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Letter of Comment No: 67
File Reference: 1082-154
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Ronald L. Leach
Vice President -
Accounting



January 15, 1995

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

RE: File Reference 154-D

Dear Sir:

We have reviewed the Exposure Draft (ED), *Consolidated Financial Statements: Policy and Procedures*, and appreciate this opportunity to present our views for your consideration. We continue to support the current practice and do not believe that current accounting standards surrounding consolidation need to be revised. The current method of accounting, which is viewed as reasonable and practical by a majority of financial statement preparers and users, would be replaced by a model that is ambiguous and highly subjective. We are not convinced that the ED advances the usefulness of financial reporting.

We have responded on specific issues of the ED on the following pages. We do not support a final standard based on the ED's conclusions as they represent an extreme change from present practice with no corresponding value added and without addressing any apparent problems. We are troubled by the inconsistent reporting that the ED proposes by entities in similar circumstances.

Sincerely,

A handwritten signature in cursive script, appearing to read "R. Leach".

Ronald L. Leach

CC: R. P. Stanich - Eaton Corporation
P. D. Ameen - General Electric Co.
K. J. Johnson - Motorola, Inc.
S. Koski-Grafer - Financial Executives Institute
T. G. Stafford - Ernst & Young

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Consolidation Policy

We strongly oppose the Exposure Draft's (ED) proposal requiring consolidation based solely on control. Control over an entity's assets and a majority ownership are and should be two separate and necessary conditions for consolidation. How users are expected to distinguish assets that the reporting entity can use completely without restriction from assets that are not, and may never be, legally owned is confusing.

The concept that control for purposes of consolidation should be extended beyond majority ownership to include effective control will require difficult and perhaps arbitrary judgments to be made resulting in inconsistent reporting between different entities as well as within the same entity. What most observers and preparers would conclude as no more than 'significant influence', the ED erroneously classifies as 'effective control'. Some companies will deem certain entities to be effectively controlled whereas other companies, in similar situations, will not. A large minority interest only provides significant influence over the investee, and not 'control'. With only a minority of voting rights, control is dependent on the actions, or apathy, of the other owners. The other owners will allow the holder of the large minority interest to control only as long as they are comfortable that their interests are being adequately served. If not comfortable, the actions of these owners can change the composition of the interests to oppose the 'parent's influence' and enable an entity to no longer be consolidated resulting from no change in ownership. The effects on financial statements due to the activism of independent parties conveys the message that the large minority voting interest owner was never in control. The fact that a change in the consolidation status of an entity could result solely from the actions of third parties unrelated to either the parent or the subsidiary indicates that effective control is not operational.

We find the ED's proposal on permitting deconsolidation of a subsidiary only if disposition is considered at the date of acquisition to be too restrictive. We believe deconsolidation is the appropriate accounting treatment for subsidiaries considered for disposition, irrespective of when the decision is made.

Consolidation Procedures

Different accounting treatment will be applied to acquisitions that are otherwise similar in nature depending on whether the acquisition had been consummated in a single transaction or several transactions. The ED proposal requires the increase in a parent's proportionate ownership in a subsidiary to be reported as an increase in additional paid-in capital, rather than goodwill. We believe that goodwill is not just created with the original transaction but also with any subsequent transactions.

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We are confused by the ED's proposal requiring the reporting entity to present on the face of the income statement the minority interest as a deduction after consolidated net income to compute income attributable to common shareholders. What value is added by this proposal? We believe that the common shareholders are only concerned with the income attributable to them. Thus, this presentation will only add confusion and complexity. If there is an absolute imperative desire to know the nonconsolidated net income attributable to the minority interest, we believe this should be a disclosure item rather than modifying the content of the income statement.

We do not understand the reasoning for the parent reporting a minority interest as a separate component of equity as the minority interest shareholders do not have an ownership interest in the parent. We believe that the parent's shareholders' equity should only reflect the parent's shareholders' interest and not commingle it with the minority interest. In addition, since current authoritative literature does not provide definitive guidance on the classification of minority interest, most entities reflect a minority interest as part of noncurrent liabilities or between liabilities and stockholders' equity as indicated by the AICPA's *Accounting Trends & Techniques*.

The ED proposes inconsistent reporting between entities, that are otherwise similar in nature, depending on the reporting entity to which they are consolidated. Entities operating in a specialized industry look to the AICPA's pronouncements for the appropriate guidance in addressing financial accounting practices and reporting issues. We are surprised by the ED's proposal to not allow subsidiaries operating in a specialized industry to follow these same AICPA pronouncements simply because they are consolidated with a parent that does not follow those policies. Why are these same pronouncements no longer appropriate? We feel that the financial statements of a consolidated entity should reflect the attributes of the individual entities comprising the consolidated entity.

We agree with the ED's intent of eliminating different fiscal periods between a parent and subsidiaries unless not practicable. We hope this intention does not include reporting lags as the elimination of reporting lags would be a difficult challenge for operations in newly developing countries or regions.