

PROSPECTUS FINANCIAL INFORMATION
AND
OTHER IPO ACCOUNTING CONSIDERATIONS

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by

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This memorandum discusses the requirements of [Regulation S-X](#) regarding inclusion in an initial public offering (“IPO”) prospectus and registration statement of financial statements and financial statement schedules of the registrant, financial statements of any acquired businesses, and pro forma financial information, as well as the requirements of [Regulation S-K](#) regarding inclusion of selected financial information, dilution information and so-called “non-GAAP financial measures.” It also discusses various other prospectus financial disclosures that involve accountants.

Financial Statements of the Registrant

[Paragraph \(e\) of Item 11 \(Information with Respect to the Registrant\) of Form S-1](#), the form used for domestic and some foreign private issuer IPOs, requires inclusion in the prospectus and registration statement of registrant financial statements meeting the requirements of Regulation S-X.¹ The financial statements required under Regulation S-X must be included in the “F” pages at the back of the prospectus distributed to potential

¹ It also requires inclusion of any financial information required by [Rule 3-05](#) (Financial Statements of Businesses Acquired or to be Acquired) and [Article 11](#) (Pro Forma Financial Information) of Regulation S-X. However, a “smaller reporting company” (see definition in footnote 9 below) may provide the information specified in [Rules 8-04](#) (Financial Statements of Businesses Acquired or to be Acquired) and [8-05](#) (Pro Forma Financial Information) of Regulation S-X in lieu of the financial information required by Rule 3-05 and Article 11 of Regulation S-X. See the sections below entitled “Financial Statements of Businesses Acquired or to be Acquired” and “Pro Forma Financial Information.”

investors during the IPO process. The “schedules” required under Regulation S-X are included only in the registration statement, as “financial statement schedules” pursuant to paragraph (b) of [Item 16 \(Exhibits and Financial Statement Schedules\) of Part II of Form S-1](#).²

[Rule 3-01 of Regulation S-X](#) contains the requirements regarding consolidated balance sheets, and [Rule 3-02 of Regulation S-X](#) contains the requirements regarding consolidated statements of income and changes in financial position. Generally, under [Rule 3-01](#), a registrant must include in its prospectus and registration statement audited consolidated balance sheets as of the end of each of its two most recent fiscal years. There are two exceptions – (1) if a company has been in existence for less than one fiscal year, it need only file a single audited³ balance sheet as of a date within 135⁴ days of the date of the initial filing of the registration statement and (2) if a company is filing within 45 days after the end of its fiscal year and does not yet have audited financial statements for the most recent fiscal year, it may include audited consolidated balance sheets as of the end of the two preceding fiscal years and an additional unaudited balance sheet as of an interim date at least as current as the end of the third fiscal quarter of its most recently completed fiscal year.⁵ Generally,

² See the section below entitled “Financial Statement Schedules of the Registrant.”

³ Subsequent updates to comply with the 135-day rule generally may be made on an unaudited basis. See [Section 1220.4 of the U.S. Securities and Exchange Commission \(“SEC”\) Division of Corporation Finance’s Financial Reporting Manual \(the “SEC Financial Reporting Manual”\)](#). See also [Section 1160 of the SEC Financial Reporting Manual](#) for more information on recently formed registrants.

⁴ Pursuant to [Rule 417 of Regulation C](#) under the Securities Act of 1933 (the “Securities Act”), whenever financial statements are required to be furnished as of a date within a specified period prior to the date of filing the registration statement and the last day of that period falls on a Saturday, Sunday or holiday, that registration statement may be filed on the first business day following the last day of the specified period. See also [Section 1220.12 of the SEC Financial Reporting Manual](#).

⁵ There is also a provision in [Rule 3-01\(c\) of Regulation S-X](#) allowing companies filing more than 45 days after, but within 90 days of, the end of their fiscal year to avail themselves of exception (2) in the sentence to (footnote continued on next page)

under [Rule 3-02\(a\)](#), a registrant must also include in its prospectus and registration statement audited consolidated statements of income and cash flows for each of the three fiscal years preceding the date of the most recent audited balance sheet being filed or such shorter period as the company (including any predecessors⁶) has been in existence. See generally [Section 1220 \(Age Requirements\) of the SEC Financial Reporting Manual](#) for further information about the age of financial statements.

[Rules 3-01\(e\)](#) and [3-02\(b\)](#) also provide that, for filings made after 134 days⁷ subsequent to the end of the registrant's most recent fiscal year, the registrant must also include a balance sheet as of an interim date within 135 days of the date of filing and statements of income and cash flows for the interim period between the latest audited balance sheet date and the date of the most recent interim balance sheet being filed and for the corresponding period of the preceding fiscal year. [Rules 3-01\(f\)](#) and [3-02\(b\)](#) provide that these interim financial statements need not be audited and can be presented in condensed format to the extent permitted by [Rule 10-01 of Regulation S-X](#). [Rule 3-12 of Regulation S-X](#) contains further information on the required age of registrant financial statements and provides information regarding required updating of financial statements prior to the effective date

which this footnote attaches if they are filing, and are current with, reports under the Securities Exchange Act of 1934 (the "Exchange Act") and meet certain profitability criteria. However, this provision would be available in the IPO context only where a registrant doing its first equity offering is already required to file Exchange Act reports (perhaps as a result of the issuance of debt in the public markets). Also, the scaled-back disclosure requirements available to "smaller reporting companies" (see definition in footnote 9 below) are discussed in the penultimate paragraph of this section on financial statements of the registrant. [Rule 8-08\(b\) of Regulation S-X](#), a provision similar to Rule 3-01(c), permits smaller reporting companies (even if they are not reporting companies) further latitude on financial statement currency if they meet certain profitability criteria. See also [Sections 1220.2 and 1220.3 of the SEC Financial Reporting Manual](#).

⁶ [Rule 3-02\(a\)](#) also potentially requires statements of income and changes in financial position for a company's predecessors. See the final paragraph of this section on financial statements of the registrant and footnote 12 below.

⁷ See footnote 4 above.

of a registration statement.⁸ [Rules 3-03](#) and [3-04 of Regulation S-X](#) provide instructions to the income statement requirements and contain the requirements for a fourth registrant financial statement – changes in stockholders’ equity.

Registrants that qualify as “smaller reporting companies”⁹ must prepare their financial statements in accordance with generally accepted accounting principles in the United States but, except as specifically provided in [Rule 8-01 of Regulation S-X](#), can elect not to comply with the form and content requirements of

⁸ [Section 1210 of the SEC Financial Reporting Manual](#) indicates that the SEC staff may not make a review decision or commence a review of a filing unless the registrant’s financial statements comply with the rules for age of financial statements at the date of filing.

⁹ [Rule 405 of Regulation C](#) under the Securities Act and [Item 10\(f\)\(1\) of Regulation S-K](#) each define a “smaller reporting company” to be a company that:

- In the case of an initial registration statement under the Securities Act for shares of its common equity, had a public float of less than \$75 million as of a date within 30 days of the date of the filing of the registration statement, computed by multiplying the aggregate worldwide number of those shares held by non-affiliates before the registration plus the number of those shares included in the registration statement by the estimated public offering price of the shares; or
- In the case of an issuer whose public float as calculated under the preceding paragraph was zero, had annual revenues of less than \$50 million during the most recently completed fiscal year for which audited financial statements are available.

The SEC promulgating release for this definition ([Release No. 33-8876 \(December 19, 2007\)](#)) indicates that a registrant qualifying as a smaller reporting company at the time of the initial filing of its registration statement will remain so qualified, notwithstanding an increase in its public float above \$75 million during the pre-effective stage of its filing, if the registrant made a bona fide eligibility determination at the time it filed its IPO registration statement. [Item 10\(f\)\(2\)\(ii\) of Regulation S-K](#) and [Rule 405 of Regulation C](#) (definition of “smaller reporting company”) each state that an IPO registrant which does not qualify as a smaller reporting company at the time of the initial filing of its registration statement may re-determine its status at the conclusion of the offering covered by the registration statement based on the actual offering price and number of shares sold. See also [Section 5100 of the SEC Financial Reporting Manual](#).

Regulation S-X.¹⁰ Pursuant to [Rule 8-02 of Regulation S-X](#), smaller reporting companies need to provide only two years of audited consolidated statements of income, cash flows and changes in stockholders' equity but otherwise must generally comply with the annual and interim financial statement requirements applicable to all registrants.¹¹ Smaller reporting companies are permitted to include more financial information than is required by the rules in [Article 8 of Regulation S-X](#) and can choose to include all financial information required of larger registrants. [Rule 8-08 of Regulation S-X](#) specifies the rules with regard to the age of smaller reporting companies' financial statements at the time of filing and effectiveness.

Registrants may also need to file predecessor company financial statements where, for example, a dormant shell acquires an active business. The registrant's attorneys and accountants will need to determine if the registrant has a predecessor.¹² If so, the

¹⁰ The principal differences regarding required financial information of the registrant are that smaller reporting companies can elect not to file the financial statement schedules ordinarily required by [Rule 5-04 of Regulation S-X](#) (see [Section 1130.2 of the SEC Financial Reporting Manual](#)), do not have stipulated quantitative thresholds for many disclosures and do not have specifically designated financial statement formats. See [Section 1410.1 of the SEC Financial Reporting Manual](#). Also, [Rule 8-03 of Regulation S-X](#) applies to interim financial statements rather than Rule 10-01 of Regulation S-X.

¹¹ [Note 5 to Section 210.8 in Rule 8-01 of Regulation S-X](#) gives authority to the SEC to permit omission of or substitution for one or more financial statements or to require the filing of other financial statements.

¹² The definition of "predecessor" in [Rule 405 of Regulation C](#) under the Securities Act is quite broad. That rule states that "predecessor" means a person the major portion of the business and assets of which another person acquired in a single succession, or in a series of related successions in each of which the acquiring person acquired the major portion of the business and assets of the acquired person. [Section 1170.1 of the SEC Financial Reporting Manual](#), however, states that, for purposes of financial statements, the SEC staff generally does not require designation of an acquired business as a predecessor except where a registrant succeeds to substantially all of the business (or a separately identifiable line of business) of another entity (or group of entities) and the registrant's own operations prior to the succession appear insignificant relative to the operations assumed or acquired.

financial statements of the predecessor and successor would typically together need to meet the financial statement requirements of [Rules 3-01](#) and [3-02 of Regulation S-X](#) with no breaks in the audited periods. See [Sections 1170.2 and 1170.3 of the SEC Financial Reporting Manual](#).

Financial Statement Schedules of the Registrant

In addition to the registrant financial statements required in an IPO prospectus and registration statement, [Items 11\(e\) and 16\(b\) of Form S-1](#) require the registrant to provide in Item 16 of Part II of its registration statement any registrant or predecessor financial statement schedules required by Regulation S-X. For commercial and industrial companies, the requirements regarding what schedules must be filed, for what periods they must be filed and when they must be audited are found in [Rule 5-04\(a\) and \(c\) of Regulation S-X](#). The form and content requirements for financial statement schedules are found in [Article 12 of Regulation S-X](#). Pursuant to [Rule 5-04\(a\)\(2\)](#) and [Rule 12-09 of Regulation S-X](#), most companies need to include a schedule II, entitled “Valuation and Qualifying Accounts,” that contains information about the registrant’s allowance/provision for doubtful accounts (and perhaps other allowances or reserves) for its last three fiscal years; other schedules are much less common. Smaller reporting companies do not need to file financial statement schedules.¹³

Financial Statements of Businesses Acquired or to be Acquired

For registrants other than smaller reporting companies,¹⁴ [Item 11\(e\) of Form S-1](#) and [Rule 3-05 of Regulation S-X](#) require, in addition to the registrant’s own financial statements, acquired business¹⁵ financial statements prepared and audited in accordance

¹³ See footnote 10 above.

¹⁴ The requirements for smaller reporting companies (see definition in footnote 9 above) to include financial statements of businesses acquired or to be acquired are discussed in the final paragraph of this section on financial statements of businesses acquired or to be acquired.

¹⁵ The requirements of [Rule 3-05](#) apply only to acquisitions made by the registrant or its predecessor(s). [Section 2005.5 of the SEC Financial](#)
(footnote continued on next page)

with Regulation S-X where a significant business combination¹⁶ (including the acquisition of an interest in a business accounted for by the equity method) has occurred or is probable or consummation of a combination between entities under common control is probable.¹⁷

In deciding whether the provisions of [Rule 3-05](#) apply, the registrant first must determine, in accordance with the guidance set forth in [Rule 11-01\(d\) of Regulation S-X](#), whether a “business,” rather than just assets and liabilities, has been acquired.¹⁸ Rule 11-01(d) provides that 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

[Reporting Manual](#) states that financial statements of recently acquired businesses of the acquiree need not be filed unless their omission would render the acquiree’s financial statements misleading or substantially incomplete. Also, the requirements of Rule 3-05 do not apply to the acquisition of a business that is a predecessor of the registrant (see [Section 2005.6 of the SEC Financial Reporting Manual](#)).

¹⁶ [Section 2060 of the SEC Financial Reporting Manual](#) has a detailed flow chart that can assist in determining the questions to be asked in deciding if acquired business financial statements are required. Also, Deloitte & Touche LLP in August 2009 published a 140-page treatise entitled “[SEC Reporting for Business Combinations and Related Topics – A Roadmap to Applying SEC Regulation S-X to the Acquisition of a Business](#)” (the “Deloitte & Touche Treatise”) that discusses Rule 3-05 of Regulation S-X section by section. It provides much greater detail with regard to each section of the rule than do the remaining paragraphs of this section and should be studied in connection with any complex questions about acquired company financials. Note that acquisitions made more than three fiscal years before the filing of the registration statement can still result in the need for inclusion of acquired company financial statements. See [Deloitte & Touche Treatise, page 101](#).

¹⁷ “Probable” is not defined in the rule, and accountants typically look for legal assistance in determining whether an acquisition is probable. [Section 2005.4 of the SEC Financial Reporting Manual](#) states that: an “[a]cquisition is probable where registrant’s financial statements alone would not provide adequate financial information to make an investment decision” and cites Codification of Financial Reporting Policies Section 506.02(c)(ii) adopted in SEC Release No. 33-6395 (April 15, 1982). See [Deloitte & Touche Treatise, page 9](#), for factors to be considered in determining if an acquisition is probable.

¹⁸ See [Section 2010.1 et seq. of the SEC Financial Reporting Manual](#).

operations prior to and after the transaction so that disclosure of prior financial information is material to an understanding of future business operations. It creates a presumption that a separate entity, a subsidiary or a division is a business. It also provides that a lesser component of an entity, such as a product line, may constitute a business. The rule sets forth a number of facts and circumstances that should be considered in evaluating whether a lesser component of an entity constitutes a business. These facts and circumstances include whether the nature of the revenue-producing activity of the component will remain generally the same as before the transaction¹⁹ or whether any of the following attributes remains with the component after the transaction: physical facilities; employee base; market distribution system; sales force; customer base; operating rights; production techniques; or trade names.

Acquisitions of a group of related businesses that are probable or that have occurred subsequent to the latest fiscal year-end for which audited financial statements of the registrant have been filed must be treated for the purposes of Rule 3-05 of Regulation S-X as if they are a single business combination. Businesses are deemed to be related if:

- they are under common control or management;

¹⁹ The [Note to Section 2010.2 of the SEC Financial Reporting Manual](#) states that: “New carrying values of assets, or changes in financing, management, operating procedures or other aspects of the business are not unusual following a business acquisition. Such changes typically do not eliminate the relevance of historical financial statements. Registrants that have succeeded to a revenue producing activity by merger or acquisition, with at least one of the other factors listed [in the text above immediately following this footnote number] remaining after the acquisition, are encouraged to obtain concurrence from the [SEC] staff in advance of a filing if they intend to omit financial statements related to the assets and activity.” The SEC Division of Corporation Finance, Office of Chief Accountant, does not grant many waivers from the definition of business; the most likely basis is proof that the registrant will use the acquired assets for a totally different purpose than did the entity from which it acquired them. See [Deloitte & Touche Treatise, pages 11-16](#), for a discussion of what constitutes a “business.”

- the acquisition of one business is conditioned on the acquisition of each other business; or
- each acquisition is conditioned on a single common event.

The required financial statements of related businesses may be presented on a combined basis for any periods they are under common control or management.

Once a company has determined that a business combination has occurred or is probable, [Rule 3-05\(b\) of Regulation S-X](#) provides the criteria for determining which financial statements of the acquired business must be included in the prospectus and registration statement. The required number of years of financial statements increases based on the size of the acquired business relative to the size of the registrant. The registrant must calculate the three financial percentages described in [Rule 1-02\(w\) of Regulation S-X](#) (the definition of “significant subsidiary”), generally based on the most recent pre-acquisition annual financial statements of each acquired business (or group of related businesses on a combined basis) and the registrant’s most recent annual consolidated financial statements filed at or prior to the date of acquisition.²⁰ The required percentage calculations²¹ are as follows:

²⁰ See [Rule 3-05\(b\)\(3\) of Regulation S-X](#), [Sections 2015.2 and 2015.3 of the SEC Financial Reporting Manual](#) and [Deloitte & Touche Treatise, pages 23-30](#). The most recent pre-acquisition statements are used even when the acquisition has occurred a number of years before the initial registration statement is filed or declared effective by the SEC. See [Deloitte & Touche Treatise, page 101](#).

²¹ According to [Sections 2015.10, 2015.11 and 2020.6 of the SEC Financial Reporting Manual](#), when measuring each of the percentage tests, intercompany transactions between the registrant and the acquired business should be eliminated in the same way that would occur if the acquired business were consolidated, the acquired business should not be considered part of the registrant’s denominator and the registrant’s assets should not be increased by including the pro forma effect of public offering proceeds received after the balance sheet date.

- Investment Test. The registrant's and its subsidiaries' investments in and advances to the acquired business divided by the total consolidated assets of the registrant (essentially the percentage of the registrant's total assets "spent" to acquire the business);²²
- Asset Test. The registrant's and its subsidiaries' proportionate share of the total assets (after intercompany eliminations) of the acquired business²³ divided by the total consolidated assets of the registrant; and
- Income Test. The registrant's and its subsidiaries' equity in the income from continuing operations before income taxes, extraordinary items and cumulative effect of a change in accounting principle of the acquired business exclusive of amounts attributable to any non-controlling interests divided by such consolidated income of the registrant.²⁴

²² [Sections 2015.5 and 2015.6 of the SEC Financial Reporting Manual](#) state that this is a comparison of the total GAAP purchase price of the acquired entity, as adjusted as set forth in those sections, to the registrant's consolidated total assets and provide guidance on the mechanics of this calculation. The appropriate adjustments are discussed in each of these sections and the notes to Section 2015.6. See [Deloitte & Touche Treatise, pages 32-37](#), for a discussion of how a registrant should perform the investment test, including the effect of contingent consideration.

²³ [Section 2015.4 of the SEC Financial Reporting Manual](#) states that ordinary receivables and other working capital amounts not acquired should nevertheless be included as part of the assets of the acquired business in the percentage tests of significance relative to the registrant's assets because that working capital is expected to be required and funded after the acquisition. See [Deloitte & Touche Treatise, pages 38-41](#), for a discussion of how a registrant should perform the asset test.

²⁴ See [Rule 1.02\(w\) of Regulation S-X](#). For purposes of this income test, [computational note 2 in Rule 1-02\(w\)](#) provides that, if the registrant's consolidated income exclusive of amounts attributable to any non-controlling interests for its most recent fiscal year is at least 10% lower than its average income for the last five fiscal years, the registrant should use its average income as the denominator. [Sections 2015.8 and 2015.9 of the](#)

(footnote continued on next page)

Once those three percentages²⁵ have been calculated, [Rule 3-05\(b\)\(2\) of Regulation S-X](#) sets forth the basis for determining the number of years of financial statements required for the acquired business.²⁶

- If none of the percentages exceeds 20%, no financial statements are required unless the aggregate impact of the individually insignificant businesses²⁷ acquired since the date of the most recent audited balance sheet filed for the registrant exceeds 50%. In this case, financial statements covering at least the substantial majority of the businesses acquired must be furnished for at least the most recent fiscal year and any interim periods specified in [Rules 3-01](#) and [3-02 of Regulation S-X](#).²⁸

[SEC Financial Reporting Manual](#) state that (1) loss years should be assigned a value of zero in computing the numerator for this average, but the denominator should be “5,” (2) the acquired entity’s income may not be averaged pursuant to this rule; and (3) in the case of a single acquisition, if either the registrant or the acquired business reported a pretax loss and the other entity reported a pretax income, the calculation should be made using the absolute values. See [Deloitte & Touche Treatise, pages 41-50](#), for a discussion of how a registrant should perform the income test.

²⁵ [Section 2015.13 of the SEC Financial Reporting Manual](#) states that the registrant should not round the percentages calculated. The financial statement requirements stated in the bullet points in the text above immediately following this footnote number are set forth in tabular format following [Section 2030.1 of the SEC Financial Reporting Manual](#) and also in the [Deloitte & Touche Treatise, page 21](#).

²⁶ In exceptional cases, the SEC may waive one or more years of financial statements. See [Section 2020.1 of the SEC Financial Reporting Manual](#).

²⁷ [Section 2035 of the SEC Financial Reporting Manual](#) discusses in detail what businesses must be included and how those calculations are to be done. See also [Deloitte & Touche Treatise, pages 62-76](#), for a discussion of the treatment of individually insignificant business acquisitions.

²⁸ See the first page of this memorandum regarding [Rules 3-01](#) and [3-02](#) and the [Deloitte & Touche Treatise, pages 89-96](#), on age of acquired entity financial statements. [Section 2035.3 et seq. of the SEC Financial Reporting Manual](#) provides detailed information on how to determine the required “substantial majority.” Also, note that, even if an acquisition is not significant at the 20% level, it may still be “material” for purposes of FASB
(footnote continued on next page)

- If any of the percentages exceeds 20% but none exceeds 40%, financial statements must be furnished for at least the most recent fiscal year (audited) and any interim periods (unaudited) specified in [Rules 3-01](#) and [3-02](#).
- If any of the percentages exceeds 40% but none exceeds 50%, financial statements must be furnished for at least the two most recent fiscal years (audited) and any interim periods (unaudited) specified in [Rules 3-01](#) and [3-02](#).
- If any of the percentages exceeds 50%, the full financial statements specified in [Rules 3-01](#) and [3-02](#) must be furnished unless the net revenues reported by the acquired business in its most recent fiscal year are less than \$50 million, in which case the earliest of the three fiscal years required may be omitted.²⁹ The annual statements must be audited; the interim period statements may be unaudited.

A separate audited balance sheet of the acquired business is not required when the registrant's most recent audited balance sheet required by Rule 3-01 of Regulation S-X is for a date after the date the acquisition was consummated.³⁰ Registrants filing initial registration statements may apply the period of time in which the operations of an acquired business are included in the audited income statement of the acquirer to reduce the number of periods

No. 141(R) [ASC805] and thus require disclosure in the financial statements in the period in which it is consummated. See [Deloitte & Touche Treatise, page 22](#).

²⁹ [Section 2030.4 of the SEC Financial Reporting Manual](#) states that, once a registrant has filed audited financial statements that include the post-acquisition results of operations of the acquired entity, the SEC staff will accept audited financial statements for a period of time less than that required by Rule 3-05 but will expect audited pre- and post-acquisition financial statements for the acquired entity to equal the periods required under Rule 3-05 and to have no gaps.

³⁰ See [Rule 3-05\(b\)\(4\)\(iv\) of Regulation S-X](#) and [Section 2030.2 of the SEC Financial Reporting Manual](#).

for which pre-acquisition income statements are required. However, registrants applying such an approach can have no gap between the audited pre-acquisition and audited post-acquisition periods.³¹

One exception to the financial statement requirements set forth in the foregoing bullet points is that registration statements generally need not include separate financial statements of the acquired or to be acquired business if none of the percentages calculated exceeds 50% and either the consummation of the acquisition has not yet occurred or the date of the final prospectus is no more than 74 days after consummation of the business combination.³²

³¹ See [Deloitte & Touche Treatise, page 101](#). This provision allowing the registrant's post-acquisition results to satisfy the financial statement requirements for the acquired entity may be helpful when the acquisition happened several years before the filing of the registration statement (note that a registrant must consider for inclusion of financial statements all businesses acquired during the registrant's last three fiscal years and any subsequent interim period (see [Deloitte & Touche Treatise, pages 102](#))). For example, if an acquisition is consummated on April 15, 2007 and the acquired business's highest level of significance was 45%, Rule 3-05 of Regulation S-K would require the acquired business' audited annual financial statements to be filed for the two years ended December 31, 2006 (assuming both the registrant and the acquired business have calendar year-ends). In lieu of financial statements for those periods, the SEC staff will accept audited financial statements of the acquired business for the year ended December 31, 2006 and the period from January 1, 2007 through April 14, 2007 provided that audited financial statements of the registrant for the year ended December 31, 2007 have been filed. See [Section 2030.4 of the SEC Financial Reporting Manual](#) and the [Deloitte & Touche Treatise, pages 103-104](#). [Rule 3-05\(b\)\(4\)\(iii\) of Regulation S-X](#) would appear not to apply in an IPO context because of its "previously filed" language, although in October 2009, Intelius sought the SEC's concurrence that the inclusion of an acquired company's operations in the registrant's audited financials for a nine-month period was equivalent to a "full fiscal year" and thus was sufficient to avoid the requirement for acquired company financial statements. The point became moot when Intelius found it could audit the acquired company without a delay in its schedule.

³² See [Rule 3-05\(b\)\(4\)\(i\) of Regulation S-X](#), [Section 2040.1 of the SEC Financial Reporting Manual](#) and [Note to Section 2035.2 of the SEC Financial Reporting Manual](#). However, if a registrant omits from its registration statement acquired entity financial statements pursuant to this (footnote continued on next page)

[Rule 3-06 of Regulation S-X](#) allows acquired business financial statements covering a period of 9 to 12 months to satisfy a requirement for filing financial statements for the period of one year.

[Section 2060 of the SEC Financial Reporting Manual](#) has a detailed flow chart that can assist in determining the questions to be asked in deciding if acquired business financial statements are required.

In some cases involving IPOs, the SEC has acknowledged that strict application of [Rule 3-05³³ of Regulation S-X](#) is problematic or results in provision of financial statements that are clearly not material.³⁴ The SEC staff has advised registrants preparing an IPO to consider the applicability of [SEC Staff Accounting Bulletin \(“SAB”\) No. 80 \(Topic 1:J\)](#). SAB No. 80 is most likely to be a helpful alternative where the registrant has done a number of acquisitions (e.g., radio stations or health care facilities), continues to operate them separately and wants to choose the ones for which it includes financial statements (perhaps because it cannot obtain audited financial statements for some of the acquired businesses). SAB No. 80 is an interpretation of Rule 3-05 for application in the case of IPOs involving businesses that have been built by the aggregation of discrete businesses that remain substantially intact after acquisition. It permits first-time registrants in their first registration statement to consider the significance of recently acquired and likely to be acquired

exception, it must furnish those financial statements and any pro forma financial information specified in [Article 11 of Regulation S-X](#) to the SEC under cover of a [Form 8-K \(Item 9.01\)](#) no later than 75 days after the consummation of the acquisition. See [Rule 3-05\(b\)\(4\)\(ii\) of Regulation S-X](#). See also [Deloitte & Touche Treatise, pages 82-83](#).

³³ Or [Rule 8-04 of Regulation S-X](#) for smaller reporting companies (see definition in footnote 9 above). See the final paragraph of this section on “Financial Statements of Businesses Acquired or to be Acquired.”

³⁴ See [Section 2070.1 et seq. of the SEC Financial Reporting Manual](#). See also “[Division of Corporation Finance: Frequently Requested Accounting and Financial Reporting Interpretations and Guidance](#)” and click on “IV.D. Financial Statements of Acquired Businesses” in the “Contents” section. In addition, see [Deloitte & Touche Treatise, pages 106-109](#), for a discussion of SAB No. 80.

companies based on pro forma financial statements for the registrant's most recently completed fiscal year. The pro forma financial statements assume all businesses to have been acquired at the beginning of that fiscal year (for income tests) and at the end of the fiscal year (for asset and investment tests). Under the provisions of SAB No. 80, the registrant may exclude pre-acquisition financial statements of businesses not included in the registrant's audited financial statements for:

- at least nine months to the extent that the sum of each acquisition's highest percentage from the three percentage tests is less than 10%;³⁵
- at least 21 months to the extent that the sum of each acquisition's highest percentage from the three percentage tests is less than 20%; and
- at least 33 months to the extent that the sum of each acquisition's highest percentage from the three percentage tests is less than 40%.³⁶

See also [SAB No. 97](#) and the SEC interpretations³⁷ of that SAB if a registrant was created through the roll-up of businesses (i.e., two or more entities combine currently with the IPO).

[Item 11\(e\) of Form S-1](#) permits smaller reporting companies³⁸ to elect to provide financial statements of businesses acquired or to be acquired in accordance with [Rule 8-04 of Regulation S-X](#) in lieu of the financial statements required by [Rule 3-05](#). Rule 8-04 allows a smaller reporting company to

³⁵ The 10%, 20% and 40% levels were established prior to the amendment of Rule 3-05 to increase the levels to 20%, 40% and 50%, and SAB No. 80 has never been revised to correspond to the new amended levels in the rule.

³⁶ See [Section 2070.7 of the SEC Financial Reporting Manual](#).

³⁷ See "[Division of Corporation Finance: Frequently Requested Accounting and Financial Reporting Interpretations and Guidance](#)" (click on "II.G. Accounting and Disclosure for Rollups of Businesses (SAB 97)" in the "Contents" section of the page to which this link leads). Also, see [Sections 2025.12 and 2025.13 of the SEC Financial Reporting Manual](#) and see [Deloitte & Touche Treatise, pages 105-106](#).

³⁸ See footnote 9 above.

include only two years of audited financial statements (and any required unaudited interim financial statements) for the acquired business even if one or more of the percentage tests discussed above exceed 50%. It also scales back the amount of required disclosure under certain circumstances.

Pro Forma Financial Information

Acquisitions. Typically, when a registrant is required to include acquired business financial statements, it must also include pro forma financial information that essentially presents, on an unaudited basis, what the registrant would have looked like had the acquisition(s) occurred at various previous times in the registrant's life cycle.³⁹ This is because [Rule 11-01 of Regulation S-X](#)⁴⁰ requires such inclusion under a variety of circumstances, including when either of the following conditions exists:

- During the most recent fiscal year or subsequent interim period for which a balance sheet is required by [Rule 3-01 of Regulation S-X](#), a significant business⁴¹ combination or an acquisition of an interest in a business accounted for by the equity method has occurred; or
- After the date of the most recent balance sheet filed pursuant to Rule 3-01, consummation of a significant business combination or a combination

³⁹ According to [Section 3210.1 of the SEC Financial Reporting Manual](#) and [Rule 11-02\(a\) of Regulation S-X](#), pro forma financial information is intended to provide investors with information about the continuing impact of a transaction by showing how a specific transaction or group of transactions might have affected historical financial statements, illustrating the scope of the change in the registrant's financial position and results of operations. See generally [Topic 3 \(Sections 3100 et seq.\) – Pro Forma Financial Information in the SEC Financial Reporting Manual](#).

⁴⁰ For smaller reporting companies (see definition in footnote 9 above), see also [Rule 8-05 of Regulation S-X](#) and the textual paragraph associated with footnote 49 below in this subsection on "Acquisitions."

⁴¹ See the text in the paragraph associated with footnote 19 above for a discussion of what constitutes a "business."

of entities under common control has occurred or is probable.⁴²

A business combination is considered significant for this purpose if a comparison of the most recent annual financial statements of the business acquired or to be acquired and the registrant's most recent annual consolidated financial statements filed at or prior to the date of acquisition indicates that any of the three percentage tests discussed in the section above entitled "Financial Statements of Businesses Acquired or to be Acquired" exceeds 20%.⁴³ The pro forma effects of a business combination need not be presented if separate financial statements of the acquired business are not included in the filing.⁴⁴ Also, according to [Sections 3220.1 and 3230.1 of the SEC Financial Reporting Manual](#), pro forma financial statements are not required under certain circumstances when the acquisition is reflected in the historical financial statements of the registrant.

The requirements regarding the period(s) for which pro forma financial statements must be presented and the requirements for their form and content are contained in [Rule 11-02 of Regulation S-X](#). Paragraph (c) of that rule states that:

- 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 Rule

⁴² Deloitte & Touche LLP in August 2009 published a 140-page treatise entitled "[SEC Reporting for Business Combinations and Related Topics – A Roadmap to Applying SEC Regulation S-X to the Acquisition of a Business](#)" that, among other things, discusses Article 11 of Regulation S-X section by section. It provides much greater detail with regard to each section of this Article than the remaining paragraphs of this section and should be studied in connection with any complex questions regarding pro forma financial information.

⁴³ See [Rule 11-01\(b\)\(1\) of Regulation S-X](#) and the text associated with footnotes 22-24 above.

⁴⁴ See [Rule 11-01\(c\) of Regulation S-X](#). Thus, for example, if the registrant omits from its registration statement acquired entity financial statements pursuant to the exception discussed in the text associated with footnote 32 above, it may also omit pro forma financial statements. See [Deloitte & Touche Treatise, page 121](#).

3-01 must be filed unless the transaction is already reflected in that balance sheet;⁴⁵ and

- Pro forma condensed statements of income must be filed for the registrant's most recent fiscal year and for the period from the most recent fiscal year-end to the most recent interim date for which a balance sheet of the registrant is required.⁴⁶

[Rule 11-02\(c\)\(2\)\(i\) of Regulation S-X](#) permits a pro forma condensed statement of income to be filed for the corresponding interim period of the preceding fiscal year;⁴⁷ a pro forma condensed statement of income may not be filed when the registrant's income statement for the last full fiscal year reflects the transaction for the entire year.

According to [Rule 11-02\(c\)\(3\) of Regulation S-X](#), pro forma condensed statements of 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

⁴⁵ According to [Section 3220.2 of the SEC Financial Reporting Manual](#), pro forma adjustments to the balance sheet should be computed assuming the transaction was consummated on the date of the latest balance sheet in the registration statement.

⁴⁶ A pro forma income statement is not required if the transaction is included in the historical financial statements for the appropriate period for which pro forma financial statements are required. Depending on the facts and circumstances, a registrant may be required to include a pro forma income statement (or statements), but would not be required to include a pro forma balance sheet to reflect a business combination. This situation could occur, for example, if an acquisition was consummated during an interim period but before the date of the registrant's balance sheet that is included in the filing. See [Deloitte & Touche Treatise, page 8](#). According to [Section 3230.3 of the SEC Financial Reporting Manual](#), pro forma adjustments to the statement of income should be computed assuming the transaction occurred at the beginning of the fiscal year being presented and carried forward through any interim period presented.

⁴⁷ See [Section 3230.1 of the SEC Financial Reporting Manual](#). Otherwise, according to the [Note to Section 3230.2 of the SEC Financial Reporting Manual](#), the SEC staff, other than within specified exceptions, generally objects to retroactive pro forma presentation of transactions for periods other than the last year and interim period.

registrant's most recent fiscal year-end by more than 93 days, the other entity's income statement must be brought up to within 93 days of the registrant's most recent fiscal year-end, if practicable. This updating can 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 that were excluded from or included more than once in the condensed pro forma income statements (e.g., an interim period that is included both as part of the fiscal year and the subsequent interim period).

In combining the financial statements of the registrant and an acquired business, the company often must make adjustments to the numbers to report more faithfully the combined operating results. Pro forma financial statements are generally presented in comparative columnar form, with separate columns for the historical financial information, the pro forma adjustments and the pro forma combined results. Registrants or their investment bankers often will wish to reflect synergies resulting from the acquisition. Whether any adjustments of this type can be made will be a "facts and circumstances" test, and it will be important to consult the registrant's accountants on what the SEC might be willing to consider as acceptable adjustments.⁴⁸

⁴⁸ [Section 3210.2 of the SEC Financial Reporting Manual](#) states that "pro forma financial information should illustrate only the isolated and objectively measurable (based on historically determined amounts) effects of a particular transaction, while excluding effects that rely on highly judgmental estimates of how historical management practices and operating decisions may or may not have changed as a result of that transaction. Information about the possible or expected impact of current actions taken by management in response to the pro forma transaction, as if management's actions were carried out in previous reporting periods, is considered a projection and not an objective of [[Article 11 of Regulation S-X](#)]. Presentation of forward-looking and projected information should be confined to supplemental information separately identified as such (information that is not required or contemplated by Article 11) and in [the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of the prospectus]. [Section 3220.3 of the SEC Financial Reporting Manual](#) goes on to say that balance sheet adjustments should give effect to events that are directly attributable to each (footnote continued on next page)

Also, pursuant to [Rule 11-02\(c\)\(4\) of Regulation S-X](#), whenever unusual events enter into the determination of the results shown for the most recently completed fiscal year, the registrant must disclose the effect of those unusual events and consider presenting a pro forma condensed income statement for the most recent twelve-month period in addition to the periods otherwise required if the most recent twelve-month period is more representative of normal operations.

Under [Item 11\(e\) of Form S-1](#), smaller reporting companies⁴⁹ may elect to provide pro forma financial information in accordance with [Rule 8-05 of Regulation S-X](#) in lieu of the information required by [Article 11 of Regulation S-X](#).⁵⁰ Rule 8-05 provides that pro forma information showing the effects of an acquisition must be furnished if financial statements of a business acquired or to be acquired are presented. It also provides that the pro forma statements should be condensed, in columnar form showing pro forma adjustments and results, and should include the following:

specific transaction and [factually supportable](#) and include those items that have continuing impact as well as those that are non-recurring. [Section 3230.4 of the SEC Financial Reporting Manual](#) states that income statement adjustments must give effect to events that are: [directly attributable](#) to each specific transaction, [factually supportable](#), and expected to have a [continuing impact](#). [Sections 3230.4, 3250 and 3310 and other sections of the SEC Financial Reporting Manual](#) provide substantial additional detail on appropriate adjustments, both generally and in particular circumstances. See [Deloitte & Touche Treatise, pages 121-129](#), for a discussion of pro forma presentation requirements.

⁴⁹ See definition in footnote 9 above.

⁵⁰ The lead-in paragraph to [Topic 3 \(Pro Forma Financial Information\) of the SEC Financial Reporting Manual](#) says that: “[a]lthough the specific rules of S-X Article 11 do not apply to smaller reporting companies, those registrants can consult [[Article 11 of Regulation S-X](#)] for guidance when preparing pro forma financial statements required by [[Rule 8-05 of Regulation S-X](#)] for business acquisitions. Smaller reporting companies should present pro forma information for other current or probable transactions if that presentation would be material to investors.” See also the final sentence of [Section 1410.1 of the SEC Financial Reporting Manual](#).

- If the transaction was consummated during the most recent fiscal year or subsequent interim period, pro forma statements of income reflecting the combined operations of the entities for the latest fiscal year and interim period, if any; or
- If consummation of the transaction has occurred or is probable after the date of the most recent balance sheet required by [Rule 8-02](#) or [8-03 of Regulation S-X](#), a pro forma balance sheet giving effect to the combination as of the date of the most recent balance sheet and pro forma statements of income reflecting the combined operations of the entities for the latest fiscal year and interim period, if any.

Pro forma financial information may also be required, where material, for changes in the registrant's capitalization at the effectiveness or closing of an IPO, receipt or application of offering proceeds by the registrant under certain circumstances or other events and transactions that have had or will have a discrete material impact on the registrant's financial statements.⁵¹

[Section 3240 of the SEC Financial Reporting Manual](#) provides detailed information as to the form that pro forma financial information should take.

Dispositions. [Rule 11-01\(a\)\(4\) of Regulation S-X](#) generally requires that, when (i) a registrant disposes of a significant portion of a business (by sale, abandonment, or distribution to stockholders by means of a spin-off, split-up or split-off) or such a disposition is probable, (ii) the disposition is not fully reflected in the registrant's financial statements included in the filing and (iii) any of the three percentage calculations set forth above in the text accompanying footnotes 22-24 yields a result in excess of 10%, the registrant must include in its prospectus and registration statement pro forma financial

⁵¹ See [Sections 3160.1, 3320.1, 3320.2 and, for "special applications," 3400 of the SEC Financial Reporting Manual](#).

statements reflecting the disposition.⁵² According to [Section 3220.1 of the SEC Financial Reporting Manual](#), a pro forma balance sheet is not required if the disposition is already reflected in an historical balance sheet.

Selected and Summary Financial Data

Selected Financial Data. [Item 11\(f\) of Form S-1](#) and [Item 301 of Regulation S-K](#) require registrants, other than smaller reporting companies,⁵³ to furnish in comparative columnar form, for each of the last five fiscal years of the registrant (or for the life of the registrant and its predecessors⁵⁴ if less) and for any additional fiscal years necessary to keep the information from being misleading, a financial data table including at least the following consolidated⁵⁵ financial items (subject to appropriate variation to conform to the nature of the registrant's business):

- net sales or operating revenues;
- income (loss) from continuing operations;
- income (loss) from continuing operations per common share;
- total assets;
- long-term obligations and redeemable preferred stock (including long-term debt, capital leases and

⁵² [Section 3120.1 of the SEC Financial Reporting Manual](#) states that pro forma financial information may be necessary, if the disposition is material, even if disposed operations do not satisfy the criteria of [Statement of Financial Accounting Standards No. 144](#) (ASC 205-20) for a discontinued operation. See [Instruction 3 of Rule 11-02 of Regulation S-X](#) for certain information regarding the form and content of disposition pro forma financial statements.

⁵³ A registrant that qualifies as a smaller reporting company (see definition in footnote 9 above) need not provide the information required by Item 301 (see [Item 301\(c\)](#)), but its underwriters may well wish it to include this information because of the ubiquity of such information in prospectuses generally and its usefulness to potential investors.

⁵⁴ See definition in footnote 12 above.

⁵⁵ See [Instruction 3 to Item 301 of Regulation S-K](#).

redeemable preferred stock as defined in [Rule 5-02.27\(a\) of Regulation S-X](#)); and

- cash dividends declared per common share.⁵⁶

[Instruction 4 of Item 301](#) also asks registrants to consider, where interim period financial statements are included or required to be included by [Article 3 of Regulation S-X](#), whether any or all of the selected financial data need to be updated for those interim periods to reflect a material change in the trends indicated. Where such updating information is necessary, the registrant must provide information on a comparative basis unless it is not necessary to an understanding of the updating information. Registrants also typically indicate, in the introduction to the table, the sources of all data (e.g., audited annual financial statements⁵⁷ or unaudited interim financial statements). If interim period financial data are included, registrants will typically state that all necessary adjustments have been made to the interim financial statements and that interim data are not indicative of future results. Note that Item 301 of Regulation S-K does not require that the data included in the table be derived from audited financial statements. However, a registrant will need to satisfy the marketing- and liability-based requirements of their underwriters. Audited financial statements for the three most recent fiscal years of the registrant will be included in the “F” pages of the prospectus, but the registrant may not have audited one or both of the first two years required in the five-year table. If that is the case and the registrant does not wish to undertake the time and expense commitment for auditing the oldest years, it should negotiate with the underwriters prior to their selection when the registrant will have maximum leverage to win this concession.

Because the purpose⁵⁸ of the “Selected Financial Data” section is to supply in a convenient and readable format selected

⁵⁶ Most of our IPO registrants have never declared a cash dividend and state this in the “Dividend Policy” section of the prospectus rather than showing zeroes or dashes in the selected financial data table.

⁵⁷ See [Section 4870.1 of the SEC Financial Reporting Manual](#).

⁵⁸ See [Instruction 1 to Item 301 of Regulation S-K](#).

financial data that highlight certain significant trends in the registrant's financial condition and results of operations, registrants are explicitly permitted to include items, in addition to those listed in the bullet points above, that they believe would enhance an understanding of and would highlight other trends in their financial condition and results of operations.⁵⁹ Most registrants elect to include in their table full or slightly condensed statements of income/operations for their last five fiscal years and for the same stub periods for which interim information is provided in the financial statement pages as required by [Rules 3-01 and 3-02 of Regulation S-X](#). Most registrants also elect to include, in addition to the required balance sheet data, information regarding cash and cash equivalents and working capital, and many will provide additional categories of balance sheet information.

[Instruction 2 of Item 301 of Regulation S-K](#) also requires registrants to describe briefly, or cross reference to a discussion elsewhere of, factors such as accounting changes, business combinations or dispositions of business operations that materially affect the comparability of the information reflected in selected financial data. In addition, it requires them to discuss, or make reference to, any material uncertainties where those matters might cause the data reflected in the required table not to be indicative of the registrant's future economic condition or results of operations.

Summary Financial Data. An IPO prospectus and registration statement will typically also have a prospectus summary designed in part to respond to [Item 503\(a\) of Regulation S-K](#) and more generally to provide a summary of the most important textual and financial information contained in the remainder of the prospectus. That summary will usually include a page of summary financial statement data that may be as complete as the selected financial data section or that condenses the income statement and perhaps reduces the number of years presented from five to three or four depending on what the underwriters view as potentially most advantageous for the company's efforts to sell its

⁵⁹ See the last sentence of the first paragraph of [Instruction 2 to Item 301 of Regulation S-K](#).

stock. It may also show selected quarterly financial data over one or more fiscal years. In addition, it typically shows pro forma balance sheet data that reflect the automatic conversion of the registrant's convertible preferred stock that will occur on the closing of the offering and pro forma as adjusted balance sheet data that also give effect to the offering and the application of the proceeds therefrom.⁶⁰ The summary has no SEC-specified requirements; thus, its content is constrained only by the antifraud provisions under the Securities Act and the Exchange Act.

Non-GAAP⁶¹ Financial Information

Many registrants choose to include non-GAAP financial measures⁶² in their IPO prospectus and registration statement. The SEC is generally not enthusiastic about non-GAAP financial measures, and will permit their inclusion only if a variety of conditions set forth in [Item 10\(e\) of Regulation S-K](#) are met. According to [Item 10\(e\)\(2\)](#), a non-GAAP financial measure is a numerical measure of a registrant's historical or future financial performance, financial position or cash flows that:

- Excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the most directly comparable measure

⁶⁰ See [Sections 3160.1, 3320.1 and 3320.2 of the SEC Financial Reporting Manual](#).

⁶¹ GAAP refers to generally accepted accounting principles in the United States, except that, in the case of foreign private issuers whose primary financial statements are prepared in accordance with non-U.S. generally accepted accounting principles, GAAP typically refers to the principles under which those primary financial statements are prepared. See [Item 10\(e\)\(3\) of Regulation S-K](#).

⁶² That is, financial measures that are not prepared in accordance with generally accepted accounting principles as defined in the previous footnote. Some common examples of non-GAAP financial measures include funds from operations (FFO), EBITDA/Adjusted EBITDA, adjusted revenues and free cash flow (FCF). See generally [Topic 8 \(Non-GAAP Measures of Financial Performance, Liquidity, and Net Worth\) of the SEC Financial Reporting Manual](#) and the other SEC sources identified in the final paragraph of this section on "Non-GAAP Financial Information."

calculated and presented in accordance with GAAP in the statement of income, balance sheet or statement of cash flows (or equivalent statements) of the company; or

- Includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the most directly comparable measure so calculated and presented.

The term “non-GAAP financial measures” explicitly excludes⁶³:

- operating and other statistical measures;⁶⁴ and
- ratios or statistical measures calculated using exclusively one or both of:
 - Financial measures calculated in accordance with GAAP; and
 - Operating measures or other measures that are not non-GAAP financial measures.⁶⁵

Non-GAAP financial measures also exclude financial measures required to be disclosed by GAAP, SEC rules, or a system of regulation of a government or governmental authority or self-regulatory organization that is applicable to the registrant.⁶⁶ However, the financial measure should be presented outside of the financial statements unless the financial measure is required or expressly permitted by the standard-setter that is responsible for establishing the GAAP used in the financial statements.

⁶³ See [Item 10\(e\)\(4\) of Regulation S-K](#).

⁶⁴ E.g., unit sales, number of employees, or number of subscribers.

⁶⁵ E.g., dollar revenues per square foot for hotels, same store sales, and revenues per slot machine for casinos, assuming that sales or revenues in each case are based on GAAP numbers.

⁶⁶ See [Item 10\(e\)\(5\) of Regulation S-K](#).

If a registrant includes a non-GAAP financial measure in its filing, pursuant to [Item 10\(e\)\(1\) of Regulation S-K](#), it must also include the following in the filing:

- A presentation, with equal or greater prominence, of the most directly comparable financial measure or measures calculated and presented in accordance with GAAP;
- A reconciliation (by schedule or other clearly understandable method), which must be quantitative for historical non-GAAP measures presented, and quantitative, to the extent available without unreasonable efforts, for forward-looking information, of the differences between the non-GAAP financial measure disclosed with the most directly comparable financial measure or measures calculated and presented in accordance with GAAP in response to the requirement in the previous bullet point;⁶⁷
- A statement disclosing the reasons why the registrant's management believes that presentation of the non-GAAP financial measure provides useful information to investors regarding the registrant's financial condition and results of operations; and
- To the extent material, a statement disclosing the additional purposes, if any, for which the registrant's management uses the non-GAAP financial measure that are not disclosed in response to the requirement in the previous bullet point.

A registrant is prohibited from:

⁶⁷ [Section 8130 of the SEC Financial Reporting Manual](#) suggests that performance measures should generally be reconciled to net income and liquidity measures should generally be reconciled to cash flows from operating activities.

- Excluding charges or liabilities that required, or will require, cash settlement, or would have required cash settlement absent an ability to settle in another manner, from non-GAAP liquidity measures, other than the measures earnings before interest and taxes (EBIT) and earnings before interest, taxes, depreciation and amortization (EBITDA);
- Adjusting a non-GAAP performance measure to eliminate or smooth items identified as non-recurring, infrequent or unusual, when the nature of the charge or gain is such that it is reasonably likely to recur within two years or there was a similar charge or gain within the prior two years;
- Presenting non-GAAP financial measures on the face of the registrant’s financial statements prepared in accordance with GAAP or in the accompanying notes;
- Presenting non-GAAP financial measures on the face of any pro forma financial information required to be disclosed by [Article 11 of Regulation S-X](#); or
- Using titles or descriptions of non-GAAP financial measures that are the same as, or confusingly similar to, titles or descriptions used for GAAP financial measures.

Other sources of valuable interpretations regarding non-GAAP financial information are [SEC Release No. 33-8176 \(January 22, 2003\)](#), the [SEC Division of Corporation Finance’s Compliance Disclosure and Interpretations \(“CD&I”\) entitled “Non-GAAP Financial Measures,”](#) published in January 2010, and [Topic 8 \(Non-GAAP Measures of Financial Performance, Liquidity and Net Worth\) in the SEC Financial Reporting Manual.](#) The SEC’s website still continues to include the following interpretations, but they may have been superseded by the recently published CD&I referenced above in this paragraph: the SEC’s FAQ entitled [“Frequently Asked Questions Regarding the Use of Non-GAAP Financial Measures”](#) and the SEC’s [“Division of](#)

[Corporation Finance: Frequently Requested Accounting and Financial Reporting Interpretations and Guidance](#)” (click on “II.C. Disclosure of Non-GAAP Measures Such as ‘EBITDA’” in the “Contents” section of the page to which this link leads).⁶⁸

Capitalization

There is no SEC requirement to include a capitalization section in an IPO prospectus or registration statement; however, substantially all IPO prospectuses and many follow-on offering prospectuses do include a capitalization table and explanatory information about it in a separate section entitled “Capitalization.” Normally, the capitalization table will be as of the date of the registrant’s most recent balance sheet (whether audited or unaudited) included in the prospectus and will include the entire stockholders’ equity section of that balance sheet in at least as much detail as is shown on the balance sheet, as well as the registrant’s long-term obligations (debt, capital lease obligations, redeemable preferred stock, etc.) and oftentimes the registrant’s cash and cash equivalents. The debt may be presented in greater detail than is contained on the balance sheet, using information such as interest rates and maturity dates contained in the financial statement footnotes.

The capitalization table will typically include two or three numerical columns. The column on the left will contain the actual (historical) numbers from the registrant’s most recent balance sheet. If there is a middle column, it will typically match the “pro forma” column of the registrant’s balance sheet in the “F” pages and will reflect such items as the conversion of the registrant’s convertible preferred stock into common stock that will occur automatically on the closing of the IPO. The right-hand column will then take the pro forma column (or the “actual” column if there is no pro forma column) and adjust it to reflect offering-related items, such as the net proceeds raised in the IPO⁶⁹ and any

⁶⁸ Note that this set of interpretations pre-dates the current rules in [Item 10\(e\) of Regulation S-K](#); so use these interpretations with extra caution.

⁶⁹ See [Sections 3160.1\(c\)-\(e\), 3320.1 and 3320.2 of the SEC Financial Reporting Manual](#).

immediate uses of those proceeds that impact the capitalization table (e.g., repayment of long-term debt). Ordinarily the capitalization table will be preceded by a textual description of the adjustments made in the table and followed by a series of bullet points that describe outstanding equity instruments, such as options and warrants, that are not reflected in the historical balance sheet and capitalization table. In the preliminary prospectus, the table will typically indicate, by footnote or otherwise, how the pro forma as adjusted cash and cash equivalents, additional paid-in capital, total stockholders' equity and total capitalization would be affected if the IPO price increases or decreases by \$1.00 from the mid-point of the price range shown on the preliminary prospectus cover page, the price on which the pro forma as adjusted column in the table is based.

Dilution

[Item 6 of Form S-1](#) and [Item 506 of Regulation S-K](#) require two different dilution tables in an IPO prospectus and registration statement. First, there is a table showing either the estimated or the actual IPO price,⁷⁰ the pro forma net tangible book value (tangible assets less liabilities) per share of the registrant as of the date of the most recent balance sheet (whether audited or unaudited) included in the prospectus, the pro forma net tangible book value per share of the registrant as of that date adjusted for the IPO proceeds and the number of shares sold in the IPO, and the differences between that adjusted pro forma net tangible book value per share and each of the estimated (or actual) IPO price and the pro forma net tangible book value per share. The former difference is deemed to be the “dilution” that will be absorbed by new investors in the IPO, and the latter is deemed to be the increase in net tangible book value per share that is attributable to the cash payments made by those new IPO investors. The registrant’s balance sheet may or may not contain sufficient detail

⁷⁰ The table uses the estimated IPO price (mid-point of the price range on the prospectus cover page) in the preliminary prospectus and the actual IPO price in the final prospectus.

to identify all of the registrant's intangible assets.⁷¹ Thus, it will be necessary to discuss with the registrant and its accountants whether intangible assets exist besides those, such as "goodwill" or "intangible assets," ordinarily shown separately on the face of the balance sheet.

The second table in the "Dilution" section typically shows, for both existing stockholders and for new investors in the IPO, the number of shares that they purchased, the percentage that those shares represent of the registrant's total shares outstanding after the IPO, the total dollars paid for the shares purchased, the percentage that those dollars represent of the total dollars paid for all of the registrant's shares outstanding after the IPO and the average price paid per share. That table is typically followed by an explanation of items, such as outstanding options and warrants, not included in the calculations. Depending on whether the underwriters' over-allotment option is provided by the registrant, the selling stockholders or both and depending on the terms of the outstanding options and warrants, there may be further text providing information regarding incremental dilution from exercise of the over-allotment option or of outstanding options or warrants.

Quarterly Financial Data

[Item 11\(g\) of Form S-1](#) requires a registrant to include in its prospectus and registration statement the information required by [Item 302 of Regulation S-K](#). Item 302(a)(5) of Regulation S-K, however, indicates that the requirements of Item 302(a) do not apply to a registrant until it is a public company.⁷² Thus, while most IPO prospectuses include quarterly information for marketing reasons, the registrant has the flexibility to include more or fewer quarters than the eight specified in Regulation S-K and can provide greater or lesser detail than required by Item 302. The anti-fraud rules would, of course, still apply to the choices made by the registrant.

⁷¹ See [Sections 8320 and 8330 of the SEC Financial Reporting Manual](#) for a discussion of what intangible assets should be excluded in calculating net tangible book value.

⁷² See [Section 4420.1 of the SEC Financial Reporting Manual](#).

Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

[Item 11\(i\) of Form S-1](#) and [Item 304 of Regulation S-K](#) mandate disclosure regarding changes in or disagreements with accountants on accounting and financial disclosure. If such a change or disagreement has occurred within the time frame specified in Item 304,⁷³ refer to that Item and [Item 4500 of the SEC Financial Reporting Manual](#).

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⁷³ See [Item 211.01 of the SEC's CD&I on Regulation S-K](#).