

Current assets	\$ 75	Current liabilities	\$ 23
Noncurrent assets	90	Long-term debt	57
		Redeemable preferred stock	10
		Common stock	30
		Retained earnings	45
	
			75
	\$165		\$165

Assume that the registrant's consolidated net assets are \$130 and there are no consolidating adjustments to be allocated to the subsidiary. The subsidiary's net assets are \$75. The subsidiary's noncurrent assets are comprised of \$40 in operating plant and equipment used in the subsidiary's business and a \$50 investment in a 30% investee. The subsidiary's equity in this investee's undistributed earnings is \$18. Restrictive covenants of the subsidiary's debt agreements are as follows:

1. Net assets, excluding intercompany balances, cannot be less than \$20.
2. 80% of accumulated earnings must be reinvested in the subsidiary.
3. Current ratio of 2:1 must be maintained.

Question 2: Are parent company footnote or schedule disclosures required?

Interpretive Response: Only the parent company footnote disclosures are required. The subsidiary's restricted net assets are computed as follows:

Restriction	Computed restriction
Net assets: currently \$75, cannot be less than \$20; therefore	\$20
Dividends: 80% of accumulated earnings (\$45) cannot be paid; therefore	36
Current ratio: must be at least 2:1 (\$46 current assets must be maintained since current liabilities are \$23 at fiscal year-end); therefore	46

Restricted net assets for purposes of the test are \$20. The amount computed from the dividend restriction (\$36) and the current ratio requirement (\$46) are not used because net assets may be transferred by the subsidiary up to the limitation imposed by the requirement to maintain net assets of at least \$20, without violating the other restrictions. For example, a transfer to the parent of up to \$55 of net assets could be accomplished by a combination of

dividends of current assets of \$9 (\$45–36), and loans or advances of current assets of up to \$20 and noncurrent assets of up to \$26.

Parent company footnote disclosures are required in this example since the restricted net assets of the subsidiary and the registrant's equity in the earnings of its 100%-owned subsidiary's investee exceed 25% of consolidated net assets $[(\$20 + 18)/\$130 = 29\%]$. The parent company schedule information is not required since the restricted net assets of the subsidiary are only 15% of consolidated net assets $(\$20/\$130 = 15\%)$.

Although the subsidiary's noncurrent assets are not in a form which is readily transferable to the parent company, the illiquid nature of the assets is not relevant for purposes of the parent company tests. The objective of the tests is to require parent company disclosures when the parent company does not have control of its subsidiaries' funds because it does not have unrestricted access to their net assets. The tests trigger parent company disclosures only when there are significant third party restrictions on transfers by subsidiaries of net assets and the subsidiaries' net assets comprise a significant portion of consolidated net assets. Practical limitations, other than third party restrictions on transferability at the measurement date (most recent fiscal year-end), such as subsidiary illiquidity, are not considered in computing restricted net assets. However, the potential effect of any limitations other than those imposed by third parties should be considered for inclusion in Management's Discussion and Analysis of liquidity.

Facts:

	Net assets
Subsidiary A	\$(500)
Subsidiary B	2,000
Consolidated	3,700

Subsidiaries A and B are 100% owned by the registrant. Assume there are no

consolidating adjustments to be allocated to the subsidiaries. Subsidiary A has restrictions amounting to \$200. Subsidiary B's restrictions are \$1,000.

Question 3: What parent company disclosures are required for the registrant?

Interpretive Response: Since subsidiary A has an excess of liabilities over assets, it has no restricted net assets for purposes of the test. However, both parent company footnote and schedule disclosures are required, since the restricted net assets of subsidiary B exceed 25% of consolidated net assets $(\$1,000/3,700 = 27\%)$.

Facts:

	Net assets
Subsidiary A	\$850
Subsidiary B	300
Consolidated	3,700

The registrant owns 80% of subsidiary A. Subsidiary A owns 100% of subsidiary B. Assume there are no consolidating adjustments to be allocated to the subsidiaries. A may not pay any dividends or make any affiliate loans or advances. B has no restrictions. A's net assets of \$850 do not include its investment in B.

Question 4: Are parent company footnote or schedule disclosures required for this registrant?

Interpretive Response: No. All of the registrant's share of subsidiary A's net assets (\$680) are restricted. Although B may pay dividends and loan or advance funds to A, the parent's access to B's funds through A is restricted. However, since there are no limitations on B's ability to loan or advance funds to the parent, none of the parent's share of B's net assets are restricted. Since A's restricted net assets are less than 25% of consolidated net assets $(\$680/3700 = 18\%)$, no parent company disclosures are required.

Facts: The consolidating balance sheet of the registrant at the latest fiscal year-end is summarized as follows: