Deloitte.

Deloitte Touche Tohmatsu
180 Strand
London WC2R 1BL
United Kingdom

Tel: +44 (0) 20 7936 3000
Fax: +44 (0) 20 7583 1198
www.deloitte.com

Direct: +44 20 7007 0907
Direct Fax: +44 20 7007 0158
kwild@deloitte.co.uk

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London
United Kingdom
EC4M 6XH

29 February 2008

Dear Sir David,

Proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* and IAS 27 *Consolidated and Separate Financial Statements: Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*

Deloitte Touche Tohmatsu is pleased to comment on the *Exposure Draft of proposed Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards and IAS 27 Consolidated and Separate Financial Statements: Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* (herein referred to as the 'exposure draft').

We agree with, and support, the majority of the proposals outlined in the exposure draft. However, we have a number of concerns with some of the proposals within the exposure draft which are outlined in our detailed responses to the specific questions for comment in Appendix A. In addition, we have included further comments and concerns on other aspects of the exposure draft in Appendix B to this letter.

We agree with the proposals relating to the use of deemed cost within IFRS 1. In particular, we agree with the proposal to permit the use of the previous GAAP carrying amount as deemed cost. We also support the proposals to amend IAS 27 by deleting the definition of the cost method. However, we are concerned that the requirement for mandatory impairment testing when a dividend has been received from a subsidiary, associate or jointly controlled entity in the period will impose an onerous burden on many entities in circumstances where it is clear that no impairment exists. As explained further in our response to question 4 in Appendix A, we suggest that receipt of a dividend, in certain circumstances, should be an indicator of impairment, rather than imposing a mandatory requirement for impairment testing whenever a dividend is received.

Further, we disagree with the proposed amendment to IAS 27 relating to the formation of a new parent. We believe that, if adopted, this amendment may have significant adverse legal and regulatory impact in some jurisdictions. We acknowledge that the current requirements may be difficult to apply in some circumstances and, therefore, recommend that the underlying issues should be debated by the Board in the context of its project on accounting for common control transactions.

If you have any questions concerning our comments, please contact Ken Wild in London at +44 (0)20 7007 0907.

Yours sincerely,

Ken Wild
Global IFRS Leader

Appendix A: Response to Invitation to Comment

Question 1 - Deemed cost

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

We agree with the proposed inclusion of the two deemed cost options within IFRS 1. We note that in our response to the January 2007 exposure draft we urged the Board to reconsider whether a simple exemption based on previous GAAP carrying amount should be provided. We also highlighted in our response to the January 2007 exposure draft that such an approach would be consistent with the existing exemptions in IFRS 1 for business combinations.

We are pleased that this suggestion has been incorporated into the exposure draft. We believe that the inclusion of the two deemed cost options within IFRS 1 as described in the exposure draft will make it easier in practice for entities to adopt IFRSs in their separate financial statements.

Question 2 - Change in scope

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

We agree with the proposal to allow the deemed cost option for investments in jointly controlled entities and associates. As noted in our response to the January 2007 exposure draft, 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 in relation to the cost of investment in an associate or jointly controlled entity as for subsidiaries, and consequently we believe that the same deemed cost option should be applicable to all investments accounted for in accordance with IAS 27.37, not just investments in subsidiaries.

Question 3 - Cost method

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

We agree with the proposal to delete the definition of the cost method from IAS 27.

The existing definition of the cost method in IAS 27 raises a number of interpretation issues which would need to be addressed if the definition were to be retained. Therefore, we welcome the proposed change to what is, in our opinion, a more principles-based approach.

Question 4 - Cost method

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 proposed requirement for an investor to recognise as income all dividends received from a subsidiary, jointly controlled entity or associate. We also agree that any consequential impairment of the investment should be recognised in profit or loss.

However, we are concerned that the proposed amendments to IAS 27 and IAS 36, as drafted, will have the effect of requiring an impairment test of the investment to be carried out in any reporting period in which a dividend is received. The imposition of mandatory impairment testing would be seen as an onerous new burden on entities as, in many cases, we believe that it will be clear whether or not an investment is impaired as a result of the payment of a dividend. Therefore, we believe that there should be no requirement for mandatory impairment testing.

In our opinion, the concerns expressed in BC 20 of the exposure draft could be addressed without imposing such an onerous burden on entities. We propose that, rather than adding the requirement for mandatory impairment testing when dividends are received into IAS 36.10, the receipt of dividends, in certain circumstances, from subsidiaries, associates and jointly controlled entities should be included within the list of indicators of impairment provided in IAS 36.12. We have identified two possible ways in which those circumstances might be expressed:

- the receipt of a dividend which is significantly in excess of the amount that could be justified based on performance; or
- the receipt of a dividend that constitutes a significant proportion of equity immediately prior to the date of declaration.

Such an approach permits the application of the concept of materiality in determining whether the recoverable amount of an asset is required to be estimated as outlined in IAS 36.15.

If the Board proceeds with the proposal within the exposure draft to include an explicit requirement in IAS 36.10 for impairment testing when dividends are received, we believe that it is essential that such a requirement should not apply to *all* dividends received. The criteria for impairment testing could be similar to those suggested above as indications of impairment. However, although we suggest this as an alternative approach, we maintain our strong preference for the approach described in the previous paragraph. Inclusion of the requirement in IAS36.10 does not permit the concept of materiality to be applied in accordance with IAS 36.15.

In addition to the key issue of mandatory impairment testing, we believe that a related presentation issue exists which is not addressed in the exposure draft. The effect of paragraph 37B in the exposure draft is that all dividends received and all related impairments will be included as gross amounts in the income statement. We ask the Board to clarify whether this gross presentation is the intention of the Board.

Question 5 - Formation of a new parent

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

We disagree with the proposed requirement that, in applying paragraphs 37(a) of IAS 27, a new parent should measure cost using the carrying amounts of the existing entity. We believe that the issues surrounding transactions in which a new parent entity is added to a group should be debated more fully in the context of the Board's project dealing with accounting for common control transactions. However, should the Board elect to proceed with the proposed amendment, we believe that the amendment should be in the form of an *optional exemption* rather than a mandatory requirement.

Such an exemption may not be necessary depending on the interpretation of paragraph 37(a) of IAS 27. We are aware of differing interpretations about whether paragraph 37(a) of IAS 27 requires the new parent to measure the investment in the existing entity at the fair value of the existing entity at the date of acquisition. We understand that in some jurisdictions this treatment may cause legal and regulatory issues, for example by trapping the undistributed profits of the existing group. We also understand that it is these concerns that have led to the proposals in the exposure draft.

However, we believe that the alternative treatment proposed in the exposure draft will also create significant difficulties in some jurisdictions. For example, in some jurisdictions it may be necessary to recognise the share issue at fair value for legal reasons. Where the investment is recognised at a lower amount based on the carrying amounts in the existing entity, this may result in a large debit balance in equity and the entity's net assets will be less than its share capital. This has the potential to have significant legal and regulatory implications.

As noted above, we believe that these issues would be better addressed through the Board's project on common control transactions. The following paragraphs set out some concerns about the detailed proposals in the exposure draft relating to the formation of a new parent company, should the Board proceed with its proposals. They should not be seen as detracting from our strong preference that the proposed amendment should not be made at this time.

The proposed amendment is limited to situations where the existing entity becomes a wholly owned subsidiary of the new parent. We believe that this requirement is unnecessarily restrictive and could result in transactions which are similar in substance being accounted for differently. There should be wider debate about the scope of the proposals before they are taken further.

The exposure draft states that the new parent shall measure the cost of its investment in the existing entity "using the carrying amounts of the equity, assets and liabilities in the separate financial statements of the existing entity at the date of formation". We understand this to mean that the cost of investment in the new parent company will equal the net asset value of the existing parent entity after taking into account all of its assets and liabilities. However, we are aware of a point of view that the cost of investment recorded in the accounts of the new parent should be equal to the cost of investment as stated in the accounts of the existing parent (i.e. ignoring other assets and liabilities). We would welcome greater clarity on this point.

The proposed treatment would apply where "the new parent is formed in a manner that does not change the relative ownership interests of the owners of the existing entity or the equity, assets and liabilities of the group". This test would be met in the case of a share for share exchange which we assume is the type of transaction that the Board has in mind. It would be helpful if this could be made clear. However, we believe that further consideration should be given to whether the scope of the proposed new treatment is too narrow or too wide given the range of possible transactions that may arise in practice. For example, it is unclear whether it applies where the new parent takes out borrowings to finance the purchase of the existing group for cash.

Question 6 - Transition

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

We agree with the proposal that the new requirements should be applied prospectively. We see no advantage in requiring retrospective restatement which would create additional work for no clear benefit.

However, some entities that have already made the transition to IFRSs for their separate financial statements may feel disadvantaged (e.g. through a reduction of profits available for distribution) by not having been able to apply the new requirements at that time. We see no reason to prohibit retrospective application which is the normal treatment in accordance with IAS 8. We therefore believe that retrospective application should be permitted but not required.

Appendix B: Other matters

Dividends receivable

We believe that the first sentence of draft paragraph 37B of IAS 27 should refer to "dividends received and receivable" rather than just dividends received. This would be consistent with IAS 18.30(c) which provides that dividends are recognised when the shareholder's right to receive payment is established.

Amendment to IAS 27 (Revised January 2008)

The proposals in the exposure draft are expressed as amendments to IAS 27 as revised in 2003 (and subsequently amended). Similar amendments will have to be made to IAS 27 as revised in 2008. The amendments should be made to both versions of the Standard to ensure that it is possible to adopt them without having to adopt the 2008 revised standard at the same time.