FINANCIAL MANAGEMENT DIVISION

SECURITIES INDUSTRY ASSOCIATION



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May 24, 1999

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

Letter of Comment No: 75
File Reference: 1082-194R

Date Received:

Re: File Reference No. 194-B

Dear Sir:

The Financial Management Division of the Securities Industry Association ("FMD") appreciates the opportunity to comment on the Financial Accounting Standards Board's ("Board") Proposed Statement "Consolidated Financial Statements: Purpose and Policy" (the "Standard or ED"). The FMD has followed with interest the Board's views in developing this proposed Standard, given the significant impact this pronouncement could have on broker dealer financial statements.

As stated in our position paper dated May 16, 1995 and commented on in our January 15, 1996 letter to the prior exposure draft (File Reference 154-D) we continue to strongly believe that consolidation of merchant banking activities by broker dealers and their affiliates would be very misleading to their financial statements. The subjectivity in the presumptions of control criteria put forth in the current exposure draft as opposed to the legal concept of control (owning a majority voting interest) will only lead to confusion and second guessing as to when consolidation should occur. Further, we believe that there is no need for a wholesale review of consolidation accounting, a topic that is well defined and applied in practice with little controversy.

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Our comments, should the Board see a need to issue a standard, are detailed below:

Scope

We believe that the consolidation of Controlled Companies held for merchant banking activities will have a very distortive effect on the broker dealers' financial statements. Generally, merchant banking activities often involve the frequent buying and selling of several investments that may be Controlled Companies. If these Controlled Companies were consolidated, the composition and character of the broker dealers' consolidated financial statements could change frequently reducing the ability of the reader to analyze the core broker dealer operations and reducing the comparability of the broker dealer with its peer group.

Broker dealers follow the guidance set forth in the American Institute of CPA's Audit and Accounting Guide "Brokers and Dealers in Securities" (the "Guide"). Securities owned and held for merchant banking purposes are accounted for at fair value with changes in fair value recorded in earnings in accordance with the Guide. Such investments may be controlled entities, which have to be consolidated based on the ED. This would be a significant change in accounting which will affect not only the reported amounts of assets, liabilities, revenues, expenses and cash flows but will also inappropriately distort net income and earnings per share.

The ED grants an exception to reporting entities that carry substantially all their assets, including investments in Controlled Companies at fair value. We believe that the scope of the exception should be changed to either 1. Include reporting entities that carry investments in Controlled Companies at fair value, or 2. The SFAS 115 wording "This Statement does not apply to enterprises whose specialized accounting practices include accounting for substantially all investments in debt and equity securities at market value or fair value, with changes in value recognized in earnings (income) or in the change in net assets. Examples of those enterprises are brokers and dealers in securities, defined benefit pension plans, and investment companies", or 3. Add "or amounts approximating fair value" to "at fair value". In this manner, Controlled Companies that are included in merchant banking activities of a broker dealer and its affiliates would continue to be shown at fair value, with changes in fair value reported in earnings.

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Partnerships

Paragraph 21of the ED makes the assumption of control when there is a sole general partner and no organized group of partners has the ability to dissolve the partnership or remove the general partner. Paragraph 63 mentions the right of the limited partners to vote on partnership matters but goes on to state that in certain large partnerships with wide dispersion of partners, the limited partners do not have the ability to organize.

It is our view that focusing on the right to organize is the wrong approach to determine control. The true test of control resides with the ability by the limited partners to vote on partnership matters, as allowed for in the partnership agreement, irrespective of the number or dispersion of the partners. A partnership agreement that provides for the removal of the general partner by a reasonable vote of the limited partners, without cause, and without the limited partners incurring a significant penalty, indicates that the sole general partner does not control the limited partnership. For example, the Board should consider the concepts proposed in the fall of 1998 by the EITF 98-6 Working Group.

We would recommend that the operative test with respect to control of the partnership rests with the ability of the partners to reasonably vote on partnership matters as allowed for in the partnership agreement, and that paragraph 21 be changed to reflect this approach.

Qualified Special Purpose Entities

The scope of the ED includes Special Purpose Entities. However, there is no mention in the ED with respect to Qualified Special Purpose Entities ("QSPE") as defined in SFAS 125. Also, there is no reference made to the SFAS 125 amendment project where the Board is addressing consolidation issues for these QSPEs. Therefore, it should be made clear in the consolidation standard that consolidation guidance for QSPEs is to be governed by SFAS 125 as amended. If the consolidation standard is to be issued before the SFAS 125 amendment than, QSPEs should be excluded from the scope of the ED.

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Implementation

The proposed Statement only addresses the purpose and policy with respect to consolidated financial statements. It does not address the procedures and methods for consolidating which the Board plans to issue at a latter date. Separating these two components makes it difficult to visualize the complete picture with respect to the consolidation issue.

We would propose that the effective date of the final standard be deferred until the exposure of the procedures and methods piece of the project is finalized.

We would be glad to discuss this letter with representatives of the staff. If you have any questions or require additional information, please call me at 212-762-6567.

Yours truly,

Charles F. Vadala

Co-Chairman

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