

Allstate Insurance Company
3075 Sanders Road
Northbrook IL 60062

Allstate[®]
You're in good hands.

January 15, 1996

Letter of Comment No: 78
File Reference: 1082-154
Date Received: 1/16/96

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

File Reference No. 154-D
Consolidated Financial Statements: Policy and Procedures

Dear Mr. Lucas:

The Allstate Corporation (Allstate) appreciates the opportunity to comment on the Proposed Statement of Accounting Standard, *Consolidated Financial Statements: Policy and Procedures*, dated October 16, 1995 (the Exposure Draft). As both a user and preparer of consolidated financial statements, Allstate is very interested in the outcome of this Exposure Draft.

Overall, we agree with the basic premise of the Exposure Draft (i.e., that owning a majority voting interest in an entity should not be the sole criterion for determining if consolidation is appropriate). However, the Exposure Draft does not distinguish between existing control over an entity and potential future control over an entity. That is, under the provisions of the Exposure Draft, if a company has the ability to obtain control over an entity in the future, it is considered to have "effective control" over the entity today and, therefore, must consolidate the entity. We believe that consolidating the results of an entity for which there is no current existing control results in the communication of misleading information to financial statement users.

Additionally, determining whether or not there is "effective control" over an entity requires judgment. Because of the degree of subjectivity involved in this process, we question whether entities will apply the provisions of this Exposure Draft consistently.

* * * * *

Mr. Timothy S. Lucas
January 15, 1996
Page 2 of 2

The first section of the attached appendix summarizes our responses to those issues for which the Board has specifically requested comment. The second section of the attached appendix summarizes our additional comments on the Exposure Draft.

Please contact me at (708) 402-2213 if you have any questions or if you would like to discuss any of our comments.

Sincerely,



Samuel H. Pilch
Vice President and Controller
The Allstate Corporation

cc: Mr. Thomas J. Wilson
Senior Vice President and
Chief Financial Officer
The Allstate Corporation
2775 Sanders Road, Suite F8
Northbrook, IL 60062-6127

Mr. Steven B. Uhler
Partner
Deloitte & Touche LLP
180 North Stetson Avenue
Chicago, IL 60601-6779

THE ALLSTATE CORPORATION

Appendix

Consolidated Financial Statements: Policy and Procedures

This appendix summarizes our comments on the Exposure Draft, *Consolidated Financial Statements: Policy and Procedures*, dated October 16, 1995 (the Exposure Draft). It is an integral part of, and should be read in connection with the accompanying letter dated January 15, 1996.

COMMENTS REQUESTED BY THE BOARD

1. Is the definition of control expressed in the Exposure Draft operational?

We believe that, for companies with relatively simple capital structures, the definition of control is operational. However, due to the degree of subjectivity inherent in the definition of "effective control," we question whether financial statement preparers with complex capital structures will apply this definition consistently.

For example, certain of the effective control indicators in paragraph 158 of the Exposure Draft are substantively similar to the "significant influence" indicators in paragraph 17 of APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock* (APB 18). We agree that the ability to exercise significant influence over an entity is an indicator of potential control over that entity. However, due to the subjectivity involved in the determination of effective control and the conceptual similarities between effective control and significant influence, we believe that it is possible for entities to account for identical investments differently. (i.e., One entity may consolidate its investment under the provisions of the Exposure Draft, and another entity with an identical investment may account for its investment using the equity method under the provisions of APB 18).

2. What effects would the Exposure Draft have on your business enterprise?

Based upon a preliminary analysis, we do not believe that the Exposure Draft would have a material impact on our results of operations or financial position. However, the Exposure Draft may create additional differences between GAAP and statutory reporting for insurance companies.

3. Please identify any implementation issues encountered in attempting to apply the specific provisions of the Exposure Draft.

We did not encounter any significant implementation issues in applying the specific provisions of the Exposure Draft because:

- We do not have a complex capital structure; and,
- Based upon a preliminary analysis, we do not have any material joint venture, partnership, or other investments that we effectively control.

If we entered into investments that would require consolidation under the Exposure Draft, we would expect to incur a great amount of incremental time and expense compiling the information necessary for consolidation. This is because a significantly greater amount of financial statement detail is required when consolidating an entity than when accounting for it under the equity method.

4. Please share the results of testing the application of the proposed provisions of the Exposure Draft to your circumstances.

As indicated above, we do not believe that the Exposure Draft would have a material impact on our results of operations or financial position.

ADDITIONAL COMMENTS

Control of an Entity

- Paragraph 10 of the Exposure Draft describes how a parent has control over a subsidiary. However, it is unclear to us if a parent must fulfill the criteria in paragraph 10.a. and the criteria in paragraph 10.b. to have control over a subsidiary, or if fulfillment of the criteria in either paragraph 10.a. or 10.b. is sufficient for the parent to have control. We suggest that the Board clarify this point in the final version of this statement.
- Paragraph 14.c. of the Exposure Draft states that, absent evidence to the contrary, an entity has effective control if it has the unilateral ability to obtain a majority voting interest through ownership of securities or other rights that may be converted into a majority voting interest at the option of the holder (emphasis added).

We believe that it is inappropriate to consolidate entities for which you have the ability to control in the future, but do not currently control today. Paragraph 34 of FASB Statement of Concepts No. 1, *Objectives of Financial Reporting by Business Enterprises*, states that financial reporting should provide information that is useful to users in making rational decisions.

Consolidating the results of entities that are not currently controlled by the parent results in the communication of misleading information, thereby impeding financial statement users from making rational decisions.

Accordingly, we suggest that the Board reflect the following changes in the final version of this statement:

- Eliminate paragraph 14.c., and
- Require entities to disclose the nature and terms of any existing rights to obtain a majority voting interest in another entity.

Intercompany Investments in Debt Securities

- The second sentence of paragraph 21 states that intercompany investments in debt securities issued by an affiliate to third parties that at the end of the reporting period are held by another affiliate shall be reported as constructively retired.

We believe that this accounting is inappropriate if an affiliate purchases the securities principally for the purpose of selling them in the near term to an outside party for the following reasons:

- Paragraph 3.a. of Statement of Financial Accounting Standards No. 76, *Extinguishment of Debt*, (SFAS No. 76) states that debt is extinguished when the debtor pays the creditor and is relieved of all its obligations with respect to the debt. If an affiliate purchases the securities principally for the purpose of selling them in the near term, the acquisition of the securities does not relieve the affiliate of all its obligations with respect to the debt, as required by SFAS No. 76. Rather, the affiliate will be required to make payments on the debt to an outside party in the near future.
- Paragraph 43 of FASB Statement of Concepts No. 6, *Elements of Financial Statements*, states that once incurred, a liability continues as a liability of the entity until the entity settles it, or another event or circumstance discharges it or removes the entity's responsibility to settle it. An affiliate's purchase of debt securities does not settle or discharge the issuing affiliate's obligation with respect to the debt if the securities will be resold, as indicated above.

- In its October 24, 1995 Exposure Draft, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, the Board has indicated that control of an asset is not surrendered if control is only assuredly temporary. When an affiliate purchases securities principally for the purpose of selling them in the near term, the affiliate's control over the securities is assuredly temporary. Therefore, a completed transaction has not occurred and gains or losses on extinguishment should not be recognized by the parent.

We suggest that the Board consider modifying the accounting guidance in paragraph 21. This modification would eliminate the requirement to account for intercompany investments in debt securities as constructively retired if:

- The securities were purchased principally for the purpose of selling them in the near term to an outside party; and,
- The affiliate's control over the securities is assuredly temporary.