FIRST
CHICAGO
NBD
CORPORATION

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January 25, 1996

Mr. Tim Lucas
Director of Research and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

File Reference 154-D

Dear Mr. Lucas:

First Chicago NBD (Corporation) appreciates this opportunity to comment on the Exposure Draft (ED), *Consolidated Financial Statements: Policy and Procedures*. Our general comments are below while more detailed comments to provisions in the ED are attached.

Concept of Control

The Corporation recommends that the scope of the Financial Accounting Standards Board (FASB) project be limited to defining the concept of control as an amendment to Statement of Financial Accounting Standards (SFAS) No. 94, *Consolidation of All Majority-owned Subsidiaries*. The existing model, which requires consolidation when an entity has a controlling financial interest (i.e., voting interest exceeds 50%), has generally worked well with the exception of certain borderline situations in which legal control exists even though a greater than 50% voting interest does not exist. Typically, such situations involve the use of special-purpose entities or partnership structures. The amendment should focus on establishing brighter lines to determine consolidation in those borderline cases with particular emphasis on special-purpose entities and partnerships.

The Board's proposed model, which focuses on control as the sole determinant of consolidation, requires more subjective judgements than the current model. As a result, the proposed model may lead to inconsistent reporting by preparers of consolidated financial statements. Specifically, it may lead to more than one company consolidating the same entity or similar transaction structures being consolidated by one entity but not by another.

The Corporation recommends that the accounting treatment found in the ED, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities,* not be undermined by provisions of this Statement. Of particular concern is the accounting treatment for a credit card securitization. The Corporation recommends that a provision be

added indicating that if a securitization qualifies as a transfer, then consolidation of the special-purpose entity is not appropriate since, by definition, control has been surrendered. Also, we recommend adding an example involving a credit card securitization to Appendix B of this ED highlighting that consolidation is not appropriate.

The Corporation also requests clarification on issues related to the concept of control. They include, but are not limited to, the following:

- How should incentives beyond base compensation found in management contracts be viewed? Our view is that incentives built into the management contract should not be viewed as an indication of control unless they are significantly above market norms.

- What is the effect of the change to the concept on control on other authoritative guidance, which are based on the risk/reward model. Examples include, but are not limited to, various SEC pronouncements, such as Staff Accounting Bulletins No. 40, 51, and 81, and Emerging Issues Task Force (EITF) conclusions.

Consolidated Level Reporting

The Corporation disagrees that the consolidated entity be limited to one method of accounting for the entire scope of its business activities. In particular, we recommend that a venture capital subsidiary be exempted from the scope of the final Statement. If a segment of an entity's business is in a specialized industry where it is more appropriate and relevant to utilize specialized industry accounting practices, then we believe the effects of such practices should flow through to the consolidated financial statements. For example, a financial services organization that controls a venture capital subsidiary would be required to reverse out certain fair value revaluations that may not be recorded under SFAS 115, or may be required to consolidate a venture capital investment. Although such reporting would result in consistent accounting for all investments in equity and debt securities at the consolidated reporting level, it ignores the fact that a particular segment is managed as a venture capital business and its results should be reflected in a similar fashion to those standalone venture companies. This is particularly true if such business is reported as a business segment. If the specialized industry reporting provision is retained, guidance will be needed regarding transition.

The Corporation also recommends that the criteria for determining what constitutes an investment company be based on the nature of an entity's operations rather than measurement of its assets and liabilities. For example, a venture capital subsidiary of a financial institution clearly is an investment company as defined by the investment company industry

audit guide. A venture capital company's profitability is typically derived from the ultimate disposition of its investments rather than from their ongoing operations. However, not all financial institutions measure investments of its venture capital subsidiaries at fair value. As a result, inconsistent accounting among different reporting entities may result simply because of the measurement approach selected by an entity. Such inconsistencies would not occur if the criteria were based on the underlying nature of the business.

Temporary Control

The Corporation generally concurs with the Board's definition of temporary control. However, consistent with our view that a venture capital subsidiary be exempt from the provisions of the final Statement (i.e., follow specialized industry accounting), we recommend that the temporary control provision should not apply to investments of a venture capital subsidiary. We also recommend that any entity received by a financial institution related to debt previously contracted, either through foreclosure or in-substance foreclosure, should be exempt from the temporary control provision. In general, financial institutions are required by banking law to sell such entities, and accordingly, do not have ultimate control over such entities. Accordingly, we do not believe consolidation is appropriate even if it may take more than one year to dispose of the entity.

APB Opinion No. 30

We recommend the following actions be taken by the Board to ensure the provisions of APB No. 30 remain intact:

- The Board should work with the SEC to amend SEC Staff Accounting Bulletin ("SAB") No. 93. Currently, it appears the ED and SAB No. 30 differ with respect to application of APB No. 30. Specifically, SAB No. 93 indicates that consolidation is appropriate under APB No. 30 unless matters outside the control of a registrant are indicative that control does not rest with the registrant or is likely to be lost. The ED only requires management to have a formal plan to dispose within one year rather than requiring that matters be outside the control of management to apply No. 30. We agree with the Board's approach.

- The Corporation recommends that the Board explicitly indicate within the provisions of the final Statement that APB 30 is not superseded by the temporary control reporting requirement, including the ability to net assets and liabilities of the discontinued segment. In the ED, the Board affirmed continued use of the provisions of APB 30 in the basis for conclusions.

Mr. Tim Lucas
Financial Accounting Standards Board
Norwalk, CT 06856-5116

First Chicago NBD again thanks the Board for this opportunity to provide comments on the ED. We are available to discuss comments in further detail.

Sincerely,

William J. Roberts
Senior Vice President and Controller

Attach. [rescons(cje)]

Detailed Comments to FASB on Consolidation Policy and Procedures Exposure Draft (ED)

Consolidation based on concept of control rather than risk/reward system

1. The Corporation recommends that the scope of the Financial Accounting Standards Board (FASB) project be limited to defining the concept of control as an amendment to Statement of Financial Accounting Standards (SFAS) No. 94, *Consolidation of All Majority-owned Subsidiaries*. The existing model, which requires consolidation when an entity has a controlling financial interest (i.e., voting interest exceeds 50%), has generally worked well with the exception of certain borderline situations in which legal control exists even though a greater than 50% voting interest does not exist. Typically, such situations involve the use of special-purpose entities or partnership structures. The amendment should focus on establishing brighter lines to determine consolidation in those borderline cases with particular emphasis on special-purpose entities and partnerships.

2. Presumptive control and control indicators approach are difficult to apply, require several subjective decisions, and may lead to inconsistent accounting treatment for the same transaction.

3. The Corporation recommends that the accounting treatment found in the ED, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities,* not be undermined by provisions of this Statement. Of particular concern is the accounting treatment for a credit card securitization. The Corporation recommends that a provision be added indicating that if a securitization qualifies as a transfer (i.e., control has been surrendered), then consolidation of the special-purpose entity is not appropriate since, by definition, control has been surrendered. Also, we recommend adding an example involving a credit card securitization to Appendix B of this ED highlighting that consolidation is not appropriate.

4. We disagree that presumptive control exists if an entity has an option to gain control. Until the option is exercised, the company does not have the voting rights to use or direct the use of the entity's assets and does not generally receive dividends related to the option. Presuming effective control when an option exists is inconsistent with the Board's view in paragraph 103 of the ED, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*. Further, what if exercise of the option were restricted or limited to a future date (i.e., european style option); how is control presumed?

5. We request clarification with respect to management contracts in terms of use of or benefitting from an entity's assets. Specifically, how should incentives beyond base compensation be viewed? We would recommend that incentives built into the management contract should not be viewed as an indication of control unless they are significantly above market norms.

6. We do not agree that prior ownership should be a control indicator; this is inconsistent with the principle developed in the ED, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities,* that different accounting should not result simply because an asset is newly acquired rather than an existing asset. In this case, the accounting for the remaining interest in an entity should not vary simply because an entity was previously owned rather than recently acquired.

7. We do not believe determining control based on a percentage expected to vote compared to a parent's percentage ownership is operational. Further, it is inconsistent with the Board's premise that control is not reversed as a result of delegation or lack of interest and it may result in volatile reporting (e.g., information available in one quarter may suggest consolidation while information available in a subsequent quarter may suggest deconsolidation.

8. The change from a risk/reward model to a control model conflicts with various SEC pronouncements (examples include Staff Accounting Bulletins No. 40, 51, and 81) and EITF conclusions. Guidance is requested on how the proposed Statement will effect existing SEC and EITF accounting guidance.

Consolidated Level Reporting

1. The Corporation disagrees that the consolidated entity be limited to one method of accounting for the entire scope of its business activities. In particular, we recommend that a venture capital subsidiary be exempted from the scope of the final Statement. If a segment of an entity's business is in a specialized industry where it is more appropriate and relevant to utilize specialized industry accounting practices, then we believe the effects of such practices should flow through to the consolidated financial statements. For example, a financial services organization that controls a venture capital subsidiary would be required to reverse out certain fair value revaluations that may not be recorded under SFAS 115, or may be required to consolidate a venture capital investment. Although such reporting would result in consistent accounting for all investments in equity and debt securities at the consolidated reporting level, it ignores the fact that a particular segment is managed as a venture capital business and its results should be reflected in a similar fashion to those standalone venture companies. This is particularly true if such business is reported as a business segment. If the specialized industry reporting provision is retained, guidance will be needed regarding transition.

2. The Corporation also recommends that the criteria for determining what constitutes an investment company be based on the nature of an entity's operations rather than measurement of its assets and liabilities. For example, a venture capital subsidiary of a financial institution clearly is an investment company as defined by the investment company industry audit guide. A venture capital company's profitability is typically derived from the ultimate disposition of its investments rather than from their ongoing

operations. However, not all financial institutions measure investments of its venture capital subsidiaries at fair value. As a result, inconsistent accounting among different reporting entities may result simply because of the measurement approach selected by an entity. Such inconsistencies would not occur if the criteria were based on the underlying nature of the business.

3. If the specialized industry reporting provision is retained, the Board will need to determine how to account for such investments. In particular does SFAS 115 or APB No. 18 (i.e., equity or cost method) apply. If SFAS 115 applies, please clarify and include in the final Statement, if appropriate, whether the guidance found in the SFAS 115 implementation guide, which allows investments to be classified as trading assets even though they are not expressly held for trading purposes, may be applied to venture capital investments. The Board also will need to provide guidance with respect to transition accounting treatment. Specifically, if a fair value gain has been recognized into income in prior periods by a venture capital investment company and such income would not have been recognized under SFAS 115 or the cost or equity method, will it need to reversed out as a cumulative change in accounting principle?

Temporary Control

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Noncontrolling Interest

1. Suggest coordination with the SEC on the classification of noncontrolling interests. Specifically, the SEC now requires classification between liabilities and equity, which is inconsistent with the Board's conclusion that noncontrolling interests be classified in a separate equity component. We believe that noncontrolling interests should continue to be reported in the parent company's consolidated balance sheet as a separate item between liabilities. Presentation as part of equity, we believe, would be misleading to the users of financial statements.

Intercompany Eliminations

1. We do not believe the intercompany elimination (i.e., extinguishment) of debt makes sense or is practical for secondary market activities of a financial institution. The requirement does not reflect the intent of most secondary market activity, which is to accommodate a customer that for whatever reason does not want to hold the Corporation's long-term debt. It also should be noted that for income statement purposes the current period may be benefitted by an extinguishment gain while future periods may be adversely effected as a result of the amortization of a discount related to reissuing/reselling the debt.

Disclosure

1. Agree that disclosure requirements for consolidation in accounting policy footnote may be deleted.