

- Discounting liabilities with respect to settled claims under the following circumstances:

- The payment pattern and ultimate cost are fixed and determinable on an individual claim basis, and
- The discount rate used is reasonable on the facts and circumstances applicable to the registrant at the time the claims are settled.

Question 2: Does the staff agree with the registrant's proposal that the change from a statutory rate to an investment related rate be accounted for as a change in accounting estimate?

Interpretive Response: No. The staff believes that such a change involves a change in the method of applying an accounting principle, *i.e.*, the method of selecting the discount rate was changed. The staff therefore believes that the registrant should reflect the cumulative effect of the change in accounting by applying the new selection method retroactively to liabilities for claims settled in all prior years, in accordance with the requirements of APB Opinion 20. Initial adoption of discounting for GAAP purposes would be treated similarly. In either case, in addition to the disclosures required by APB Opinion 20 concerning the change in accounting principle, a preferability letter from the registrant's independent accountant is required.

O. Research and Development Arrangements

Facts: Statement 68 paragraph 7 states that conditions other than a written agreement may exist which create a presumption that the enterprise will repay the funds provided by other parties under a research and development arrangement. Paragraph 8(c) lists as one of those conditions the existence of a "significant related party relationship" between the enterprise and the parties funding the research and development.

Question 1: What does the staff consider a "significant related party relationship" as that term is used in paragraph 8(c) of Statement 68?

Interpretive Response: The staff believes that a significant related party relationship exists when 10 percent or more of the entity providing the funds is owned by related parties.¹ In unusual circumstances, the staff may also question the appropriateness of treating a research and development arrangement as a contract to perform service for others at the less than 10 percent level. In reviewing these matters

the staff will consider, among other factors, the percentage of the funding entity owned by the related parties in relationship to their ownership in and degree of influence or control over the enterprise receiving the funds.

Question 2: Paragraph 7 of Statement 68 states that the presumption of repayment "can be overcome only by substantial evidence to the contrary." Can the presumption be overcome by evidence that the funding parties were assuming the risk of the research and development activities since they could not reasonably expect the enterprise to have resources to repay the funds based on its current and projected future financial condition?

Interpretive Response: No. Paragraph 5 of Statement 68 specifically indicates that the enterprise "may settle the liability by paying cash, by issuing securities, or by some other means." While the enterprise may not be in a position to pay cash or issue debt, repayment could be accomplished through the issuance of stock or various other means. Therefore, an apparent or projected inability to repay the funds with cash (or debt which would later be paid with cash) does not necessarily demonstrate that the funding parties were accepting the entire risks of the activities.

P. Restructuring Charges

1. Deleted by SAB 103

2. Deleted by SAB 103

3. Income Statement Presentation of Restructuring Charges

Facts: Restructuring charges often do not relate to a separate component of the entity, and, as such, they would not qualify for presentation as losses on the disposal of a discontinued operation. Additionally, since the charges are not both unusual and infrequent¹ they are not presented in the income statement as extraordinary items.

Question 1: May such restructuring charges be presented in the income statement as a separate caption after income from continuing operations before income taxes (*i.e.*, preceding income taxes and/or discontinued operations)?

Interpretive Response: No. Paragraph 26 of APB Opinion 30 states that items that do not meet the criteria for classification as an extraordinary item should be reported as a component of income from continuing operations.²

¹ See APB Opinion 30, paragraph 20.

² Paragraph 26 of APB Opinion 30 further provides that such items should not be reported on the income statement net of income taxes or in any manner that implies that they are similar to extraordinary items.

Neither Opinion 30 nor Rule 5-03 of Regulation S-X contemplate a category in between continuing and discontinued operations. Accordingly, the staff believes that restructuring charges should be presented as a component of income from continuing operations, separately disclosed if material. Furthermore, the staff believes that a separately presented restructuring charge should not be preceded by a subtotal representing "income from continuing operations before restructuring charge" (whether or not it is so captioned). Such a presentation would be inconsistent with the intent of Opinion 30.

Question 2: Some registrants utilize a classified or "two-step" income statement format (*i.e.*, one which presents operating revenues, expenses and income followed by other income and expense items). May a charge which relates to assets or activities for which the associated revenues and expenses have historically been included in operating income be presented as an item of "other expense" in such an income statement?

Interpretive Response: No. The staff believes that the proper classification of a restructuring charge depends on the nature of the charge and the assets and operations to which it relates. Therefore, charges which relate to activities for which the revenues and expenses have historically been included in operating income should generally be classified as an operating expense, separately disclosed if material. Furthermore, when a restructuring charge is classified as an operating expense, the staff believes that it is generally inappropriate to present a preceding subtotal captioned or representing operating income before restructuring charges. Such an amount does not represent a measurement of operating results under GAAP.

Conversely, charges relating to activities previously included under "other income and expenses" should be similarly classified, also separately disclosed if material.

Question 3: Is it permissible to disclose the effect on net income and earnings per share of such a restructuring charge?

Interpretive Response: Discussions in MD&A and elsewhere which quantify the effects of unusual or infrequent items on net income and earnings per share are beneficial to a reader's understanding of the financial statements and are therefore acceptable.

MD&A also should discuss the events and decisions which gave rise to the restructuring, the nature of the charge and the expected impact of the

¹ Related parties as used herein are as defined in paragraph 24 of Statement 57.