

Memorandum

Impact of Adoption of New Revenue Recognition Standard on Financial Statements Required in Form S-3

September 12, 2017

New Revenue Recognition Standard

The new revenue recognition standard, Accounting Standards Codification Topic 606 (ASC 606), is effective for most U.S. public companies for annual reporting periods beginning after December 15, 2017. For a calendar year reporting registrant, ASC 606 is effective January 1, 2018 and will be required to be reflected in a registrant's first quarter 2018 Form 10-Q.

Under ASC 606, a registrant has two adoption alternatives: the modified retrospective transition method or the full retrospective transition method. A calendar year registrant that adopts ASC 606 under the modified retrospective transition method will be required to reflect the cumulative effect of the adoption of ASC 606 to the financial statements included in its first quarter 2018 Form 10-Q, but this method does not call for the revision of any historical financial statements that pre-date adoption. Conversely, a calendar year registrant that adopts ASC 606 under the full retrospective transition method will be required to reflect the adoption of ASC 606 to the financial statements included in its first quarter 2018 Form 10-Q and the financial statements for the comparative 2017 quarter. In its 2018 10-K, such registrant would need to reflect the adoption of ASC 606 in its 2018 annual financial statements, and revise its 2017 and 2016 annual financial statements to do the same.

As discussed below, a registrant that adopts ASC 606 under the full retrospective transition method and files a Form S-3 after the first interim period report reflecting the adoption will be required to revise three full years of financial statements, which would include the financial statements for a historical period that would not be included in the registrant's next 10-K or otherwise be required to be revised.¹

¹ The requirement to restate financial statements in connection with the Form S-3 does not apply in the period between adoption of ASC 606 and the filing of the first interim period report reflecting ASC 606 (FRM Section 13110.2).

Discussion

A registrant is required to update previously issued audited annual financial statements incorporated by reference into a Form S-3 to reflect a subsequent change in accounting principle.² The SEC staff (the Staff) has indicated that a registrant opting for the full retrospective transition method to adopt ASC 606 is required to provide retrospectively revised financial statements to be included in a Form S-3 unless it is “impracticable” to do so.³ A registrant that adopts ASC 606 as of January 1, 2018, for example, will be required to retrospectively revise its full year 2017, 2016 and 2015 financial statements to reflect the new standard in a Form S-3 filed after its first quarter 2018 Form 10-Q is filed with the SEC. In this example, a registrant would be required to retrospectively revise its 2015 financial statements even though it would not be required to include such financial statements in its 2018 Form 10-K.⁴

A registrant may use an effective Form S-3 filed prior to the full retrospective adoption of ASC 606 for a shelf takedown without revising prior year information unless a registrant concludes that the adoption of ASC 606 represents a “fundamental change” under Item 512(a) of Regulation S-K.⁵

Considerations

A registrant planning to adopt ASC 606 under a full retrospective transition method and that planned to file a Form S-3 after the registrant has filed its first interim period report reflecting the adoption of the new standard (e.g., for a registrant adopting ASC 606 as of January 1, 2018, the filing date for the first quarter 2018 Form 10-Q) may want to consider filing the new Form S-3 in advance of such date to avoid the requirement to include retrospectively revised financial statements for an earlier period that would have not otherwise been required.

² Item 11(b)(ii) of Form S-3

³ The transition provisions in ASC 606 reference GAAP, which provides for an impracticability exception (*see* Accounting Standards Codification 250-10-45-9). The Staff has indicated that a registrant that has concluded it would be impracticable to revise one or more comparative prior periods may, but is not required to, consult with the Staff.

⁴ FRM Section 11100

⁵ FRM Section 13110.2

For further information, please contact one of the following members of the Firm's Corporate Department.

NEW YORK CITY

Joshua Ford Bonnie

+1-212-455-3986

jbonnie@stblaw.com

Joseph H. Kaufman

+1-212-455-2948

jkaufman@stblaw.com

Arthur D. Robinson

+1-212-455-7086

arobinson@stblaw.com

Kenneth B. Wallach

+1-212-455-3352

kwallach@stblaw.com

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UNITED STATES

New York
425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston
600 Travis Street, Suite 5400
Houston, TX 77002
+1-713-821-5650

Los Angeles
1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto
2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.
900 G Street, NW
Washington, D.C. 20001
+1-202-636-5500

EUROPE

London
CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA

Beijing
3901 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong
ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul
25th Floor, West Tower
Mirae Asset Center 1
26 Eulji-ro 5-Gil, Jung-Gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo
Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA

São Paulo
Av. Presidente Juscelino
Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000