June 16, 1999

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

Re: Exposure Draft (Revised), Proposed Statement of Financial Accounting Standards,
Consolidated Financial Statements: Purpose and Policy. File Reference No. 194-B.

Gentlemen:

I am pleased to enclose a memo containing comments and recommendations regarding the above Exposure Draft. As discussed therein, we believe that the Proposed Statement requires clarification in certain sections to address the consolidation policy for investment partnerships.

We appreciate the opportunity to comment on this very important Proposed Statement. Please contact me in the event you have any questions or comments.

Sincerely yours,

David M. Kirchheimer
Managing Director, Chief Financial & Administrative Officer

Enclosure

cc: G. Thomas Willis, PricewaterhouseCoopers, LLP
Comment submitted on June 16, 1999 by:

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Summary

Issue 1 of the Statement should be revised to clarify the treatment of limited partnerships in which an entity is the sole general partner. As currently drafted, the Statement is ambiguous with respect to the consolidation implications for an investment advisor which is not subject to the Investment Company Act of 1940 (the "1940 Act"). This ambiguity should be eliminated by conforming the treatment of these companies to the treatment of their counterparts which are registered under the 1940 Act. Otherwise, one could conclude that an investment advisor should consolidate its limited partnerships which merely serve as investment vehicles. Consolidation of such entities in the investment advisor's financial statements would likely result in those statements being materially distorted, confusing and misleading.

This clarification could occur in either paragraph 37 or 70. Paragraph 37, which exempts trustees and fiduciaries from consolidation, could be expanded to include general partners whose fiduciary responsibilities override a minor ownership interest. At paragraph 70, the exemption granted mutual funds or other management investment companies subject to the Investment Company Act of 1940, could be broadened to cover all such investment companies.

Alternatively, the same result could be achieved by clarifying that the "explicit benefit" notion recently incorporated into the control definition does not apply to situations where the general partner benefits incidentally as a result of exercising its fiduciary responsibilities.

Without one or both clarifications, consolidation could appear to be required for off-balance sheet investment partnerships which are similar in virtually all other respects to Investment Company Act funds except that they are not subject to that specific Act. Such a result does not seem consistent with the intent of the Statement or other accounting pronouncements, nor would it facilitate the "fairly stated" objective of GAAP-compliant financial statements.

Background

Oaktree Capital Management, LLC ("Oaktree" or the "Company") is an investment advisor registered under the Investment Advisers Act of 1940. Oaktree provides investment management services in the following specialized areas: high yield bonds, convertible securities, emerging markets, distressed debt, private equity (for control) and real estate. The
Company has a largely institutional and ERISA client base, including many Fortune 500 and public pension plans, as well as endowments and foundations. As of December 31, 1998, Oaktree had approximately $12 billion in assets under management. Oaktree has full discretionary authority over these assets, subject to the very specific investment guidelines and restrictions contained in its investment management and limited partnership agreements.

Among the key tenets of Oaktree's investment philosophy for each asset class are (a) uniform performance between accounts and (b) extensive diversification. To help achieve these objectives, Oaktree encourages clients to invest through commingled funds. In the case of less liquid investment areas, which include distressed debt, private equity, real estate and emerging markets, multi-year closed-end limited partnerships are the only investment vehicle offered so as to discourage investments by short-term oriented investors, whose sudden need for liquidity could hinder long-term performance.

Other investment areas, which involve more liquid marketable securities, offer both commingled funds and separate accounts. In each of these marketable securities asset classes, two open-ended commingled funds exist: a group trust for ERISA plans and a limited partnership for others. Within each asset class, all accounts, including commingled funds, are managed in an identical manner, with the exception of infrequent and typically de minimus differences caused by investment restrictions imposed by separate account clients. Thus, there is no meaningful performance difference in how Oaktree manages an account, whether it is a separate account, a group trust or a limited partnership. Likewise, investment management fees charged by Oaktree are the same for separate accounts and commingled investment vehicles (including limited partnerships) within the same asset class.

Of the Company's $12 billion in assets under management at December 31, 1998, approximately $4.5 billion represented existing holdings or capital commitments of the limited partnerships. Oaktree is the sole general partner for each of its limited partnerships, subject to removal for customary reasons as provided in the particular limited partnership agreement. In its capacity as general partner and investment advisor, Oaktree exercises control over the investment activities of each limited partnership, subject to the limited partnership agreement's very specific guidelines and restrictions.

Oaktree's corporate financial statements had $31.1 million of total assets at December 31, 1998, including $6.3 million in cash and equivalents, $6.5 million in accounts receivable, $8.7 million in fixed assets and $8.8 million in general partner investments. Oaktree owns and controls each of these assets. The three main components on the right side of the balance sheet are accounts payable/accrued liabilities, bank debt and Members' capital. Thus, for the three main constituents of its financial statements -- owners, creditors and regulators -- the balance sheet presents a meaningful and comprehensive snapshot of the net assets and liabilities which Oaktree owns and controls. Creditors, for example, are able to calculate liquidity ratios and easily assess tangible net worth.

Likewise, the consolidated income statement shows only those revenues and expenses which the Company or its consolidated operating entities directly receive or incur. This income statement
presentation facilitates easy and direct preparation of income tax returns, local tax filings and profit-based employee bonuses, all of which utilize one or more financial statement line items.

Discussion
The proposed Statement correctly emphasizes the importance of control in determining whether an entity should consolidate a subsidiary or affiliate. However, as currently worded, the emphasis accorded control appears to be too great. Other factors, such as access to and ownership of assets, are of equal or greater importance to ensure that the financial statements are truly “fairly stated.”

Evaluating Oaktree’s situation only using the control criterion, for example, could result in 100% of its investment limited partnerships being consolidated even though:

- Unlike many limited partnerships, an investment limited partnership does not possess most of the key characteristics of a separate operating entity, such as capital expenditures, operating budgets, employees, officers, offices, etc.

- Similarly, and even more importantly, an investment limited partnership, by its very specific nature and mandate, is not a typical going concern entity free to engage in a wide range of business activities and operations. The Statement acknowledges the importance of this factor when explaining the definition of control at paragraph 205: “The ability to obtain and direct the use of assets – exchange them for cash or other assets or use them to produce needed or desired goods and services – is essential to the economic functioning of all entities, whether they are corporations or partnerships ...”

- As an ownership percentage, Oaktree’s general partnership investment generally amounts to only 1.0% or less of each partnership. As of December 31, 1998, these interests represented only 28% of Oaktree’s consolidated assets. These general partner stakes are not a part of Oaktree’s main business, as evidenced by their classification on the income statement as “Other income.” For the year ended December 31, 1998, the aggregate unrealized gain on these investments amounted to less than 1% of Oaktree’s total income.

- Oaktree may exercise a significant degree of control over the investment activities of its investment partnerships, but its control certainly does not translate into ownership, a far more important factor. By any fiduciary or regulatory standard, Oaktree cannot hypothecate the net assets of these partnerships, nor can it or would it ever take direct possession of them (Mellon Trust, Morgan Stanley and The Bank of New York serve as custodians for the partnerships).

- The same holds for liabilities, which are the obligation of the limited partnership and do not fall solely on the general partner except in the very
unlikely event that the partnership’s entire capital is exhausted. This situation is different from that implied at paragraph 217: “Furthermore, because of the stewardship responsibilities and risks associated with being in control of an entity, the Board believes that an entity rarely acquires control of another entity without obtaining significant opportunities to benefit from that control. For example, a sole general partner of a limited partnership assumes risk for all partnership liabilities. There would be no economic incentive to control that type of entity if the controlling entity did not have at least an equivalent potential for deriving benefits from its ownership or residual interest, from its ability to gain access to and use of the service potential inherent in the partnership assets, or from both.” The presence of economic incentives alone does not justify consolidation, because if it did then virtually every business transaction would result in the revenue-derived entity consolidating the one to which it is rendering the goods or services.

- Each limited partner’s undivided interest in the respective partnership’s net assets already is included in that partner’s pension plan or similar financial statements, which are specifically exempted from this Statement at paragraph 5.

- Oaktree’s investment advisory revenues from its investment limited partnerships amounted to about half of its total consolidated revenues in 1998. The other half represented similar revenues from separate accounts and group trusts. To consolidate one half of Oaktree’s business and not the other half, despite the fact that Oaktree has both the same degree of control over all assets and renders identical services and applies identical fee structures regardless of the legal form of the investment portfolio, would appear to be quite arbitrary.

- Consolidating its off-balance sheet partnerships would cause the net assets and operating results of those entities to overwhelm Oaktree’s own activities on the Company’s financial statements. Assuming such consolidation, total assets at December 31, 1998, would have increased over 100-fold, from $31 million to $3.44 billion. Meanwhile, consolidation of these partnerships would transform the income statement into that of an investment fund from an investment advisory company, with a sizeable portion of Oaktree’s core revenues, ironically, being eliminated in consolidation. All tax filings, bank covenants, employee bonus computations and other customary uses of the income statement would warrant the preparation of an entirely separate set of statements - no minor issue, particularly when it comes to regulatory and tax filings which allow only audited statements.

It is possible that, among other reasons, investment limited partnerships would be exempt from consolidation as a result of the explicit benefit notion added to the control definition in the current Statement (as discussed at paragraph 206). However, here again there are ambiguities. For example, in certain cases Oaktree’s investment advisory fees
are dependent on market values of securities held by the limited partnership, while in the
case of closed-end funds the Company shares in any ultimate profits of the partnership.
Thus, Oaktree benefits in gains resulting from its investment decisions. However, there
is no comparable down-side participation and, most importantly, Oaktree’s decisions are
driven entirely by its fiduciary responsibilities and the limited partnership agreement,
without any desire or ability to affect the outcome for the personal benefit of Oaktree.
Hence, one would conclude that the Company’s investment partnerships are not subject
to consolidation.

At paragraph 216, the Board states: “Information about the amounts of an entity’s assets
and liabilities, revenues and expenses, gains and losses, and its cash flows is relevant to
users of consolidated financial statements in assessing an entity’s financial position and
performance.” However, this is not the case with our investment limited partnerships.
Oaktree’s investor clients, including those in its limited partnerships, assess the
Company’s investment performance using rates of return and other industry-standard
statistical measures generated as part of each account’s stand-alone financial statements.
Oaktree’s owners and creditors, on the other hand, assess the Company’s management
performance using liquidity, profitability and other data commonly associated with the
Company’s stand-alone financial statements. When clients inquire about the Company’s
financial condition, they are interested in Oaktree’s own financial health and not in an
aggregation of all of its partnerships. Since the formation of Oaktree in April 1995, no
one, including our hundreds of clients, prospective clients, owners, regulators, creditors,
vendors, auditors, lawyers, business partners and other users of our financial statements
have ever complained about the basis of consolidation, nor has anyone ever asked us to
produce statements which consolidate our limited partnerships. Furthermore, I have
never heard of such a request being made of any of my counterparts at other investment
advisory firms. Presumably, if such consolidation had perceived benefits, at least one
request would have been made.

Conclusion
Paragraph 176 of the Statement appropriately affirms the conclusion of ARB 51: “The purpose
of consolidated statements is to present, primarily for the benefit of the shareholders and
creditors of the parent company, the results of operations and the financial position of a parent
company...” [emphasis added]. As explained above, consolidating 100% of the assets of
investment partnerships on the books of a company which holds tiny ownership interests in
those partnerships, causes the financial statements to be very inaccurate, confusing and
misleading for owners, creditors, taxing authorities and other financial statement users. The
Statement should be corrected to avoid this possible unintended consequence by clarifying that
such partnerships do not fall under these provisions.