New Revenue Recognition Rules Could Create a Speed Bump for Offerings in 2018

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New revenue recognition rules (ASC 606 and IFRS 15) are required to be adopted by most public companies starting January 1, 2018 and most private companies starting January 1, 2019. These changes are widely regarded as some of the most significant accounting changes since the adoption of the Sarbanes-Oxley Act of 2002. Companies may choose between the full retrospective method and the modified retrospective method to implement the new rules.

- Companies implementing with the full retrospective method must revise and reissue fiscal 2016 and 2017 financial statements in connection with their Form 10-K for 2018
- Companies implementing with the modified retrospective method need not reissue prior periods but must instead provide additional footnote disclosure and record the cumulative effect of the change in opening retained earnings on January 1, 2018

As discussed below, companies electing to use the full retrospective method may find their ability to access the capital markets delayed until they have revised and reissued all required prior periods.

Special considerations for companies using the full retrospective method

One issue that companies using the full retrospective method need to address is when they will reissue financial statements for prior periods to give effect to the new principles. Absent a need or desire to access the capital markets, a company could, at least technically, wait until the comparable current period is presented – i.e. reissue financial statements for Q1 2017 in the Form 10-Q for Q1 2018, reissue Q2 2017 in the Form 10-Q for Q2 2018 . . . and reissue fiscal 2016 and 2017 in the Form 10-K for 2018. It remains to be seen, however, whether investors will demand that companies issue revised financial statements more promptly, at least for companies where the change in policy causes material revisions to financial reporting.

Leaving aside investor demands, there are also practical reasons why companies adopting the full retrospective method should consider reissuing prior periods sooner.

Filing a new registration statement. Any filing of a registration statement (other than Form S-8) that includes financial statements covering a period reflecting adoption of the new revenue recognition rules (i.e. Q1 2018 or later financial statements) will be required to include retrospectively reissued financial statements for all prior periods that are required to be included or incorporated by reference. Therefore if a company delays reissuing its 2016 and 2017 financial statements until it files its Form 10-K for 2018, it will not be able to file a new registration statement after it files its Form 10-Q for Q1 2018, until it files its Form 10-K for 2018 (the "2017 Blackout Window"). Even if a company accelerates the reissuance of its 2016 and 2017 financial statements, it would also need to reissue its 2015 financial statements in order to be able to file a registration statement during the 2017 Blackout Window since 2015 financial statements were required in the 2017 Form 10-K. Accordingly, filing a registration statement during the 2017 Blackout Window would require a company to reissue its 2015 financial statements when it would not otherwise be required to (absent relief from the staff of the SEC). As a result, companies using the full retrospective method that have a shelf registration statement expiring before they intend to file their 2018 Form 10-K should consider filing a new shelf registration statement before filing their Q1 2018 Form 10-Q to avoid having to reissue 2015 financial statements, subject to consideration of the topics discussed below.

Offerings off an effective shelf registration statement. It is less clear what the impact will be for offerings off of an effective shelf registration statement. The financial statement requirements for a registration statement are generally determined at the time it becomes effective; however, Regulation S-K Item 512(a) requires registration statements on Form S-3 to include an undertaking to update the registration statement for a "fundamental change." There is no specific definition of "fundamental change" and Keith Higgins, the former director of the SEC's Division of Corporation Finance, had previously indicated that the SEC would not object if a company and its counsel concluded that the adoption of new accounting standards (such as those on revenue recognition and leases) is *not* a "fundamental change." That does not mean it's *not* a fundamental change, it just provides latitude for a company to reach that conclusion under the appropriate facts and circumstances. Accordingly, companies that may need to access the public capital markets during the 2017 Blackout Window should assess sooner rather than later the impact of the new revenue recognition rules and whether they believe the impact constitutes a "fundamental change."

Shelf offerings and Rule 144A private placements. Another issue for takedowns from an effective shelf registration statement, which also applies to Rule 144A private placements, is the willingness of the company's auditor to provide comfort on any included or incorporated financial statements that have not been recast. A company wanting to retain flexibility to access the public or private capital markets during the 2017 Blackout Window should confirm its auditor's willingness to provide customary comfort on the historical financials after filing its Q1 2018 Form 10-Q.

Initial public offerings. "Emerging growth companies" can elect to defer the application of new accounting standards until the effective date for private companies. Since the new revenue recognition rules are not required to be adopted by private companies until January 1, 2019 and since EGCs typically account for over 80% of initial public offerings, one might assume that the new revenue recognition rules would have little impact on the IPO market during 2018. Unfortunately, given the significance of the accounting change for certain industries, investors may demand that EGCs in those industries not take advantage of the election so that their published results are comparable to their peers. A recent survey by Deloitte & Touche of private companies considering IPOs found that only 8% had completed preparations for implementing the new revenue recognition standard and that 60% had not even begun preparing or were still performing assessments. Given the complexity of implementation, this may hinder the IPO market in early 2018.

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