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

Consumers Power Company and CMS Energy Corporation (collectively, the Company) are pleased to comment on the Exposure Draft, Consolidated Financial Statements: Policy and Procedures, issued by the Financial Accounting Standards Board (FASB). Consumers Power Company, with consolidated assets of \$7 billion and annual operating revenues of \$3 billion, is the nation's fourth-largest electric and gas utility and the principal subsidiary of CMS Energy Corporation. CMS Energy Corporation, whose common stock is traded on the New York and Midwest Stock Exchanges, is a diversified international and domestic energy company also engaged in independent power production, natural gas transportation and storage, gas and electric marketing, and oil and gas exploration and production. CMS Energy's consolidated assets are \$8 billion, and annual operating revenues are \$4 billion.

The Company supports the FASB's efforts to establish accounting standards for consolidated financial statements. The Company concurs with the FASB's premise that consolidated statements are prepared primarily for the benefit of the shareholders and other resource providers of the parent company. While we support many of the proposals in the exposure draft, we would like to offer our comments on consolidation based on effective control, ownership changes, and conforming accounting policies.

Consolidation Based on Effective Control

The Company believes that a business enterprise should generally consolidate an entity if it owns a majority of voting shares and controls the entity through its rights to a majority of economic benefits, and should generally not consolidate the entity if these conditions are not met. However, the FASB's proposed statement would require a business enterprise to consolidate all entities over which it has legal or effective control, unless control is temporary when the entity becomes a subsidiary. Since the FASB's proposed definition of control encompasses the concept of deriving economic benefits from the assets of the subsidiary, the Company could support consolidation based

on these two categories of control, with some exceptions discussed below. We agree that *legal control* typically results from majority ownership of shares in a corporation, giving the parent the unconditional right to elect a majority of the governing board, while *effective control* can result from owning a large minority voting interest together with other favorable circumstances. In both situations, the parent is able to direct the subsidiary's management and establish its policies and budgets, and derives significant economic benefits from the subsidiary's assets. A determination of whether effective control is present, and whether consolidation is appropriate, requires that management carefully assess the relevant facts and circumstances. In particular, management must consider whether it expects the parent to **retain** control of the subsidiary in future periods. Otherwise, the parent might consolidate a subsidiary in the current period, because it has dominated a recent board election, but not in subsequent periods. This could result in volatile financial statements that are not comparable between periods.

In the Company's opinion, consolidation is not necessarily appropriate in some of the circumstances described in the exposure draft. For example, the exposure draft states that effective control should be **presumed** to exist, and consolidation is generally required, when an entity owns a large minority voting interest (approximately 40 percent) and no other party or organized group has a significant interest. We believe that effective control may not exist in this situation, since the remaining shareholders could collectively determine the composition of the board. The exposure draft also states that effective control should be **presumed** to exist when an entity is able to obtain control. The Company believes that consolidation is not appropriate until intention is translated into acts that commit the entity to a course of action. Finally, the exposure draft states that a sole general partner should be **presumed** to have effective control of a limited partnership, due to the statutory limitations on the other partners' ability to participate in management. The Company contends that a general partner with a small equity interest should not consolidate a limited partnership, regardless of whether it has effective control, unless other arrangements give the general partner the right to significant economic benefits.

While the Company does not consider it appropriate to require consolidation based on a presumed existence of effective control, we believe that the existence of a large minority voting interest, together with other favorable circumstances, provides an indication that an entity may have effective control. Management should then be required to assess this evidence to determine whether effective control does exist, and whether consolidated financial statements would provide useful and meaningful information to the parent's shareholders.

Changes in a Parent's Ownership Interest in a Subsidiary

The proposed statement would require that a change in a parent's ownership interest in a subsidiary that does not result in a loss of control be accounted for as an equity transaction, with no gain or loss recognized. The Company opposes this change to existing requirements, regardless of whether the transaction originates with the parent or the subsidiary. We concur with the position taken by the Accounting Principles Board in Opinion No. 18, which requires that a gain or loss be recognized when a parent sells stock in a subsidiary. Further, we concur with the American Institute of Certified Public Accountants and the Securities and Exchange Commission, which have supported recognition of gains or losses when a subsidiary issues stock.

In the Company's opinion, there are several persuasive reasons why the parent should recognize a gain or loss when it sells stock in a subsidiary. First, this accounting is consistent with the parent company approach to consolidated financial statements, which the Company supports because it focuses on the interests of the parent's shareholders. Second, the parent's earnings process is culminated when it has sold subsidiary stock in an arm's-length transaction to a third party. Such a transaction is comparable to the parent's sale of tangible property or any other assets. Finally, the proposed accounting for a parent's sale of subsidiary stock would create a difference in net income between the parent's financial statements and the consolidated statements, because a gain or loss must be recognized in the parent's unconsolidated accounts.

Because the Company supports recognition of a gain or loss when a **parent** sells subsidiary stock, we also believe that issuance of stock by the **subsidiary** can result in a gain or loss. The Securities and Exchange Commission permits this accounting, unless the sale of shares is part of a broader corporate reorganization. From the viewpoint of the parent company's shareholders, a subsidiary's issuance of additional shares has the same result as the parent's sale of stock in the subsidiary. In both cases, the parent decides to sell the stock and controls the cash proceeds.

Conforming Accounting Policies

The proposed statement would require a parent and its subsidiaries to apply a consistent accounting policy for similar transactions or events, unless generally accepted accounting principles (GAAP) permit a single entity to use different accounting methods for the same type of transactions or events. In the Company's opinion, conforming the accounting policies of a parent and subsidiaries should be permitted, but not required. The fact that enterprises within a consolidated group are organized as separate legal entities often implies that their economic activities differ significantly, and that different accounting policies may best reflect these circumstances. This is frequently the case when only one entity within a consolidated group is regulated. Therefore, management should be allowed to choose the most appropriate accounting policy for each legal entity that the parent controls, provided the policy is permitted by GAAP and is adequately disclosed.

The Company appreciates the opportunity to contribute to the standard-setting process and hopes these comments will be useful in the FASB's deliberations.

Sincerely,

Dennis DaPra

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