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Financial statements required for securities offerings by U.S. companies

July 1, 2024 | Client update

The need for financial statements is one of the items most likely to become a gating issue in a capital markets transaction. SEC rules require the company issuing securities to present audited income statements and balance sheets with a clean audit report. Additional financial statements may also be required, such as pro forma financial statements or financial statements for recent or probable acquisitions.

This client update reviews the key financial statement requirements that are most likely to apply to a registered offering by a U.S. company. Offering documents for Rule 144A offerings will often include many of the same disclosures although they are technically not required to do so. As always, specific circumstances surrounding an anticipated transaction could yield different answers – there are interpretive and other nuances to the rules and considerations at play even where offering participants conclude that financial statements technically are not required.

Basic financial statement requirements for registered offerings

A company conducting a securities offering should expect to provide the following basic financial statements. Emerging growth companies, or EGCs, are entitled to provide reduced financial disclosure in registration statements. We have noted below where the financial statement disclosure requirements differ for EGCs and non-EGCs.

EGCs are companies that have less than $1.235 billion in annual revenue in the year prior to their IPO. A company will remain an EGC until (1) the last day of the year in which its revenues first exceed $1.235 billion, (2) the last day of the year in which the fifth anniversary of its IPO occurs, (3) it has issued $1 billion of debt securities in a three-year period or (4) it becomes a large accelerated filer (basically, when its global market capitalization exceeds $700 million and it has been filing SEC reports for at least a year). The federal securities laws also provide accommodations for “smaller reporting companies,” generally defined as those companies that (1) have a public float of less than $250 million or (2) have less than $100 million in revenues and either no public float or public float less than $700 million. We do not address the financial statement requirements applicable to smaller reporting companies here, but please contact us if you are interested in learning about the rules applicable to this class.

Insights

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Audited annual financial statements

Statement	EGCs	Non-EGCs	Notes
Balance Sheet	Two fiscal year-ends	Two fiscal year-ends	
– **Income Statement** – **Changes in Stockholders' Equity** – **Statement of Cash Flows**	– Two fiscal years in IPO registration statement – After its IPO, an EGC is generally subject to the same requirements as a non-EGC, but is not required to provide financial statements for any period prior to the first period disclosed in its IPO registration statement.	Three fiscal years	Some EGCs nevertheless provide income statements for the most recent three fiscal years.

Unaudited interim financial statements (requirements are the same for EGCs and non-EGCs)

Statement	Periods required	Notes
Balance Sheet	As of the most recently completed quarter-end.	See the discussion below of how soon after a quarter-end a company is required to provide financial statements for that quarter.
– **Income Statement** – **Changes in Stockholders' Equity** – **Statement of Cash Flows**	For period from the latest fiscal year-end to the most recently completed quarter-end and for the corresponding period in the prior fiscal year.	

The audit of the annual financial statements and the limited review of the unaudited interim financial statements of the registrant must be in accordance with standards adopted by the Public Company Accounting Oversight Board, or PCAOB, as opposed to the generally less onerous standards applicable to a private company. Unlike the audited financials, which must include an audit report, interim financials need not include a limited review report.

Other financial information required in registration statement

Disclosure	EGCs	Non-EGCs	Notes
Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A)	Two fiscal years plus interim periods	Three fiscal years plus interim periods	The MD&A must cover the periods presented in the audited financial statements and any interim periods; however, a registrant may omit discussion of the earliest of three years to the extent that the discussion of such earlier year was already included in an SEC filing.

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Staleness/age of required financial statements

A key consideration in planning the timing for an offering is when the company's financial statements will go stale. In other words, when will the company's existing financial statements need to be updated to a more recent period? Staleness dates are the same regardless of whether the company is an EGC or a non-EGC but may vary slightly depending upon whether the company is an IPO filer or an existing SEC registrant already filing reports. The chart below summarizes the general requirements relating to the age of financial statements, and addresses when certain financial statements may be omitted (mostly relevant in the context of an IPO).

General rule	The most recent balance sheet date in a registration statement must not be more than 134 days before the effective date at the registration statement (129 days for a company whose Form 10-Q is due at such time), except that third-quarter data is timely through the 45th day after the most recent fiscal year-end. After the 45th day, audited financial statements for the most recent fiscal year must be included in the registration statement. Example: A Form S-1 for a company with a calendar year-end cannot be declared effective after August 12 without updating to the end of the second quarter (June 30). A Form S-1 for a calendar year-end company cannot be declared effective after February 14 without audited year-end numbers.
Accommodations for SEC reporting companies	If an SEC reporting company (1) has been timely in its filing obligations, (2) has reported income in at least one of the last two years and (3) expects to report income in the most recently ended fiscal year, the SEC will declare the registration statement effective more than 45 days after year-end through the date on which the company's Form 10-K is due (60 days after year-end for large accelerated filers, 75 days for accelerated filers and 90 days for all other companies) without the inclusion of audited financial statements for the most recently completed fiscal year. **Despite this accommodation, comfort letter and marketing considerations may impact a company's ability to do a deal during this period.** Staleness dates differ from the Form 10-Q filing deadlines because the 10-Q deadlines are based on 45 days (or 40 days for large and large accelerated filers) after the end of the quarter versus 134 days after the end of the prior quarter. Nonetheless, the SEC Staff generally provides an accommodation for reporting companies that have been timely filers for the past 12 months by allowing their registration statements to become effective after the staleness date and before the applicable 10-Q filing deadline.
Omission of certain financial information	If a company submits a draft registration statement to the SEC for confidential or nonpublic review, it may omit annual and interim financial information for otherwise required historical periods provided that the omitted financial information relates to a historical period that will not be required in the registration statement at the time of the offering (for EGCs) or first public filing (for non-EGCs). A registration statement must include all required financial information at the time of the offering (for EGCs) or at the time of first public filing (for non-EGCs). For practical purposes, "at the time of the offering" means at the time an amendment to the registration statement is filed that contains the preliminary prospectus that will be provided to investors and used to market the offering.
Effect of holiday or weekend	If the last day of the period after which financial statements must be updated falls on a Saturday, Sunday or holiday, the filing may be made on the next following business day without updating the financial statements.
Shelf takedowns	A company must be current in its Exchange Act reports in order to do a shelf takedown off an effective shelf. The financial statements in the company's Exchange Act reports are incorporated by reference into the prospectus for the shelf takedown, and the staleness rules set out above do not apply although there may be comfort letter and marketing considerations.

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Financial statements for recent or probable acquisitions

If a company has completed an acquisition recently or an acquisition is probable, the company may be required to include financial statements of the target in the registration statement. SEC reporting companies may also have an obligation to file a Form 8-K with an acquired company's financial statements. Below we outline the relevant factors used to determine what financial statements a company should expect to provide, if any.

Step 1. Determine whether the acquisition is both a "business" and "probable."

An acquisition potentially requires separate financial statements only if the target entity or assets is a "business." What constitutes a "business" for this purpose? This is a facts and circumstances determination but some factors to consider are:

- the continuity of the target's operations and revenue producing activities before and after the acquisition; and
- the retention of physical facilities, employee base, market distribution system, sales force, customer base, operating rights, production techniques or trade names after the transaction.

A presumption exists that a separate entity, a subsidiary or a division is a business, but a lesser component of an entity may also constitute a business. If, after considering these factors, the working group determines that the company has or will acquire something less than a "business," no additional financial statements are required.

Whether an acquisition is "probable" is also fact-specific. Factors to consider include:

- the likely timing of the announcement;
- whether significant business issues stand in the way of a deal;
- whether a definitive agreement or letter of intent has been signed;
- board approval of a transaction;
- public announcement of the transaction; and
- the status of regulatory approvals related to the transaction.

A potential acquisition may be required to be disclosed even before the acquisition is probable, based on the general proposition that all material information must be included in a prospectus. As part of that disclosure, it may be useful to provide some financial data even if full financial statements and pro formas are not available.

Step 2. Is the acquisition significant to the company?

Acquisition is significant if any one of three tests exceed 20%

Investment test	Acquirer's investments in target compared to acquirer's public float (or compared to acquirer's total assets if acquirer not publicly traded)
Asset test	Acquirer's share of the target's assets compared to acquirer's total assets
Income test – Both prongs must exceed 20% – Lesser result determines required financials	– Pre-tax income prong: target's pre-tax income compared to acquirer's pre-tax income – Revenue prong: acquirer's share of target's revenues compared to acquirer's revenues

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Whether a target's financial statements are needed in the registration statement will turn on whether the acquired business is "significant" when compared to the company's existing business. Generally, an acquired business is "significant" if the results of any one of the three tests described below exceed a 20% threshold:

- **Investment test**. The acquiring company's investments in and advances to the target (including assumed liabilities) compared to the acquiring company's aggregate worldwide market capitalization, or if the acquiring company does not have publicly traded common stock, compared to the acquiring company's total assets as of the end of its most recently completed fiscal year.
- **Asset test**. The acquiring company's share of the target's assets compared to the acquiring company's total assets as of the end of its most recently completed fiscal year.
- **Income test**. The income test consists of both a net income and a revenue component, each of which must exceed the 20% significance threshold to trip the test, but the operative test component to determine what financials are required is the lesser of:
  - the target's pre-tax income from continuing operations compared to the pre-tax income of the acquiring company for the most recently completed fiscal year (using absolute values if either the acquiring company or the target incurred a loss from continuing operations); and
  - the acquiring company's share of the target's consolidated total revenues from continuing operations (after intercompany eliminations) compared to the acquiring company's consolidated total revenues for the most recently completed fiscal year.

If an acquisition (or a probable acquisition) is "significant" based on any of one of the three tests above, target financials are generally required. There are many implementation points and details applicable to these tests so a company's counsel and accountants should be involved in the calculation. Some things to consider:

- *Income calculation*. For purposes of the income test, an average of the acquiring company's income over the last five years may be used when the acquiring company's income in the most recent year is 10% or more lower than its average income for the last five years.
- *SAB 80*. IPO companies that have been built by the aggregation of discrete businesses that remain substantially intact after acquisition may be able to use Staff Accounting Bulletin No. 80 (SAB 80) to determine significance. SAB 80 allows an issuer to measure significance against the financial statements of the combined entities, including those to be acquired, which comprise the registrant at the time the registration statement is filed.
- *Pro forma information may be used for significance test*. An acquiring company can measure significance using pro forma financial information that depicts significant acquisitions and dispositions consummated after the last fiscal year, so long as the company has filed required historical and pro forma financial information for the transactions and subject to certain specified conditions.
- *No need for a PCAOB audit report for the acquired business*. While any audited financial statements provided to satisfy the requirements described above should include an audit report, the audit report need not be issued by a PCAOB-registered accounting firm, and need not refer to PCAOB standards, assuming that the acquired business is not already an SEC reporting company.
- *Individually insignificant businesses*. If the aggregate impact of individually insignificant businesses acquired since the date of the most recent audited balance sheet filed for the acquiring company exceeds 50% under any of the three tests, the acquiring company would need to provide historical financial statements for the businesses whose individual significance exceeds 20%, in addition to pro forma financial information (further discussed below) depicting the aggregate effects of all of the individually insignificant businesses in all material respects.

  "Individually insignificant businesses" include any acquisition consummated after the audited balance sheet date of the company that does not exceed 20% in significance, any probable acquisition that does not exceed 50%, and any other consummated acquisition that exceeds 20% but not 50% in significance and for which the acquired company financial statements are not yet required to be filed because of the 75-day period discussed below.
- *Related Businesses*. Acquisitions of a group of related businesses that are probable or that have occurred since the company's most recent balance sheet date are treated as a single business

acquisition. Businesses are related if they are under common control or management, their acquisitions are dependent on each other, or each acquisition is conditioned on a single common event.

Step 3. If the acquisition is significant, what financial statements are required?

The financial statement periods to be presented for a recent or probable acquisition depend upon (1) the timing of the acquisition in comparison to the offering and (2) its level of significance, as described below.

Acquisitions closing in the 74 days before the date of the offering or after the offering

Significance exceeds 50%	Financial statements of the acquired business must be provided for the two most recent fiscal years (audited) and the latest required interim period (unaudited but reviewed in accordance with Auditing Standards No. 4105: Reviews of Interim Financial Information (AS 4105)) that precedes the acquisition and the corresponding interim period of the preceding year (unaudited).
Significance does not exceed 50%	SEC rules do not technically require the filing of target financial statements in the registration statement but financial statements of the target or other disclosure related to the acquisition are typically included to ensure appropriate disclosure or for marketing purposes. A company that omits a significant acquiree's financial statements from the registration statement during this 74-day grace period is required to file them on Form 8-K within 75 days of the acquisition.

Recent acquisitions closing 75 days or more before the offering

Significance does not exceed 20%	No financial statements of the acquired business are required.
Significance exceeds 20% but not 40%	Financial statements of the acquired business must be provided for the most recent fiscal year (audited) and the latest required interim period (unaudited but reviewed in accordance with AS 4105) that precedes the acquisition, but no corresponding interim period of the preceding year is required.
Significance exceeds 40%	Financial statements of the acquired business must be provided for the two most recent fiscal years (audited) and the latest required interim period (unaudited but reviewed in accordance with AS 4105) that precedes the acquisition and the corresponding interim period of the preceding year (unaudited).

Pre-acquisition financial statements for targets that exceed 20% but do not exceed 40% significance may be omitted once they are included in an acquiring company's post-acquisition audited financial statements for nine months. For targets that exceed 40% significance, financial statements may be omitted once they have been included in the acquiring company's audited financial statements for a full fiscal year.

Particular circumstances: Foreign businesses, net assets, oil and gas

The financial statement requirements in certain circumstances such as for foreign businesses, acquisitions of net assets (like a product line) and acquisitions of oil and gas businesses differ in some respects, as discussed below.

- *Foreign businesses*. If a "foreign business" is acquired and its financial statements are not prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) or International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS-IASB), a reconciliation to U.S. GAAP may be required. If the acquired foreign business is below 30% for each of the three significance tests, financial statements prepared in accordance with local home-country generally accepted accounting principles (local GAAP) or International Financial Reporting Standards

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(IFRS) other than IFRS-IASB without reconciliation to U.S. GAAP are permitted. If any of the three significance tests equals or exceeds 30%, reconciliation to U.S. GAAP must be included for the relevant periods required by the significance thresholds described above. If the business acquired is not a "foreign business" but would qualify as a foreign private issuer if it were an SEC registrant, financial statements may be prepared in accordance with IFRS-IASB without reconciliation to U.S. GAAP.

A "foreign business" is defined under SEC rules as "a business that is majority owned by persons who are not citizens or residents of the United States and is not organized under the laws of the United States or any state thereof, and either: (1) more than 50 percent of its assets are located outside the United States; or (2) the majority of its executive officers and directors are not United States citizens or residents."

- *Net assets that constitute a business.* When a company acquires a component of a business, such as a product line, it may present abbreviated financial statements of the acquired component, provided that the following qualifying conditions are met:
  - the total assets and revenues of the acquired component constitute 20% or less than those of the selling entity as of and for the most recently completed fiscal year;
  - separate financial statements for the acquired component have not previously been prepared;
  - the acquired component was not a separate entity, subsidiary, operating segment (as defined in U.S. GAAP or IFRS-IASB, as applicable) or division during the periods for which the acquired component's financial statements would be required; and
  - the seller has not maintained the distinct and separate accounts of the acquired component necessary to present financial statements that include the omitted expenses and it is impracticable to prepare such financial statements.
- *Oil and gas businesses.* For acquisitions of a business that includes significant oil and gas producing activities, a company may provide abbreviated financial statements that consist of income statements modified to exclude expenses not comparable to the proposed future operations, such as depreciation, depletion and amortization, corporate overhead expense, income taxes and interest expense, provided that certain conditions are met. These accommodations only apply to a business that generates substantially all of its revenues from oil and gas producing activities.

Pro forma financial statements

If a significant acquisition or disposition has occurred in the last year or is probable, pro forma financial information is required in a registration statement to show how the transaction might have impacted the company's historical financial position and results of operations had it occurred at the beginning of the company's most recently completed fiscal year. For these purposes, both for an acquisition and a disposition, significance is assessed at the 20% level under any one of the investment, asset or income significance tests discussed above.

Pro forma financial information may also be necessary in other circumstances such as

- an offering by a company as an autonomous entity when it was recently part of another entity;
- changes in capitalization at the effectiveness or the close of an IPO; or
- the repayment of debt which has a material impact on the company's financial statements.

As discussed above, pro forma financial information may be required for individually insignificant businesses aggregating more than 50% significance on a combined basis depicting the aggregate effects of all such businesses in all material respects (even where separate historical financial statements of the individual businesses are not required).

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Presentation of pro forma financial statements

Pro forma information typically starts with an introductory paragraph which briefly describes the transaction and explains the pro forma information. The pro forma financial information itself is presented in columnar form, with separate columns presenting historical results, pro forma adjustments and pro forma results. In limited cases where there are only a few easily understood adjustments, a narrative description of the effects of the transaction is used.

Pro forma condensed balance sheet. The pro forma balance sheet information is based on the latest balance sheet included in the filing. A pro forma balance sheet is not required if the acquisition or disposition is already reflected in a historical balance sheet. Pro forma adjustments are computed assuming the transaction was consummated on the date of the latest balance sheet included in the filing.

Pro forma condensed income statement. The pro forma income statement information is based on the latest fiscal year and interim period included in the filing. In addition, a company may present a pro forma income statement for the corresponding prior interim period and an "LTM" period (also known as last 12 months or trailing 12 months period). The SEC generally does not permit pro forma presentations for additional historical periods.

Pro forma adjustments. Pro forma adjustments are computed assuming the transaction occurred at the beginning of the fiscal year presented for income statement purposes, and on the balance sheet date for balance sheet purposes, and carried forward through any interim period presented. The following types of adjustments are required:

- transaction accounting adjustments giving effect to the acquired or disposed businesses reflecting the application of required accounting principles; and
- autonomous entity adjustments to reflect the operations and financial position of the acquiring company as an autonomous entity in cases when it was previously part of another entity.

In addition, if management believes that certain adjustments would help an investor better understand the pro forma effects of a transaction, a company may include management adjustments that depict synergies and dis-synergies, subject to specified conditions, including disclosure of the basis for, and material limitations of, each adjustment.

Presentation of adjustments. Transaction accounting adjustments and autonomous entity adjustments must be presented in separate columns in the pro forma financial statements. Management's adjustments, if any, must be in the explanatory notes to the pro forma financial information in the form of reconciliations of pro forma net income and related pro forma earnings per share data after giving effect to the adjustments. All pro forma financial information must disclose revenues, expenses, gains, losses and related tax effects that will not recur in the income of the company beyond 12 months after the transaction. If the transaction is structured in such a manner that significantly different results may occur, additional pro forma presentations that give effect to the range of possible results must be included. Historical and pro forma revenue per share information must be on the pro forma income statement and may only give effect to transaction accounting adjustments and autonomous entity adjustments.

Guaranteed or secured securities

If registered securities are guaranteed by, or secured by the securities or other assets of, one or more subsidiaries or affiliates of the company, financial statements or supplemental financial information about the subsidiary or affiliate may be required. The financial statement requirements in these instances can be burdensome for companies. Fortunately, SEC rules allow for certain alternative and less onerous disclosures if certain conditions are met, and we summarize these alternative disclosures below.

Guaranteed securities

If a subsidiary issuer or guarantor is consolidated in the parent company's financial statements and certain other conditions are met, the parent company may omit otherwise required financial statements of the guarantor if it instead includes certain specific financial and non-financial disclosures in the registration statement:

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Financial disclosures. The following list of summarized financial information must generally be included for the issuer and guarantors for the most recent fiscal year and subsequent interim period:

- Current assets, non-current assets, current liabilities, non-current liabilities, and, when applicable, redeemable preferred stocks and non-controlling interests.
- Net sales or gross revenues, gross profit (or, alternatively, costs and expenses applicable to net sales or gross revenues), income or loss from continuing operations, net income or loss, and net income or loss attributable to the entity.

This information need not be included if not material, or in certain limited circumstances specified in SEC rules and guidance, including where the assets, liabilities and results of operations for the combined issuer and guarantor group are not materially different than amounts presented in the consolidated parent company financials, or where the issuer is a finance subsidiary and the parent company is a guarantor or co-issuer. A company must also include such other financial information it deems material for investors.

Non-financial disclosures. The registration statement must include disclosure about the guarantors and the terms of the guarantees, including any contractual or statutory restrictions on dividends or guarantee enforceability.

The financial and non-financial disclosures must be included in Exchange Act reports for as long as the companies and guarantors have an Exchange Act reporting obligation with respect to the guaranteed securities, an obligation that usually lapses in the company’s next fiscal year following the issuance (unless the debt securities are listed).

Secured debt offerings

A company is required to provide certain specified financial and non-financial disclosures relating to affiliates whose securities are pledged as collateral to secure the company’s registered debt securities to the extent such disclosures are material. In most cases, issuers conclude that the specified financial information is not material and omit that information, and instead include non-financial disclosures consistent with those provided in Rule 144A secured debt offerings. Non-financial disclosures include information about the securities pledged as collateral, such as the terms and conditions of the collateral arrangement, whether a trading market exists for the pledged securities, and disclosure about additional facts and circumstances specific to particular affiliates that would be material to investors.

Rule 144A offerings

Unlike in an SEC-registered offering, in a Rule 144A offering there are no specific form requirements for the information that must be provided to qualified institutional buyers (QIBs) at the time they make their investment decision. A party selling securities pursuant to Rule 144A is, however, subject to potential liability if the security is sold by means of an oral statement or written document which contains false or misleading information, provided that scienter is shown, and the company is required to provide certain basic financial information to potential purchasers upon request.

Therefore, investors in a Rule 144A transaction are generally provided similar information to what is provided in registered deals. The absence of preset rules and form requirements does, however, provide some flexibility in preparing an offering document for a Rule 144A transaction. Certain financial information that would be required in a registered offering may be dispensed with if the company and underwriters conclude that it is not material in light of the other disclosure provided.

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