

College of Business • Accounting and Finance
One Washington Square • San José, California 95192-0066 • 408/924-3460 • FAX 408/924-3419

Letter of Comment No: 39 A File Reference: 1082-154 Date Received: 1/1/96

January 6, 1996

Director of Research and Technical Activities File Reference No. 154-D Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

To the Financial Accounting Standards Board:

I offer the following additional comments (beyond those contained in my letter of December 17, 1995) on the October 16, 1995 exposure draft on Consolidated Financial Statements: Policy and Procedures:

1. Change to Allowing The Gain or Loss on the Constructive Retirement of Intercompany Debt to Fall Along Legal Lines--Do Not Impose 100% Attribution to the Issuing Entity (paragraph 21).

I was unable to find any rationale for the proposed treatment of attributing the entire gain or loss to the issuing entity. "Attributing" is artificiality. (Perhaps it is assumed to be part of the economic unit concept; if so, I cannot understand why it would or should be so.)

"Attributing" produces results that do not reflect the true equity of either the controlling interest or the noncontrolling interest (NCI). Under the proposed treatment, an 80%-owned subsidiary that issued debt at face value would have 20% of the parent's discount (or premium) reported as part of the NCI in the consolidated balance sheet. This is flat wrong. The proof of the pudding is in an assumed liquidation of the subsidiary (at no gain or loss on its assets). In an assumed liquidation, the NCI wwould receive only their share of the subsidiary's book equity--which includes none of the parent's discount. Thus the NCI would not receive any distribution whatsoever pertaining to the parent's discount. (Of course, an actual liquidation of the subsidiary sometime down the road would produce the same result.)

Furthermore, even from an instructor's standpoint, this proposed treatment really complicates teaching something that otherwise is quite simple to deal with (using legal boundary methodology, which involves no artificial assumption). From a practicality standpoint alone, I would not impose the use of attribution.

2. Incorporate the SEC's 25% Rule Regarding Disclosing Restrictions on Paying Dividends.

In Regulation S-X, Article 4-08 (e), the SEC requires certain disclosures depending on the results of a 25% test they set forth therein. Why does the exposure draft not include something along these lines? I would think that it is essential to do so.

I have one reservation regarding the SEC's 25% test. I think a much stronger case can be made for using consolidated retained earnings in the denominator instead of consolidated net assets. (In fact, I cannot see much of a case at all for using net assets.)

I hope these comments are useful. Incidentally, I applaud the elimination of layering of goodwill that is proposed in the pronouncement. This is very practical and makes good sense.

Very truly yours,

and I. Paller

Arnold J. Pahler