

SEC Regulations Committee
July 8, 2008 - Joint Meeting with SEC Staff
SEC Offices – Washington DC

Discussion Document A

Topic: Restricted Net Assets Computations after FAS 160 is Implemented

Issue: Rules 4-08(e)(3) and 5-04(c) of Regulation S-X require certain disclosures if restricted net assets of subsidiaries exceed the percentages specified in those rules. This discussion document addresses computing those percentages after FASB Statement 160 is implemented.

Background: Rule 4-08(e)(3) of Regulation S-X requires certain disclosures about restricted net assets of subsidiaries. These disclosures are required if “the restricted net assets of consolidated and unconsolidated subsidiaries and the parent’s equity in the undistributed earnings of 50 percent or less owned persons accounted for by the equity method together exceed 25 percent of consolidated net assets as of the end of the most recently completed fiscal year.” The rule specifically states that “restricted net assets of subsidiaries shall mean that amount of the registrant’s proportionate share of net assets (after intercompany eliminations) reflected in the balance sheets of its consolidated and unconsolidated subsidiaries as of the end of the most recent fiscal year which may not be transferred to the parent company” and “Redeemable preferred stocks (Rule 5-02.28) and minority interests shall be deducted in computing net assets for purposes of this test.” Rule 5-04(c) follows a similar approach to determine whether Schedule I (condensed parent company financial statements) is required.

Statement 160 amended ARB 51 by adding paragraph 26, which requires that a “noncontrolling interest shall be reported in the consolidated statement of financial position within equity.” However, noncontrolling interest is reported “separately from the parent’s equity.” In addition, under paragraph 30, “Net income or loss and *comprehensive income* or loss, as described in paragraph 10 of FASB Statement No. 130, *Reporting Comprehensive Income*, shall be attributed to the parent and the noncontrolling interest.” Statement 160 also amended paragraph 9 of Statement 128 to exclude income from noncontrolling interests from earnings per share: “For purposes of computing EPS in consolidated financial statements (both basic and diluted), if one or more less-than-wholly-owned subsidiaries are included in the consolidated group, income from continuing operations and net income shall exclude the income attributable to the noncontrolling interest in subsidiaries.”

Questions: After Statement 160 is implemented, how should registrants compute restricted net assets percentages? If the percentages should be computed differently, should Regulation S-X be amended?

Discussion: Consider the example of a registrant with an 80% owned subsidiary. The subsidiary has equity of \$100. All of its assets are restricted. Prior to adopting Statement 160, the registrant reported equity of \$330 and minority interest of \$20. Under Statement 160, the registrant would report equity of \$350, including the noncontrolling interest of \$20.

View A: The registrant should compute the restricted net assets percentage in the same manner as before Statement 160 was implemented. The percentage is 24% (80 divided by 330). This approach continues to be required by Regulation S-X. Further, although the noncontrolling interest is measured and presented differently under Statement 160, it continues to be

segregated within equity, and the calculation of earnings-per-share amounts in consolidated financial statements continues to be based on amounts attributable to the parent.

View B: The numerator used to compute the restricted net assets percentage is defined by Regulation S-X and is not affected by the issuance of Statement 160. However, the registrant should compute the denominator using the equity classification called for by Statement 160. The percentage is 23% (80 divided by 350).

View C: Under the single economic entity approach, noncontrolling interests are not relevant to the calculation. Therefore, neither the numerator nor the denominator used to compute the restricted net assets percentage should consider them. The percentage is 29% (100 divided by 350).

SEC Staff Response: The staff indicated that it supports View A.