

Letter of Comment No: 128
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Director of Research and Technical Activities Financial Accounting Standards Board 401 Merritt 7 P. O. Box 5116 Norwalk, CT 06856-5116

Re: File Reference No. 154-D

Exposure Draft on "Consolidated Financial Statements: Policy and Procedures"

Dear Sirs:

ENSERCH Corporation (ENSERCH) is pleased to submit its comments concerning the Exposure Draft Proposed Statement of Financial Accounting Standards - Consolidated Financial Statements: Policy and Procedures (ED). ENSERCH is an integrated natural gas company based in Dallas, Texas. The Corporation's major businesses are: Natural Gas and Oil Exploration and Production; Natural Gas Pipeline, Gathering, Processing & Marketing; and Natural Gas Distribution. The Corporation's natural gas and oil exploration and production segment operates as an independently traded corporation, Enserch Exploration, Inc., 83% owned by ENSERCH. ENSERCH's natural gas distribution business is one of the largest such utilities in the United States, serving 1.3 million customers in Texas. Revenues are about \$1.8 billion and total assets exceed \$3 billion. ENSERCH has an active acquisition program that involves varying degrees and forms of ownership.

GENERAL COMMENTS

ENSERCH believes that portions of the ED are improvements over existing standards and supports those portions of the ED that are explicitly designed to address perceived abuses in current practice. However, ENSERCH is concerned that the overall result of the ED will be to turn the current simple and operational consolidation model into a subjective approach that will lead to counterintuitive results and inconsistent reporting of similar transactions.

ENSERCH believes that the current rules concerning consolidations are generally adequate. Consolidated financial statements are prepared primarily to meet the needs of shareholders and creditors of the parent, not those of a noncontrolling interest. A change to the

economic unit approach does not seem warranted based on the views of a majority of the respondents to the Discussion Memorandum. We are not aware of substantive research to indicate that the economic unit approach provides more meaningful data. Accordingly, procedures used in preparing consolidated financial statements should continue to follow the parent company approach. The proposed consolidation policy is too subjective and judgmental, and, because of differing corporate agendas, implementation will result in less comparability among entities.

ENSERCH agrees that in the situation described in Example 5, the assets and related obligations should be included in the creator's financial statements. However, ENSERCH is puzzled by the Board's choice of this circuitous route to address concerns about leasing transactions. Special-purpose leasing entities likely would not exist absent SFAS 13. ENSERCH believes that existing pronouncements for lease transactions (SFAS 13 and EITF 90-15) should be reconsidered by the Board directly rather than indirectly as a consolidation issue.

CONSOLIDATION POLICY

Control of an Entity

ENSERCH believes the definition of control also should comprehend the ability to participate significantly in the risks and rewards derived from control of the assets of the entity. ENSERCH believes the ability to significantly participate in risks and rewards from such control derives from a substantial ownership interest.

ENSERCH recognizes that there are contrived entity structures in which control exists in the absence of a direct substantial ownership interest because the noncontrolling interest does not have veto rights over major transactions and events. ENSERCH agrees that consolidation should be required in these circumstances.

ENSERCH believes that effective control should not be presumed unless (1) the parent has a substantial ownership interest (in the 30%-40% or greater range) or (2) the substance of the inter-entity relationship is one of control without veto rights, such as the situations described in Example 1 (first alternative), Example 2, Example 3, Example 4 and Example 5. Where the noncontrolling interest has veto rights, it should not be assumed that these rights will not be exercised if deemed necessary to protect the investment.

Assessing the Existence of Control

ENSERCH agrees with the alternate view expressed in paragraph 141.

The Examples included in the ED generally present situations where no accountant could reasonably differ in the application of the ED. However, such clear cut distinctions are

rarely present in practice; therefore, the use of these simplistic examples fails to aid in determining when control exists. Real life examples suggest that the guidance of the ED may not be meaningful.

The ED exhibits a bias toward consolidation in stating that, in the absence of evidence to the contrary, control should be presumed if an entity has the sole general partnership interest in a limited partnership (paragraphs 14.f. and 86). ENSERCH believes that paragraph 14 should go on to state that presumption of control of a limited partnership would not exist if the conditions described in paragraph 156 were present.

Example 2 states a case in which it is obvious control exists and consolidation should be required. However, ENSERCH believes that the example should go on to state that the presumption of control would not exist if the conditions designated in paragraph 156 were present. In practice, limited partners generally have the investor protections of paragraph 156. Also, the rationale for consolidation in paragraph 86 is that the general partner would not assume the risks of ownership without control. It is apparent in Example 2 that these risks are not significant to the ultimate reporting entity (Company C).

ENSERCH believes that the fact that noncontrolling investors have been passive in certain situations does not warrant a conclusion that they always will be passive. ENSERCH does not agree that the second alternative of Example 1 indicates control because Company A must rely on the cooperation of other investors. If other investors do not believe they are being treated fairly, they will exercise their veto rights.

Accordingly, ENSERCH supports consolidation based on illustrations of effective control in paragraph 14.a., 14.c., 14.d. and 14.e., but does not support consolidation in the illustrations in paragraph 14.b. and 14.f. (because conditions described in paragraph 156 are commonly present).

CONSOLIDATION PROCEDURES

Reporting Noncontrolling Interest in Subsidiaries

ENSERCH believes that shareholders of an entity will be confused by the inclusion in equity of the amounts attributable to the noncontrolling interest. We fail to see any improvement in financial reporting from changing the placement of noncontrolling interest in the balance sheet. Likewise, we believe that the ED's proposed allocation of net income between controlling and noncontrolling interests will be confusing to users.

Acquisition of a Subsidiary

ENSERCH does not agree that 100% of the identifiable assets and liabilities of an acquired entity should be reflected at fair value. ENSERCH believes that the noncontrolling interest should be reflected at historical cost.

Changes in a Parent's Ownership Interest in a Subsidiary

The accounting proposed is a convenience convention that only works for insignificant transactions. If a purchase of a significant interest in a subsidiary occurs, the inherent goodwill that would be present would be written off at acquisition, contrary to APB 17. If the ED is issued as drafted, APB 16, paragraph 92 and APB 17, paragraph 21 would need to be modified. ENSERCH believes that such a significant overhaul of APB 16 should be addressed in a separate Board project on business combinations.

Under the ED, if an entity obtained a 40% interest in a target and then in a subsequent unrelated transaction obtained the remaining 60% interest, the goodwill applicable to the latter 60% would be charged to paid in capital. This anomaly will likely encourage some companies to structure acquisitions in a manner to improve future reported earnings, since only the goodwill applicable to the initial acquisition will be amortized to earnings. The substance of recording the acquisition of the 60% interest pursuant to the ED would be similar to part purchase, part pooling accounting for a business combination. Such transactions occurred prior to the issuance of APB 16 over twenty-five years ago but were precluded by the issuance of that statement. Further, it would give the equivalent of pooling-of-interests treatment for the 60% interest even if the acquisition were for cash or securities other than common stock.

ENSERCH believes that charging material amounts of goodwill to paid in capital immediately upon acquisition will significantly impact reported shareholders' equity of the entity and could result in financial statement presentations that are not representationally faithful. If the ED is issued in its present form, the Board should add guidance on how to display a potentially negative paid in capital balance or negative shareholders' equity balance that could result from charges to paid in capital under step purchases of subsidiaries. Allocating fair value only to identifiable assets and liabilities could result in significantly less value (or even a deficiency) being assigned to noncontrolling interests than either historical or fair value statements would ascribe. Consider, for example, the acquisition of a service or high technology company that has grown by purchase acquisitions and has significant goodwill recorded.

ENSERCH does not agree that single step versus multiple step dispositions should result in different reported results. In some transactions, the provisions of the ED would result in reporting income from the disposition of a subsidiary in the statement of operations while the economic reality is that a loss, permanently charged directly to paid in capital, had occurred. This result seems to be in violation of ARB 43, Chapter 1A, paragraph 2. If the ED is adopted as drafted, that reference would need to be modified.

ENSERCH believes that there should be no accounting difference between a subsidiary selling additional shares of its stock and a parent selling a portion of its interest in the subsidiary's stock. In both instances, ENSERCH believes that gain or loss should be recognized. Also, ENSERCH suggests that the Board resolve this issue as it relates to transactions involving equity investees.

Transition and Effective Date

ENSERCH believes that there may be situations other than SAB 51 gains that would have resulted in different income statement effects in prior years had the provisions of the ED been in effect. Accordingly, consistent with its exception for SAB 51 gains, the Board should recognize and acknowledge that the retroactive application of the Statement should not change previously reported earnings applicable to the controlling interest.

ENSERCH appreciates the opportunity to comment on the exposure draft. Should you have any questions concerning our response, please contact me at (214) 573-3235.

Yours very truly,

Jeny W. Pinkerton

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