Paul Munter KPMG Professor of Accounting Department of Accounting – 317 Jenkins Building University of Miami Coral Gables, FL 33146-6531 305/284-2849 pmunter@miami.edu

Comment Letter No. /O
File Reference: 1082-194R
Date Received: 5/18/99

May 14, 1999

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

Re: File Reference No. 194-B

Dear Mr. Lucas:

Thank you for the opportunity to comment of the FASB's recent proposal regarding consolidated financial statements. Let me begin with a couple of general observations. While I know that the comment letters are not a "popularity" contest, I would nonetheless like to express my support for the FASB's efforts in this area. I am familiar with a variety of entities who have significant unconsolidated operations which represent a substantial (and thus, unreported) part of their overall operations. I believe that this proposal would move to address some of those issues (I will provide examples later in my comment letter).

Having expressed my general support for the proposal, I also willingly acknowledge that many of my colleagues and friends in the preparer auditor community are not very enthusiastic about the proposal. I believe that this concern stems largely from the lack of a bright-line in the proposal (since consolidation would not longer be wedded primarily to the majority ownership test). This, of course, means that the resulting standard would require the exercise of more judgment in evaluating the facts and circumstances surrounding the relationship with an affiliate.

While I understand that concern among the preparer/auditor community, I do not believe that such concern should override sound accounting and reporting principles. Additionally, I have long-believed that standard-setters should move away from "bright-line" based standards. Indeed, the lease accounting literature to me serves as more than ample proof that bright-line standards do not work since it becomes relatively easy for those who understand the bright-lines to construct agreements which narrowly miss those bright-lines.

The same is true relative to consolidated reporting. Since practice has evolved around the ownership test (where an ownership interest in excess of 50% warrants consolidation – subject to the exceptions of SFAS No. 94), it is relatively easy to gain control of an operation, but, with less than a majority ownership in the venture, argue that consolidation is not necessary. As an example, I am familiar with several real estate development companies which create separate limited partnerships for each project. The real estate development firm serves as the general partner of each partnership but holds a small equity position (typically less than 10%). As such, they typically do not consolidate the affiliated companies resulting in financial statements which show only the investment account and (under the equity method) equity income from the investments. The detail of the operations are obscured from the reader of the real estate entities' financial statements.

Beyond these examples, there are other circumstances as well where control exists and, because a majority ownership position is not held by the investor, consolidation is avoided. Thus, I believe that the FASB's approach represents a very positive step in developing better financial reporting. Furthermore, I believe that it can be argued that the FASB's proposal is entirely consistent with ARB No. 51. As you know, ARB No. 51 notes that the usual situation demonstrating control is majority ownership of an investee. Importantly, however, ARB No. 51 does **NOT** say that majority ownership is the only way to achieve control—a fact the FASB is now attempting to confirm.

Regarding the specific issues outlined in the exposure draft:

Issue 1: I believe that the current definition of control and the related discussion does help clarify the concept of control. I recognize where there will be difficulties in practice in applying this (or, perhaps, any non-quantitative) definition, it is, nonetheless, a reasonable and adequate discussion. The one point I would make is that there may be an ability to tie in this discussion somewhat with the concepts articulated in SFAS No. 131. That document uses a management approach to identify segments. One could argue that the CODM is receiving information on the operations which the entity actively manages (and, thus, conceivably controls). As such, it may be possible to look to the segment-type information as some guidance in determining whether control may or may not exist.

Issue 2: I believe that the rebuttable presumptions of control which are stated in the exposure draft are both clear and implementable. However, I am somewhat concerned about the wisdom of including these (or other) rebuttable presumptions in the standards. It seems to me that in doing so, the Board runs the risk of having practitioners interpret

those as the only circumstances requiring consolidation in the absence of majority ownership. Since it would be unlikely that the Board would ever be able to develop an exhaustive list which incorporates all situations, I would recommend that the Board clarify that these are example scenarios and are not intended to be all-inclusive.

Issue 3: The Board has specified that the proposed standard would be adopted by retroactive application. Frankly, I cannot conceive of a reason NOT to implement via retroactive restatement. If this standard were implemented without retroactive application, entities would be reporting, in effect, noncomparative information since their comparative information would include information relating to the same investees but treated on an unconsolidated basis in previous periods and on a consolidated basis in the current period. Granted, the process needed to consolidate the information for prior periods is somewhat time-consuming (especially for the period of transition), but I believe that having comparative information available to the investing public outweighs this consideration. Additionally, I would think that items included elsewhere in the financial report (notably MD&A) would be much easier to address if the entity has a comparative reporting model.

The one issue that might require further consideration is the application of this standard to interim periods. With a proposed effective date for periods beginning after December 15, 1999, calendar year-end companies would need to have the provisions completely adopted by the end of the first quarter of 2000. Depending upon when the final standard is issued, that may create an undo hardship on some entities.

Once again, I thank you for the opportunity to provide input to the Board as it continues on its deliberations regarding consolidated financial reporting and I urge the Board to move forward towards the adoption of this proposal.

Sincerely,

Paul Munter KPMG Professor of Accounting