citigroup

Roger W. Trupin
Controller

Citigroup Inc.
153 East 53rd Street
New York, NY 10043

Tel 212 559 2867
Fax 212 793 6521

roger.trupin@citicorp.com

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

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Consolidated Financial Statements: Purpose and Policy

Dear Mr. Lucas:

Citigroup Inc. appreciates the opportunity to comment on the FASB's exposure draft, proposed statement of financial accounting standards, Consolidated Financial Statements: Purpose and Policy (ED).

We believe the current accounting framework works well and is not so flawed that a major overhaul of its theoretical framework is necessary or beneficial for financial statement users. The long-standing practice of consolidation based on holding a majority voting interest has been widely accepted and consistently applied and is also understood by financial statement users. Such legal control is stable and can be corroborated. We seriously doubt that financial statements that have been inflated with assets and liabilities, and revenues and expenses, of general partnerships and minority-owned corporations, whose assets and revenues are not in fact available to the parent entity and whose liabilities will not be paid by the parent, could be useful to financial statement users for credit evaluation or investment decision-making purposes.

Citigroup does not support issuance of the ED as a final standard, most importantly because we do not believe the ED's concept of effective control is workable and the application of the standard would be highly subjective. When there is not majority ownership, the evaluation of the existence of effective control would be highly judgmental, based on specific facts and circumstances that each reporting entity may weigh differently. As a result, we believe there will be an unacceptable level of diversity in practice in applying the proposed standard.

We agree that a presumption of control is reasonable where a presumed parent has both a majority voting interest and the ability to significantly increase the benefits and decrease the losses it derives from the subsidiary entity. However, we do not think the ED makes a convincing case that control has been established in the three remaining rebuttable presumptions in paragraphs 18 and 21. At best, these three presumptions are no more than indicators that control may exist and that the situation should be evaluated.

Furthermore, in one area where the accounting literature is incomplete and where additional guidance would be valuable, that is for special purpose entities resulting from financial securitization activities, the ED does not provide any specific guidance. The ED is also silent on how its requirements intersect with the consolidation guidance proposed for qualifying special purpose entities in the draft of the Amendment to SFAS No. 125 and in EITF Issue No. 96-20. We would strongly oppose any decision to supersede that guidance.

We believe that if FASB proceeds with this project without making substantial revisions, serious problems will arise in practice. Our comments on various aspects of the proposed standard follow.

Definition of Control – Rebuttable Presumptions (Issues No. 1 and 2)

We think that consolidation decisions should not be based on an entity's forecasts of voting patterns or predictions of the degree of organization or behavior of shareholders and limited partners. Errors in projecting voting results, as well as actual changes in historic voting patterns, could lead to frequent changes in the consolidated entity as subsidiaries are included or excluded from the consolidated financial statements from one year to the next. Compounding this unfortunate situation, the ED is silent on whether prior year financial statements would need to be restated each time an entity is removed or added to the consolidated group. Although the basis for conclusions section does discuss this issue, it does not resolve the question or state whether this would be a change in reporting entity covered by APB Opinion No. 20. This needs to be clarified.

We believe the ED places undue reliance on the concept that dispersed minority interest holders with voting rights will remain dispersed and disorganized. This is key to arriving at the presumption that a large minority voting interest will be able to control a corporation and that a general partner will be able to control a limited partnership. With the communications capability of the internet and its bulletin boards, for example, we believe that a dissatisfied minority shareholder could, with very limited costs, rally support among minority shareholders for ousting current board members whose views they oppose. Similarly, the concept that a disorganized group of limited partners will remain disorganized if it is not content with the performance of a sole general partner is questionable. Limited partners are usually entitled to a list of all the entity's partners and would thus have an even easier time in communicating their dissatisfaction with the general partner and organizing the general partner's replacement. We believe that the apparent passivity of minority investors is primarily a sign that these investors are satisfied with management's performance and is not an indicator of an inability or disinclination to become more active if management's performance declines.

The ED assumes that the most recent years' voting patterns are indicative of a relatively permanent state of affairs. Were this not the assumption, the effective control the ED states results from the largest minority shareholder's vote exceeding 50% of the vote typically cast in the election of directors would be an example of temporary control, not a presumption that consolidation should occur. We disagree. As long as the reporting entity is not the owner of the majority voting interest, any perceived control resulting from a large minority interest can be readily overturned and control may not currently exist.

We are also concerned that the ED would require the holder of warrants, options, or convertible debt to consolidate an entity if exercise of those rights would enable the holder to obtain a majority voting interest in the entity. We do not believe this is appropriate, since there is no way to be assured that those rights will be exercised without a clear statement of the investor's intent. Even if such rights are "in the money," the holder may have no intention of exercising the rights, since he could realize the conversion value through sale of the rights. In addition, there is no guarantee that they will be exercised since there may be a significant cost attached to exercising the rights or the holder may have other reasons for holding the investment. At best, this presumption is an indicator that control could be obtained at some time in the future. It does not currently exist.

We are also perplexed about how these rights would be presented in the consolidated financial statements. Although the ED does not address consolidation procedures, the standard needs to specify whether the right would be presented "as if" converted or exercised or not. It also needs to provide guidance on whether the income statement would present interest payments on the convertible debt as interest expense or dividends or reflect changes in fair value of warrants, options and other rights as trading gains (losses) or in shareholders' equity. We are also confused about how this ED would intersect with SFAS No. 133's guidance on embedded derivatives. In the case of debt securities convertible into equity securities, SFAS No. 133 requires that the conversion feature be bifurcated and marked to market; but once the conversion right is recorded separately, the remaining debt security is no longer "convertible".

We believe the ED's provisions could lead to an inappropriate requirement to consolidate an entity in certain cases where there is no equity ownership. We support the establishment of a minimum ownership level, below which entities would be exempted from consolidation. Such a minimum ownership level needs to represent a significant financial interest. Where there is no actual ownership, it may not be possible to have access to financial statements needed to consolidate the entity before the entity's results are made publicly available without violating securities laws. Moreover, where certain characteristics of control exist and either an investment manager cannot be removed by the investors or the manager receives a performance-based fee with no offsetting downside risk, consolidation would be required.

We are also troubled by the implications of paragraph 243 of the ED for structures that have total return swaps. Paragraph 243 implies that an entity could be required to be consolidated even though none of the presumptions of control are present when one party receives all or a majority of the benefits (and is exposed to a majority of the risks). We believe the ED's language needs to be clarified to state that merely the presence of total return swaps in an entity is not sufficient reason to determine that control is apparent, even though not present. As we noted earlier, we believe that both ownership and beneficial interest must be present before consolidation should be required.

In any situation where the reporting entity has limited or no actual equity ownership, the consolidated financial statements would show all the assets and liabilities, and revenues and expenses, of the "subsidiary" entity along with 100% minority interest. We believe this result would provide misleading financial information to investors, creditors and other financial statement users. From the perspective of a creditor, assets which cannot by law be reached by a creditor in the event of default need to be excluded when determining whether to extend credit. Similarly, mingling liabilities of the "subsidiary" entity with the reporting entity's confuses the evaluation of the borrower's leverage level and also needs to be excluded. From an investor's perspective, return on assets, return on equity, and profitability ratios will be distorted and will not reflect a true measure of the performance of the reporting entity. In this situation combining or consolidating financial statements would become essential for financial statement users.

Transition, Effective Date, and Interaction with Other Proposed Standards (Issue No. 3)

We believe the ED's proposed effective date is unrealistic and inoperable. The ED assumes that information needed to consolidate a potential subsidiary is readily available on a timely basis and, therefore, it would not be overly burdensome to require restatement in comparative financial statements at the date of implementation of the standard. We disagree. While full financial statements with notes may be prepared for many entities that would be required to be consolidated under the ED, they may not be available in the timeframe of the company's normal closing schedule, may not be audited, may have a different fiscal year, or may not be prepared on a U.S. GAAP basis. The information needed today for an equity method pick-up is far less detailed. No information may be available currently for a cost-method investment. It is also very likely that information on intercompany transactions that would need to be eliminated in consolidation is not readily available; reconstructing this data for prior years will not be a simple task.

In our view, an adequate curing period would need to be established so that companies could modify their debt covenants, arrange to obtain the needed financial information, and adjust fiscal years where necessary to coincide closely with the parent company's fiscal year to avoid adverse consequences of applying the proposed standard.

In addition, the ED does not take into account the considerable work involved in analyzing whether consolidation is required for literally hundreds of special purpose vehicles, investment entities, general partnerships, and merchant banking investments that exist at every major financial institution. This work would be very difficult to complete by the first quarter 2000 and would be multiplied if prior year financial statements must be restated as well.

Moreover, consolidation decisions will also be affected by the outcome of deliberations on the expected Amendment to SFAS No.125, which is projected to have an implementation date that is one year later than the effective date proposed for the ED. It will be very burdensome to have to evaluate many structures for consolidation twice within a one-year period. Therefore, we request that the effective date of this project be delayed and synchronized with the effective date of the amendment to SFAS No. 125 and, for the reasons given above, that implementation be prospective.

The ED is silent on whether various EITF issues (e.g., EITF Issues No. 90-15, 96-21, 97-1, and EITF Appendix Topic D-14) that have been relied on to make consolidation decisions for special purpose entities that do not meet the definition of a QSPE will be superseded by this standard. This must be clarified in the final standard. As we noted above, we agree with the draft proposed Amendment to SFAS No. 125 and EITF Issue No. 96-20 that QSPEs should not be consolidated. Without certainty about how these concerns will be resolved by the Board, it is hard to evaluate the full impact the proposed standard will have.

The ED is silent about whether its concept of effective control would also be extended to equity method investments accounted for in accordance with APB Opinion No. 18. Would the concept of significant influence used to determine whether the equity method is applied rather than the cost method need to now consider whether there is "effective significant influence"? We think this should be clarified.

We also note that if a standard is issued requiring that all financial assets and liabilities be recorded at fair value, many entities (e.g., commercial banks, insurance companies, and investment banks) included in the scope of the ED today may qualify for exclusion from the scope in the near future. These entities would have to undergo a major evaluation of all consolidation decisions again within a few short years. The Board needs to state its intent clearly.

Other comments

There is limited discussion in the ED that there may be situations where an entity will not be consolidated by another (e.g., when there is shared control). We think this point needs to be made more clearly in other cases, such as for a joint venture or where there is no majority owner and other presumptions of control are not present. We believe accounting standards should be unbiased and not favor a predetermined conclusion.

The ED states that general partners are in control because in theory they bear legal liability for the partnerships' obligations. In reality, this is not the case for a going concern. In addition, general partners are frequently protected from any such liability by being placed in bankruptcy remote entities. We believe that basing accounting decisions on legal concepts that are not well understood by accountants and which may not be crystal clear even to attorneys would result in greater reliance on legal opinions to close the books. Furthermore, U.S. legal concepts may differ from comparable concepts in non-U.S. legal jurisdictions, adding unnecessary complexity to consolidation decisions.

We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Roger W Trupin