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ED 152 sub 3

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Our Ref: DR/MP

David

Re: ED 152 Proposed Amendments to AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*

Deloitte Australia welcomes the opportunity to comment on the exposure draft ED 152 Proposed Amendments to AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* ('ED 152'). This letter sets out our main comments to the Exposure Draft.

Use of deemed cost

We welcome the fact that the IASB has taken this issue on to its agenda. The proposals in the Exposure Draft address a real concern that it may be impracticable to apply IAS 27 with full retrospective effect on transition. This is creating a significant barrier, in some jurisdictions, to the adoption of IFRSs for the separate financial statements of parent companies.

The IASB rejected the use of a deemed cost based on previous GAAP carrying amount on the grounds that it might bear little resemblance to cost in accordance with IAS 27. We agree that this may be true in some cases but question whether it should lead to requirements that are more onerous than the IFRS 1 exemption for business combinations. For example, under the IFRS 1 exemption for business combinations, assets (including goodwill) arising from a pre-date of transition business combination may be stated at significantly different amounts than would have been required by the full retrospective application of IFRS. It does not appear to us to be appropriate to take a stricter line for the separate financial statements of a parent company, particularly as these are often prepared primarily to meet legal and regulatory requirements and are of little interest to investors.

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The IASB's conclusions may have been based on the concern expressed in BC1 that the previous GAAP carrying amount might be a very low amount based on the nominal value of the shares issued. This is true in some cases but it is likely that, in many more instances (from an international perspective), the carrying amount will be broadly comparable to fair value at the date of acquisition but will not have been adjusted for dividends received out of pre-acquisition profits as required by IAS 27. Another common practice, in some jurisdictions, is for the investment in subsidiaries to be carried at an amount based on the underlying local GAAP net asset value of the subsidiaries. This may often be similar to the IFRS net asset value but considerable work might be required to confirm this. It is questionable whether requiring a restatement (under the proposals of ED 152) in these circumstances is justified on cost benefit grounds.

We would therefore urge the IASB to reconsider whether a simple exemption based on the previous GAAP carrying amount, subject to an impairment test, could be justified on cost / benefit grounds. We encourage the AASB to raise this issue with the IASB.

If the IASB reaffirms its decision that it cannot support an exemption based previous GAAP carrying amount, we agree that the proposals in the Exposure Draft will provide a practicable solution in most cases. We particularly welcome the choice of two methods to arrive at deemed cost. The approach based on IFRS net asset value will always be possible from the available records although it will require some work. However, this approach may, in many instances, lead to a significant reduction in the carrying amount of the investment and an equivalent debit within equity. This may be unattractive to many companies for commercial, legal or regulatory reasons. Companies in this position could use the alternative approach of fair value at the date of transition. This will often involve considerably greater cost and effort although it is practicable. One or other approach should therefore address the needs of most companies although at a greater cost than one based on previous GAAP carrying amount.

The above approaches are applicable in arms length transactions however where separate financial statements are also prepared by entities under common control, given there is currently no definitive guidance as to how to account for common control transactions alternative measures may be applied under IFRS going forward which we think should also be available at the time of first-time adoption. By imposing limited bases on which to determine the cost of the investment it may be seen to be limiting the approaches that may be adopted going forward for future common control transactions.

The treatment of dividends

We have a significant concern about the proposals in the Exposure Draft on the treatment of dividends received after the date of transition when the deemed cost exemption has been used. The proposals require that, in this case, all of the subsidiary's accumulated profits under IFRSs at the date of transition are treated as pre-acquisition accumulated profits. We understand the rationale given in BC8 and the IASB's wish to avoid a 'double credit'. However, this does not take account of the fact that the adoption of the IFRS net asset value approach will very often result in a reduction in the carrying amount of the investment (unless our recommendation above is adopted). Companies in this situation may in fact suffer a 'double debit' rather than a 'double credit'.

For example, a subsidiary may have substantial accumulated profits at the date of transition which are known to have been earned post-acquisition. However, its parent may have to use the deemed cost exemption (under the proposals of ED 152) because it is unable to determine whether any dividends were received out of pre-acquisition profits many years ago and credited to income. If the parent elects to use IFRS net asset value as deemed cost (under the proposals of ED 152), it will first suffer a debit to equity on transition. It will also be unable to record as income the receipt of dividends out of the post-acquisition profits of its subsidiary resulting in a further reduction in equity compared with what it would have been if the exemption had not been used.

A simple solution to this problem would be to amend B6(a) to state that when the deemed cost exemption is used, all dividends subsequently received are deemed to be out of post-acquisition profits, subject to a requirement to test the investment for impairment. This approach avoids the 'double credit' problem identified in BC8 without creating a 'double debit' issue for other companies.

Other matters

The accounting treatment for investments in associates and jointly controlled entities in the separate financial statements of the investor is the same as that for subsidiaries. The same issues can arise about the cost of investment in an associate or jointly controlled entity as those addressed in the Exposure Draft. The amendment to IFRS 1 should therefore be framed more generally as applicable to investments accounted for in accordance with IAS 27(37).

The Exposure Draft places the new exemptions within Appendix B to IFRS 1 which deals with business combinations. The issues addressed in the Exposure Draft are not about accounting for business combinations. They concern the separate financial statements. Many investments to which the proposals will apply will have been accounted for as business combinations in the consolidated financial statements of the parent but this will not always be the case. Therefore it would be appropriate to relocate the proposed new exemptions within the body of the standard. We are aware that there is a current project to restructure IFRS 1 and it may be appropriate to address this issue as part of that project.

We also urge the AASB to lobby the IASB to review, as part of the project to revise IAS 27, the treatment of dividends received out of pre-acquisition profits. We agree with the principle that the receipt of a distribution which is in the nature of a return of capital should be deducted from the cost of investment. This is, however, an economic concept which should not necessarily be influenced by the accounting framework adopted by the subsidiary. There are complexities when applying the requirements of IAS 27 in practice which would be reduced by a less rule based approach. It is our understanding that there are various methods adopted globally on accounting for distributions received and determining whether they are pre or post acquisition. We would welcome a broader debate on these issues.

Finally, the Exposure Draft does not contemplate 'accounting' distributions and contributions, for example, as may be created under AASB 1052 *Tax Consolidation Accounting*. We believe the AASB should consider the consequences for these in discussions about the above issues.

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Due to the later IASB submission deadline for the discussion paper, the global firm of Deloitte Touche Tohmatsu has not finalised its views in relation to the matters raised. Furthermore, in this letter we have highlighted issues and concerns in the Australian context that may not have the same degree of relevance internationally or which may not be considered of sufficient significance to warrant separate comment by the global firm of Deloitte in its submission. Therefore, the views presented in this document should be read in this context and may not necessarily represent the view of the global firm of Deloitte.

Our responses to the AASB specific questions raised in the Exposure Draft are outlined below.

If you have any questions concerning our comments, please contact Darryn Rundell on (03) 9208 7916.

Yours sincerely

Darryn Rundell
Partner
Deloitte Touche Tohmatsu

MATTERS FOR SPECIFIC COMMENT

Question 1: Any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particular any issues relating to (i) not-for-profit entities, and (ii) public sector entities?

We are not aware of any other Australian issues that would affect the implementation of the proposals.

Question 2: Whether the proposals are in the best interests of the Australian economy?

We believe that the adoption of IFRS as converged Australian Standards will improve the ability of Australian entities to compete for funds in global capital markets. Accordingly, we believe that there must be no change made by the AASB to the IFRS when issuing the AASB equivalent, other than any amendments applicable to not-for-profit and public-sector entities that are considered absolutely necessary.