

to transfer funds to the parent through intercompany loans, advances or cash dividends [Rule 4-08(e)(3)], and (2) the presentation of condensed parent company financial information and other data in a schedule (Rule 12-04). To determine which disclosures, if any, are required, a registrant must compute its proportionate share of the net assets of its consolidated and unconsolidated subsidiary companies as of the end of the most recent fiscal year which are restricted as to transfer to the parent company because the consent of a third party (a lender, regulatory agency, foreign government, etc.) is required. If the registrant's proportionate share of the restricted net assets of consolidated subsidiaries exceeds 25% of the registrant's consolidated net assets, both the footnote and schedule information are required. If the amount of such restrictions is less than 25%, but the sum of these restrictions plus the amount of the registrant's proportionate share of restricted net assets of unconsolidated subsidiaries plus the registrant's equity in the undistributed earnings of 50% or less owned persons (investees) accounted for by the equity method exceed 25% of consolidated net assets, the footnote disclosure is required.

**Question 1:** How are restricted net assets of subsidiaries computed?

**Interpretative Response:** The calculation of restricted net assets requires an evaluation of each

subsidiary to identify any circumstances where third parties may limit the subsidiary's ability to loan, advance or dividend funds to the parent. This evaluation normally comprises a review of loan agreements, statutory and regulatory requirements, etc., to determine the dollar amount of each subsidiary's restrictions. The related amount of the subsidiary's net assets designated as restricted, however, should not exceed the amount of the subsidiary's net assets included in consolidated net assets, since parent company disclosures are triggered when a significant amount of consolidated net assets are restricted. The amount of each subsidiary's net assets included in consolidated net assets is determined by allocating (pushing down) to each subsidiary any related consolidation adjustments such as intercompany balances, intercompany profits, and differences between fair value and historical cost arising from a business combination accounted for as a purchase. This amount is referred to as the subsidiary's adjusted net assets. If the subsidiary's adjusted net assets are less than the amount of its restrictions because the push down of consolidating adjustments reduced its net assets, the subsidiary's adjusted net assets is the amount of the subsidiary's restricted net assets used in the tests.

Registrants with numerous subsidiaries and investees may wish to

develop approaches to facilitate the determination of its parent company disclosure requirements. For example, if the parent company's adjusted net assets (excluding any interest in its subsidiaries) exceed 75% of consolidated net assets, or if the total of all of the registrant's consolidated and unconsolidated subsidiaries' restrictions and its equity in investees' earnings is less than 25% of consolidated net assets, then the allocation of consolidating adjustments to the subsidiaries to determine the amount of their adjusted net assets would not be necessary since no parent company disclosures would be required.

**Question 2:** If a registrant makes a decision that it will permanently reinvest the undistributed earnings of a subsidiary, and thus does not provide for income taxes thereon because it meets the criteria set forth in APB Opinion 23, is there considered to be a restriction for purposes of the test?

**Interpretative Response:** No. The rules require that only third party restrictions be considered. Restrictions on subsidiary net assets imposed by management are not included.

#### b. Application of Tests for Parent Company Disclosures

**Facts:** The balance sheet of the registrant's 100%-owned subsidiary at the most recent fiscal year-end is summarized as follows:

|                         |       |                           |       |
|-------------------------|-------|---------------------------|-------|
| Current assets .....    | \$120 | Current liabilities ..... | \$30  |
| Noncurrent assets ..... | 45    | Long-term debt .....      | 60    |
|                         |       |                           | 90    |
|                         |       | Common stock .....        | 25    |
|                         |       | Retained earnings .....   | 50    |
|                         |       |                           | 75    |
|                         | \$165 |                           | \$165 |

Net assets of the subsidiary are \$75. Assume there are no consolidating adjustments to be allocated to the subsidiary. Restrictive covenants of the

subsidiary's debt agreements provide that:

- Net assets, excluding intercompany loans, cannot be less than \$35

- 60% of accumulated earnings must be maintained

**Question 1:** What is the amount of the subsidiary's restricted net assets?

**Interpretative Response:**

| Restriction   | Computed restrictions |
|---|-----------------------|
| Net assets: currently \$75, cannot be less than \$35; therefore .....             | \$35                  |
| Dividends: 60% of accumulated earnings (\$50) cannot be paid out; therefore ..... | 30                    |

Restricted net assets for purposes of the test are \$35. The maximum amount that can be loaned or advanced to the parent without violating the net asset covenant is \$40 (\$75-\$35). Alternatively,

the subsidiary could pay a dividend of up to \$20 (\$50-\$30) without violating the dividend covenant, and loan or advance up to \$20, without violating the net asset provision.

**Facts:** The registrant has one 100%-owned subsidiary. The balance sheet of the subsidiary at the latest fiscal year-end is summarized as follows: