Exposure Draft of Proposed

AMENDMENTS TO IFRS 1 *FIRST-TIME ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS*

COST OF AN INVESTMENT IN A SUBSIDIARY

Comments to be received by 27 April 2007

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Introduction and Invitation to Comment

In this Exposure Draft the International Accounting Standards Board proposes to amend IFRS 1 *First-time Adoption of International Financial Reporting Standards* to provide relief from particular requirements of IAS 27 *Consolidated and Separate Financial Statements* in the separate financial statements of a parent. The Board invites comments on the proposals. It would particularly welcome answers to the questions set out below. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, when applicable, provide a suggestion for alternative wording.

The Board is not requesting comments on matters in IFRS 1 not addressed in this Exposure Draft.

Comments should be submitted in writing so as to be received no later than **27 April 2007**.

Question 1

IAS 27 requires a parent, in its separate financial statements, to account for an investment in a subsidiary either at cost or at fair value (in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*). However, the Board believes that in some cases, on first-time adoption of IFRSs, the difficulties in determining cost in accordance with IAS 27 exceed the benefit to users.

This Exposure Draft proposes to allow a parent, at its date of transition to IFRSs, to use a deemed cost for an investment in a subsidiary. The deemed cost would be determined using either the carrying amount of the net assets of the subsidiary, or its fair value, at that date. Is this appropriate? If not, why?

Question 2

The cost method in IAS 27 requires a parent to recognise distributions from a subsidiary as a reduction in the cost of the investment to the extent they are received from the subsidiary's pre-acquisition profits. This may require a parent, in some cases, to restate the subsidiary's pre-acquisition accumulated profits in accordance with IFRSs.

Such a restatement would be tantamount to restating the original business combination, requiring judgements by management about past conditions after the outcome of the transaction is known.

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This Exposure Draft proposes a simplified approach to determining the pre-acquisition accumulated profits of a subsidiary for the purpose of the cost method in IAS 27. Is this appropriate? If not, why?

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Proposed Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

In the Standard, paragraph 47F and in Appendix B, after paragraph B3, a heading and paragraphs B4–B6 are added.

Effective date

47F An entity shall apply paragraphs B4–B6 for annual periods beginning on or after [date to be determined after exposure]. Earlier application is permitted. If an entity applies those paragraphs for an earlier period, it shall disclose that fact.

Appendix B
Business Combinations

Investments in subsidiaries in the separate financial statements of the parent

B4 IAS 27 *Consolidated and Separate Financial Statements* requires a parent to account for investments in subsidiaries in its separate financial statements (unless they are classified as held for sale, or included in a disposal group that is classified as held for sale, in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*) either:

(a) at cost, or

(b) at fair value in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.

B5 In determining cost in accordance with IAS 27, a first-time adopter may elect to use a deemed cost to measure some or all investments in subsidiaries as at the date of transition to IFRSs. For this purpose, a parent shall use as the deemed cost:

(a) its interest in the carrying amount of the subsidiary's assets less liabilities, using the carrying amounts that IFRSs would require in the subsidiary's balance sheet; or

(b) the fair value of the investment in the subsidiary.

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A first-time adopter may choose which measurement to use for each individual investment in a subsidiary.

B6 For the purpose of applying the cost method in IAS 27:

(a) when a parent measures an investment in a subsidiary using a deemed cost in accordance with paragraph B5, the parent shall, at the date of transition to IFRSs, treat that subsidiary's accumulated profits under IFRSs as pre-acquisition accumulated profits;

(b) a parent shall, for subsidiaries that have not been measured in accordance with paragraph B5, either:

(i) determine the pre-acquisition accumulated profits of each subsidiary under IFRSs, or

(ii) treat the pre-acquisition accumulated profits of each subsidiary under previous GAAP as the pre-acquisition accumulated profits under IFRSs.

In the Guidance on implementing IFRS 1, after paragraph IG31, paragraphs IG31A and IG31B and IG Examples 9A and 9B are added.

IAS 27 *Consolidated and Separate Financial Statements*

IG31A Paragraph B5 of Appendix B of the IFRS refers to the carrying amount of a subsidiary's assets and liabilities. If the subsidiary is also a parent, the assets and liabilities referred to in paragraph B5 are the assets and liabilities of the group of which the subsidiary is the parent.

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IG31B IG Examples 9A and 9B illustrate the application of paragraphs B4–B6 of the IFRS.

IG Example 9A Cost of an investment in a subsidiary

Background

Parent X's date of transition to IFRSs is 1 January 2007. Parent X has one subsidiary, Subsidiary Y. On transition to IFRSs, Parent X elects to account for Subsidiary Y in its separate financial statements using the cost method in IAS 27.

On 1 January 2007:

(a) Parent X owns 100 per cent of Subsidiary Y.

(b) under its previous GAAP, Parent X measures its investment in Subsidiary Y at 100 in its separate financial statements.

(c) under IFRSs, Subsidiary Y would measure its assets at 800 and its liabilities at 300. On this basis, Subsidiary Y's net assets are 500 under IFRSs.

(d) the fair value of Parent X's investment in Subsidiary Y is 600.

Application of requirements

At 1 January 2007, Parent X may measure its investment in Subsidiary Y at any of the following amounts:

(a) deemed cost of 500 (the carrying amount of Subsidiary Y's assets less liabilities, using the carrying amounts that IFRSs would require in Subsidiary Y's balance sheet).

(b) deemed cost of 600 (fair value of its investment in Subsidiary Y).

(c) cost determined under IAS 27.

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IG Example 9B Post-transition distributions

Background

Parent X's date of transition to IFRSs is 1 January 2007. Parent X has two subsidiaries, Subsidiary Y and Subsidiary Z. All entities use the same GAAP before Parent X's transition to IFRS.

On 1 January 2007:

(a) Parent X elects to use the cost method in IAS 27 for the subsidiaries in its separate financial statements.

(b) for Subsidiary Y only, Parent X uses a deemed cost to measure the cost of the investment.

(c) under its previous GAAP, Subsidiary Y has pre-acquisition accumulated profits of 350 and total accumulated profits of 800.

(d) under its previous GAAP, Subsidiary Z has pre-acquisition accumulated profits of 300 and total accumulated profits of 900.

(e) there are IFRS transition adjustments in Subsidiary Y and Subsidiary Z that would change their accumulated profits at the acquisition date.

(f) in accordance with IFRSs, the accumulated profits of Subsidiary Y and Subsidiary Z are 650 and 1,000 respectively.

Some time after the date of transition to IFRSs, Subsidiary Y and Subsidiary Z pay a dividend to Parent X equal to their entire accumulated profits calculated in accordance with IFRSs. Their accumulated profits at this time were 750 and 950 respectively.

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...continued

IG Example 9B Post-transition distributions

Application of requirements

On transition to IFRSs, Parent X elects to use a deemed cost for its investment in Subsidiary Y only.

At Parent X's date of transition to IFRSs the accumulated profits of Subsidiary Y under IFRSs are 650. In accordance with paragraph B6(a) of the IFRS, 650 is Subsidiary Y's pre-acquisition accumulated profits for the purpose of applying the cost method in IAS 27. Therefore, Parent X treats 650 of the dividend from Subsidiary Y as a reduction in the cost of its investment in Subsidiary Y. Parent X recognises the remainder of the dividend (100) as revenue.

In accordance with paragraph B6(b) of the IFRS, Parent X elects to use Subsidiary Z's pre-acquisition accumulated profits arising under its previous GAAP for the purpose of applying the cost method in IAS 27. Therefore, Parent X treats the portion of the dividend that relates to the pre-acquisition accumulated profits of Subsidiary Z under its previous GAAP as a return on the investment in Subsidiary Z (300). Parent X recognises the remainder of the dividend (650) as revenue.

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Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the draft amendments.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in the Exposure Draft of Proposed Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards—*Cost of an Investment in a Subsidiary*. Individual Board members gave greater weight to some factors than to others.

Cost of an investment in a subsidiary on first-time adoption of IFRSs

BC2 The Board has received comments about difficulties, on first-time adoption of IFRSs, of measuring, in the separate financial statements of a parent, the cost of an investment in a subsidiary in accordance with IAS 27 *Consolidated and Separate Financial Statements*. These difficulties result from practices under previous GAAP that were inconsistent with those required by IAS 27 (such as determining the carrying amount of the subsidiary by reference to the nominal value of shares issued to acquire the subsidiary). In these circumstances, some believe it is too difficult or even impossible to restate cost in accordance with IFRSs because the information required may be unavailable or difficult to obtain. Acknowledging those difficulties, the Board proposes to allow a parent to use a deemed cost at the date of transition to IFRSs instead of restating the cost in accordance with IAS 27.

BC3 The Board considered three ways of determining a deemed cost of an investment in a subsidiary at the parent's date of transition to IFRSs. These were:

- the cost of the investment in the subsidiary under previous GAAP (previous GAAP deemed cost)
- the parent's interest in the carrying amount of the subsidiary's assets less liabilities, using the carrying amounts that IFRSs would require in the subsidiary's balance sheet (net asset deemed cost)
- the fair value of the investment (fair value deemed cost).

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BC4 The Board decided that the net asset deemed cost would provide relevant information to users about the subsidiary's financial position at the date of transition to IFRSs and would be relatively easy for an entity to determine. Conversely, the fair value deemed cost would provide information about the underlying market value of a subsidiary at the date of transition to IFRSs, but might be more costly and difficult to determine. In some situations, the cost of an investment in a subsidiary determined in accordance with an entity's previous GAAP bore little resemblance to cost in accordance with IAS 27. Therefore, the Board rejected the use of a deemed cost based on the previous GAAP cost because it would provide less useful information than the other two methods proposed. As a result, the Board proposes to allow preparers a choice between the net asset deemed cost and the fair value deemed cost.

Post-transition distributions

BC5 The cost method in IAS 27 requires a parent to recognise distributions received from the pre-acquisition accumulated profits of a subsidiary as a reduction in the cost of the investment. If the parent acquired a subsidiary before the parent's date of transition to IFRSs, the parent might need to know the subsidiary's pre-acquisition accumulated profits under IFRSs for the purpose of the cost method.

BC6 Restating the pre-acquisition accumulated profits would be a task tantamount to restating the business combination (for which IFRS 1 provides an exemption in paragraph 15 and Appendix B). It might involve subjective, and potentially selective, use of hindsight, which would diminish the relevance and reliability of the information. In many circumstances, the restatement would be time-consuming and difficult. In some circumstances it would be impossible (because it would involve making judgements about the fair values of the assets and liabilities of a subsidiary at the acquisition date).

BC7 Having considered these difficulties, the Board proposes to provide an exception on transition to IFRSs from restating the accumulated profits of the subsidiary at the date of acquisition for the purpose of applying the cost method. The form of the exception depends on whether the parent used the proposed exemption from restating the cost of the investment on first-time adoption.

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BC8 If the parent uses the proposed exception from restating the cost of an investment in a subsidiary, the Board proposes that the accumulated profits of that subsidiary at the parent's date of transition should be deemed to be the pre-acquisition accumulated profits for the purpose of applying the cost method in IAS 27. This approach prevents a parent from recognising the subsidiary's profits that were earned after its acquisition, but before the parent's transition to IFRSs, twice—once on restating the investment in the subsidiary to deemed cost (measuring the deemed cost using either the net assets or the fair value of the subsidiary) and again in income (when distributions from the subsidiary were received).

BC9 If the parent did not use the exemption from restating the cost of the investment in a subsidiary, the Board proposes that a parent can determine the pre-acquisition accumulated profits of the subsidiary using IFRSs or using the pre-acquisition accumulated profits under the previous GAAP for the purpose of the cost method. The Board believes that using the previous GAAP accumulated profits would, in most circumstances, not result in a different treatment of distributions received by the parent after its transition to IFRSs.

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