Macquarie Group Limited
ABN 94 122 169 279

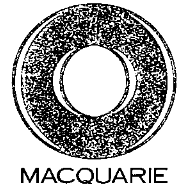
No.1 Martin Place
Sydney NSW 2000
GPO Box 4294
Sydney NSW 1164
AUSTRALIA

Telephone (61 2) 8232 3333
Facsimile (61 2) 8232 7780
Internet http://www.macquarie.com.au

ED 160 sub 8

18 February 2008

Amy Schmidt
Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom



Dear Ms Schmidt

Re: Exposure Draft - Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate

We are pleased to submit our comments in response to the IASB's Exposure Draft of proposed amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards and IAS 27 Consolidated and Separate Financial Statements.

About Macquarie Group

The Macquarie Group is a diversified international provider of banking, financial, advisory and investment services, headquartered in Sydney, Australia.

Macquarie's strategy is to expand selectively and enter markets only where its particular skills and expertise deliver real value to clients. This approach provides the strategic flexibility to enter new sectors and regions as opportunities arise and to respond to the specialist requirement of individual markets. As a result, Macquarie has established leading positions in a diverse range of markets.

In Australia and New Zealand, Macquarie is a market leader in investment and financial services. In Asia, Macquarie offers a full range of investment, financial market and advisory products and services, and in Europe, the Middle East, Africa and the Americas, Macquarie focuses on particular business areas in which it expertise delivers value to clients.

Macquarie has grown substantially since its beginnings in Australia in 1969 - and more recently has reported successive years of record profits and

Macquarie Group Limited is not an authorised deposit-taking institution for the purposes of the Banking Act 1959 (Cwth), and its obligations do not represent deposits or other liabilities of Macquarie Bank Limited ABN 46 008 583 542 (MBL). MBL does not guarantee or otherwise provide assurance in respect of the obligations of Macquarie Group Limited.

growth since 1992. Macquarie now employs more than 11,000 people in 25 countries.

Macquarie Group's particular interest in the Exposure Draft

During early 2007, the Australian Federal Government enacted new financial sector legislation that removed many of the Corporations Act and taxation barriers to a NOHC structure. In October 2007, Macquarie Group was the first major financial organisation within Australia to receive shareholder and court approvals to implement a restructure of its group such that Macquarie Bank Limited's (MBL was the pre-existing ultimate parent of the group) shareholders and optionholders have now exchanged their equity interests for equivalent equity interests in the newly established parent, Macquarie Group Limited (MGL).

The restructure was intended to position the Macquarie Group to continue to pursue the strategies which have been responsible for its strong growth, whilst at the same time assist it to meet its obligations to the Australian Prudential Regulation Authority.

As a consequence of our restructure and based on our interpretation and that of our auditors, we determined MGL's 'cost' of investment in MBL was the fair value of MBL's shares and options at the time of the restructure (ie the current interpretation described in Basis for Conclusions paragraph BC 21). This treatment has had the effect in MGL's separate financial statements of recording the investment in MBL at MBL's fully-diluted market capitalisation (approx A$ 24bn), as compared to MBL's net asset carrying value at the time of A$ 8.5bn (in its separate financial statements) / A$ 9.6bn (in its consolidated financial statements).

Our overall comments

Overall, we are pleased that the IASB has responded to the requests for it to reconsider the practical difficulties by those entities transitioning from their national GAAP to IFRS, and to remove the wide divergence of accounting treatments for internal restructures involving a non-operating holding company (NOHC). The proposals addressing the latter issue are particularly relevant to Macquarie Group as we are the first major financial organisation within Australia to have very recently undertaken such a restructure.

Subject to our comments below, we agree with the IASB's measurement proposals for investments in subsidiaries, associates and jointly controlled entities. Our comments on specific questions raised by the IASB are provided in Appendix A.

As currently drafted, the IASB's proposals regarding NOHC restructures would not change Macquarie Group's accounting treatment of recording the new parent's investment in the pre-existing entity at fair value at the date of

restructure. Our policy would not change due to the IASB's proposal in IAS 27 paragraph 37A that the pre-existing entity become a "wholly-owned subsidiary" of the new parent post-restructure (and further supported in its Basis for Conclusions paragraph BC21). This drafting may have been the IASB's shorthand attempt at describing these restructures simply, but the drafting unnecessarily introduces a condition that does not reflect the complexity of commercial and regulatory issues having to be addressed and therefore the consequential commercial outcome.

We do not agree that the proposed "wholly-owned subsidiary" condition is conceptually necessary, and therefore recommend it be removed. Instead, we consider that, in addition to the conditions described in Basis for Conclusions paragraph BC22, where a pre-existing entity has equity participants other than its existing ordinary (and potential ordinary) shareholders (who all participate in the restructure) that:

1. those equity participants continue to exist after the restructure as before; and
2. their rights and entitlements (legal and economic) are not affected individually or in aggregate by the restructure

In addition to the questions raised by the IASB, we have included our comments in Appendix B on the additional questions raised by the Australian Accounting Standard Board.

If you have any questions about our comments or would like to discuss the matters we have raised, then please contact either Stuart Dyson (+61.2.8232.8670) or Frank Palmer (+61.2.8232.5193)

Yours sincerely,

Greg Ward
Chief Financial Officer

Cc: The Chairman, Australian Accounting Standards Board

Appendix A: Macquarie Group's comments to the IASB's specific questions in the exposure draft

Question 1 — Do you agree with the two deemed cost options as they are described in this exposure draft? If not, why?

We agree.

Question 2 — Do you agree with the proposal to allow the deemed cost option for investments in jointly controlled entities and associates? If not, why?

We agree with the proposal to use the deemed cost option for investments in jointly controlled entities and associates, since many of the practical problems are similar to those for investments in subsidiaries.

Questions 3 — Do you agree with the proposal to delete the definition of the cost method from IAS 27? If not, why?

We agree.

Removing the cost method will eliminate the difficult judgement sometimes required in the separation of dividends into those sourced from pre and post-acquisition retained earnings.

If this proposal were not to be finalised in its current form, and therefore dividends received need to continue to be separated into those sourced from pre and post acquisition retained earnings, we recommend that the IASB provide an exception to the treatment of dividends received in the separate financial statements of a new parent created by a restructure as described in the proposals of IAS 27 paragraph 37A. That is, assuming the proposals in IAS27 paragraph 37A are finalised, when such a new parent receives dividends subsequent to the restructure and those dividends are sourced from the pre-acquisition retained earnings of the pre-existing entity, then those dividends should be recognised as income rather than a reduction of the parent's investment. We consider this to be an extension of the reasons used by the IASB (Basis for Conclusions paragraph BC22) for proposing the parent account for its investment at the carrying amount of the pre-existing entity's equity.

Question 4 — Do you agree with the proposed requirement for an investor to recognise as income dividends received from a subsidiary, jointly controlled entity or associate and the consequential requirement to test the related investment for impairment? If not, why?

We agree with the proposal to recognise dividends received from an investment as income. However, we recommend that the IASB clarify whether this is to apply to all amounts received regardless of their source or to only those dividends as defined in IAS18 para 3(c) as being 'distributions of profits...'. That is, if the Board intends on retaining the definition of a dividend in IAS18, then our view is that effect of the IASB proposals will mean amounts received that are sourced

from 'profits' are to be recognised as income under IAS18, and those sourced from capital (eg redemptions/cancellations) are not income ie. recognised as a reduction of the investment. If our view is supported by the IASB, we also ask that the IASB clarify that 'profits' refers to 'an investee's profits in its separate financial statements' so as to avoid an unintended interpretation that 'profits' could mean only post-acquisition profits (ie profits of the investee as recognised in the investor's consolidated financial statements that includes the subsidiary / associate / joint venture making the distribution).

We disagree with the consequential proposal for testing the investment for impairment. We consider the proposal would be an onerous requirement in jurisdictions where subsidiaries within large corporate groups are also required to prepare their own separate financial statements under IFRS. In practice, dividends are sourced <u>throughout a reporting period</u> from the profits earned in <u>many</u> underlying subsidiaries, and are paid up through a multitude of intermediary holding subsidiaries eventually reaching the ultimate parent. Consequently, the IASB's proposal places an undue amount of effort to test each investment held by all intermediary subsidiaries (or directly by the ultimate parent) that individually have their own financial reporting obligations, whenever they receive a dividend in a reporting period.

If the IASB's approach to testing for impairment is to be pursued, then we recommend that:

- dividends received only in the form of cash or other assets in-kind are to be considered (receipt of dividends in the form of an investee's own scrip is unlikely to give rise to impairment)
- the impairment testing is only to be performed at the end of the annual reporting period (and not every time during a reporting period that a dividend is received from an investment)
- the trigger event for impairment be changed from receipt of any dividend to receipt of a significant cumulative amount of dividends from an investee during a reporting period as compared to either that investee's current period profit, or retained earnings & reserves immediately before distribution.

Question 5 — Do you agree with the proposed requirement that, in applying paragraph 37(a) of IAS 27, a new parent should measure cost using the carrying amounts of the existing entity? If not, why?

Overall, we agree with the IASB's measurement proposals for such restructures.

(i) inclusion of 'wholly-owned subsidiary' in paragraph 37A

As discussed in our opening comments, Macquarie Group's policy for accounting for its restructure in the new parent's separate accounts would not have changed had the IASB's current proposals been finalised before our restructure. The reason is due to the proposal in IAS 27 paragraph 37A that the pre-existing entity

become a "wholly-owned subsidiary" of the new parent post-restructure (further supported in Basis for Conclusions paragraph BC21).

We disagree that the proposed "wholly-owned subsidiary" condition is conceptually necessary, or a consequence of the conditions in Basis for Conclusions paragraph BC22, and therefore recommend it be removed. Instead, we consider that, in addition to the conditions described in Basis for Conclusions paragraph BC22, where a pre-existing entity has equity participants other than its existing ordinary (and potential ordinary) shareholders (who all participate in the restructure) that:

1. those equity participants continue to exist after the restructure as before; and
2. their rights and entitlements (legal and economic) are not affected individually or in aggregate by the restructure

In Macquarie Group's situation, a new parent (MGL) was inserted between Macquarie Bank Limited (the pre-existing entity with its ordinary shares listed on the Australian Stock Exchange) and MBL's ordinary shareholders & optionholders without affecting the rights or entitlements held by any non-controlling interests. That is, certain hybrid securities previously issued by MBL remain on issue by MBL after the restructure. These securities, or their component parts, are classified for accounting purposes as equity by MBL but did not before the restructure (and continue to not after the restructure) share proportionately and pari passu with MBL's ordinary shareholders. So, while the rights of those security holders were unaffected by the restructure, technically MGL (the new parent) does not wholly-own MBL after the restructure. These hybrid securities are typically used by financial institutions to manage their capital base.

ii) 'owners'

Due to the issue above regarding the use of wholly-owned subsidiary, the use of 'owners' in IAS27 paragraph 37A would also need to be modified to refer to only the existing ordinary (and potential ordinary) shareholders of the pre-existing entity – those with full voting rights, rank pari passu and participate last in the net assets of the entity in liquidation. We note that the holder of an "ordinary share" (or "potential ordinary share") could take on the same definition as that currently used in IAS33 *Earnings Per Share* paragraph 5. Otherwise, the use of 'owners' as currently proposed would present the same problems as the use of 'wholly-owned subsidiary'.

iii) clarify 'parent or single entity'

As part of Macquarie Group's restructure when the new ultimate parent (MGL) was inserted between the pre-existing ultimate parent entity (MBL) and its ordinary shareholders, MGL (as the new ordinary shareholder of MBL) then inserted another newly incorporated entity (Macquarie B.H. Pty Ltd) directly between it and MBL (such that MBL became a direct wholly-owned subsidiary of MBHPL, which is a direct wholly-owned subsidiary of MGL). This transaction

would also seem to meet the conditions of IAS27 paragraph 37A and the Basis for Conclusions paragraphs BC21 & BC22.

We ask for clarification of whether this subsequent transaction would fall within IAS27 paragraph 37A, because MBHPL has its own statutory reporting requirements and is required to prepare its separate financial statements in accordance with IFRS.

If this subsequent transaction, from the perspective of MBHPL, is not intended to fall within IAS27 paragraph 37A, then please refer below to our comments on the proposed transitional requirements.

vi) clarify 'equity, assets and liabilities'

We consider the IASB should clarify what is meant by 'equity, assets and liabilities'. We suggest that the new parent should measure the cost of its investment in the pre-existing entity in IAS 27 paragraph 37A 'at the ordinary (and potential ordinary) shareholders' share of the carrying amounts of equity (or assets less liabilities) of the pre-existing entity in its separate financial statements immediately before the date of restructure'.

Question 6 – Do you agree that prospective application of the proposed amendments to IFRS 1 and IAS 27 is appropriate? If not, why?

We disagree.

Given the possibility of future impairment charges from having recognised an investment in a subsidiary at fair value for restructures described in IAS27 paragraph 37A, based on our view of the only acceptable accounting treatment under IFRS at the time of Macquarie Group's restructure, and its associated impact of creating a future dividend trap in the ultimate parent, we consider that a permissive retrospective approach (discussed further below) should be adopted.

A permissive retrospective approach would follow the approach included in IFRS 1 Appendix B, Business combinations, paragraph B1. Under this approach, an entity may elect to apply the amendment retrospectively to past transactions from an earlier date (transactions that occurred before the application date of the amendment), but where the entity chooses this approach then it applies the amendment to all transactions that occur after the designated date.

As all restructures of the type described in IAS27 paragraph 37A will be accounted for in a similar manner where they occur after the proposals in the exposure draft are finalised, an entity that restructured beforehand should be given the opportunity to apply the new approach retrospectively to earlier transactions to enable greater comparability across entities.

Subsequent transactions

If the IASB were to adopt, and an entity chooses, a permissive retrospective approach to transition, we would also like clarification regarding the accounting for transactions occurring:

- before these proposals are finalised (ie we had previously recognised an investment in subsidiary using fair value); and
- after the date chosen by the entity for retrospective restatement (ie we restate the carrying amount of an investment in subsidiary from fair value to cost)

and involve the investments that are restated under the finalised proposals. For example, where a new parent is inserted as described in IAS27 paragraph 37A, and subsequently that parent divests itself of that investment in subsidiary (the pre-existing entity), we consider a restatement of the carrying of the investment in subsidiary as a result of these proposals should flow on to restate any gain/loss previously recognised by the new parent if it disposed of the investment (even if this occurred before the IASB finalises it proposals).

Appendix B - AASB specific matters for comment

In addition, the AASB would value comments on:

(a) 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;

No comment

(ii) public sector entities;

Many of the issues have been overcome through the Australian Federal Government's introduction of financial sector legislation earlier in 2007. An entity within the scope of the legislation also has the ability to submit an individual application to the Federal Treasurer for relief from certain provisions of the Corporations Act 2001 and Incomes Tax Assessment Act.

Despite an entity's ability to obtain individual relief from certain provisions of the Corporations Act 2001, we consider it important that the Federal Government works toward replacing the 'dividends from profit' rule under s.254T of the Corporations Act 2001 with the more internationally recognised insolvency test for all entities governed by the Corporations Act 2001.

(b) whether, overall, the proposals would result in financial reports that would be useful to users; and

We strongly consider these proposals will result in financial reports that represent faithfully the economic outcome of restructures contemplated by IAS27 paragraph 37A. Where such restructures occur, subsequent dividends received by the new parent that are sourced from pre-acquisition profits will not be trapped, which will keep the ultimate ordinary shareholders in the same economic position as before the restructure (again faithfully representing the economic outcome of such restructures)

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

It is important that Australia's accounting rules remain consistent with those of the IASB in the interests of working towards the ultimate goal of one set of high quality globally accepted standards.