SEC Regulations Committee Highlights

Joint Meeting with SEC Staff - June 21, 2001

Location: SEC Headquarters – Washington, D.C.

NOTICE: The AICPA SEC Regulations Committee meets periodically with the staff of the SEC to discuss emerging technical accounting and reporting issues relating to SEC rules and regulations. The purpose of the following highlights is to summarize the issues discussed at the meetings. These highlights have not been considered and acted on by senior technical committees of the AICPA, or by the Financial Accounting Standards Board, and do not represent an official position of either organization.

In addition, these highlights are not authoritative positions or interpretations issued by the SEC or its staff. The highlights were not transcribed by the SEC and have not been considered or acted upon by the SEC or its staff. Accordingly, these highlights do not constitute an official statement of the views of the Commission or of the staff of the Commission.

I. **ATTENDANCE**

A. **SEC Regulations Committee**

- Amy Ripepi, Chair
- Ernie Baugh
- David Eihhorn
- John Gerdener
- Joseph Graziano
- John Guinan
- Wendy Hambleton
- Jay Hartig
- Chris Holmes
- Jim Ledwith
- Bob Rouse
- Roy Van Brunt
- John Wolfson
- Bill Yeates
- Mary Jane Young

B. **Securities and Exchange Commission**

Office of the Chief Accountant

- Lynn Turner, Chief Accountant
- Bob Burns, Chief Counsel
- Shelly Luisi, Associate Chief Accountant
- Michael Pierce, Professional Accounting Fellow
- Esmerelda Rodriguez, Associate Chief Accountant
- Michael Thompson, Professional Accounting Fellow

Division of Corporation Finance

- Craig Olinger, Deputy Chief Accountant

C. **AICPA**
- Annette Schumacher Barr
- Jennifer Roddy, SECPS

D. **Guests**
- Scott Pohlman, McGladrey & Pullen

II. STATUS UPDATES

A. Equity Compensation Plan Disclosure Proposal

Craig Olinger reported that the staff has received 28 comment letters on its Equity Compensation Plan Disclosure Proposal. Generally, the concerns expressed in the comment letters fell into two (conflicting) camps: (1) the proposed disclosure requirements were redundant with FAS No. 123 and (2) even more disclosures should be required. The staff is in the process of analyzing and processing the comments and is hoping to issue a final rule sometime this Fall in time for the annual proxy season.

B. Supplemental Financial Information Proposal

Lynn Turner indicated that he has received a number of letters from Congressional representatives raising questions about the adequacy of environmental reserves and related disclosures. In light of these concerns, his office will reevaluate the requirements in the proposal relating to environmental disclosures prior to issuing any final rules.

C. Guide 3 Revisions

The staff hopes to have the revisions to Guide 3 completed sometime this Fall.

III. PERSONNEL CHANGES

A. Division of Corporation Finance

Craig Olinger reported that Todd Hardiman has been promoted to Associate Chief Accountant in the Division of Corporation Finance (DCF). He added that DCF has hired eight new permanent staff and is currently reviewing additional applications for numerous other positions. In addition to looking for qualified candidates for permanent hires, DCF is also soliciting applications for its Professional Accounting Fellow program.

B. Office of the Chief Accountant (OCA)

Esmerelda Rodriguez and Jenifer Minke-Girard have been promoted to Associate Chief Accountant.

C. GAO REPORT

In June the GAO issued its report on the OCA's review process. In the report, the GAO recommends that the OCA make public additional information that explains its current policies and procedures for reviewing accounting issues. Lynn Turner noted that in response to this recommendation, the staff is drafting an article that summarizes the OCA's policies and procedures for reviewing public filings. Mr. Turner asked the Committee for specific areas that should be addressed in the article. The Committee offered the following suggestions:

- The OCA's policies with respect to the review and approval of restatements;
- How DCF and OCA interact, including a basic discussion of their operations; and
- How issues are internally deliberated and decided.

Mr. Turner asked the Committee to contact either him or Jackson Day if other additional areas should be covered.

IV. PRACTICE ISSUES

A. Transition Issue Related to SAB No. 101, Revenue Recognition

Question: Assume a registrant concludes that its revenue recognition policies are acceptable and does not make a change under SAB No. 101 within the prescribed time frame allowed by the rule. If the SEC staff reviews the registrant's filing and determines that a change should have been recorded under SAB No. 101, will the SEC staff object to the registrant reporting the change by restating the year in which SAB 101 was effective and classifying the change as a cumulative effect of a change in accounting principle in that year? Assume, for purposes of this discussion, that the revenue recognition policy in question is not one that should have been reported as an error under SAB No. 101.

Background: Although SAB No. 101 does not change existing accounting literature, it does provide for transition and permits registrants to report certain revisions in revenue recognition policies as a cumulative effect of a change in accounting principle in accordance with APB Opinion No. 20. For example, Question 7 of SAB No. 101 specifies that when rights of refund are available to customers, a registrant may not recognize revenue until the refund right expires if certain criteria are not met. In general, a change in accounting principles related to the adoption of this guidance would be reported as a cumulative effect of a change in accounting principle. However, because judgement is involved in reaching the conclusion that reliable estimates of refunds can or can not be made, it is possible that the SEC staff might object to a registrant's conclusion on this (or other) SAB 101 issue.

Discussion: We acknowledge that if the accounting policy in question should have been reported as an error when SAB No. 101 was issued then it would not be appropriate to report the change as being from one acceptable method of accounting to another. Accordingly, in that fact pattern restatement of all periods would be necessary. However, when the accounting policy in question is one that would have been reported as a cumulative effect of a change in accounting principle, an argument can be made that the revision should be reported as an error, but limited to the year in which SAB No. 101 was effective. We recognize that this is a difficult question to answer definitively because each fact pattern will be slightly different. Nonetheless we expect this situation to arise because of the judgements required in reaching conclusions about revenue recognition. Accordingly, we welcome any information the staff can offer regarding how they would deal with this type of issue would be welcome.

Staff Comment: In situations of an error in the application of SAB 101, the periods required to be restated would be the period in which SAB 101 was adopted and all subsequent periods reported, including quarterly filings. The registrant would be expected to apply the guidance in SAB 101 with regard to restatement of periods prior to adoption versus cumulative effect of change in accounting principle in the period of adoption. We agree that an error in the application of GAAP that would have been reported as an error pursuant to SAB 101 would require restatement of all periods presented.

B. SAB No. 80 in a Spin Off

Question: Assume a subsidiary of a public company is being spun off. Also assume that the operation being spun off is the product of numerous acquisitions, each of which has remained autonomous and substantially intact. For purposes of determining which acquired businesses financial statements need to be presented in the subsidiary's Form S-1 (or Form 10), can the guidance in SAB No. 80 (Topic 1J) be followed?

Background: SAB No. 80 refers to an "initial public offering" and "first time " but does not directly address whether a subsidiary that is being spun off by its public parent represents a first time registrant. The accounting literature defines a "public company" differently in different circumstances. For example, a subsidiary of a public company is not itself considered a public company for purposes of SFAS Nos. 128 on earnings per share or 131 on segment reporting. However, under SFAS No. 123 on stock compensation, a wholly owned subsidiary of a public parent is considered a public company.

Discussion: This question comes up from time to time because of the benefit that SAB No. 80 provides to initial registrants. Some believe that the SEC staff will accept the application of SAB No. 80 in this circumstance based on inquiries and experiences they have had with the staff. However, because there is nothing definitive in the SAB itself or in other publications from the staff, we thought it would be helpful to either confirm or clarify the staff's position on this issue.

Staff Comment: The staff generally would not object to the use of SAB 80 in these circumstances.

C. Changes in Segment Reporting

Question: Assume a registrant has changed its definition of operating segments internally. This change will result in a change in its reportable segments under SFAS No. 131 dealing with segment reporting and it is practicable for the registrant to recast some, if not all, of its previously reported segment data. However, the change occurred after the registrant's most recent 10-Q was filed, the financial statements reported in its most recent Form 10-K and Form 10-Q do not reflect any revisions to reportable segment information. Assume also that the registrant has filed a Form S-3 that incorporates the most recent Form 10-K and 10-Q by reference. Is this change in segment reporting a "fundamental change" for purposes of Form S-3 such that the registrant should report recasted segment information prior to the effective date of the Form S-3?

Background: We are not aware of any discussions on the issue of whether material changes in footnotes that result from changes in circumstances are considered a fundamental change for this purpose. There is a section in the current issues outline on segment recasting but it does not address this issue.

Discussion: In general, in a registration statement on Form S-3, registrants provide restated historical financial statements for a subsequent event such as a discontinued operation, pooling, stock split that is considered material. However, these types of subsequent events affect the basic financial statements. Although disaggregated information about a company is important for investors, a change in reportable segments affects the footnotes, not the basic financial statements. In fact, changes in the definition of a segment result in revised historical information only to the extent that it is practicable to obtain the revised information. Accordingly, a strong argument can be made that changes in reportable segments should be reported in the normal course of periodic reporting on Forms 10-Q and 10-K and not accelerated for purposes of a registration statement on Form S-3. We are interested in the staff's view on this.

Staff Comment: The registrant, in consultation with its counsel, is responsible for determining whether a fundamental change has occurred. The staff would not ordinarily expect a change in segment definitions after the balance sheet date to constitute a fundamental change. Accordingly, the staff would not ordinarily expect segment information to be recast until the historical financial statements include the period in which the change in segment definition occurred. However, disclosure of the nature and expected effects of the change would be required under Items 101 and 303 of Regulation S-K.

D. Applying Rule 3-09 when a registrant and its equity method investee have different year-ends

Questions: How should a registrant apply Rule 3-09 of Regulation S-X when its equity method investee has a different year-end? How and when should the significance tests be performed? What is the due date for the investee's financial statements?

Background: Rule 3-09 requires a registrant to file the financial statements of an equity method investee if the investee is significant at the 20% level under the investment or income tests in Rule 1-02(w). The investee financial statements may cover its fiscal year, rather than the fiscal year of the registrant. In Form 10-K filings the financial statements of an investee that is not a foreign business are due 90 days after the investee's year-end.

Discussion: It's not clear how a registrant should apply Rule 3-09 when its equity method investee has a different year-end. Questions arise both when a registrant records its equity in the investee's income with a consistent lag and when it does not. Consider the following two examples.

Example 1 - Equity income is recorded on a lag basis

Registrant has a 12/31 year-end
Investee has a 9/30 year-end and is not a foreign business
Registrant records equity income on a three month lag basis, i.e., the registrant records its equity in the investee's income for the fiscal year ended 9/30/00 in its 12/31/00 financial statements

Presumably, the registrant should perform the significance tests using amounts reflected in its 12/31/00 financial statements. If the investee is significant and its 9/30/00 financial statements are required, the registrant must file them by 12/29/00 to comply with the due date in Rule 3-09. However, the registrant's 12/31/00 financial statements, which provide the amounts for the significance tests, won't be available until after 12/29/00. How should the registrant apply Rule 3-09?

View A - Since the significance tests can't be performed without the registrant's 12/31/00 financial statements, in this situation it is acceptable to file the investee's financial statements after they would otherwise be due. The registrant should calculate significance using the amounts reflected in its 12/31/00 financial statements. If the investee is significant, then the registrant should file the investee's 9/30/00 financial statements no later than the date it files its 12/31/00 financial statements.

View B - Notwithstanding the practical difficulties described above, if the investee is significant, the registrant should file the investee's 9/30/00 financial statements no later than 12/29/00 as required by Rule 3-09. The registrant should be able to determine the numerators for the significance tests before 12/29/00. The registrant should estimate its 12/31/00 asset and income amounts and use the estimated amounts as the denominators for the significance tests.

Example 2 - Equity income is not recorded on a lag basis

Registrant has a 12/31 year-end
Investee has a 6/30 year-end and is not a foreign business
The registrant's 12/31/00 financial statements include its equity in the investee's income for the 12 months ended 12/31/00 (i.e., there is no lag in reporting)

In this fact pattern, the registrant records equity income based on investee statements for a period that differs from the investee's fiscal year. However, the investee financial statements a registrant would file to comply with Rule 3-09 would usually cover the investee's fiscal year. How should the registrant calculate the investee's significance? Should the registrant calculate significance using amounts reflected in its 12/31/00 financial statements? Or, should the numerators for the significance calculations be the registrant's investment as of 6/30/00 and its equity income for the twelve months ended 6/30/00? If so, should the denominators be registrant amounts as of and for the twelve months ended 12/31/99, 6/30/00, or 12/31/00? Does the registrant need to perform the calculations using more than one set of numerators and/or as of more than one of these dates? When are the investee's financial statements due? Although there are additional options, two approaches that might be considered are as follows.

View A - The registrant should calculate significance using amounts reflected in its 12/31/00 financial statements. If the investee is significant, then the registrant should file the investee's 6/30/00 financial statements. The next significance test should be performed using amounts reflected in the registrant's 12/31/01 financial statements. If the investee is significant, then the registrant should file the investee's 6/30/01 financial statements. The due date for the investee's financial statements should be determined based on the resolution of Example 1. (Note that in this fact pattern the practical difficulties in applying View B in Example 1 increase.)

This approach is appealing because it is practical and because significance is determined based on amounts in the registrant's annual financial statements. However, it may trigger requirements for audited investee financial statements that may not be material to investors and fail to trigger requirements for audited investee financial statements that may be material. In the fact pattern above, the investee may be significant due to a large unusual loss incurred in the six months ended 12/31/00. Using this approach would trigger a need for the investee's 6/30/00 audited financial statements. However, if the investee's results return to normal levels, the investee will be insignificant based on the amounts in the registrant's 12/31/01 financial statements. Therefore, investee audited financial statements for the year ended 6/30/01, the period with the large loss, will not be required. (However, investee 6/30/01 unaudited financial statements will be required.)

View B - As in View A, the registrant should calculate significance once each year using amounts reflected in its 12/31 financial statements. However, if the investee is significant, the registrant must file investee audited financial statements for the period tested (i.e., the twelve months ended 12/31). In this example, if the investee is significant based on amounts reflected in the registrant's 12/31/00 financial statements, the registrant must file investee audited financial statements for the twelve months ended 12/31/00. If the registrant elects to meet this requirement by filing investee financial statements covering the investee's fiscal year, it must file investee audited financial statements for both the years ended 6/30/00 and 6/30/01. The due date for the investee's 6/30/00 financial statements should be determined based on the resolution of Example 1. The registrant should file the investee's 6/30/01 financial statements by 9/28/01.

Staff Comment: Example 1 - Rule 3-09 permits the investee's financial statements to be filed up to 90 days after the investee's fiscal year end when the investee's fiscal year end is within 90 days of the registrant's filing date or later. When the investee's fiscal year end is the same as the registrant's or earlier, Rule 3-09 permits the investee's financial statements to be filed when the registrant's Form 10-K is due. The significance tests should be performed using the 9/30/00 financial statements of the investee and the 12/31/00 financial statements of the registrant.

Example 2 - Calculate significance based on the amounts recognized in the registrant financial statements. That is, the significance calculations should be based on the investee's 12/31/00 results compared to the registrant's 12/31/00 results. Investee financial statements for its fiscal year ended 6/30/00 would meet the requirements of Rule 3-09 (View A). Of course, the staff would not object if the registrant files investee financial statements that are more current than those described under View A.

E. Financial statement requirements for equity method investees of a target

Question: A registrant acquires a business. The target has equity method investees. How should the registrant evaluate whether it needs to provide financial statements of some or all of the target's equity method investees to comply with Rule 3-05 of Regulation S-X?

Background: When a registrant acquires an interest in another company, Rule 3-05 requires it to provide the target's audited financial statements if the target is significant to the registrant. There may be circumstances where the financial statements of the target alone are not sufficient. This might occur if the target has recently made a significant acquisition. It might also occur if the target has a significant equity method investee. Rule 3-05 does not address this situation, so a registrant needs to use judgment to decide whether it has reported sufficient information.

SAB Topic 6-K.4.a. provides guidance for computing the significance of an investee of an investee when applying Rule 3-09. A registrant might evaluate the need for financial statements of its target's investee by calculating the investee's significance (using the methodology in the SAB) to the registrant and providing whatever Rule 3-05 would require for an acquisition of that significance level.

Discussion: It's not clear how a registrant should make the judgment described above if the target has more than one equity method investee. For example, assume that Company A acquires a 40% equity interest in Company B. This acquisition is significant at the 25% level. Therefore it requires one year of Company B audited financial statements. Company B's operations consist of the production and sale of durable goods. It also owns 30% equity method investments in three companies: Investee X, Investee Y, and Investee Z. How should Company A evaluate whether it needs to also file audited financial statements for Investees X, Y, and/or Z?

View A - Company A acquired its indirect investments in Investees X, Y, and Z in a single transaction. Based on Rule 3-05(a)(3), Company A should view them as related acquisitions. If Investees X, Y, and Z, viewed in the aggregate, are significant to Company A, then Company A should provide financial statements for Investees X, Y, and Z. This is the approach Company A would use if it had simply purchased the three investees from Company B.

View B - This approach is similar to View A. However, in this approach the operations of Company B (excluding the equity method investees) and Investees X, Y and Z should be viewed as four related acquisitions. Company A should "strip out" the operating activities of Company B and measure their significance in combination with the three investees. Some might find this approach appealing if the operations of Company B are small in relation to Company B's equity method investments.

View C - Company A should evaluate the significance of Company B and each of the three investees individually. In subsequent filings, this is the manner in which Company A will evaluate the need to provide their separate financial statements to comply with Rule 3-09. The reporting pursuant to Rule 3-05 at the time of the acquisition should be consistent with the reporting pursuant to Rule 3-09 subsequent to the acquisition.

Staff Comment: The staff agrees that Rule 3-05 does not directly address this situation, and that judgement is required to determine whether sufficient information has been reported in the particular facts and circumstances.

F. **SAS No. 71 review reports of other accountants**

Questions: A registrant's independent accountant issues a SAS No. 71 review report on the registrant's interim financial statements. In the report, the accountant refers to the review report of another accountant (for example, the accountant for a significant equity method investee). The registrant includes that review report in a Form 10-Q. Does the registrant need to also include the review report of the other accountant in its Form 10-Q? If so, and if the other entity is a registrant, does this create a requirement for the other registrant to include its accountant's review report in its Form 10-Q?

Background: Under CSAS AU 722.31, an "accountant may use and make reference to the report of another accountant on a review of interim financial information of a significant component of the reporting entity." In the example report, the accountant adds a second paragraph stating that it was furnished with the report of the other accountant. The accountant modifies the concluding paragraph to refer to the report of the other accountant.

Rule 2-05 of Regulation S-X addresses examinations of financial statements made by more than one accountant. It states that if the principal accountant refers to the report of the other accountant, the registrant must file the report of the other accountant.

Rule 10-01(d) of Regulation S-X indicates that a registrant normally has a choice of whether to include an accountant's review report in its Form 10-Q. It states, "If, in any filing, the company states that interim financial statements have been reviewed by an independent public accountant, a report of the accountant on the review must be filed with the interim financial statements."

Discussion: Given the concept in Rule 2-05, one could read Rule 10-01(d) broadly, i.e., to say that the registrant including its principal accountant's review report in its Form 10-Q should also include the other accountant's review report in its Form 10-Q. However, reading Rule 10-01(d) literally, one might interpret it to mean that the registrant needs to file only the principal accountant's review report.

If the other accountant's review report must be filed, this raises the question of whether the other registrant must file its accountant's review report in its Form 10-Q. One could read Rule 10-01(d) to say that since the first registrant stated in a filing that the review of the other registrant's financial statements had been performed, the other registrant must file its accountant's review report. On the other hand, the other registrant is not the registrant that stated that a review had been performed. Therefore, reading Rule 10-01(d) literally, one might interpret it to mean that the other registrant does not need to file its accountant's review report.

Staff Comment: If an accountant's review report is included in a filing, and that review report makes reference to the review report of another accountant, then the other accountant's review report should also be filed. This view is consistent with Rule 2-05 of Regulation S-X. The other registrant (investee) would not be required to file its accountant's review report unless it also made reference to that report in its filing.

G. Presenting income taxes in carveout financial statements

Question: Should carveout financial statements (i.e., financial statements of a business that is not a legal entity, e.g., a division) reflect income tax expense and deferred tax assets/liabilities if the reporting entity is a component of a taxable entity?

Background: The accounting literature does not clearly address the issue of accounting for income taxes by a reporting entity that is not a legal entity.

Paragraph 1 of SFAS 109 states that it "addresses financial accounting and reporting for the effects of income taxes that result from an enterprise's activities . . . ." Paragraph 40 provides standards for accounting for income taxes in the "separate financial statements of a subsidiary." It states that tax expense "shall be allocated among the members of the group when those members issue separate financial statements." (Emphasis added.) SFAS 109 does not define the term "enterprise." However, paragraph 40 seems to apply only to legal entities.

SAB Topic 1-B is entitled Allocation of Expenses and Related Disclosures in Financial Statements of Subsidiaries, Divisions, or Lesser Business Components of Another Entity. In its text, it seems to use the word "subsidiary" as a surrogate for the larger collection of reporting entities listed in its title. The response to Question 1 states that "the historical income statements of a registrant should reflect all of its costs of doing business." However, the response then states that "income taxes . . . are discussed separately below." Question 3 addresses income tax expense. Although the SAB seems to use the term "subsidiary" broadly, the discussion of subsidiary income taxes in the response to Question 3 seems to be written in the context of legal entities, referring to issues of whether the entity can be included in a consolidated tax return (this is not an issue for a component of a legal entity) with its "parent." The response states the need to provide a pro forma tax provision if the financial statements do not reflect income taxes on a separate return basis. Guidance in the Staff Training Manual (at Topic Three.IV.A.1. and Topic Seven.IV.A.4.) also focuses on the need for pro forma tax provision information.

Although an allocation of deferred tax assets and liabilities needs to be made to apply the separate return method, none of this guidance specifically addresses balance sheet presentation or footnote disclosure issues. The guidance calling for pro forma information focuses on the need for tax provision information.

Discussion: Many accountants focus on the concept stated in SAB Topic 1-B that income statements should reflect all costs of doing business. They present income tax provisions as part of the historical accounts reflected in carveout financial statements. Others believe that since reporting entities that are not legal entities do not have legal tax status, they do not have tax liabilities or expenses. Therefore, they present income tax information in carveout financial statements only on a pro forma basis. Although practice does not appear to be uniform, it appears that registrants present income taxes in carveout financial statements as part of the historical accounts more frequently than they present them as pro forma information. This observation is based in part on comments made by the Big 5 accounting firms in communications discussing the question of whether a single member LLC should present a tax provision in its financial statements. A single member LLC is treated as a "disregarded entity" for tax purposes. In other words, it is treated no differently than a division of a taxpayer. The majority of the firms felt that a single member LLC should present a tax provision. The other firms did not have strong views.

Staff Comment: As stated in SAB Topic 1B, the staff believes that financial statements are more useful to investors if they reflect all costs of doing business. As the transactions reported in the carveout financial statements have income tax implications to the taxable entity of which the reporting entity is a part, the staff believes that carveout financial statements should reflect income tax expense and deferred tax assets/liabilities attributable to the reporting entity.

H. Computing significance of a disposition when the business sold was previously reported as a discontinued operation

Question: How should a registrant compute the significance of a disposition, for purposes of determining whether it must file a Form 8-K, when it reported the business it disposed of as a discontinued operation in its financial statements for its most recent fiscal year?

Background: Item 2 of Form 8-K requires a registrant to file a Form 8-K to report a disposition of "a significant amount of assets." Instruction 4 to Item 2 defines a "significant amount of assets." It indicates that a Form 8-K is required if a registrant disposed of a business that meets the definition of a significant subsidiary as defined by Rule 1-02(w) of Regulation S-X.

Discussion: It's not clear how a registrant should perform the income test and the asset test in Rule 1-02(w) when it reported the business being tested as a discontinued operation in its financial statements for its most recent fiscal year.

Income Test - The income test requires a registrant to calculate the contribution of the tested subsidiary to its total pretax income from continuing operations for its most recent fiscal year. However, under APB 30, the results of discontinued operations are reported on a single line below income from continuing operations. Therefore, in this fact pattern, the registrant's total pretax income from continuing operations does not include any income related to the tested subsidiary. How should a registrant perform the income test?

View A - The numerator in the calculation is zero. Accordingly, the significance level under this test is zero. This answer makes sense given the prior reporting of the business as a discontinued operation. Investors' primary interest is now in whether the disposal involved a significant amount of assets or proceeds.

View B - The numerator in the test should be the historical operating results of the discontinued operation (which may include future operating and disposition losses recognized on the measurement date). The denominator in the test should be net income. The registrant needs to consider all aspects in evaluating the significance of the disposition.

Asset Test - Practice for presenting the assets and liabilities of discontinued operations varies. Some registrants segregate the asset and liabilities of discontinued operations and report net amounts for current and noncurrent items. Others do not report these items net. When the amounts are reported net, how should a registrant perform the asset test?

View A - A registrant should perform the test using the gross amount of the assets of the discontinued operation and the gross amount of its total assets. This approach is most appropriate because the gross asset amount is generally the amount for which the registrant is at risk.

View B - A registrant should perform the test using the net amounts it reported in its financial statements. If reporting the amounts net is the most meaningful approach for presenting the financial statements, it is also the most meaningful approach for measuring the significance of the disposition.

Staff Comment: The significance tests should be based on the historical gross amounts of the disposed business (View B for the income test and View

A for the balance sheet). Item 2 of 8-K has a different purpose than APB Opinion 30. The staff believes that APB 30 presentation and classification practices for expected dispositions should not alter the measurement of significance, nor delay the timely reporting of the terms and effects of consummated dispositions. In certain circumstances, the material effects of the disposition may already be reflected in the historical financial statements, so that no pro forma information would be required.

I. Applicability of Item 2 of Form 8-K when a registrant's subsidiary sells stock

Question: A registrant's subsidiary sells stock to another investor, reducing the registrant's ownership percentage. Is this transaction a "disposition" that the registrant must report under Item 2 of Form 8-K if it is significant?

Background: Instruction 2 to Item 2 of Form 8-K defines the term "disposition" broadly. It states, "The term "disposition" includes every sale, disposition by lease, exchange, merger, consolidation, mortgage, or hypothecation of assets, assignment, whether for the benefit of creditors or otherwise, abandonment, destruction, or other disposition."

Discussion: After the transaction, the registrant's financial statements will reflect a lower percentage of the subsidiary's income. Also, the registrant might need to stop consolidating the subsidiary. Therefore, some might believe that a disposition subject to Item 2 reporting has occurred.

Others might focus on the fact that the registrant has not disposed of any asset. It still owns all of the shares of the subsidiary that it owned before the transaction. They might conclude that no disposition has occurred.

Still others might focus on the accounting for the transaction. They might take the view that if a gain or loss was recognized pursuant to SAB 51, it is because the substance of the transaction is the same as one in which the registrant sold its shares in the subsidiary to the investor. Therefore, the transaction was a disposition. However, if the "SAB 51 gain" was credited to equity, then the transaction was not a disposition.

Staff Comment: The staff views the sale of subsidiary stock as a disposition of the registrant's investment in the subsidiary. The registrant must report the disposition under Item 2 of 8-K if significant.