

an investment in the subsidiary, in the manner specified by paragraph 34 of APB Opinion 20?

Interpretive Response: Not ordinarily. If the Company was required to file periodic reports under the Exchange Act within one year prior to the spin-off, the staff believes the Company should reflect the disposition in conformity with Statement 144. This presentation most fairly and completely depicts for investors the effects of the previous and current organization of the Company. However, in limited circumstances involving the initial registration of a company under the Exchange Act or Securities Act, the staff has not objected to financial statements that retroactively reflect the reorganization of the business as a change in the reporting entity if the spin-off transaction occurs prior to effectiveness of the registration statement. This presentation may be acceptable in an initial registration if the Company and the subsidiary are in dissimilar businesses, have been managed and financed historically as if they were autonomous, have no more than incidental common facilities and costs, will be operated and financed autonomously after the spin-off, and will not have material financial commitments, guarantees, or contingent liabilities to each other after the spin-off. This exception to the prohibition against retroactive omission of the subsidiary is intended for companies that have not distributed widely financial statements that include the spun-off subsidiary. Also, dissimilarity contemplates substantially greater differences in the nature of the businesses than those that would ordinarily distinguish reportable segments as defined by Statement 131.

AA. Deleted by SAB 103

BB. Inventory Valuation Allowances

Facts: ARB 43, Chapter 4, Statement 5, specifies that: “[a] departure from the cost basis of pricing the inventory is required when the utility of the goods is no longer as great as its cost. Where there is evidence that the utility of goods, in their disposal in the ordinary course of business, will be less than cost, whether due to physical obsolescence, changes in price levels, or other causes, the difference should be recognized as a loss of the current period. This is generally accomplished by stating such goods at a lower level commonly designated as market.”

Footnote 2 to that same chapter indicates that “[i]n the case of goods which have been written down below cost at the close of a fiscal period, such reduced amount is to be considered the

cost for subsequent accounting purposes.”

Lastly, Opinion 20 provides “inventory obsolescence” as one of the items subject to estimation and changes in estimates under the guidance in paragraphs 10–11 and 31–33 of that Opinion.

Question: Does the write-down of inventory to the lower of cost or market, as required by ARB 43, create a new cost basis for the inventory or may a subsequent change in facts and circumstances allow for restoration of inventory value, not to exceed original historical cost?

Interpretive Response: Based on ARB 43, footnote 2, the staff believes that a write-down of inventory to the lower of cost or market at the close of a fiscal period creates a new cost basis that subsequently cannot be marked up based on changes in underlying facts and circumstances.¹

CC. Impairments

Standards for recognizing and measuring impairment of the carrying amount of long-lived assets including certain identifiable intangibles to be held and used in operations are found in Statement 144. Standards for recognizing and measuring impairment of the carrying amount of goodwill and identifiable intangible assets that are not currently being amortized are found in Statement 142.

Facts: Company X has mainframe computers that are to be abandoned in six to nine months as replacement computers are put in place. The mainframe computers were placed in service in January 20X0 and were being depreciated on a straight-line basis over seven years. No salvage value had been projected at the end of seven years and the original cost of the computers was \$8,400. The board of directors, with the appropriate authority, approved the abandonment of the computers in March 20X3 when the computers had a remaining carrying value of \$4,600. No proceeds are expected upon abandonment. Abandonment cannot occur prior to the receipt and installation of replacement computers, which is expected prior to the end of 20X3. Management had begun reevaluating its mainframe computer capabilities in January 20X2 and had included in its 20X3 capital expenditures budget an estimated amount for new mainframe computers. The 20X3 capital expenditures budget had been prepared by management in August 20X2, had been discussed with

the company’s board of directors in September 20X2 and was formally approved by the board of directors in March 20X3. Management had also begun soliciting bids for new mainframe computers beginning in the fall of 20X2. The mainframe computers, when grouped with assets at the lowest level of identifiable cash flows, were not impaired on a “held and used” basis throughout this time period. Management had not adjusted the original estimated useful life of the computers (seven years) since 20X0.

Question 1: Company X proposes to recognize an impairment charge under Statement 144 for the carrying value of the mainframe computers of \$4,600 in March 20X3. Does Company X meet the requirements in Statement 144 to classify the mainframe computer assets as “to be abandoned?”

Interpretive Response: No. Statement 144, paragraph 28, provides that “a long-lived asset to be abandoned is disposed of when it ceases to be used. If an entity commits to a plan to abandon a long-lived asset before the end of its previously estimated useful life, depreciation estimates shall be revised in accordance with Opinion 20 to reflect the use of the asset over its shortened useful life.”

Question 2: Would the staff accept an adjustment to write down the carrying value of the computers to reflect a “normalized depreciation” rate for the period from March 20X3 through actual abandonment (e.g., December 20X3)? Normalized depreciation would represent the amount of depreciation otherwise expected to be recognized during that period without adjustment of the asset’s useful life, or \$1,000 (\$100/month for ten months) in the example fact pattern.

Interpretive Response: No. The mainframe computers would be viewed as “held and used” at March 20X3 under the fact pattern described. There is no basis under Statement 144 to write down an asset to an amount that would subsequently result in a “normalized depreciation” charge through the disposal date, whether disposal is to be by sale, abandonment, or other means. For an asset that meets the requirements to be classified as “held for sale” under Statement 144, paragraph 34 of that standard requires the asset to be valued at the lower of carrying amount or fair value less cost to sell. For assets that are classified as “held and used” under Statement 144, an assessment must first be made as to whether the asset (asset group) is impaired. Paragraph 7 of Statement 144 indicates that an impairment loss shall be recognized only if the carrying amount of a long-

¹ See also disclosure requirement for inventory balances in Rule 5–02(6) of Regulation S–X.