## S. J. GALLINA & CO.

January 12, 1996

Letter of Comment No: 95
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Financial Accounting Standards Board Director of Research and Technical Activities File Reference Number 154-D 401 Merritt 7 Post Office Box 5116 Norwalk, Connecticut 06856-5116

Re: Exposure Draft No. 154-D

"Consolidated Financial Statements: Policy and Procedures"

## Gentlemen:

S. J. Gallina & Co. would like to submit the following comments regarding our views on the practice problems of applying this proposed statement of financial accounting standards to our practice and our clients.

Our clients are primarily small to medium size closely held construction and real estate development companies. These companies operate primarily as corporations and many of them are involved in performing construction contracts on a joint venture basis through general partnerships. A small number of these clients are also involved in the development, building, and holding of investment real estate projects, both residential and commercial.

Paragraphs 163 and 164 of the exposure draft make it quite clear that general partnerships, no matter what the ownership percentages are, would generally not be part of a control entity and, therefore, would not be included in consolidated financial statements. Since most of our clients operate in this business form, it would be our presumption that those joint ventures would continue to have freedom to report on the various acceptable reporting methods now utilized by the construction industry. However, more and more of our clients are turning to limited liability companies as the joint venture entity rather than partnerships. In reading through the exposure draft, (1) limited liability companies are not addressed at all and (2) it would appear that the reasoning behind paragraphs 163 and 164 would not apply to limited liability companies.

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Therefore, the consolidation of LLC's would be required because of the fact that the legal responsibilities of jointly and severally liable do not follow through to the LLC's. This would mean that two very similar construction companies would have significantly different looking financial statements based upon their requirements under generally accepted accounting principles. We feel that this will be disadvantageous both to the company issuing the financial statements and to the users of the financial statements, complicating their ability to analyze similar companies.

Because of the varying ways in which construction companies enter into joint venture agreements for the performance of a project and the risks that are taken on by the individual members of the LLC or partners of the general partnership, it would be clearly nonsensical to require consolidated financial statements for these entities on a control basis where their control does not spread to the entire project. Other joint ventures might better be reported as consolidated whether operating as a partnership or not, because the controlling managing partner has complete and absolute risk on the performance of the contract, even though another partner may have the same legal risk and responsibilities.

The underlying operations of joint ventures in the construction industry are managed in many ways and each joint venture operates on its own set of rules between the parties, although their outside responsibilities and liabilities may fall, as stated in paragraph 164, jointly and severally liable. The financial reporting should follow the operation of the joint venture (disclosing all risks and liabilities), but not be in conflict with the agreement of the parties.

As with construction joint ventures, we see a significant problem with our clients that operate their construction, real estate and development operations as limited partnerships in which they own a small partnership interest as the only general partner. Under the exposure draft they would be considered to have control of the entity and, therefore, would have to consolidate the financial statements of their real estate limited partnerships with their corporate entity. Conversely, those builders and developers who use general partnership real estate investment entities would not follow the same reporting requirements because of paragraphs 163 and 164. Entities that form limited partnerships would be at a significant disadvantage with their competitors when their statements are analyzed by surety companies and credit grantors, as the debt to equity ratios would in most cases be significantly worse for those entities in limited partnerships because of the small amount of financial statement equity that normally exists in these real estate limited partnerships. Again, should those companies forming general partnerships start using LLC's to hold real estate, their reporting would be the same as the limited partnership

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entities because of the control factor, whereas their competitors' general partnership entities would continue reporting on an unconsolidated basis.

Although we understand that it is very difficult to deal with industry specific items in such a broad financial accounting standards pronouncement, we felt that it was necessary for us to comment regarding the various entity forms used to achieve similar results by different companies in the construction industry, and the fact that the form of doing business would now dictate financial reporting rather than the similar ownership percentages, "real" control, or other factors to which this pronouncement applies.

In approaching reporting requirements for unconsolidated entities as referenced in paragraph 41, we would hope that the Board would address such construction industry joint venture reporting methods as proportionate consolidation, joint venture partners reported as subcontractors, the equity method, reporting only the joint venture partner's bid items, or full consolidation.

We would hope that the areas of LLC's would be addressed in a final document and that the significant impact of consolidating limited partnership real estate operations into a construction company's financial statements would again be reviewed by the Board with some discussion in the final pronouncement to assist practitioners in the implementation of these items.

Although we do not have the complete details of the board member's objections outlined in paragraphs 141 and 142, we concur with those objections.

Very truly yours

S. J. GALLINA & CO.

Certified Public Accountants

Edmond E. Traille, Managing Partner

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