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Director of Research and Technical Activities  
Financial Accounting Standards Board  
401 Merritt 7  
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**Letter of Comment No:** 67  
**File Reference:** 1082-194R  
**Date Received:** 5/27/99

Re: File Reference No. 194-B

Dear Sir:

We would like to take this opportunity to comment on the issues addressed by the Board in its Proposed Statement of Financial Accounting Standards, "Consolidated Financial Statements: Purpose and Policy."

In general, we strongly oppose the proposed changes to consolidation policy. We believe that the existing guidance in this area is objective and practical and should remain essentially intact. While we do not object to the Board's proposed definition of control, we feel that the operational issues associated with implementing that definition do not justify fundamental changes to current consolidation policy.

We believe that control should be clearly demonstrated prior to consolidation, not presumed to exist due to favorable circumstances. Thus, we do not agree with the situations leading to rebuttable presumptions of control set forth in (b) and (c) in paragraph 18 and in paragraph 21 of the exposure draft. While these situations may be indications of control, it is inappropriate to assume that control exists before the required decision-making ability is established. Likewise, we agree with the dissenting Board member that "it is unreasonable to require evidence that demonstrates or proves that control is not present in circumstances in which an entity has taken no action to attempt to effectuate a perceived ability to direct the policies and management of another entity" (paragraph 251). We especially object to the assumption of situation (b) that a minority voting interest is large if it exceeds 50 percent of votes typically cast in an election. Past turnout should not be a basis for consolidation; it provides no evidence on how other shareholders will react in a current, potentially controversial election. These presumptions of control could lead to consolidation of an entity when, in fact, control does not exist. Such a consolidation would only mislead financial statement users.

We firmly disagree that situation (c) in paragraph 18 provides a basis to presume control. Consolidation should not take place when control is contingent upon the occurrence of an uncertain future event. A presumption of control in situation (c) would be especially difficult to apply in circumstances where a minority owner has an option to acquire a majority voting interest. Situation (c) asserts that control should be presumed if the expected benefit of exercising such an option would exceed the expected cost. We believe that the event demonstrating transfer of control (i.e., the option exercise) should be the

precursor to consolidation, not a prediction of the likelihood of the event's occurrence. In particular, if the option involves the purchase of a significant interest in an entity at fair value, it would be extremely difficult to objectively assume that the option would be exercised. We do not believe that consolidation is appropriate until the option is exercised and a majority voting interest is obtained. However, if this provision is retained, control should not be presumed to exist unless the option to acquire a majority interest is de minimus (e.g., less than 10 percent of the voting shares).

We believe that situation (a) in paragraph 18 of the exposure draft is the only appropriate rebuttable presumption of control. Control can be clearly demonstrated when an entity has legal control through a majority voting interest or a contractual agreement that provides the parent with unilateral decision-making powers. Control should only be presumed to exist based on this principle, unless evidence to the contrary indicates otherwise. In addition, consolidation is not meaningful to financial statement users unless the entity is entitled to significant participation in the risks and rewards of ownership of the assets involved. Consequently, we feel that consolidation should generally be limited to situations in which an entity currently holds both legal control and a majority or near-majority financial interest. In fact, we have found situations in certain non-U.S. jurisdictions (e.g., the United Kingdom) where it is difficult to exercise control even when holding a majority voting and financial interest. For example, legal counsel advises that the majority owner cannot be provided more information (financial or otherwise) than is provided to the minority shareholders.

We acknowledge that in certain limited circumstances one entity may effectively control another without legal control. Therefore, if the Board ultimately determines that revisions to existing rules are necessary, we believe that the presumptions listed in the proposed standards should be modified to be a list of potential indicators that could be used to evaluate the existence of control. These elements could then be used to objectively determine whether consolidation would be appropriate given the specific facts and circumstances. Finally, jointly controlled, fifty-percent owned joint ventures are a special case and should be proportionately consolidated by both parties.

In conclusion, we feel that the Board should withdraw this exposure draft and leave existing guidance intact, or amend the presumptions of control to be potential indicators of control, as described herein. If adopted, the current exposure draft could result in the consolidation of an entity for which control has not been—and may never be—established. Such consolidation would “diminish the representational faithfulness and usefulness of the information provided by those financial statements” (paragraph 249).

We appreciate the opportunity to respond to this proposed Statement of Financial Accounting Standards and trust that our comments will be seriously considered in future Board deliberations on this issue.

Sincerely,

A handwritten signature in cursive script that reads "Richard J. Schlueter". The signature is written in dark ink and is positioned above the printed name and title.

Richard J. Schlueter  
Assistant Controller

RJS/kkw