

# Mobil Corporation

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3225 GALLOWS ROAD  
FAIRFAX, VIRGINIA 22037-0001

January 15, 1996

Mr. Timothy S. Lucas  
Director of Research and  
Technical Activities  
Financial Accounting Standard Board  
401 Merritt 7  
P. O. Box 5116  
Norwalk, CT 06856-5116

**FILE REFERENCE 154 - D  
PROPOSED STATEMENT OF  
FINANCIAL ACCOUNTING  
STANDARDS - CONSOLIDATED  
FINANCIAL STATEMENTS:  
POLICY AND PROCEDURES**

Dear Mr. Lucas:

We are pleased to have the opportunity to comment on the Proposed Statement of Financial Accounting Standards (Proposed FAS) entitled Consolidated Financial Statements: Policy and Procedures.

We continue to question the need for a statement of financial accounting standards addressing consolidation issues. As we stated in our comments on the Discussion Memorandum and Preliminary Views documents, we do not believe that there is sufficient need to change the underlying accounting model for consolidations. Current consolidation policies and procedures have been followed for decades and should not be altered simply to make a change.

While we acknowledge that the Board has provided good theoretical support for the economic unit concept of consolidation, we would argue that current practice (primarily the parent company concept) can be equally well supported. As with many issues relating to accounting principles, there can be wide diversity of opinions and those that are "generally accepted" may not always achieve theoretical purity. We would argue that current consolidation policies have general acceptance, which is supported by the majority views expressed on the Discussion Memorandum. These views are discussed in the Proposed FAS and summarized below.

- More than half of the respondents to the Discussion Memorandum supported the parent company concept, whereas only about one-third supported the economic unit approach.
- The majority view supports recognition of gains or loss on the changes of the parent's ownership interest in subsidiaries.

- The majority view supports displaying noncontrolling interest in income as a deduction in measuring net income.
- The majority view supports both control and a significant level of ownership as necessary conditions for consolidation. In addition, most supported an ownership level of 50% or more.
- A majority of respondents to the Discussion Memorandum suggested that conforming the Accounting Policies of a subsidiary should be permitted but not required.

It is evident from the above that current practices, which primarily follow the parent company concept of consolidation are "generally accepted". In our opinion, the Board has not made a compelling case that the economic unit concept would result in a preferable accounting model. We therefore believe that the Board should discontinue any further work on this project.

#### **CONSOLIDATION POLICY**

We are opposed to an accounting model where consolidation is based on control alone. We believe that consolidated financial statements are intended to serve primarily the needs of the shareholders of the parent. Consequently, the shareholders' equity of the consolidated financial statements should reflect the interests of the parent in its subsidiary company, which is an ownership concept.

We do recognize, however, that control can be an important element which would indicate that a company should be consolidated. We expressed this belief in our comments to the Preliminary Views document, which we reproduce below.

"While we are opposed to control as the sole determinant of consolidation, we also recognize that it is possible (but rare) to have effective control without majority ownership. In those situations, consolidation would be appropriate. However, we do not believe that it is necessary to quantify the minority ownership percent, which would require consolidation. Rather than establishing specific control indicators, the Board should consider adopting the SEC's approach in Rule 3A-02 of Regulation S-X that requires consolidation in some circumstances, notwithstanding the lack of majority ownership. This approach relies on management judgment to determine whether evidence of control is sufficient to require consolidation based on the specific facts."

### **CONSOLIDATION PROCEDURES**

In our opinion, the conceptual problems with the economic unit concept of consolidation become evident when the underlying procedures required to implement the concept are examined.

#### **Reporting noncontrolling interests in subsidiaries**

The issue of where minority interest in subsidiaries should be classified on the balance sheet can best be answered from the perspective of the minority shareholders. We do not believe that this group of investors would consider themselves as equity stockholders in the consolidated entity. While we acknowledge that the minority (noncontrolling) interest amount is also not actually "owed" to the minority shareholders, we believe that the current practice of reporting it between liabilities and equity reflects the leveraging relationship that minority shareholders have to the consolidated group. The relationship of minority shareholders to the corporation is similar in some respects as those of mandatorily redeemable preferred stockholders where the investment amount is also reported between liabilities and shareholder equity in accordance with Regulation S-X.

With respect to net income, we are strongly opposed to reporting net income for controlling interest and net income for noncontrolling interest. In our view, it will diminish the understandability of financial statements because, we suspect, that many less sophisticated investors will be confused over their applicable interest. Increasing the complexity of financial reporting is in contradiction to the recent Board and SEC initiatives of simplification.

#### **Acquisition of a Subsidiary**

We believe that the procedures for acquiring subsidiaries, and those for changing ownership discussed later in this letter, also highlight the weaknesses of the economic unit concept. When a parent acquires less than 100% interest in a subsidiary, there is no basis for recording the assets at 100% of fair value and offsetting it by a proportional amount allocated to the noncontrolling interest. The fair value of a subsidiary on the date that control is obtained has no meaning to the noncontrolling interests in the subsidiary. It is simply the cost basis of the parent company's investment. After the date of acquisition, it becomes less and less related to the fair value of the subsidiary, but it continues to be the cost basis of the parent company. Reporting the noncontrolling interest's proportional share in the acquisition cost of the parent company has no more meaning than reporting minority interest at the original book value of the subsidiary (unless the minority shareholder was the founder of the subsidiary, in which case the book value would be the minority interest's cost basis). Consequently, we do not see any greater conceptual merit in the Proposed FAS's requirement versus current practice.

**Changes in a Parent's Ownership Interest in a Subsidiary**

It contradicts reality to account for changes in a parent's proportionate ownership interest, where control is maintained, as equity transactions.

Under this approach, in a step acquisition, the excess (or shortfall) of costs over book value of additional purchases of subsidiary stock would be recorded in equity and therefore the investment decision to purchase shares after control is achieved would never be reflected in income. This will create a situation where a parent making a 100% acquisition would have different results than if it acquired the 100% in a second step after it had control. In the second case, future income would be greater. In our view, this is an unacceptable result.

**Disposition of a Subsidiary**

When a subsidiary is sold that was acquired through a step acquisition, the underlying economics of the deal will never be properly reflected in income. As discussed above, much of the purchase cost of a subsidiary acquired through a step acquisition can be charged to shareholders' equity. When that subsidiary is sold, the portion of the acquisition cost charged to shareholders' equity would never be reported as a cost of sale. This could result in gain being reported in income when in fact an economic loss may have been incurred. Furthermore, when a portion of a parent's investment in a subsidiary is sold, where control is not lost, the gains and losses on that portion would be reflected in shareholders' equity. These are not acceptable outcomes as we believe that these are transactions with unrelated third parties and their economic results should be reflected in net income.

We also believe that not reporting a gain or loss when a subsidiary sells additional shares that reduces a parent's percentage ownership, but not control, is contrary to the SEC's Staff Accounting Bulletin 51 that, in certain circumstances, permit the reporting of a gain when the ownership percentage of a parent company is reduced due to the sale of shares by the subsidiary.

**CONCLUSION**

In our December 21, 1994 letter on the Preliminary Views document, we commented that consolidation policy should not be considered separately from consolidation procedures because the policy cannot be fully conceptualized without studying its impact on the financial statements. We are pleased that the Board agreed with this view and published the Proposed FAS to cover both policy and procedures. In our view, the procedures necessary to implement the economic unit concept demonstrate the deficiencies inherent in the concept.

**Mobil**

Mr. Timothy S. Lucas

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While we acknowledge that there are also deficiencies in current practice, which is essentially the parent company concept, they are not sufficiently greater (and, in our opinion, are less) than those found in the economic unit concept to warrant a wholesale change in the accounting model.

We cannot emphasize more strongly that, in our view, the Board should discontinue the project on consolidation policy and procedures. We believe that it is a waste of time, effort, and resources and has the objective of conceptual purity (which is impossible to achieve) rather than general acceptance. We do acknowledge that there are a few specific areas, such as special purpose entities, joint venture accounting, and control where there is less than majority ownership that need to be addressed. However, these are topics that can be addressed by the EITF similar to other practice problems.

Very truly yours,



G. Broadhead