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January 11, 1996

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File Reference 154-D

Dear Sir:

We are pleased to comment on the FASB's Exposure Draft, "Consolidated Financial Statements: Policy and Procedures" (the "ED"). Generally, we do not support the Board's proposed provisions as outlined in the ED, and we urge the Board not to proceed with a final Statement that would be based on such provisions. The principal reasons for this are that we foresee significant implementational issues and we do not believe the ED would result in improved financial reporting. We do, however, agree with the Board that consolidation issues associated with special purpose entities is an area that needs to be addressed.

Notwithstanding our general position, if the Board intends to proceed with issuing a final statement based on the provisions outlined in the ED, we have discussed below our views on the conceptual issues. These views are consistent with our response to the Preliminary Views on Major Issues related to Consolidation Policy.

**Scope**

We agree with the Board that any resultant standard for consolidated financial statements should apply to all enterprises, whether organized for profit or not. We further believe entities that carry substantially all of their assets at fair value should continue to be exempt from consolidation requirements. The Board, however, in exempting entities refers to entities that carry substantially all their assets and liabilities at fair value. Given that the entities cited by the

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Board (mutual funds, pension plans, investment companies) do not tend to carry substantially all liabilities at fair value, we suggest that the Board revise the sentence to refer solely to assets.

As it relates to not-for-profit entities that have or will have implemented the provisions of SOP 94-3, Reporting of Related Entities by Not-for-Profit Organizations, if the Board proceeds with issuing a final statement, we recommend that the Board put forward guidance that explains the differences between the said SOP and the provisions of the ED, particularly discussing those organizations or situations that the Board believes would be most affected by the ED.

### Consolidation Policy

We continue to believe that the purpose of consolidated financial statements is to present, for the benefit of the parent's shareholders, the results achieved by a group of companies under common control as though they were one entity. In order for those financial statements to be meaningful, the parent must not only have control of a subsidiary but also have a majority interest in the subsidiary's residual cash flows (positive or negative). Existing standards do not explicitly define control; rather, control was deemed implicit in the ownership of a majority voting interest. In this regard, we support the Board's initiative in providing a definition of control. However, the definition of control as proposed in the ED as the sole criterion for consolidation is not only conceptually unsound in that it could result in significant financial amounts being reported in the financial statements in which the parent's shareholders have little or no beneficial interest, but it also would create many practical problems in practice given the high degree of subjectivity inherent in its application.

In essence, we support the views of that Board member that are presented in paragraphs .139 through .142 of the ED -- that control alone is not sufficient and some level of benefit/detriment in the ultimate cash inflows or outflows is necessary. While that Board member did indicate that such cash flows should "inure substantially for the benefit of, or detriment to, investors in the parent," he finds it difficult to determine the level of such benefit that would make the criterion operational. As previously indicated, we believe the "level-of-benefit" test should be a majority interest in the residual cash flows of the subsidiary's operations. In this regard, we also agree with that Board member's objection to the requirement to consolidate a limited partnership that is controlled by a general partner that has a small equity interest.

We further agree with that Board member's support of consolidation of less-than-50-percent- controlled entities when, because of the presence of control, the parent has the ability to structure transactions entered into by the controlled entity in such a way as to derive future benefits beyond the level represented by its investment in the entity. That is, if the parent, in substance, is exposed to the majority of that entity's ultimate net cash flows, consolidation would be appropriate. This provision, which would require consolidation if the parent "in substance" has a majority interest in an entity's residual cash flows, would address, in part, the issue of special purpose entities, an issue that has created a number of practice problems.

Additionally, if the Board elects to proceed with a consolidation policy based on the control alone, we recommend that consideration be given to the implications of minority veto rights on the ED's definition of effective control. By way of illustration, assume a company owns 60 percent of the voting stock of a company and therefore the ability to appoint a majority of the board of directors and it has managerial control of day to day operations. However, the minority shareholder retains veto rights in two areas: decisions regarding dividend policy and the selection of the president. Does that company have effective control as defined in the ED? We believe that the lack of definition in the area of restrictions on control in the ED will put preparers and their auditors in a quandary as to how to weigh the effects of minority veto rights on control . We therefore recommend that the Board actively consider the ways in which minority veto rights are used in corporate governance and provide guidance on the degree to which such rights are permitted to limit the parent's power over the assets of the subsidiary before the criteria for effective control are no longer met.

#### Consolidation Procedures

Since we support the parent company view, we favor consolidation procedures which, in the main, are consistent with this view. We observe that these procedures are also consistent with current consolidation practice which appears to work well. We are not aware, except for the issue of accounting for special purpose entities, of any significant current demand for change in current consolidation procedures. Accordingly, we question whether benefits resulting from changing these procedures will offset the costs that inevitably attend accounting change.

Our views on each aspect of consolidation procedures covered in the ED are set forth below.

### Elimination of Intercompany Transactions and Balances

We concur with the Board's decision to continue to require all intercompany assets, liabilities, revenues, and expenses to be eliminated in full. We also agree with the Board that the entire amount of unrealized intercompany profit/loss should be eliminated and allocated proportionately between the controlling and noncontrolling shareholders.

### Reporting Noncontrolling Interest in Subsidiaries

We agree with the Board in the "Basis for Conclusions" of the ED that the display of noncontrolling interest as a liability has "no conceptual support because it does not meet the definition of a liability as defined in Concepts Statement 6." We do not believe, however, that the display of noncontrolling interest as equity has conceptual support, in that the noncontrolling shareholders do not have an ownership interest in the parent. The shareholders' equity presented in the consolidated financial statements should reflect just that - the parent shareholders' equity in the residual interest of the subsidiary. We, therefore, believe that the Board's proposal to present the noncontrolling interest in equity would be inappropriate. Hence, we see no reason to change the display from the most prevalent current practice -- presenting the noncontrolling interest between liabilities and equity.

Similarly, the net income presented in the consolidated financial statements should be that of the parent. In our view, the display of the noncontrolling interest as a reduction of consolidated net income as proposed by the Board would result in a confusing and less useful presentation. Accordingly, the noncontrolling interest should be a deduction in arriving at consolidated net income.

### Acquisition of a subsidiary in a single transaction

We disagree with the Board's proposal to fair value all assets and liabilities of the subsidiary at the date the parent-subsidiary relationship is established. Since the parent's shareholders have a beneficial interest only in their portion of the subsidiary's assets, we believe that only the parent's share of the assets and liabilities of the subsidiary in the parent's consolidated financial statements should be reflected at fair value and the noncontrolling interest's share should be reflected at historical cost. Further, by including all assets and liabilities at fair value, operating income may be reduced as a result of greater cost of sales and depreciation/amortization attributable to the full fair value of assets recorded.

We do support the Board's view, which is consistent with current practice, that only the parent's purchased goodwill should be reflected in the consolidated financial statements.

Acquisition of a subsidiary in more than one transaction ("Step acquisitions")

We do not support the Board's view that all assets and liabilities be measured at the date control is attained and that the cost of acquiring an entity in steps be determined based on the carrying value of the pre-control investment plus the purchase price of the interest that results in control. We believe that the current accounting for step acquisitions - retroactive application of the equity method and treating each acquisition as a separate layer -- produces more meaningful information in that it recognizes the parent's "true" cost of acquiring the subsidiary. Retroactive application of the equity method allows for the same ultimate carrying amounts of the subsidiary's assets and liabilities, regardless of how the original pre-control investment was accounted for. In this regard, we disagree with the Board that any unrealized gains/losses previously recorded in equity for pre-control investments accounted for pursuant to FAS 115, Accounting for Certain Investments in Debt and Equity Securities, be recognized in earnings at the date control is obtained. Such unrealized gains/losses should be eliminated at the date control is obtained, and the equity method should be retroactively applied to the investment.

The Board's approach is also inconsistent in that the Board is still requiring retroactive application of the equity method in situations when an entity has for example a 10 percent investment in another company (assume cost basis) and that investment is subsequently increased to a level where significant influence is obtained. This position, coupled with the Board's proposal of the accounting for step acquisitions, will lead to abuses as the structure of transactions can be manipulated depending on the desired results. (For example, transactions executed in strategic steps to minimize the amount of recorded goodwill.)

Similarly, given that the Board is further proposing to account for any additional purchases by a parent after control is obtained as capital transactions, we recommend that, if the Board elects to move forward with the proposed statement, the Board put forward guidance to minimize any potential abuses in this area. The guidance can be in the form of a specified window period where a series of transactions is viewed as one, or instead of a specified period, guidance that is based on the ultimate intent of the acquiring company (that is, is the

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entity contemplating at the time it makes its initial investment(s) that do not result in control to ultimately enter into transactions resulting in control or upon assuming control at a very low equity level to eventually obtain a higher equity interest).

#### Changes in a Parent's Ownership Interest in a Subsidiary While Maintaining Control

We disagree with the Board's view that any changes in a parent's proportionate interest in a subsidiary either as a result of purchases or sales of the subsidiary's stock by the parent, or the acquisition or the issuance of additional shares by the subsidiary, should be accounted for as capital transactions. As previously indicated, we believe that the purpose of consolidated financial statements is to provide the parent's shareholders with information about their ownership interest in the parent and its subsidiaries. When a parent's ownership interest changes as a result of transactions involving noncontrolling shareholders, such transactions should be viewed as third-party transactions. Accordingly, we support the view that any increases in the parent's ownership interest should be accounted for as additional purchases, and decreases as sales with gain or loss recognition.

#### Disposition of a Subsidiary

We agree with the Board that if a disposition of a subsidiary occurs, even if a noncontrolling interest is retained, gain or loss on the disposition should be recognized in the consolidated statements. However, we wish to point out to the Board that given their proposed accounting on dispositions resulting in a loss of control differs from dispositions while maintaining control, abuses similar to those noted above for step acquisitions could occur. For example, in a situation where a parent's intent is to dispose of a subsidiary, different accounting could result if the transaction were executed in steps. If the Board goes forward with their proposed approaches, they should develop similar guidance as previously mentioned, to minimize potential abuses. However, we would favor the Board requiring that the gain/loss that is to be recognized upon disposition of a subsidiary take into account any amounts previously recorded in equity that were attributable to partial acquisitions or dispositions.

#### Conforming Accounting Policies

We disagree with the Board that the accounting policies of the subsidiary and parent be conformed. We believe that as long as an accounting method is U.S. GAAP for a subsidiary, the

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subsidiary's accounting policies can be carried over in the parent's consolidated financial statements, regardless of whether those policies are specialized policies for the subsidiary and may not be such for the parent. Requiring conformity in a "specialized accounting" situation, from a practical standpoint, would involve the preparation of two sets of subsidiary financial statements, and would somewhat conflict with the Board's basis for exempting entities, such as investment companies, from consolidation requirements in situations where an investment company has a non-investment company parent.

If the Board, however, proceeds with its proposal to require conformity (except where GAAP permits a single entity to use different accounting methods for the same type of transactions or events), we recommend that the Board provide additional examples as to situations where nonconformity (acceptable alternatives) is permissible, and examples of situations where specialized policies are allowable for a subsidiary, but not for the parent.

#### Conforming Fiscal Periods

We agree with the Board that fiscal periods should be conformed unless conformity is not practicable. However, we recommend that the Board provide additional guidance as to what would be deemed "not practicable." For example, would the Board's view as to "not practicable" encompass seasonality issues -- that is, where a subsidiary's year-end differs from the parent because the subsidiary's year-end is based on the seasonality of its business (e.g. subsidiary in a retail industry and the parent's year-end differs because it is manufacturing intensive).

We would be pleased to discuss our comments with the Board or its staff at their convenience.

Sincerely,

Handwritten signature of Hal Rogero, Jr. in cursive script, with a small 'LR' monogram at the end of the signature.

L. Hal Rogero, Jr.  
Chairman  
Financial Reporting Committee