

# ARTHUR ANDERSEN

ARTHUR ANDERSEN & CO, SC

Letter of Comment No: **7B**  
File Reference: **1082-154**  
Date Received: **3/18/96**

March 12, 1996

Arthur Andersen LLP

Mr. Timothy S. Lucas  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

69 West Washington Street  
Chicago IL 60602-3002  
312 580 0069

Dear Mr. Lucas:

This letter is our attempt to respond to your letter of February 29, 1996 requesting additional input on the FASB's project on consolidations.

## **Goodwill and contrived accounting results**

As you might suspect, we thought a great deal about goodwill avoidance and contrived accounting results prior to responding to the Exposure Draft and our comments beginning on page 6 of our response address the issue. Our view was then and continues to be that the "modified" parent company approach does not create the problems you are attempting to fix and the consolidation procedures followed in practice is not in need of significant change. The FASB should focus its efforts on eliminating any inconsistencies in current practice relating to consolidation procedures while retaining the "modified" parent company approach.

In direct response to your question, the FASB clearly should modify the provisions of the Exposure Draft to preclude or minimize the opportunities for entities to enter into the transactions listed in your letter. We support alternative d. which retains AICPA Accounting Interpretation 26 of APB No. 16, *Business Combinations*. The parent should record the cost of each investment, the fair value of the underlying assets acquired and the goodwill for each step purchase. Further, alternative f. is our choice for the recognition of gains or losses on the sale of an interest in a subsidiary directly or through an SAB 51 transaction. Whether the subsidiary is sold in one or a series of transactions should not change the accounting requirement to record the gain or loss that results from the sale.

## **Shareholder veto rights**

Shareholder veto rights recently have come under additional scrutiny because the SEC staff has questioned registrants consolidating subsidiaries with minority interests that have the ability to block decisions that the SEC staff believed impacted the parent's ability to control the subsidiary. If those decisions were deemed to affect the "ordinary, day-to-day operations of

# ARTHUR ANDERSEN

ARTHUR ANDERSEN & CO. SC

Mr. Timothy S. Lucas

Page 2

March 12, 1996

the subsidiary" or prevented the parent from disposing of significant assets, the SEC staff has taken the position that the subsidiary should not be consolidated. (This increased scrutiny of the control issue is the basis for some to ask the EITF Agenda Committee to add the topic to the EITF agenda. To date, the Agenda Committee has declined due to the FASB project on the topic.) To our knowledge, the SEC staff has not published a comprehensive list of the characteristics that they believe prevent consolidation, but the possibilities are numerous. (We received a list from Ed Trott of KPMG that contained approximately 20 such items. You should obtain that list from him.) You might also refer to an SEC staff speech dated January 12, 1993, given at the 1993 AICPA SEC Conference.

Our difficulty with this question is that most often the veto rights occur in private companies (or subsidiaries of public companies that are not traded separately) and the minority interests require the majority to give them protections that prevent the majority from actions that are considered by the minority to harm the value of their investment. Sometimes the minority rights are similar to the restrictions placed on the company by debt holders except that security is a share of stock. For example, the restriction may prevent the sale and distribution of assets exceeding X% of the total assets of the entity without the agreement of the minority interests. In other cases, the minority has the power to block decisions that normally would be considered to belong solely to the controlling entity. For example, the right to approve operating budgets or long-term plans.

We often see these restrictions relating to the creation of a relationship between the creators of a new venture or the sale of an interest in an existing entity to a new minority owner. Depending on the desires of the entity asking the question, the questions are, "How many of these rights can we retain and not have to consolidate the new entity?" or "How many of these rights can we transfer to the buyer without losing the right to consolidate this entity?" Neither of these questions is answered easily by applying the FASB's definition of control.

At the same time, we do not claim to have an easy answer for this question. To date, we have had to consider each factual situation on its own merits and make the determination. We clearly believe if the minority has the right to approve operating budgets and the right to fire management that the majority owner does not have control. Others also likely will meet that test if considered in total. Our concern is that we do not know at what point we should conclude that the rights given up do not cause the majority to lose control. The literature we use and analogize to is AICPA Statement of Position 78-9, "Accounting for Investments in Real Estate Venturer." The SOP provides a framework to begin the process of considering the question but is very general and, some feel, too easy to circumvent. We also use the SEC staff speech dated January 12, 1993, referred to above.

ARTHUR  
ANDERSEN

ARTHUR ANDERSEN & Co, SC

Mr. Timothy S. Lucas

Page 3

March 12, 1996

Sorry that we could not be more precise in our response. We will be happy to discuss these or any other of our comments at your convenience.

Very truly yours,

*Arthur Andersen LLP*