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Maryville, TN 37801  
May 20, 1999

**Letter of Comment No:** 37  
**File Reference:** 1082-194R  
**Date Received:** 5/25/99

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

Re: File Reference No. 194B, Consolidated Financial Statements: Purpose and Policy

Gentlemen:

The following are comments of a private individual who invests for my own account, and carefully analyzes the financial statements of companies in which I invest or consider investing.

I am concerned that the proposed standard will lead to the consolidation by one entity of another entity despite the consolidating entity not being entitled to a majority of the benefits of ownership and not being subject to a majority of the risks of ownership. Placing the assets and liabilities of another entity on the consolidated financial statements creates the impression that the consolidating entity will be able to reap the benefits of ownership and use of the assets. It also creates the impression that the consolidating entity bears the risks associated with the assets and liabilities, and the obligation to satisfy the liabilities. If this is not true, as generally would be the case if the consolidating entity holds less than a majority equity interest in the other entity, then the resulting consolidated financial statements are likely to be misleading to an actual or potential investor or creditor.

I realize that it is possible for an entity to control another entity without having a majority of the risks and rewards of ownership, but I do not agree that the controlling entity's consolidated financial statements should include the assets, liabilities, revenues, and expenses of the other entity in that situation. The exposure draft only requires that the controlling entity have some undefined, possibly minimal opportunity to benefit from controlling the other entity. At the very least, the standard should require that the consolidating entity have a substantial (say 35% or greater) share of the benefits, and that there be clear disclosure of both the less-than-majority share of benefits and the effect that consolidation of the other entity had on major financial statement totals.

I also realize that it is possible for an entity to have effective control over another entity without ownership of an equity interest in that entity, and that effective control may enable the first entity to receive the majority (or at least a substantial part) of the benefits from assets and operations of the other entity, possibly through contracts that provide for pass-through of those benefits. I agree that an entity that effectively controls another

entity without equity ownership, or with a minority equity interest, and is entitled to a majority of the benefits from the other entity's assets and operations should consolidate that entity.

However, I do not believe that the provisions in the exposure draft are sufficiently clear in defining the circumstances in which effective control may exist without majority voting equity. The proposed statement probably would be good if it were a concepts statement, but is too vague to be an effective accounting standard. I expect that the interpretations will vary widely, resulting in inconsistent application.

My recommendation is that you re-think the proposal and then issue a new exposure draft. You are moving in the right direction regarding effective control, but you are not yet at the destination.

Kenneth McCollum