

The considerations discussed above regarding recognition of a divestiture for accounting purposes are also of importance in reaching a determination as to whether or not collection of the sale price is reasonably assured and profit recognition is therefore appropriate. In addition, circumstances such as the following tend to raise questions as to the propriety of profit recognition at any given time subsequent to the transaction:

1. Evidence of financial weakness of the buyer.

2. Substantial uncertainty as to the amount of future costs and expenses to be incurred by the seller.

3. Substantial uncertainty as to the amount of proceeds to be realized because of the form of consideration received; e.g., nonrecourse debt, notes with optional settlement provisions, purchaser's stock, or other nonmonetary consideration which may be of indeterminable value.

(Where satisfaction of the buyer's obligations to the seller remains dependent on earnings of the business divested, it will frequently be appropriate for the seller to continue to measure the uncertainty of ultimate collection by the operating losses of the business.)

The degree of uncertainty surrounding ultimate realization of the consideration is a matter which must be evaluated in the light of the attendant circumstances each time realization is evaluated. The degree of uncertainty is enhanced, however, by the presence of any of the factors referred to above, and such factors must be considered in reaching a determination with respect to recognition of gain.

F. Accounting Changes Not Retroactively Applied Due to Immateriality

Facts: A registrant is required to adopt an accounting principle by means of restatement of prior periods' financial statements. However, the registrant determines that the accounting change does not have a material effect on prior periods' financial statements and, accordingly, decides not to restate such financial statements.

Question: In these circumstances, is it acceptable to adjust the beginning balance of retained earnings of the

period in which the change is made for the cumulative effect of the change on the financial statements of prior periods?

Interpretive Response: No. If prior periods are not restated, the cumulative effect of the change should be included in the statement of income for the period in which the change is made (not to be reported as a cumulative effect adjustment in the manner of APB Opinion 20). Even in cases where the total cumulative effect is not significant, the staff believes that the amount should be reflected in the results of operations for the period in which the change is made. However, if the cumulative effect is material to current operations or to the trend of the reported results of operations, then the individual income statements of the earlier years should be retroactively adjusted.

This position is consistent with the requirements of Statement 5 and Statement 13, which indicate that "the cumulative effect [of the change] on retained earnings at the beginning of the earliest period restated shall be included in determining net income of that period."

G. Transfers of Nonmonetary Assets by Promoters or Shareholders

Facts: Nonmonetary assets are exchanged by promoters or shareholders for all or part of a company's common stock just prior to or contemporaneously with a first-time public offering.

Question: Since paragraph 4 of APB Opinion 29 states that Opinion 29 is not applicable to transactions involving the acquisition of nonmonetary assets or services on issuance of the capital stock of an enterprise, what value should be ascribed to the acquired assets by the company?

Interpretive Response: The staff believes that transfers of nonmonetary assets to a company by its promoters or shareholders in exchange for stock prior to or at the time of the company's initial public offering normally should be recorded at the transferors' historical cost basis determined under GAAP.

The staff will not always require that predecessor cost be used to value nonmonetary assets received from an enterprise's promoters or shareholders. However, deviations from this policy have been rare applying generally to situations where the fair value of either the stock issued¹ or assets acquired is objectively measurable and the transferor's stock ownership following the transaction was not so significant

that the transferor had retained a substantial indirect interest in the assets as a result of stock ownership in the company.

H. Accounting for Sales of Stock by a Subsidiary

Facts: The registrant owns 95% of its subsidiary's stock. The subsidiary sells its unissued shares in a public offering, which decreases the registrant's ownership of the subsidiary from 95% to 90%. The offering price per share exceeds the registrant's carrying amount per share of subsidiary stock.

Question 1: When an offering takes the form of a subsidiary's direct sale of its unissued shares, will the staff permit the amount in excess of the parent's carrying value to be reflected as a gain in the consolidated income statement of the parent?

Interpretive Response: Yes, in some circumstances. Although the staff at one time insisted that such transactions be accounted for as capital transactions in the consolidated financial statements, it has reconsidered its views on this matter with respect to certain of these transactions where the sale of such shares by a subsidiary is not a part of a broader corporate reorganization contemplated or planned by the registrant. In situations where no other such capital transactions are contemplated, the staff has determined that it will accept accounting treatment for such transactions that is in accordance with the Advisory Conclusions in paragraph 30 of the June 3, 1980 Issues Paper, "Accounting in Consolidation for Issuances of a Subsidiary's Stock." The staff believes that this issues paper should provide appropriate guidance on this matter until the FASB addresses this issue as a part of its project on Accounting for the Reporting Entity, including Consolidations, the Equity Method, and Related Matters.

Question 2: What is meant by the phrase "broader corporate reorganization contemplated or planned by the registrant" and are there other situations where the staff has objected to gain recognition?

Interpretive Response: The staff believes that gain recognition is not appropriate in situations where subsequent capital transactions are contemplated that raise concerns about the likelihood of the registrant realizing that gain, such as where the registrant intends to spin-off its subsidiary to shareholders or where reacquisition of shares is contemplated at the time of issuance. The staff will presume that repurchases were contemplated at the date of issuance in those situations

footnote 8, which states, in pertinent part: "The Board recognizes that there are exceptional cases where receivables are collectible over an extended period of time and, because of the terms of the transactions or other conditions, there is no reasonable basis for estimating the degree of collectibility. When such circumstances exist, and as long as they exist, either the installment method or the cost recovery method of accounting may be used."

¹ Estimating the fair value of the common stock issued, however, is not appropriate when the stock is closely held and/or seldom or ever traded.