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September 16, 2005

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116

File Reference 1205-001 - Consolidated Financial Statements

Dear Director:

This letter represents my comments on the Proposed Statement of Financial Accounting Standards, "Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries – a replacement of ARB No. 51." In summary, I do not support the conclusions of this Exposure Draft and I urge that it be withdrawn.

As noted in Appendix C, in January 1982 the FASB "added to its agenda a project on accounting for the reporting entity, including consolidation policy and procedures, the equity method, and related matters." However, nearly a quarter century of research and deliberations on these matters has not resulted in final decisions in this area. And the consolidation practices that would result from this ED and the related one on Business Combinations would be much more complicated than at present while producing arguably less useful financial information.

The principal requirements of this ED are (1) to classify minority interests as equity in the balance sheet with related effects in the income statement, and (2) to significantly revise the accounting for changes in ownership in a subsidiary. While these topics were among those raised in issues papers developed by the AICPA Accounting Standards Executive Committee in the late 1970's or early 1980's in which I participated (be careful what you wish for!), practice has lived quite well without formal rulemaking for many years. I am not aware of current

demands from users or others to address the matters covered in this proposal. In fact, as noted in paragraphs C6 and C10, two earlier exposure drafts that dealt with many of these same issues (particularly minority interests) were met with widespread opposition by the Board's constituents. And more recent discussions with field visit participants described in paragraph C11 apparently resulted in similar disagreement.

The reasons for the ED are not persuasive

As noted in the Summary of the ED, the Board has three primary reasons for issuing this document. First, the Board states that there is diversity in practice for the accounting for minority interests in subsidiaries. However, as the Board notes, most companies report minority interests in between liabilities and equity in balance sheets, to reflect the fact that these amounts don't mesh nicely with the notions of liabilities or of equity of the shareholders of the reporting company. Companies reporting these amounts as liabilities probably do so only because the amounts are so small that a separate caption isn't warranted. Thus, I'm not sure that practice is all that diverse for minority interests. It is understandable that the Board does not wish to explicitly endorse the long-standing, so-called mezzanine treatment for minority interests, but simply leaving this matter alone would be better than the changes proposed.

Second, the Board asserts that the various changes would "improve the relevance and transparency of information provided to investors, creditors, and other users of financial statements." While the proposal would certainly change the way certain information is provided in fairly dramatic ways, I disagree that the results would be an improvement. If nothing else, there would have to be significant reeducation of investors in order for them to understand that not all equity they see in a company's financial statements is their equity and not all net income belongs to them.

The Board seems to undermine its own belief in the application of the economic unit theory when it (a) requires that earnings per share information be computed, presented, and disclosed from the perspective of the common shareholders of the parent, and (b) requires separate disclosure of the amounts of net income and comprehensive income attributable to the controlling and noncontrolling interests. The Board also would require disclosure of a gain or loss recognized on the loss of control of a subsidiary, thus implying that users will question the relevance of including such amounts in net income.

The third primary reason given to justify the ED is to "improve international comparability." That might be understandable if the FASB were moving to adopt a position where international accounting is well entrenched and can be argued to

be superior to U.S. GAAP. However, this is a joint proposal by the FASB and IASB and both bodies are seeking to have their respective accounting regimes changed in significant ways. Are the current differences between U.S. and international accounting that important? Even if they are, is such radical surgery required in order to bring them together? The Basis for Conclusions makes only brief references to international accounting in this area and it would have been interesting to see how both boards are proposing to change existing accounting.

The underlying concept should be rethought

As noted in my separate letter on the Business Combinations exposure draft, the economic unit theory for consolidation has never received much support vs. the much more widely accepted view of consolidation based on the parent company theory. In particular, I believe there is an extensive record that users of financial statements such as equity analysts and credit officers in lending institutions are far more interested in financial information from the parent company's perspective than they are in economic unit financial information. As noted above, the Board seems to acknowledge this in the proposed requirements to continue breaking out or disclosing parent company information. The bottom line seems to be that the Board is more concerned with what it views as conceptual purity than useful information.

Beginning in 1995 the Board has issued several proposals on consolidation policy and procedures that rely on the economic unit theory. I've always thought the parent company theory made more sense and was more consistent with the manner in which investors and others actually read and interpret financial statements. In other words, financial statements must contain decision useful information. Yet the existing concepts do not address one of the most fundamental aspects of financial reporting – the nature of the reporting entity, or consolidation policy. Isn't it time to do this?

While reasonable people can disagree on accounting theory, I think it would be preferable for the Board to try to establish formal conceptual support rather than continuing to build on what many believe to be an unsound foundation in this area. One of the most fundamental aspects of the framework is the determination of the objectives of financial reporting. In its existing framework the Board has decided that financial statements should help investors and creditors make predictions about future cash flows. The economic unit theory for consolidation does not seem consistent with that objective. Notwithstanding my personal opinion on this matter, I think it's important for the Board to formally establish the relevant principle here rather than just continuing to build ever more complicated rules.

As you may recall, I have disagreed with recent decisions by the Board that are based on Concepts Statement No. 7, particularly requirements to recognize and

measure nonfinancial liabilities at fair value. In its reasoning for those decisions the Board generally has stated that the decisions in those individual projects were mandated by the conceptual conclusion reached earlier. This is somewhat like the famous Flip Wilson character who always excused her actions by saying, "The Devil made me do it!" Given this background I am somewhat reluctant to urge a conceptual resolution of consolidation policy. However, that would at least have the benefit of proving an understandable foundation for later decisions. As it is now, we have 25 years of Board decisions and other false starts that are based primarily on the personal prejudices of the Board members at that time.

While consolidation policies and procedures certainly aren't perfect, I feel we would be better off to accept a certain amount of diversity rather than adopting the current proposals. At a minimum, however, I believe the FASB should return to the conceptual underpinnings of the consolidation matter and resolve them for once and for all rather than adopting piecemeal changes that will greatly complicate accounting in this area.

I will not comment in detail on the issues raised in the Notice for Recipients. I think my summary comments make clear that I do not support the key aspects of the ED – accounting for minority interests and accounting for changes in ownership in subsidiaries.

Please let me know if you have any questions on my comments.

Sincerely,

Dennis R. Beresford
Ernst & Young Executive Professor of Accounting