Goldman, Sachs & Co. | 85 Broad Street | New York, New York 10004 Tel: 212-902-5534 | Fax: 212-357-4794 | email: gary.gensler@gs.com

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Guldhan Sadas

January 15, 1996

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

Dear Mr. Lucas:

This letter sets forth our comments related to the FASB's Exposure Draft, Consolidated Financial Statements: Policy and Procedures, dated October 16, 1995.

## **Treatment of Managed Funds**

Background: Paragraph 14 states, "Absent evidence to the contrary, one entity shall be presumed to have effective control of another if that entity directly or indirectly through its subsidiaries, has a sole general partnership interest in a limited partnership."

The Firm is the general partner of several investment funds where it generally holds between a 10-30% interest. The limited partners are comprised of numerous institutions and individuals, and generally hold between a 70-90% interest.

The ED exempts certain investment companies from the scope of this statement as "consolidated financial statements would not provide meaningful information about the investment companies" (paragraph 96). Further the ED indicates, in paragraph 98, that "there is no sufficiently precise definition of an investment company on which to base an exemption."

The Board has made it clear in public discussions that this exemption does not apply to Broker-Dealers. We concur with this treatment for investments in operating entities. If exempted, Broker-Dealers would no longer be required to report consolidated financial statements for any of its subsidiaries. This is because, as stated in paragraph 212, all prior accounting literature with respect to investments is superseded.

However, we believe that the criteria in paragraph 14a needs to be clarified or revised for managed investment funds because the concept of effective control is not appropriate. Many financial institutions hold partnership interests in investment vehicles for third party investors. The intent of these funds is to pool money to achieve stated investment objectives.

We strongly believe that the current accounting treatment is most appropriate, whereby such investments are carried at fair market value with changes in the value reported in the income statement. This will result in the most meaningful information to the readers of the financial statements. If necessary, a schedule of investments could be utilized to report the details of such investments.

For the reasons described below, we believe our proposal is the most meaningful presentation of the financial statements:

- Although the Firm, through a general partnership interest, has control of the fund assets, the "intent is to profit from the ultimate disposal of the investment rather than from its operations" (paragraph 96). Further, the investors delegate the management of the assets to the GP, not the use of the assets. As such, the GP acts only in an agency capacity.
- The consolidation of investments held by the funds would distort the financial results of the reporting entity and the risks related to such investments. As such, the ED would mislead the readers rather than provide meaningful information regarding the financial position and cash flows of the reporting entity. The consolidation of these funds would be in direct conflict with the spirit and purpose of consolidated financials as described in paragraph 7 of the ED.

In addition, the excess cost of compiling consolidated financials that do not "fulfill a significant need" to the financial statement reader. No additional benefit is derived.

In summary, the ED, as suggested in its current format, would result in misleading financial statements which do not accurately reflect the risk and related future cash flows. Effective control, as defined, is not relevant in this scenario. Our proposal is consistent with the theory and logic as to why investment companies do not prepare consolidated financial statements for their investments while at the same time provide financial statement readers with relevant information concerning the "financial position, results of operations, and cash flows of the reporting entity" (paragraph 54).

Furthermore, we direct you to the Alternate View presented in the ED, paragraphs 139-144. We strongly support expanding the scope of paragraphs 161-162 to all situations where limited economic benefits inures to the controlling entity. In our view, it is important that a distinction be made between an entity which buys and sells companies for a profit, and an entity which controls and operates a business.

## Treatment of Principal Investment Activity

The Firm invests in equity and debt securities in privately negotiated transactions, corporate acquisitions and real estate transactions. In accordance with the additional criteria set forth in paragraph 14, certain of these investments would need to be consolidated.

However, we believe the same argument presented above for managed investment funds should also apply to these investments where:

- The day-to-day operations are not managed,
- Profit is derived from the ultimate disposal of the entity not from normal, recurring operations,
- Investments are carried at fair value, and
- Combining the financial statements of businesses which are not related to core operations would not be meaningful and would dilute an investor's ability to evaluate the true ongoing business of the Broker-Dealer.

## Funding Versus Trading

ED (paragraph 21) requires "investments in debt securities issued by an affiliate to third parties that are held by another affiliate at the end of the reporting period shall be reported as constructively retired."

Broker-Dealers regularly make a market for debt securities issued by affiliates. The Broker-Dealer provides this service to ensure that a liquid market exists for its debt. In cases where a Broker-Dealer purchases a debt security of an affiliate, most securities are resold in a short period of time. Under current accounting treatment, the gain or loss on the purchase is not recognized because the security has not been retired. Recognition of gain or loss should only occur when the debt is truly retired.

The proposed "constructively retired" treatment would allow entities to manipulate earnings by purchasing in the open market debt securities that are trading at a significant discount from par and reselling the securities in the following reporting period.

Furthermore, in most instances, the debt securities are hedged to mitigate interest rate risk (typically with interest rate swap contracts.) Any resultant gain or loss on retirement of debt will have a corresponding opposite gain or loss on the hedging instrument. For a perfectly correlated hedging contract, the net effect to earnings is zero. Because the intent is not to retire the debt, the hedge will not be closed out, and no gain or loss will be recognized. This results in the reporting of a gain or loss on the constructive retirement of debt without the close-out of the hedge, a scenario that would not exist if the security was truly retired.

If you have any questions concerning our comments, please contact Debra Hess at (212) 902-4050.

Very truly yours,