

EITF ABSTRACTS

Issue No. 85-1

Title: Classifying Notes Received for Capital Stock

Dates Discussed: February 14, 1985; March 28, 1985

Reference: SEC Staff Accounting Bulletin No. 40, Topic 4E, *Receivables from Sale of Stock*

ISSUE

An enterprise receives a note, rather than cash, as a contribution to its equity. The transaction may be a sale of capital stock or a contribution to paid-in capital.

The issue is whether an enterprise should report the note receivable as a reduction of shareholders' equity or as an asset.

EITF DISCUSSION

The Task Force reached a consensus that reporting the note as an asset is generally not appropriate, except in very limited circumstances when there is substantial evidence of ability and intent to pay within a reasonably short period of time. Some Task Force members would require collateralization, or payment of the note prior to issuance of the financial statements, to permit asset recognition.

The SEC requires that public companies report notes received in payment for the enterprise's stock as a deduction from shareholders' equity. Task Force members confirmed that the predominant practice is to offset the notes and stock in the equity section. However, such notes may be recorded as an asset if collected in cash prior to issuance of the financial statements.

Some Task Force members stated that they were aware of very few cases in which nonpublic companies reported such notes as an asset except in circumstances in which they (1) were secured

by irrevocable letters of credit or other liquid collateral or were discountable at a bank and (2) included a stated maturity in a reasonably short period of time.

The SEC Observer stated that, for registrants, exceptions to the general rule would be very rare.

STATUS

No further EITF discussion is planned.