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Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London
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10 February 2014

Dear Mr Hoogervorst

Exposure Draft ED 2013/10 – Equity Method in Separate Financial Statements

Deloitte Touche Tohmatsu Limited is pleased to respond to the International Accounting Standards Board's (the IASB's) Exposure Draft *Equity Method in Separate Financial Statements* ('the exposure draft').

The Basis for Conclusions of the exposure draft states that the reason for the proposed amendment is to provide relief to entities where laws and regulations in certain jurisdictions require an entity to use the equity method to account for its investments in subsidiaries, joint ventures and associates in preparing its separate financial statements. The current requirements of IAS 27 only allow investments in subsidiaries, joint ventures and associates to be accounted for either at cost or in accordance with IFRS 9 (or, when applied, IAS 39) in an entity's separate financial statements. We do not object to the proposal, as a short-term measure, to address the issue raised by entities in these jurisdictions, provided that as noted below certain modifications are made prior to the IASB finalising the proposed amendments. However, we are concerned that this proposal has been made without a full consideration of the conceptual issues around both separate financial statements and the equity method of accounting.

Currently, IAS 27 does not explain either the purpose of separate financial statements or the principles underpinning the measurement of an entity's investments in its separate financial statements. Similarly, and as noted in our response to the IASB's Request for Views on its Agenda Consultation in 2011 and to the Discussion Paper on the Board's Review of the Conceptual Framework in 2013, the purpose of equity accounting remains an area of controversy. We believe that the merits of the equity method and the scope of its use should be considered fully as part of the fundamental assessment of the equity method of accounting planned as part of the IASB's Technical Work Programme. Also, the IASB should develop an underlying basis for the preparation of 'separate financial statements'. From there, the measurement principles for the various types of investments recorded in an entity's separate financial statements could be developed. As part of this review, the IASB should evaluate whether in its separate financial statements an entity should be permitted to account for different types of investments on an inconsistent basis. For example, under the proposals in the exposure draft an investor could elect to account for its

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investments in subsidiaries using the equity method, its associates under IFRS 9 and its joint ventures at cost.

In addition, we do not agree with the consequential amendment to IAS 28 included in the exposure draft as we do not believe that the principles applied to loss of control over a subsidiary in IFRS 10 should be applied in a situation where loss of control does not result in a change in the method of accounting applied because both subsidiaries and associates or joint ventures are accounted for using the equity method.

Our detailed responses to the questions in the invitation to comment are included in the Appendix to this letter.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader

Appendix

Question 1 – Use of the equity method

The IASB proposes to permit the equity method as one of the options to account for an entity's investments in subsidiaries, joint ventures and associates in the entity's separate financial statements.

Do you agree with the inclusion of the equity method as one of the options? If not, why?

The Basis for Conclusions of the exposure draft states that the reason for the proposed amendment is to provide relief to entities where laws and regulations in certain jurisdictions require an entity to use the equity method to account for its investments in subsidiaries, joint ventures and associates in preparing its separate financial statements. The current requirements of IAS 27 only allow investments in subsidiaries, joint ventures and associates to be accounted for either at cost or in accordance with IFRS 9 (or, when applied, IAS 39) in an entity's separate financial statements. We do not object to the proposal, as a short-term measure, to address the issue raised by entities in these jurisdictions, provided that as noted below certain modifications are made prior to the IASB finalising the proposed amendments. However, we are concerned that this proposal has been made without a full consideration of the conceptual issues around both separate financial statements and the equity method of accounting.

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Question 2 – Transition provisions

The IASB proposes that an entity electing to change to the equity method would be required to apply that change retrospectively, and therefore would be required to apply IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

Do you agree with the proposed transition provisions? If not, why and what alternative do you propose?

We agree that for investments in associates and joint ventures retrospective application of the exposure draft is appropriate as the equity accounting that would be used in an entity's separate financial statements would be consistent with its consolidated financial statements (or, for an entity with no subsidiaries, the primary financial statements in which the equity method is applied to investments in associates and/or joint ventures).

With respect to investments in subsidiaries, we believe that the statement in paragraph BC12 of the Basis for Conclusions of the exposure draft that the information previously used in the preparation of consolidated financial statements could be used to retrospectively apply the equity method in an entity's separate financial statements is, for the most part, correct. However, this is not necessarily the case in respect of impairment testing as:

- the subsidiary could have formed part of a cash-generating unit (CGU) or group of CGUs to which goodwill is allocated, meaning that an impairment review may not historically have been carried out at the level of the individual subsidiary; and
- the additional consideration of impairment under IAS 39 (as required by paragraph 40 of IAS 28) would not have been performed in preparing the consolidated financial statements.

Retrospectively performing these assessments could be problematic (in particular, avoiding the use of hindsight). For this reason, we recommend that the final standard should include transition relief to allow an entity to perform impairment testing from a fixed date (for example, at the start of the year in which equity accounting is first applied in the separate financial statements).

Retrospective application of the equity method of accounting for investments in subsidiaries could also prove problematic in other areas including foreign exchange, borrowing costs and hedge accounting. For this reason, we recommend that a general exemption from retrospective application when this is impracticable be provided.

Question 3 – First-time adopters

The IASB does not propose to provide any special relief for first-time adopters. A first-time adopter electing to use the equity method would be required to apply the method from the date of transition to IFRSs in accordance with the general requirements of IFRS 1 First-time Adoption of International Financial Reporting Standards.

Do you agree that a special relief is not required for a first-time adopter? If not, why and what alternative do you propose?

We agree that additional relief is not required for a first-time adopter as the exemptions provided by Appendix C to IFRS 1 already cater for the application of equity accounting by first-time adopters. However, we recommend that paragraph C5 of IFRS 1 be amended to specify that these exemptions apply to a subsidiary accounted for using the equity method in an entity's separate financial statements.

Question 4 – Consequential amendment to IAS 28 *Investments in Associates and Joint Ventures*

The IASB proposes to amend paragraph 25 of IAS 28 in order to avoid a conflict with the principles of IFRS 10 Consolidated Financial Statements in situations in which an entity loses control of a subsidiary but retains an ownership interest in the former subsidiary that gives the entity significant influence or joint control, and the entity elects to use the equity method to account for the investments in its separate financial statements.

Do you agree with the proposed consequential amendment? If not, why?

We do not agree with the proposed consequential amendment as we do not believe that the principles applied to loss of control in IFRS 10 should be applied in a situation where loss of control does not result

in a change in the method of accounting applied in the entity's separate financial statements because an entity accounts for both subsidiaries and associates or joint ventures using the equity method.

In addition, we note that applying the principles applied to acquisition (in IFRS 3) and loss (in IFRS 10) of control in consolidated financial statements to separate financial statements would affect the accounting in separate financial statements for changes in ownership, whether or not the equity method of accounting is used. For example, applying the principles of IFRS 10 to the loss of control of a subsidiary would result in the remeasurement of any retained interest to fair value when the entity's accounting policy is to measure those investments at cost in its separate financial statements. We do not believe that this is currently a requirement of IFRSs or is appropriate without further consideration of the purpose of separate financial statements.

Question 5 – Other comments

Do you have any other comments on the proposals?

We believe that the proposals could be clarified in two ways.

- Noting that the equity method of accounting is viewed by some as a 'mini-consolidation', by clarifying how transactions between a subsidiary, associate or joint venture and members of the consolidated group are treated in separate financial statements when the equity method of accounting is applied. For example, if transactions between an associate and members of the group are eliminated, would the proposed accounting be affected by whether the reporting entity itself is party to the transaction? If not, what would be the basis is for eliminating (or partially eliminating) the effect of transactions to which the entity is not party?
- By incorporating into the definition of 'separate financial statements' in paragraph 4 of IAS 27 that separate financial statements are additional financial statements. The proposed amendments as drafted could lead to confusion as the financial statements of an investor in an associate or joint venture accounted for using the equity method would meet the definition in paragraph 4, but then be excluded from that definition by paragraph 6. It may be clearer to provide a definition of 'separate financial statements' and of other types of financial statement (including those of an entity that does not have any subsidiaries, associates or joint ventures) rather than references to 'not separate financial statements'.

In addition, if the Board decides to proceed with the amendment to IAS 28 (with which, as noted in our response to Question 4, we disagree), its effect should be clarified. The proposed consequential amendment to IAS 28 appears only to exclude loss of control transactions from the scope of paragraph 25 of that standard, while paragraph BC11 of the Basis for Conclusions of the exposure draft goes further and indicates that the entity is required to apply the principles of IFRS 10 and remeasure the remaining stake at its fair value when control is lost.