

IFRS Briefing Sheet

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

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This IFRS Briefing Sheet summarises the International Accounting Standards Board's (IASB) Exposure Draft (ED) of *Proposed Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards – Cost of an Investment in a Subsidiary*, which was published on 25 January 2007.

This ED proposes that a parent entity that is a first-time adopter of International Financial Reporting Standards (IFRSs) be permitted, but not required, to measure the cost of its investments in subsidiaries at a "deemed cost" in its separate financial statements rather than determining cost under IFRSs.

Background and Issue

Under IAS 27 *Consolidated and Separate Financial Statements* a parent is required to account in its separate financial statements for investments in subsidiaries either at cost, or at fair value under IAS 39 *Financial Instruments: Recognition and Measurement*.

IFRS 1 provides an exemption from restating business combinations that occurred before the date of transition

to IFRSs. However, this exemption does not apply to establishing the cost of investments in subsidiaries in the separate IFRS financial statements of a parent.

In certain jurisdictions difficulties arise in the transition to IFRSs and the restatement of the cost of investments in subsidiaries, because of practices under previous GAAP that are inconsistent with the requirements of IAS 27. For example, in certain jurisdictions the carrying amount of a subsidiary under previous GAAP was determined by reference to the nominal value of the shares issued to acquire the subsidiary; in such cases it may be difficult for a parent to restate the cost of its investments under IFRSs if the necessary information is not readily available.

In addition, if the parent accounts for an investment in a subsidiary using the cost method under IAS 27, then it is required to recognise distributions received from pre-acquisition accumulated profits of the subsidiary as a reduction in the cost of its investment. If the subsidiary was acquired by the parent prior to the parent's date of transition to IFRSs, then this may require the parent to determine the subsidiary's pre-acquisition accumulated profits under IFRSs for the purposes of applying the cost method.

A supplement to KPMG's publication IFRS in Brief

As a result of these difficulties, the IASB has proposed amendments to IFRS 1 to allow first-time adopters relief from particular requirements of IAS 27 in the separate financial statements of a parent.

Proposed Amendments

Cost of an Investment in a Subsidiary

The ED proposes to amend IFRS 1 to allow a parent, at its date of transition, to measure the cost of its investment in a subsidiary under IAS 27 at a deemed cost. Deemed cost would be determined using either:

- the parent's interest in the carrying amount of the net assets of the subsidiary, based on the carrying amounts in the subsidiary's IFRS balance sheet (net assets under IFRSs); or
- the fair value of the parent's investment in the subsidiary.

If the parent has more than one subsidiary, then it would be able to choose whether to use the deemed cost exemption, and which exemption to use, on a subsidiary by subsidiary basis.

The ED also proposes that if the subsidiary is itself a parent, then the net assets under IFRSs of the

subsidiary would be the assets and liabilities of the group of which the subsidiary is a parent, i.e., the amounts in the sub-consolidated financial statements of the subsidiary.

Post-transition Distributions

If a parent elects to use the deemed cost exemption from restating the cost of its investment in a subsidiary, then the IASB proposes that, at the date of transition to IFRSs, the subsidiary's accumulated profits under IFRSs be treated as pre-acquisition accumulated profits. Therefore dividends received by the parent from the transition date reserves of the subsidiary would be deducted by the parent from the cost of its investment.

If the parent does not use the exemption from restating the cost of an investment in a subsidiary, then the IASB proposes that, for the purpose of applying the cost method, the parent either:

- determines the pre-acquisition accumulated profits of the subsidiary under IFRSs; or
- treats the pre-acquisition accumulated profits of the subsidiary under previous GAAP as the pre-acquisition accumulated profits under IFRSs.

Effective Date

The ED does not propose an effective date, but does propose to permit early adoption of the final standard.

Response to IASB

The IASB has invited comments on the proposals in the ED by 27 April 2007.

If you would like further information on any of the matters discussed in this issue of *IFRS Briefing Sheet*, please talk to your usual local KPMG contact or call any of KPMG firms' offices.

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