

# NatWest Group

Letter of Comment No: 83  
File Reference: 1082-154  
Date Received: 2/6/96

Your ref: File Reference 154-D  
Our ref: ad&c\winword\peerless\l-lucas.doc  
Date: 11 January 1996

Mr Timothy S Lucas  
Director of Research and Technical Activities  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116  
USA

## Group Reporting Performance Management

41 Lothbury  
London EC2P 2BP  
Telephone 0171 726 1800  
Switchboard 0171 726 1000  
Facsimile 0171 726 1877

Dear Mr Lucas

### Proposed Statement of Financial Accounting Standards - Consolidated Financial Statements: Policy and Procedures

We are responding to the Board's invitation to comment on its proposed Statement of Financial Accounting Standards on consolidated financial statements. The shares of National Westminster Bank Plc are listed on the New York Stock Exchange and, consequently, we have an interest in US financial reporting.

#### **Control of an entity**

We agree with the proposal in paragraph 10 that an entity should consolidate all entities that it controls unless such control is intended to be temporary at the time that the entity becomes a subsidiary, and that the definition of control should be wider than merely a majority of voting rights, as these can be arranged so that the parent effectively controls the subsidiary without a majority of such rights.

However, we believe that the proposals are too wide. Where the parent does not have a majority of voting rights, it should be regarded as having control only where it actually and demonstrably exercises such control; it should not be presumed to have control where it does not, in practice, exercise its power. For example, a parent holding forty-five per cent of another entity may well use its position to determine the operating policies of that entity; alternatively, it may play an essentially passive role. In the latter case, the entity should not be consolidated; it should not be presumed that the parent could use such power without opposition (for example, an attempt by it to replace the existing management might cause the other shareholders to form an organised group to oppose it). Any presumption that a parent has effective control, where this control is not currently exercised, is too hypothetical a basis for accounting.

Similarly, where the parent has (paragraph 14(c)) a unilateral ability to obtain a majority voting interest, but has not exercised that right, control should not be presumed. Only where the parent already acts as though in control of the subsidiary, and uses the potential to obtain legal control to enforce its decisions, should the entity be regarded as a subsidiary. This paragraph should also make it clear that it applies only to a right that can currently be exercised, and not, for example, to convertible securities where the option to convert lies in the future.

Continued /2...

We also disagree with the description of control in paragraph 10 as being the power to use assets in essentially the same way as the controlling entity can use its own assets. Even where the parent has a majority of voting rights, the management of the subsidiary must have regard to their legal obligations to minority shareholders, the general creditors of the subsidiary, and possibly also obligations to employees and tax authorities. These are mentioned briefly in paragraph 12, but it is unclear how the restricted control discussed there is to be regarded as being effectively the same as that over the entity's own assets. This point is of some significance, as similar restrictions may be identified in considering evidence that may overturn the presumption of effective control in paragraph 14.

We would prefer the specific percentage of 40 per cent in paragraph 14(a) to be omitted; the level of shareholding that gives rise to effective control depends on many factors, including the disposition of the other shareholdings, the nature of the other shareholders (e.g. individuals or institutional investors) and the voting arrangements for board elections, and in some cases effective control will arise at shareholding levels below 40 per cent. Stating a specific percentage in the standard will lead to an arbitrary cut-off becoming established.

#### **Control arising from default on a borrowing**

In certain circumstances (for example, under UK law, where a lender is given a floating charge over the assets of the borrower) an act of default gives the lender the right to appoint a receiver to manage the affairs of the company. These powers go well beyond the power relating to sales of pledged assets referred to in paragraph 172. We consider that such powers should not require the borrower to be consolidated, as they are only exercised for the purposes of generating sufficient funds to repay the borrowing, and accordingly the control over the assets is not equivalent to the lender's control over its own assets. However, the lender may have substantially the aspects of control set out in paragraphs 10(a) and (b), and for the avoidance of doubt, we ask that such situations should be specifically exempted from the requirement to consolidate.

#### **Securitisation vehicles**

We are concerned that the draft standard does not make it sufficiently clear that it is not appropriate to consolidate a properly constructed securitisation vehicle. These are established by the originator of the securitised assets, in conjunction with other parties to the securitisation, and many of the benefits from the securitised assets, after settlement of finance obligations, flow to the originator. Nevertheless, we do not think that the originator retains sufficient control over the securitised assets to be regarded as having essentially the same control over those assets as over its own assets.

#### **Conforming accounting policies**

We agree the need to conform accounting policies throughout the group, but do not understand the reference in the last sentence of paragraph 31 to the need to conform the accounting policies of a subsidiary operating in a specialised industry to accord with the parent's policies. Surely if the accounting policies adopted by the subsidiary are appropriate for its industry, they remain appropriate when the subsidiary is consolidated into the group accounts.

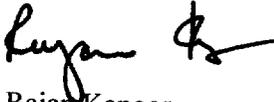
#### **Intercompany transactions**

We see no need for the elimination of transactions in financial instruments between group companies which are demonstrably at open market prices, and which are dealt with a group company that is a participant in the market as a cost-effective alternative to effecting the transaction with a market

Continued /3...

participant not connected with the group. The need to identify and eliminate all such transactions would be a considerable and continuing cost burden on the reporting entity.

Yours sincerely

A handwritten signature in black ink, appearing to read "Rajan Kapoor", with a stylized flourish at the end.

Rajan Kapoor  
Group Chief Accountant