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Crisis Averted

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Overview

At the July 20, 2017, meeting of the Emerging Issues Task Force (EITF), and in response to concerns expressed by accountants, registrants, and other stakeholders, the SEC staff provided significant relief to registrants that are required to include financial statements or financial information of other reporting entities in their SEC filings. Specifically, the SEC staff announced¹ that it would not object to elections by certain public business entities (PBEs) to use the non-PBE effective dates for the sole purpose of adopting the FASB's new standards on revenue (ASC 606²) and leases (ASC 842).

The staff announcement makes clear that the ability to use non-PBE effective dates for adopting the new revenue and leases standards is limited to the subset of PBEs "that otherwise would not meet the definition of a public business entity except for a requirement to include or inclusion of its financial statements or financial information in another entity's filings with the SEC" (referred to herein as "specified PBEs").

While the staff announcement is written in the context of specified PBEs, the principal beneficiaries of the relief will be SEC filers that include financial statements or financial information prepared by specified PBEs in their own filings, for example, under the following SEC Regulation S-X rules:

- Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired."

¹ Readers should monitor the FASB's [Web site](#) for the minutes of the EITF meeting, which are expected to include a transcript of the announcement.

² For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's "[Titles of Topics and Subtopics in the FASB Accounting Standards Codification.](#)"

- Rule 3-09, “Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons.”
- Rule 3-14, “Special Instructions for Real Estate Operations to Be Acquired.”
- Rule 4-08(g), “Summarized Financial Information of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons.”

Although the staff announcement does not address the FASB’s new standard on credit losses (ASC 326), as explained in more detail [below](#), the effective-date guidance in ASC 326 is similar to the ASC 606 and ASC 842 effective-date guidance available to specified PBEs as a result of the SEC staff announcement. Accordingly, it was not necessary for the SEC staff to include ASC 326 within the scope of the announcement.

Background

Under ASC 606 and ASC 842, there is one adoption date for PBEs and another (later) adoption date for non-PBEs.³

The ASC master glossary defines a PBE, in part, as a business entity that is “required by the [SEC] to file or furnish financial statements, or [that] does file or furnish financial statements (including voluntary filers), with the SEC **(including other entities whose financial statements or financial information are required to be or are included in a filing)**” (emphasis added). The definition further states that “[a]n entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity’s filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.”

Before the staff’s announcement, the use of the PBE definition in the adoption-date criteria would have required certain nonpublic companies to apply the public-company adoption dates under ASC 606 and ASC 842. While the SEC staff announcement provides considerable and welcome relief to registrants preparing to adopt ASC 606 and ASC 842, it is purposely narrow in scope and should not be applied by analogy to the adoption-date assessment for any other standard. The SEC staff announcement does not preclude specified PBEs from adopting the provisions of ASC 606 and ASC 842 on the adoption date applicable to all other PBEs if a specified PBE desires to use the PBE adoption date.

Example

Company A, a publicly traded manufacturer, holds equity method investments in three of its nonpublic suppliers. On the basis of applying the Regulation S-X significance tests, Company A has determined that it must include summarized financial information for Suppliers X, Y, and Z (under Regulation S-X, Rule 4-08(g)) in its SEC filing. Suppliers X, Y, and Z meet the definition of a PBE only because of the required inclusion of their financial information in Company A’s SEC filing (i.e., they qualify as specified PBEs). Consequently, Suppliers X, Y, and Z plan to use the non-PBE adoption dates of ASC 606 and ASC 842 for their own stand-alone financial statement preparation purposes. When including the summarized financial information of Suppliers X, Y, and Z in its own SEC filing, Company A is not required to adjust the suppliers’ financial statements to reflect the PBE adoption date of ASC 606 and ASC 842.

³ ASC 606-10-65-1 indicates that PBEs and certain other specified entities must adopt ASC 606 for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. All other entities must adopt it for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. ASC 842-10-65-1 indicates that PBEs and certain other specified entities must adopt ASC 842 for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. All other entities must adopt it for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.



Connecting the Dots

When certain significant tests required by Regulation S-X have been met, a registrant's SEC filing may be required to include the financial statements or financial information of another entity. We believe that, in a manner consistent with paragraph 11120.2 of the SEC Division of Corporation Finance's [Financial Reporting Manual](#), it is also appropriate for the registrant to use financial information prepared by specified PBEs that apply non-PBE adoption dates when performing these significance tests. However, on the basis of paragraph 11120.3 of the Financial Reporting Manual, if pro forma financial information is being prepared under Regulation S-X, Article 11,⁴ to reflect the acquisition of a significant business, the registrant must still conform the target's transition dates and methods of adoption to its own in the pro forma presentation for the periods after adoption of ASC 606.⁵

Adoption of ASC 326 (Current Expected Credit Losses)

Like ASC 606 and ASC 842, ASC 326 provides staggered effective dates for preparers of financial statements. Unlike ASC 606 and ASC 842, ASC 326's transition provisions are not based exclusively on the PBE definition but distinguish between "public business entities that meet the definition of [an SEC] filer" and "public business entities that do not meet the definition of an SEC filer." Entities in the latter category have an additional year to adopt the provisions of ASC 326.⁶ ASC 326-10-20 defines an SEC filer as follows:

An entity that is required to file or furnish its financial statements with either of the following:

- a. The [SEC]
- b. With respect to an entity subject to Section 12(i) of the Securities Exchange Act of 1934, as amended, the appropriate agency under that Section.

Financial statements for other entities that are not otherwise SEC filers whose financial statements are included in a submission by another SEC filer are not included within this definition. [Emphasis added]

On the basis of the above definition, the effective date guidance in ASC 326 is similar to the relief provided for specified PBEs in the SEC staff announcement. Accordingly, it was not necessary for the SEC staff to include ASC 326 within the scope of the announcement.

⁴ SEC Regulation S-X, Article 11, "Pro Forma Financial Information."

⁵ See the [appendix](#) of this *Heads Up* for relevant excerpts from the SEC's Financial Reporting Manual.

⁶ ASC 326-10-65-1 requires PBEs that meet the definition of an SEC filer to adopt ASC 326 for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. PBEs that do not meet the definition of an SEC filer must adopt ASC 326's provisions for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. All other entities within the scope of ASC 326 must adopt its provisions for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021.

Appendix — Relevant Excerpts From the SEC’s Financial Reporting Manual

Paragraphs 11120.2 and 11120.3 of the SEC’s Financial Reporting Manual are reproduced below.

11120.2

Question

A registrant adopts the new revenue standard as of a different date and/or under a different transition method than the other entity. For example, a calendar year-end registrant adopts the new revenue standard on January 1, 2018, but its equity-method investee adopts it on January 1, 2017. Must the registrant conform the other entity’s transition dates and methods to its own for purposes of performing the significance tests under Regulation S-X to determine whether financial statements (or financial information) of the other entity need to be included with the financial statements of the registrant?

Answer

No. The registrant need not conform the transition dates and methods for significance testing under Regulation S-X.

11120.3

Question

A registrant adopts the new revenue standard as of a different date and/or under a different transition method than a significant acquired business. Must the registrant conform the other entity’s transition dates and methods to its own in its Article 11 pro forma financial information?

Answer

Yes.

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