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On the Radar

SEC Reporting Considerations for Equity Method Investees

SEC registrants may have equity method investments, including those accounted for under the fair value option or hypothetical liquidation basis. In their filings with the SEC, they are required to provide financial information about any significant equity method investees. Therefore, such registrants must consider whether to provide financial information about such investee in any report filed with the SEC that includes their own financial statements.

Evaluating Equity Method Investments

A registrant is required to identify all investments accounted for under the equity method. For each of those investments, it should measure their significance by using the applicable tests and thresholds under SEC Regulation S-X, Rules 3-09, 4-08(g), and 10-01(b)(1). If an equity method investee is considered significant to a registrant, the registrant may be required to provide either or both of the following:

1. Separate financial statements of the investee.
2. Summarized financial information of the investee in the footnotes to the registrant's financial statements.

The registrant may also need to provide summarized income statement information in its interim financial statements.

Level of Significance

The amount of information a registrant must present about an investee depends on the investee's significance level. To determine the significance level, a registrant performs the applicable tests (as indicated below) for each equity method investee individually and, in certain cases, for all such investees in the aggregate:

- *The investment test* — The registrant's and its other subsidiaries' investments in and advances to the tested equity method investment are compared with the total consolidated assets of the registrant as of the end of the most recently completed fiscal year.
- *The asset test* — The registrant compares its share of the investee's assets with the registrant's consolidated total assets. Such amounts are generally as of the most recently completed fiscal year for both the investee and the registrant.
- *The income test* — The test has two components:
  - *Income component* — The absolute value of the registrant's proportionate share of the investee's pretax income or loss from continuing operations is compared with the absolute value of the registrant's own pretax income or loss from continuing operations.
  - *Revenue component* — If both the registrant and the investee have material revenue in each of the two most recently completed fiscal years, the revenue component is calculated by comparing the registrant's proportionate share of the investee's revenue with the registrant's revenue. The determination of whether the investee has material revenue is separate from the determination of whether the registrant has material revenue.

  An investee will only be considered significant under the income test if both the income component and the revenue component (if applicable) exceed the significance threshold. When both components exceed the significance threshold, the lower of the income or revenue component is used to determine significance in accordance with the income test.

The test that results in the highest significance level will be used to establish the financial reporting requirements. A registrant may use the following table to determine which information must be presented:

Information to Present	Applicable Period	Individually	Aggregate	Significance Test	Percentage Significant
Separate financial statements	Annual	X		• Investment • Income	>20%
Summarized financial information	Annual	X	X	• Investment • Income • Asset	>10%
Summarized income statement information	Interim	X		• Investment • Income	>20%

The SEC staff may issue comments related to how a registrant complied with SEC rules and ask the registrant to provide the calculations it used in performing the significance tests.

Separate Financial Statements

When separate financial statements of the investee are required, a registrant must present such statements as of and for the same periods as the registrant's financial statements unless the registrant did not account for the investment by using the equity method for the whole period for which its financial statements are required. In such cases, the investee's financial statements should only be presented for the periods in which the investee was accounted for under the equity method, which may result in partial-year financial statements.

The financial statements for the period in which the significance test has been met must also be audited by an accountant that is independent under SEC rules. The audits can typically be performed in accordance with AICPA standards, but in some instances PCAOB standards apply.

The form and content of the financial statements, including the schedule requirements, must comply with Regulation S-X.

Summarized Financial Information

Under SEC rules, to determine whether it must provide summarized financial information in its annual financial statements, the registrant performs the applicable significance tests on all equity method investees individually and as part of an aggregated group.

When deemed significant under the applicable tests, the registrant's annual financial statements must include summarized financial information for all equity method investees. Such information should not be labeled "unaudited."

To determine whether it must provide summarized income statement information in its interim financial statements, the registrant performs the applicable significance tests for each equity method investee individually. The registrant's interim financial statements must include summarized income statement information of an equity method investee only if the investee is significant to the registrant during the interim period.

When acquiring an equity interest in an entity, the registrant may want to incorporate the ongoing SEC reporting requirements related to equity method investees into the purchase agreement to ensure that the investee will be able to make the required financial information available within the timeline required by such rules.

Other Considerations

In addition to the requirements discussed above, a registrant should consider the following:

- If it reports a discontinued operation retrospectively, the registrant will need to reevaluate the significance of its equity method investees for all periods.
- It may wish to ask the SEC for a waiver if an equity method investee becomes significant because of unusual circumstances.
- Smaller reporting companies have different reporting requirements related to significant equity method investments.
- The separate financial statements of a significant equity method investee may be included in the annual report filed by the registrant or in an amendment to the annual report depending on a number of considerations, including the equity method investee's year-end and filing status and whether the investee is a foreign business.

- When applying the income test to equity method investees for which a registrant has elected the fair value option in accordance with ASC 825-10-15-4, the registrant should calculate the income and revenue components as follows:
    - *Income component* — Determine by using the change in fair value of the investee reflected in the registrant's income statement.
    - *Revenue component* — Determine by using the registrant's proportionate share of the investee's revenue (i.e., the registrant's ownership interest in the investee multiplied by the investee's revenue).

Deloitte's Roadmap *SEC Reporting Considerations for Equity Method Investees* provides comprehensive guidance on this topic. For guidance on the U.S. GAAP requirements related to equity method investees, see Deloitte's Roadmap *Equity Method Investments and Joint Ventures*.

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