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Financial Accounting Standards Board
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Letter of Comment No: 69
File Reference: 1082-194R
Date Received: 5/24/99

Re: File Reference No. 194-B, Draft Standard - "Consolidated Financial Statements: Purpose and Policy"

Dear Tim:

Over the years, Exxon Corporation has provided its views to the Board relative to what we have believed would represent a superior approach to the subject of consolidation policy and practice. Our views on this subject have remained firm over these many years, and recent developments in this area, such as EITF 96-16 dealing with "minority veto rights," have only served to reinforce our view that there is a better accounting model than that currently found in practice and better than that embodied in the subject exposure draft proposal. Following is a summary of our views on consolidation policy.

In brief, we again urge the FASB to reconsider the entire theory of how we bring into consolidated financial statements the results of both controlled and uncontrolled entities. In our view, present practice fails to show clearly the shareholders' financial stake in the various assets, obligations, revenues, expenses, and cash flows of the various entities included in financial statements. These distortions result from inconsistent treatment accorded various legal forms of joint ventures and majority (versus minority) owned companies. For many years, we have found it necessary to footnote and/or supplement our conventional financial statements in our external and internal business segment and total corporate reporting in order to overcome these distortions. It would make more sense to deal with the problem directly, in the primary financial statements.

More specifically, we recommend proportionate consolidation (on a line-by-line basis) of both controlled entities and those uncontrolled entities where there is either joint control or significant influence over operating and financing policies; investments in entities where the investor has no significant influence would continue to be accounted for on a cost basis. We recommend a financial statement note for the purpose of identifying the amounts included in the financial statements that are applicable to those noncontrolled entities given proportionate consolidation treatment. This note would be similar to that now required for material amounts related to equity companies, except the new note would identify amounts included in, rather than excluded from, the financial statements.



We recognize that the "control" and "beneficial interest" perspectives are both important in consolidated financial statements. However, in the final analysis, it is beneficial interest that motivates and rewards the shareholders of the parent company. Control, while important, is secondary to beneficial interest. Control is a means, but not the only means, of enhancing financial returns on the capital invested by the parent company's shareholders.

Current and proposed approaches to consolidation policy, with their over-emphasis on control, together with the striking difference in financial statement treatment accorded controlled vs. noncontrolled entities, mask the real financial stake that the shareholders have in the assets, liabilities, revenues, expenses, and cash flows of the consolidated group. The emphasis should be turned around to give first importance to that which is most important to the shareholders—their financial stake. Under proportionate consolidation, the shareholders' financial stake in both controlled and noncontrolled entities would be accounted for in the same manner. The part of that financial interest that was obtained through noncontrolled entities should be displayed separately.

Use of proportionate consolidation produces financial statements that are consistent with the way our internal management views the underlying activity, and in our view, believe its use will provide much more useful information about the operations and financial resources of investors, as well as the risks to which they are subject. Certainly this type of reporting would avoid the distortions currently created by the "one-line" approach, e.g., offsetting of liabilities against assets where the right of offset does not exist, omission of the debt-financed portion of the investment and the related debt, and non-reporting of revenues, expenses, and cash flows. Also, it would avoid the substantial distortions in financial ratios (such as returns on total assets or capital employed, effective income tax rates, debt to equity ratios, and profit to sales) which result when equity companies are not included in the ratios in the same fashion as data on consolidated companies.

In summary, we urge that the FASB give serious consideration to the approach to consolidation policy described above. While use of proportionate consolidation will not "solve" all practice problems, we believe its use would facilitate an enhanced understanding of financial issues of prime importance to current and prospective investors, namely their financial stake in the enterprise. In our view this outcome will serve to strengthen public financial reporting.

Sincerely,

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