

David B. Elsbree, Jr., CPA
33 Pond Avenue, Unit 1109
Brookline, MA 02445
e-mail: david.b.elsbree.91@alum.dartmouth.org

Director of Technical Application and Implementation Issues
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

October 28, 2005

Ladies and Gentlemen:

Re: File Reference No. 1205-001

I appreciate the opportunity to express my views on the Board's proposed Statement of Financial Accounting Standards *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries – a replacement of ARB No. 51* ("Exposure Draft II"). The Board has issued Exposure Draft II concurrently with its proposed Statement of Financial Accounting Standards *Business Combinations – a replacement of FASB Statement No. 141* ("Exposure Draft I," collectively the "Exposure Drafts"). I have written a separate letter to the Board commenting on Exposure Draft I, and these two letters should be read in conjunction with one another.

The Board's proposed approaches set forth in the Exposure Drafts represent radical changes from the current accounting models: from an historical cost model to a fair value model for business combinations and from a parent company model to an entity model for consolidations. For the reasons set forth below, I cannot support these changes, and I urge the Board not to move forward with these projects in their current form.

As both an investor and an auditor, I am a firm believer in the historical cost model of accounting. I believe that it is a common sense model that has withstood the test of time and is easy for common investors to understand. You buy an asset, you record that asset in your balance sheet at the price you paid for it. You sell an asset, you recognize a gain or loss. If an asset you hold becomes impaired, you recognize that loss when the impairment occurs. However, if the value of that asset increases, you do not recognize the gain until it is realized or realizable and earned.

It is the historical cost model that is still the basis for accounting for almost all assets and liabilities. In light of the fact that business combination and consolidation accounting is based on the concept of "seeing through" the shares acquired or held by the parent company and accounting for the individual assets and liabilities of the controlled subsidiary, it seems only logical that the accounting for business combinations should be consistent with the existing model for accounting for those individual assets and liabilities.

I also have certain misgivings about the fair value model of accounting. I have previously communicated those concerns in a letter to the Board dated September 7, 2004, and therefore I will not repeat them here.

Additionally, I am a believer in the parent company model for consolidations. My support for this model is based on the view that consolidated financial statements are prepared primarily for the benefit of investors and potential investors in the parent company. I believe that such individuals are interested in the earnings, assets, liabilities, and equity of the group that are attributable to the parent company's interest in its subsidiaries. After all, earnings or net assets attributable to the parent company's interest are what investors in the parent company would be entitled to receive if all of the earnings were divided up the ownership chain or if all of the group entities were liquidated.

I also believe that we as accountants should strive to make financial statements easier for common investors to understand. I believe that we all benefit when common investors take the time to read financial statements and make informed investment decisions, rather than simply relying on investment advisors to make those decisions for them. Unfortunately, common investors are discouraged from taking the time to read financial statements when they contain a plethora of extraneous information and/or when they are so complicated that only an elite few can understand them. Having read the examples of the presentation and disclosure requirements of Exposure Draft II contained in paragraphs A3-A9, I am convinced that the proposed requirements would make financial statements *more difficult* for common investors to understand than under existing guidance.

Consistent with these views, I disagree with almost all of the proposed changes to current practice set forth in the Exposure Drafts. And while I applaud the efforts of the Financial Accounting Standards Board and the International Accounting Standards Board to work together to develop accounting standards that strive toward convergence, I cannot support those efforts at the expense of accepting what would be, in my opinion, lower quality US GAAP accounting standards.

I have included specific responses to most of the questions from Exposure Draft II in Appendix I, and I have also included some additional comments for the Board to consider in Appendix II.

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Thank you for taking the time to consider my views. If you have questions or comments, do not hesitate to contact me.

Sincerely yours,



David B. Elsbree, Jr.

Appendices

Responses to Questions in Exposure Draft II

(Paragraph references in the appendices are to Exposure Draft II unless otherwise noted.)

Question 1 – Do you agree that the noncontrolling interest is part of the equity of the consolidated entity? If not, what alternative do you propose and why?

Whether noncontrolling interests in subsidiaries actually represent part of the equity of the consolidated entity is perhaps an interesting philosophical question that one could debate *ad nauseam* and never arrive at a consensus. I think that the more relevant question is: “What approach to the presentation of noncontrolling interests, in both the statement of financial position and the statement of operations, is the most relevant to the users of those financial statements?” For my answer to this question, see my response to question 2 below.

Question 2 – Do you agree with the proposed requirement to present the noncontrolling interest in the consolidated statement of financial position within equity, separately from the parent shareholders’ equity? If not, what alternative do you propose and why?

I disagree with the proposed requirement to present noncontrolling interests in the equity section of the consolidated statement of financial position. I also disagree with the approach of showing a net income or loss figure in the consolidated statement of operations that includes amounts that are attributable to the noncontrolling interests. My position is based primarily on my view that (1) consolidated financial statements are prepared primarily for the benefit of investors and potential investors in the parent company, and (2) of the solutions available to this problem, the approach advanced by the Board appears to be the least useful to that group of financial statement users.

With regard to point (1), I believe that the consolidated financial statements of a parent company can be presumed to have little to no usefulness to noncontrolling interest holders of subsidiaries. Such interest holders are entitled to receive dividends from only the specific entity or entities in which they have an ownership interest. They are not entitled to receive dividends from the earnings of the entities of rest of the group. Nor can noncontrolling interest holders of subsidiaries discern from the consolidated financial statements of the parent company the amount of earnings to which their interests may be entitled, because there are no disclosure requirements (either existing or proposed) that would require the parent company to specifically identify the subsidiaries to which the noncontrolling interests relate. Noncontrolling interest holders of subsidiaries can obtain information that better serves their needs by reading stand-alone financial statements of the subsidiary in which they own an interest.

Indeed, paragraph 6 confirms that “[t]he purpose of consolidated financial statements is to present, *primarily for the benefit of the shareholders and creditors of the parent*, the results of operations and the financial position of a parent and all its subsidiaries as if the group were a single economic entity” (emphasis added).

With regard to point (2), I believe that we accountants should focus on requiring presentation of information in financial statements that is truly material to the users of financial statements, i.e., it would change the judgment of a reasonable reader of the financial statements, and we should eliminate requirements for information that might be “nice to have” for investors but is extraneous and not truly material.

Investors (or potential investors) in a parent company are interested in the earnings, assets, liabilities, and equity that are (or would be) attributable to *their* ownership interest and therefore

to the parent company's ownership interest. The approach that is the most relevant to these individuals is to present total equity and net income or loss figures that include only those amounts that are attributable to the parent company's interest (the controlling interest).

While it is clear that the Board's proposed approach would require presentation of this information, it would also require presentation of a whole host of incremental information (e.g., total equity and net income or loss on a combined basis with amounts attributable to the noncontrolling interests) that is not relevant to investors (or potential investors) in the parent company (controlling interest). Accordingly, I believe the preferable answer is not to require the presentation of such information in the financial statements.

If noncontrolling interests are not presented in the equity section of the consolidated balance sheet, that leaves only two possible options for its presentation, in my view: (1) presentation on a "mezzanine" level consistent with existing prevalent practice, or (2) use of the proportional method of consolidation, resulting in no presentation of noncontrolling interests at all. In my view, it would be inappropriate to categorize noncontrolling interests as liabilities, and the Board appears to agree with me on this point.

In my response to Exposure Draft I, I have suggested that the proportional method of consolidation should not categorically be excluded from the debate about the most appropriate approach to consolidation of less-than-100-percent-owned subsidiaries. While such an approach certainly has its drawbacks, it does have the benefit that it would eliminate presentation of the noncontrolling interests altogether, thus resolving this debate.

That said, it seems to me that the approach that likely involves the fewest of the evils is the existing prevalent practice of showing noncontrolling interests on the "mezzanine" level in the statement of financial position. If the Board feels that this approach requires the creation within the conceptual framework of a new element of the statement of financial position, viz. "noncontrolling interests in subsidiaries" (paragraph B13), I suggest that the compelling reason to do so is that it is in the interests of providing the most relevant information to users of parent company financial statements.

Question 3 – Do you agree with the proposed requirements for attributing net income or loss and the components of other comprehensive income to the controlling and noncontrolling interests? If not, what alternative do you propose and why?

I agree with the clarification that the attribution of income to the controlling and noncontrolling interests should be based on relative ownership interests unless a contractual arrangement dictates otherwise (paragraph 21).

I generally disagree, however, with the proposed guidance in paragraph 22 that would require continued attribution of losses to the noncontrolling interests when those losses exceed their interests in the subsidiary's equity. I agree with the reasoning stated in paragraph 15 of ARB 51, *Consolidated Financial Statements*, for discontinuing such attribution under those circumstances. I also note that the required treatment under ARB 51 is the mirror image of the treatment required of an equity-method investor in such circumstances under Opinion 18, *The Equity Method of Accounting for Investments in Common Stock*.

As for other comprehensive income, I would observe that I disagree in principle with the concept of "other comprehensive income," because I do not believe that common investors understand what that term means. In my opinion, in order to make financial statements easier for common

investors to understand, we accountants should strive to eliminate requirements to classify items as other comprehensive income from the existing literature.

Question 4 – Do you agree that changes in ownership interest in a subsidiary after control is obtained that do not result in a loss of control should be accounted for as equity transactions? If not, what alternative do you propose and why?

I disagree with this approach on the basis that it is inconsistent with both the historical cost model of accounting and my recommended approach to present noncontrolling interests outside of equity in the statement of financial position.

Under the historical cost model, sales transactions give rise to gains or losses, and purchase transactions do not. Whether the parent company has control over another entity is, in my view, not relevant to the question of whether gain or loss recognition upon purchase or sale of that entity's shares is appropriate.

Question 5 – Do you agree that any gain or loss resulting from the remeasurement of a retained investment in a former subsidiary should be recognized in income of the period? If not, what alternative do you propose and why?

I disagree with the proposed broad requirement that companies remeasure the retained investment upon loss of control of a subsidiary. There is no basis in the accounting literature for an entity to recognize a *gain* on asset A when it sells asset B.

However, I would note that if a *loss* is indicated on the retained investment because the per-share selling price of the sold shares is less than the per-share carrying value of the retained investment, it seems that some form of impairment test on that investment would be in order. I would support a requirement to perform an impairment test on that investment in such circumstances, in accordance with the generally accepted accounting principles applicable to that investment. (In this regard, it would be helpful if the Board would provide additional guidance on determining when an impairment charge should be recorded on an equity-method investment.)

Question 6 – Do you agree with the proposed guidance for determining whether multiple arrangements should be accounted for as a single arrangement? If not, what alternative do you propose and why?

I agree with the proposed guidance on this subject, and I believe such guidance should be expanded to apply broadly to *all* transactions, not just to transactions that are within the scope of Exposure Draft II.

Question 7 – Do you agree that earnings per share amounts should be calculated using only amounts attributable to the controlling interest? If not, what alternative do you propose and why?

I agree that earnings per share amounts should be calculated using only amounts attributable to the controlling interest, as these are the amounts that are most relevant to investors and potential investors in the parent company. As discussed above in my response to question 2, I also believe that net income should be calculated using only amounts attributable to the controlling interest, consistent with existing prevalent practice.

Question 8 – Do you agree that disclosure of the total amounts of consolidated net income and consolidated comprehensive income, and the amounts of each attributable to the controlling interest and the noncontrolling interest should be required? If not, why?

As discussed in my response to question 2, I believe that such information is not relevant to the decision making of investors or potential investors in the parent company, and therefore presentation of such information should not be required.

Question 10 – Do you agree that a reconciliation of the changes in the noncontrolling interest should be required? If not, why?

In my opinion, such a reconciliation fits squarely into the category of “information that might be ‘nice to have’ for investors but is extraneous and not truly material.” Accordingly, I disagree with requiring such a reconciliation.

Question 11 – Do you agree that disclosure of a separate schedule that shows the effects of any transactions with the noncontrolling interest on the equity attributable to the controlling interest should be required? Please provide the basis for your position.

It is not clear to me how such a schedule would be relevant to investors and potential investors in the parent company. Therefore I would not support a requirement for such a schedule.

Question 12 – Do you agree that disclosure of the gain or loss recognized on the loss of control of a subsidiary should be required? If not, why?

As discussed in my response to question 5, I disagree that a gain or loss on the loss of control of a subsidiary should be recognized on the retained investment unless an impairment charge is required. Such an impairment charge should be disclosed in accordance with existing generally accepted accounting principles applicable to the retained investment.

Additional Comments

As I noted in my introductory comments, I urge the Board not to go through with these radical changes to the model for presentation of noncontrolling interests. Nevertheless, I have included some additional comments and questions below for the Board to consider.

- It is not clear to me why the Board chose to highlight the general principles in bold type in Exposure Draft I but not in Exposure Draft II. As I noted in my response to question 19 in Exposure Draft I, I support printing the general principles in bold type. I recommend that the Board use this approach in all new Standards going forward.
- I agree with the Board's proposed clarification that parent-company only financial statements are not a valid substitute for consolidated financial statements (paragraph 19).
- I disagree with the Board's proposed treatment of "SAB 51 gains" as equity transactions (paragraphs B28 and B29). I also disagree with the existing guidance in SEC Staff Accounting Bulletin Topic 5-H, *Accounting for Sales of Stock by a Subsidiary*, on this subject, which requires that SAB 51 gains be treated as equity transactions under certain circumstances. I support gain recognition for SAB 51 gains for the following reasons:
 - They represent realized gains of the parent company,
 - They result from sales transactions (as opposed to purchase transactions, in which case gain recognition would be inappropriate), and
 - They result from transactions with parties who are (presumably) not shareholders of the parent company (as opposed to transactions with the shareholders of the parent company, in which case treatment as an equity transaction would be appropriate).

I would not object to a requirement to classify all SAB 51 gains as extraordinary items, in light of their unique nature.

- The Board should clarify the extent to which existing generally accepted accounting principles governing the derecognition of assets and liabilities (e.g., Statement 66, *Accounting for Sales of Real Estate*, and Statement 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*) apply when a parent company loses control over a subsidiary and deconsolidates that subsidiary. Existing prevalent practice is that the assets and liabilities of that subsidiary are derecognized only if the criteria for derecognition of those assets and liabilities have been met. I recommend that the Board provide specific guidance on this subject, regardless of whether it goes forward with the proposed changes in Exposure Draft II.