

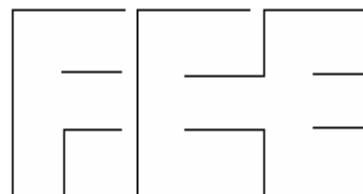
Date  
17 April 2007

Le Président

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Mr. Stig Enevoldsen  
Chairman  
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commentletter@efrag.org

Dear Mr. Enevoldsen,

Re: EFRAG draft comment letter to IASB on ED of Proposed amendments to IFRS 1 First-time Adoption of IFRS: Cost of an Investment in a Subsidiary

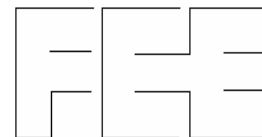
1. FEE (Fédération des Experts Comptables Européens, European Federation of Accountants) welcomes the support expressed by EFRAG for the ED constituting relief from certain requirements of IAS 27 "Consolidated and Separate Financial Statements" on first-time adoption of IFRS, in particular in circumstances where it can be burdensome to determine the cost amount for an investment in a subsidiary. We appreciate the Board's proposals to grant some relief from particular requirements of IAS 27 in the first separate financial statements of a parent. We also welcome the proposal to provide relief from restating the subsidiary's accumulated profits at the acquisition date in accordance with IFRS.
2. Even though we agree that the choice of the two methods proposed to arrive at deemed cost is valid, we still consider that in certain circumstances both of them will be unattractive or unworkable and would prefer to ask the Board to reconsider the possibility to allow the use of "previous GAAP" (explicitly including equity accounting) as deemed cost as set out below.

#### 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 the fair value, at that date. Is this appropriate? If not, why?*

3. We support the remarks provided on equity accounting. We would however have preferred that EFRAG would argue for using "previous GAAP" as deemed cost.
  - (i) Determining the fair value of an unlisted company is often difficult and highly subjective and could lead to a wide range of values. Furthermore, IAS 39 specifically acknowledges this fact by providing relief from marking fair value unlisted investments. This alternative is therefore not always workable.
  - (ii) On the other hand, BC1 of the proposed amendment states that a reason for the Board to reject the previous GAAP carrying amount as an alternative for deemed cost was that this



amount might be low as it is based on the nominal value of shares issued. This is true in some cases but in many other examples the carrying amount will be similar to the fair value at the date of investment even if this amount has not been reduced by dividends received out of pre-acquisition profits. Determining what would be the net assets/liabilities value under IFRS at the subsidiary level will sometimes require additional and specific work as this value will not equal the subsidiary's contribution to the group consolidated financial statements. It is thus questionable whether requiring a restatement in these circumstances is justified on cost benefit grounds. Allowing the previous GAAP carrying amount as an alternative for deemed cost should not lead to such vastly different amounts as to be unacceptable. In the case where the previous GAAP carrying amount resembles 'cost' with the exception of application of the equity method although not calculated in accordance with IAS 27, the criticism expressed in paragraph BC4 will therefore not apply. Where the net assets in the parent separate financial statements will reduce when the deemed cost method is applied for the investments in subsidiaries, this approach is likely to be unattractive in the context of some territories' legal and regulatory environments, outweighing its relative simplicity. We therefore suggest a modification of the proposals, such that where using the net asset basis leads to a reduction in the net assets of the parent, deemed cost may instead be determined by reference to previous GAAP (subject to testing for impairment). The effect of this is that deemed cost will be the higher of the previous GAAP and net asset basis. This will allow preparers the convenience of a simplified approach in many circumstances, but only where the problem of the 'double credit', identified by the Board in paragraph BC8, cannot arise.

4. We suggest that EFRAG will make an additional comment to support the use of previous GAAP as deemed cost. According to IG31A, if the subsidiary is also a parent, the assets and liabilities referred to in ED IFRS 1.B5 are the assets and liabilities of the group of which the subsidiary is the parent. This seems to imply that in this case it is always the assets and liabilities of the group of which the subsidiary is the parent that have to be used, even if the subsidiary does not prepare consolidated financial statements.
5. We support the clarification request by EFRAG in relation to paragraph 5B(a).

### 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.*

*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 not?*

6. We prefer to use "previous GAAP" as deemed cost. In this case, there is no need for a correction of the distributions of a subsidiary. If the solution to use "previous GAAP" would not be acceptable, then the same option of deducting distributions should be made available for both fair value and not fair value of assets and liabilities under IFRS.
7. Furthermore, it may be helpful to observe in the EFRAG letter that, where deemed cost is used, paragraph B6(a) requires pre-acquisition profits to be reset to the accumulated balance at the date of transition. This is illustrated in IG Example 9B where a subsidiary that was able to distribute 450 of post acquisition profits (800 less 350), is restricted to post acquisition profits of 100 (750 less 650) by using the deemed cost option.

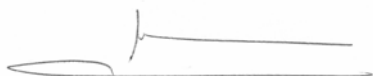
8. The underlying principle of the rule about dividends in IAS 27 is that a receipt which is in the nature of a return of capital should be deducted from the cost of investment. This is an economic concept that has nothing to do with the adoption of any particular accounting framework by the subsidiary. The reference to 'profits' in IAS 27 is therefore inappropriate and certainly should not be restricted to profits computed in accordance with IFRSs. If the Board wishes to retain the substance of the existing requirement it should express it in terms of whether the receipt is in the nature of a return of capital rather than linking it to profits.

Other

9. We suggest that paragraph B6(a) should be amended, such that when applying deemed cost in accordance with paragraph B5, a parent need not treat the subsidiary's accumulated profits under IFRSs as pre-acquisition profits when the application of the IFRS net asset value method reduces the carrying value of the investment on transition. The effect of this amendment would be that the deemed cost is the higher of the previous GAAP carrying amount and the IFRS net asset value.
10. Another comment that could be considered to be included in the EFRAG letter is a suggestion that the proposals in the Exposure Draft apply also to associates and jointly controlled entities. IFRS 1(B3) states that the exemption for past business combinations also applies to past acquisitions of investments in associates and of interests in joint ventures and it should be made clear that this extends to the new paragraphs B4 to B6.

We would be pleased to discuss any aspect of this letter you may wish to raise with us.

Yours sincerely,



Jacques Potdevin  
President