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Letter of Comment No: 89

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

RE: File Reference No. 194-B
Consolidated Financial Statements: Purpose and Policy

Dear Mr. Lucas:

Conoco appreciates the opportunity to comment on the FASB Exposure Draft, *Consolidated Financial Statements: Purpose and Policy*. Our summary comments are as follows:

- Conoco favors a consolidation standard that relies primarily on objective, reliable rebuttable presumptions of control such as having majority voting interest (SFAS 94) or control of a majority vote of an entity's governing body. As such we support the presumptions of control in paragraphs 18a and 18c of the Exposure Draft but prefer an approach to defining control through these determinative characteristics rather than the subjective definition in this Exposure Draft.
- Presumptions of control such as in paragraphs 18b and 21 that would not hold true when minority shareholders apply legally available voting or veto rights is a poor basis for defining control and requiring consolidation. Such presumptions open ample opportunity for different consolidation practice as well as creating issues to achieving consolidation and related reporting when such assumptions do not align with the views of either the parent or subsidiary.
- We do not believe the Standard should apply to undivided ownership interests in assets and liabilities for which the oil and gas industry applies pro rata consolidation as discussed in the AICPA Interpretation to APB 18. We believe pro rata consolidation is appropriate in such circumstances because of the nature of those operating agreements and asset usage. We don't believe the Board intended application of this standard to these ownership arrangements and would like to see the standard is clearer on this matter.

Detailed comments to issues raised by the document follow.

Issue 1:

Does the revised definition of control, together with the discussion of the characteristics of control and descriptive guidance, help clarify when one entity controls another entity? Will the revised definition and guidance lead to common understandings and application of this Statement's definition of control?

Response:

If the purpose of this Statement is to provide a clear definition of control and the means for identifying its existence, then certainly the definition and guidance proposed by this Exposure Draft (ED) is less clear, relatively, than guidance based on factual characteristics (such as majority voting rights) that doesn't rely on presumptions. The Board implicitly acknowledges this by the reference several times in the Exposure Draft to the judgment required under the proposed standard. Given the length of time that this project has been on the Board's agenda, the obvious difficulties that Board members have had over those years in reaching a consensus, the subjective nature of the proposed definition of control, and the nature of comments received to the October 1995 Exposure Draft, it would seem evident that there will be legitimate differences in understanding and applying this standard. General and subjective definitions of control are not likely to achieve consistent practice. We believe SFAS 94 with its principal focus on voting control is a good standard. To the extent that specific issues arise in application of that standard, the EITF - with FASB and SEC oversight - is well suited to deal with fine-tuning and interpretations of SFAS 94, a standard which has been well accepted. In fact, the EITF has already addressed some of the more pressing issues in practice with regard to consolidation policy such as deciding when certain "veto" rights held by minority or / noncontrolling shareholders preclude consolidation. In that Issue 96-16, the EITF came up with some mostly objective, factual references a company could look to in assessing whether control existed. It is not clear how the definition of control and related guidance provided in this Exposure Draft affects the guidance for assessing protective and participating rights described in the consensus to Issue 96-16 which we find to be helpful. It is noteworthy that the Task Force decided that resolution of this issue was best resolved by reference to very specific and objective characteristics.

A significant point of clarification to the ED that would be helpful for the oil and gas industry is whether the term "entity", which is an integral part of the ED guidance, applies to assets and related liabilities owned by multiple parties with undivided ownership interests (no single legal entity owns the assets and liabilities). Currently, it is industry practice for such ownership to be accounted for on a proportionally consolidated basis as provided for by AICPA Accounting Interpretation - APB 18. The ED makes a broad statement in paragraph 187 that proportionate consolidation is not representationally faithful. However, we do not believe the Board meant to eliminate proportional consolidation for undivided interests, and we believe that the nature of the agreements between parties with the undivided interests and the nature of operation of the underlying assets would show that the definition of control proposed by the ED would not require consolidation by any undivided interest owner. We ask that the Board insert language either to specifically exclude undivided interest ownership from the scope of this ED or to include language clarifying that undivided interest owners would not be deemed to have control similar to the language included in paragraphs 22 and 23 for trusts and other arrangements. If you need further information about typical terms of undivided interest ownership in the oil and gas industry, we would be happy to provide this information and work with you separately.

Issue 2: Will guidance for applying the definition of control in the form of rebuttable presumptions be necessary? Do the circumstances described in each of the situations given provide a reasonable basis for presuming that one entity controls another entity in the absence of evidence that demonstrates or proves otherwise? Are they sufficiently clear and operational? Are additional presumptions of control necessary for specific circumstances?

Response: We support the rebuttable presumptions in paragraphs 18a and 18c, which identify existing majority control at the governing body or unilateral ability to gain majority control at the governing body as a characteristic of control. This is notably consistent with the voting rights guidance of SFAS 94 and applied appropriately to the governing body of an organization. This characteristic is cohesive and can be correlated with the guidance in EITF 96-16 for identifying when minority shareholders have significant participating rights precluding consolidation by a shareholder with majority ownership interest. In effect, this would recognize the inverse of EITF 96-16 - that controlling a majority of an entity's governing body constitutes control of the entity. We think that if the two characteristics in paragraphs 18a and 18c were simply added as an extension to, or interpretation of, the SFAS 94 focus on voting rights, then we would have a solid and objective consolidation standard that would make this Exposure Draft unnecessary.

However, we strongly disagree with paragraph 18b that having a significant minority interest when no other party or organized group has a significant voting interest constitutes a definitive basis of control. Our experience has been that when we desire or intend to exert control we do so by obtaining majority voting rights or majority seats on the entity's Board of Directors or governing body. This is done because a minority stake in either leaves too much uncertainty with regard to protecting our investment and guiding the ongoing activities, both of the fundamental characteristics underpinning your proposed definition of control. All it takes is for a group of other minority shareholders to band together when they perceive their economic interests threatened to thwart the assumptions that control can be exerted by a single minority shareholder. With today's technology, with the near instantaneous ability to send e-mail and disseminate information on the World Wide Web, it does not take much for a motivated shareholder or shareholders to generate publicity and organize other shareholders and make past voting percentages irrelevant. In addition, we wonder about the wisdom of making such an assumption part of an accounting standard. If future cases do not reflect this fact pattern and control by a large minority shareholder is found not to exist, the result will be a standard with a rebuttable presumption widely viewed as baseless and flawed and therefore ignored in practice.

We are also concerned with the assumption in paragraph 21 that a sole general partner in a limited partnership should be presumed to control and should therefore consolidate the partnership when there is little to no ability by the limited partners to dissolve the partnership or remove the general partner. Specifically, we have two concerns. First, the same flaw exists as with paragraph 18b which presumes control exists without reference to voting rights or rights to control the entity's governing body. Our view is that control and the ability to direct assets of another entity cannot fully exist unless one has the legal wherewithal to direct that entity in any situation. This nearly always means having the majority voting rights or majority votes of the governing body of an entity. Second, the presumption given in the

exposure draft would mean that a general partner meeting the criteria described with 1% ownership (not uncommon) would consolidate and have 99% minority interest. We don't agree that this is a better or more faithful representation of the economic status of the general partner than exists at present.

Issue 3: With certain exceptions, it would be applied by restatement of comparative financial statements for earlier periods. Are the benefits of complete and comparative financial statements for all interim periods in the initial year of application sufficient to justify requiring, rather than permitting, that the provisions of this Statement are applied for the first and each subsequent interim period in the year of adoption?

Response: Since the proposed standard would require consolidation of some entities for which ownership is less than 50%, by deduction the proposed implementation rules assume that access to data, financial information, and the ability to direct a subsidiary's Finance Department is the same at that level of ownership as when ownership is greater than 50%. While this may be true in some cases, it certainly is not uniformly true since the affiliated entity may not believe itself to be controlled, and it may be especially difficult with regard to prior period data. (Could inability to receive cooperation from an entity's business or finance management be sufficient rebuttal for a paragraph 18b presumption of control? Also, even presuming the assumption of control in paragraph 18b is valid, it still may require some time before that control can be exerted and cooperative management inserted.) If the Board goes forward with this Standard, we maintain that collection of prior year's data for consolidation could be difficult, especially for foreign entities, and would therefore urge the Board to permit rather than require retroactive application, or perhaps allow for some optional selective disclosure, such as pro forma disclosure of current year financial statements as if the entity were not consolidated in order to provide comparison with the prior year.

If you or the staff have any questions about the above information, please contact me at (281) 342-5366.

A handwritten signature in black ink that reads "W. David Welch". The signature is written in a cursive, flowing style.