

where shares are repurchased within one year of issuance or where a specific plan existed to repurchase shares at the time shares were issued. In addition, the staff believes that realization is not assured where the subsidiary is a newly-formed, non-operating entity; a research and development, start-up or development stage company; an entity whose ability to continue in existence is in question; or other similar circumstances. In those situations, the staff believes that the change in the parent company's proportionate share of subsidiary equity resulting from the additional equity raised by the subsidiary should be accounted for as an equity transaction in consolidation. Gain deferral is not appropriate.

Question 3: In the staff's opinion, may gain be recognized for issuances of subsidiary stock in situations other than sales of unissued shares in a public offering?

Interpretive Response: Yes. The staff believes that gain recognition is acceptable in situations other than sales of unissued shares in a public offering as long as the value of the proceeds can be objectively determined. With respect to issuances of stock options, warrants, and convertible and other similar securities, gain should not be recognized before exercise or conversion into common stock, and then only provided that realization of the gain is reasonably assured (see Question 2 above) at the time of such exercise or conversion.

Question 4: Will repurchasing shares of a subsidiary's stock affect the potential for gain recognition by the registrant in consolidation for subsequent issuances of that subsidiary's stock? ¹

Interpretive Response: Yes. Where previous gains have been recognized in consolidation on issuances of a subsidiary's stock and shares of the subsidiary are subsequently repurchased by the subsidiary, its parent or any member of the consolidated group, gain recognition should not occur on issuances subsequent to the date of a repurchase until such time as shares have been issued in an amount equivalent to the number of repurchased shares. The staff views such transactions as analogous to treasury stock transactions from the standpoint of the consolidated entity that should not result in recognition of gains or losses.

Question 5: May registrants selectively apply the guidance in the

SAB by recognizing the impact of certain issuances by a subsidiary in the income statement and other issuances as equity transactions?

Interpretive Response: No. The staff believes that income statement treatment in consolidation for issuances of stock by a subsidiary represents a choice among alternative accounting methods and, therefore, must be applied consistently to all stock transactions that meet the conditions for income statement treatment set forth herein for any subsidiary. If a registrant recognizes gains on issuances of stock by a subsidiary, thus adopting income statement recognition as its accounting policy, then it must also recognize losses for stock issuances by that or any other subsidiary that result in decreases in its proportionate share of the dollar amount of the subsidiary's equity. Regardless of the method of accounting selected, when a subsidiary issues securities at prices less than the parent's carrying value per share, the registrant must assess whether the investment has been impaired, in which case a provision should be reflected in the income statement.

Question 6: How should the registrant disclose the accounting for issuances of a subsidiary's stock in the consolidated financial statements?

Interpretive Response: The staff believes that gains (or losses) arising from issuances by a subsidiary of its own stock, if recorded in income by the parent, should be presented as a separate line item in the consolidated income statement without regard to materiality and clearly be designated as non-operating income. An appropriate description of the transaction should be included in the notes to the financial statements, as further described below.

The accounting method adopted by the registrant for issuances of a subsidiary's stock should be disclosed in its accounting policy footnote and consistently applied (See Question 5). The staff believes that the registrant also should include a separate footnote that describes issuances of subsidiary stock that have occurred during all periods presented. This footnote should clearly describe the transaction, the identification of the subsidiary and nature of its operations, the number of shares issued, the price per share and the total dollar amount and nature of consideration received, and the percentage ownership of the parent both before and after the transaction. Additionally, the registrant should clearly state whether deferred income taxes have been provided on gains recognized and, if no provision has been recorded, a clear explanation of the

reasons. Finally, the staff expects registrants to include disclosure in their Management Discussion and Analysis of the impact of specific transactions that have occurred and the likelihood of similar transactions occurring in future years.

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J. Push Down Basis of Accounting Required in Certain Limited Circumstances

Facts: Company A (or Company A and related persons) acquired substantially all of the common stock of Company B in one or a series of purchase transactions.

Question 1: Must Company B's financial statements presented in either its own or Company A's subsequent filings with the Commission reflect the new basis of accounting arising from Company A's acquisition of Company B when Company B's separate corporate entity is retained?

Interpretive Response: Yes. The staff believes that purchase transactions that result in an entity becoming substantially wholly owned (as defined in Rule 1-02(aa) of Regulation S-X) establish a new basis of accounting for the purchased assets and liabilities.

When the form of ownership is within the control of the parent the basis of accounting for purchased assets and liabilities should be the same regardless of whether the entity continues to exist or is merged into the parent's operations. Therefore, Company A's cost of acquiring Company B should be "pushed down," i.e., used to establish a new accounting basis in Company B's separate financial statements.¹

Question 2: What is the staff's position if Company A acquired less than substantially all of the common stock of Company B or Company B had publicly held debt or preferred stock at the time Company B became wholly owned?

Interpretive Response: The staff recognizes that the existence of outstanding public debt, preferred stock or a significant minority interest in a subsidiary might impact the parent's ability to control the form of ownership. Although encouraging its use, the staff generally does not insist on the application of push down accounting in these circumstances.

¹ The Task Force on Consolidation Problems, Accounting Standards Division of the American Institute of Certified Public Accountants issued a paper entitled "Push Down" Accounting, October 30, 1979. This paper addresses the issues relating to "push down" accounting, cites authoritative literature and indicates that a substantial change in ownership justifies a new basis of accounting.

¹ This question and interpretive response assume that the repurchases were not contemplated at the time of earlier gain recognition. See Question 2.