

January 31, 1996

Letter of Comment No: /49 File Reference: 1082-154 2/6/96

Date Received:

Director of Research and Technical Activities Financial Accounting Standards Board 401 Merritt 7 Post Office Box 5116 Norwalk, CT 06856-5116

Re: File Reference No. 154-D

Dear Sir:

The Accounting Standards Committee of the Maryland Association of Certified Public Accountants ("MACPA") met to discuss the Exposure Draft for Consolidated Financial Statements: Policy and Procedures ("Proposed Statement"). The comments expressed below result from that meeting but should not be considered as representing the views or positions of the entire membership of the MACPA.

The committee believes this statement is a valuable addition to accounting literature and supports its adoption, with certain improvements. Our discussion and the resulting comments shown below were limited to portions of the Proposed Statement that we believe raise the greatest issues; the committee's failure to discuss and include comments on other issues should not be misconstrued as acceptance of those other issues.

#### General

The more expansive scope of consolidation policy expressed in this Proposed Statement is, in our view, a logical extension of accounting for and by affiliated persons. It is also a recognition that formal ownership through equity investments should not be considered as the sole basis for such accounting. We recognize the difficulty of determining control on other than an objective basis; however, reasonable effort and professional judgment should overcome these obstacles.

# Veto Rights by Noncontrolled Subsidiary

The definition of "control", as outlined in paragraphs 10-13 and further elaborated upon in paragraphs 72-87, correctly notes the significance of the power to use assets of a subsidiary. However, the Proposed Statement does not recognize the effect on such power of the ability of a noncontrolling interest to veto the controlling interest's use of the subsidiary's assets when limited to significant transactions. A noncontrolling entity's veto. for example, of the subsidiary's entry into a new business or the subsidiary's payments from equity should not reduce the status of the controlling entity if the parent controls the day-to-day business operation of the subsidiary.

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#### **Unexercised Control**

The scope of the Proposed Statement in paragraph 4 includes both business enterprises and not-for-profit organizations. Paragraph 10 recognizes the fact that control is not diminished where a control person elects not to exercise its control. A committee member expressed concern that consolidation would be required for a group of controlled entities where the exercise of control by the control person would occur only in the most unusual circumstance.

For example, some religious groups may have a hierarchy different from that expressed by paragraph 171. Some religious orders have ecclesiastical control over other subordinate religious organizations. The higher group would not exercise its control over the subordinate organization, except in the most unusual circumstances. The control person's actual use of the subsidiary organization's assets, while possible according to church law, would occur only in theory. Consolidation of these groups, which appears to be required by the Proposed Statement, could be considered misleading in that the relationship is not as modular as that contemplated by paragraph 171. Thus, we recommend the Board review the requirements expressed in paragraph 171.

## Step Transactions

Accounting for an acquisition of a subsidiary may cause a gain to be reflected on the statement of operations when an economic loss occurs. Paragraphs 26-28 call for goodwill attributable to a transaction after control is established to be charged or allocated to paid-in capital. When control is relinquished, measurement of the gain or loss from the sale is limited to valuation of assets from the first transaction resulting in control. This can cause a gain to be reflected when, in fact, an economic loss occurred. This is because the charges that would cause the gains to become a loss are buried in paid-in capital.

The committee suggests two possible solutions. One alternative is to revalue all assets and liabilities (and adjust goodwill) at the time of each step transaction. The other alternative is to reduce any gain by the amount of the excess of the cost of acquiring the subsidiary over the net fair value of the assets acquired in transactions after control is established.

The first alternative would reflect economic gains or losses but would not be in accordance with the thought process underlying paragraphs 26-28. The second alternative would only prevent an accounting gain to be shown when an economic loss occurs.

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### **Conforming Accounting Policies**

The committee questions the basis for restating subsidiary financial statements in consolidation if the accounting principles of the subsidiary are different from (not permitted by) those of the parent as shown in paragraph 31. As an illustration, a venture capital company or broker-dealer subsidiary, which account for assets and liabilities at value (in accordance with investment company or broker-dealer accounting), would be required to restate its assets and liabilities in consolidation. The cost to restate may outweigh the benefit, with or without a reconciliation. Some committee members believe the requirement for restatement should be reconsidered. Rather, these members believe, appropriate disclosure should suffice.

These comments are transmitted after the comment deadline but before scheduled public hearings. We appreciate the opportunity to respond to the Proposed Statement and hope the comments contained in this letter will be considered during the Board's deliberation of this topic.

James S. Schaefer, CPA

Committee Chair