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Rule Affects Public Companies with Private Company Investments

Public companies with investments in private companies—accounted for under the equity method—risk inadequate Securities and Exchange Commission filings under certain scenarios.

''If a public company owns a significant amount—usually about 20 percent or more—in a private company and accounts for the investment using the equity method because it has significant influence, the relationship with the public company would require the private company to adopt the new revenue standard,'' Beth Paul, a partner in PwC's National Professional Services Group, told Bloomberg BNA June 14.

''You might think you're a private company because you have no public equity, no public debt, but the FASB defines a public business entity as an entity whose financial information is in an SEC filing,'' Paul said.

On SEC's Radar The equity method is an accounting technique used by companies to assess the profits companies earned by their investments in other companies. For public companies, if those investments in private companies spark a deficiency filing— meaning incomplete or untimely—by the SEC, they can lose their eligibility to use short form registration statements and can't use those quick forms to access the capital market. This can have a negative effect on a company's share value.

The issue, also raised June 12 at the Practising Law Institute's financial reporting conference in New York, is on the Securities and Exchange Commission's radar. ''We're aware of the issue,'' SEC deputy chief accountant Sagar Teotia said. ''And so we're working through it as well because obviously there's a lot of different moving parts and elements to it, but we haven't yet concluded on it.''

Among concerns, panelists said, are the technicalities and nuances of the issue. ''A company that has lots of equity investments, may have 20, 30 equity investments, they may not know until the end of the year whether any will trip the test, and so this becomes a very difficult process,'' Linda Griggs, a consultant at global law firm Morgan, Lewis & Bockius, said during the discussions.

Public companies could face significant resistance from those equity method investees, who might refuse to apply the rules early, which might bring the public company in violation of SEC rules, said Griggs.

Public Company Definition Sparks Issue The new revenue standard, Revenue from Contracts with Customers, ASC 606, takes effect Jan. 1, 2018 for public companies, but private companies have until 2019 to begin applying it.

The standard, one of the most historic financial reporting changes, requires massive effort for some companies to adopt because of the systems changes and analysis it requires. Assessing the adoption process is timely and can incur costs for some companies. Impacts generally vary based on specifics of a company, for example, types of contracts, size of the organization.

A private company would be considered public, and therefore would have to adopt the revenue rules next year, if it's required by the SEC to file or furnish financial statements or if it files or furnishes financial statements, according to the definition of a public company under generally accepted accounting principles (GAAP). This includes voluntary filers with the Securities and Exchange Commission and other entities whose financial statements or financial information are included in the filing.

''In many cases the interest accounted for by the equity method would be immaterial to the public company and it would not matter if the private company adopted the revenue recognition standard or not,'' Judith O'Dell, of O'Dell Valuation Consulting CPA LLC, told Bloomberg BNA. ''But that might not always be the case,'' said O'Dell, a former chair of the private company body that helps the Financial Accounting Standards Board craft private company accounting.

Various Rules Collide If the private company that fits the fact pattern of a public company, doesn't know it has to adopt the rules at the same time as a public company, this would have repercussions for the public company that has invested in it, practitioners said. This is because Regulation S-X rule 3-09 requires public companies to include in their filings a separate audited financial statement for significant investments that are accounted for under the equity method.

For equity investees at the 10 percent to 20 percent level, summary financial information may be required under Regulation S-X 4-08(g). ''If the public company couldn't get what they need to file with the SEC, then they would need to talk to securities council because once the deadline passed and they didn't have the financial statements that they needed to file, they would have a deficient filing absence some sort of waiver from the SEC,'' said PwC's Paul.

Some private companies, irritated by the hassle of new accounting, might put up some resistance, practitioners told Bloomberg BNA. ''I would think that they would want to come up with an argument to delay revenue recognition adoption and I doubt the private company CFO would know—unless they have a penchant for reading FASB's rules,'' Wayne Spivak, president and chief financial officer at New York-based SBA Consulting Ltd, said.

''If they know, it will probably be because of the public company CFO/CPA firm that informs them, because I'm sure as part of the audit is a check mark that all subsidiaries are following GAAP.''

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