

**MCI Communications
Corporation**

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February 15, 1996

Mr. Timothy S. Lucas
Director of Research and Technical Activities
Financial Accounting Standards Board
File Reference No. 154-D
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Mr. Lucas:

**Exposure Draft
Proposed Statement of Financial Accounting Standards
Consolidated Financial Statements: Policy and Procedures**

On behalf of MCI Communications Corporation, I am writing to express our strong disagreement with the Board's proposed accounting as described in its Exposure Draft on "Consolidated Financial Statements: Policy and Procedures" (ED). While we recognize that the Board is sometimes asked to provide guidance concerning accounting for affiliations between entities, we cannot endorse the drastic changes proposed by the Board to deal with what most practitioners perceive to be minor imperfections in current practice. In addition, for the reasons discussed below, we believe that your current proposal contains a number of shortcomings which would lead to inconsistent financial statement treatment of "controlled" affiliates.

Definition of Control

The ED would require a company to consolidate all entities that it "controls" (subsidiaries) unless this control is temporary in nature. In defining control, the Board states that control of an entity is "power to use or direct the use of the individual assets of another entity in essentially the same ways as the controlling entity can use its own assets." Under current generally accepted accounting principles, legal control of a majority of an entity's voting shares creates the presumption that the holder of the shares controls said entity. This "bright line" has led to the consistent practice by accountants of consolidating all majority-owned entities, while also reviewing a company's less than majority-owned affiliates for indications of control. The ED, while retaining the concept of legal control, stresses that a company may also gain "effective control" of an affiliated entity in the absence of an unconditional legal right. In addition to giving much more prominence to the concept of effective control, the ED would also further complicate the accounting for affiliated entities by including the following points in the definition of effective control:

- Effective control need not be unrestricted;
- Actual exercise of effective control is not required;
- Little or no economic interest in the affiliate is required.

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In our opinion, the ED's expanded definition of control would substantially increase the number of irrelevant consolidated affiliates. Furthermore, where the rules for consolidation have always been reasonably straightforward in the past, the ED will lead to increased instances where the consolidation of an affiliated entity will be determined based upon often subjective assessments by the "parent" management team. As it will be difficult for external auditors to rebut such subjective management assessments, we believe that this expanded definition of control could result in more accounting motivated transaction structures.

Economic Unit Concept

By embracing the economic unit concept, the ED would require that the noncontrolled interest in an affiliated entity be classified in stockholders' equity. In addition, the noncontrolled interest in the net income of an affiliate would be displayed in the income statement as a deduction after consolidated net income. Once again, we feel these departures from the historical use of the parent company concept are unwarranted and will only confuse readers of financial statements who have become accustomed to the presentation of minority interests in affiliates as a separate line between liabilities and stockholders' equity. In addition, since a noncontrolling interest in an affiliate has no ownership interest in the parent company, the current presentation outside of the parent company's equity section is considered to be more meaningful and appropriate.

Under the economic unit concept, the ED also treats all transactions involving the controlled entity's stock as treasury stock transactions, unless the transaction results in a loss of control of said entity. Consistent with our objections above, since we do not view the noncontrolled interest of an affiliated entity as an appropriate component of the parent company's equity section, we also see no logical reason to treat stock transactions of a controlled entity as tantamount to treasury stock transactions. Regardless of whether it results in a change in control, we view a sale of stock in a controlled affiliate as the culmination of the earnings process which requires the recognition of any associated gain or loss. Similarly, the purchase of additional shares of a controlled affiliate should result in an increased investment basis.

Finally, the economic unit concept results in the recognition of goodwill only at the point at which an affiliated entity becomes controlled. We disagree with this accounting treatment which could lead to a significantly different amount of goodwill related to a controlled affiliate depending solely on whether control was obtained in one transaction or a series of steps.

Other Matters

Illustrative Examples

The examples in Appendix B should be expanded to cover the following facts and circumstances:

- Example 1 - At what threshold, above 3%, would the other shareholders be deemed to own a significant interest in the company? How would such significant interest of other shareholders impact on the conclusions presented?
- Example 3 - In this example, it would be helpful to provide an illustration of some instances where the controlling entity would not be assuming "risks in excess of the expected benefits from conversion."
- New examples should also be added to deal with the impact on the controlling entity (parent) of veto and consent rights often granted to noncontrolling shareholders.

Conforming Fiscal Periods

We are unaware of any significant problems created by the current practice of allowing differences of up to three months between the fiscal year of the parent and its controlled affiliates. Accordingly, the ED provision that calls for the conforming of these fiscal periods is deemed unnecessary. Furthermore, the ED's discussion of the ease with which the Board feels such conformity can be achieved is representative of what we perceive to be a gross understatement of the cost and effort that will be required by many companies to implement this proposed standard.

* * * * *

In closing, we must reiterate our belief that the current guidance provided in ARB 51 and SFAS 94, while not perfect, has served the accounting profession well and has led to consistent, relevant financial statement presentation and disclosure of affiliations between entities. In our opinion, if current GAAP were to be superseded by this ED, it would represent a significant step backwards,

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away from the accounting profession's goal of providing consistent, relevant information to the users of financial statements. As summarized in the Alternative View portion of Appendix A, we concur with the Board member who argued as follows:

That is, if the parent in substance is exposed to the majority of that entity's ultimate net cash flows, he would consolidate the entity. Otherwise, for those less-than-50-percent-owned controlled entities, he believes that the equity method of accounting for an investment in a controlled entity combined with disclosure in notes to the parent's financial statements provides a better basis for assessing the probable amounts and timing of future net cash inflows to investors in the parent company.

I would be pleased to discuss our comments with you in more detail at your convenience.

Sincerely,



James M. Schneider
Senior Vice President, Finance
and Chief Accounting Officer

CC: Douglas L. Maine, Chief Financial Officer
David M. Case, Controller
Robert M. Tarola, Price Waterhouse