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Mr. Timothy S. Lucas
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Dear Tim:

IBM appreciates the opportunity to comment on the Exposure Draft, *Consolidated Financial Statements: Purpose and Policy*. The nature of many of the ventures in which IBM invests requires significant judgment to determine the appropriate accounting treatment. Thus, the outcome of this project is of great interest to us.

IBM acknowledges the FASB's position in paragraph 3 of the ED that FASB Statement No. 94, Consolidation of All Majority-Owned Subsidiaries, did not define control nor did it resolve several important issues including determining when (a) control exists through means other than a majority voting interest, (b) control is temporary, and (c) control does not rest with the owner of a majority voting interest. We believe that EITF Issue No. 96-16, Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights, provides useful guidance to address issues (a) and (c). (We provide more detailed comments about Issue 96-16 in our response to Issue 2.)

We also believe that practice is adequately addressing issue (b) and, more importantly, that the guidance in Statement 94 and Issue 96-16 taken as a whole is more indicative of an entity's ability to direct and, thus, realize the rewards (or mitigate the loss) of the controlled entity's resources than the guidance proposed in the ED. Thus, we question the need for the Board to proceed with this project.

Within that overall framework, our comments on the specific questions follow.

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## **Definition of Control and Its Implementation Guidance**

### Issue 1

Does the revised definition, together with the discussion of the characteristics of control (paragraphs 10-14) and descriptive guidance (paragraphs 15-23 and 30-47), help clarify when one entity controls another entity? Will the revised definition and guidance lead to common understandings and application of this Statement's definition of control?

We believe that an entity should consolidate other entities that it controls rather than consolidating only those entities in which it has greater than a 50 percent ownership interest. However, we do not believe that the "revised" definition represents a substantial improvement to the guidance in Statement 94 and Issue 96-16.

If the Board decides to proceed to issue a final Statement based on the ED, we believe that the form of the guidance, presented as a definition, in-depth implementation direction and illustrations, diffuses the effectiveness of the guidance and puts a burden on a financial statement preparer to analyze and weigh numerous sources within the document to determine whether control exists. Ideally, the definition should provide stand-alone guidance that a preparer can use to determine whether it controls an entity.

#### Issue 2

Will guidance in the form of rebuttable presumptions of control be necessary? Do the circumstances described in each of the situations identified in paragraphs 18 and 21 provide a reasonable basis for presuming that one entity controls another entity in the absence of evidence that demonstrates or proves otherwise? Are they sufficiently clear and operational? Are additional presumptions of control necessary for specific circumstances? (If so, please identify those circumstances.)

Under the definition of control in the ED, rebuttable presumptions are necessary to identify the conditions that lead to a determination of control in the absence of evidence that demonstrates otherwise. The presumptions identified in paragraphs 18 and 21 provide a reasonable basis to begin analysis of parent-subsidiary relationships. As is stated in paragraph 239 of the ED, it is impossible to outline every circumstance in which control would be highly probable or likely; nonetheless, these presumptions provide a good working model because they are clear and operational.

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We believe that Issue 96-16 also provides valuable guidance for applying a control-based notion of consolidation. Issue 96-16 requires consideration of the provisions of the ownership agreement, beyond the relative percentage interests, to determine whether equity or consolidation accounting is appropriate. The EITF's guidance clearly outlines protective and participating rights that often are granted to minority owners in the ownership agreement. The guidance goes even further to provide factors to consider when investees are evaluating their relationships with other entities.

As the ED is drafted, it is not clear whether the Board intends to supersede the EITF's guidance. Based on our reading, we believe that the guidance in Issue 96-16 and the ED do not conflict. We acknowledge that Issue 96-16, as with all EITF guidance, applies to only a subset of transactions, in this case, parent-subsidiary relationships. However, we believe that the guidance is more broadly applicable than the specific issues addressed in the EITF consensus and that the FASB should make that broader applicability explicit in the final Statement. We believe that Issue 96-16 has been consistently applied in practice and that that guidance should be carried forward into the proposed Statement.

# **Transition and Implications for Interim Reporting**

#### Issue 3

Are the benefits of complete and comparative financial statements for all interim periods in the initial year of application sufficient to justify requiring, rather than permitting, that the provisions of this Statement be applied for the first and each subsequent interim period in the year of adoption? Are there specific circumstances surrounding the application of this proposed Statement that would justify delaying its application to interim periods in the year of adoption?

The benefits of complete and comparative financial statements for all interim periods in the initial year of application are sufficient to justify a requirement that the provisions of the Statement be applied for the first and each subsequent interim period in the initial year of adoption. However, we believe that adoption in 2000 is an aggressive deadline, especially considering the requirement for retroactive restatement of comparative financial statements for earlier periods. Corporations already have onerous workloads during the remainder of 1999 and throughout 2000 including resolving failures or uncertainty related to Y2K issues, implementation of the Euro, and implementation of FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities.

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Inasmuch as a final Statement is not expected until the fourth quarter of 1999, a parent company would be required within a short time frame to complete its analysis of currently unconsolidated subsidiaries that it potentially controls, or consolidated subsidiaries that it potentially does not control, and prepare restated statements for prior periods. In view of the already demanding tasks facing corporations in the first quarter of 2000, implementing this standard under the proposed effective date would be burdensome. We recommend requiring implementation in the first quarter of 2001.

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Please contact James Brzoska at (914) 766-0672 if you have questions about our comment letter.

Regards,

Joseph J. Martin Assistant Controller