EFRAG

European Financial Reporting Advisory Group

XX April 2007

IFRS 1 Amendments
Jeff Singleton
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UK

DRAFT COMMENT LETTER
Comments should be sent to Commentletter@efrag.org by 19 April 2007

Dear Sir

Re: Exposure Draft of Proposed Amendments to IFRS 1 *First-Time Adoption of International Financial Reporting Standards: Cost of an Investment in a Subsidiary*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft of Proposed Amendments to IFRS 1 *First-Time Adoption of International Financial Reporting Standards: Cost of an Investment in a Subsidiary* (the ED). This letter is submitted in EFRAG's capacity of contributing to the IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive IFRS.

EFRAG supports the proposal in the ED to grant some relief from certain of the requirements in IAS 27 *Consolidated and Separate Financial Statements* on first-time adoption of IFRS. The proposed reliefs relate to IAS 27's requirement that parents shall measure their investments in subsidiaries at cost or fair value. There are circumstances in which it can be burdensome to determine this cost amount—particularly if under national GAAP the carrying amount of the subsidiary has been measured in a manner that is not in accordance with IAS 27—and EFRAG understands that this is making some companies reluctant to adopt IFRS.

Furthermore we welcome the proposal to amend IFRS 1 by providing relief from restating the subsidiary's accumulated profits at the acquisition date in accordance with IFRSs. This requirement is also causing problems for parents that have not under previous national GAAP been required to distinguish between pre- and post-acquisition profit.

Our detailed answers to the questions are stated in the attached note.

If you would like further clarification of the points raised in this letter, Charlotte Norre or I would be happy to discuss these further with you.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

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?

1 We agree that some relief should be granted from the existing requirements in IFRS 1 that apply when a first-time adopter is determining the cost of an investment in a subsidiary in accordance with IAS 27.

2 We also agree with the IASB that an appropriate form of relief would be to allow a parent at its date of transition to IFRSs to use as the deemed cost of an investment in a subsidiary either the transition date carrying amount of the net assets of the subsidiary or the transition date fair value.

We note that that the IASB considered a third possibility—that the deemed cost should be the cost as calculated under previous GAAP—and concluded that in some situations that number would bear little resemblance to cost calculated in accordance with IAS 27 and would also provide less useful information that two methods proposed in the ED. However, as far as we can tell from the Basis for Conclusions, the IASB has not considered an approach that is commonly used in some jurisdictions: equity accounting. In some jurisdictions in Europe the required practice is for parent entities to use equity accounting to account for their subsidiaries in their own financial statements. Although such accounting is no longer permitted under IFRS, we think that it can provide information that is as useful as the two methods proposed in the ED and therefore merits further consideration as a possible third form of relief.

3 On a more detailed level, we think that some clarification is needed in respect to paragraph 5B(a). In particular, clarification would be helpful on which IFRS amounts should be used by the parent entity when determining the deemed cost of its investment in the subsidiary in accordance with the ED. Paragraph 5B(a) requires that, when using net assets as deemed cost, the deemed cost is to be determined as 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." We believe that clarification is needed because IFRS 1 paragraph 24 permits a subsidiary that adopts IFRSs *later* than its parent to measure its assets and liabilities at either:

(i) the amounts included in the parent's consolidated financial statements, based on the parent's date of transition to IFRS (excluding any effects arising from consolidation adjustments such as accounting policy adjustments and the business combination in which the parent acquired the subsidiary); or

(ii) the carrying amounts required by IFRSs based on the subsidiary's own date of transition to IFRSs.

Because of IFRS 1 paragraph 24, the carrying amounts that IFRSs would require by the subsidiary entity may depend on:

(i) the date of transition to IFRSs for, respectively, the parent's consolidated financial statements and the subsidiary's financial statements; and

(ii) consolidation adjustments such as accounting policy adjustments, in the event that the subsidiary chooses accounting policies that differ from those selected by the parent entity in its consolidated financial statements.

Further, in our view example 9A seems to imply that there is only one set of IFRS numbers that could pertain to the subsidiary entity. However, and as explained above, this is not necessarily always the case. We think it would be helpful if example 9A (IG) could also clarify this point and illustrate which IFRS numbers should in fact be used i.e. how the choice available in IFRS 1 paragraph 24 might have an effect, if any, on the "carrying amounts" as described in 5B(a).

4 When the parent entity adopts IFRS later than its subsidiary entity, IFRS 1 paragraph 25 does not permit a choice, and the consolidated financial statements of the parent must measure the net assets of the subsidiary, after adjusting for the effects of consolidation procedures and business combinations. We think it would be helpful if paragraph 5B(a) of the ED would clarify whether the carrying amounts that IFRS would require, exclude any effects arising from consolidation adjustments such as accounting policy adjustments and the business combination i.e. whether the measurement is determined on a "separate" or a "consolidated" basis.

5 We believe that the above examples in 3 and 4 illustrate that this issue is not as straightforward as it might at first seem and that, as a result, clarification as to what "carrying amounts" mean should be provided in the form of implementation guidance or by expanding the defined terms in Appendix A of IFRS 1.

6 Finally, we wonder whether it might be more appropriate to position the proposed amendment to IFRS 1 in the standard section near to the material to which it is closely related (the material in paragraphs 24 and 25 on 'Assets and liabilities of subsidiaries, associates and joint ventures') rather than in Appendix B.

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?

7 It is proposed in the ED (paragraph B6(a)) that, when a parent takes advantage of one of the reliefs discussed in question 1 when measuring an investment in a subsidiary, that parent shall treat that subsidiary's accumulated profits under IFRSs at the date of transition to IFRSs as the pre-acquisition accumulated profits. EFRAG agrees that relief in this area is needed. It also agrees with the relief proposed.

8 It is proposed in paragraph B6(b) that a parent that is not taking advantage of the relief discussed in question 1 shall for all other subsidiaries either determine the pre-acquisition accumulated profits of each subsidiary in accordance with IFRSs or treat the pre-acquisition accumulated profits of each subsidiary under previous GAAP as the pre-acquisition accumulated profits under IFRSs.

(i) We agree that relief should be available to parents that do not need the relief discussed in question 1 but have difficulties determining whether the distributions from a subsidiary that were received by the parent after adopting IFRSs were income or a return of the original investment.

(ii) We also agree with the relief proposed. We note that the effect of the relief proposed under paragraph 6B(b)(ii) will sometimes be to allow the entity to treat as income distributions paid out of what could be pre-acquisition under IFRS. That is not ideal, but we accept that such issues can arise when relief of this kind is given.