Goldman Sachs

May 24, 1999

Mr. Timothy S. Lucas
Director of Research and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
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Letter of Comment No: 76
File Reference: 1082-194R
Date Received: 5/28/99

Re: Proposed Statement of Financial Accounting Standards, "Consolidated Financial Statements: Purpose and Policy" (File Reference 194-B)

Dear Mr. Lucas:

We appreciate the opportunity to comment on the Revised Exposure Draft, *Consolidated Financial Statements: Purpose and Policy* (the ED).

In general, we believe the concept of effective control as the basis for consolidation should combine the two fundamental elements of legal control and economic benefit. Although we believe that the basic definition in paragraph 6 captures these two elements, we have concerns regarding how this definition has been further developed and expanded in the ED, especially via the presumptions of control in paragraphs 18-23, the implementation guidance in Appendix A, and the Basis for Conclusions.

In particular, we note that although the basic definition incorporates the notion of economic benefits, we do not believe the ED as a whole gives sufficient weight to the ability of a controlling entity to benefit from its control. In this regard, we are especially concerned about the possibility of certain investments being consolidated in situations where the investor is entitled to only a nominal economic interest from the investment.

We note that the FASB has specifically avoided setting a minimum threshold, or otherwise giving guidance, regarding the level of economic interest one should look to in determining when to consolidate an entity. However, we believe that such guidance is necessary for the standard in order to result in meaningful financial statements. In contrast to the arguments presented in paragraphs 215 and 216, we do not believe that a consolidation standard based on some measure of economic benefit would introduce irrelevant and unnecessary conditions for consolidations. We believe that the primary

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purpose of financial statements is to reflect the economic position of an entity, and that therefore, economic benefit is a most relevant condition for consolidation. Without such a condition, we believe that the definition of control would weaken the link between financial statements and the economic condition of an entity.

Though we realize this point has been made to the Board before, by ourselves as well as by other respondents, we feel it bears repeating. Example 3 in Appendix A describes a general partner who owns only a 1% interest in a limited partnership, but who is required to consolidate the partnership, absent evidence which overcomes the presumption of control. The example notes that the level of economic interest is irrelevant to the decision; however, we believe that if the general partner were entitled to only a nominal (say, 1%) return, it would be misleading to present in the financial statements of the general partner all of the assets, revenues, and cash flows of the partnership, from which the general partner will not receive any future benefit of substance.

We realize the Board is reluctant to establish any minimum thresholds as they are considered to be "arbitrary." However, we note that at a very fundamental level, all accounting standards are a matter of accepted conventions, and this would be merely another instance of such. The benefits of such an approach are, of course, comparability and consistency in practice, and we believe the Board should reconsider these benefits. Moreover, we note that as a practical matter, such thresholds, or "rules of thumb" invariably tend to evolve in practice, as practitioners and auditors attempt to create a "level playing field." Should the Board still be uncomfortable setting a minimum amount, however, we would strongly suggest incorporating a condition of either a "significant" or, at a minimum, a "more than nominal" economic benefit that inures to the controlling entity as a requirement for consolidation.

A second area of concern with the definition of control and the implementation guidance is the requirement to look to potential, rather than actual, control. This surfaces in the requirement to predict voting outcomes at corporate elections where an investor's financial statements are issued prior to the shareholder meeting of an investee; the requirement to assess the likelihood of limited partners exercising veto rights; and the requirement to look to the existence of convertible securities or other options entitling the holder upon conversion to a majority economic interest of an investee. We are concerned about the reliability of such predictions, especially when used as a basis for an accounting decision which will have a significant impact on the financial statements. Accordingly, we firmly believe that the definition of control should be revised to require an investor to look to actual control, rather than potential or probable control.

Finally, we are concerned about the potential for similar investment vehicles being treated differently under the ED. Typically, in the areas of both merchant banking and asset-based finance, there are a variety of legal structures that can be used to accomplish

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the same economic objectives, and the ultimate choice of a structure is driven in large part by legal and tax reasons. Such structures include trusts, limited partnerships, and limited liability corporations. Each of these vehicles serves the same business and economic purpose. In each case, a sponsoring entity (trustee, general partner, or manager) pools investor capital, and invests and manages it to within certain investment guidelines for the benefit of the investors. The sponsoring entity may or may not invest in the entity along with the investors, and generally receives a fee for the management of the investments, which may or may not be performance-based. In all cases, the sponsoring entity/manager has a fiduciary responsibility to act in the best interest of the investors. We are concerned that despite the fact that the role and responsibilities of the sponsoring entity/manager are virtually the same regardless of the legal form of the investment vehicle, the conclusion regarding consolidation may differ depending on the legal form of the vehicle, especially given the ED's presumptions regarding a general partner's control over a limited partnership. We therefore urge the Board to reconsider its conclusions in this area.

In addition to these comments regarding the definition of control, we have the following comments on the ED.

Scope

• The scope of the ED provides an exemption for entities that carry substantially all of their assets at fair value with all changes in value reported in a statement of net income. Many financial institutions, especially those with significant broker-dealer operations, carry substantially all of their assets at fair value, or at a value which has been determined to approximate fair value. Although we understand that FASB may not have intended such organizations to qualify for this scope exemption, we suggest that the ED more clearly articulate that fact as well as the reason therefor.

Guidance on Limited Partnerships

• We note an inconsistency with the guidance on limited partnerships, and specifically, in what instance the presumption that the general partner has control over the partnership may be overcome. Paragraph 21 states that "the existence of control of a limited partnership shall be presumed if an entity...is the only general partner in a limited partnership and no other partner or organized group of partners has the current ability to dissolve the limited partnership or otherwise remove the general partner." Paragraph 64 reiterates this by stating that "if a limited partner or partners have a current ability to propose and approve the liquidation of the limited partnership or the removal of the sole general partner, that generally would indicate that the general partner merely has delegated decision-making powers..." From this guidance, it appears that the presumption of control is overcome if the limited partners have either the right to liquidate the partnership or remove the general partner at will. In contrast,

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paragraph 108 suggests that the rebuttable presumption can be overcome if the limited partners can "(a) initiate proposed changes in the nature of the partnership or the removal of the general partner **and** (b) vote to approve or disapprove actions of the general partner by majority vote." This would suggest that limited partners need to have *not only* the right to remove the general partner, *but also* the ability to veto actions of the general partner. We suggest replacing the word *and* with the word *or* in this section of paragraph 108, so as to be consistent with the earlier guidance and avoid confusion in practice.

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Again, we thank you for the opportunity to provide our feedback to you, and we look forward to continuing to do so in the future. If you have any questions regarding this letter, please do not hesitate to contact me at (212) 357-8437.

Sincerely,

Esther Mills

Vice President, Accounting Policy

Goldman, Sachs & Co.