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MARKEM KEENENEWHAMPSHIRE

Letter of Comment No: 4/A File Reference: 1082-154 **Date Received:** 1/16/96

January 13, 1996

Financial Accounting Standards Board File Reference 154-D 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Specialisty, Japana Singapore, Australia

Attn: Director of Research and Technical Activities

Re - Exposure Draft "Consolidated Financial Statements: Policy and Procedures"

MARKEM Corporation has reviewed the referenced exposure draft and has serious concerns with the potential for misleading and even abusive interpretations of its provisions.

We feel that the theoretical basis upon which this draft is based is not sufficiently compelling to warrant a change of this magnitude. There are good arguments on both sides of the theory of the classification of minority interests as liabilities or as equity. In practical terms, investors don't particularly care where minority interest is classified as long as it is identified separately. Needless to say, if the exposure draft is adopted, all the equity-based ratios that companies, investors and analysts have come to use over the years will need to be recomputed.

The practical application of the contemplated acquisition policy causes us the most concern and is the single area where abuses can be constructed in all manner of situations. For example, MARKEM has interest in acquiring a small technology company which has a book value of \$1M. In the event we acquire a controlling interest, we would follow normal acquisition accounting - recording assets and liabilities and goodwill, if applicable. We have determined the overall price per share for the company, and need to decide how to structure the payout (taking care to make separate transactions, of course) and considering the eventuality that we may have to sell this risky enterprise at an economic loss someday. Using the exposure draft, here are some ways we could structure this deal-

Plan 1 - Acquire a controlling 51% of Sub for \$1M. Subsequently acquire 49% for \$50M. $\overline{\text{Total Paid for sub}} = \51M . Sell Sub for \\$20\text{M}.

We will show a P&L gain of \$18.51M.

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<u>Plan 2</u> - Acquire 51% of sub for \$10M. Subsequently acquire 49% for \$41M. Total paid for sub =\$51M. Sell sub for \$20M.

Result -

Singapore, Australia

We will show a P&L gain of \$9.51M.

<u>Plan 3</u> - Acquire 51% of sub for \$50M. Subsequently acquire 49% for \$1M. Total paid for sub =\$51M. Sell sub for \$20M.

Result -

We will show a P&L loss of \$30.49M.

Note that none of these answers are correct. We have purchased \$1M of assets for \$51M. We then sell that value for \$20M, which is a loss of \$31M. Application of the proposed standard has allowed us to change this loss into a gain of over \$18M.

Changing the facts a little highlights another problem.

<u>Plan 1a</u> - Acquire 51% of sub for \$1M. Subsequently acquire 49% for \$20M. Total paid for sub =\$21M. Sell sub for \$20M.

Result -

We will show a P&L gain of \$18.51M.

<u>Plan 2a</u> - Acquire 51% of sub for \$10M. Subsequently acquire 49% for \$11M. Total paid for sub =\$21M. Sell sub for \$20M.

Result -

We will show a P&L gain of \$9.51M.

<u>Plan 3a</u> - Acquire 51% of sub for \$20M. Subsequently acquire 49% for \$1M. Total paid for sub =\$21M. Sell sub for \$20M.

Result -

We will show a P&L loss of \$.49M.

Any procedure that can lead to either losses or gains depending on how one structures the controllable portion (i.e. the acquisition portion) of a deal creates the opportunity for confusion or abuse. Again, note that the correct answer should be a loss of \$1M, which this exposure draft has allowed us to turn into a gain of over \$18M.

It can also be seen that the gains in Plans 1 and 1a as well as in 2 and 2a are the same. This is due to having the same "controlling" purchase prices and the same selling amounts. The fact

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that additional investments are or are not made does not impact the P&L. This concept makes little sense to us - the recognition of gains or losses on the disposal of an enterprise should reflect the complete values that have been invested, not just the initial investment.

In practice, it appears that there is a clear acquisition strategy by which one can virtually ensure that any disposition will result in a gain - stagger the acquisition elements so the bulk of the acquisition price is paid after control is gained. Any subsequent disposal will result in a gain on the P&L. If the standard is adopted we would envision a significant number of deals structured with a one dollar "control" purchase, followed by an appropriately worded multi-million dollar follow on investment.

We do not feel that this would be beneficial to any constituency.

While we have concerns relative to the nearly impossible consolidations this standard would impose on general partners and to the issues of restatements and tax accounting, we feel that the examples given demonstrate the fundamental weakness with the draft as stated.

Thank you for the opportunity to comment.

Sincerely,

MARKEM Corporation