

# THE ROBERT MORRIS ASSOCIATES

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Mr. Timothy S. Lucas
Director of Research and Technical Activities
Financial Accounting Standards Board
File Reference 154-D
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

Dear Mr. Lucas:

The Accounting Policy Committee (APC) of The Robert Morris Associates (RMA) is pleased to comment on *Proposed Statement of Financial Accounting Standards*, "Consolidated Financial Statements: Policies and Procedures" (ED). RMA is an association representing nearly 16,000 bank loan and credit officers from institutions across North America which represent approximately eighty percent of total banking assets. The APC is the RMA committee charged to work for the continuous improvement in the quality of financial information available to credit grantors. Our responses on accounting and financial reporting issues are, therefore, primarily from the financial statement users' perspective and, more particularly, from the perspective of those who lend or participate in the lending and credit process.

The APC has previously filed with you comment letters dated July 15, 1992 and January 10, 1995 on the consolidation project's Discussion Memorandum and Preliminary View documents, respectively. This letter incorporates some of those previous comments by reference.

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The needs for consolidated financial statements, and their uses by lenders and credit analysts have certain unique characteristics. For example, loans are made to legal entities and must be repaid from the stream of cash flows legally available to the borrower regardless of the level of the borrower's control over the operating and financial policies of other legal entities. That point of view is reflected in several of our comments below. However, we also wish to acknowledge that financial statements prepared under generally accepted accounting principles (GAAP) must serve many different users and there may be good reasons for GAAP to differ in certain respects from the specific information requirements of credit grantors. Nevertheless, we believe the comments in this letter deserve careful consideration by the FASB.

We agree in principle with the key shift from current practice in the ED, the adoption of a control criterion for inclusion of a subsidiary in the consolidation process in place of the current requirement of majority ownership. Although judgment will be required under the proposed standard instead of the "bright line" now used, we will also no longer see investments of just under or just over fifty percent ownership, which appear to be based more on accounting than business considerations. The result will be more economically meaningful displays of relevant information, subject to demanding more judgment of the part of preparers and more acuity on the part of auditors. However, there are some matters that we believe the Board should consider before it issues the standard in final form.

#### **Definition of Control**

The definition of control in the ED (paragraphs 10-13 and 75-87) appears to us to be excessively legalistic. That definition does not seem to put sufficient emphasis on the benefits, risks and rewards that should flow to a parent company as a result of controlling its subsidiaries. We do not believe the words "to use or direct the use of the assets of a subsidiary" (paragraph 76) are sufficient.

It seems as if the new criterion of control will result in a legalistic approach to reporting economic enterprise and will replace the current standard which (ironically) takes an economic approach to defining the enterprise in legal terms. This economic enterprise concept is of substantially less importance than the previous legal entity focus.

<sup>&#</sup>x27;APC members have some concern as to how the proposed consolidation standard will be implemented by smaller less sophisticated enterprises, particularly those whose financial statements are unaudited. However, that is a matter of compliance and is only indirectly a consideration in the standard-setting process. Nonetheless, our concern is real.

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### **Limited Liability Partnerships**

We conclude from reading the ED that general partners in limited liability partnerships (LLPs) will have to consolidate the partnership assets and liabilities (except under the limited conditions of paragraph 156). We believe that blanket consolidation requirement will in many cases produce financial statement that are not representationally faithful to the underlying economic circumstances. Those are cases in which a control criterion reflecting economic benefits would have yielded more meaningful results.

In our January 10, 1995 response to the Board's *Preliminary Views* we stated "...there may be a point at which the ownership interest of the controlling entity becomes so small (and the ownership interest of others so large) that consolidated financial statements would not be useful." We suggested that a minimal level of ownership be established as a necessary condition for consolidation. We wish to reaffirm that position, although we have revised our thoughts as to what that level should be. We now believe the Board should establish the threshold at a fixed percentage of ownership somewhere between five percent and ten percent. If such a percentage threshold were established, it would in most cases exempt the general partner in most LLPs from the requirements of the proposed standard, in our opinion a salutatory effect.

## Classification of the Noncontrolling Interest

In our previous letters we pointed out our singular view of the noncontrolling interest and we reiterate it here. Although the outside shareholders in subsidiaries have an equity interest in those subsidiaries and have supplied equity capital, our view is that of a lender to the parent company. For lenders, the noncontrolling interests in an enterprises' subsidiaries are *obligations* which must be satisfied before the subsidiaries' assets are available to service the parent company's debt. Thus, as lenders we must be able to reclassify the noncontrolling (minority) interest as a liability higher in rank than our loans to the parent company.

We do not expect the Board to change its views on the classification of noncontrolling interest. But, we do emphasize the need for the final standard to specify a clear requirement for complete and separate disclosure of noncontrolling interests so it will be possible for lenders to reclassify them to suit their own needs.

## Consolidating Financial Statements

We commented in our previous letters about the high relevance to lenders of consolidating financial statements. That is, of course, because of lenders' emphasis on legal entities, thus the need for information about those entities. We believe the proposed standard would be improved if it contained provisions and specifications for the presentation of consolidating financial statements, even though they are not required to be presented. Certainly a variety of extant accounting standards provide guidance for the presentation of voluntary disclosures. We believe similar guidance could (and should) be given here.

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<u>Disclosure of Companies Included in and Excluded from Consolidation</u>

This disclosure would be particularly useful in the period of transition to the new standard.

We also need to know which significant subsidiaries are newly included in a consolidation and which few (we hope) companies are newly excluded because of the new rules. In those cases, we would welcome a brief statement of the facts and circumstances accounting for the change in treatment of each significant subsidiary.

On behalf of RMA, the Accounting Policy Committee appreciates the opportunity to respond to *Proposed Statement of Financial Accounting Standards*, "Consolidated Financial Statements: Policies and Procedures" (ED). We would be pleased to answer any questions you or the Board may have concerning our views.

Yours very truly,

James L. Gertie, CPA, CFA

Chairman, Accounting Policy Committee