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Mr David Boymal
Chairman
Australian Accounting Standards Board
PO Box 204
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21 September 2005
Our Ref: FB:DR

Dear David

ED 141 'Proposed Amendments to AASB 127 Consolidated and Separate Financial Statements'

Deloitte Australia welcomes the opportunity to comment on the proposals contained in Exposure Draft ED 141 'Proposed Amendments to AASB 127 *Consolidated and Separate Financial Statements*' (ED 141 or the 'exposure draft').

The purpose of our submission is to provide our views on the various matters discussed in ED 141 to assist the Australian Accounting Standards Board (AASB) in making its own submission to the IASB on the proposals, with the ultimate objective of developing a converged AASB Accounting Standard that is consistent with the proposed revised IAS 27 *Consolidated and Separate Financial Statements*.

Overall, we support the proposed amendments to AASB 127/IAS 27 within the context of the complimentary proposals in ED 139 *Proposed Amendments to IFRS 3 'Business Combinations'* (ED 139). However, we have noted a number of significant issues in our submission on ED 139 and where these matters impact the application of AASB 127, we have drawn these to your attention in this submission as well.

Ultimately, any Australian Accounting Standard issued by the AASB as a result of ED 141 must continue to fully maintain Australia's convergence with International Financial Reporting Standards. Therefore, we suggest that the AASB reconsider the Australian specific amendments and guidance included in AASB 127 as part of its consideration of ED 141.

As these current proposals contain consequential amendments to IAS 31 *Investments in Joint Ventures*, we strongly suggest that the AASB also reconsider their Australian specific

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amendments to its equivalent Standard AASB 131 to permit the proportionate consolidation of interests in jointly controlled entities to bring AASB 131 fully into line with IAS 31. This change is urgently required and is essential to maximise the benefits to Australian entities from the transition to Australian equivalents to International Financial Reporting Standards (A-IFRS) and to minimise the impacts on multi-national corporations from differential requirements in jurisdictions that purport to fully comply with IFRS.

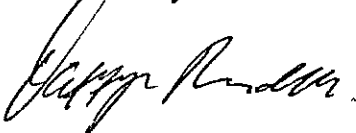
We also note that the comment period for ED 141 is poorly timed. With the transition to A-IFRS in full swing, the majority of Australian entities are currently focussed on either full A-IFRS reporting in half-year financial reports, or alternatively finalising transition projects and full-year financial report disclosures under AASB 1047 *Disclosure of the Impacts of First-Time Adoption of Australian Equivalents to International Financial Reporting Standards*.

As a result, many entities may not have had a suitable opportunity to fully consider the proposals in relation to accounting for business combinations, and the consequential proposed amendments to accounting for consolidations as included in ED 141. It has also diverted the resources of the major accounting firms over this same period and reduced the opportunity for us to engage our clients in debate over the proposals in order to identify more of the practical issues surrounding the exposure drafts. We therefore suggest that the AASB request the IASB and FASB to extend the comment period on these proposals in order to elicit more complete feedback from constituents.

Due to the later submission deadline for the equivalent IASB exposure drafts, 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.

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

Yours sincerely



Darryn Rundell
Partner

MATTERS FOR SPECIFIC COMMENT – IASB

Question 1

Draft paragraph 30A proposes that changes in the parent's ownership interest in a subsidiary after control is obtained that do not result in a loss of control should be accounted for as transactions with equity holders in their capacity as equity holders. As a result, no gain or loss on such changes would be recognised in profit or loss (see paragraph BC4 of the Basis for Conclusions).

Do you agree? If not, why not and what alternative would you propose?

We support this proposal on the basis that recognising the impacts of these transaction directly in equity is consistent with the definition of 'income' and 'expenses' and the concept of 'capital maintenance' in the *Framework for the Preparation and Presentation of Financial Statements* (Framework). However, we are concerned that the suggested approach is a significant de-emphasis of the performance of the consolidated group from the perspective of the controlling interest shareholders.

It is important that the Standards clearly acknowledge that the controlling interest shareholders are the primary user of financial reports. To this end, gains/losses made on changes in ownership levels of subsidiaries are an important factor in measuring the performance by the controlling shareholder group and should therefore be appropriately disclosed and highlighted in the financial statements section of the financial report.

As a result, we believe that the proposals should be enhanced by requiring disclosure on the face of the financial statements of the impacts of gains/losses arising on changes in ownership interests.

We also note below our preference that earnings per share (EPS) disclosures require additional measures of EPS adjusted for the impacts of gains/losses on changes in ownership interests.

Impact on earnings per share (EPS)

Under Australian Accounting Standards applying to annual reporting periods beginning before 1 January 2005 (A-GAAP), the gain or loss arising on changes in ownership levels formed part of the profit or loss attributable to members of the parent entity (as noted above). As a result, the calculation of earnings per share (EPS) included any such gain or loss in the numerator for basic and diluted EPS.

Under the exposure draft, IAS 33 *Earnings Per Share* would be amended to permit, but not require, the calculation of an 'additional' measure of EPS which includes the effects of equity transactions with non-controlling interests in the numerator.

The gain or loss arising from equity transactions with non-controlling interests is a real gain or loss from the perspective of the controlling interest shareholders, notwithstanding that no gain or loss arises from the perspective of the 'economic entity'. Therefore, we believe that reporting the impacts of those gains or losses to the controlling interest shareholders is relevant and useful. We would therefore suggest that EPS should *require* a measure of EPS

that includes the effect of equity transactions with non-controlling interests, even if only by way of additional disclosure in the notes to the financial statements.

If this matter is not addressed in as part of the finalisation of the proposals in the exposure draft, we recommend that it is addressed when the IASB progresses its performance reporting project.

Treatment of revaluation reserves on applying the proposed requirements

The exposure draft proposes in paragraph 30E that “the gain or loss arising on loss of control of a subsidiary includes the parent’s share of gains or losses that were recognised previously directly in equity”. This effectively requires the ‘recycling’ of these reserves through the profit and loss in the event that control over a subsidiary is lost.

The examples provided in paragraph 30E(a)-(c) to illustrate this concept do not include revaluation reserves that may arise on applying the revaluation basis of measurement under IAS 16 *Property, Plant and Equipment* or (rarely) IAS 38 *Intangible Assets*. Both IAS 16.41 and IAS 38.87 both require that any transfer between revaluation reserves to retained earnings cannot be made through the income statement (profit or loss). We also note that the examples included in the proposed paragraphs 30E(a)-(c) would be ‘recycled’ through the profit and loss in due course, even if control is not lost over a subsidiary.

Therefore, it is unclear whether the proposed requirements of IAS 27 are intended to override the requirements of IAS 16 and IAS 41, so that revaluation reserves would be recycled to profit and loss where control over a subsidiary was lost. We recommend that this matter be clarified as part of the finalisation of the amendments to IAS 27 and that consideration be given to providing a further illustrative example to illustrate how this matter would be treated¹.

Proposed amendments to IAS 1

We believe that the proposed amendments to the guidance on implementing IAS 1 *Presentation of Financial Statements* do not adequately reflect the ‘economic entity’ basis of consolidation and the new disclosure requirements in the proposed revised paragraph 97 of IAS 1.

In the example statement of changes in equity, we believe that the examples provided in the section between ‘total recognised income and expense for the period’ and the ‘balance’ for the period should be amended as follows:

- the existing example showing for “decrease in interest in subsidiary” is not consistent with the economic entity approach as this transaction should not give rise to an adjustment to the ‘other reserves’ as indicated by an ‘X’
- “issue of share capital” and “equity share options issued” should have an ‘X’ under the ‘attributable to non-controlling interest’ column to indicate that (under the economic entity approach) additional equity may be issued to and attributed to the non-controlling interest – this would also be consistent with the treatment for dividends
- a separate line should be included for “gain/loss on transactions between equity holders”, with ‘X’s’ only under the attribution columns with a positive amount in

¹ Alternatively, existing Illustrative Example 5 could be expanded to make it more comprehensive by including a revaluation reserve along with other amounts recognised directly in equity.

one column and a negative in the other (as the two amounts should offset each other with no impact on the economic entity's amounts)

We also suggest that consideration be given to:

- requiring the statement of changes in equity to provide a reconciliation of the closing balance of each category of equity attributing the stated amounts between the controlling and non-controlling interests. This could be a requirement of the IAS 1 and would permit easily reconciliation to the stated amounts for the various reserves stated elsewhere in the financial statements (as these will be the controlling interest shareholder's share only)
- providing an alternative example disclosure required in relation to paragraph 97(b) where a statement of recognised income and expense is provided instead of a statement of changes in equity

Follow on impacts on investments accounted for using the equity method

We strongly recommend that the consequential amendments to IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures* explicitly deal with changes in ownership interests in investments accounted for using the equity method. This is particularly important given the commentary in IAS 28.20 regarding equity accounting and consolidation principles being largely consistent.

Conceptually, we therefore believe that the accounting for ownership changes in associates and jointly controlled entities should be largely consistent with the proposals in the exposure drafts. In this regard, we note the following:

- it is acknowledged that under the equity method, there is no 'non-controlling' interest recognised in the balance sheet
- notional goodwill included in any equity accounted carrying amount is the amount of goodwill attributable to the investor only, meaning that adjustments would need to be made to the notional amount of any goodwill on any ownership change
- it is unclear how movements in the investor's share of equity accounted reserves arising from increases or decreases in ownership interest levels should be accounted for under the current versions of IAS 28 and IAS 31 – we are aware of the existence of divergent views on this issue under IAS 28 and IAS 31
- it is unclear whether any equity accounted reserve would arise where a gain/loss occurs on a change in ownership interest.

We strongly recommend that this issue be clarified as part of the finalisation of the proposals in the exposure draft.

Question 2

Paragraph 30D proposes that on loss of control of a subsidiary any non-controlling equity investment remaining in the former subsidiary should be remeasured to its fair value in the consolidated financial statements at the date control is lost. Paragraph 30C proposes that the gain or loss on such remeasurement be included in the determination of the gain or loss arising on loss of control (see paragraph BC7 of the Basis for Conclusions).

Do you agree that the remaining non-controlling equity investment should be remeasured to fair value in these circumstances? If not, why not and what alternative would you propose?

Do you agree with the proposal to include any gain or loss resulting from such remeasurement in the calculation of the gain or loss arising on loss of control?

If not, why not, and what alternative would you propose?

We appreciate the conceptual basis for remeasuring any remaining interest in a former subsidiary to its fair value and understand that the proposed approach is consistent with the amended requirements in relation to business combinations proposed in ED 139 *Proposed Amendments to IFRS 3 'Business Combinations'* where a pre-combination interest in an acquiree is fair valued at the acquisition date. However, consistent with our observations in our submission on ED 139, we have some concerns as to whether the gain or loss should be recognised at all, and if so, whether it should be recognised directly in equity, rather than in the profit and loss as proposed.

In our view, any gain/loss should be recognised to the profit and loss only when control over the entity is lost and no existing ownership is retained (as either an associate, jointly controlled entity or available for sale financial asset). Therefore, to the extent that any remaining interest is held in a former subsidiary, we believe that the gain should not be recognised, or if it must be recognised, it should be deferred in equity². An exception to this general rule would apply where the remaining investment was designated as a financial asset carried at fair value through the profit and loss, whereby the gains/loss would be better recognised in the income statement.

Where the retained interest is equity accounted as an associate or jointly controlled entity (JCE) under IAS 28 or IAS 31, the following arguments support the non-recognition of a gain/loss in these circumstances:

- the process of equity accounting is effectively a 'one line consolidation' (per IAS 28.20) and it would be inconsistent with the proposed treatment of changes in ownership levels in a subsidiary to recognise a gain/loss when in substance the entity remains consolidated in much the same way as a subsidiary

² The loss of control of a subsidiary can also be seen as akin to a change in nature of any retained investment. The proposed treatment might then be considered to be inconsistent with the principles established in other standards where a change in the nature of an asset occurs, e.g. where an owner-occupied property becomes an investment property. Under IAS 40.61, the revaluation of an owner-occupied building prior to its reclassification as an investment property is recognised in accordance with AASB 116, i.e. directly in equity as a revaluation.

- the revaluation of the investment to its fair value would effectively trigger a reassessment of the fair values of the assets and liabilities of the associate or JCE, causing consequential impacts through the profit and loss (and also giving rise to the additional issues arising under the proposed amendments to IFRS 3 that are noted in our submission on ED 139, such as the impact on hedging relationships, the reassessment of embedded derivatives and the treatment of stamp duties and other transaction costs)
- the reassessment of fair values of assets would effectively be the recognition of internally generated goodwill or intangible assets of the associate or JCE.

Where equity accounting is applied, our preferred view would be to treat the entity as being equity accounted since its original acquisition date so that the equity accounted carrying amount of the investment in the associate or JCE at the date that control is lost is effectively that which would be obtained had the final ownership interest always been held and IAS 28 or IAS 31 were always applied³.

In the event that the IASB proceeds with its existing proposals to include the gain/loss on measuring the remaining interest in a former subsidiary in the income statement, then we do not support that the gain/loss should be included in the gain/loss arising from the loss of control, but should be separately recognised and disclosed in the financial statements. Even if the gain/loss *is* included in the amount recognised the gain/loss on loss of control, we believe that it would be appropriate to require separate disclosure of the amount in the notes to the financial statements.

³ In other words, the equity accounted carrying amount would effectively 'reconsolidate' the post-acquisition profits of the former subsidiary to the extent of the ownership interest in the former subsidiary at the date that control is lost. Depending on the factors behind the loss of control over the subsidiary, consequential amendments may also need to be made for gains/losses arising on loss of control transactions, e.g. contributions of capital by other interest holders at higher than the existing per-share equity accounted carrying amount.

Question 3

As explained in Question 1, the Exposure Draft proposes that changes in a parent's ownership interest in a subsidiary that do not result in a loss of control should be treated as transactions with equity holders in their capacity as equity holders. Therefore, no gain or loss would be recognised in profit or loss. However, a decrease in the parent's ownership interest resulting in the loss of control of a subsidiary would result in any gain or loss being recognised in profit or loss for the period. The Board is aware that differences in accounting that depend on whether a change in control occurs could create opportunities for entities to structure transactions to achieve a particular accounting result. To reduce this risk, the Exposure Draft proposes that if one or more of the indicators in paragraph 30F are present, it is presumed that two or more disposal transactions or arrangements that result in a loss of control should be accounted for as a single transaction or arrangement. This presumption can be overcome if the entity can demonstrate clearly that such accounting would be inappropriate (see paragraphs BC9-BC13 of the Basis for Conclusions).

Do you agree that it is appropriate to presume that multiple arrangements that result in a loss of control should be accounted for as a single arrangement when the indicators in paragraph 30F are present? Are the proposed factors suitable indicators? If not, what alternative indicators would you propose?

We support this proposal.

We also believe that in practical terms, many of the requirements outlined in the proposed paragraph 30F are commonly applied in practice in determining the substance of arrangements under current IFRS. To this end, in our view it would be more appropriate to express the requirements of paragraph 30F in terms of reflecting the substance of the arrangements surrounding the loss of control and then provide the factors as examples of the factors to consider when determining the substance of the arrangements. This approach would also provide a clear 'principle based' solution to the question of how to account for a series of transactions and avoid many of the potential 'gaming issues' identified by the IASB.

Notwithstanding the above comments, we believe that the opportunity for 'gaming' issues may be limited in many cases by the requirements of the proposed paragraph 30C. Under that paragraph, the gain/loss on deconsolidation includes the parent's share of gains or losses related to the former subsidiary that were recognised previously in consolidated equity. This would presumably include the gains/losses deferred in equity under the proposed paragraph 30A. In the example given in paragraph BC9 of the draft Basis for Conclusions, in the two-step transaction the second step would give rise to loss of control and therefore the gain on sale of the 19 percent interest in step one would be 'recycled' through the profit and loss on sale of the remaining 51 percent interest. As a result, the total recognised gain would be CU2,800 regardless of whether the interest were disposed in one or two steps.

We note that because of the wording of the proposed amended paragraphs and the example included in the draft Basis for Conclusions, that this treatment may not be intended by the IASB/FASB. However, we believe that this is the correct treatment and that the final revised IAS 27 should clarify that this is the case. It would also be useful to include an example where control over a subsidiary is lost through two transactions so that this principle is clearly illustrated.

Question 4

Paragraph 35 proposes that losses applicable to the non-controlling interest in a subsidiary should be allocated to the non-controlling interest even if such losses exceed the non-controlling interest in the subsidiary's equity. Non-controlling interests are part of the equity of the group and, therefore, participate proportionally in the risks and rewards of investment in the subsidiary.

Do you agree with the proposed loss allocation? Do you agree that any guarantees or other support arrangements from the controlling and non-controlling interests should be accounted for separately? If not, why not, and what alternative treatment would you propose?

We fully support this proposal as we believe it more correctly reflects the attribution of the total equity of the economic entity. In our view, it is inappropriate to attribute losses of the non-controlling interest to the controlling interest as the controlling interest is not in any sense responsible for bearing those losses.

However, we question whether guarantees or other supporting arrangements should be necessarily accounted for separately from the non-controlling interests share where they relate to the maintenance of and return of capital of the non-controlling interest (rather than guarantees or other arrangements in relation to a particular asset or liability of the subsidiary such as the guarantee of a debt). If they are accounted for separately, we believe that such transactions would be equity transactions with equity holders in their capacity as equity holders and therefore should be treated in a manner consistent with other equity transactions identified in the exposure drafts. As a result, separate accounting for any guarantees or other supporting arrangements would in all likelihood be treated in exactly the same manner as considering the guarantee or other supporting arrangement as part of the attribution process for the non-controlling interest.

Furthermore, because the guarantee or other supporting arrangement is effectively entered into between the controlling and non-controlling interests within the economic entity, they may not be on 'normal' commercial terms and conditions but instead be couched in light of the control relationship between the parent and subsidiary. Therefore, normal accounting for guarantees in this situation may be difficult.

We therefore suggest that this proposal be reconsidered and the existence of any guarantees or other supporting arrangements should be taken into account in the measurement of the non-controlling interest, rather than been accounted for separately. We would support disclosure of the impact of any guarantees or support agreements.

In the event that the existing proposal of separate accounting for guarantees or other supporting arrangements proceeds, we would recommend:

- specific mention of the requirement for separate accounting be included in proposed paragraph 35 of IAS 27
- it is clarified that the guarantee or other supporting arrangement is effectively an equity transaction between equity holders in their capacity as equity holders which is to be accounted for in a manner consistent with other equity transactions
- the scope of IAS 32 *Financial Instruments: Presentation*, IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments:*

Disclosures be amended if necessary to clarify that these types of guarantee or other supporting arrangements are outside the scope of those Standards.

Question 5

The transitional provisions in the Exposure Draft propose that all of its requirements should apply retrospectively, except in limited circumstances in which the Board believes that retrospective application is likely to be impracticable.

Do you agree that proposed paragraphs 30A, 30C and 30D should apply on a prospective basis in the cases set out in paragraph 43B? Do you believe that retrospective application is inappropriate for any other proposals addressed by the Exposure Draft? If so, what other proposals do you believe should be applied prospectively and why?

We agree with these proposals.

MATTERS FOR SPECIFIC COMMENT - AASB

(a) whether constituents support the proposed amendments

Subject to our comments made elsewhere in this letter, we generally support the proposed amendments to AASB 127.

(b) whether there are any forms of business combination that are not covered by the revisions but which should be addressed

Our response to this question is included in our submission on ED 139.

(c) any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

(i) not-for-profit entities;

(ii) public sector entities

Consistent with our views expressed in our submission on ED 139, we believe that caution should be exercised before including not-for-profit and public entity sectors within the scope of AASB 127 in relation to the matters outlined in the exposure draft.

However, we appreciate that the occurrence of non-controlling interests in the not-for-profit and public sectors might be expected to be much lower than in the for-profit sector.

Furthermore, we draw the AASB's attention to our analysis in our submission to ED 139 of the regulatory issues surrounding the application of IAS 27 and IFRS 3 to consolidated financial statements where a reverse acquisition accounting is adopted or business combinations involving mutual entities or by contract alone have occurred. In particular, that the entity obtaining control in a business combination (the acquirer) is considered the 'parent' for the purposes of applying IAS 27 when preparing consolidated financial statements. We recommend that this issue be revisited by the AASB, including the wording and effect of the existing Australian scope paragraphs of AASB 127.

(d) whether the proposals are in the best interests of the Australian economy.

We believe that the proposals are in the best interests of the Australian economy. In order to ensure that the maximum benefits are obtained, there must be no change made by the AASB to IAS 27 when reissuing AASB 127, other than any amendments applicable to not-for-profit and public-sector entities that are considered absolutely necessary.