apply to significant acquisitions of all businesses, which includes real estate operations. Therefore, unless specifically indicated otherwise, where this Handbook refers to business acquisitions, the same principles apply to acquisitions of real estate operations that are deemed significant. However, to trigger pro forma reporting for acquisitions of real estate, the acquisition must meet (1) the SEC's definition of a 'real estate operation' and (2) a modified version of the significance test.

Definition of a real estate operation

Acquired real estate is a 'real estate operation' if it meets the SEC's definition of a business and generates substantially all of its revenues through leasing of real property. See section 8.2 of KPMG Handbook, SEC Business combinations. Also see section 2.3.20 of this Handbook for the SEC's definition of a business.

Modified significance test

The acquisition of a real estate operation is significant if the investment test indicates the acquisition is greater than 20% significant. The other two significance tests – the asset test and income test – do not apply. See section 8.3 of KPMG Handbook, SEC Business combinations.

2.4 Disposition of a significant business

2.4.10 Overview

A registrant is required to file pro forma financial information when the disposition of a significant business (whether by sale, abandonment, or distribution to shareholders in a spinoff) is either probable or has been consummated. (The 'disposition of a significant business' is also referred to in this Handbook as a 'significant disposition'.) Like business acquisitions, business dispositions are subject to quantitative significance thresholds. A registrant files pro forma financial information for business dispositions that are greater than 20% significant if the transaction is not fully reflected in its historical financial statements (e.g. an operation is discontinued after the balance sheet date). [Form 8-K Item 9.01, S-X Rule 11-01(a)(4), 11-01(b)]

See section 2.3.20 on the SEC's definition of a business. Also see chapter 3 of KPMG Handbook, SEC Business combinations, for general guidance on applying the significant tests and section 3.7.20 for specific guidance on dispositions.

2.4.20 Interaction with US GAAP for dispositions

Disposals may be reflected in a registrant's US GAAP financial statements well before consummation of the disposal. This situation can reduce the scope of the required pro forma financial information, or eliminate the requirement to provide it.

Question 2.4.10 When is a disposal fully reflected in financial statements before consummation?

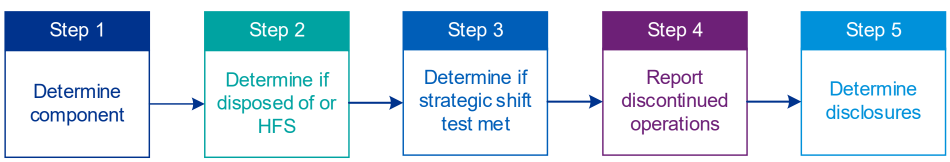
Interpretive response: Although Reg S-X Article 11-01(a)(4) does not define 'fully reflected', we believe a disposition is fully reflected in the registrant's historical financial statements when the transaction has been separately presented in both the balance sheet and income statement for the entire period for which pro forma financial information is required (see Question 3.2.50).

Under paragraph 360-10-45-9, a disposal group is presented separately on the balance sheet when six 'held-for-sale' criteria are met. These criteria may be met as long as one year or more before the actual disposal.

If the disposal group is a component of the entity and its disposal represents a strategic shift for the entity, then separate income statement presentation as a discontinued operation is required. When discontinued operations reporting has been triggered under Subtopic 205-20, the historical financial statements will already delineate the ongoing effects of discontinued operations from continuing operations. This may reduce how much pro forma financial information the registrant is required to provide (see in Question 3.2.50).

Meeting the held-for-sale criteria is not a recognized subsequent event (also referred to as a Type 1 subsequent event). For example, if a calendar year-end registrant commits to sell a significant operating segment during January 20X2 and all other criteria are met, the Form 10-K for the year ended December 31, 20X1 would not reflect the retrospective reclassification of the disposal group or discontinued operations. Instead, the discontinued operations would be separately presented for the first time in the first quarter 20X2 Form 10-Q and it would not be considered fully reflected in the registrant's Form 10-K for the year ended December 31, 20X1. [360-10-45-13]

Key steps to applying Subtopic 205-20 are depicted below and explained in KPMG Handbook, Discontinued operations and held-for-sale disposal groups.



Question 2.4.20 Can pro forma financial information be required even if separate presentation under US GAAP is not triggered?

Interpretive response: Yes. Pro forma financial information may be required under Reg S-X Article 11's distinct quantitative significance tests even if separate presentation under paragraph 360-10-45-9 or Subtopic 205-20 has not been triggered. [FRM 3120.1]

Such scenarios could include the following.

- A registration statement or proxy statement is filed after management has committed to a plan to sell a segment. While the plan will trigger discontinued operations presentation under Subtopic 205-20, discontinued operations have not yet been separately presented in the registrant's financial statements on Form 10-Q or 10-K because a decision to sell a business or collection of assets is not a recognized subsequent event (also referred to as a Type 1 subsequent event) based on applying paragraph 360-10-45-13. Pro forma financial information would be required for all periods presented in the registration statement for the probable disposition in this circumstance. [Regs Comm 03/2002]

- Management closed the sale of certain operations, which are significant under Article 11's quantitative tests (e.g. the asset test) but do not represent a strategic shift under Subtopic 205-20. Pro forma financial information on Form 8-K is due within four business days of consummation even though the discontinued operations will never be separately presented in the historical financial statements under Subtopic 205-20.

Question 2.4.30 Can consummation of a sale trigger the need to file pro forma financial information after the discontinued operations were already presented separately?

Interpretive response: Yes. Consummation of a disposition can trigger the requirement to file pro forma financial information on Form 8-K even when the discontinued operations were already presented separately in the historical financial statements. This is the case when there are significant incremental effects of the disposition that are not captured by discontinued operations presentation.

For example, the receipt of proceeds, accrual of contingent deal fees, reclassification of deferred taxes to current taxes, and mandatory debt repayments are common examples of incremental, material effects that often arise from and are directly related to the consummation.

Further, consummation also often enables management to proceed with other transactions and restructuring events that could require pro forma disclosure (generally in a separate column) under Reg S-X Rule 11-01(a)(8). Common examples of this include discretionary debt repayments and special dividends or share repurchases.

See section 6.3 for further discussion and illustration of the need to file pro forma financial information after the discontinued operations were presented separately.

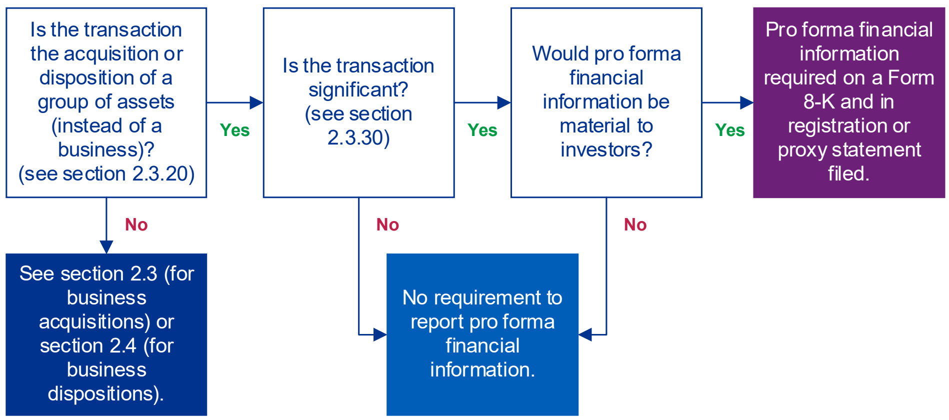
2.4.30 Spinoff considerations

Some dispositions are achieved by forming a new registrant (SpinCo) whose shares will be distributed to shareholders. These transactions are commonly referred to as 'spinoffs'. SpinCo may already have stand-alone financial statements. If it does not, its financial statements may need to be 'carved out' from the registrant because a spinoff does not qualify for presentation as a discontinued operation prior to consummation – i.e. under paragraph 360-10-45-15, a spinoff is accounted for as a transaction with shareholders, and not as a sale. [205-20-45-1B]

However, the registrant generally must solicit a shareholder vote prior to effecting a spinoff. The registration statement or proxy materials used to solicit this shareholder vote will generally require pro forma financial information depicting the spinoff. Therefore, pro forma financial information will usually reflect the presentation of the disposition (which may qualify as a discontinued operation) before the historical financial statements do.

See section 6.4 for further discussion of spinoff presentation in pro forma financial information.

2.5 Acquisition or disposition of a significant group of assets



A registrant's acquisition or disposition of a significant asset or group of assets that is not in the ordinary course of business is disclosed on Form 8-K. Pro forma financial information is required only if the information would be material to investors. If such information is required, it must be provided within four business days of consummation. Therefore, the 71-calendar-day extension allowed to provide pro forma financial information for a business acquisition does not apply to asset acquisitions or dispositions. [Form 8-K Item 2.01, S-X Rule 11-01(a)(8)]

The significance test for a group of assets also differs from the significance test for a business. A group of assets is significant if the amount paid or received for the assets (or the registrant's equity in the net book value) exceeds 10% of the registrant's consolidated total assets before the transaction. [Form 8-K Item 2.01 (Instruction 4)]

Question 2.5.10 When is pro forma financial information required for significant asset acquisitions and dispositions?

Interpretive response: It depends.

Item 9.01(b) of Form 8-K states, "For any transaction required to be described in answer to Item 2.01 of this form, file any pro forma financial information that would be required pursuant to Article 11 of Regulation S-X."

Item 2.01 requires describing "the acquisition or disposition of a significant amount of assets, otherwise than in the ordinary course of business." However, pro forma financial information is required under Item 9.01 for such transactions only if they are required by Reg S-X Article 11.

Article 11 specifies certain transactions that require pro forma financial information – most notably the acquisition, probable acquisition or disposition of a business. Asset acquisitions and dispositions are not in this list of specified transactions. However, Article 11 also requires pro forma financial information for other transactions when the disclosure of that information would be material to investors. Therefore, a registrant needs to determine whether pro forma financial information for significant asset acquisitions or dispositions it reports under Item 2.01 would be material to investors. [S-X Rule 11-01(a)(8)]

Based on how Item 2.01, Item 9.01 and Article 11 interact, it is possible that an asset acquisition or disposition is reported on Form 8-K under Item 2.01 but no pro forma financial information is required. Although such a transaction would meet Item 2.01's significance test, the registrant in this situation could conclude that pro forma financial information would not be material to investors.

Determining whether pro forma information would be material to investors is a matter of judgment about which a registrant should consult with its legal counsel. Nevertheless, we believe Item 2.01's significance test for asset acquisitions and dispositions is relevant in making this determination. Under that test, an asset or group of assets is significant if the amount paid or received for the assets (or the registrant's equity in the net book value) exceeds 10% of the registrant's consolidated total assets before the transaction. However, other quantitative and qualitative factors may be relevant as well, and those factors could lead a registrant to conclude that pro forma financial information would not be material to investors even though the transaction is significant and reported under Item 2.01.

Registration and proxy statements

Similarly, pro forma financial information is not required on registration or proxy statements for significant asset acquisitions or dispositions unless such information would be material to investors. The analysis above applies to these statements. When a registrant determines materiality to investors, we believe the significance test performed for purposes of Item 2.01 is relevant, but other quantitative and qualitative factors may also be relevant.

3. Content of pro forma financial information and periods to be presented

Detailed contents

Examples

3.1 How the Rules work

Article 11 pro forma financial information ordinarily consists of an introductory paragraph, pro forma balance sheet, pro forma income statement(s) and explanatory notes. The pro forma balance sheet and income statement(s) are condensed in a manner similar to interim financial statements presented in the quarterly Form 10-Q. Pro forma statements of cash flows and shareholders' equity are not required by Reg S-X Article 11 and generally are not presented.

Introductory paragraph (see section 3.2.10)

Pro forma balance sheet and income statement(s)			
Columnar presentation (see section 3.2.20):			
Historical financial statement balances	Transaction accounting adjustments (see section 3.3.20)	Autonomous entity adjustments, if applicable (see section 3.3.30)	Pro forma total
Income statement includes (see section 3.2.40): • EPS (basic and diluted) • Related share counts			Income statement includes (see section 3.2.40): • EPS (basic and diluted) • Related share counts

Explanatory notes
Management's adjustments, if elected (see section 3.4)

The following table summarizes the requirements for each of these elements.

Requirement	Summary
Core components	• Introductory paragraph • Pro forma balance sheet • Pro forma income statement(s) • Explanatory notes *Pro forma statements of cash flows and shareholders' equity are generally* not *required.*
Types of adjustments	**Transaction accounting adjustments:** Required adjustments reflecting how the transaction – accounted for under US GAAP or IFRS® Accounting Standards-IASB – would have affected the registrant's historical financial statements assuming the transaction had occurred earlier. These adjustments are included in the columnar presentation. **Autonomous entity adjustments:** Required, when applicable, to reflect the financial effect as if a carved-out entity had operated on a stand-alone basis during the historical periods. These adjustments are also included in the columnar presentation.

Requirement	Summary
	Management's adjustments: Optional forward-looking adjustments disclosed – when specific criteria are met – to illustrate expected synergies or dis-synergies from the transaction. These items are disclosed *only* in the explanatory notes.
Presentation style	• Columnar format based on the registrant's historical financial statements • Incremental columns reflect: — Transaction accounting adjustments — Autonomous entity adjustments (when applicable) • Final 'Pro Forma' column shows cumulative effect of all required adjustments *Optional management's adjustments cannot be included in the columnar presentation and may be disclosed only in the explanatory notes.*

3.2 General presentation

3.2.10 Introductory paragraph

Excerpt from Reg S-X Rule 11-02

Preparation requirements.

(a) *Form and content.*

…

(2) The pro forma financial information must be accompanied by an introductory paragraph which briefly sets forth a description of:

(i) Each transaction for which pro forma effect is being given;

(ii) The entities involved;

(iii) The periods for which the pro forma financial information is presented; and

(iv) An explanation of what the pro forma presentation shows.

The introductory paragraph summarizes the transaction(s), the relevant entities, and the periods presented in the pro forma financial information. A registrant should explain that pro forma financial information is intended to illustrate how the transaction(s) may have affected its historical financial statements if the transaction(s) had occurred at an earlier date. Further, it should explain that the assumptions may or may not be useful to predicting the registrant's financial condition or results of operations in the future.

Example 3.2.10 Introductory paragraph

Registrant and Target have entered into a merger agreement that is contingent on obtaining shareholder and regulatory approvals. Registrant intends to finance the acquisition through the issuance of secured notes payable. It files a registration statement and proxy on Form S-4 that includes pro forma financial information and the following introductory paragraph. For purposes of this example, assume the Form S-4 was filed on November 15, 20X2 after Registrant filed its Form 10-Q for the nine months ended September 30, 20X2.

Unaudited Pro Forma Condensed Combined Financial Statements

On October 15, 20X2, Registrant and Target entered into a merger agreement whereby Registrant would pay $8.1 million to acquire all of the outstanding shares of Target.

The following unaudited pro forma condensed combined financial statements (which we refer to as the 'pro forma financial statements') have been prepared from the respective historical consolidated financial statements of Registrant and Target, adjusted to give effect to the business combination, as well as the issuance of $7.1 million of secured notes payable to finance the acquisition. The unaudited pro forma condensed combined income statements for the nine months ended September 30, 20X2, and the year ended December 31, 20X1, combine the historical consolidated income statements of Registrant and

Target, giving effect to the business combination as if it had been consummated on January 1, 20X1. The unaudited pro forma combined balance sheet combines the historical consolidated balance sheets of Registrant and Target as of September 30, 20X2, giving effect to the business combination as if it had been consummated on September 30, 20X2.

The unaudited pro forma condensed combined financial statements are presented to reflect the business combination and issuance of secured notes payable, and do not represent what Registrant's financial position or results of operations would have been had the business combination occurred on the dates noted above, nor do they project the financial position or results of operations of the combined company following the business combination. The unaudited pro forma condensed combined financial statements are intended to provide information about the effect of the business consummation as if it had been consummated earlier. The pro forma adjustments are based on available information and certain assumptions that management believes are reasonable.

The unaudited pro forma condensed combined financial information should be read in conjunction with:

- the accompanying notes to the unaudited pro forma condensed combined financial statements;
- Registrant's audited historical financial statements and related notes included in its Annual Report on Form 10-K for the year ended December 31, 20X1 and unaudited historical condensed financial statements and related notes in its Quarterly Report on Form 10-Q for the quarterly period ended September 30, 20X2; and
- Target's audited historical financial statements and related notes included in this filing as of and for the year ended December 31, 20X1 and unaudited historical condensed financial statements and related notes as of and for the nine months ended September 30, 20X2.

3.2.20 Columnar presentation

Excerpt from Reg S-X Rule 11-02

Preparation requirements.

(a) *Form and content.*

…

(3) The pro forma condensed financial information need only include major captions (i.e., the numbered captions) prescribed by the applicable sections of Regulation S-X. Where any major balance sheet caption is less than 10 percent of total assets, the caption may be combined with others. When any major statement of comprehensive income caption is less than 15 percent of average net income attributable to the registrant for the most recent three fiscal years, the caption may be combined with others. In calculating average net income attributable to the registrant, loss years should be excluded unless losses were incurred in each of the most recent three years, in which case the

average loss must be used for purposes of this test. Notwithstanding these tests, *de minimis* amounts need not be shown separately.

(4) Pro forma statements will ordinarily be in columnar form showing condensed historical statements, pro forma adjustments, and the pro forma results.

(5) The pro forma condensed statement of comprehensive income must disclose income (loss) from continuing operations and income or loss from continuing operations attributable to the controlling interest.

The pro forma financial information is presented in a series of columns, for example:

- the registrant's historical financial statements;
- acquired or disposed business's historical financial statements, as applicable;
- transaction accounting adjustments. Separate columns are permitted, and may be necessary, if multiple transactions are being presented – e.g. an acquisition accompanied by a disposition, or an acquisition with conforming reclassifications (see section 3.3.20);
- autonomous entity adjustments (if applicable); and
- pro forma total.

Example 3.2.20 Columnar presentation

See Example 3.2.10 for background of this example, as well as the introductory paragraph that would proceed the pro forma financial information below. This example does not include any autonomous entity adjustments.

Unaudited Pro Forma Condensed Combined Balance Sheet
As of September 30, 20X2
(in millions)

	Historical		Transaction accounting adjustments[1]	
	Registrant	Target	Business combination	Pro forma combined
Cash	1,500	525	(1,000)	1,025
Property & equipment	3,000	2,500	2,000	7,500
Trademark	–	–	3,000	3,000
Other assets	516	363	–	879
Total assets	5,016	3,388	4,000	12,404
Accounts payable	350	150	–	500
Debt	1,000	–	7,100	8,100

	Historical		Transaction accounting adjustments[1]	
	Registrant	Target	Business combination	Pro forma combined
Other liabilities	1,205	138	–	1,343
Total liabilities	2,555	288	7,100	9,943
Common stock	500	600	(600)	500
Additional paid-in capital	3,000	1,500	(1,500)	3,000
Retained earnings	(1,039)	1,000	(1,000)	(1,039)
Total equity	2,461	3,100	(3,100)	2,461
Total liabilities and equity	5,016	3,388	4,000	12,404

Note:

1. Notes to the transaction accounting adjustments have been excluded for illustration purposes of this example.

Unaudited Pro Forma Condensed Combined Income Statement
For the year ended December 31, 20X1
(in millions, except per share amounts)

	Historical		Transaction accounting adjustments[1]	
	Registrant	Target	Business combination	Pro forma combined
Revenue	3,000	2,100	–	5,100
Cost of sales	1,400	1,150	–	2,550
SG&A	500	400	–	900
Depreciation & amortization	375	313	450	1,138
Interest expense	50	–	355	405
Income before tax	675	237	(805)	107
Tax expense	169	59	(201)	27
Net income	506	178	(604)	80
Basic & diluted EPS	5.06			0.80
Weighted-average shares	100			100

Note:

1. Notes to the transaction accounting adjustments have been excluded for illustration purposes of this example.

Unaudited Pro Forma Condensed Combined Income Statement
For the nine months ended September 30, 20X2
(in millions, except per share amounts)

	Historical		Transaction accounting adjustments[1]	
	Registrant	Target	Business combination	Pro forma combined
Revenue	2,100	1,470	–	3,570
Cost of sales	980	805	–	1,785
SG&A	350	280	–	630
Depreciation & amortization	263	219	338	820
Interest expense	35	–	266	301
Income before tax	472	166	(604)	34
Tax expense	118	42	(151)	9
Net income	354	124	(453)	25
Basic & diluted EPS	3.54			0.25
Weighted-average shares	100			100

Note:

1. Notes to the transaction accounting adjustments have been excluded for illustration purposes of this example.

3.2.30 Narrative presentation of pro forma financial information

Excerpt from Reg S-X Rule 11-02

Preparation requirements.

(a) *Form and content.*

(1) Pro forma financial information must consist of a pro forma condensed balance sheet, pro forma condensed statements of comprehensive income, and accompanying explanatory notes. In certain circumstances (i.e., where a limited number of pro forma adjustments are required and those adjustments are easily understood), a narrative description of the pro forma effects of the transaction may be disclosed in lieu of the statements described in this paragraph (a)(1).

In certain cases, such as transactions that only require a small number of easily understood pro forma adjustments, registrants may elect to use a narrative description of the quantitative pro forma effects in lieu of the statements described above. [S-X Rule 11-02(a)(1)]

However, the registrant must still include a brief statement that describes all the following:

- the transaction for which pro forma effects are presented;
- the entities involved;
- the periods for which the pro forma financial information is presented;
- an explanation of what the pro forma presentation shows.

A narrative presentation of pro forma financial information is not appropriate for complex transactions, such as a significant business combination.

Example 3.2.30 Narrative presentation of pro forma financial information

Registrant is offering long-term debt securities, the proceeds of which will be used to pay down an outstanding line of credit. Registrant has determined that pro forma presentation of this refinancing is material to investors, but that it can be easily understood in a narrative presentation given its nature and the small number of pro forma adjustments required. An example of how Registrant's pro forma disclosure might be presented is shown below.

Illustrative narrative pro forma financial information

On March 1, 20X2, Registrant will issue long-term debt securities of $10 million in the form of senior secured notes due in five years bearing interest at 5% per annum. Registrant will use the proceeds to pay down the $10 million outstanding line of credit with Bank, which bears interest at 10% per annum.

If the transaction had occurred on December 31, 20X1, the pro forma balance sheet would have reflected an adjustment to reduce current liabilities and increase long-term debt by $10 million as of December 31, 20X1. If the transaction had occurred on January 1, 20X1, the pro forma income statement would have reflected an adjustment to reduce interest expense from $1 million to $500,000 and pro forma net income for the year ended December 31, 20X1 would have decreased to $49.6 million. Pro forma basic and diluted EPS would have decreased $0.02 per share to $1.98 per share.

3.2.40 Pro forma per share amounts

Excerpt from Reg S-X Rule 11-02

Preparation requirements.

(a) *Form and content.*

…

(9) (i) Historical and pro forma basic and diluted per share amounts based on continuing operations attributable to the controlling

interests and the number of shares used to calculate such per share amounts must be presented on the face of the pro forma condensed statement of comprehensive income and only give effect to Transaction Accounting Adjustments and Autonomous Entity Adjustments.

(ii) The number of shares used in the calculation of the pro forma per share amounts must be based on the weighted average number of shares outstanding during the period adjusted to give effect to the number of shares issued or to be issued to consummate the transaction, or if applicable whose proceeds will be used to consummate the transaction as if the shares were outstanding as of the beginning of the period presented. Calculate the pro forma effect of potential common stock being issued in the transaction (e.g., a convertible security), or the proceeds of which will be used to consummate the transaction, on pro forma earnings per share in accordance with U.S. GAAP or IFRS-IASB, as applicable, as if the potential common stock were outstanding as of the beginning of the period presented.

Basic and diluted earnings per share (EPS) from continuing operations attributable to the registrant and the related number of shares used are presented on the face of the pro forma income statement on both a historical and pro forma basis. Pro forma basis EPS includes only transaction accounting adjustments and autonomous entity adjustments, but not management adjustments that are only presented in the explanatory notes (see sections 3.3 and 3.4). [S-X Rule 11-02(a)(9)]

Question 3.2.10 How is the pro forma conversion of convertible securities reflected in pro forma EPS?

Interpretive response: As of the beginning of the earliest period presented.

The calculation of weighted average shares outstanding that is used in pro forma EPS calculations includes any shares that have been, or would be, issued to complete the transaction for which pro forma financial information is being presented. That pro forma adjustment to the weighted average shares outstanding is made as of the beginning of the period presented. This is true even if the entity's convertible securities were not actually outstanding for all of that historical period. [Regs Comm 03/2021]

Similarly, if the transaction for which pro forma financial statements are being presented includes the issuance of new convertible securities, those potentially dilutive securities are included in the calculation of pro forma diluted EPS as of the beginning of the period presented. [S-X Rule 11-02(a)(9)(ii)]

3.2.50 Required statements and periods presented

Excerpt from Reg S-X Rule 11-02

Preparation requirements.

(c) *Periods to be presented.*

(1) A pro forma condensed balance sheet as of the end of the most recent period for which a consolidated balance sheet of the registrant is required by § 210.3-01 must be filed unless the transaction is already reflected in such balance sheet.

(2) (i) Pro forma condensed statements of comprehensive income must be filed for only the most recent fiscal year, except as noted in paragraph (c)(2)(ii) of this section, and for the period from the most recent fiscal year end to the most recent interim date for which a balance sheet is required. A pro forma condensed statement of comprehensive income may be filed for the corresponding interim period of the preceding fiscal year. A pro forma condensed statement of comprehensive income must not be filed when the historical statement of comprehensive income reflects the transaction for the entire period.

(ii) For transactions required to be accounted for under U.S. GAAP or, as applicable, IFRS-IASB by retrospectively revising the historical statements of comprehensive income (e.g., combination of entities under common control and discontinued operations), pro forma statements of comprehensive income must be filed for all periods for which historical financial statements of the registrant are required. Retrospective revisions stemming from the registrant's adoption of a new accounting principle must not be reflected in pro forma statements of comprehensive income until they are depicted in the registrant's historical financial statements.

…

(4) Whenever unusual events enter into the determination of the results shown for the most recently completed fiscal year, the effect of such unusual events should be disclosed and consideration should be given to presenting a pro forma condensed statement of comprehensive income for the most recent twelve-month period in addition to those required in paragraph (c)(2)(i) of this section if the most recent twelve-month period is more representative of normal operations.

The required periods of pro forma financial information are generally: [S-X Rule 11-02(c)]

- the most recent annual or interim balance sheet filed or required to be filed under Reg S-X Rule 3-01 (or included in the same filing), unless the transaction is already reflected in the historical balance sheet;
- the income statement for the most recent fiscal year; and
- the income statement for the year-to-date interim period subsequent to the most recent fiscal year through the required balance sheet date (if the

balance sheet date is as of an interim period). Presentation of the corresponding year-to-date interim period in the prior fiscal year is optional.

Generally, the historical balance sheet and income statements of an acquired business included in the pro forma information should be as of, and for the same periods as, the registrant, unless the acquired business has a different fiscal year-end.

The age (i.e. period) of annual and interim pro forma financial statements that must be provided varies based on the type of filing. The type of filing establishes a specific date that is important for determining the age of pro forma financial statements.

Form 8-K	The earlier of date when initially filed with the SEC and date on which it must be initially filed
Registration statement	Date declared effective
Proxy material	Date mailed

For detailed discussion of the age of financial statements, see chapter 4 of KPMG Handbook, SEC Business combinations.

Question 3.2.20 If the financial statements for the most recently completed period have not yet been filed and are not yet required to be filed, what period is presented in the pro forma balance sheet?

Interpretive response: The pro forma balance sheet presented is as of the end of the most recent period for which a consolidated balance sheet of the registrant is required by Reg S-X Rule 3-01 (i.e. the most recent annual or interim period filed or required to be filed by Rule 3-01).

The pro forma balance sheet need not be updated through a registrant's most recently completed annual or interim period if at the time of the transaction:

- the registrant's required annual or interim financial statements have not been filed, and
- the allowable time period to file those financial statements has not expired (e.g. 90 days for Form 10-K and 45 days for Form 10-Q for a registrant that is not an accelerated filer).

See Question 3.2.30 for additional guidance related to the effect of the filing of a periodic report after the initial Form 8-K.

Question 3.2.30 Are the pro forma periods required affected by the filing of a periodic report after the initial Form 8-K?

Interpretive response: It depends. A registrant that timely reports a significant business acquisition on Item 2.01 of Form 8-K within four business days of consummation is allowed an additional 71 calendar days to file pro forma financial information under Item 9.01 of Form 8-K (see Question 2.2.40).

Quarterly financial statements are frequently filed during that grace period. In that circumstance, the pro forma financial information filed in the amended Form 8-K may include the periods from either:

- the most recent financial statements filed, or required to be filed, before the initial Form 8-K's filing date or due date (whichever comes first); or
- the financial statements filed after the initial Form 8-K and before the amended Form 8-K is timely filed.

If a registrant elects the second option, the acquisition would generally be fully reflected in the historical balance sheet, making a pro forma balance sheet unnecessary. Additionally, care should be taken not to double-count the acquiree's post-acquisition operating results, since they would already be included in the registrant's historical financial statements for a portion of the current quarter.

Example 3.2.40 Date of pro forma balance sheet required

On November 5, 20X2, Registrant acquired Target, a significant business. Registrant, which has a calendar year-end and is an accelerated filer, filed its 20X1 Form 10-K on February 28, 20X2, and filed its June 30, 20X2 Form 10-Q on August 1, 20X2. It has not yet filed its September 30, 20X2 Form 10-Q, which is due on November 9, 20X2.

If Registrant files the initial Item 2.01 Form 8-K to report the acquisition of Target before the September 30, 20X2 Form 10-Q is filed, the pro forma condensed balance sheet and income statement may be as of June 30, 20X2. If Registrant files the initial Item 2.01 Form 8-K to report the acquisition after the due date for the September 30, 20X2 Form 10-Q, the pro forma condensed balance sheet and income statement must be as of September 30, 20X2.

While beyond the scope of this example, note that staleness dates do not correspond exactly with the Form 10-Q filing deadlines because those deadlines run from the end of the most recently ended quarter, whereas the staleness dates run from the end of the preceding quarter. However, the SEC staff generally provides an accommodation for repeat issuers that have been timely filers for the past 12 months by allowing such issuers' registration statements to become effective during the gap period between the staleness dates shown above and the nearest Form 10-Q filing deadline, absent unusual circumstances. As a result, for most repeat issuers, the effective staleness date is the same as the Form 10-Q filing deadline.

Question 3.2.40 Is it ever appropriate to omit a pro forma financial statement?

Interpretive response: Yes. If the transaction requiring pro forma financial information is already reflected in the historical balance sheet, a pro forma balance sheet is not required. However, a pro forma income statement would still be required, unless the relevant transaction(s) have already been included in the historical income statement for the entire period required to be presented, in which case that pro forma income statement is *not permitted* to be presented in the filing. [S-X Rule 11-02(c), FRM 3220.1, FRM 3230.1]

In addition, related to an acquisition, a registrant may omit the pro forma financial statements from registration statements and certain proxy statements if Reg S-X Rule 3-05 or Rule 3-14 permits the acquiree's separate historical financial statements to be omitted or those historical statements are otherwise not included in the filing. For example, an acquiree's historical financial statements may be omitted when its operating results have been reflected in the audited, consolidated financial statements of the registrant for specified periods of time at effectiveness (depending on significance). See Questions 2.3.140, 2.3.160, and 4.4.80 in KPMG Handbook, SEC Business combinations. [S-X Rule 11-01(c)]

Example 3.2.50 Transaction reflected in historical balance sheet

Registrant, which has a calendar year-end, files a registration statement in November 20X2. At the time of filing, Registrant already has filed its Form 10-Q for the quarter ended September 30, 20X2. On January 30, 20X2, Registrant had acquired a business that was significant and it filed the information required under Form 8-K with respect to the acquisition in a timely manner. The registration statement includes any required audited annual and unaudited interim period historical financial statements of Registrant and the acquired business.

Registrant must include in the registration statement a pro forma condensed income statement for the year ended December 31, 20X1 and for the nine months ended September 30, 20X2 to reflect the acquisition of the business. A pro forma condensed balance sheet is not required because Registrant's September 30, 20X2 quarter-end balance sheet already includes the acquired business.

Question 3.2.50 Are pro forma income statements permitted or required to be presented for more than one annual period?

Interpretive response: Yes, in specific circumstances.

Pro forma income statements are required only for the registrant's most recent fiscal year and the subsequent year-to-date interim period for which a balance sheet is required. A registrant may, but is not required to, present a pro forma income statement for the corresponding prior interim period. [S-X Rule 11-02(c)(2)(i), FRM 3230.1]

However, if relevant US GAAP or IFRS Accounting Standards-IASB require full retrospective presentation of the transaction at issue, then the registrant must provide pro forma income statements for all periods for which its historical financial statements are required. [S-X Rule 11-02(c)(2)(ii), FRM 3230.2]

The following are two examples of such an instance:

- reorganization of entities under common control (paragraph 805-50-15-6);
- discontinued operations (Subtopic 205-20) not yet reflected in the historical financial statements because the date of sale or classification as held-for-sale occurs after the date of the latest balance sheet included in the filing.

See chapter 6 for additional guidance related to discontinued operations not yet reflected in the historical financial statements.

Question 3.2.60 How do pro forma financial statements for transactions requiring three-year presentation reflect other transactions limited to a one-year presentation?

Interpretive response: The SEC requires three years of pro forma financial information for common control mergers and discontinued operations to correspond with the US GAAP reporting requirements for such transactions (see Question 3.2.50).

When additional annual periods are included, only the effects of the reorganization of commonly controlled entities or discontinued operations are 'pushed back' beyond the first annual period. If pro forma financial information is also required for other transactions (e.g. a new contractual arrangement or reduction in interest expense attributable to repayment of debt), the pro forma presentations for those other transactions is limited to the most recent year and interim period, regardless of whether they are related or unrelated to the common control merger or discontinued operations. In other words, the 'as adjusted' column of the earlier annual periods is generally expected to agree to the historical periods presented in subsequently filed Forms 10-Q or 10-K. Disclosures should clearly describe how the transactions are reflected in the periods presented.

The periods for which pro forma income adjustments are presented are based on the transaction that triggers the pro forma reporting requirements.

For example, assume a registrant:

- presents pro forma financial information for a significant business acquisition, and
- then elects to also include the pro forma effects of a disposition that occurred during the most recent year (or interim period) that was insignificant at the 10% level but was required to be presented as discontinued operations under Subtopic 205-20.

In this case, the pro forma adjustment for the disposition is limited to only the most recent annual period and subsequent interim period. This is because the transaction that triggered the pro forma reporting requirements was the significant business acquisition.

Example 3.2.60 Presentation of separate financial statements for multiple transactions (1)

Registrant disposes of Subsidiary B in April 20X3 and Subsidiary B qualifies for but has not yet been reflected in discontinued operations in Registrant's historical financial statements.

In conjunction with the disposal, Registrant uses the proceeds to repay certain outstanding debt obligations and as a result, it must reflect the pro forma effect of the reduction in interest expense.

In this case, in the pro forma financial information giving effect to the disposition, Registrant would also reflect the pro forma reduction in interest expense as if the repayment had occurred as of January 1, 20X2 (not January 1, 20X0) even though three years of pro forma income statements are presented reflecting the discontinued operation.

Example 3.2.70 Presentation of separate financial statements for multiple transactions (2)

Registrant consummates a significant business combination in December 20X2. It will be filing a Form 8-K that will include pro forma income statements for the nine months ended September 30, 20X2 and the year ended December 31, 20X1.

Registrant has disposed of three businesses during the year (none of which were individually significant) that have been reflected as discontinued operations in its Form 10-Q for the nine months ended September 30, 20X2. It has not filed any new or amended registration statements so it has not been required to retrospectively recast the 20X1 annual financial statements to present the discontinued operations. It now plans to separately reflect the effects of the discontinued operations in the pro forma income statement for the year ended December 31, 20X1 to be included in the Form 8-K.

In this scenario, the transaction giving rise to the pro forma requirement is the business combination, so Registrant would generally not be required to provide three years of pro forma financial information for the discontinued operations (subject to the caveat below). The SEC staff would not object to Registrant limiting the effects of the insignificant discontinued operations in the pro forma adjustments to the year ended December 31, 20X1.

However, in circumstances in which the additional pro forma income statements for a discontinued operation are considered material to investors, the SEC staff has indicated pro forma income statements for the discontinued operation may be necessary for the three most recent fiscal years (two years for a smaller reporting company) and comparative interim periods.

Question 3.2.70 Can a pro forma income statement be presented for a period other than the registrant's most recently completed fiscal year or interim period?

Interpretive response: Yes, in specific circumstances.

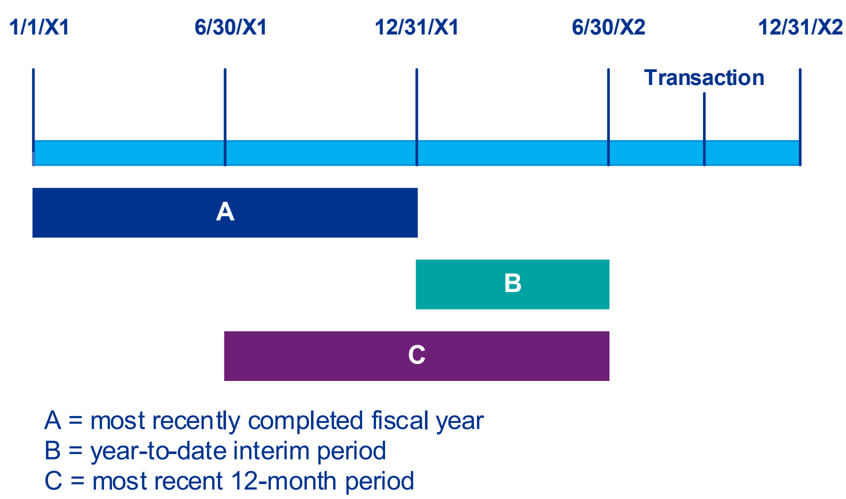
Reg S-X Article 11 requires the following pro forma income statements:

- the most recently completed fiscal year; and
- subsequent interim year-to-date period.

The SEC rules generally do not allow the inclusion of more than one pro forma annual income statement (see Question 3.2.50). However, when the most recently completed fiscal year includes unusual events, the effect of those unusual events should be disclosed. The registrant should also consider presenting an additional pro forma income statement for the most recent 12 month period (i.e. trailing pro forma income statement) if it would be more representative of normal operations. An option does not exist to include an additional pro forma income statement for the comparable prior year.

This third pro forma income statement period may only be provided in addition to (and not in place of) the pro forma income statement for the most recently completed fiscal year, and the subsequent interim year-to-date pro forma income statement. Clear disclosure of the reasons for the two presentations should be provided. [S-X Rule 11-02(c)(4)]

The following diagram reflects the two required pro forma income statements (A and B) and this third income statement (C).



The registrant cannot remove the unusual effect from any pro forma income statement presented. However, it may present a financial forecast in lieu of a pro forma income statement. [FRM 3302.1]

Circumstances giving rise to a third pro forma income statement are rare but might occur for registrants in highly seasonal businesses.

Example 3.2.80 Presentation of a 12-month trailing pro forma income statement

Registrant is a home fuel-oil company with a calendar year-end and is planning an IPO in the summer of 20X1. It recently completed the acquisition of Target, also a home fuel-oil company, and will include pro forma financial information in the initial registration statement.

Management concludes that the negative effect on Registrant's operations because of unusually warm winter months in the past year would be clearer to investors if it presented a third pro forma income statement for the 12 months ended March 31, 20X1. This would be presented in addition to pro forma income statements for the year ended December 31, 20X0 and the three months ended March 31, 20X1. Registrant may not substitute the trailing pro forma income statement for the 12 months ended March 31, 20X1 for the pro forma income statement covering the required annual period.

All three pro forma income statements are prepared as if Target had been acquired on January 1, 20X0.

Example 3.2.90 Period to include in a 12-month trailing pro forma condensed income statement

Registrant has a calendar year-end and its most recent financial statements filed with the SEC are for the quarter ended June 30, 20X2. It has consummated numerous acquisitions during the past fiscal year and in the current fiscal year. In a current registration statement, Registrant must include pro forma financial information under Reg S-X Article 11. The pro forma financial information will include a pro forma condensed balance sheet as of June 30, 20X2, and pro forma condensed income statements for the six months ended June 30, 20X2 and for the year ended December 31, 20X1.

Because of its numerous acquisitions in the last 18 months, Registrant believes the trailing 12-month income statement would be more indicative of normal operations. Therefore, it intends to also include in the registration statement a trailing 12-month pro forma condensed income statement for the period ended June 30, 20X2.

As discussed in section 3.3.20, Reg S-X Rule 11-02(a)(6)(i)(B) specifies that pro forma adjustments related to the pro forma condensed income statement must be computed assuming the transaction was consummated at the beginning of the fiscal year presented. Therefore, the pro forma condensed income statements for the most recently completed fiscal year and for the 12-month trailing period should use January 1, 20X1 as the measurement date.

3.3 Types of pro forma adjustments

3.3.10 Overview

Excerpt from Reg S-X Rule 11-02

Preparation requirements.

(a) *Form and content.*

…

(6) The pro forma condensed balance sheet and pro forma condensed statements of comprehensive income must include, and be limited to, the following pro forma adjustments, except as noted in paragraph (a)(7) of this section:

(i) *Transaction Accounting Adjustments*.

(A) Adjustments that depict in the pro forma condensed balance sheet the accounting for the transaction required by U.S. Generally Accepted Accounting Principles (U.S. GAAP) or, as applicable, International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS-IASB). Calculate pro forma adjustments using the measurement date and method prescribed by the applicable accounting standards. For a probable transaction, calculate pro forma adjustments using, and disclose, the most recent practicable date prior to the effective date (for registration statements), qualification date (for offering statements under 17 CFR 230.251 through 230.263 (Regulation A)), or the mail date (for proxy statements).

(B) Adjustments that depict in the pro forma condensed statements of comprehensive income the effects of the pro forma balance sheet adjustments in paragraph (a)(6)(i)(A) of this section assuming those adjustments were made as of the beginning of the fiscal year presented. Such adjustments must be made whether or not the pro forma balance sheet is presented pursuant to paragraph (c)(1) of this section. If the condition in § 210.11-01(a) that is met does not have a balance sheet effect, then depict the accounting for the transaction required by U.S. GAAP or IFRS-IASB, as applicable.

(ii) *Autonomous Entity Adjustments.* Adjustments that depict the registrant as an autonomous entity if the condition in § 210.11-01(a)(7) is met. Autonomous Entity Adjustments must be presented in a separate column from Transaction Accounting Adjustments.

…

(11) The accompanying explanatory notes must disclose:

(i) Revenues, expenses, gains and losses and related tax effects which will not recur in the income of the registrant beyond 12 months after the transaction.

…

(b) *Implementation guidance –*

...

(5) *Tax effects.*

(i) Tax effects, if any, of pro forma adjustments normally should be calculated at the statutory rate in effect during the periods for which pro forma condensed statements of comprehensive income are presented and should be reflected as a separate pro forma adjustment.

(ii) When the registrant's historical statements of comprehensive income do not reflect the tax provision on the separate return basis, pro forma statements of comprehensive income adjustments must reflect a tax provision calculated on the separate return basis.

Reg S-X Rule 11-02(a)(6) outlines the types of pro forma adjustments to be included in the pro forma financial information and how they are to be measured and presented.

There are two types of pro forma adjustments:

- Transaction accounting adjustments: [S-X Rule 11-02(a)(6)(i)]
  - depict in the pro forma balance sheet how the relevant transaction will be accounted for under the applicable GAAP as if it had occurred on the pro forma balance sheet date; and
  - depict in the pro forma income statement(s) the effects of the pro forma balance sheet adjustments as if they had been made at the beginning of the annual pro forma period.
- Autonomous entity adjustments are only required when the registrant was previously part of another entity and are made to demonstrate how the registrant would have looked as a stand-alone registrant. [S-X Rule 11-02(a)(6)(ii)]

See sections 3.3.20 and 3.3.30 for additional discussion specific to transaction accounting and autonomous entity adjustments, respectively.

Question 3.3.10 How are nonrecurring items accounted for in pro forma income statements?

Interpretive response: Nonrecurring items are fully accounted for in pro forma income statements, as follows.

- **Nonrecurring effects of the transaction requiring the pro forma information –** Nonrecurring effects on continuing operations (e.g. transaction costs in a business combination) are included in pro forma income statement adjustments.
- **Nonrecurring items in income from continuing operations of the historical operations –** Such items (e.g. an historical impairment or restructuring event) are not 'adjusted out' by pro forma adjustments.

However, items that will not recur beyond 12 months after the transaction and their related income tax effects are disclosed in the explanatory notes. [SEC Rel 33-10786 p 110-111, S-X Rule 11-02(a)(11)]

Question 3.3.20 How are the income tax effects of pro forma adjustments determined?

Interpretive response: The income tax effects of pro forma adjustments normally are based upon the statutory tax rates in effect during the relevant period(s) presented, and are reflected as a separate pro forma adjustment. Registrants are not required, but may elect, to modify the statutory rate to include other aspects of income tax accounting (e.g. permanent items, law changes, full valuation allowance). In these cases, registrants should provide an explanation in the notes to the pro forma financial information. [S-X Rule 11-02(b)(5), FRM 3270.1]

New tax rates that are enacted for future periods do not affect the tax rate that is applied to pro forma income from continuing operations in the historical periods. Instead, an enacted future tax rate is disclosed in the notes to the pro forma financial information.

Additionally, a tax effect of pro forma adjustments is calculated on a separate return basis, even when the registrant's historical income statements may not reflect the broader tax provision on that basis. [S-X Rule 11-02(b)(5), SAB Topic 1.B.1 (Q 3), FRM 3270.2]

Issues unique to business combinations

A business combination may require presentation of transaction accounting adjustments for unique circumstances, such as the following.

- The registrant might acquire deferred tax liabilities in a taxable acquisition, which enable the registrant to reverse a preexisting valuation allowance on its own deferred tax assets.
- The target may not have been able to recognize tax benefits on the losses in its historical financial statements due to a full valuation allowance. A transaction accounting adjustment to recognize the benefit of those losses may be necessary if reversal of the valuation allowance would be enabled by the business combination.

See section 4.7 for further detail.

3.3.20 Transaction accounting adjustments

Excerpt from Reg S-X Rule 11-02

Preparation requirements.

(a) *Form and content.*

…

(6) The pro forma condensed balance sheet and pro forma condensed statements of comprehensive income must include, and be limited to, the following pro forma adjustments, except as noted in paragraph (a)(7) of this section:

(i) *Transaction Accounting Adjustments.*

(A) Adjustments that depict in the pro forma condensed balance sheet the accounting for the transaction required by U.S. Generally Accepted Accounting Principles (U.S. GAAP) or, as applicable, International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS-IASB). Calculate pro forma adjustments using the measurement date and method prescribed by the applicable accounting standards. For a probable transaction, calculate pro forma adjustments using, and disclose, the most recent practicable date prior to the effective date (for registration statements), qualification date (for offering statements under 17 CFR 230.251 through 230.263 (Regulation A)), or the mail date (for proxy statements).

(B) Adjustments that depict in the pro forma condensed statements of comprehensive income the effects of the pro forma balance sheet adjustments in paragraph (a)(6)(i)(A) of this section assuming those adjustments were made as of the beginning of the fiscal year presented. Such adjustments must be made whether or not the pro forma balance sheet is presented pursuant to paragraph (c)(1) of this section. If the condition in § 210.11-01(a) that is met does not have a balance sheet effect, then depict the accounting for the transaction required by U.S. GAAP or IFRS-IASB, as applicable.

…

(11) The accompanying explanatory notes must disclose:

…

(ii) For Transaction Accounting Adjustments:

(A) A table showing the total consideration transferred or received including its components and how they were measured. If total consideration includes contingent consideration, describe the arrangement(s), the basis for determining the amount of payment(s) or receipt(s), and an estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why; and

(B) The following information when the accounting is incomplete: A prominent statement to this effect; the items for which the accounting depicted is incomplete; a description of the information that the registrant requires, including, if material, the uncertainties affecting the pro forma financial information and the possible consequences of their resolution; an indication of when the accounting is expected to be finalized; and other available information that will enable a reader to understand the magnitude of any potential adjustments to the measurements depicted.

…

(b) *Implementation guidance –*

…

> (4) *Multiple transactions.*
>
> (i) When consummation of more than one transaction has occurred, or is probable, the pro forma financial information must present in separate columns each transaction for which pro forma presentation is required by § 210.11-01.
>
> (ii) If the pro forma financial information is presented in a proxy or information statement for purposes of obtaining shareholder approval of one of the transactions, the effects of that transaction must be clearly set forth.

Transaction accounting adjustments reflect the GAAP effects of the transaction requiring pro forma information under Reg S-X Rule 11-01 (see section 2.2).

Question 3.3.30 What is the measurement date for adjustment amounts presented in a pro forma balance sheet?

Interpretive response: Adjustment amounts are measured as of the actual or expected measurement date for the transaction under GAAP even though those adjustments may be presented as if they occurred at the earlier pro forma balance sheet date.

For example, it is not necessary to perform an incremental valuation analysis as of the pro forma balance sheet date to determine the adjustments for a business combination assuming it had occurred on that date. The valuation performed as of the actual GAAP acquisition/measurement date is adequate for pro forma purposes because the objective of pro forma financial information is merely to present how the actual transaction might have affected the historical financial statements. [S-X Rule 11-02(a)(6)(i)(A)]

Question 3.3.40 How are transaction accounting adjustments determined for a probable transaction?

Interpretive response: Pro forma adjustments are calculated using the measurement date and method prescribed by the applicable accounting standards. For a probable transaction, pro forma adjustments are calculated using the most recent practicable date prior to the effective date (for registration statements), qualification date (for offering statements), or the mail date (for proxy statements). What constitutes the 'most recent practicable date' is a facts and circumstances determination. For example, when estimating the value of stock to be issued, a registrant uses the most recent stock price that is practicable at the time of filing the pro forma financial information (see Question 4.3.10). An entity should also disclose the applicable date used. [S-X Rule 11-02(a)(6)(i)(A), FRM 3244.3]

Question 3.3.50 How are transaction accounting adjustments presented in a pro forma income statement?

Interpretive response: Transaction accounting adjustments depict in the pro forma income statement(s) the effects of the pro forma balance sheet adjustments as if they had been made at the beginning of the annual pro forma period. Pro forma income statement transaction accounting adjustments are required even when the transaction has no balance sheet effect or has already been reflected in the historical balance sheet. In cases in which the transaction has no balance sheet effect, the pro forma income statement adjustment(s) are determined using the applicable accounting standard. [S-X Rule 11-02(a)(6)(i)(B)]

Example 3.3.10 Assumed transaction dates for preparation of pro forma financial statements

Registrant (with a calendar year-end) acquires a significant business on August 31, 20X5. Registrant is preparing pro forma financial information for the acquisition as of June 30, 20X5.

Included in the acquired assets is a building valued at $10,000, with a 10-year life. The June 30, 20X5 pro forma balance sheet shows a $10,000 increase in PP&E and an equal decrease in cash. Pro forma depreciation expense increases by $1,000 for the calendar year ended 20X4 and $500 for the six months ended June 30, 20X5.

Note that the pro forma increase to PP&E on June 30, 20X5 is $10,000 and not $8,500, even though $1,500 of total depreciation expense is included in the pro forma income statements for 20X4 and 20X5.

Note: This example reflects the pro forma adjustments of only the acquired business's building. Pro forma adjustments to account for other assets acquired or liabilities assumed have not been included in this example.

Question 3.3.60 What are the general disclosures required in the explanatory notes related to transaction accounting adjustments?

Interpretive response: In addition to disclosures describing each transaction accounting adjustment, the explanatory notes must also provide the following disclosures when applicable.

- The pro forma adjustments should be referenced to explanatory notes that clearly explain the assumptions involved. [S-X Rule 11-02(a)(8)]
- The explanatory notes should include a table showing the total consideration transferred or received, including its components and how they were measured. Additional information is required if the total consideration includes contingent consideration and/or if the accounting is

incomplete. See Question 4.2.20 for additional guidance related to requirements when the accounting is incomplete. [S-X Rule 11-02(a)(11)(ii)]

Question 3.3.70 How are the transaction accounting adjustments presented when there are multiple transactions depicted in pro forma financial information?

Interpretive response: Because transaction accounting adjustments reflect the GAAP effects of the transaction requiring pro forma information, Reg S-X Rule 11-01 generally requires separate columnar presentation of each transaction. For example, a company that is making a series of unrelated acquisitions would generally present the transaction accounting adjustments for each acquisition in separate columns. [S-X Rule 11-02(b)(4)]

In some cases, a single acquisition (or disposition) may give rise to 'other material' transactions – i.e. separate, downstream transactions for which pro forma information is considered material to investors under Rule 11-01(a)(8). Examples of other material transactions include the incurrence of severance benefits, or the use of proceeds from a significant disposition or from an issuance of securities.

Pro forma adjustments for an 'other material transaction', as defined under Rule 11-01(a)(8), are presented in a separate column if the other transaction is discrete from the primary transaction. However, when a single significant transaction triggers multiple other material transactions and each is discrete from the primary transaction, we believe those separate transactions could be presented in a single column apart from the primary transaction if single-column presentation would not be misleading to investors.

Other transactions considered material under Rule 11-01(a)(8) should also be discussed in the introductory paragraph (see section 3.2.10).

Example 3.3.20 Separate transaction accounting adjustment columns

Registrant files a proxy statement in connection with soliciting a vote of the shareholders on a proposed acquisition of Target. The proxy includes pro forma financial information.

Transaction accounting adjustments – Business combination

Registrant concludes the following adjustments should be included in a column entitled 'Transaction accounting adjustments – Business combination'.

Adjustment	Example
Allocation of consideration transferred to adjust acquired assets and assumed liabilities to fair value (and the related subsequent effects on income)	Target's plant, property and equipment is adjusted to fair value and depreciation expense is adjusted based on the fair value.

Adjustment	Example
Transaction expenses and items specified in the acquisition agreement	Registrant agrees to modify Target's share-based compensation agreements as part of the acquisition agreement and includes the effects of these modifications in consideration transferred in the acquisition.
Related accounting effects that, although not part of acquisition accounting under Topic 805, cannot be avoided based on the terms and structure of the acquisition	Acquisition of Target's deferred tax liabilities in a taxable acquisition will enable Registrant to recognize a tax benefit from reversal of the preexisting valuation allowance on Registrant's deferred tax assets.

Transaction accounting adjustments – Other

Registrant also concludes that consummation of the acquisition is the only remaining contingency for management to execute other changes that, while conditioned upon consummation, are logically distinct and separate (the acquisition could close even if these actions were not taken). Those other changes relate to the following items:

- compensation arrangements for employees that will be terminated upon or after consummation as part of a detailed plan that is not part of the acquisition agreement but would otherwise meet the relevant US GAAP recognition criteria at consummation (i.e. Topic 710 or Topic 712) or the communication to employees is expected to occur imminently thereafter (i.e. Topic 420);
- contract termination accruals for the combined entity's redundant agreements that management intends to terminate shortly after consummation;
- a special dividend whereby Registrant plans (post-acquisition) to return excess liquidity to shareholders that had been held while Registrant evaluated potential acquisition opportunities.

Management concludes that each of these items is an 'other transaction' considered to be material under Reg S-X Rule 11-01(a)(8) that requires pro forma financial information. After evaluating the factors in Question 3.3.70 management elects to present them in a single column entitled 'Transaction accounting adjustments – Other'.

The pro forma adjustments associated with these transactions would also be discussed separately from the acquisition in the introductory paragraph. [S-X Rule 11-02(a)(2)]

See section 6.3 for examples of 'directly related' versus 'other' transaction accounting adjustments in the context of a disposition.

3.3.30 Autonomous entity adjustments

Excerpt from Reg S-X Rule 11-02

Preparation requirements.

(a) *Form and content.*

…

(6) The pro forma condensed balance sheet and pro forma condensed statements of comprehensive income must include, and be limited to, the following pro forma adjustments, except as noted in paragraph (a)(7) of this section:

…

(ii) Autonomous Entity Adjustments. Adjustments that depict the registrant as an autonomous entity if the condition in § 210.11-01(a)(7) is met. Autonomous Entity Adjustments must be presented in a separate column from Transaction Accounting Adjustments.

(11) The accompanying explanatory notes must disclose:

…

(iii) For each Autonomous Entity Adjustment, a description of the adjustment (including the material uncertainties), the material assumptions, the calculation of the adjustment, and additional qualitative information about the Autonomous Entity Adjustments, if any, necessary to give a fair and balanced presentation of the pro forma financial information.

Excerpt from Reg S-X Rule 11-01

Presentation requirements.

(a) Pro forma financial information must be filed when any of the following conditions exist:

…

(7) The registrant previously was a part of another entity and such presentation is necessary to reflect operations and financial position of the registrant as an autonomous entity.

Autonomous entity adjustments are required when the registrant previously was a part of another entity and such presentation is necessary to reflect the operations and financial position of the registrant as a stand-alone entity. [S-X Rule 11-01(a)(7)]

These adjustments frequently represent the difference between the parent's historical allocation of costs to the new registrant (e.g. a spinoff) and the amount of costs that the new registrant will incur on a stand-alone basis. They may also reflect agreements for services that will be provided by the former parent company to the new registrant. [S-X Rule 11-02(a)(6)(ii)]

Autonomous entity adjustments should only be made to reflect changes in costs resulting from agreements in place or expected to be executed in connection with the spinoff. Changes in costs that are not evidenced by agreements in place would ordinarily not be autonomous entity adjustments and should be considered for disclosure as management's adjustments (see section 3.4).

A separate, discrete column is used to present autonomous entity adjustments. They cannot be presented in the same column as transaction accounting adjustments. [S-X Rule 11-02(a)(6)(ii)]

Question 3.3.80 What are some common sources of autonomous entity adjustments?

Interpretive response: The effects of transition services agreements, major distribution agreements, cost-sharing or management agreements and compensation or benefit plans should be considered for possible autonomous entity adjustments when the transaction involves a spinoff or other creation of a new registrant that was previously part of another entity.

In connection with a spinoff, autonomous entity adjustments give effect to changes in the spinnee's costs resulting from agreements in place, such as new lease arrangements or transition services agreements with its spinnor/parent. Changes in costs that are not evidenced by agreements in place ordinarily would not be autonomous entity adjustments but may be synergies and dis-synergies of the spinoff that may, in the registrant's discretion, be presented as management's adjustments if the applicable conditions are met (see section 3.4) [FRM 3246.2]

Question 3.3.90 What explanatory notes are required for autonomous entity adjustments?

Interpretive response: The explanatory notes describe the adjustment (including the material uncertainties), the material assumptions, the calculation of the adjustment, and additional qualitative information, if any, necessary to give a fair and balanced presentation of the pro forma financial information. [S-X Rule 11-02(a)(11)(iii)]

Example 3.3.30 Autonomous entity adjustments

Parent, a calendar-year-end registrant, plans to spin off its subsidiary into a new public company (SpinCo) on March 1, 20X3. The historical financial information of SpinCo is taken from its carve-out financial statements. In connection with the spinoff transaction, SpinCo and Parent will enter into a transition service agreement in conjunction with the closing of the transaction, under which SpinCo will pay Parent an annual fee to perform various administrative services for three years following the transaction. SpinCo expects to also incur additional costs as a stand-alone company including, but not limited to, new equity-based awards issued in connection with the separation.

Unaudited Pro Forma Condensed Combined Income Statement
Year Ended December 31, 20X2
(in millions, except per share amounts)

	Historical	Autonomous entity adjustments	Note	Pro forma
Sales	8,000			8,000
Cost of sales	3,000	200	1	3,200
Selling, general and administrative	1,700	350	1	2,050
Other (income) expense, net	30	25	1	55
Income from continuing operations before taxes	3,270	(575)		2,695
Taxes on income	520	(100)		420
Net income from continuing operations	2,750	(475)		2,275
Basic earnings per share				8.99
Diluted earnings per share				8.96
Weighted average shares outstanding:				
Basic				253
Diluted				254

Notes to Unaudited Pro Forma Condensed Combined Financial Information

1. As a stand-alone public company, SpinCo expects to incur certain additional costs including costs resulting from:
   - incremental costs related to commercial, manufacturing, research and business support functions that were previously shared with Parent;
   - higher costs for the services to be provided by Parent to SpinCo under the transition services agreement for information technology services, research and development, distribution, support for operations, legal, payroll, finance, tax and accounting, general administrative and other support services;
   - compensation, including new equity-based awards in connection with the separation from Parent; and
   - depreciation and amortization related to information technology infrastructure investments.

   As a result, SpinCo expects to incur approximately $575 million of expenses (including one-time expenses of approximately $200 million expected to be incurred within 12 months following the completion of the separation), in addition to Parent's corporate and shared costs that were already allocated to SpinCo's historical financial statements.

   Accordingly, the pro forma condensed combined financial statements have been adjusted to depict the SpinCo as an autonomous entity. The additional expenses have been estimated based on assumptions that management believes are reasonable. However, actual additional costs that will be incurred could be different from the estimates and would depend on several factors, including the economic environment and strategic decisions made in areas such as separation, manufacturing, selling and marketing, research and development, information technology and infrastructure.

Question 3.3.100 How do autonomous entity adjustments relate to expenses allocated to a carve-out entity under SAB Topic 1.B?

Interpretive response: They are similar but different concepts.

An autonomous entity adjustment in the pro forma financial information is made to reflect the expenses that the registrant estimates it would have incurred during the period if it had operated on a stand-alone basis.

By contrast, carve-out financial statements typically include allocations under SAB Topic 1.B to reflect the carve-out entity's allocation of the parent's expenses. That allocation of the parent's expenses may or may not correlate with the expenses that are expected to be incurred by the new registrant on a stand-alone basis. For instance, the stand-alone expenses of a registrant may exceed what was allocated to it in the historical carve-out financial statements because of economies of scale experienced by the parent.

Historical carve-out financial statements must include a disclosure of management's estimate of expenses on a stand-alone basis 'when practicable'. Practicability is assessed based on the relevant facts and circumstances.

Autonomous entity adjustments are required under Reg S-X Rule 11-01(a)(7) when "the registrant previously was a part of another entity and such presentation is necessary to reflect operations and financial position of the registrant as an autonomous entity," and are not subject to a practicability exception.

Although quantification of the relevant autonomous entity adjustment may enable disclosure in the historical carve-out financial statements, we understand the requirements are not intended to address the historical carve-out financial statements and that this interplay should be addressed on a facts-and-circumstances basis.

Question 3.3.110 Are the incremental costs of being a public entity presented as an autonomous entity adjustment?

Interpretive response: It depends. The SEC staff has indicated that when the registrant was previously part of another entity, an autonomous entity adjustment to reflect the incremental cost of complying with public company regulations, if material, should be considered.

However, this adjustment should only be made to reflect costs supported by agreements in place or expected to be executed in connection with the spinoff.

Costs that are not evidenced by agreements would ordinarily not be autonomous entity adjustments and should be considered for disclosure as management's adjustments.

3.4 Management's adjustments in the explanatory notes

Excerpt from Reg S-X Rule 11-02

Preparation requirements.

(a) *Form and content.*

…

(7) Management's Adjustments depicting synergies and dis-synergies of the acquisitions and dispositions for which pro forma effect is being given may, in the registrant's discretion, be presented if in its management's opinion, such adjustments would enhance an understanding of the pro forma effects of the transaction and the following conditions are met:

(i) *Basis for Management's Adjustments.*

(A) There is a reasonable basis for each such adjustment.

(B) The adjustments are limited to the effect of such synergies and dis-synergies on the historical financial statements that form the basis for the pro forma statement of comprehensive income as if the synergies and dis-synergies existed as of the beginning of the fiscal year presented. If such adjustments reduce expenses, the reduction must not exceed the amount of the related expense historically incurred during the pro forma period presented.

(C) The pro forma financial information reflects all Management's Adjustments that are, in the opinion of management, necessary to a fair statement of the pro forma financial information presented and a statement to that effect is disclosed. When synergies are presented, any related dis-synergies must also be presented.

(ii) *Form of presentation.*

(A) If presented, Management's Adjustments must be presented in the explanatory notes to the pro forma financial information in the form of reconciliations of pro forma net income from continuing operations attributable to the controlling interest and the related pro forma earnings per share data specified in paragraph (a)(9) of this section to such amounts after giving effect to Management's Adjustments.

(B) Management's Adjustments included or incorporated by reference into a registration statement, proxy statement, Regulation A offering statement, or Form 8-K should be as of the most recent practicable date prior to the effective date, mail date, qualification date, or filing date as applicable, which may require that they be updated if previously provided in a Form 8-K that is appropriately incorporated by reference.

(C) If Management's Adjustments will change the number of shares or potential common shares, reflect the change within Management's Adjustments in accordance with U.S. GAAP or IFRS-IASB, as applicable, as if the common stock or potential common stock were outstanding as of the beginning of the period presented.

(D) The explanatory notes must also include disclosure of the basis for and material limitations of each Management's Adjustment, including any material assumptions or uncertainties of such adjustment, an explanation of the method of the calculation of the adjustment, if material, and the estimated time frame for achieving the synergies and dis-synergies of such adjustment.

Instruction 1 to paragraph (a)(7): Any forward-looking information supplied is expressly covered by the safe harbor rules under §§ 230.175 and 240.3b-6 of this chapter.

Registrants have the option to disclose 'management's adjustments' in the explanatory notes. These adjustments relate to the effect of synergies and dis-synergies and must satisfy certain requirements to be presented.

Question 3.4.10 What are the requirements for presenting management's adjustments?

Interpretive response: If presented, management's adjustments must comply with the following conditions.

- There is a reasonable basis for each adjustment.
- The adjustments are limited to the effect of synergies and dis-synergies on the historical financial statements that form the basis for the pro forma income statement as if they had existed as of the beginning of the fiscal year presented. For instance, a management adjustment to reflect synergistic reduction in expense cannot reduce the given expense category below zero.
- The pro forma financial information reflects all management's adjustments that are, in the opinion of management, necessary to a fair statement of the pro forma financial information presented and a statement to that effect is disclosed.
- If synergies are presented, any related dis-synergies also are presented.
- The adjustments are presented in the explanatory notes to the pro forma financial information (not on the face or in the columnar adjustments for transaction accounting adjustments or autonomous entity adjustments).
- The adjustments are presented as a reconciliation of pro forma net income and pro forma EPS to the 'as adjusted by management' amounts.

- The adjustments should be determined as of the most recent practicable date prior to the filing date, mailing date or effective date, as applicable based on the form filed. Updating of management's adjustments may be required if, e.g., management's adjustments were previously presented in a Form 8-K that will be incorporated by reference into certain registration statements and proxy statements.

The following is to be disclosed in the explanatory notes for each adjustment:

- the basis for the adjustment and any material limitations;
- material assumptions or uncertainties;
- explanation of the method used to calculate the adjustment, if material; and
- the estimated time frame for achieving the related synergies or dis-synergies.

Example 3.4.10 Management's adjustments

Assume the pro forma financial information was filed in a registration statement and proxy for a proposed business combination.

Registrant is proposing to acquire Target and expects to realize significant synergies that, in management's opinion, would enhance an understanding of the proposed acquisition.

Note 4. Management's Adjustments

Management expects that, following completion of the merger with Target, the post-acquisition company will realize certain cost savings as compared to the historical combined costs of Registrant and Target operating independently. Such cost savings, which result from the elimination of duplicate costs and the manner in which the post-acquisition company will be integrated and managed prospectively, are expected soon after completion of the merger and continuing into future periods. Management's adjustments described below are based on estimated cost savings as a result of the integration of personnel and related reduction in payroll and other costs of the combined company. They are not reflected in the pro forma income statements.

- For the nine months ended September 30, 20X2, $75 million related to direct costs for Target's officers, board, and other corporate costs, as well as Registrant's $125 million of corporate and regional costs and $50 million of general and administrative expenses.

- For the year ended December 31, 20X1, $120 million related to direct costs for Target's officers, certain other employees, board, and other corporate costs, as well as Registrant's $230 million of corporate and regional costs and $100 million of general and administrative expenses.

Material limitations of these adjustments include not fully realizing the anticipated benefits, taking longer to realize these cost savings, or other adverse effects that Registrant does not currently foresee. Further, there may be additional charges incurred in achieving these cost savings for which management cannot determine the nature and amount as of the date of this proxy. Actual results may vary significantly from the pro forma financial information. The Company believes there exists a reasonable basis for each such adjustment. The pro forma financial information reflects all Management's Adjustments that are, in the opinion of management, necessary to a fair statement of the pro forma financial information presented.

Had the merger been completed as of January 1, 20X1, and after giving effect to Management's Adjustments described above, management estimates additional cost savings would have been realized as follows.

For the Nine Months Ended September 30, 20X2 (in millions, except per share amounts)			
	Net income	**Basic and diluted earnings per share**	**Basic and diluted weighted average shares**
Pro forma combined[1]	12,610	8.41	1,500
Management's adjustments:			
Anticipated cost savings	250		
Tax effect	(40)		
Pro forma combined after management's adjustments	12,820	8.55	1,500

Note:

1. As shown in the unaudited Pro Forma Condensed Consolidated Income Statement

For the Year Ended December 31, 20X1 (in millions, except per share amounts)			
	Net income	**Basic and diluted earnings per share**	**Basic and diluted weighted average shares**
Pro forma combined[1]	13,450	8.97	1,500
Management's adjustments:			
Anticipated cost savings	450		
Tax effect	(70)		
Pro forma combined after management's adjustments	13,830	9.22	1,500

Note:

1. As shown in the unaudited Pro Forma Condensed Consolidated Income Statement

Question 3.4.20 May some synergistic management's adjustments be included while others are omitted?

Interpretive response: Yes, some may be omitted if based on management's judgment there is an insufficient level of confidence on which to base them. In this context, the disclosure of certain synergies must be accompanied by their related dis-synergies.

When adopting the amendments that became effective on January 1, 2021, the SEC noted the following basis for its conclusions about management's adjustments, "…[T]here may be different levels of confidence about different types of synergies and transaction effects and that disclosure requirements should be crafted with appropriate flexibility to permit management to depict full run-rate synergies and the nonrecurring costs to achieve them if, and in a manner, they deem appropriate. For example, we believe cost synergies should be permitted to be presented without revenue synergies provided that they incorporate related dis-synergies and the related disclosure describes the nature, uncertainties, and limitations of the amounts presented and the time-frames and uncertainties inherent in achieving them. We also believe such disclosure should be linked to pro forma financial information as a means to more fully demonstrate how historical amounts could change based on the transaction." [SEC Rel 33-10786 (p111)]

Question 3.4.30 Is a range estimate for management's adjustments required in the notes to the pro forma information?

Interpretive response: It depends. There may be different levels of confidence about different types of synergies and transaction effects. A range should be provided if management believes a range is necessary to provide a fair statement. [S-X Rule 11-02(a)(7)(ii)(D)]

We understand the SEC staff has expressed a view that if a range is disclosed, both ends of the range should be reconciled to pro forma income from continuing operations attributable to the controlling interest.

3.5 Other specific issues and considerations

3.5.10 Presentation of non-GAAP financial measures

Article 11 pro forma financial information that is filed with the SEC must comply with Reg S-K Item 10(e). Therefore, non-GAAP financial measures cannot be presented on the face of the pro forma financial information. Instead, they may be presented after the notes to the pro forma financial information with a reconciliation to the most directly comparable GAAP measure (e.g. pro forma combined net income could be reconciled to pro forma combined EBITDA). [S-K Item 10(e)(1)(ii)(D), Non-GAAP CFI 101.05]

Question 3.5.10 What are the key criteria for disclosing a non-GAAP financial measure?

Interpretive response: Below is a summary of the key criteria from Reg S-K Item 10(e).

- A non-GAAP financial measure cannot be misleading.
- The most directly comparable GAAP measure must be presented with equal or greater prominence.
- A non-GAAP financial measure must be reconciled to the most directly comparable GAAP measure.
- The reasons why management believes the non-GAAP financial measure is useful to investors must be disclosed.
- Any additional purposes, to the extent material, for which management uses the non-GAAP financial measure must be disclosed.
- Items that require cash settlement cannot be excluded from a liquidity measure.
- Adjustments to GAAP earnings for nonrecurring, infrequent or unusual items are prohibited.
- There are restrictions on the placement of non-GAAP financial measures.
- Use of certain titles or descriptions are prohibited.

See chapter 4 of KPMG Handbook, Non-GAAP financial measures, for additional information on the requirements above.

Question 3.5.20 Which pro forma GAAP balance should a pro forma non-GAAP financial measure be reconciled to?

Interpretive response: When a registrant presents both transaction accounting adjustments and autonomous entity adjustments in the pro-forma information, it reconciles to total pro forma after both. If it includes only transaction accounting adjustments, it reconciles to that total.

We believe that non-GAAP financial measures should not be reconciled to a total that includes management's adjustments.

Example 3.5.10 Non-GAAP financial measure included in pro forma financial information

Registrant routinely reports EBITDA as a non-GAAP performance measure in its quarterly reporting to investors and believes that it provides useful incremental information to investors. Management believes that the pro forma effect of a significant business acquisition on EBITDA would be meaningful to investors for similar reasons. Registrant's pro forma financial information includes the following disclosure after the pro forma explanatory notes.

A reconciliation of pro forma net income to pro forma EBITDA is provided below (in millions).

	Historical	Transaction accounting adjustments	Pro forma
Net income	400	20	420
Interest expense	20	5	25
Income tax expense	100	1	101
Depreciation and amortization	60	15	75
EBITDA	580	41	621

Note: For brevity, this example excludes the disclosure of why management believes that EBITDA provides useful information to investors as required by Reg S-K Item 10(e) and the limitations of using non-GAAP financial measures.

3.5.20 Varying year-ends or filing requirements

Excerpt from Reg S-X Rule 11-02

Preparation requirements.

(c) *Periods to be presented.*

…

(3) Pro forma condensed statements of comprehensive income must be presented using the registrant's fiscal year end. If the most recent fiscal year end of any other entity involved in the transaction differs from the registrant's most recent fiscal year end by more than one fiscal quarter, the other entity's statement of comprehensive income must be brought up to within one fiscal quarter of the registrant's most recent fiscal year end, if practicable. This updating could be accomplished by adding subsequent interim period results to the most recent fiscal year end information and deducting the comparable preceding year interim period results. Disclosure must be made of the periods combined and of the sales or revenues and income for any periods which were excluded from or included more than once in the condensed pro forma statement of comprehensive income (e.g., an interim period that is included both as part of the fiscal year and the subsequent interim period).

Instruction 1 to paragraph (c)(3): In circumstances where different fiscal year ends exist, § 210.3-12 may require a registrant to include in the pro forma financial information an acquired or to be acquired foreign business historical period that would be more current than the periods included in the required historical financial statements of the foreign business.

The registrant’s fiscal year-end is used to determine which pro forma income statements are required and presented. Further, if the pro forma financial information includes another entity’s (e.g. an acquired business’s) income statement, it must be brought to within one quarter of the registrant's most recent fiscal year-end, if practicable. [S-X Rule 11-02(c)(3)]

Question 3.5.30 How are varying year-ends dealt with in pro forma financial statements?

Interpretive response: Presenting pro forma income statements when the registrant's and acquired business's year-end dates differ is addressed as follows.

- If the variance is one fiscal quarter or less, the annual income statements are simply combined with no adjustment.
- If the variance is greater than one quarter, the acquired business's income statement is adapted to produce a 12-month period ending within one quarter of the registrant's year-end. This "could be accomplished by adding subsequent interim periods to the most recent fiscal year-end information and deducting the comparable preceding year interim period results." [S-X Rule 11-02(c)(3), FRM 3301.1]

For interim-period pro forma financial statements, the pro forma income statement of the acquired business must contain the same number of months as that of the registrant and the periods must not end more than one quarter apart.

Disclosure must be made of the periods combined and of the revenue and income for any periods that are excluded from or included more than once in the condensed pro forma income statement (e.g. an interim period that is included both as part of the fiscal year and the subsequent interim period). [S-X Rule 11-02(c)(3)]

Similarly, when an accelerated filer acquires an entity that is a non-accelerated filer or private company, a gap of up to one fiscal quarter is acceptable – both for the entities' historical financial statements, as well as for the pro forma financial information. The mismatched periods of the interim financial statements of the registrant and acquired business may be due to the different updating requirements for accelerated filers versus non-accelerated filers. [2003 AICPA Conf (Summary of SEC Presentations, Joel Levine, 'Accelerated Filer Update')]

Question 3.5.40 What should be considered when adapting a target's fiscal period to align with the registrant's fiscal period?

Interpretive response: A registrant should evaluate the following practical considerations when adapting a target's fiscal period to align with the registrant's fiscal period.

- The interim periods that are added and subtracted to adapt an entity's fiscal year can be an interim quarter, month or other appropriate period, as long as the remaining gap is reduced to one quarter or less.

- The target's addition and subtraction of interim periods should achieve an adapted period that is of equal length as the registrant's annual income statement (generally one year in both cases). However, if the registrant is also changing its fiscal year as part of the transaction, the 'annual' pro forma period could be as short as nine months for the registrant, in which case the 'updated annual' period of the target would be of a consistent length (see section 3.5.30).
- The interim year-to-date income statements that are combined should contain an equal number of months for all relevant entities.

In adapting the annual income statement, a registrant may use a month or quarter that is already included in the subsequent, interim year-to-date income statement. This is appropriate under Reg S-X Rule 11-02(c)(3), provided that fact is disclosed.

Example 3.5.20 Registrant is an accelerated filer, but the acquiree is not

Registrant is a calendar year-end accelerated filer and Target is a calendar year-end non-accelerated filer. The acquisition of Target is probable and the significance is calculated to be greater than 50%. Audited financial statements of both entities will be provided for the three years ended December 31, 20X0.

Registrant plans to file a registration statement that it expects to be declared effective on August 10, 20X1, shortly after it plans to file its second quarter Form 10-Q. However, Target will not have filed its second quarter Form 10-Q at that time because it is not an accelerated filer. The registration statement will include historical interim financial statements of Registrant for the six months ended June 30, 20X1, and of the Target for the three months ended March 31, 20X1. [S-X Rule 3-01(e)(1), (e)(2)]

The interim year-to-date pro forma income statement will reflect:

- Registrant's operations for the six months ended June 30, 20X1; and
- Target's operations for either:
  - the six months ended March 31, 20X1 (in which case disclosure would note that the three months ended December 31, 20X0 are included in both the annual pro forma income statement and the interim year-to-date income statement); or
  - the six months ended June 30, 20X1.

Example 3.5.30 Registrant's and Target's fiscal year-ends differ

Registrant has a calendar year-end and acquires Target on November 30, 20X1. Target has an April 30 fiscal year-end. The acquisition is significant and pro forma financial information is provided on Form 8-K/A on January 31, 20X2.

Registrant adapts Target's fiscal period to align (within one fiscal quarter) to Registrant's own fiscal period. This results in duplicating the three-month period ended January 31, 20X1 in both pro forma income statement periods. Such duplication (or omission) of a period is acceptable, provided that it is disclosed.

Pro forma income statement for the year ended December 31, 20X0

This statement includes (1) Registrant's year ended December 31, 20X0, and (2) Target's 12-month period that ends within one fiscal quarter of December 31, 20X0. Registrant's pro forma income statement may be presented as follows.

Unaudited Pro Forma Condensed Combined Income Statement (in thousands)

	Historical Registrant year ended 12/31/20X0	Target – 12 months ended 1/31/20X1[1]	Transaction accounting adjustments	Pro forma combined
Revenue	100,000	55,000	–	155,000
Expenses	80,000	44,000	–	124,000
Net income	20,000	11,000		31,000

Note:

1. Target's financial statements were derived by adding the nine months ended January 31, 20X1 to its year ended April 30, 20X0, and removing the nine months ended January 31, 20X0.

Note: Registrant could have presented any 12-month period of Target that ended within one fiscal quarter of Registrant's year-end.

Pro forma income statement for the nine-month interim period

This statement includes (1) Registrant's nine months ended September 30, 20X1, and (2) Target's nine-month period that ended within one fiscal quarter of September 30, 20X1. Registrant's pro forma income statement may be presented as follows.

Unaudited Pro Forma Condensed Combined Income Statement (in thousands)

	Historical Registrant – 9 months ended 9/30/20X1	Target – 9 months ended 7/31/20X1[1]	Transaction accounting adjustments	Pro forma combined
Revenue	75,000	41,000	–	116,000
Expenses	60,000	33,000	–	93,000
Net income	15,000	8,000		23,000

Note:

1. Target's financial statements for the interim period were derived by adding the three months ended July 31, 20X1 to Target's year ended April 30, 20X1, and removing the six months ended October 31, 20X0. The nine months ended July 31, 20X1 includes the three-month period ended January 31, 20X1, which was

also included in the pro forma income statement for the year ended December 31, 20X0. Summarized operating information for the duplicated quarter was as follows:

Revenue	4,300
Expenses	3,600
Net income	700

Note: Registrant could have presented any nine-month period for Target that ended within one fiscal quarter of Registrant's quarter-end.

3.5.30 Change in fiscal year

A registrant or successor registrant may change its fiscal year-end date. Rules 13a-10 and 15d-10 of the '34 Act provide the reporting and filing requirements in these circumstances. A fiscal period of less than one year will result from such a change and the period from the end of the latest fiscal year to the beginning of the new fiscal year is referred to as the 'transition period'.

Question 3.5.50 When the registrant has a transition period, how are a target's fiscal periods adapted in pro forma statements?

Interpretive response: Under Reg S-X Rule 3-06, a transition period of nine to 12 months is considered a full year. In such circumstances, a registrant may provide an audited period of less than 12 months for the most recently completely fiscal year to satisfy the Rule 3-06 requirement for filing financial statements for a period of one year. Similarly, a historical transition period of nine to 12 months may be used to meet Reg S-X Article 11's requirement for an annual pro forma income statement.

In this circumstance, a target's historical annual income statement presented in the pro forma financial information would need to be adapted to include an equal number of months as the registrant's transition period income statement. The period-end for the registrant's and acquired business's financial statements must be within one fiscal quarter of each other (see section 3.5.20). [S-X Rule 11-02(c)(3)]

Transition period of less than nine months

When a registrant has a transition period of less than nine months and then acquires a business, there are two options to satisfy the annual pro forma income statement requirement. A registrant can include either:

- a pro forma income statement for a nine-to-12 month period ending as of the new fiscal year-end balance sheet date (i.e. the transition period of the registrant supplemented by earlier periods sufficient to provide nine to 12 months of the registrant's historical financial information, in reliance on Rule 3-06); or

- a pro forma income statement for the transition period along with a pro forma income statement for full fiscal year immediately preceding the transition period.

In either case, the financial information for the acquired business used in the pro forma condensed income statement(s) should be for a period(s) ending within one fiscal quarter of the registrant's period-end and for the same number of months. [Regs Comm 04/2004]

The registrant would also include a subsequent year-to-date interim pro forma income statement if a Form 10-Q was filed, or required to be filed, after the end of the transition period (coterminous with the pro forma balance sheet).

Example 3.5.40 Pro forma financial information following a change in fiscal year – Transition period of nine months or longer

Registrant changes its fiscal year-end from December 31, 20X0 to September 30, 20X1, creating a nine-month transition period, for which a transition report is filed according to Rules 13a-10 and 15d-10 of the '34 Act.

Target has an October 31 fiscal year-end. Registrant acquires Target on December 1, 20X1; the acquisition is greater than 20% significant and therefore pro forma financial information is required on a Form 8-K. Pro forma financial information for the acquisition will be filed on Form 8-K/A on December 15, 20X1.

Registrant's transition period for the nine months ended September 30, 20X1 qualifies as an annual period under Reg S-X Rule 3-06. Because Target's year-end is within one fiscal quarter of Registrant's new year-end, there is no need to adapt Target's financial statements for a different period-end. Registrant's income statement for the nine months ended September 30, 20X1 can be combined with Target's income statement for the nine months ended October 31, 20X1.

A subsequent interim pro forma income statement is not required because Registrant's September 30, 20X1 year-end balance sheet is the most recent balance sheet filed (or due to be filed) when the pro forma financial information for this acquisition will be filed on Form 8-K/A on December 15, 20X1. Registrant's first quarter Form 10-Q Is not required to be filed until February 20X2.

Example 3.5.50 Pro forma financial information following a change in fiscal year – Transition period of less than nine months

Registrant changes its fiscal year-end from April 30, 20X1 to December 31, 20X1, and files a transition report covering the eight-month transition period.

Registrant acquires Target on July 31, 20X2; the acquisition is greater than 20% significant and therefore pro forma financial information is required on a Form 8-K. Target has a calendar year-end. The following are two options available for Registrant to satisfy the requirement to present a pro forma annual income statement.

Option 1: Twelve months ended December 31, 20X1

Registrant	January 1 – April 30, 20X1	Plus May 1 – December 31, 20X1 (transition period)
Target	Fiscal year ended December 31, 20X1	

For Registrant, the transition period is less than nine months, so additional months preceding the transition period are added to provide nine to 12 months of Registrant's historical financial information. For Target, the length of the period must align to the period for Registrant (i.e. 12 months in this example).

Option 2: Transition period along with previous 12-month period

	Transition Period	Previous 12 months
Registrant	May 1 – December 31, 20X1	Fiscal year ended April 30, 20X1
Target	May 1 – December 31, 20X1	May 1 – December 31, 20X0 plus January 1, 20X1 – April 30, 20X1

For Registrant, the transition period is less than nine months so the transition period is supplemented by Registrant's previous fiscal year (i.e. May 1, 20X1 – April 30, 20X1). For Target, the length of the period must align to the period for Registrant (i.e. 12 months in this example). See section 3.5.20 for guidance to align Target's fiscal period to Registrant's fiscal period.

3.5.40 Cross-border acquisitions

Question 3.5.60 Is the age of pro forma financial information affected by cross-border transactions?

Interpretive response: No. A registrant bases the age of pro forma financial information included in a filing on the age of the financial statements it is required to file (see section 3.2.50).

- If a US domestic registrant acquires a target that is a foreign entity, the age of the pro forma financial information is based on the most recent financial statements the domestic registrant is required to file.
- If an FPI acquires a US target, the age of the pro forma financial information is determined under Item 8 of Form 20-F.[1]

The above two scenarios may result in the period of the pro forma financial information not aligning with target's financial statements. A US domestic registrant in a cross-border transaction may be required to have more current historical financial statements included in a filing than the foreign target. As a result, the pro forma income statement may include an additional quarter since the age of the pro forma financial information is based on the financial statements required to be filed by the US domestic registrant. Conversely, an FPI that acquires a US target will base the age of the pro forma financial information on its financial statements included in the filing, which may be less current than the target's financial statements.

As described in section 3.5.20, the end date of the target company's financial information may differ from that of the registrant by up to one fiscal quarter. Therefore, a registrant may use a combination of periods that involve overlaps and gaps in the information of the target company of up to one fiscal quarter, as long as the resulting annual and interim periods are of the same length as that of the registrant, and there are no overlaps or gaps in the registrant's information. A registrant may not omit interim pro forma financial information because of different fiscal periods.

Note:

1. FPIs should consider whether relevant exceptions exist. For instance, if the FPI publishes quarterly financials for its local stock exchange, quarterly SEC filings would be triggered. FPIs should consider Item 8.A.5 of Form 20-F for further guidance.

Example 3.5.60 Cross-border pro forma requirements

This example illustrates two scenarios of pro forma requirements in cross-border transactions: (1) the domestic registrant acquires the FPI target, and (2) the FPI registrant acquires the domestic registrant target.

A cross-border business combination occurs between Domestic Registrant and FPI. Domestic Registrant is a large accelerated filer. Both registrants have a calendar year-end.

Assume the following in both scenarios.

- The registration statement (Form S-4 or Form F-4, as applicable) will go effective on May 10, 20X9, immediately following the Domestic Registrant filing its Form 10-Q for the first quarter.
- FPI will file its semi-annual interim financial statements by July 31, 20X9.
- Audited stand-alone financial statements for both entities are required in the registration statement for the three years ended December 31, 20X8.
- The acquisition is significant and an annual pro forma condensed income statement for the year ended December 31, 20X8 is required.

The *interim* financial statement filing effects are as follows under the respective scenarios.

Scenario	Historical stand-alone interim financial statements (in addition to annual financial statements)	Subsequent interim YTD pro forma financial information
Domestic registrant acquires FPI target	Domestic registrant: three months ended March 31, 20X9	Domestic registrant: three months ended March 31, 20X9 FPI target: Choose either: • Three months ended March 31, 20X9 • Three months ended December 31, 20X8 and disclose the duplication with the annual pro forma financial information
FPI registrant acquires domestic registrant target	FPI registrant: None	None. Registrant is an FPI with no interim historical financial statement filing requirements to be included in the registration statement.

Note: If the two entities had different fiscal year-ends, the target's historical financial information included in the pro forma financial information would need to be brought within one quarter of the registrant's year-end. See section 3.5.20 for guidance on aligning the target's fiscal period with the registrant's fiscal period.

See section 3.5.50 for guidance on presenting pro forma adjustments to align the target's and registrant's basis of accounting.

Question 3.5.70 Does a target's basis of accounting have to conform to the registrant's in pro forma financial information?

Background: The comprehensive bases of accounting applied by registrants is summarized as follows:

- Domestic registrants: US GAAP
- FPI or a foreign business under Reg S-X Rule 1-02(l):
  - US GAAP;
  - IFRS Accounting Standards-IASB; or
  - Local GAAP with reconciliation to US GAAP.

Interpretive response: Yes. In a cross-border combination, the registrant and target often apply different bases of accounting. Generally, the target's basis of accounting must be adjusted to match the registrant's. For example, an FPI using IFRS Accounting Standards-IASB should prepare pro forma financial information by presenting its results on that basis and converting the financial statement amounts of the acquired (or to-be-acquired) business to IFRS Accounting Standards-IASB (from either US GAAP or home-country GAAP).

Similarly, if the registrant prepares its financial statements based on home-county GAAP (reconciled to US GAAP under Form 20-F, Item 18), its pro forma financial information should be prepared based on home-country GAAP reconciled to US GAAP. However, the SEC staff generally will not object if an FPI applying local GAAP with a reconciliation to US GAAP elects to present its pro forma financial information directly in US GAAP. [FRM 6360.1 – 2, SEC Rel 33-8879]

Pro forma adjustments are used to conform the basis of accounting. These adjustments are frequently presented in a separate column from the acquisition transaction accounting entries but may be combined in a single column.

Question 3.5.80 Are a target's historical financial statements required to be presented in the same currency as the registrant's financial statements?

Interpretive response: No. The SEC staff believes the target's historical financial statements are not required to be presented in the same currency as the registrant's financial statements. Therefore, the target's historical financial statements presented under Reg S-X Rule 3-05 could be presented in local currency. [FRM 6620.7]

The pro forma financial information would present two 'historical' columns for the target – one in local currency and one in the registrant's currency. The translation should be calculated consistent with the basis of accounting used in the pro forma financial information (generally the registrant's GAAP, except in certain reverse acquisitions). This enables all pro forma adjustment columns to be presented in a single currency. The foreign currency exchange rates used are disclosed.

3.5.50 Adoption of a new accounting principle

Excerpt from Reg S-X Rule 11-02

Preparation requirements.

(c) *Periods to be presented.*

…

(2) (ii) … Retrospective revisions stemming from the registrant's adoption of a new accounting principle must not be reflected in pro forma statements of comprehensive income until they are depicted in the registrant's historical financial statements.

Question 3.5.90 What pro forma adjustments are required when a registrant has adopted a new accounting standard but its target has not?

Interpretive response: If a registrant adopts a new accounting standard that has not yet been adopted by the acquired business, the pro forma financial information generally is adjusted to reflect the adoption of the new standard by the acquired business. However, such pro forma adjustments are permissible only if the registrant has filed financial statements reflecting the new standard.

The following paragraphs discuss different scenarios involving the adoption of a new accounting standard.

Registrant adopts accounting standard retrospectively

The registrant may have adopted an accounting standard with retrospective application. In that case, the new standard might be reflected in both the current-year and comparable prior-year interim income statements, but the recast prior-year annual income statement will not be presented until the Form 10-K is filed at year-end. In that circumstance, if the registrant believes the effect of the new standard on the annual financial information is material, it should disclose in the notes to the pro forma financial information that the standard adoption has not been reflected in the annual pro forma income statement but has been reflected in the interim year-to-date pro forma income statement. [FRM 3303.1]

Registrant early adopts an accounting standard

If the registrant has early adopted a new standard that has not yet been adopted by the target, then a transaction accounting adjustment generally is made to conform the target's adoption date and method to that of the registrant.

Registrant and target both have adopted an accounting standard

If the registrant and target have both adopted a new standard, but did so on a different date, or with a different transition method, the adoption should be conformed via a transaction accounting adjustment. However, the SEC staff will consider requests for relief in this circumstance. [FRM 3250.3]

Registrant has not adopted a forthcoming accounting standard

The effects of a forthcoming accounting standard that has not yet been adopted by the registrant should not be included as a transaction accounting adjustment in the pro forma financial information. Instead, forthcoming accounting changes should be disclosed pursuant to SAB Topic 11.M.

Example 3.5.70 Adoption of new accounting standard

Registrant, with a September 30 fiscal year-end, acquires Target, also with a September 30 fiscal year-end, on March 15, 20X9. Registrant early adopted a new accounting standard, effective October 1, 20X7. However, Target did not adopt that new accounting standard until October 1, 20X8.

The new accounting standard is reflected in Registrant's financial statements for the year ended September 30, 20X8 and interim three-month period ended December 31, 20X8. Target's interim financial statements for the three-month period ended December 31, 20X8 reflect the adoption of the same accounting standard.

In conjunction with the acquisition, Registrant files pro forma financial information for the fiscal year ended September 30, 20X8 and the interim three-month period ended December 31, 20X8. Registrant includes transaction accounting adjustments in the pro forma financial information for the fiscal year ended September 30, 20X8 to reflect Target's adoption of the new accounting standard on October 1, 20X7.

Alternative scenario

If Registrant had adopted a new accounting standard on October 1, 20X8 that required retrospective application and Target had not yet adopted the same standard, the pro forma financial information for the fiscal year ended September 30, 20X8 would not be adjusted to reflect Target's adoption of the new accounting standard. This is because Registrant has not yet revised its historical financial statements for the annual periods prior to adoption (i.e. the year ended September 30, 20X8).

However, because the new accounting standard is reflected in Registrant's financial statements for the interim three-month period ended December 31, 20X8, transaction accounting adjustments would be made to reflect Target's adoption of the new accounting standard in the interim pro forma financial information. In this circumstance, the notes to the pro forma financial information include appropriate disclosure about the differences in the annual and interim pro forma financial information due to the new accounting standard.

Question 3.5.100 May a transaction accounting adjustment be made to reflect a new accounting standard before adoption?

Interpretive response: No. The pro forma income statement cannot reflect adoption of the new accounting standard before it is actually adopted by the registrant. This is true even when the registrant's subsequent interim year-to-date income statement reflects the adoption but the annual pro forma income statement does not. Therefore, it would be inappropriate to 'push back' the adoption of a new accounting standard to the beginning of the annual period to have a consistent basis of accounting presented for both the annual and subsequent interim periods.

A transaction accounting adjustment generally would be made to align the target's adoption of the new accounting standard to the registrant's date and method of adoption.

Question 3.5.110 How are pro forma adjustments presented for new accounting standards when the financial statements include predecessor/successor periods?

Background: An entity's financial statements can include predecessor and successor periods only when there is a different basis of accounting (e.g. due to a change in control, push-down accounting, or applying fresh-start accounting upon emergence from bankruptcy). In these circumstances, the financial statements prepared by the successor entity are effectively those of a new entity, and therefore they are not comparable with those of the predecessor entity.

Full retrospective transition to a new accounting standard generally requires the reporting entity to recast its financial statements from the earliest presented period forward, with an adjustment to beginning retained earnings.

Interpretive response: We believe the pro forma transaction accounting adjustments presented by a registrant for its acquisition of a target with predecessor and successor periods would exclude the predecessor periods when quantifying the effects of the new accounting standard's adoption.

This approach is consistent with observations of the SEC staff that there is no general US GAAP or other regulatory requirement to retrospectively adjust predecessor period financial statements for accounting changes by a successor entity. [Regs Comm 09/2017]

3.5.60 Updating pro forma financial information

A registration statement must include historical financial statements and pro forma financial information that are within their respective age requirements. The age requirements must be met not only when the registration statement is filed, but also through its effectiveness date. The age of pro forma financial information provided in a registration statement is based on the age of the registrant's historical financial statements that must be included in the registration statement. Those requirements are provided in Reg S-X Rule 3-12 or Rule 8-08 for domestic registrants and Item 8 of Form 20-F for FPIs.

The pro forma financial information may also need to be updated when a post-effective amendment is made.

Further, when the registrant has completed a significant business acquisition, and files a new or amended registration statement thereafter, the pro forma income statements are updated until the registrant is able to omit the historical financial statements of the acquired business required by Reg S-X Rule 3-05 from the registration statement. When a registrant can omit Rule 3-05 financial statements depends on whether the acquiree's operations have been included in the registrant's post-acquisition results for a sufficient period of time given the significance of the acquisition (i.e. nine months if the significance of the acquisition exceeds 20% but not 40% and one full fiscal year if the significance of the acquisition exceeds 40%). See Question 7.2.10 of KPMG Handbook, SEC

Business combinations. A pro forma balance sheet would also be updated until the transaction is already reflected in the latest historical balance sheet filed with the SEC. [S-X Rule 11-02(c)]

If a registrant files an Item 2.01 Form 8-K reporting a significant acquisition that includes audited financial statements of the acquired business and pro forma financial information, the registrant may need to update the pro forma financial information in a subsequently filed registration statement even if the financial statements of the acquired business do not require updating. The updated pro forma financial information would include financial information for the acquired business up to the date of acquisition (rather than up to the latest balance sheet presented in the acquiree's financial statements previously filed) to avoid any gaps in the pro forma condensed income statement information, which assumes that the acquisition occurred at the beginning of the earliest period presented.

Example 3.5.80 Updating pro forma financial information in a registration statement

Registrant acquires Target on June 1, 20X8. Target's acquisition is 35% significant to Registrant, and both companies have calendar year-ends. Registrant reports the significant business acquisition in a timely filed Form 8-K. The Form 8-K includes Target's financial statements and pro forma financial information through March 31, 20X8.

Registrant files a registration statement on December 1, 20X8 that is expected to become effective on March 20, 20X9. This registration statement includes the following.

- Registrant's financial statements for the years ended December 31, 20X7, 20X6, 20X5 and the interim period through September 30, 20X8.
- Target's historical financial statements for the year ended December 31, 20X7 and the interim period through March 31, 20X8.
  - Under Reg S-X Rule 3-05, there is no requirement to update Target's historical, pre-acquisition financial statements (i.e. to June 1, 20X8) because the transaction was consummated before Target's second fiscal quarter-end.
- Pro forma financial information updated through September 30, 20X8.
  - This includes Target's pre-acquisition operating results and related pro forma adjustments from January 1 to June 1, 20X8. This contrasts with the Form 8-K, which only reflects that information from January 1 to March 31, 20X8.
  - No pro forma balance sheet is presented because the acquisition is already fully reflected in Registrant's June 30, 20X8 and September 30, 20X8 balance sheets.

When the 20X8 Form 10-K is filed, the registration statement is updated to:

- include or incorporate by reference Registrant's financial statements for the year ended December 31, 20X8; and

- update the pro forma financial information through December 31, 20X8. The only update in this scenario would be to add Registrant's fourth quarter results, because the previous update was made through September 30, 20X8. Presentation of the updated pro forma income statement in the registration statement is still necessary, however, because Registrant's income statement for the year ended December 31, 20X8 does not yet include Target's operations for a full fiscal year.

If the registration statement's effective date were postponed until after the filing of Registrant's first quarter 20X9 Form 10-Q, then an additional update to the pro forma financial information would also be necessary.

Question 3.5.120 Is materiality considered when assessing whether pro forma financial information should be updated?

Interpretive response: No. The SEC staff stated that if the registrant's financial statements used to prepare the pro forma financial statements are required to be updated, the pro forma financial information must also be updated. The update is required regardless of any materiality assessment. [Regs Comm 06/2025]

The staff discussed this issue in the context of de-SPAC transactions (where a public shell company acquires a private operating company). However, the staff confirmed that its conclusion also applies to transactions other than de-SPAC transactions (e.g. transactions specified in Reg S-X Rule 11-01 – see section 2.2.10). [Regs Comm 06/2025]

De-SPAC transactions

The de-SPAC scenario discussed by the SEC staff illustrates how pro forma financial information may need to be updated based solely on an update to financial statements. Specifically, once a registrant provides pro forma information reflecting the accounting for a de-SPAC transaction in a proxy or registration statement (e.g. a Form S-4), it may need to update its and the target's financial statements in a subsequent filing to remain compliant with the applicable age of financial statement requirements in Reg S-X. For example, this can occur when subsequent filings such as a Super 8-K reporting the transaction or unrelated registration statements are required.

Question 3.5.130 Can pro forma financial information required by US GAAP satisfy the Reg S-X Article 11 requirements, including updating pro forma financial information?

Interpretive response: No. The pro forma financial information required to be disclosed under paragraph 805-10-50-2(h) differs in significant respects from that presented under Article 11. Therefore, the inclusion of pro forma financial information required to be disclosed in a registrant's financial statements under

US GAAP would generally not be sufficient to meet the pro forma financial information presentation requirements under Article 11. However, to the extent the requirements of Topic 805 and Article 11 are consistent, we believe the approach followed by an entity in developing the pro forma disclosures required under paragraph 805-10-50-2(h) and the pro forma information required to be presented under Article 11 should be consistent.

See section 13 of KPMG Handbook, Business combinations, for discussion of the pro forma financial information disclosure requirements of paragraph 805-10-50-2(h).

Example 3.5.90 Updating pro forma financial information and interaction of Topic 805 and Reg S-X Article 11 requirements

Registrant files Form 8-K in December 20X2 to report an acquisition of a business with a calendar year-end. The Form 8-K includes financial statements of the acquiree and pro forma financial information as required by Article 11 through September 30, 20X2. Registrant provided the pro forma financial information required under paragraph 805-10-50-2(h) in its annual financial statements for year ended December 31, 20X2. Registrant files a new registration statement in May 20X3 after filing Form 10-Q for the quarter ended March 31, 20X3, which also includes pro forma financial information required under paragraph 805-10-50-2(h).

Although Registrant provided the pro forma financial information as required by paragraph 805-10-50-2(h) in its Form 10-K and Form 10-Q, all information included in a registration statement must comply with Reg S-X, including the age of financial statement requirements in Reg S-X Rule 3-12, at the date of effectiveness of the registration statement. Therefore, Registrant will need to update the pro forma financial information as required by Article 11 through December 31, 20X2 for filing in the registration statement.

Question 3.5.140 When updating pro forma financial information in a registration statement for a previously reported acquisition with a different year-end, can there be a gap between the acquired business's pre- and post-acquisition financial periods?

Background: On December 27, 20X1, Registrant, with a December 31 year-end, acquired a significant business, Target, a public company with whose most recent fiscal year-end was February 28, 20X1.

On December 28, 20X1, Registrant filed an initial Form 8-K to report the acquisition. It then amended the initial Form 8-K on March 11, 20X2 to provide the financial statements of Target as of and for the three years ended February 28, 20X1, and the six-month period ended August 31, 20X1, which was Target's last quarter for which a Form 10-Q was required to be filed before the acquisition, as well as Article 11 pro forma financial information.

The pro forma income statements included in the Form 8-K/A were prepared using the following information as permitted under the guidance in section 3.5.20.

- **Most recent fiscal year –** Registrant year ended December 31, 20X0, plus Target year ended February 28, 20X1
- **Subsequent interim period –** Registrant nine-month period ended September 30, 20X1, plus Target nine-month period ended August 31, 20X1

On April 15, 20X2, Registrant files a registration statement, which requires updated financial statements for Target and updated pro forma financial information. Registrant includes in the registration statement updated financial statements for Target through November 30, 20X1, and proposes to update the pro forma income statement to depict the acquisition of Target using the following information.

- **Most recent fiscal year –** Registrant year ended December 31, 20X1 (which includes four days of Target activity post-acquisition), plus Target for the eleven months and 26 days ended November 26, 20X1
- **Subsequent interim period –** Not yet required

Interpretive response: No. The guidance in section 3.5.20 cannot be applied such that there is a gap between the pre- and post-acquisition periods included for the acquired business (i.e. November 27, 20X1 to December 27, 20X1 in the above example). Registrant should prepare the updated pro forma income statement using Target's income statement for the period from January 1, 20X1 through December 27, 20X1.

4. Business combinations

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Question

Question 4.10.10 How is a disposition related to a business combination reflected in pro forma financial information?

4.11 Abbreviated financial statements

Question

Question 4.11.10 When abbreviated financial statements are used in a pro forma income statement, can forward-looking information be included in transaction accounting adjustments or autonomous entity adjustments?

4.1 How the Rules work

The acquisition of a business is the most common transaction requiring pro forma information. Pro forma effects for such transactions are depicted through transaction accounting adjustments and, subject to certain conditions, management's adjustments (see section 3.4). Transaction accounting adjustments reflect the accounting for the transaction as required by US GAAP or IFRS Accounting Standards-IASB, as applicable, linking the effects of the acquired business to the registrant's audited historical financial statements.

Common transaction accounting adjustments for significant business acquisitions include those related to:

- **Purchase price allocation –** The allocation of consideration transferred to the acquired assets, liabilities and goodwill (if any).
- **Acquisition agreement specifics –** Adjustments mandated by the terms of the acquisition agreement or otherwise necessary to complete the acquisition.
- **Accounting policy alignment –** Harmonizing the accounting policies of the acquired business with those of the registrant.
- **Registrant-incurred transaction costs –** Specific costs incurred by the acquiring entity directly related to the transaction.

Adjustments related to the business combination that do not fall into one of the above categories are presented in a separate column in the pro forma financial statements if they are material.

Consideration transferred

Consideration transferred or to be transferred (i.e. the purchase price) is disclosed in the explanatory notes in the pro forma financial information reflecting a business combination. When there are multiple components of consideration transferred (e.g. cash, noncash assets, equity), a tabular summary is disclosed showing the components and how they were measured. Issues arise when the consideration includes contingent amounts or the business combination is not yet consummated when the pro forma financial information is required.

Acquired assets and liabilities

Transaction accounting adjustments are made for the allocation of the purchase price to the identified assets and liabilities, along with the related changes in depreciation and amortization expense.

Acquired assets and liabilities	Transaction accounting adjustment (Yes or No)	Explanation
Inventory	Yes	Adjustments necessary to reflect the inventory's fair value on the pro forma balance sheet.

Acquired assets and liabilities	Transaction accounting adjustment (Yes or No)	Explanation
Intangible and long-lived assets	Yes	Adjustments necessary to reflect the assets at their fair values on the pro forma balance sheet and reflect the amortization and depreciation based on the adjusted amounts in the pro forma income statement. Goodwill impairment charges made in the target's historical financial statements are reversed (but impairment charges to other assets are not under US GAAP and only in rare or unusual cases under IFRS Accounting Standards-IASB).
Acquired in-process research and development (IPR&D)	No	Although IPR&D is recognized at fair value in a business combination, no adjustments are made to reverse R&D expenses related to IPR&D that the target historically expensed.
Assumed target debt	Yes	Adjustments reflect the difference between the debt's carrying value and fair value.

Other items

Item	Transaction accounting adjustment (Yes or No)	Explanation
Gains and losses arising from business combination	Yes	Adjustments required if the gain/loss is included in the purchase price allocation. Gains or losses related to a material underlying transaction are reflected in other transaction accounting adjustments.
Transaction costs to be incurred by the acquirer	Yes	However, no adjustments are made for transactions costs the acquirer has already incurred in a historical period, or for the acquiree's transaction costs (whether already incurred or to-be-incurred).
Deferred tax assets (DTAs) and tax liabilities (DTLs)	Yes	Adjustments reflect (1) changes in a net DTL (or DTA) from adjusting the target's net assets to fair value and (2) the reduction in the acquirer's valuation allocation to reflect the expected realization of the acquirer's historical DTAs.
Compensation costs stemming from preexisting contracts or the merger agreement	Yes	In contrast, costs related to a new or discretionary arrangement are reflected as an other transaction accounting adjustment if material.

4.2 Overall

Under US GAAP, acquisitions meeting the definition of a business combination are accounted for under Topic 805 using the purchase method of accounting. This requires the acquirer to determine the fair value of assets acquired and liabilities assumed, and to allocate purchase price to those items based on the fair values. Under IFRS Accounting Standards-IASB, business combinations are accounted for under IFRS 3. While the requirements of IFRS 3 are largely aligned with Topic 805, differences may exist. Discussing the differences between IFRS 3 and Topic 805 is beyond the scope of this Handbook. See section 2.6 of KPMG Handbook, IFRS® compared to US GAAP, for additional information on the similarities and differences between IFRS 3 and Topic 805.

This chapter explains the various considerations in preparing pro forma financial statements when triggered by a business combination. See section 2.2.10 for information on the triggering conditions.

4.2.10 Use of preliminary purchase price allocation

Excerpt from Reg S-X Rule 11-02

Preparation requirements.

(a) *Form and content.*

…

(11) The accompanying explanatory notes must disclose:

…

(ii) For Transaction Accounting Adjustments:

…

(B) The following information when the accounting is incomplete: A prominent statement to this effect; the items for which the accounting depicted is incomplete; a description of the information that the registrant requires, including, if material, the uncertainties affecting the pro forma financial information and the possible consequences of their resolution; an indication of when the accounting is expected to be finalized; and other available information that will enable a reader to understand the magnitude of any potential adjustments to the measurements depicted.

Pro forma financial information for a significant business acquisition must often be filed before the business combination accounting is finalized, with Item 2.01 Form 8-K reporting the transaction due within four days of consummation and an amended Form 8-K (Form 8-K/A) with Rule 3-05 financial statements and pro forma financial information due within 71 days of the initial Form 8-K due date. An intervening registration statement or proxy statement may accelerate that time.

The SEC staff does not expect the pro forma financial information to reflect definitive conclusions about the business combination accounting or other effects. However, when the business combination accounting is preliminary, additional information must be disclosed both under Topic 805 and Reg S-X Rule 11-02. [805-20-50-4A, S-X Rule 11-02(a)(11)(ii)(B), FRM 3244.6]

Question 4.2.10 What is preliminary purchase price allocation?

Interpretive response: If the initial accounting for a business combination under Topic 805 is not complete at the end of the financial reporting period following the acquisition date, the acquirer reports provisional amounts for the assets, liabilities, equity interests, or items of consideration for which the accounting is incomplete. It then makes adjustments to those provisional amounts (that affect the accounting for the business combination) during the measurement period provided those adjustments meet certain criteria. [805-10-25-13, 25-15]

Section 10 of KPMG Handbook, Business combinations, for additional guidance.

Question 4.2.20 What is disclosed when the pro forma financial information reflects preliminary accounting for a business combination?

Background: Without disclosing the preliminary nature of the business combination accounting, users of the pro forma financial information might reasonably (but incorrectly) assume that the accounting is complete. They might further assume that any future adjustments to the amounts recognized in the preliminary accounting will affect net income instead of the business combination accounting.

Interpretive response: When the pro forma financial information for a significant acquisition reflects the preliminary accounting for a business combination, registrants must make a prominent statement to this effect, as well as disclose and discuss: [S-X Rule 11-02(a)(11)(ii)(B), 805-20-50-4A, FRM 3244.6]

- the reasons why the accounting is incomplete;
- the items for which the accounting depicted is incomplete;
- a description of the information the registrant needs to finalize the accounting, including any material uncertainties and the related potential consequences of their resolution on the pro forma financial information;
- when the accounting is expected to be finalized; and
- other available information that will enable a reader to understand the magnitude of any potential adjustments to the measurements depicted.

Disclosing a sensitivity analysis may be necessary to properly convey the magnitude of a potential material change to the preliminary accounting. For example, when the acquisition consideration includes issuance of the registrant's stock, the explanatory notes of the pro forma financial information should include a sensitivity analysis for the range of possible outcomes (see Question 4.3.10).

Question 4.2.30 Are registrants obligated to revise the pro forma financial information for adjustments to finalize the preliminary purchase price allocation?

Interpretive response: No. Registrants have no obligation to revise the pro forma financial information for subsequent changes to the preliminary purchase price allocation, but should clearly disclose that the accounting is preliminary as noted in Question 4.2.20 so that financial statement users do not infer that the accounting is final.

However, when amending an existing registration statement (i.e. post-effective amendment) or filing a new one, a registrant may need to update previously filed pro forma information. See section 3.5.60 for discussion of the requirements to update pro forma financial information.

Example 4.2.10 Disclosure of preliminary purchase price allocation

The following is an example of the preliminary purchase price allocation disclosed by Registrant with its pro forma financial information presented in a registration statement filed on December 30, 20X3.

Note 3. Preliminary purchase price allocation

The following represents the preliminary purchase price allocation based on Registrant's preliminary estimate of the fair values of Target's tangible and intangible assets to be acquired and liabilities to be assumed as of September 30, 20X3.

	Preliminary purchase price allocation (in thousands)
Assets acquired	
Cash, cash equivalents and restricted cash	150,000
Property, plant and equipment, net	230,000
Goodwill	57,000
Intangible assets	80,000
Other assets	6,000
Total assets to be acquired	523,000

	Preliminary purchase price allocation (in thousands)
Liabilities assumed	
Accounts payable	100,000
Accrued expenses	52,000
Deferred revenue	20,000
Total liabilities to be assumed	172,000
Net assets to be acquired	351,000

The allocation of the purchase price consideration is dependent upon certain valuation studies that have not yet been finalized. Accordingly, the preliminary purchase price allocation is subject to further adjustment as additional information becomes available and as additional analyses and final valuations are completed. There is significant uncertainty at this stage regarding the valuation of identifiable intangible assets and the determination of their useful lives. Pro forma adjustments are based on our preliminary estimates of fair value and useful lives and prepared for the purpose of providing unaudited pro forma condensed combined financial information to illustrate the estimated effect of the business combination.

Upon closing of the acquisition, which is expected to be in the first quarter of 20X4, and completion of the valuation studies, the final purchase price allocation could change materially (for example, the amount of goodwill recognized and the fair values, useful lives and subsequent amortization of other identifiable intangible assets).

4.2.20 Accounting policy conformity changes

A registrant and its target may apply the same GAAP, but have elected different acceptable accounting policies (e.g. FIFO versus LIFO). Similarly, they may classify items differently in their respective balance sheets or income statements.

See section 3.5.50 regarding the adoption of new accounting standards.

Question 4.2.40 Do the accounting policies and classification of a registrant and target need to conform in pro forma financial information?

Interpretive response: Yes.

For example, assume in applying Topic 932 (extractive activities – oil and gas) a registrant uses the successful efforts method to account for its oil and gas exploration and development activities and its target uses the full cost method to account for its similar activities. The registrant must conform the target's method of accounting to the successful efforts method. Therefore, a transaction accounting adjustment to the pro forma income statement is necessary to reflect the conformed accounting methods. [FRM 3250.2, 3250.3]

Transaction accounting adjustments

Different accounting policy elections within the same comprehensive basis of accounting	Make pro forma adjustments to conform the accounting policies of the target to the registrant's for all periods presented.
Different adoption date and/or transition method for new accounting standards	Make pro forma adjustments to align the adoption date and transition method of a new accounting standard of the target to the registrant's in the pro forma financial information.
Different classifications of balance sheet and income statement items	Make pro forma adjustments to reclassify target's items to conform with the registrant's classification for all periods presented. These reclassifications are commonly presented in a separate column but can be included with the transaction accounting adjustments for the business combination with adequate disclosure in the notes to the pro forma financial information.

Example 4.2.20 Reclassifications shown in separate column on the face of pro forma financial information

For this example, Registrant elects to present accounting policy conformation (i.e. reclassifications) on the face of the pro forma financial information as an additional column of transaction accounting adjustments. As an alternative, Registrant could instead include the related transaction accounting adjustment in the 'Business combination' column (not illustrated).

Note: EPS information and pro forma income statement for the nine months ended September 30, 20X2 are omitted for brevity.

Unaudited Pro Forma Condensed Combined Balance Sheet
As of September 30, 20X2
(in thousands)

	Historical		Transaction accounting adjustments		Pro forma combined
	Registrant	Target	Reclassifications (Note 1)	Business combination	
Intangible assets	400	–	150		550
Other assets	1,100	200	(150)		1,150

Unaudited Pro Forma Condensed Combined Income Statement
For the year ended December 31, 20X1
(in thousands)

	Historical		Transaction accounting adjustments		
	Registrant	Target	Reclassifications (Note 1)	Business combination	Pro forma combined
Cost of sales	1,400	1,000	50		2,450
SG&A	500	450	(50)		900

Notes to Unaudited Pro Forma Condensed Combined Financial Information

1. The pro forma financial statements have been adjusted to reflect reclassifications of Target's financial statements to conform with Registrant's presentation. The following reclassifications were made:
   - reclassification of $150,000 from Other assets to an increase of Intangible assets as of September 30, 20X2;
   - reclassification of certain expenses from Selling, general, and administrative expense to Cost of sales, totaling $50,000 and $35,000 for the year ended December 31, 20X1 and nine months ended September 30, 20X2, respectively.

4.3 Consideration transferred

4.3.10 Overview

Consideration transferred in a business combination includes only the consideration exchanged by the acquirer for the acquiree to the sellers of the target, which could include cash, noncash assets, contingent consideration (see Question 4.3.20), equity instruments of the acquirer (see Question 4.3.10) and/or liabilities incurred. Consideration transferred is recognized at fair value except for certain share-based payment awards. [805-10-25-20, 805-30-30-7]

Contingent consideration represents amounts payable to or receivable from the sellers upon the occurrence of certain future events or meeting certain conditions, and it is initially measured at its fair value. A registrant determines whether contingent consideration is recognized as a liability (or asset) or equity, which affects its subsequent measurement.

- **Liability (or asset) –** Subsequently remeasured to its fair value at the end of each reporting period with those changes generally included in earnings.
- **Equity –** Not subsequently remeasured.

See chapter 6 of KPMG Handbook, Business combinations, for additional information about identifying, recognizing and measuring consideration transferred in a business combination, including contingent consideration.

4.3.20 Disclosing consideration transferred in pro forma financial information

Excerpt from Reg S-X Rule 11-02

Preparation requirements.

(a) *Form and content.*

…

(6) The pro forma condensed balance sheet and pro forma condensed statements of comprehensive income must include, and be limited to, the following pro forma adjustments, except as noted in paragraph (a)(7) of this section:

(i) *Transaction Accounting Adjustments.*

(A) Adjustments that depict in the pro forma condensed balance sheet the accounting for the transaction required by U.S. Generally Accepted Accounting Principles (U.S. GAAP) or, as applicable, International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS-IASB). Calculate pro forma adjustments using the measurement date and method prescribed by the applicable accounting standards. For a probable transaction, calculate pro forma adjustments using, and disclose, the most recent practicable date prior to the effective date (for registration statements), qualification date (for offering statements under 17 CFR 230.251 through 230.263 (Regulation A)), or the mail date (for proxy statements).

…

(11) The accompanying explanatory notes must disclose:

…

(ii) For Transaction Accounting Adjustments:

(A) A table showing the total consideration transferred or received including its components and how they were measured. If total consideration includes contingent consideration, describe the arrangement(s), the basis for determining the amount of payment(s) or receipt(s), and an estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why; and…

Consideration transferred or to be transferred (i.e. the purchase price) is disclosed in pro forma financial information reflecting a business combination. When there are multiple components of consideration transferred (e.g. cash, noncash assets, equity), a tabular summary is disclosed showing the components and how they were measured. [S-X Rule 11-02(a)(11)(ii)(A), FRM 3244.6)]

Issues arise when the consideration includes contingent amounts or the business combination is not yet consummated when the pro forma financial information is required.

Question 4.3.10 What stock price is used to estimate the value of stock included in the consideration to be transferred in a probable business combination?

Interpretive response: When estimating the value of stock to be issued for a probable acquisition, a registrant uses the most recent stock price that is practicable at the time of filing the pro forma financial information. This date is based on facts and circumstances. It discloses the date at which the stock price was determined and includes a sensitivity analysis illustrating the effects of reasonably possible increases or decreases in the stock price. This analysis should consider recent volatility in the registrant's stock price. [S-X Rule 11-02(a)(6)(i)(A), Note to FRM 3244.3]

Question 4.3.20 Is an adjustment for changes in the fair value of contingent consideration reflected in an updated pro forma income statement?

Interpretive response: No. A transaction accounting adjustment is not made for any expected changes in the fair value of contingent consideration. Further, if updated pro forma income statements are filed (e.g. in a post-acquisition registration statement), changes in the fair value of contingent consideration should not be 'pushed back' to the earliest pro forma period presented. Instead, notes to the pro forma financial information should include transparent disclosure about the contingent consideration arrangement and known changes in fair value that have been recognized in the registrant's post-acquisition financial statements. [FRM 3250.12]

See Example 4.3.20 for an illustration involving changes in the fair value of contingent consideration prior to a filing that includes updated pro forma financial information.

Example 4.3.10 Disclosure of preliminary consideration transferred

The following is an example disclosure of the estimated amount of consideration to be transferred by Registrant with its unaudited pro forma condensed combined financial information presented in a registration statement filed on December 30, 20X3.

Note 2. Preliminary consideration transferred

The preliminary consideration transferred of approximately $351 million is based on Registrant's proposal to purchase each outstanding share of Target for $1 of cash and ½ share of Registrant. Target has an estimated 30 million shares outstanding as of December 23, 20X3. The merger agreement also includes a contingent consideration arrangement, payable based on achieving operating income targets.

The actual number of Registrant shares issued to Target shareholders at closing will be based on the actual number of Target shares outstanding when the acquisition closes.

Preliminary consideration transferred	
Shares of Registrant common stock to be issued to Target's common stockholders	15,000,000
Closing share price of Registrant common stock on December 23, 20X3	× 21
Consideration to be paid in common stock	315,000,000
Cash consideration	30,000,000
Contingent consideration	6,000,000
Total consideration	351,000,000

A fluctuation in the market price of Registrant's shares would affect the value of the preliminary consideration transferred reflected in the unaudited pro forma condensed combined financial information with a corresponding effect on goodwill, as illustrated in the following table.

	Consideration transferred	Goodwill
As presented	351,000,000	57,000,000
10% increase in share price	382,500,000	88,500,000
10% decrease in share price	319,500,000	25,500,000

The merger agreement also requires Registrant to pay additional cash consideration, contingent upon the level of operating income actually generated by Target's legacy operations in the first year after close of the acquisition. Contingent consideration payable could range from $0 if the minimum operating income threshold is not achieved to $12 million if the maximum operating income threshold is met or exceeded, with linear interpolation for actual performance between the minimum and maximum targets. Measuring the fair value of the contingent consideration liability is complex and represents a Level 3 fair value measurement under Topic 820. For purposes of the unaudited pro forma condensed combined financial information, we have initially estimated the fair value of this liability as $6 million. This preliminary estimate may be adjusted when a third-party valuation analysis is completed, with an equal and offsetting adjustment to goodwill.

Post-acquisition changes in the fair value of the contingent consideration liability will be recognized in earnings.

Example 4.3.20 Changes in contingent consideration

Registrant has a calendar year-end and closes a business acquisition on April 1, 20X2 that is significant at 25%. The acquisition includes contingent consideration, the actual payment of which could range from $0 to $20 million. The acquisition is accounted for as a business combination under Topic 805. Prior to consideration of the contingent consideration, the consideration transferred is $341 million. Pertinent information about the fair value of the contingent consideration is included in the following table along with subsequent filings by Registrant and its accounting for the contingent consideration in those filings.

Facts and filings	Balance sheet(s) and income statement(s) included in the filing
April 1, 20X2	
Business acquisition is closed.	N/A
April 4, 20X2	
Item 2.01 Form 8-K is filed to report the consummation of the acquisition.	N/A
April 30, 20X2	
Form 10-Q is filed for the first quarter.	Registrant's balance sheets as of March 31, 20X2 and December 31, 20X1 Registrant's income statements for the three months ended March 31, 20X2 and March 31, 20X1
Accounting/disclosures for the business acquisition in the historical financial statements	**Transaction accounting adjustments/disclosures reflected in pro forma financial statements**
There is no business combination accounting because the acquisition date occurred after the balance sheet date. However, disclosures about the business combination are provided under paragraph 805-10-50-4 because the acquisition date occurred before the financial statements were issued.	No pro forma financial statements are required.
May 31, 20X2	
Amended Form 8-K Item 9.01 is filed for the business acquisition. Pending receipt of a final third-party valuation analysis, the initial fair value estimate for contingent consideration *as of the acquisition date* is $10 million.	Target's historical financial statements: • Audited annual financial statements as of and for the year ended December 31, 20X1 Pro forma financial information: • Pro forma balance sheet as of March 31, 20X2 • Pro forma income statements for: — three months ended March 31, 20X2; and — year ended December 31, 20X1 This example assumes Registrant has elected to use the more recent balance sheet date included in the recently filed Form 10-Q for the period ended March 31, 20X2 in determining the periods to present for the pro forma balance sheet and pro forma income statement (see Question 3.2.30).

Facts and filings	Balance sheet(s) and income statement(s) included in the filing
Accounting/disclosures for the business acquisition in the historical financial statements	**Transaction accounting adjustments/disclosures reflected in pro forma financial statements**
There is no accounting because the acquisition date occurred after the balance sheet date. However, disclosures about the business combination are provided under paragraph 805-10-50-4 because the acquisition date occurred before the financial statements were issued.	The transaction accounting adjustment for the business acquisition reflects: • a liability for the $10 million estimated fair value of contingent consideration; and • goodwill calculated based on assumed total consideration of $351 million ($341 million in cash consideration plus $10 million, equal to the fair value of the contingent consideration). The disclosure for the transaction accounting adjustment indicates that the actual payment of contingent consideration could range from $0 to $20 million, and the fair value estimate of the contingent consideration liability is preliminary until a valuation specialist's analysis is completed.
June 15, 20X2	
The final third-party valuation analysis is received and indicates the final fair value estimate for contingent consideration *as of the acquisition date* is $5 million.	N/A
July 31, 20X2	
Form 10-Q is filed for second quarter. Prior to the filing, the fair value estimate for contingent consideration *as of June 30, 20X2* is $5 million – i.e. the fair value of the contingent consideration as of the acquisition date and as of June 30, 20X2 is the same.	Registrant's balance sheets as of June 30, 20X2 and December 31, 20X1 Registrant's income statements for three and six months ended June 30, 20X2 and June 30, 20X1
Accounting/disclosures for the business acquisition in the historical financial statements	**Transaction accounting adjustments/disclosures reflected in pro forma financial statements**
The acquisition accounting reflects the $5 million final fair value estimate for contingent consideration *as of the acquisition date*. The acquisition accounting reflects a contingent consideration liability of $5 million and goodwill calculated using total expected consideration of $346 million. Disclosures about the business combination are provided pursuant to Topic 805.	There is no obligation to revise the pro forma financial information filed on May 31, 20X2 because it adequately disclosed that the initial estimate of contingent consideration was preliminary (see Question 4.2.30).

4.4 Acquired assets and liabilities

Transaction accounting adjustments are made for the allocation of the purchase price to the identified assets and liabilities, along with the related changes in depreciation and amortization expense.

- **Pro forma balance sheet –** The adjustments to reflect the purchase price allocation to the assets and liabilities are made as if the business combination had closed on the balance sheet date.
- **Pro forma income statement –** The adjustments in related changes are made as if the business combination had closed on the first day of the annual income statement period presented, using the same fair values shown in the pro forma balance sheet.

The following sections explain these adjustments for certain types of assets and liabilities.

4.4.10 Inventory

Inventory acquired in a business combination is recognized at its fair value. Transaction accounting adjustments are used to reflect the fair value adjustments to inventory acquired in a business combination in the pro forma financial information.

Chapter 17 of KPMG Handbook, Business combinations, discusses determining that fair value in detail.

Question 4.4.10 What transaction accounting adjustments affect inventory?

Interpretive response: Because inventory acquired in a business combination is measured at its fair value, a registrant includes transaction accounting adjustments in: [FRM 3250.1]

- the pro forma balance sheet to reflect the step-up of the target's inventory to fair value; and
- the pro forma income statement to reflect the effect of the step-up on cost of sales.

Example 4.4.10 Transaction accounting adjustments – Inventory

The following is an example of the unaudited pro forma condensed combined financial information presented by Registrant in a registration statement that is filed on January 1, 20X3. The acquisition was consummated on October 1, 20X2 and this example assumes there are no other pro forma effects of the transaction other than those described in Question 4.4.10 (in thousands).

	Registrant	Target	Transaction accounting adjustment	Note	Pro forma combined
Balance sheet as of September 30, 20X2					
Cash	1,500	400	(230)	1	1,670
Inventory	2,100	900	200	1	3,200
Goodwill	3,900	2,200	30	1	6,130
Income statement for the nine months ending September 30, 20X2					
Cost of sales	4,500	2,700	-		7,200
Income statement for the year ending December 31, 20X1					
Cost of sales	5,000	3,200	200	2	8,400

Notes to Unaudited Pro Forma Condensed Combined Financial Information

1. Represents the application of purchase accounting and the difference between the preliminary fair value of Target's inventory, which is subject to change, and its carrying amount. The fair value considers replacement cost for materials and net realizable value for work-in-process and finished goods. See note 2 for further details.
2. Represents the additional cost of goods sold recognized in connection with adjusting inventory to its fair value. The increased value of inventory will be recognized in cost of sales as the inventory is sold, which for purposes of these pro forma financial statements is assumed to occur within the first year after the merger. See note 1 for additional details.

4.4.20 Intangible and long-lived assets

A key feature of business combination accounting is recognizing and measuring acquired intangible assets (such as customer relationships) and long-lived assets (such as PP&E) at their fair values. Goodwill (or, in rare circumstances, a bargain purchase gain) is also recognized. [805-10-05-4, 805-20-25-1]

Chapter 7 of KPMG Handbook, Business combinations, provides detailed guidance on recognizing and measuring intangible and long-lived assets acquired in a business combination.

Question 4.4.20 What transaction accounting adjustments affect intangible and long-lived assets?

Interpretive response: A registrant includes transaction accounting adjustments in: [FRM 3250.1]

- the pro forma balance sheet to reflect the fair values of the acquired intangible assets and long-lived assets – in some cases, this results in recognizing intangible assets not previously recognized by the target (e.g. customer relationship intangible assets); and

- the pro forma income statement to reflect the amortization and depreciation based on the adjusted amounts of acquired intangible and long-lived assets.

The following presents the measurement dates used for the intangible and long-lived assets and related amortization and depreciation expense reflected in the pro forma financial statements (see section 3.3). [S-X Rule 11-02(a)(6)]

Pro forma balance sheet	Pro forma income statements
Acquired intangible and long-lived assets measured as if the business combination had closed on the balance sheet date.	Amortization and depreciation determined as if the business combination had closed on the first day of the annual income statement period presented, using the same fair values shown in the pro forma balance sheet.

Based on this approach, the pro forma balance sheet does not accumulate the pro forma depreciation and amortization expense shown in the pro forma income statements. Further, the calculation of pro forma amortization and depreciation expense does not reflect the fair value of the acquired intangible and long-lived assets as of the beginning of annual income statement period (versus fair value at the balance sheet date).

Question 4.4.30 How is goodwill recognized by the target for its legacy acquisitions treated in pro forma financial information?

Interpretive response: Any goodwill recognized by the target for its legacy acquisitions is derecognized by the registrant in the pro forma financial information. This is because US GAAP requires the elimination of an accounting acquiree's goodwill.

Additionally, the registrant includes a transaction accounting adjustment to reflect goodwill created by the merger based on the preliminary purchase price allocation.

Question 4.4.40 What are the disclosures for transaction accounting adjustments affecting intangible and long-lived assets?

Interpretive response: When the pro forma financial statements reflect transaction accounting adjustments affecting intangible and long-lived assets, the registrant discloses in an explanatory note: [FRM 3250.10]

- the expected useful lives of significant acquired intangible and long-lived assets; and
- the amortization or depreciation method if other than straight-line, as well as the estimated effects on operating results (if material) for each of the first five years following acquisition.

Question 4.4.50 How are transaction accounting adjustments for intangible and long-lived assets affected when the business combination accounting is preliminary?

Interpretive response: At the time pro forma financial information is filed, the registrant may have limited or preliminary information from which to estimate the fair value of intangible and long-lived assets. For example, consider the following two scenarios.

- Registrant must prepare the pro forma financial information included in a registration statement and proxy to seek shareholder approval of a proposed stock-for-stock acquisition before acquired intangible assets have even been fully identified. Further, for some of those that have been identified, either:
  - there are not yet estimates of fair value; or
  - management may have prepared only high-level estimates based on publicly available information pending a valuation specialist's detailed analysis.
- Registrant must prepare pro forma financial information included in a Form 8-K/A filed 75 days after the close of an acquisition, and the fair value estimates for certain acquired intangible assets are based on a valuation specialist's draft report pending the valuation specialist's final report.

As discussed in section 4.2.10, pro forma financial information for a significant business acquisition can be preliminary, but additional information must be disclosed (see Question 4.2.20). Often, the information needed to determine the fair value of acquired intangible or long-lived assets is not available when pro forma information must be filed. In this case, a registrant should not disclose that the target's carrying value is necessarily indicative of its fair value. Instead, it could disclose that fair values for the intangible and long-lived assets have not yet been estimated and that carrying value has been used in preparing the pro forma financial information.

Additionally, in cases where preliminary fair value estimates have been made, it may be appropriate to disclose sensitivity ranges to demonstrate the potential for revision (see Example 4.4.20).

Example 4.4.20 Transaction accounting adjustments – Intangible and long-lived assets with preliminary fair values

The following is an example of the unaudited pro forma condensed combined financial information presented by Registrant in a Form 8-K/A filed on December 15, 20X2 after the acquisition closed on October 15, 20X2. This example assumes there are no other pro forma effects of the transaction (e.g. the impact to cash for the consideration transferred is excluded for brevity) (in thousands).

	Registrant	Target	Transaction accounting adjustments	Note	Pro forma combined
Balance sheet as of September 30, 20X2					
PP&E, net	1,200	500	200	1	1,900
Intangible assets, net	3,000	100	4,000	2	7,100
Goodwill	7,000	2,500	600	3	10,100
Income statement for the nine months ended September 30, 20X2					
Depreciation	250	50	25	1	325
Amortization	200	5	535	2	740
Income statement for the year ended December 31, 20X1					
Depreciation	450	120	33	1	603
Amortization	400	10	710	2	1,120

Notes to Unaudited Pro Forma Condensed Combined Financial Information

1. Reflects the adjustment necessary to record acquired PP&E at its fair value depreciated over an estimated remaining useful life of six years. The fair value estimates are preliminary and based on a cost method that considers the PP&E's replacement cost, age and certain other factors.
2. Reflects the recognition of acquired finite-lived intangible assets as follows (in thousands).

	Estimated fair value	Estimated useful life	Annual expense for 20X1	Expense for the nine months ended Sep. 30, 20X2
Trademark	1,000	10	100	75
Customer relationships	3,100	5	620	465
Subtotal	4,100		720	540
Less: Amounts historically recognized by Target	(100)		(10)	(5)
Transaction accounting adjustments	4,000		710	535

These fair value estimates are preliminary and based on an income model that requires a projection of future cash flows from the respective intangible assets. The estimated fair values and useful lives are subject to change as the valuation analysis is completed and could change materially in relation to the unaudited pro forma condensed combined financial statements. A 10% increase or decrease in the fair value of these assets would cause an offsetting effect on goodwill and would also cause annual amortization expense to increase or decrease by $72 million, assuming a weighted average estimated useful life of 6.2 years.

3. Reflects the adjustment necessary to record our preliminary estimate of goodwill on the acquisition of Target as follows (in thousands).

Reversal of Target's goodwill on legacy acquisitions	(2,500)
Recorded goodwill on Registrant's acquisition of Target	3,100
Transaction accounting adjustment	600

A detailed valuation analysis will be completed after the acquisition closes, and the final amount of goodwill could vary materially from this preliminary estimate, which was developed solely for the purpose of preparing pro forma financial information.

4.4.30 In-process research and development

Under Topic 805, acquired in-process research and development (IPR&D) is recognized as an indefinite-lived intangible asset at its fair value until the acquirer completes or abandons the project. See Question 2.3.40 of KPMG Handbook, Research and development.

Question 4.4.60 Is a transaction accounting adjustment made to reverse R&D expenses related to IPR&D that the target historically expensed?

Interpretive response: No. While the target may have historically expensed R&D related to the same projects that the registrant recognizes at fair value under Topic 805, a transaction accounting adjustment is not made to reverse those historical expenses recognized in the target's historical financial statements. That is because transaction accounting adjustments are made to reflect the accounting for the relevant transaction (e.g. the acquisition) under the relevant GAAP. Accounting for an acquisition under Topic 805 does not result in the target reversing historical R&D expenses in its historical income statement, and therefore a similar adjustment is not made in the pro forma income statement. This is similar to not reversing historical impairment charges recognized by the target as discussed in Question 4.4.70. [S-X Rule 11-02(a)(6)(i)]

4.4.40 Impairment charges in the target's historical financial statements

Question 4.4.70 Is a transaction accounting adjustment made to reverse impairment charges recognized under US GAAP in a target's historical financial statements?

Interpretive response: With the exception of the impairment of goodwill, transaction accounting adjustments are not made to reverse historical impairment charges, even if the fair value ascribed in the business combination accounting indicates that the asset's fair value has since rebounded. That is because transaction accounting adjustments are made to reflect the accounting for the transaction (e.g. the acquisition) under the relevant GAAP. Accounting for an acquisition under Topic 805 does not result in the target reversing historical impairment charges in its historical income statement, and therefore a similar adjustment is not made in the pro forma income statement. [S-X Rule 11-02(a)(6)(i)]

In contrast, goodwill impairment in the target's historical financial statements is eliminated through a transaction accounting adjustment in the pro forma condensed income statement. This is because US GAAP requires the elimination of target's goodwill, which is also reflected by a transaction accounting adjustment in the pro forma condensed balance sheet (see Question 4.4.30). This treatment of goodwill impairment in the pro forma financial statements only applies to goodwill impairment recognized by the target (i.e. accounting acquiree) and therefore goodwill impairment recognized by the registrant (i.e. accounting acquirer) should not be eliminated. [FRM 3245.3]

Question 4.4.80 Is a transaction accounting adjustment made to reverse impairment charges recognized under IFRS Accounting Standards in a target's historical financial statements?

Interpretive response: Only in rare or unusual cases.

IFRS Accounting Standards allows reversal of impairment charges in certain circumstances (e.g. the factors leading to impairment are no longer present and the fair value has increased). Whether a transaction accounting adjustment is appropriate to reverse these impairment charges depends on whether these certain circumstances already existed on the acquisition date.

If those circumstances (e.g. a rebound in fair value) would likely have been present prior to and irrespective of the acquisition, then the impairment changes would be reversed in the target's historical financial statements. If the reversal is already reflected in the historical financial statements, no pro forma transaction accounting adjustment is necessary.

There may be rare or unusual cases where appropriate evidence of a rebound in the fair value would only be obtained upon close of the acquisition (e.g. no comparable market transactions have occurred yet). In these cases, the reversal of the impairment charge would not be recognized in the target's historical financial statements. As a result, we believe a transaction accounting adjustment in the pro forma financial information to reverse the impairment charge may be appropriate.

4.4.50 Debt financing

Business combinations are frequently financed by the issuance of new debt and may involve the acquirer assuming the acquiree's debt. When an acquirer legally assumes the acquiree's debt as part of the acquisition, the acquirer recognizes a liability equal to the acquisition-date fair value of the assumed debt (see paragraph 7.035 of KPMG Handbook, Business combinations, for additional information). [805-20-30-1]

Question 4.4.90 How does financing a significant acquisition with new debt or assuming the target's debt affect pro forma financial information?

Interpretive response: When a registrant is financing a significant acquisition with new debt or assuming the target's debt, the following transaction accounting adjustments are made to the pro forma financial information (as necessary). [S-X Rule 11-02(a)(6)(i)(A), Rule 11-01(a)(8), FRM 3250.1]

- **New debt –** If the debt transaction is material, record as an other transaction accounting adjustment at the amount borrowed less debt issuance cost. Interest expense on the debt is also reflected as an other transaction accounting adjustment.
- **Assumed debt –** Record a transaction accounting adjustment (related to the business combination) to adjust the carrying value of the assumed debt to its fair value. Record a corresponding transaction accounting adjustment for interest expense to reflect the amortization of any incremental premium or discount.

Pro forma interest expense on a new debt issuance generally reflects the terms of a committed financing agreement or one that is expected to be obtained based on the current level of the relevant interest index (the 'current rate'). The committed or current rate of interest is determined at or reasonably close to the filing date of the pro forma financial information. [S-X Rule 11-02(a)(6)(i)(A), FRM 3260.2]

If actual rates in the transaction can vary from those depicted, the registrant discloses the effect of a 1/8% change in the interest rate. [FRM 3260.1]

Question 4.4.100 When is pro forma interest expense calculated based on a rate other than the committed or current rate?

Interpretive response: Only in those limited facts and circumstances in which using the committed or current rate would not be reasonable.

Overall, the SEC staff believes the interest rate used to calculate pro forma interest expense should be 'reasonable'. While it acknowledges this is the committed or current rate in most cases, the staff also indicates careful consideration should be given to which rate is reasonable in the specific facts and circumstances.

For example, the SEC staff believes it would not be reasonable to use the current or committed rate to calculate pro forma interest expense when the acquired assets generate variable interest income and are financed by variable rate debt. In this situation, it may be appropriate to use historical rate(s) to better align the pro forma interest expense with the historical interest income. [FRM 3260.2]

The following information must be prominently disclosed in the introduction to the pro forma financial information (wherever that information is provided) when the registrant uses a rate other than the current or committed rate to calculate pro forma interest expense: [FRM 3260.2]

- the basis of presentation; and
- the anticipated effects of the current interest rate environment.

Question 4.4.110 Is a material short-term bridge loan used to finance an acquisition reflected in pro forma financial information?

Interpretive response: Yes. A short-term bridge loan being used to finance an acquisition is reflected as an other transaction accounting adjustment in the pro forma financial information if material. [S-X Rule 11-01(a)(8)]

Short-term bridge loans may be replaced with permanent financing at or before the end of their term. In that situation, the short-term and permanent financing together may mean that the transaction accounting adjustments (e.g. related to interest expense) do not need to be identified as a nonrecurring item.

Example 4.4.30 Transaction accounting adjustments – Debt assumption and bridge loan

The following is an example of the unaudited pro forma condensed combined financial information presented in a registration statement filed on November 30, 20X2 (in thousands).

	Registrant	Target	Other Transaction accounting adjustments	Note	Pro forma combined
Balance sheet as of September 30, 20X2					
Current bridge loan	–	–	10,000	1	10,000
Long-term debt	7,500	5,000	700	2	13,200
Income statement for the nine months ended September 30, 20X2					
Interest expense	300	150	335	3	785
Income statement for the year ended December 31, 20X1					
Interest expense	470	190	444	3	1,104

Notes to Unaudited Pro Forma Condensed Combined Financial Information

1. Registrant has arranged a bridge loan in an aggregate principal amount of $10.0 million. If needed, this bridge loan will be available to fund cash consideration payable to Target stockholders. The variable interest rate on the bridge loan is

assumed to be 5.0%, based upon the current market index. Interest expense on the bridge loan has been included in the pro forma statements of income based on the assumption that Registrant will continue to finance the remaining cash consideration through the bridge loan for its full term of 364 days.

2. Target's debt will be legally assumed by Registrant in the proposed acquisition and recorded at its fair value, which is estimated to be $700,000 greater than its carrying value.
3. The net increase in interest expense results from the issuance of the bridge loan, offset by effective interest method amortization of the premium that is expected to result from adjusting Target's debt to its fair value upon assumption, as follows (in thousands).

	Nine months ended Sep. 30, 20X2	Year ended Dec. 31, 20X1
Interest expense on bridge loan	375	500
Amortization of premium on debt assumed	(40)	(56)
Transaction accounting adjustment	335	444

While registrant expects to issue a series of term notes with varying maturity dates that will ultimately fund repayment of the bridge loan, pro forma interest expense based on the bridge loan's terms is presented for the nine months ended September 30, 20X2, as well as for the year ended December 31, 20X1. Although the bridge loan's term is 364 days, its committed terms have informed pro forma interest expense for the nine months ended September 30, 20X2. A 1/8% increase (decrease) in the interest rate relative to interest expense on the fully drawn bridge loan would increase (decrease) annual interest expense by $12.5 million.

4.5 Gains and losses arising from the business combination

Examples of gains and losses arising from business combinations include: [805-10-25-10, 25-20 – 25-21, 805-30-25-2]

- a bargain purchase gain (see chapter 8 of KPMG Handbook, Business combinations);
- a gain from adjusting what had been an equity method investment to its fair value at the time that control is obtained in a step acquisition (see chapter 9 of KPMG Handbook, Business combinations); and
- the recognition of a gain or loss on the settlement or termination of a preexisting relationship (see chapter 11 of KPMG Handbook, Business combinations).

Question 4.5.10 Are gains and losses arising from a business combination reflected in pro forma financial information?

Interpretive response: Yes. If a gain or loss is recognized in the business combination accounting and included in the purchase price allocation, a transaction accounting adjustment is reflected in the pro forma financial statements. For example, a transaction accounting adjustment may be required to reflect a bargain purchase gain or a gain recognized in a step acquisition.

Gains or losses related to a material underlying transaction under S-X Rule 11-01(a)(8) are presented as part of an other transaction accounting adjustment. This might include a gain or loss recognized on the settlement or termination of a preexisting relationship between the acquirer and acquiree upon consummation of the acquisition. However, if these gains and losses were recognized in the historical financial statements, a transaction accounting adjustment is not made to reverse them. [S-X Rule 11-02(a)(6)(i)]

4.6 Transaction costs

The requirement to reflect transaction accounting adjustments as if those adjustments were made at the start of the fiscal year presented is influenced by two key factors: [S-X 11-02(a)(6)(i)(B), FRM 3250.4]

- whether transaction expenses are included in the historical annual or interim periods used to present the pro forma financial information, or if they are incurred following those periods; and
- whether the transaction expense is incurred by the registrant or the entity being acquired.

The following table summarizes when transaction accounting adjustments are made for transaction costs.

	Incurred transaction costs (see Question 4.6.20)	To-be-incurred/future transaction costs (see Question 4.6.10)
By registrant/acquirer	No transaction accounting adjustment	Transaction accounting adjustment
By acquiree	No transaction accounting adjustment	No transaction accounting adjustment

Question 4.6.10 Is a transaction accounting adjustment made for the expected transaction costs of a business combination?

Interpretive response: Yes, provided those expected transaction costs are incurred by the *registrant* and have not yet been recognized in the registrant's historical financial statements. We understand the SEC staff does not believe transaction costs related to a business combination should be presented as a separate material transaction; instead, they should be included with the other adjustments for the business combination. [S-X Rule 11-02(a)(6)(i), FRM 3250.5]

However, if an *acquiree* incurs transaction costs after the historical periods presented in the pro forma financial information, no pro forma adjustment should be made to include those expenses. This is because the pro forma financial information reflects the registrant's accounting for the transaction, and the acquiree's transaction expenses are not included in the registrant's accounting. [FRM 3250.6]

Question 4.6.20 Is a transaction accounting adjustment made to reverse transaction costs recognized in the historical financial statements?

Interpretive response: No.

When transaction expenses are incurred by either a registrant or an acquiree during the historical periods used for pro forma financial information, no pro forma adjustments are made to remove the expenses. Additionally, no adjustments are made to move the expenses from the interim pro forma period to the annual pro forma period, or vice versa. [S-X Rule 11-02(a)(6)(i), FRM 3250.5 - .6]

In addition, any transaction costs included in the pro forma income statement that will not recur in the registrant’s income beyond 12 months after the transaction are disclosed in the explanatory notes of the pro forma financial information (see Question 3.3.10). [FRM 3230.5]

Example 4.6.10 Transaction accounting adjustments – Transaction costs

The following is an example of the unaudited pro forma condensed combined financial information presented by Registrant in a registration statement that is filed on November 30, 20X2. This example assumes there are no other pro forma effects of the transaction (e.g. tax effects are excluded for brevity) (in thousands).

	Registrant	Target	Transaction accounting adjustments	Note	Pro forma combined
Balance sheet as of September 30, 20X2					
Accounts payable	18,000	16,000	2,100	1	36,100
Income statement for the nine months ended September 30, 20X2					
Purchased services & other	9,500	2,500	–	1	12,000
Merger costs	–	800	–	1	800

	Registrant	Target	Transaction accounting adjustments	Note	Pro forma combined
Income statement for the year ended December 31, 20X1					
Purchased services & other	10,000	3,000	2,100	1	15,100

Notes to Unaudited Pro Forma Condensed Combined Financial Information

1. During the nine months ended September 30, 20X2, $1.6 million of transaction costs had been recognized in 'Purchased services & other' by Registrant and $800,000 had been recognized as 'Merger costs' by Target. Those expenses have not been removed from the pro forma income statement for the nine months ended September 30, 20X2. An additional $2.1 million of transaction costs expected to be incurred by Registrant, related to the acquisition, subsequent to September 30, 20X2 have been recognized in the pro forma income statement for the year ended December 31, 20X1 in 'Purchased services & other'. This is to reflect the acquisition as if it had occurred on January 1, 20X1. These costs will not affect Registrant's income statement beyond 12 months after the acquisition date.

   The estimated transaction costs are preliminary, may change and are nonrecurring adjustments.

4.7 Deferred tax asset valuation allowances

The income tax effects of pro forma adjustments normally are based on the statutory tax rates in effect during the relevant period(s) presented, and are reflected as a separate pro forma adjustment (see Question 3.3.20). In a business combination, pro forma financial information includes the recognition of deferred tax assets (DTAs) and deferred tax liabilities (DTLs) on the assets acquired and liabilities assumed. These adjustments should be consistent with the anticipated structure of the transaction (e.g. taxable versus non-taxable) and the combined entity's expected post-combination tax filing position (e.g. whether or not a consolidated tax return will be filed).

The combined entity may expect to realize DTAs that had previously been reduced by a valuation allowance. For instance, this can result when one entity's excess DTLs can be scheduled to realize DTAs that the other entity had not previously expected to realize. Excess taxable income from one entity or an increase in projected taxable income from post-combination results may have a similar effect.

When the combination drives a change in the acquiree's valuation allowance, that effect is reflected in acquisition accounting (effectively with an offset to goodwill or bargain purchase gain). Conversely, when the combination enables a change in the acquirer's valuation allowance, a tax expense (benefit) is generally recognized in the period in which the acquisition closes. For example, a tax benefit would be included in the pro forma income statement to reflect a reduction of the registrant's valuation allowance, which would be disclosed as a nonrecurring benefit (see Question 3.3.10). An adjustment would also be made to the pro forma balance sheet to reflect the reduction of the valuation allowance.

See section 6 of KPMG Handbook, Income taxes, for additional discussion related to the accounting for income taxes in business combinations under Topic 740 and Topic 805.

Example 4.7.10 Transaction accounting adjustments – Deferred tax valuation allowances

Registrant acquires Target March 15, 20X2. Target has significant net operating losses (NOLs) that it expected to realize through the reversal of its DTLs as well as other sources of future taxable income. Additional DTLs will be recorded in the business combination accounting as Target's assets and liabilities are stepped-up to their fair value. The combined entity expects to file a consolidated federal tax return, but has determined that a portion of Target's NOLs can no longer be realized as a result of IRC 382 limitations.

Conversely, Registrant historically recorded a valuation allowance on a significant portion of its DTAs that it did not previously expect to realize through the generation of adequate taxable income. However, Registrant now expects the DTAs to be realized via reversal of the DTLs acquired from Target.

Assume that there are no other pro forma effects on the respective line items.

Unaudited Pro Forma Condensed Combined Balance Sheet
As of December 31, 20X1
(in thousands)

	Registrant	Target	Transaction accounting adjustments	Note	Pro forma combined
Deferred tax assets (liabilities)	20,000	(40,000)	10,000	1	(10,000)

Unaudited Pro Forma Condensed Combined Income Statement
For the year ended December 31, 20X1
(in thousands)

	Registrant	Target	Transaction accounting adjustments	Note	Pro forma combined
Pre-tax income	16,000	12,000	–		28,000
Income tax expense (benefit)	4,000	3,000	(40,000)	2	(33,000)
Net (loss) income	12,000	9,000	40,000		61,000

Notes to Unaudited Pro Forma Condensed Combined Financial Information

1. Represents the following (in thousands):

Increase in net DTL from adjusting Target's net assets to their fair value	(20,000)[1]
Increase in valuation allowance from IRC 382 limitation on the post-combination utilization of Target's legacy NOLs	(10,000)[1]

Reduction in Registrant's valuation allowance to reflect the expected realization of Registrant's historical DTAs	40,000
Transaction accounting adjustment	10,000

Note:

1. The offset to these entries would be made to goodwill or bargain purchase gain, but is omitted from the example for brevity.

2. Represents the $40 million nonrecurring tax benefit resulting from a reduction in the Registrant's legacy valuation allowance to reflect the combined entity's expectations of future taxable income. Transaction accounting adjustments to income tax expense (benefit) reflect the blended statutory rate of 25%.

Question 4.7.10 Are transaction accounting adjustments made for a transaction's income tax effects when the target is not subject to entity-level taxation?

Interpretive response: When the target is not subject to entity-level taxation (e.g. because it is a partnership or Subchapter S corporation), transaction accounting adjustments are made to reflect the income tax effects under Topic 740 as if the target had been included in the registrant's consolidated tax return, or on a separate return basis, as appropriate based upon the expected post-combination tax structure.

Similarly, if the target was previously included in the seller's consolidated corporate tax return and the target's stand-alone historical financial statements do not include income tax expense, the acquirer makes a pro forma transaction accounting adjustment to reflect income tax expense under the separate return basis. [S-X Rule 11-02(b)(5)(ii), SAB Topic 1.B.1 (Q3)]

More generally, the SEC staff requires that if a registrant's historical financial statements in a registration statement are not reflective of the ongoing entity (e.g. as a result of a change in, or termination of, a tax-sharing or cost-sharing arrangement with its parent company), the registration statement must include Article 11 pro forma financial information that reflects the effect of terminating or revising the sharing agreements. [SAB Topic 1.B.2]

4.8 Compensation arrangements

4.8.10 Overview

Business combinations are frequently accompanied by the amendment, settlement or replacement of compensation agreements for the acquiree's employees. Those compensation agreements may be share-based or cash payments and structured as a bonus, benefit plan, retention plan, severance payment, share-based award or something else.

Costs to amend, settle or replace an acquiree's existing compensation arrangements may represent:

- a cost of the acquiree (recognized in its pre-combination financial statements);
- consideration transferred in the acquisition;
- a post-combination cost (recognized in the post-combination financial statements); or
- a mix of the above.

Determining the appropriate accounting for compensation arrangements in a business combination can be complex. Entities should consider the detailed guidance beginning in paragraph 11.017 of KPMG Handbook, Business combinations.

4.8.20 Change-in-control provisions

Compensation arrangements, particularly share-based awards, frequently include change-in-control provisions. These provisions typically accelerate the vesting of awards upon a change in control of the issuing company. In some cases, such provisions are added to existing awards specifically in contemplation of a change in control of the acquiree. From the acquirer's perspective in a business combination, the accounting question for these provisions is whether the cost represents consideration for past employee service (making it part of the business combination) or an expense for future service (making it a post-combination cost). The answer to this question dictates how the cost is ultimately recognized and, consequently, its treatment in Article 11 pro forma financial statements.

See the detailed guidance beginning in paragraph 11.036 of KPMG Handbook, Business combinations, related to the accounting for change-in-control provisions.

Question 4.8.10 Is a transaction accounting adjustment made for acceleration of compensation expense under a change-in-control provision?

Interpretive response: It depends. Transaction accounting adjustments are required to reflect the accounting effects of the transaction under US GAAP or IFRS Accounting Standards-IASB, as applicable. The accounting for the change-in-control provision by the acquirer depends on how the change-in-control provision arose and the nature of the provision (i.e. single trigger versus double trigger). 'Double trigger' refers to a situation in which the acceleration of vesting is contingent on an event in addition to the change-in-control event.

The accounting treatment affects the Article 11 pro forma financial statements as illustrated below.

Original terms of the acquiree award include a change-in-control provision (single trigger)	Single trigger awards are accounted for as part of the business combination, either as consideration transferred or as a liability assumed. See paragraph 11.037a in KPMG Handbook, Business combinations. Post-combination expense (e.g. if incremental fair

	value is given to the award holder) should be reflected as an other transaction accounting adjustment in the pro forma financial statements.
Original terms of the acquiree award include a change-in-control provision (double trigger)	If the additional triggering event is substantive and within the control of, or for the benefit of, the acquirer or the combined entity, any expense related to the acceleration of vesting would be recognized by the acquirer as post-combination compensation cost. If material, it would be presented as an other transaction accounting adjustment in the pro forma financial statements.
Existing award modified to add change-in-control provision (acquirer initiated)	Similar to a change-in-control provision with a double trigger in the original terms of an acquiree award, any expense related to the acceleration of vesting would be recognized by the acquirer as post-combination compensation cost and, if material, would be presented as an other transaction accounting adjustment in the pro forma financial statements.
Existing award modified to add change-in-control provision (acquiree initiated)	When an acquiree adds a change-in-control feature to existing awards, determine whether the modification is, in substance, part of the consideration for the business combination or post-combination compensation; present the resulting effect accordingly in SEC pro forma information. See paragraphs 11.042 through 11.044 of KPMG Handbook, Business combinations.

Items in the pro forma financial information that are not expected to recur beyond 12 months after the transaction are disclosed in the explanatory notes (see Question 3.3.10). [FRM 3230.5]

Example 4.8.10 Transaction accounting adjustments – Accelerated vesting when triggered by change-in-control provision in the original terms of acquiree award

On July 1, 20X7, Registrant pays cash to acquire all of the outstanding equity securities of Target, including outstanding equity-classified share options. The share option awards contain a change-in-control provision that was included in the original award terms such that they immediately vest on a change in control of Target. The grant-date fair value of the share options is $8 million. The fair value of the share options on July 1, 20X7 is $12 million. All share awards vest at the date of the business combination and the cash paid to redeem the share options is $12 million.

Because this scenario involves a change-in-control provision with a single trigger in the original terms of the acquiree award and the awards were equity-classified in Target's pre-combination financial statements, Registrant determines that the amount paid to settle the awards is part of the consideration transferred, and includes the following language in the notes to its pro forma information.

Notes to Unaudited Pro Forma Condensed Combined Financial Information

Represents $12 million paid to settle fully vested awards resulting from the change in control of Target and is included in the consideration transferred. The share option awards contained a change-in-control provision that was included in the original award terms such that they immediately vest on a change in control of Target.

Example 4.8.20 Transaction accounting adjustments – Accelerated vesting when change-in-control provision added

Scenario 1

In January 20X6, Target owners consider future liquidity event scenarios, including the sale of Target. As a result, Target modifies all share-based compensation agreements to add a single trigger change-in-control provision such that awards immediately vest upon a change in control of Target. In January 20X7, Target enters into discussions with Registrant regarding the sale of Target to Registrant.

Because the change-in-control provision was added by Target during the process of strategic planning and before discussions with Registrant, Registrant concludes that the modification was not initiated by or for its benefit. Target would need to consider the accounting effect, if any, in its pre-combination financial statements, and the accounting and effect on the pro forma financial statements would be the same as Example 4.8.10.

Scenario 2

On July 1, 20X6, Target grants share options with a grant date fair value of $8 million and a 48-month vesting period. In January 20X7, Target enters into discussions with Registrant regarding the sale of Target to Registrant. As a result, Target modifies all share-based compensation agreements to add a single trigger change-in-control provision such that awards immediately vest upon a change in control of Target. The fair value of the share options on the acquisition date is $12 million.

Because the change-in-control provision was added as a result of merger discussions with Registrant that had extended beyond a preliminary stage, Registrant concludes that the modification should be accounted for as if it was initiated by Registrant, and therefore Registrant includes the $3 million (calculated as 12/48 months multiplied by $12 million acquisition date fair value) attributed to pre-combination vesting in the consideration transferred. It includes the following language in the notes to its pro forma information.

Notes to Unaudited Pro Forma Condensed Combined Financial Information

Represents Registrant's one-time post-combination compensation cost of $9 million related to the accelerated vesting of the share options of Target in contemplation of the acquisition. This cost is reflected as an other transaction accounting adjustment separate from the business combination.

4.9 Restructuring activities

This section addresses both a target's pre-acquisition restructuring activities and the acquirer's post-combination restructuring activities.

Question 4.9.10 Is a transaction accounting adjustment made to reverse an acquiree's historical restructuring charges?

Interpretive response: No, historical restructuring charges incurred by the target are not removed via a transaction accounting adjustment for the same reasons that historical impairment charges are not removed (see Question 4.4.70).

Question 4.9.20 When and how are cost savings related to post-combination exit activities presented in pro forma financial information?

Background: The acquirer's integration plan may involve restructuring the combined operations without exiting any revenue-producing activities. Employee terminations, facility closures, or other actions may be taken to eliminate costs perceived by management as redundant.

Interpretive response: Cost savings are not permitted to be reflected as a transaction accounting adjustment in the pro forma financial statements. However, a registrant may present such savings as 'management's adjustments' in the explanatory notes, if the conditions for presentation are met. This is because management's adjustments depict the effect of synergies and dis-synergies of the acquisition (or disposition) (see section 3.4).

When management's adjustments depicting such synergies and dis-synergies related to post-combination exit activities are not presented, consideration should be given to whether the explanatory notes of the pro forma financial information nonetheless should reflect narrative discussion about such actions to make the pro forma financial information not misleading. Similarly, consideration should be given to whether other requirements, such as MD&A, require discussion and analysis of how these actions (and other business integration activities not specifically associated with the acquisition of a business) are expected to affect the operations and liquidity of the newly combined companies going forward. [FRM 3249.5]

4.10 Disposal in connection with a business combination

The registrant or acquiree may plan to dispose of certain operations in conjunction with a business combination. This may occur when such operations must be disposed to gain regulatory approval for the business combination.

Question 4.10.10 How is a disposition related to a business combination reflected in pro forma financial information?

Interpretive response: When the registrant or its target expects to dispose of certain operations as a condition to obtain the approval of one or more regulatory agencies for a business combination, the treatment of these disposals in pro forma financial information is subject to specific disclosure and presentation requirements.

Disclosure requirements

The introductory paragraph and explanatory notes of the pro forma financial information reflecting the business combination should, at a minimum, clearly disclose the circumstances related to these expectations, any contingencies or uncertainties related to the disposal, and the reasonably possible effects on the financial statements. For instance, when there is uncertainty regarding which operations will be disposed of at the time the pro forma financial information is prepared, the explanatory notes should explicitly acknowledge this uncertainty and describe how it may affect the financial statements.

Separate columnar presentation for probable disposals

In presenting pro forma financial information for the business combination, any probable disposal must be shown in a separate column if the operations constitute a significant business (see Reg S-X Rule 11-01(a)(4)) or, if not a business, are still material (see Reg S-X Rule 11-01(a)(8)).

Consummated disposals and filing requirement

Pro forma financial information reflecting a significant business disposal must be filed on Item 2.01 of Form 8-K when the disposal occurs. [FRM 3250.11]

4.11 Abbreviated financial statements

Abbreviated financial statements are typically used in carve-out scenarios or when full financial statements are impractical to prepare. In certain acquisition scenarios, the SEC permits the use of abbreviated financial statements in lieu of full historical financials. These provisions are especially relevant when preparing pro forma financial statements, where the acquired business either: [S-X Rule 3-05(e) - (f), FRM 2935.7 - .12]

- qualifies for abbreviated financial statements; or
- includes oil and gas producing activities.

In these cases, the registrant presents audited statements of revenues and direct expenses, omitting items such as a balance sheet and certain operating costs (e.g. depreciation, corporate overhead, income taxes) that are not indicative of future operations. See chapter 10 of KPMG Handbook, SEC Business combinations, for guidance related to abbreviated financial statements.

Question 4.11.10 When abbreviated financial statements are used in a pro forma income statement, can forward-looking information be included in transaction accounting adjustments or autonomous entity adjustments?

Interpretive response: No. Forward-looking information cannot be included in transaction accounting adjustments or autonomous entity adjustments when the pro forma condensed income statement reflects the acquisition of either (i) a business for which abbreviated historical financial statements are permitted and presented under Reg S-X Rule 3-05, or (ii) a business primarily involved in oil and gas producing activities. However, management's adjustments may include forward-looking information if the applicable criteria for such disclosures are met.

It is also important to clearly disclose the limitations of the pro forma condensed income statement. Specifically, the presentation is not indicative of future operations because it excludes various operating expenses. This disclosure is especially critical when abbreviated financial statements omit material historical costs (such as corporate overhead or selling, general and administrative expenses) that are relevant to understanding the ongoing financial profile of the acquired business. [FRM 3280]

5. Financing transactions

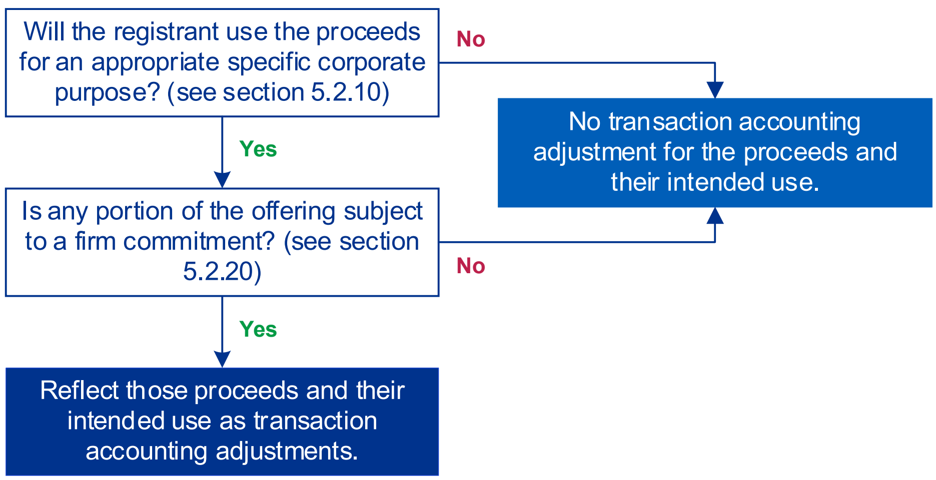
Detailed contents

5.1 How the Rules work

In preparing pro forma financial information to be included in a registration statement for a planned offering of equity securities or debt for cash, an entity must determine the appropriate transaction accounting adjustments for (1) the anticipated receipt of cash (the proceeds) from the sale and (2) the intended use of those proceeds. The analysis depends on whether the offering is of equity or debt.

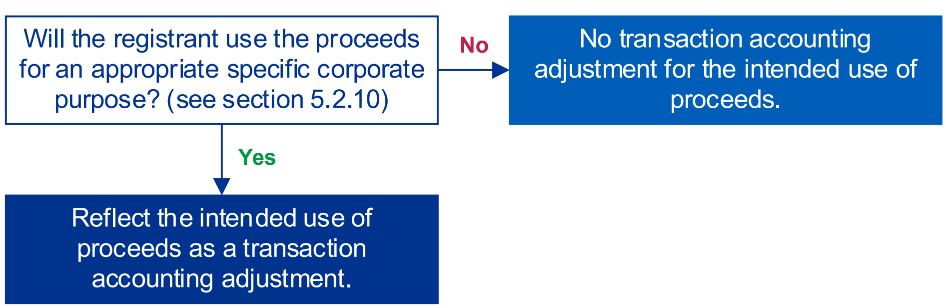
Equity securities offerings

The anticipated receipt of proceeds from such offerings, as well as the intended use of those proceeds, are reflected in transaction accounting adjustments only if they meet the requirements in the following decision tree.



Debt securities offerings

The anticipated receipt of proceeds and the interest expense from a debt offering are reflected in a transaction accounting adjustment. However, the intended use of the proceeds is also reflected in a transaction accounting adjustment only if the requirement in the following decision tree is met.



5.2 Equity securities offerings

5.2.10 Use of proceeds requirement

In an equity securities offering, the anticipated offering proceeds and their intended use are reflected in transaction accounting adjustments if the registrant has a plan to use the proceeds for a specific corporate purpose. In contrast, proceeds whose intended use involves significant discretion or uncertainty are not included in transaction accounting adjustments. Consider the following examples. [Reg S-K Item 504, FRM 3304.1, FRM 3304.2]

Examples	Appropriate as a transaction accounting adjustment?
• Acquiring a business or group of assets • Making specific capital investments • Repayment of debt • Committed plan to pay a dividend or repurchase shares	✓
• General corporate purposes • Expansion of current activities • Research and development activities	✗

Disclosure in registration statements

Excerpt from Reg S-K Item 504

Use of proceeds.

State the principal purposes for which the net proceeds to the registrant from the securities to be offered are intended to be used and the approximate amount intended to be used for each such purpose. Where registrant has no current specific plan for the proceeds, or a significant portion thereof, the registrant shall so state and discuss the principal reasons for the offering.

[Instructions omitted]

Reg S-K Item 504 requires disclosure in a registration statement of the principal purposes for which the net proceeds from a securities offering will be used.

Question 5.2.10 Is disclosure of the use of proceeds required only for those proceeds that will be included in the pro forma information?

Interpretive response: No, the expected use of all proceeds from securities offerings are to be disclosed, even those that will not be included in the pro forma information. If a registrant has no current specific plan for all or a significant portion of the proceeds, it discloses that fact and discusses the principal reasons for the offering. [S-K Item 504, FRM 3304.1]

Reg S-K Item 504 contains very specific instructions on what to disclose under different circumstances.

Example 5.2.10 Use of proceeds from a common share offering

Registrant intends to file a registration statement to sell 10 million common shares at $20 per share for total proceeds of $200 million. The use of proceeds section of the registration statement discloses the following:

1. $20 million to be used to purchase the corporate headquarters building currently leased by the company;
2. $50 million to extinguish long-term debt currently outstanding;
3. $70 million for a marketing and research and development campaign; and
4. the remainder for general corporate purposes.

The pro forma financial information presented in the registration statement may include adjustments for items 1 and 2 because the applications of proceeds are for a specific corporate purpose, but only to the extent those proceeds are subject to a firm underwriting agreement (see section 5.2.20 for the firm commitment requirement).

Items 3 and 4 cannot be included in pro forma financial statements because the expenditures involve a high degree of discretion with respect to applying the proceeds.

Question 5.2.20 Are all shares offered and all offering proceeds included in pro forma EPS?

Interpretive response: No. Pro forma EPS reflects only those common shares in the offering whose proceeds are reflected as a transaction accounting adjustment – i.e. those meeting the use of proceeds requirement and firm commitment requirement (discussed in section 5.2.20). [FRM 3241.4]

However, an entity may elect to present an *additional* EPS calculation to reflect all of the shares issued, if it considers that information meaningful and it labels the additional EPS appropriately. [FRM 3241.4]

Question 5.2.30 Does a pro forma capitalization table presented in a filing reflect the receipt or application of offering proceeds?

Interpretive response: No. The receipt or application of offering proceeds are not reflected in a pro forma capitalization table presented in a filing. However, the SEC staff has accepted the following in a pro forma capitalization table: [FRM 3304.3]

- in a minimum/maximum offering, presenting both the minimum and maximum; and

- in a rights offering or offerings of securities upon exercise of outstanding warrants, reflecting the proceeds to the extent exercise is likely in view of the current market price.

5.2.20 Firm commitment requirement

Excerpt from 1933 Exchange Act Rule 170

Financial statements which purport to give effect to the receipt and application of any part of the proceeds from the sale of securities for cash shall not be used unless such securities are to be offered through underwriters and the underwriting arrangements are such that the underwriters are or will be committed to take and pay for all of the securities…

If the anticipated proceeds from an equity securities offering are intended for a specific corporate purpose (see section 5.2.10), those proceeds are reflected in transaction accounting adjustments only if they are subject to a firm commitment. This requirement is based on the SEC staff's application of Rule 170 of the '33 Act to equity securities offerings.

Specifically, the SEC's Financial Reporting Manual states that the pro forma financial information should reflect only the receipt or application of proceeds from a securities offering to the extent that the amount of the adjustment is subject to a firm commitment from an underwriter. If a firm commitment underwriting is limited to a minimum amount or a certain amount, only the firmly committed amount of the proceeds may be included as a transaction accounting adjustment. [FRM 3304.2(a)]

Question 5.2.40 What type of firm commitments exist and how do they affect pro forma information?

Interpretive response: Pro forma financial statements may not reflect the receipt or application of offering proceeds, except as follows: [FRM 3304.2]

- to the extent of a firm commitment from an underwriter;
- to the extent of the minimum commitment in a best-efforts minimum/maximum offering;
- the offering amount in a best-efforts, all-or-none offering; and
- in certain savings and loan conversions.

If a firm commitment is for all of the shares to be offered, the offering amount of all the shares is included in the pro forma financial information.

If the commitment is a guarantee to sell a minimum number of shares, with best efforts to sell any excess, only the offering amount of the minimum number of shares is included in the pro forma financial information.

In contrast, if the commitment is a best-efforts, all-or-none arrangement, the pro forma financial information may reflect the offering amount of all of the shares, because no securities will be sold unless all securities offered are sold.

In a savings and loan conversion, it may be appropriate to present pro forma financial information reflecting the entity's conversion from a mutual company (member-owned) to stock ownership. This includes adjustments for the change in capital structure and the proceeds from the sale of common stock.

Example 5.2.20 Firm commitment

Registrant enters into an agreement to acquire a business for $20 million of cash. It will finance the acquisition using the proceeds of an equity offering and files a registration statement to sell one million shares at $20 per share.

Scenario 1: All shares subject to firm commitment

The securities offering will be made on a firmly committed underwritten basis for the entire amount. Therefore, the entire $20 million offering amount is included in the pro forma financial information.

Scenario 2: Shares subject to best-efforts with a minimum guarantee

The securities offering will be made on a best-efforts basis with a minimum guarantee of 200,000 shares at the offering price (i.e. $20 per share). Therefore, Registrant includes proceeds of $4 million (200,000 minimum number of shares at $20 per share) in the pro forma financial information.

It further indicates the alternative method used to finance the remaining $16 million of the acquisition price. Specifically, it discloses that it is offering up to one million shares and that it will apply any additional proceeds (i.e. above $4 million) to the acquisition price and reduce any debt or other sources that would otherwise be used to fund the acquisition.

Scenario 3: Shares subject to best-efforts, all-or-none arrangement

The securities offering will be made on a best-efforts, all-or-none basis. Therefore, Registrant reflects the full proceeds of the offering in the pro forma financial information, because no securities will be sold unless all securities offered are sold.

5.3 Debt securities offerings

Question 5.3.10 Does pro forma financial information include adjustments for the proceeds from a debt offering?

Interpretive response: It depends. Pro forma financial information included in a registration statement for a debt offering includes adjustments for the full amount of the debt being offered and the interest expense on that debt. Pro forma adjustments may be included for the use of the debt proceeds to the extent that there are specific projects to which the proceeds are committed. Adjustments are not appropriate if the proceeds will be used for activities that involve significant discretion, or uncertainty, or both, such as for general corporate purposes. See section 5.2.10 for information about the use of proceeds requirement. [S-K Item 504, FRM 3304.1]

Example 5.3.10 Debt issuance

Registrant files registration statement on Form S-1 to register a debt offering. The registration statement includes the following pro forma financial information.

Note: EPS information and subsequent interim income statement omitted for brevity.

Unaudited Pro Forma Condensed Combined Balance Sheet
As of December 31, 20X5
(in thousands)

	Historical	Transaction accounting adjustment	Note	Pro forma
Cash	10,000	100,000	1	
		(75,000)	1	35,000
Other Assets	75,000			75,000
Total assets	85,000	25,000		110,000
Debt	75,000	100,000		
		(75,000)		100,000
Equity	10,000			10,000
Total liabilities and equity	85,000	25,000		110,000

Unaudited Pro Forma Condensed Combined Income Statement
For the year ended December 31, 20X5
(in thousands)

	Historical	Transaction accounting adjustment	Note	Pro forma
Revenue	1,000,000			1,000,000
Cost of sales	800,000			800,000
SG&A	100,000			100,000
Interest expense	11,250	(11,250)	1	
		8,000	1	8,000
Income before income taxes	88,750	3,250		92,000

	Historical	Transaction accounting adjustment	Note	Pro forma
Income tax expense	30,250	1,110		31,360
Income from continuing operations	58,500	2,140		60,640

Notes to Unaudited Pro Forma Condensed Combined Financial Information

1. Represents the issuance $100 million of debt bearing interest at 8% annually and retirement of $75 million of debt bearing interest at 15% annually. The remaining proceeds of $25 million will be used to expand Registrant's overseas operations.

5.4 Miscellaneous issues involving financing transactions

Question 5.4.10 Can interest income resulting from investing the proceeds of an offering (or from an asset sale) be included in a transaction accounting adjustment?

Interpretive response: No. Interest income from the use of proceeds from an offering or asset sale generally is not appropriate in pro forma financial information. [FRM 3305.1]

In certain unusual situations, income on invested proceeds can be included as a transaction accounting adjustment. However, the permissible circumstances for this adjustment generally are limited to required escrow arrangements or other similar obligations.

6. Dispositions

Detailed contents

6.1 How the Rules work

A business disposition may require pro forma financial information when certain criteria are met, helping investors understand how the transaction affects the registrant's ongoing operations. This requirement applies when a disposition is:

- **Significant –** The disposition pertains to a significant business, broadly defined to include events material to an investor's understanding, extending beyond those qualifying as discontinued operations under Subtopic 205-20.
- **Triggered –** The disposition involves a sale, abandonment, or distribution to shareholders (such as a spinoff).
- **Timed –** The disposition is either probable or has already been consummated.
- **Not fully reflected –** The effects of the disposition are not yet fully reflected in the historical financial statements being presented.

Type of transaction	Significance threshold	Pro forma requirement
Disposition of a business (see section 2.4)	Exceeds 20%	On Form 8-K (Item 9.01) within four business days of consummation
Probable disposition of a business (see section 2.4)	Exceeds 20%	In a registration statement or proxy statement
Disposition of a group of assets (see section 2.5)	Exceeds 10%[1]	On Form 8-K (Item 9.01) within four business days of consummation if pro forma information would be material to investors

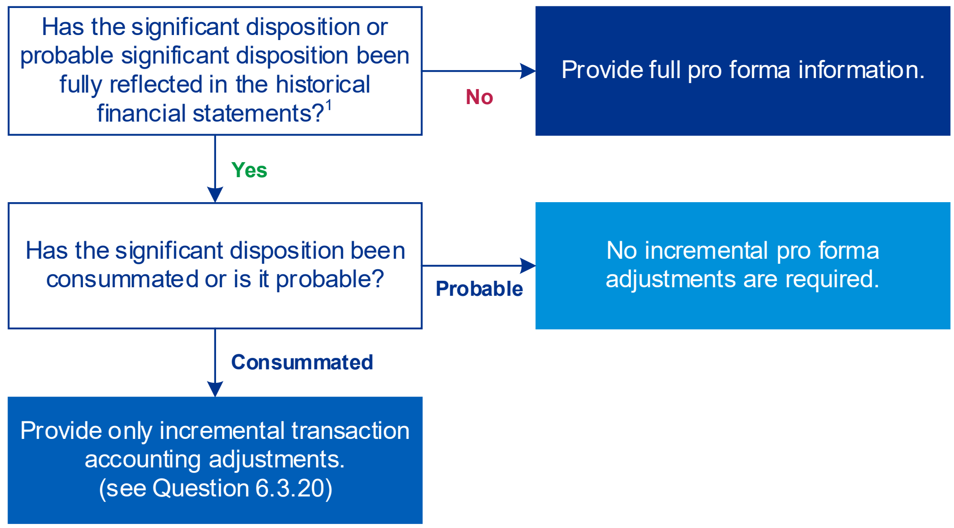
Note:

1. Item 2.01 of Form 8-K specifies the tests for determining significance to be used for a group of assets that do not constitute a business, rather than referencing the test in Reg S-X Rule 1-02(w). Specifically, Item 2.01, Instruction 4 states that "an acquisition or disposition shall be deemed to involve a significant amount of assets:
   (i) if the registrant's and its other subsidiaries' equity in the net book value of such assets or the amount paid or received for the assets upon such acquisition or disposition exceeded 10 percent of the total assets of the registrant and its consolidated subsidiaries; or
   (ii) if it involved a business (*see* Rule 11-01(d)) that is significant (*see* Rule 11-01(b))."

See chapter 3 (including section 3.7.20, which is specifically related to dispositions) of KPMG Handbook, SEC Business combinations, for guidance related to determining the significance of dispositions.

Summary of requirements

Pro forma financial information for a significant disposition may be required in a Form 8-K, a registration statement or a proxy statement. The extent of pro forma financial information required in these instances depends on whether the disposal or probable disposal has already been reflected in the historical financial statements.



Note:

1. Full pro forma information is often required for a probable significant disposition. This is because a disposition is not fully reflected in the historical financial statements before it is consummated unless it is a discontinued operation.

In the pro forma financial statements reporting a disposal, transaction accounting adjustments should reflect the consideration received and the elimination of the disposed assets, liabilities and operations. Any other probable or consummated transactions related to the disposition are evaluated under Reg S-X Rule 11-01(a)(8) (i.e. they are included if the information would be material to investors). Additionally, because the pro forma income statement stops at income from continuing operations, the registrant should not include a line item for discontinued operations, even if the disposal meets the criteria for such classification.

Special considerations for spinoff transactions

Some dispositions are achieved by forming a new registrant (SpinCo) whose shares will be distributed to shareholders. Known as spinoff transactions, these transactions may trigger presentation of the disposition in the pro forma financial information included in a registration statement or proxy statement before it is triggered in the historical financial statements. Spinoffs typically also generate transaction accounting adjustments for the modification of contracts between the parent and SpinCo, which frequently accompany a spinoff.

6.2 Prior to consummation of the disposition

Excerpt from Reg S-X Rule 11-01

Presentation requirements.

(a) Pro forma financial information must be filed when any of the following conditions exist:

…

(4) The disposition of a significant portion of a business either by sale, abandonment or distribution to shareholders by means of a spin-off, split-up or split-off has occurred or is probable and such disposition is not fully reflected in the financial statements of the registrant included in the filing.

The filing of Form 8-K is required only when a significant disposition is consummated – not when it becomes probable. However, pro forma financial information is included in a registration statement or proxy statement filed after a significant disposition of a business has become probable, and the extent of the information depends on whether the probable distribution has been fully reflected in the historical financial statements (see section 2.4.20).

Question 6.2.10 For which periods is pro forma financial information required for a probable disposition?

Interpretive response: Pro forma financial statements are required in a registration statement or proxy statement filing that includes a significant probable disposition.

When a probable disposition is determined to be significant, a pro forma balance sheet for the most recent period (whether it be an interim or annual period) is required. Generally, a pro forma income statement should be presented for the most recent fiscal year and year-to-date interim period. However, the number of annual periods required for the pro forma income statements depends on whether the probable disposition has already been fully reflected in the historical financial statements as a discontinued operation, based on the criteria in Subtopic 205-20. See KPMG Handbook, Discontinued operations and held-for-sale disposal groups.

If the probable disposition qualifies as discontinued operations after the date of the latest balance sheet included in the registration or proxy statement (i.e. it is not yet reflected in the annual historical financial statements), this generally means the required pro forma financial statements include: [S-X Rule 11-02(c)(2)(ii), FRM 3230.2]

- the most recent balance sheet (whether it be an interim or annual period);
- year-to-date income statement; and
- income statements for all historical periods presented in the filing as discussed in Question 3.2.50 (three annual income statements unless a smaller reporting company).

However, if the probable disposition has been fully reflected in the historical financial statements of the registrant included in the filing, pro forma financial information need not be presented for those statements. Question 2.4.10 explains when a disposition has been fully reflected in the historical financial statements. Question 6.3.10 describes when a registrant may be required to file pro forma financial information under Item 9.01 of Form 8-K when a significant subsidiary that was classified as a discontinued operation is disposed.

If the probable disposition does not meet the criteria for discontinued operations, a pro forma income statement is required for only one annual period rather than three.

Example 6.2.10 Registration statement filed when discontinued operations have not been reported in the historical financial statements

Facts

Registrant has a calendar year-end and files its second quarter Form 10-Q on July 31, 20X5. On August 15, 20X5, its board of directors approves a plan to sell an operating segment (disposal group) and has appropriate authority to do so (corporate law and bylaws do not require a shareholder vote).

- All of the held-for-sale criteria in paragraph 360-10-45-9 are met, but the disposal group will not be classified as held-for-sale until the filing of the third quarter Form 10-Q balance sheet.
- The probable sale represents a strategic shift, but the disposal group will not be classified as a discontinued operation until the filing of the third quarter Form 10-Q income statement.

Registrant issues a registration statement on September 15, 20X5 to raise additional capital. The transaction represents a significant probable business disposition.

Analysis

Because the planned sale represents a significant probable business disposition, Registrant is required to provide pro forma information in its registration statement to reflect the probable disposition. Further, because discontinued operations have not been separately presented in the historical financial statements as of the filing of the registration statement, the Article 11 pro forma financial information would include:

- balance sheet as of June 30, 20X5
- income statement for the six months ended June 30, 20X5
- income statement for each of the three years ended December 31, 20X4, 20X3, and 20X2, respectively.

Note: Pro forma income statements for the years ended December 31, 20X3 and 20X2 as well as EPS for all periods are omitted for brevity.

Unaudited Pro Forma Condensed Combined Balance Sheet
As of June 30, 20X5
(in thousands)

	Historical	Transaction accounting adjustments Discontinued operations (Note 1)	Pro forma
Cash	15,000	(100)	14,900
Accounts receivable	30,000	(2,000)	28,000
Current assets held-for-sale	–	2,100	2,100
PP&E	20,000	(5,000)	15,000
Intangible assets, net	65,000	(7,000)	58,000
Deferred taxes	10,000	(250)	9,750
Other assets	10,000	(2,500)	7,500
Noncurrent assets held-for-sale	–	14,750	14,750
Total assets	150,000	–	150,000
Accounts payable	35,000	(11,000)	24,000
Current taxes	3,000		3,000
Current liabilities held-for-sale	–	11,000	11,000
Long-term debt	50,000		50,000
Other liabilities	25,000		25,000
Total liabilities	113,000	–	113,000
Common stock & APIC	52,000		52,000
Retained earnings	190,000		190,000
AOCI	(205,000)		(205,000)
Total equity	37,000	–	37,000
Total liabilities and equity	150,000	–	150,000

Unaudited Pro Forma Condensed Combined Income Statement
For the six months ended June 30, 20X5
(in thousands)

	Historical	Discontinued operations (Note 1)	Pro forma
Total revenue	25,000	(10,000)	15,000
Cost of sales	12,000	(5,000)	7,000
Selling, general and administrative	8,000	(2,000)	6,000

	Historical	Discontinued operations (Note 1)	Pro forma
Income tax expense	1,250	(750)	500
Income from continuing operations	3,750	(2,250)	1,500

Unaudited Pro Forma Condensed Combined Income Statement
For the year ended December 31, 20X4
(in thousands)

	Historical	Discontinued operations (Note 1)	Pro forma
Total revenue	70,000	(25,000)	45,000
Cost of sales	30,000	(13,000)	17,000
Selling, general and administrative	15,000	(5,000)	10,000
Income tax expense	6,250	(1,750)	4,500
Income from continuing operations	18,750	(5,250)	13,500

Notes to Unaudited Pro Forma Condensed Combined Financial Information

1. On August 15, 20X5, management of the appropriate authority committed to a plan to sell the XYZ reporting segment. The expected divestiture of the XYZ operations represents a strategic shift in the Company's business and is presented as a discontinued operation. The related assets and liabilities are presented as held-for-sale in the unaudited condensed consolidated pro forma balance sheet.

6.3 At consummation of the disposition

A Form 8-K must be filed for a significant disposition within four days of the disposition's consummation. The 71-day extension described in Item 9.01 of Form 8-K for filing financial statements and Article 11 pro forma financial information for acquisitions is not available for dispositions, except for exchange transactions. Additionally, the historical financial statements of the disposed business are not required in Form 8-K. [Form 8-K Item 2.01, Exchange Act Form 8-K CFI 129.01, FRM 3120.2]

Question 6.3.10 Does a registrant file pro forma condensed financial statements under Item 9.01 of Form 8-K if it disposes of a significant subsidiary that was classified as a discontinued operation?

Interpretive response: A registrant must file pro forma financial information under Item 9.01 of Form 8-K notwithstanding that the subsidiary has been reported as a discontinued operation. Item 9.01(b) of Form 8-K refers to Reg S-X Article 11 for guidance on the filing requirements. Reg S-X Rule 11-01(a)(4) requires pro forma financial information if a disposition is not fully reflected in the registrant's historical financial statements. Although Article 11 requires the registrant to present pro forma operations before discontinued operations, which is consistent with the registrant's historical financial statements, a registrant should consider presenting the pro forma effect on the balance sheet.

Question 6.3.20 For which periods is pro forma financial information required for a consummated disposition?

Interpretive response: Pro forma financial statements are required in a filing including a significant disposition.

When a consummated disposition is determined to be significant, a pro forma balance sheet for the most recent period (whether it be an interim or annual period) is required. Generally, pro forma income statements should be presented for the most recent fiscal year and year-to-date interim period. However, the number of annual periods required for the pro forma income statements depends on whether the consummated disposition has already been fully reflected in the historical financial statements as a discontinued operation, based on the criteria in Subtopic 205-20. (See KPMG Handbook, Discontinued operations and held-for-sale disposal groups.)

If the consummated disposition qualifies as discontinued operations after the date of the latest balance sheet included in the registration or proxy statement (i.e. it is not yet reflected in the annual historical financial statements), this generally means the required pro forma financial statements include: [S-X Rule 11-02(c)(2)(ii), FRM 3230.2]

- the most recent balance sheet (whether it be an interim or annual period);
- year-to-date income statement; and
- income statements for all historical periods presented in the filing as discussed in Question 3.2.50 (three annual income statements unless a smaller reporting company).

However, if the consummated disposition has been fully reflected in the historical financial statements, pro forma financial information need not be presented for those statements except as discussed in Question 6.3.40. Question 2.4.10 explains when a disposition has been fully reflected in the historical financial statements. Question 6.3.10 describes when a registrant may be required to file pro forma financial information under Item 9.01 of Form

8-K when a significant subsidiary that was classified as a discontinued operation is disposed.

If the consummated disposition does not meet the criteria for discontinued operations, a pro forma income statement is required for only one annual period rather than three.

Question 6.3.30 In a Form 8-K to disclose a discontinued operation, can the registrant limit the pro forma financial information to the latest fiscal year and applicable interim period?

Interpretive response: No. Even though Reg S-X Rule 11-02(c) requires disclosure for only the latest fiscal year and the most recent interim period, the SEC staff has required pro forma presentation of all periods for a disposition that qualifies for discontinued operations presentation that is not yet required to be reflected in the registrant's historical financial statements. [FRM 3230.1 – .2, Regs Comm 03/2002]

Question 6.3.40 What are examples of incremental transaction accounting adjustments triggered by consummation of a disposition?

Interpretive response: When a significant subsidiary has been reflected as discontinued operations in the registrant's historical financial statements prior to its disposition, additional transaction accounting adjustments may be required in the pro forma financial statements presented in Form 8-K triggered by the closing of the disposition. Examples of incremental transaction accounting adjustments triggered by consummation include:

- the consideration received, such as the receipt of proceeds and accrual of contingent deal fees and other contingent liabilities where the recognition criterion could not be met prior to consummation;
- reclassification of deferred taxes to current taxes in the balance sheet (for taxable dispositions);
- debt repayments that are contractually-required upon a significant disposition, and the 'recycling' of any hedging gains or losses, net of tax, recorded on related interest rate swaps in AOCI;
- certain compensation arrangements resulting from preexisting contractual provisions or communicated benefit formulae, or that are triggered by the sale agreement. Compensation arrangements may include management contracts, severance agreements, share-based compensation awards or benefit plans. See Question 6.3.50 for additional guidance related to compensation arrangements.

Additionally, consummation often enables management to proceed with other transactions and restructuring efforts that could require pro forma disclosure under Reg S-X Rule 11-01(a)(8). These would generally be presented in a separate column and examples include the following.

- **Uses of the proceeds –** discretionary debt repayment, special dividends, share repurchases, etc.
- **Issuance of new debt –** When provided by the legacy lender(s) this could represent either a significant or insignificant debt modification under Subtopic 470-50.

Question 6.3.50 Can a transaction accounting adjustment reflect that compensation expense is expected to be lower after a disposition and severance event?

Interpretive response: It depends. Reg S-X Rule 11-02(b)(3) states "Transaction Accounting Adjustments giving effect to the disposition of a business must not decrease historically incurred compensation expense for employees who were not, or will not be, transferred or terminated as of the disposition date."

Therefore, if the employees will be terminated as of the disposition date (e.g. the consummation date), then a transaction accounting adjustment related to the business disposition may be made.

If the terminations are not (or will not be) made as of the disposition date, management may still elect to present the expected synergy, along with any dis-synergies, as management's adjustments in the footnotes. See section 3.4 for more information on management's adjustments.

Example 6.3.10 Pro forma information for a disposition

Facts

Registrant has a calendar year-end. On November 14, 20X5, Registrant completed the sale of its ABC operating segment to Acquirer. The sale will require presentation as a discontinued operation under Subtopic 205-20 and has not yet been presented in discontinued operations in Registrant's historical financial statements.

On November 17, 20X5, Registrant files a Form 8-K presenting Article 11 pro forma financial information related to its significant disposition of a business.

Analysis

The pro forma financial information includes:

- balance sheet as of June 30, 20X5;
- income statement for the six months ended June 30, 20X5; and
- income statement for the years ended December 31, 20X4, 20X3 and 20X2.

Note: Pro forma income statements for the years ended December 31, 20X3 and 20X2 as well as EPS for all periods are omitted for brevity. Example assumes that Registrant did not include any management's adjustments.

Unaudited Pro Forma Condensed Combined Balance Sheet
As of June 30, 20X5
(in thousands)

	Historical	Transaction accounting adjustments	Note	Pro forma
Cash	10,000	20,000	1	30,000
Accounts receivable	20,000	(15,000)	2	5,000
Other current assets	4,500	(2,000)	2	2,500
PP&E	12,500			12,500
Intangible assets, net	70,000	(9,000)	2	61,000
Other assets	5,000			5,000
Total assets	122,000	(6,000)		116,000
Accounts payable	21,000	(8,000)	2	13,000
Other current liabilities	4,750	(3,000)	2	1,750
Long-term debt	50,000			50,000
Other liabilities	25,000			25,000
Total liabilities	100,750	(11,000)		89,750
Common stock	10			10
APIC	10,000			10,000
Retained earnings	11,240	5,000	4	16,240
Total equity	21,250	5,000		26,250
Total liabilities and equity	122,000	(6,000)		116,000

Unaudited Pro Forma Condensed Combined Income Statement
For the six months ended June 30, 20X5
(in thousands)

	Historical	Transaction accounting adjustments	Note	Pro forma
Total revenue	28,000	(5,000)	3	23,000
Cost of sales	11,000	(2,000)	3	9,000
Selling, general and administrative	8,500	(2,000)	3	6,500
Income tax expense	2,125	(250)	5	1,875
Income from continuing operations	6,375	(750)		5,625

Unaudited Pro Forma Condensed Combined Income Statement
For the year ended December 31, 20X4
(in thousands)

	Historical	Transaction accounting adjustments	Note	Pro forma
Total revenue	60,000	(13,000)	3	47,000
Cost of sales	25,000	(5,000)	3	20,000
Selling, general and administrative	15,000	(2,500)	3	12,500
Gain on disposal	–	5,000	4	5,000
Income tax expense	5,000	(125)	5	4,875
Income from continuing operations	15,000	(10,375)		4,625

Notes to Unaudited Pro Forma Condensed Combined Financial Information

1. The sale of ABC operating segment to Acquirer for $20 million closed on November 14, 20X5 and this adjustment represents the receipt of cash consideration at the closing of the transaction.
2. This adjustment reflects the elimination of assets and liabilities attributable to ABC operating segment.
3. This adjustment represents the elimination of revenues and expenses of ABC operating segment.
4. This adjustment represents the gain of $5 million arising from the transaction on November 14, 20X5.
5. The income tax effect of the transaction accounting adjustments was estimated based on a statutory tax rate of 25%.

6.4 Spinoff dispositions

As discussed in section 2.4.30, some dispositions are achieved when a registrant forms a new entity (SpinCo) and distributes its shares to existing shareholders. This transaction, known as a spinoff, effectively separates the new entity from the parent company, allowing it to operate independently as a stand-alone entity. If the disposition is significant, pro forma financial statements are required to reflect the effect of the separation of the registrant's assets and operations into the new entity (SpinCo).

Question 6.4.10 When and how are spinoff dispositions reflected in pro forma information?

Interpretive response: The registrant generally must solicit a shareholder vote prior to effecting a spinoff. As such, the registration statement or proxy materials used to solicit this shareholder vote will generally require pro forma financial information depicting the spinoff. Therefore, assuming the disposition qualifies as a discontinued operation under Subtopic 205-20, pro forma financial information will usually reflect the presentation as discontinued operations before the historical financial statements do. That said, even when a spinoff does not qualify as a discontinued operation, the registration statement or proxy materials may still need to include pro forma financial information.

Because a spinoff is not a sale, the disposal group cannot be considered disposed of until the shares have been distributed to the owners. Its assets and liabilities are classified as held-and-used and its operations are reported in continuing operations until the shares have been distributed. (See Questions 4.3.50 and 4.3.60 in KPMG Handbook, Discontinued operations and held-for-sale disposal groups.)

In registration statements and proxy statements soliciting shareholder approval, the registrant (seller) includes pro forma financial information giving effect to the significant disposal for the latest complete fiscal year and subsequent interim period. If the disposal qualifies as a discontinued operation, the pro forma income statement is presented for each of the past two years and interim periods. However, if three years plus interim historical financial statements are presented, the pro forma financial statements also are to include three years plus interim periods. Separate financial statements of the registrant (seller) and to be spun entity may be required to accompany the pro forma financial information. [FRM1140.6, 2120.2, 2120.3]

Upon consummation of the distribution (i.e. spinoff), pro forma financial statements are to be filed under Item 2.01 of Form 8-K within four business days of the spinoff. See section 6.3 for pro forma requirements.

The effects of major distribution agreements, cost-sharing or management agreements, compensation or benefit plans and intercompany sales agreements should be evaluated for potential pro forma adjustments as well. The parent's pro forma financial information would present these as an other transaction accounting adjustment. These same agreements may qualify as autonomous entity adjustments in any pro forma financial information filed by SpinCo (see Question 3.3.80). Additionally, the registrant (SpinCo) may consider including adjustments for synergies and dis-synergies of the disposition if it believes such adjustments would enhance a reader's understanding of the pro forma effects of the transaction, provided the conditions for management's adjustments are met (see section 3.4 on management's adjustments).

Question 6.4.20 How does pro forma financial information reflect a spinoff when parent intends to keep certain assets or operations that legally belong to SpinCo?

Background: SpinCo might legally own net assets and operations that the registrant/parent intends to keep. For instance, the parent may plan to restructure these assets or sell them separately.

Interpretive response: SpinCo's historical financial statements would include all of the net assets and operations that it legally owned. A pro forma adjustment would then be made to reflect SpinCo's distribution of those net assets and operations back to the parent. The 'as-adjusted' pro forma financial information would reflect SpinCo's reduced profile. It would not be appropriate to 'collapse' this presentation and simply exclude the net assets and results of operations of the facilities that the registrant is retaining. [2001 AICPA Conf]

Question 6.4.30 How is income tax expense allocated to the disposed subsidiary in a spinoff transaction?

Interpretive response: The parent's allocation of income tax expense to SpinCo is driven by the intraperiod tax allocation of Topic 740.

SpinCo's recognition of income tax expense on stand-alone financial statements should be based on an allocation method.

The SEC staff has noted that a parent company may sell an interest in its subsidiary but retain a sufficient ownership interest to permit continued inclusion of the subsidiary in its consolidated tax returns. In that scenario, the staff believes that it is material to investors to know what the effect on income would have been if the subsidiary had not been eligible to be included in a consolidated income tax return with its parent. [SAB Topic 1.B.1 (Q3)]

In practice, the staff noted some subsidiaries have calculated their tax provision on the separate return basis, which the staff believes is the preferable method. Others, however, have used different allocation methods. When the historical income statements in the filing do not reflect the tax provision on the separate return basis, the staff has required a pro forma income statement for the most recent year and interim period reflecting a tax provision calculated on the separate return basis. [SAB Topic 1.B.1 (Q3)]

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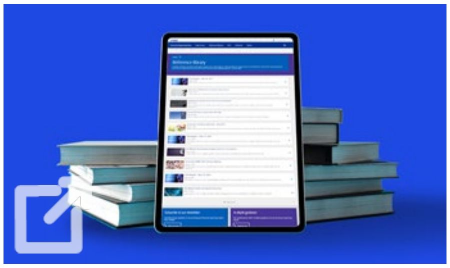

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