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

Re: Addendum to comments on the Exposure Draft, Consolidated Financial Statements: Policy and Procedures (File Reference 154-D)

Dear Mr. Lucas:

The purpose of this letter is to expand on two matters that arose during our testimony at the public hearings on the Consolidations Exposure Draft.

Proportionate Consolidation/Non-Controlling Interests

As you know, the acceptability of proportionate consolidation of majority-owned subsidiaries has been debated by accountants for many years. Most accountants would agree with the Board's conclusion in paragraph 65 of the ED that this approach would not be representationally faithful. However, no one (to our knowledge) has suggested that proportionate consolidation would be in conflict with the conceptual framework.

We understand that one of the Board's objections to the parent company concept is that it leads to an item in the financial statements that is neither an asset, a liability, or equity and this is in conflict with the conceptual framework. We recommend that the Board view non-controlling interests as a "first cousin" to the equity method, i.e., as a convenient place to gather the non-controlling interests' share of the individual assets and liabilities of the entity in which they have an equity interest. If a proportionate consolidation approach does not conflict with the conceptual framework, why should an account that merely summarizes the offsetting amounts arising from the full consolidation (gross-up) of majority-owned subsidiaries cause concern?

Economic Interest/Service Potential

Paragraph 11 of the ED describes the concept of "service potential." The Board's conclusion that economic interest is not a requisite condition for consolidation appears to rest on the premise that the ability to obtain the service potential of another entity's assets is indistinguishable from possessing an economic interest in that entity. We found the Board's views in this area to be unclear. For example, at least one Board member indicated that the concept of service potential was meant to apply only to not-for-profit entities, while other Board members expressed differing views. In particular, we found the discussion concerning hotels to be troubling, particularly when those conclusions are extended to other situations.

"Hotel example"

At the public hearings, several Board members said that hotel management companies should consolidate the entities that own the hotel property regardless of whether the hotel management company has any equity interest in that entity or any responsibility for its liabilities. As we stated at that time, we do not agree with those views. We believe the view that consolidation is appropriate because "one cannot be in the hotel business without having a hotel to operate" and "the hotel management company is the recipient of the primary economic benefits/service potential of the hotel property" is akin to stating that, when one party uses assets owned by another party, the first party should consolidate the second. For example, assume a developer forms a corporation and constructs a one floor building that can be used for any type of business. The building and the related debt are the sole net assets of the corporation. The building is leased to one tenant who will use it to operate a 24 hour convenience store. The lease term is five years with fair market rent and is accounted for as an operating lease by the owner of the convenience store. Is it the Board's view that the convenience store owner should consolidate the corporation that owns the building? We believe that including in the balance sheet an asset in which a company has no equity interest would be misleading at best.

In addition to our conceptual disagreement with the views expressed, we believe that the Board should consider certain practical issues associated with such an approach. For example, the real estate developers may have constructed other properties that are managed by different hotel management companies. Who would consolidate when a development company awards management contracts on its various properties to different hotel management companies? Given the Board's underlying premise regarding service potential, one would expect that its views should not change; however, given that only one entity can be deemed the controlling entity, none or only one of the management companies could consolidate the developer. That conclusion, however, appears to be inconsistent with the Board's view that "one cannot be in the hotel business without having a hotel to operate."

It is very difficult to understand the views expressed at the hearings. For example, those views appear to suggest that entities with sole suppliers should consolidate those suppliers, even though the reporting entity has no economic interest in that supplier. Although the ED specifically precludes consolidation in situations involving franchisers and franchisees (paragraph 169), and

managers and managed entities (paragraph 161), we do not understand the basis for the Board's distinction between those situations and its views with respect to hotel management companies and similar situations. We believe that the Board should reconsider its views in this area.

Level-of-Benefits Test

At the second day of public hearings we understand that certain Board member characterized our views with respect to the level of benefits test in discussions with other respondents. Our understanding of those comments suggests that our views were not clearly understood by the Board. Accordingly, we believe it is important that we clarify our position.

Our view is that some level of economic interest is required as a condition (in addition to control) for consolidation. Our January 15 letter stated that such an interest needed to be more than a de minimis amount. As communicated at the public hearings, we do not believe that a "bright line" test as to what constitutes more than a de minimis economic interest is necessary or appropriate in the context of an effective control standard. However, in response to specific concerns raised by Board members that such a "bright line" was needed, we suggested that the Board consider establishing a 20 percent test. In other words, while we would accept a 20 percent test, we believe that the standard should instead provide for a more than de minimis standard, with no specific threshold stated.

We appreciate the opportunity to express our views. If you have any questions regarding our comments, please contact Ronald J. Murray at (212) 536-2809, James F. Harrington at (212) 536-2706 or John P. Glynn at (212) 536-3170.

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