

ASHLAND OIL, INC. • POST OFFICE BOX 391 • ASHLAND, KENTUCKY 41114 • PHONE (606) 329-3333

KENNETH L. AULEN Administrative Vice President and Controller (606) 329-5454

February 16, 1996

Letter of Comment No: 154 File Reference: 1082-154
Date Received: 2/20/96

Financial Accounting Standards Board File Reference 154-D 401 Merritt 7 P. O. Box 5116 Norwalk, CT 06856-5116

Dear Sirs:

Ashland appreciates the opportunity to respond to the FASB's Exposure Draft of its Proposed Statement entitled Consolidated Financial Statements: Policy and Procedures. We apologize for our delay in responding, but our fiscal year ended on September 30 and we have not had an opportunity to adequately review the Statement until just recently.

Due to the significant diversity in current practice, we agree there is a need for additional guidance concerning consolidation policies. In addition, we concur with the Board's basic premise that legal control may not be the most appropriate standard for consolidation in many circumstances. Control is sometimes a subjective matter that cannot always be addressed through definitive standards. The Proposed Statement generally provides broad parameters for decision making, but allows discretion for reasonable judgment based on the related facts and circumstances.

However, the Proposed Statement focuses solely on situations where less than majority-owned entities should be consolidated because of the presence of effective control. The Statement does not address situations where effective control may not be present with respect to majority-owned entities due to supermajority provisions or similar restrictions. In addition, the Statement could lead to a diversity in accounting for identical transactions, such as leases, where the only substantive difference may be the legal status of the lessor. And finally, the Statement could produce additional confusion when a controlling interest is obtained in an entity in which the parent already has an investment. Our comments with respect to each of these issues follow.

Supermajority Issues

While effective control may be a better barometer for consolidation purposes than a simple majority voting interest in many situations, the Proposed Statement does not fully address this issue from both sides. The Statement goes to great lengths in describing situations where one entity has effective control over the assets of another entity, even though it does not have a majority voting interest. Although the presumption of control with a significant minority interest can be overcome by evidence to the contrary, the basic premise throughout the Statement appears to be that majority-owned entities are always effectively controlled.

In our opinion, this premise is incorrect in certain circumstances due to the presence of supermajority provisions or other restrictions in an entity's constitution, articles of incorporation, bylaws or partnership agreement. Such provisions can severely limit the ability of a majority owner to use or direct the use of the assets of an entity in the same manner as the parent's assets. Such provisions can deal with essential corporate governance matters (i.e., the selection of executive management and directors), major operating issues (i.e., the approval of capital or operating budgets), financing decisions (i.e., the payment of dividends or issuance of debt and equity securities) or strategic direction (i.e., acquisitions and divestitures). Where supermajority provisions are present which require the concurrence of significant minority shareholders, effective control does not rest with the majority owner.

As a result, the Board should address supermajority issues in the context of the Proposed Statement. If the standard for consolidation is effective control, the Statement should provide an appropriate balance on both sides of the majority ownership issue. As the Statement now stands, it appears that less-than-majority-owned entities may be consolidated, while majority-owned entities will always be consolidated.

Accounting Diversity

The provisions of the Proposed Statement could result in a diversity of accounting for identical transactions simply as a result of differences in the legal status of the counterparties to the transactions. For instance, companies engaged in leasing agreements similar to those described in Example 5 of Appendix B to the Statement would probably have to consolidate the lessor if it were a special purpose entity engaged in leasing transactions with only one lessee or with lessees with a common parent. For all practical purposes, the accounting result is that operating leases would be transformed into capital leases. However, identical leases with a general purpose leasing company would continue to be accounted for as operating leases. In either situation, lessees would have the same degree of control over the leased property and

any residual cash flows would benefit the lessor rather than the lessee. Furthermore, it is also conceivable that in certain situations, both the lessee and the parent of the lessor could be construed as having effective control over the lessor, a result which is clearly contrary to the intent of the Statement.

The Proposed Statement should make it clear that third party lessors should not be consolidated if they have economic substance apart from the lessee. To do otherwise would void certain provisions of FASB Statement No. 13, Accounting for Leases, and produce diversity in accounting for similar transactions which would not supported by the underlying facts and circumstances.

Acquisitions of Controlling Interests

As indicated in the Basis for Conclusions, the current method of accounting for partial acquisitions of an entity has been criticized because the carrying values of the individual assets and liabilities of that entity are only revalued to the extent of the percentage interest the controlling entity is acquiring. As a result, this process produces carrying values for assets and liabilities which are a blend of fair values (for the percentage interest being acquired) and historical costs (for the percentage interest not being acquired). Paragraph 27 of the Proposed Statement resolves this inconsistency by requiring the carrying values of individual assets and liabilities to be revalued to their full fair value, with the portion applicable to the interest not being acquired reflected as an adjustment of minority interest on the balance sheet. However, this inconsistency remains unresolved with respect to the accounting for purchases of a controlling interest in an entity in which the parent already has an investment accounted for on the equity method.

Under the provisions of Paragraph 28, the parent purchasing a controlling interest in an entity will adjust the carrying values of assets and liabilities of the acquired entity to their full fair values, including the portion related to any previous investments. If the fair value of such net assets has depreciated, their carrying values will be written down, creating a shortfall compared to the parent's investment. Presumably, this shortfall would result in the retroactive creation of goodwill, which is not only counterintuitive, but will probably also be counter to the economic facts and circumstances. In most cases, a decline in the fair value of an entity's net assets will be accompanied by a decline in the value of its goodwill, rather than an increase. Furthermore, such handling would seem to be in direct opposition to the provisions of FASB Statement No. 121 which requires a write-down of any goodwill associated with impaired assets.

On the other hand, if the fair value of the acquired entity's net assets has appreciated, the result is again counterintuitive since goodwill will be reduced,

Page 4 February 16, 1996

rather than increased. In some circumstances, appreciation in the fair value of an entity's net assets could exceed goodwill, creating negative goodwill which is generally accounted for as a reduction in the carrying value of the entity's noncurrent assets. As a result, the majority owner's interest in such assets could be written down due to the purchase of a controlling interest, while the minority owner's interest in those assets will be written up. This apparent inconsistency is compounded by the fact that the greater the appreciation, the greater the difference between the relative carrying values. If financial statement users were somewhat confused and critical of current accounting practices, they will be totally confused by the results obtained under Paragraph 28 of the Proposed Statement.

As a result, we believe it would be preferable to retain the current method of accounting for situations in which a parent purchases a controlling interest in an entity in which it already has an investment. To do otherwise will further complicate the existing confusion.

Sincerely,

Kenneth L. Aulen

Kennech J. aulen

mja