

October 26, 2005

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International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
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**Exposure Draft of Proposed Amendments to IAS 27, *Consolidated and Separate Financial Statements***

Dear Mr. Teixeira:

Deloitte Touche Tohmatsu is pleased to comment on the IASB's June 2005 Exposure Draft of proposed Amendments to IAS 27, *Consolidated and Separate Financial Statements* ("proposed Amendments" or "Exposure Draft").

The Exposure Draft is part of the second phase of the IASB and Financial Accounting Standards Board ("FASB") joint business combinations project, which involved broad reconsideration of the requirements of accounting and reporting for business combinations. Our comment letter dated October 26, 2005, on the IASB's June 2005 proposed Amendments to IFRS 3, *Business Combinations*, does not support the adoption of the proposed Amendments to IFRS 3 as an amended Standard. In essence, our concerns in applying the full entity approach — recognizing 100 percent of the fair value of goodwill, including the non-controlling interest's portion of goodwill — outweigh the perceived advantages. Therefore, except for certain improvements, we believe the accounting for business combinations under IFRS 3 should remain unchanged at the present time.

Consequently, we do not support the majority of this Exposure Draft's proposed changes to the accounting and reporting of non-controlling interests. The attached Appendix I contains our responses to the specific questions raised in the "Invitation to Comment" section of the Exposure Draft. Other items for the IASB's consideration are set forth in Appendix II.

In its previous revision to IAS 27, *Consolidated and Separate Financial Statements*, the IASB reached the conclusion that non-controlling interests represent a class of equity in a consolidated entity separate from the parent shareholders' equity. In the Exposure Draft, the IASB concluded that transactions between the controlling and non-controlling shareholders should be accounted for as equity transactions. We believe these conclusions are premature and should be deferred until completion of the IASB and FASB's joint conceptual framework project. We are not yet convinced that the single economic entity view of consolidated financial statements provides the most relevant information to financial statement users. Indeed, shareholders of the parent entity tend to focus on a parent view, thereby not viewing transactions with non-controlling shareholders as transactions among owners.

Another aspect of IAS 27 that should be improved relates to the accounting and reporting of changes in a parent's ownership interest in a subsidiary that do not result in loss of control. Although the IASB previously concluded that non-controlling interests are required to be presented in equity, no guidance was provided as to the accounting treatment for changes in a parent's ownership interest in subsidiaries after control is obtained that do not result in loss of control. Said another way, IAS 27 requires presentation of non-controlling interests within equity, but not equity accounting for transactions involving non-controlling interests.

This lack of guidance has resulted in financial statement preparers applying differing accounting treatments to transactions involving non-controlling interests based on their respective accounting policy elections, which has in turn resulted in reduced financial statement comparability. Indeed, we have seen in practice the application of as many as five differing methods in accounting for increases in ownership interest after control of a subsidiary has been obtained. We have included a summary of these methods for the IASB's reference as Appendix III to this letter.

As this diversity is not desirable, we encourage the IASB to provide accounting guidance for these types of transactions. Therefore, until the joint conceptual framework is completed, the IASB should provide interim guidance regarding the accounting and reporting of increases and decreases in a parent's ownership interest in a subsidiary that do not result in a loss of control. For increases in ownership interest after control is obtained, the net assets associated with the additional percentage of the subsidiary acquired should be recorded at fair value at the acquisition date. That is, while a transaction that results in an entity obtaining control results in recognizing 100 percent of assets and liabilities at fair value (excluding goodwill), increases in ownership subsequent to taking control result in a remeasurement of assets and liabilities based upon only the incremental percentage acquired. Goodwill would be recognized for any difference between (1) the cost of the additional interest acquired and (2) the percentage of the fair value of the identifiable assets and liabilities associated with the newly acquired interest. This approach is consistent with existing U.S. generally accepted accounting principles, and as such represents an interim position that can be applied until completion of the joint conceptual framework. For decreases in ownership interest without a loss of control, any difference between the amount by which the non-controlling interest is adjusted and the fair value of the consideration received should be recognized as a gain or loss in profit or loss in the period the transaction occurs.

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We welcome any questions regarding our response.

Yours truly,

A handwritten signature in black ink, appearing to read "Ken Wild", written over a horizontal line.

Ken Wild  
Global IFRS Leader

**Appendix I**  
**Responses to Questions Raised in the “Invitation to Comment” Section of the Exposure Draft**

*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.*

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

We understand how under the current conceptual framework the Board reached a conclusion that a non-controlling interest is part of the entity’s equity. However, we are not convinced that users of the consolidated financial statements view non-controlling interests as equity but instead may view these interests as an element separate from equity and liabilities. Until the Board is able to address this issue as part of its project on the conceptual framework, we do not believe transactions between the controlling and non-controlling interests should necessarily be accounted for as equity transactions.

However, in view of diversity in practice (see Appendix III) we do encourage the IASB to provide interim accounting guidance for these types of transactions to address such diversity and resulting lack of financial statement comparability.

Therefore, for increases in ownership interest after control is obtained, the net assets associated with the additional percentage of the subsidiary acquired should be recorded at fair value at the acquisition date. That is, while a transaction that results in an entity obtaining control results in recognizing 100 percent of assets and liabilities at fair value (excluding goodwill), increases in ownership subsequent to taking control result in a remeasurement of assets and liabilities based upon only the incremental percentage acquired. Goodwill would be recognized for any difference between (1) the cost of the additional interest acquired and (2) the percentage of the fair value of the identifiable assets and liabilities associated with the newly acquired interest. For decreases in ownership interest without a loss of control, any difference between the amount by which the non-controlling interest is adjusted and the fair value of the consideration received should be recognized as a gain or loss in profit or loss in the period the transaction occurs.

We also encourage the Board to consider whether such guidance is appropriate for additional acquisitions of interests in associates when such additional acquisitions do not result in obtaining control over the investee, and to potentially add this guidance to IAS 28, *Investments in Associates*.

*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 believe that a partial disposition of a subsidiary, including a disposition that results in loss of control, is a significant economic event requiring recognition of any gain or loss in profit or loss in the period in which the transaction occurs. However, we do not believe that the remaining non-controlling equity investment should be remeasured to fair value. In a historical cost model, no event has occurred that warrants such a remeasurement. Therefore, we do not agree that the gain or loss resulting from the disposition should include any fair value remeasurement gain or loss related to the retained equity interest.

Any remaining non-controlling equity investment should be accounted for under the provisions of IAS 28, *Investments in Associates*, IAS 31, *Interests in Joint Ventures*, or IAS 39, *Financial Instruments: Recognition and Measurement*, as applicable.

*Question 3 — 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 acknowledge that the accounting requirements of the proposed Amendments may encourage transaction structuring on the part of preparers. As such, to the extent the proposed Amendments are issued as an amended Standard, guidance addressing when multiple transactions should be accounted for as a single arrangement is necessary. However, we do not believe that the guidance provided in paragraph 30F of the proposed Amendments is sufficient.

Specific to item (b) of paragraph 30F, it is not clear how to apply this factor, since seemingly all multiple arrangements could be grouped together and deemed to have formed a single arrangement that achieved an overall commercial effect, whether or not that was the intent of the arrangements. Further, both paragraph 30F and EITF Issue No. 04-13, “Accounting for Purchases and Sales of Inventory with the Same Counterparty”, include guidance on linking together multiple transactions to be accounted for as a single arrangement. From a consistency and simplicity perspective, we believe the guidance in the proposed Amendments should be consistent with that found in Issue 04-13.

Additionally, the “Illustrative Examples” that accompany the proposed Amendments should provide examples of how to apply the paragraph 30F criteria to real-life transactions, and the resulting accounting treatment. For instance, an example illustrating the accounting treatment for the following fact pattern would be helpful: two transactions, which together result in loss of control, are determined to be part of a single arrangement, and the transactions occur in different reporting periods.

Likewise, examples should be provided on the required accounting for complex single-agreement structures likely to be seen in practice, such as agreements that involve a forward or an option. For illustrative purposes, assume an 80 percent controlling interest enters an agreement to sell 29 percent of its controlling interest to the non-controlling interest on July 1, 20XX, coupled with (1) a forward to sell the remaining 51 percent controlling interest six months from the initial sale date or (2) an American option to put the remaining 51 percent controlling interest to the non-

controlling interest (the option writer) for a term of one year from the initial sale date. It is not clear how to account for this type of transaction under the proposed Amendments.

*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 agree with the proposed loss allocation. A non-controlling interest participates proportionately with the controlling interest in the risks and rewards of an investment in a subsidiary. As such, income and losses should be allocated to the controlling and non-controlling interests either proportionately based on relative ownership percentages or based on contractual allocation requirements when such agreements exist.

However, we believe the IASB should provide guidance regarding the accounting for guarantees and similar arrangements among the controlling and/or non-controlling interests, particularly obligations to absorb and/or cap losses or provide additional funding. The IASB also should provide examples of guarantees and similar arrangements likely to be seen in practice, and the required accounting. Examples should include, at a minimum, (1) an arrangement that involves a floor on the non-controlling interest holders' losses in the subsidiary, and (2) an arrangement that requires the parent to provide additional funding to the subsidiary in the event of subsidiary losses.

*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?*

As discussed in our responses to Questions 1 and 2 above, we do not support adoption of the proposed Amendments as an amended Standard. However, to the extent the IASB accepts our suggested alternative accounting treatments as discussed above, we agree with the transition provisions.

However, we also believe that retrospective application of paragraphs 30A, 30C, and 30D should be permitted, but only to the extent an entity could apply the provisions to all historical transactions (i.e., an "all or none" retrospective application). We do not believe financial reporting would be improved if an entity looked retrospectively to some arbitrary point in time (e.g., the years presented or all transactions within the last five years) or only applied the provisions to certain historical transactions.

## **Appendix II**

### **Other Items for the IASB's Consideration**

The following comments should be considered by the IASB to the extent the proposed Amendments are issued as an Amended Standard.

#### **Assets Held for Sale Considerations**

The proposed Amendments do not address assets held for sale considerations under IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, in situations where an entity makes a decision to sell a portion of its ownership interest in a subsidiary that will result in loss of control, but the entity will retain significant influence over or joint control of the former subsidiary.

Entities generally do not classify a subsidiary as assets held for sale upon a decision to sell the subsidiary when an equity method or joint venture investment will be retained. That is, there is a conceptual difference (and resulting accounting difference) between selling a subsidiary or certain assets of a subsidiary and reducing an ownership (equity) interest in a subsidiary. However, in a loss of control scenario under the proposed Amendments, an entity is, in essence, selling (and deconsolidating) 100 percent of the subsidiary and acquiring a new, non-controlling investment.

As such, a question arises as to whether assets held for sale classification may be appropriate at the time the decision to sell the controlling interest in the subsidiary is made, assuming the other criteria required for such classification are met.

For illustrative purposes, assume an entity has an 80 percent controlling interest in a subsidiary and decides to sell 40 percent of its interest. The sale will result in loss of control, but the entity will exert significant influence over the former subsidiary (i.e., a resulting 40 percent equity method investment). If the criteria for assets held for sale recognition under IFRS 5 are met, should the entity reclassify the subsidiary's net assets as assets held for sale at the time the decision is made, or wait until the transaction occurs to deconsolidate and record the equity method investment? We do not support deconsolidation based upon an entity's intent to sell its controlling interest. This question should be addressed in the amended Standard.

#### **Foreign Exchange Differences Recognized Directly in Equity**

In the "Amendments to Other Pronouncements" appendix of the Exposure Draft, paragraph A5 denotes the proposed amendments to IAS 21, *The Effects of Changes in Foreign Exchange Rates*. We believe there is an inconsistency between certain proposed amendments to IAS 21 and the concepts in the Exposure Draft.

Specifically, paragraph 48 of IAS 21 (as would be amended by IAS 27) states, in part:

In the case of partial disposal or reduction in an entity's proportionate ownership interest in a foreign operation, only the proportionate share of the related accumulated foreign exchange difference is recognized in profit or loss.

In the full context of paragraph 48, we have interpreted this guidance as applying to partial disposals or reductions that do not result in loss of control. As such, this treatment is inconsistent with the IASB's conclusion that transactions that do not result in loss of control are accounted for as equity transactions. Therefore, we believe this sentence should be modified as follows:

In the case of partial disposal or reduction in an entity's proportionate ownership interest in a foreign operation that does not result in loss of control, the related accumulated foreign exchange difference should be reallocated to the controlling and non-controlling interests after the transaction.

### **Other Matters**

In the Illustrative Examples section of the Exposure Draft, paragraph 3.6 references "Company G". This reference should be to "Company E".

### **Appendix III**

#### **Summary of Differing Methods Seen in Practice in Accounting for Increases in Ownership Interest of a Subsidiary after Control Has Been Obtained**

##### Method 1

Goodwill is calculated and recorded as the difference between the cost of the additional interest acquired and the parent's newly acquired interest in the carrying value of the net assets of the subsidiary, excluding goodwill.

##### Method 2

Goodwill is calculated and recorded as the difference between the cost of the additional interest acquired and the fair value in the subsidiary's identifiable assets and liabilities associated with the newly acquired interest. This method is accomplished by revaluing all of the identifiable assets and liabilities of the subsidiary to fair value, excluding goodwill. The resulting revaluation difference is captured in the revaluation reserve, and is then allocated between the parent and non-controlling interest.

##### Method 3

Goodwill is calculated on the same basis as Method 2, but only the proportion of the values attributable to the additional interest acquired is recognized. This method is accomplished by recording at fair value the net assets associated with the additional percentage of the subsidiary acquired at the acquisition date. That is, while a transaction that causes an entity to obtain control results in recognition of 100 percent of assets and liabilities at fair value (excluding goodwill), increases in ownership subsequent to gaining control result in a remeasurement of identifiable assets and liabilities based upon only the incremental percentage acquired. Goodwill is then recognized for any difference between (1) the cost of the additional interest acquired and (2) the percentage of the fair value of the identifiable assets and liabilities associated with the newly acquired interest.

##### Method 4

Goodwill is calculated and recorded on the same basis as Method 2, but the revaluation surplus is not recognized in the consolidated balance sheet. Instead, the resulting variance is recorded as a separate reserve in equity (or perhaps directly to retained profits).

##### Method 5

Goodwill is calculated and recorded based on the initial purchase of goodwill (i.e., the transaction in which control of the subsidiary was obtained), with changes in ownership interest recognized as an equity transaction. This method is accomplished by extrapolating the goodwill recognized in the acquisition of the controlling interest in the subsidiary to the new ownership interest acquired. That is, the portion of goodwill attributable to the non-controlling interest at the initial acquisition date is now attributed to the parent.