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Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Hans

IASB Exposure Draft ED/2011/7
***Transition Guidance* (Proposed amendments to IFRS 10)**

The Australian Accounting Standards Board is pleased to submit its comments on Exposure Draft ED/2011/7 *Transition Guidance* to the International Accounting Standards Board. In formulating these comments, the AASB sought and considered the views of Australian constituents. The comment letters received are published on the AASB's website.

The AASB generally supports the proposed amendments to the Appendix C requirements in IFRS 10 *Consolidated Financial Statements*. The nature of the relief proposed to be given and the reasons therefor are well set out in the IASB's Introduction to the ED and the Basis for Conclusions.

However, the AASB has concerns about several aspects of the proposed amendments, namely:

- the amendments should address the appropriate version of IFRS 3 *Business Combinations* to be applied retrospectively when retrospective consolidation of an investee is required;

- the proposed amendments for the retrospective deconsolidation of an investee should be revised in relation to both the date of the retrospective adjustment and the measurement of the adjustment; and

- drafting differences across the proposed amendments.

These matters are considered in detail in the attachment, along with a range of editorial comments.

If you have any queries regarding any matters in this submission, please contact me or Clark Anstis (canstis@aasb.gov.au).

Yours sincerely

K.M. Stevenson

Kevin M. Stevenson
Chairman and CEO

Specific AASB comments on IASB Exposure Draft ED/2011/7 *Transition Guidance* (Proposed amendments to IFRS 10)

Specific Questions for Comment

The AASB provides the following comments on the IASB's specific questions for comment set out in the Exposure Draft.

<u>Question 1</u>

The Board proposes to clarify the 'date of initial application' in IFRS 10. The date of initial application for IFRS 10 would be 'the beginning of the annual reporting period in which IFRS 10 is applied for the first time'. The Board also proposes to make editorial amendments to paragraphs C4 and C5 of IFRS 10 to clarify how an investor shall adjust comparative period(s) retrospectively if the consolidation conclusion reached at the date of initial application is different under IAS 27/SIC-12 and IFRS 10.

Do you agree with the amendments proposed? Why or why not? If not, what alternative do you propose?

<u>Date of Initial Application</u> (paragraph C2A)

The AASB agrees with the approach to clarifying the date of initial application, apart from the following minor comments.

The AASB considers that the proposed description in paragraph C2A of the date of initial application should be amended to state: "… the beginning of the annual reporting period ~~in~~ <u>to</u> which this IFRS is applied for the first time". This change would ensure that the reference is to the 'current' reporting period (i.e. the period to which the financial statements relate) rather than the period in which the financial statements are actually prepared.

Furthermore, we suggest that the sentence that comprises paragraph C2A should instead be added to the end of paragraph C2. Paragraph C2 concerns retrospective application of the IFRS, and the meaning of the date of initial application is an important feature of this. New paragraphs should be added only if necessary.

<u>Retrospective Adjustments</u> (paragraphs C4 and C5)

The AASB agrees in general with the approach to these proposed amendments, based on the arguments set out in the Basis for Conclusions that retrospective adjustment is necessary only when the consolidation conclusion at the date of initial application is different under IAS 27/SIC-12 and IFRS 10. However, the AASB considers that the drafting needs to be amended to properly reflect retrospective application of IFRS 10.

Version of IFRS 3 for Retrospective Consolidation

The proposed paragraphs C4 and C4A address the circumstances where an investor is required to consolidate an investee that was not previously consolidated. The amendments to Appendix C should also clarify which version of IFRS 3 *Business Combinations* should be applied in these circumstances, as the proposed amendments are silent on this.

In straightforward cases, there may be no difference in the accounting depending on which version of IFRS 3 should be applied. However, differences could arise in respect of aspects such as non-controlling interests that have been the subject of amendments to IFRS 3. Therefore, Appendix C should specify whether (i) the version of IFRS 3 current at the date of initial application or (ii) the version of IFRS 3 applicable as at the date of a combination giving rise to retrospective consolidation should be required to be applied.

Retrospective Adjustment for Deconsolidation Cases

The proposed paragraphs C5 and C5A address the circumstances where an investor is required to deconsolidate an investee that was previously consolidated. The AASB considers that paragraph C5 does not deal adequately with the date of retrospective adjustment and the measurement of the adjustment. The following analysis sets out our view of how the wording of paragraph C5 should be amended, to resolve the issues.

(a) The date of retrospective adjustment

Paragraph C5 finishes with the requirement that the retrospective adjustment to retained earnings should be recognised as at the beginning of the earliest comparative period presented, or (if later) on the date when the investor became involved with, or lost control of, an investee. This wording is unclear as to the extent to which retrospective application of IFRS 10 is required, if both the date when the investor became involved with the investee and the date when control over the investee is lost are later than the beginning of the earliest comparative period presented: which date should be the date of adjustment?

Paragraph C5 addresses the circumstances of an investee consolidated under IAS 27 / SIC-12 that should not be consolidated under IFRS 10 as at the date of initial application, presumably on the grounds that the investor does not control the investee at that date in accordance with the requirements of IFRS 10. This covers <u>two cases</u>: (1) the investee would never have been consolidated under IFRS 10, and (2) the investee would have been consolidated under IFRS 10 until control was lost. Therefore, the wording of paragraph C5 addresses two dates: the date when the investor became involved with the investee, and the date when the investor lost control of the investee.

Under case 1, the date of the initial retrospective adjustment to deconsolidate the investee is either the beginning of the earliest comparative period presented or, if later, the date when the investor became involved with the investee, as the investor has never controlled the investee per IFRS 10. The loss of control date is not relevant to this case. The wording at the end of paragraph C5 appropriately deals with this case.

However, the wording at the end of paragraph C5 does not appropriately deal with case 2. Under this case, the investee involvement date and the loss of control date both arise, but are different. Therefore, the wording at the end of the paragraph does not clearly indicate whether the date of the initial retrospective adjustment is the date when the investor became involved with the investee or the date when the investor lost control of the investee, if both of those dates are later than the beginning of the earliest comparative period presented.

This issue affects the extent to which retrospective accounting for the investee would be required.

In our view, the general principle that should be followed in case 2 is that the retrospective accounting should emulate the accounting that would have occurred had IFRS 10 been applied by the investor from the outset. This means that, retrospectively, the investor should consolidate the investee from the date when the investor became involved with the investee (assuming that that involvement would have given rise at that time to control according to IFRS 10), and the investor should deconsolidate the investee as at the date when control was lost.

To cover both cases, the text ", or lost control of," should be deleted from the wording at the end of paragraph C5. That wording thus would read as follows:

> "shall be recognised as an adjustment to retained earnings at the beginning of the earliest comparative period presented or, if later, on the date when the investor became involved with the investee."

The application of this wording to case 1 is straightforward. In application to case 2, this wording means that the investor makes the initial retrospective adjustment to consolidate the investee (at the beginning of the earliest comparative period or the investee involvement date, whichever is the later), and the subsequent loss of control is retrospectively accounted for in the period when the loss of control occurs.

This wording could be clarified further to distinguish the date of control from the date of involvement, if control (per IFRS 10) of the investee arose only after the date of the investor's involvement.

If it is impracticable for an investor to apply this approach to either case 1 or case 2, then the simplified alternative approach set out in paragraph C5A would apply.

Finally, the first reference in paragraph C5 (at the end of the first sentence) to "when the investor became involved with, or lost control of, the investee" should also be amended by the deletion of the text ", or lost control of,". This wording would then cover both cases 1 and 2.

However, that would mean that the paragraph does not refer at all to the investor losing control of the investee (if it had ever had control). Accordingly, it may be helpful to add the following sentence at the end of the paragraph:

> "If the investor obtained control of the investee through its involvement with the investee, the investor's loss of control of the investee is accounted for retrospectively in the period when the loss of control occurs."

(b) The measurement of the retrospective adjustment

Having clarified the appropriate date of retrospective adjustment under part (a) above, the next problem with the proposed paragraph C5 is the specified measurement basis for that adjustment. The measurement basis specified is the difference between (a) the previous amount of assets, liabilities and non-controlling interests recognised and (b) the carrying amount of the investor's retained interest in the investee.

The problem with this is that the carrying amount of the investor's retained interest is relevant only if the date of retrospective adjustment is the date when the investor loses control of the investee. However, under the analysis above, the loss of control date would not be the date of the initial retrospective adjustment.

The appropriate measurement of the initial retrospective adjustment amount as at the beginning of the earliest comparative period presented or, if later, on the date when the investor became involved with the investee, is any difference between:

"(a) the previous amount of assets, liabilities and non-controlling interests recognised; and

(b) the amount of assets, liabilities and non-controlling interests that would have been recognised had this IFRS been effective when the investor became involved with the investee."

This wording (without the full stop) should replace the wording proposed in the ED for paragraphs C5(a) and (b) – note that only the wording in (b) is different. If there is no difference between the measurements (a) and (b), then the only retrospective adjustment would be the retrospective accounting for the loss of control as at the date when that occurs.

The reference in the first sentence of paragraph C5 to "retained interest in the investee at that date" (i.e. the date of initial application) is appropriate. It is just that the measurement of any initial retrospective adjustment to retained earnings for both deconsolidation cases 1 and 2 should not refer to the retained interest of the investor.

<u>Question 2</u>

The Board proposes to amend paragraph C3 of IFRS 10 to clarify that an entity is not required to make adjustments to the previous accounting for its involvement with entities if the consolidation conclusion reached at the date of initial application is the same under IAS 27/SIC-12 and IFRS 10. As a result, the Board confirms that relief from retrospective application of IFRS 10 would apply to an investor's interests in investees that were disposed of during a comparative period such that consolidation would not occur under either IAS 27/SIC-12 or IFRS 10 at the date of initial application.

Do you agree with the amendments proposed? Why or why not? If not, what alternative do you propose?

The AASB agrees with the proposed amendments. The AASB supports the arguments set out in the Basis for Conclusions, that retrospective adjustment is necessary only when the consolidation conclusion at the date of initial application is different under IAS 27/SIC-12 and IFRS 10.

Other Comments

The following additional comments are largely editorial in nature. Differences in the drafting across the amendments proposed in the ED do not appear to be justified. Where possible, the same wording should be used if the same meaning is intended.

(a) Rubric before paragraph C2A – change “amended” to “deleted” in the last sentence, so that it refers to “deleted text is struck through.”

(b) Paragraphs C4(a) and (b) – the words “on that date” (i.e. the date of initial application) is potentially confusing in both of these paragraphs, and should be deleted.

Paragraphs C4(a) and (b) each set out the calculation of the initial retrospective adjustment, which requires the measurements relative to the date of the adjustment, not the date of initial application. The words “on that date” in these paragraphs tends to imply that the initial retrospective adjustment is based on the investee amounts as at the date of initial application, but that is not the case. Accordingly, the words are best deleted.

These paragraphs set out the measurement basis required for the investee’s assets, liabilities and non-controlling interests as at the date of initial application – i.e. measurement as if the previously unconsolidated investee had been consolidated from the date of control (assessed per IFRS 10’s requirements). However, the same measurement basis is also required for the retrospective consolidation accounting per IFRS 10 at all intervening reporting dates up to the date of initial application – although of course the amounts will normally be different at different dates. Therefore, deleting “on that date” will not create any problem in relation to when the specified measurement basis applies.

(c) Paragraph C4(b) – for consistency of wording, insert “but” after “IFRS 3” similarly to the insertion of “but” in paragraph C4A(b). That is, paragraph C4(b) would say “… (applying the acquisition method as described in IFRS 3 but without recognising any goodwill …”

(d) Paragraph C4A – amend the proposed lead-in text as follows: “If measuring an investee’s assets, liabilities and non-controlling ~~interest~~ interests in accordance with paragraph C4(a) or (b) is impracticable …”. Also need to show the deletion of the original references (i) and (ii), as they became the new references (a) and (b) – at present, the (a) and (b) references are correctly shown underlined, but the struck-through (i) and (ii) references that were formerly under paragraph C4(c) are missing.

(e) Paragraphs C4A and C5A – the words “beginning of the” should be deleted from the second sentence in each of these paragraphs, which both start “The investor shall adjust comparative periods …”

The present wording is logically flawed as it effectively states that the beginning of a period can be a period. The beginning of a period is a point in time. All that needs to be stated is that the earliest period for which application is practicable is the current period. (Paragraph C4A would continue to refer in this sentence to application of the paragraph, and paragraph C5A to application of the IFRS.)

(f) Paragraph C4A – this paragraph has two paragraphs C4A(a) and two paragraphs C4A(b). The second pair would be better presented as paragraphs C4A(c) and C4A(d) to avoid confusion.

(g) Paragraph C5 – the wording of the proposed paragraph C5(a) differs from the wording of the present paragraph C5A(a) without apparent justification: "previous amount … recognised" versus "previously recognised amount …" Consistent wording, either way, is desirable. Paragraphs C4A(b) – the second one – and C5A(a) both use "previously recognised", so that might be the better wording then for paragraph C5(a).

(h) Paragraph C5A – the style of the initial words of paragraphs C4A and C5A differ without apparent reason. Consistency of wording is to be preferred. For example, the initial words of paragraph C5A should be changed to either of the following choices to be more consistent:

> "If measuring a retained interest in accordance with paragraph C5 is impracticable (as defined in IAS 8), an investor shall …"
>
> OR
>
> "If measuring an investor's retained interest in accordance with paragraph C5 is impracticable (as defined in IAS 8), the investor shall …"

Alternatively, both paragraphs C4A and C5A could start with "If measurement of …", as paragraph C5A presently does, if the passive tense was preferred.

(i) Paragraph C5A – amend the second sentence for consistency of wording – "The investor shall adjust comparative periods <u>retrospectively</u> unless …". The word "retrospectively" appears in the same proposed new wording in paragraphs C4(a), C4(b), C4A and C5, but appears to have been omitted inadvertently from paragraph C5A.

(j) Paragraph C5A(a) – amend as follows "non-controlling ~~interest~~ <u>interests</u>", in order to use the general term.