Letter of Comment No: 3/A
File Reference: 1082-154
Date Received: 1/17/96

SMITH BARNEY

A Member of *TravelersGroup*

January 15, 1996

Financial Accounting Standards Board
File Reference No. 154-D
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Attention: Mr. Timothy S. Lucas
Director of Research and Technical Activities

Re: Proposed Statement of Financial Accounting Standards
Consolidated Financial Statements: Policies and Procedures

Gentlemen:

This letter is in response to the Financial Accounting Standards Board's Exposure Draft of the Proposed Statement of Financial Accounting Standards entitled "Consolidated Financial Statements: Policies and Procedures" (herein referred to as the "Statement"). On December 15, 1995, we indicated to the Board our interest in making a statement at the public hearings scheduled for February 20-21, 1996. This letter is in support of our objection to the Statement.

Smith Barney Inc. is a large financial services firm engaged in, among other things, broker-dealer, investment management and investment banking activities. In such endeavors, we frequently advise clients on the values of individual securities as well as of companies or their divisions. In addition, we engage in principal trading activities and access the capital markets as an issuer. We are addressing our comments to fundamental concerns raised by the Statement from the point of view of the principal users of financial statements, specifically investors and financial analysts who support their activities. We have significant concerns regarding the effects that the proposed Statement, if adopted, would have on the formation of capital and on the integrity of the capital markets, which rely on financial statements presented to investors. Similarly, in our opinion, the ability of investors to rely on financial statements in order to make informed investment decisions will be adversely affected by adoption of the proposed Statement. Finally, we believe that the adoption of the

Statement could encourage companies to engage in potentially inefficient acquisition and divestiture activities primarily to achieve favorable accounting results, while remaining in accord with the guidelines of the Statement.

The economic unit model, on which the Statement is founded, has some fundamental appeal in that it presents a unitized picture of the financial attributes of a theoretical unit consisting of related entities. This model, however, ignores certain realities in the way capital markets operate. The ability for issuers to effectively raise capital in the public and private markets depends in large part on the ability of investors to gauge from the company's published financial statements the financial condition and earnings capacity of the companies in which they propose to invest. Clearly, an understanding of the parent company's affiliation with partially owned subsidiaries is important to that understanding. As stated by the Board in its statement of the purpose of ARB 51, "The purpose of consolidated statements is to present, **primarily for the benefit of the shareholders and creditors of the parent company**, the results of operations and financial position of a parent company and its subsidiaries . . . ." (Emphasis added). As recognized by the Board, it is the parent company in which investors invest, and it is the parent company that should be the focus of financial analysis by investors. We believe that the implementation of the Statement would induce a number of distortions to that view.

Under the proposed Statement income and equity could be distorted in a number of ways in the event of certain changes in ownership of consolidated subsidiary companies. One major concern stems from the proposed accounting for various multi-step transactions. For example, Paragraph 28 of the proposed Statement describes situations in which a parent purchases a controlling interest in an entity in which the parent already has an investment. At the date control is obtained, unrealized gains or losses on earlier investments would be recognized in earnings. We agree with the Board members whose views are cited in Paragraph 123 of Appendix A of the proposed Statement, that earlier investments are part of the aggregate cost of the acquisition and that recognizing gains or losses as a result of purchasing additional shares is not a desirable result. Conversely, under Paragraph 29 of the proposed Statement any change in a parent's proportionate ownership interest in a subsidiary that does not result in a loss of control would be accounted for as a treasury stock transaction, with no gain or loss recognized. We believe that it may be inconsistent, and potentially misleading, to users of the financial statements, that gains or losses would be recognized in purchase transactions but no gains or losses would be recognized in sale transactions that do not result in a loss of control.

Another result that we believe is undesirable would stem from Paragraph 29 upon an additional acquisition of an ownership interest in a previously controlled subsidiary. Since such a transaction would be accounted for as a treasury stock transaction, no goodwill would be recorded on the balance sheet (and accordingly would not be amortized), but rather there would be an immediate charge to additional paid-in-capital. We fail to see the logical justification for this different treatment of goodwill simply because shares were acquired at different times. The potential difference in recognition of goodwill in single as compared to multiple step transactions may encourage companies to utilize multi-step transactions to avoid the full income statement impact of goodwill amortization, potentially making the financial statements less informative to the user. In an effort to achieve comparability between companies, the financial analyst community would need to adjust companies' financial presentation either to eliminate all goodwill impact or to capitalize goodwill along current guidelines.

We believe that from investors' and analysts' points of view the consistency and certainty of the existing "bright line" test contained in FAS 94, (requiring consolidation of majority owned subsidiaries) is desirable. Under the proposed Statement, whether or not to consolidate a subsidiary would be determined based on subjective judgments as to whether "control" has been achieved. As a result, in analyzing financial statements, particularly on a comparative basis, analysts and investors would have greater difficulty in accurately assessing the effect of partially owned subsidiaries on earnings, as well as on assets, liabilities and equity, than under the present procedures.

Finally, we believe that the effects of the adoption of the Statement could be so far reaching and even unanticipated as to disrupt commercial and capital transactions that are directly tied to financial statements. For example, consolidation of minority owned subsidiaries would often result in increased equity with no real economic change to the company. Should investors who are beneficiaries of financial covenants (such as debt-to-equity ratios) be deprived of the protection they bargained for even though they have no greater right to the assets of the minority subsidiary? It is obvious that such aberrant results could have sweeping effects on contracts between borrowers and lenders, but they also could have serious negative effects on the value of securities in trading markets.

We believe that investors (and professional financial analysts who support them) are among the most important users of financial statements. This is evidenced by the degree to which the financial accounting rules and procedures are integrated into the federal securities rules and regulations. It is for this reason that we believe that their interests should be weighed heavily in determining whether or not to adopt changes having such broad impact on the ability to interpret and rely on financial statements.

We appreciate the opportunity to express our views. If you have any questions regarding our comments, please feel free to contact Bruce Cummings at (212) 816-7394 or Jonathan Cohen at (212) 816-0205.

Very truly yours,

Smith Barney Inc.

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