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Financial Accounting Standards Board Director of Research and Technical Activities File Reference No. 154-D 401 Merritt 7 P. O. Box 5116 Norwalk, CT 06856-5116

Re: Comment letter on Proposed Statement of Financial Accounting Standards Consolidated Financial Statements: Policy and Procedures

I am writing to express my opinions regarding the above referenced Exposure Draft ("ED"). While I generally support the conclusions reached in the ED, I believe some clarification is needed for a few provisions of the ED. Also, I disagree with a few of the specific conclusions. In addition, the ED makes some broad, fundamental changes in current GAAP (especially with respect to accounting for acquisitions of subsidiaries, changes in a parent's ownership interest in a subsidiary and the reporting of noncontrolling interests in subsidiaries), and I believe additional implementation guidance is required.

1. <u>Control of an Entity</u>

I do not believe holding sufficient unconditional rights to elect or appoint a majority of an entity's governing board by voting rights or provisions of a partnership agreement or other contractual arrangement is always sufficient to attain control. I think that one also has to look to the powers of such governing board to see if they are consistent with the definition of control pursuant to paragraph 10. Consider the following Company A and B form a 50/50 joint venture governed by a fivemember board. For various business reasons, Company A appoints three of the five members, and Company B appoints the other two. The joint venture agreement allows the governing board to make certain policy decisions by majority vote, while other policy decisions require approval of a majority of the joint venture owners themselves (i.e., in this case, unanimous approval of both owners). If the powers delegated to the governing board do not meet the definition of control pursuant to paragraph 10 (i.e. those powers consistent with paragraph 10 are effectively in the hands of the owners themselves), then Company's A ability to appoint a majority of the governing board does not establish control of the joint venture. I recommend that paragraph 13 be clarified to state that holding sufficient unconditional rights to elect or appoint a majority of an entity's governing board by voting rights or provisions of a partnership agreement or other contractual arrangement is sufficient to attain control only if the governing board has powers consistent with paragraph 10.

B. I recommend paragraph 10 be clarified to explicitly state that it is possible that no one may control a specific entity (i.e. clarify that the

existence of control is not established just because one owner proves no other owner has control).

- C. Paragraph 14 lists six examples which, absent evidence to the contrary, is presumptive evidence of control. Does the Board intend that the specific absence of one of those six examples gives presumptive evidence that control does not exist (e.g., does an entity's inability to unilaterally dissolve an entity and assume control of its assets subject to claims of creditors paragraph 14(e) mean that control does not exist, regardless of other factors which tend to support the existence of control)? I recommend that paragraph 14 be clarified to make the Board's intentions regarding this issue explicit.
- D. I agree with the one Board member's alternative view pursuant to paragraphs 139-141 that control should not be sufficient for consolidation when the parent is not, in substance, exposed to the majority of the entity's ultimate net cash flows. I believe there should be some minimum level of ownership in addition to control before consolidation is appropriate; otherwise the equity method is preferable. While I acknowledge that Board member's view that determining when "enough" benefits are present is subjective, I recommend that paragraph 10 be modified to require an ownership level of at least 40% for requiring consolidation so long as control exists. I acknowledge the 40% level is arbitrary, but there are other arbitrary thresholds in existing GAAP.

2. Elimination of Intercompany Transactions and Balances

E. I believe paragraph 21 needs to be clarified regarding the elimination of shares of a parent held by a subsidiary. The third sentence of paragraph 21 talks about "gains or losses for the difference in the carrying amount of the issuer and acquirer." I believe the Board intends that the third sentence is to provide guidance for elimination of intercompany investments in debt securities and not elimination of intercompany equity securities (otherwise, I would be uncertain as to just what is the "carrying amount" of a parent's equity securities). I recommend that paragraph 21 be clarified to state that the dollar amount reported as treasury stock for equity shares of a parent held by a subsidiary shall be the subsidiary's cost basis in such equity shares, and that part of the elimination should be allocated to any noncontrolling interest in that parent.

3. <u>Reporting Noncontrolling Interests in Subsidiaries, Acquisitions of Subsidiaries and Changes in Ownership Levels of Subsidiaries</u>

- F. I recommend that paragraph 22 be clarified to state that the amount of net income or loss attributable to the noncontrolling interest in a subsidiary include the noncontrolling interests' pro-rata portion of amortization of purchase accounting basis differences generated by implementation of paragraphs 26-28 (which, pursuant to such paragraphs, would not include any goodwill amortization as goodwill is never to be allocated to the "noncontrolling interest").
- G. I found the last sentence in paragraph 29 to be somewhat confusing. For example, consider a parent's acquisition of part of a subsidiary's stock in market transactions (acquisition of noncontrolling interest). The last sentence of paragraph 29 seems to imply that the reduction in the carrying amount of the noncontrolling interest in the consolidated balance sheet upon

acquisition of part of the noncontrolling interest by the controlling interest would exactly equal an increase in paid-in-capital. What I believe the Board intends is that the difference between (i) the amount of cash or other consideration paid to acquire the noncontrolling interest and (ii) the prorata reduction in the carrying amount of the noncontrolling interest in the consolidated balance sheet at the date of acquisition, should be the change in paid-in-capital. The change in paid-in-capital would probably never exactly equal the change in the noncontrolling interest, and there would be no change in paid-in-capital if the amount of cash or other consideration paid exactly equals the reduction in the noncontrolling interest in the consolidated balance sheet.

In addition, I am unsure how to implement paragraph 29 when a parent's ownership level decreases upon the subsidiary's issuance of additional shares of its common stock. Under current GAAP, a "SAB 51" gain/loss is measured based upon the relative change in the parent's ownership level and the change in the subsidiary's separately-reported net assets. However, pursuant to paragraphs 26-28, the amount reported as noncontrolling interest in a consolidated balance sheet no longer equals the noncontrolling interest's ownership level multiplied times the subsidiary's separately-reported net assets (i.e. the link between the subsidiary's separately-reported net assets and the carrying amount of the noncontrolling interest in the consolidated balance sheet now no longer exists). I am unclear as to the Board's intent regarding how the change in the subsidiary's separately-reported net assets is to be allocated between the controlling and noncontrolling interest.

I recommend clarification, implementation guidance and examples be added for paragraph 29.

- H. I recommend that paragraph 29 also be modified to clarify that following a change in a parent's ownership level of a subsidiary, the allocation of amortization of purchase accounting basis differences between net income attributable to the controlling and noncontrolling interests also be appropriately modified to reflect the new relative ownership percentages.
- I. There appears to me to be an incongruity between the guidance in paragraph 29 and paragraph 30. I am bothered by the logic behind (i) having "gains/losses" from a parent's reduction in ownership level of a subsidiary while control is still maintained be accounted for as transactions in the equity of the consolidated entity, while (ii) having "gains/losses" from a parent's reduction in ownership level of a subsidiary where control is lost be accounted for in the income statement. This would seem to be open for abuse (i.e. arranging a series of transactions, the ultimate intent of which is to give up control, whereby all but the last transaction gives rises to "losses" charged to equity where the last transaction, in which control is given up, gives rise to a large "gain). I recommend the ED be modified to make the accounting required pursuant to paragraphs 29 and 30 be consistent.
- J. Has the Board considered whether an amendment to paragraph 19(b) of APBO No. 18 is required, which states that "a difference between the cost of an investment and the amount of the underlying equity in net assets of an investee should be accounted for as if the investee were a consolidated subsidiary"? Under the ED, the "purchase price allocation" is done at the date control is established (i.e. the date the parent-subsidiary relationship is established). However, with an equity investee control, by definition, has not yet been established, and it is unclear to me how one would implement paragraph 19(b) following adoption of the ED. Also, one could purchase an

additional interest in an equity investee but still not have control of the investee, and again it is unclear to me what the Board intends regarding paragraph 19(b) of APBO No. 18. I believe the Board needs to consider the impact of the ED upon paragraph 19(b) of APBO No. 18 and provide implementation guidance and examples.

4. Transition

K. I am unclear as to the restatement provisions of paragraph 37 as they relate to paragraphs 26-30.

If you implement and restate all provisions, including paragraphs 26-30, how far back are you required and/or permitted to go? If you are only permitted to go back to the earliest year of an income statement presented in the basic financial statements, what about the five-year table in a 10-K (the first two years would not be consistent). Are you permitted to go back to a date earlier than the start of the year for which an income statement is presented? If so, how far back are you permitted to go?

If you implement and restate all provisions, including paragraphs 26-30, how do you handle prior business combinations and the resulting purchase accounting basis differences when control was established prior to the date of implementation? Do you "gross-up" existing basis differences (which currently only relate to the parent's ownership percentage) pro-rata to cover the noncontrolling interest? This seems like the most logical and least time-consuming method.

I recommend the Board clarify and add implementation guidance for paragraph 37 as it relates to paragraphs 26-30. Examples would help tremendously.

Thank you for your consideration of these comments and suggestions.

Best regards,

Greg Swalwell