

30 Cannon Street, London EC4M 6XH, United Kingdom
Phone: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: <http://www.iasb.org>

**International
Accounting Standards
Board**

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: 22 September 2006, London

Project: Cost of an investment in a subsidiary in the separate financial statements of a parent on first time adoption of IFRSs

Subject: Proposed relief (Agenda Paper 16)

1. At the May 2006 meeting, the staff presented several alternative methods of relief from restating the cost of an investment in a subsidiary in accordance with IAS 27 *Consolidated and Separate Financial Statements* on first time adoption of IFRSs.
2. At that meeting, the Board directed the staff to analyse one of those methods further. The purpose of this paper is to present the results of this analysis.

Staff Recommendation

3. The staff recommends that IFRS 1 *First-time Adoption of International Financial Reporting Standards* be amended to allow:
- a parent to use either:
 - the carrying amount of the net assets of a subsidiary (in accordance with IFRSs); or
 - the fair value of a subsidiary at the date of the parent's transition to IFRSs;
as the deemed cost for the investment in the subsidiary in the separate financial statements of the parent on transition to IFRSs.
 - that, if a parent applies the relief from restating the cost of an investment in a subsidiary in accordance with IAS 27 on transition to IFRSs, the accumulated profits of the subsidiary at that date are deemed to be pre-acquisition profits for the purposes of the cost method in IAS 27.
 - that, if a parent does not use the relief from restating the cost of an investment in a subsidiary in accordance with IAS 27 on transition to IFRSs, the pre-acquisition accumulated profits of the subsidiary under the previous national GAAP at that date are deemed to be the pre-acquisition profits for the purpose of IAS 27.

COST OF AN INVESTMENT IN A SUBSIDIARY ON TRANSITION TO IFRSs

Background

4. Constituents argue that, in some circumstances, it is difficult to measure the cost of an investment in a subsidiary in accordance with IAS 27 *Consolidated and Separate Financial Statements* on first time adoption of IFRSs.
5. Some entities adopting IFRSs may have measured the cost of an investment in a subsidiary under their previous national GAAP in a manner that is not in accordance with IAS 27.
6. Constituents have highlighted difficulties measuring the cost of an investment in a subsidiary in accordance with IAS 27 on first time adoption of IFRSs. Difficulty arises in situations where the value of the consideration paid can only be determined with reference to the value of the entity acquired. For example, if an entity issues unlisted shares to obtain 100% of the share capital of another entity, the value of the consideration would be determined with reference to the value of the acquired entity.
7. In these circumstances, when a method of accounting other than the purchase method in accordance with IFRS 3 *Business Combinations* has been used under national GAAP, a parent would have to reconstruct the business combination using the purchase method in order to determine cost on adoption of IFRSs.
8. In addition to difficulties in measuring the initial cost of an investment in a subsidiary, constituents have highlighted difficulties in determining the cost of an investment in a subsidiary on first time adoption when dividends have been paid since acquisition. IAS 27 requires that 'dividends' received by a parent from a subsidiary are assessed to determine whether they relate to the pre- or post- acquisition profits of the subsidiary. Under IAS 27, a distribution received by a parent from the pre-acquisition profits of a subsidiary is credited to the investment in the subsidiary and not recognised as income.
9. In some jurisdictions, prior to the transition to IFRSs, there was no requirement under national GAAP to assess whether distributions were received from the pre- or post-acquisition profits of a subsidiary. In these

jurisdictions, at the date of transition to IFRSs, a parent entity would need to reassess every distribution received from its subsidiaries to determine whether they were a return on the amount invested (income) or a return of the amount invested (and hence deducted from the cost of the investment in the subsidiary).¹

10. At its March 2006 meeting, the Board added a project to its technical agenda to consider issues relating to measuring the cost of an investment in a subsidiary in the separate financial statements of a parent on first time adoption of IFRSs.
11. Subsequently, at the May 2006 meeting, the Board directed the staff to analyse a potential method of relief (the ‘proposed relief’) from the requirement to restate the cost of the investment in a subsidiary in accordance with IAS 27. The proposed relief permits a parent to use a deemed cost for its investments in subsidiaries instead of restating cost in accordance with IAS 27. This deemed cost is to be calculated by reference to the underlying IFRSs-compliant net asset position at the date of transition.^{2,3}
12. The proposed relief would be provided by way of an exemption in IFRS 1.

¹ In assessing every distribution, the distributions immediately post-acquisition would be the most important as there is greater likelihood that they could be from pre-acquisition profits. From a record keeping point of view, these distributions would be more difficult to determine as considerable time may have passed since acquisition.

² The ‘date of transition’ refers to the parent’s date of transition to IFRSs.

³ Reference to the net assets of the subsidiary is defined as the IFRS-compliant statement of financial position of the subsidiary (or IFRS-compliant consolidated statement of financial position of its group if the subsidiary itself has subsidiaries). It does not include any push down accounting of goodwill that occurs under some other GAAPs.

Staff Analysis of the Proposed Relief

More useful information

13. The proposed relief provides users with information that is reflective of the financial position of the subsidiary at the date of transition. By aligning the cost of the investment in a subsidiary with its underlying net asset position (determined in compliance with IFRSs), the information available would be more relevant to users than historical cost as it is more current.⁴

Ease of application

14. The proposed relief is easy to apply in most circumstances as the information required is readily available (since it is required in order to prepare the consolidated financial statements). Constituents suggest that there may be significant effort in preparing sub-group consolidations to determine the underlying net asset position of a subsidiary (which itself is a parent with subsidiaries) at the date of transition. Whilst the staff acknowledge that there may be an additional burden in some circumstances, the task of preparing sub-group consolidations would be possible.

Goodwill

15. The proposed relief does not consider goodwill (or purchase price premium) in its design. As a result, using the relief as proposed, some parents may have to write down their investment in a subsidiary on transition to IFRSs. This may have significantly adverse effects from a taxation or legal view primarily associated with the distribution of dividends (or ability to distribute dividends).

⁴ The staff notes that in some circumstances, the historical purchase price will be relevant to users as they may wish to assess the level of returns on the original investment.

Consider an example where under national GAAP, a parent had purchased 100% of a subsidiary in X1 for CU180 which included goodwill of CU80 (hence, the net assets of the subsidiary at this time were CU100). In years X2 and X3, the subsidiary makes profit of CU25 in each year; this profit is not distributed to the parent.

Using the relief as proposed, on transition to IFRSs, the parent would restate the cost of the subsidiary to CU150. This would create a debit to accumulated profits of CU30 in the separate financial statements of the parent. Further, if the subsidiary distributed the profits it recorded post-acquisition but pre-transition (2 years x CU25 or CU50) to the parent, this distribution may be recognised against the cost of investment and not as income.⁵ This result is contrary to the aim of the relief which to provide a relatively neutral impact for those parents using it.

16. It could be argued that for a scenario in which goodwill is known, the parent must know the initial cost. However, as discussed in ‘Background’ above, in many circumstances, whilst the initial cost is known, the adjustments to that amount (historical cost) as a result of distributions are unable to be determined.
17. Consider a parent that acquired a subsidiary 15 years ago that had paid out its profits in dividends to the parent at the end of each year. If this parent was unable to use a form of relief, it would be required to retrospectively assess each distribution as to whether it was income or a return of the amount invested at the time it was received. In order to do this, the parent would need to restate the acquisition balance sheet of its subsidiary at the date of transition under IFRSs to determine the pre-acquisition profits of the subsidiary (see discussion on *Post-transition distributions* commencing at paragraph 35). Only then would a parent be able to determine whether the distributions it received had been from the pre- or post-acquisition profits of the subsidiary.
18. Even if a parent did not have to restate pre-acquisition profits (ie, if a form of relief was granted to deem these profits on transition in some manner), the task of reassessing the distributions over the life of the subsidiary may be considerable for some parents. For example, in the UK, the FTSE 100 companies have approximately 40,000 subsidiary entities. Some of these entities could conceivably be over 50 years old. The reconstruction of

⁵ The distribution to the parent would reduce the net assets of the subsidiary which could result in impairment.

distribution data for the sake of transition has been described by some constituents as onerous and providing no gain in information. The staff have been told that this issue is the main reason that these companies have not adopted IFRSs for subsidiaries and separate financial statements of parent entities.

Should historic goodwill be included in the restated amount?

19. The staff considered that a solution to the issue described above would be to include the historical goodwill amount in the deemed cost of an investment in a subsidiary on transition to IFRSs. If the historic goodwill amount (not an amortised amount) was added to the net assets when the parent restated the subsidiary on transition, the purchase premium (goodwill) would be taken into account (appropriately) when the re-measurement occurred.

Using the example above, if the goodwill was included when the parent restated the subsidiary, the value would be increased to CU230 (being CU150 of net assets and CU80 of historic goodwill). This would create a CU50 credit to accumulated profits in the separate financial statements of the parent. By increasing the accumulated profits of the parent by CU50 when the cost of the investment in the subsidiary was restated, the parent's financial statements are increased by an amount equal to the accumulated post-acquisition profits of the subsidiary.

20. However, discussions with constituents highlight that it may not be possible to identify the goodwill of each subsidiary. In situations where group re-organisations have been completed since the original acquisition, the goodwill that is applicable to each subsidiary may not have been reallocated.

Staff Analysis - Other options considered

21. Given the issues with the proposed relief analysed above, the staff are presenting, for the Boards consideration, two other options for relief (which have previously been considered and rejected by the Board).

National GAAP cost

22. Retaining the national GAAP cost of an investment in a subsidiary on transition to IFRSs is the simplest option to the issues faced by constituents. It is also consistent with the exemption provided to restating business combinations in IFRS 1 at present. That is to say, it relieves the entity from having to recreate data at the date of acquisition and transition.
23. This option is likely to result in a measured cost that has low information content, particularly where nominal values were used to measure cost. For example, in situations where merger relief has been used, the cost under previous national GAAP represents a nominal amount relating to the number of shares issued as consideration for the acquisition of a subsidiary. This amount holds little information value to users.
24. Whilst more useful information could be obtained by other methods of relief, constituents argue that unless these methods have an on-going re-measurement requirement, it is difficult to see the usefulness of this information to users of future financial statements (as the amounts will lose their relevance in the same way as historical cost).
25. The Board has previously rejected a proposal to use a relief based on national GAAP. Given the complications that have been highlighted in the analysis of the proposed relief, the staff believe this option is worth reconsidering. As this option uses the previous national GAAP amounts, it is unlikely to create any legal or tax difficulties and would be readily accepted by constituents.

Fair value

26. Recording the cost of a subsidiary at fair value is already one of the permitted measurement bases in IAS 27. The staff have considered the possibility of using the fair value of a subsidiary at the date of the parent's transition to IFRSs as a deemed cost. This was the method preferred by some Board members originally.
27. Using this method, the parent would not be required to fair value the subsidiary at each reporting date subsequent to the date of transition to IFRSs. Subsequent to the transition to IFRSs, the parent would apply the cost method, in accordance with IAS 27, to account for the investment in the subsidiary. The staff believe the on-going requirement for re-measurement was perceived by most constituents as a burden (ie the reason why they did not wish to use the IAS 27 fair value option). However, giving constituents the choice of using fair value as the deemed cost without subsequent ongoing re-measurement at fair value is expected to have greater appeal.
28. This method of relief (the 'fair value' relief) would provide information about the underlying market value of a subsidiary at the date of transition to IFRSs. The staff believe that this information would be more useful to users than historical cost or restated cost amounts based on net assets of the subsidiary as the information represents a measure of the economic value of the investment. It is anticipated that there will be 'one off' costs (staff time, external resources required) and difficulties (valuation complexities, re-creation of data, subjective estimations) of applying the fair value relief. Some constituents may believe that these costs outweigh the expected benefits (particularly in structures where the subsidiary itself has one or more subsidiaries and other assets and liabilities that are not traded in active markets). They may also consider fair value information regarding subsidiaries to be sensitive and as such, they may be adverse to using this method.
29. The staff believe that requiring a parent to fair value each subsidiary could be a disincentive from adopting IFRSs. Whilst the data would be relevant and useful to users, a parent entity would need to create, as a minimum, a discounted cash flow model for each subsidiary (and its group). For some

entities, this could be a difficult task as it would involve making assessments and judgements of the cash flows of the group, calculating risk rates, determining the current market demand, etc. In some instances, using a fair value exposes a parent entity to increased volatility as a reduction in the fair value of a subsidiary subsequent to the date of transition may result in impairment.

Staff recommendation

30. Using a deemed cost based on the previous national GAAP cost would be the most straightforward option for entities to apply as the deemed cost would be the same as that used prior to a parent's transition to IFRSs. However, the relevance of this amount may be doubtful as it may be based on a nominal amount or other amount that is not relevant or compliant with the measurement bases in IAS 27 (historical cost, fair value).
31. Conversely, using a deemed cost based on the fair value of the subsidiary at the date of transition would provide current market based information at that date but may be costly and difficult (as discussed in paragraph 28-29).
32. The proposed relief which aligns the cost of an investment in a subsidiary with its underlying net asset position (the 'net asset' relief) provides understandable and reliable information with (relatively) minor difficulty. However, the issues regarding goodwill could result in constituents choosing not to adopt IFRSs due to unfavourable taxation and legal outcomes.

33. Based on its analysis, the staff recommends that the ‘net asset’ relief is adopted but that an option is provided for parents to use the fair value relief. Accordingly, the staff recommends that IFRS 1 *First-time Adoption of International Financial Reporting Standards* be amended to allow a parent to use either:
- the carrying amount of the net assets of a subsidiary (in accordance with IFRSs) or
 - the fair value of a subsidiary at the date of the parent’s transition to IFRSs;
- as the deemed cost for the investment in the subsidiary in the separate financial statements of the parent on transition to IFRSs.
34. **Does the Board agree?**

POST-TRANSITION DISTRIBUTIONS

35. This section discusses an issue that is related to the relief from restating the cost of an investment in a subsidiary. However, it is not a continuation of the previous discussion.

Background

36. Even if an entity applied the relief which allows for a subsidiary to be carried at deemed cost, there would be difficulty in 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.

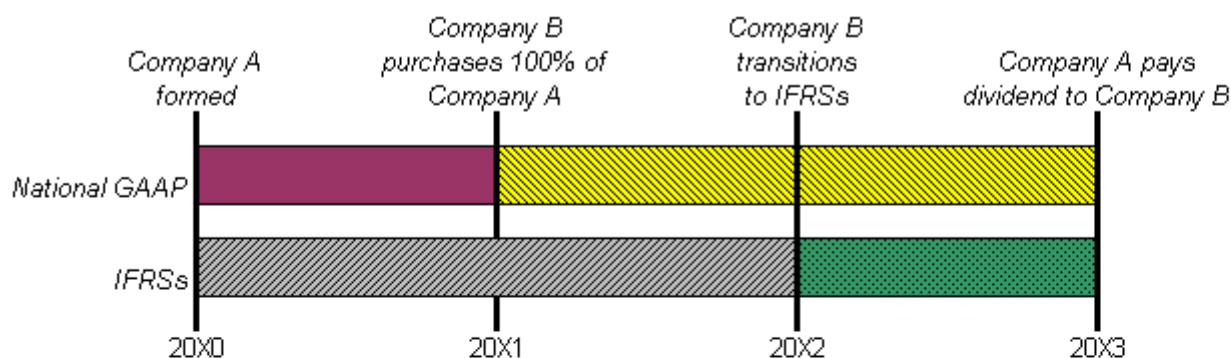
Difficulties in determining whether distributions are from the pre- or post-acquisition accumulated profits of a subsidiary after a parent has adopted IFRSs



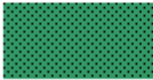
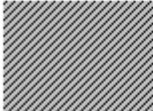
37. Parent entities that adopt IFRSs will need to comply with the requirements of IAS 27 when accounting for distributions they receive from subsidiaries. The cost method in IAS 27 paragraph 4 states that an 'investor recognises income from the investment only to the extent that the investor receives distributions from accumulated profits of the investee arising after the date of acquisition. Distributions in excess of such profits are regarded as a recovery of the investment and are recognised as a reduction of the cost of the investment (emphasis added)'.
38. Therefore, in order to determine how to treat distributions received from a subsidiary, the parent entity needs to know the accumulated profits of the subsidiary earned before the subsidiary was acquired (the 'pre-acquisition' profits) and after (the 'post-acquisition' profits).

39. Subsidiaries that were acquired prior to their parent's transition to IFRSs would (in most cases) have their profits calculated using the previous national GAAP. Once a parent has adopted IFRSs, these profits (both pre- and post-acquisition) would need to be recalculated in accordance with IFRSs. This is required in order for a parent to comply with the requirements of IAS 27.4 when a distribution has been received from a subsidiary (ie to determine which distributions had been received from pre- or post-acquisition profits).

Consider the following scenario in relation to Company A and Company B. Company A was formed in 20X0 and purchased by Company B in 20X1. In 20X2, Company B adopted IFRSs for the first time. At this stage it restated its statement of financial position and the statement of financial position of Company A. An IFRSs transition adjustment was made at this time that reduced Company A's accumulated profits. In 20X3, Company A paid a dividend to Company B equivalent to its entire IFRSs accumulated profits. In order to assess which parts of this distribution were a return on the amount invested (income) or a return of the amount invested (as required by IAS 27.4), Company B would need to restate Company A's pre-acquisition accumulated profits in accordance with IFRSs.

40. This scenario is represented by the diagram below.



-  = the period before acquisition. Any profits earned in this period are pre-acquisition profits and treated by the parent as a return of the amount invested if distributed
-  = the period after acquisition. Any profits earned in this period are post-acquisition profits and treated by the parent as income if distributed
-  = the period post-transition to IFRS. Any profits earned in this period are post-acquisition profits and are treated by the parent as income if distributed
-  = the period pre-transition to IFRSs. In order to determine the split between pre- and post-acquisition profits in this period, the parent would have to recalculate the national GAAP pre-acquisition accumulated profits using IFRSs.

41. Recalculating pre- and post-acquisition profits to be compliant with IFRSs would be a task tantamount to restating the business combination (for which there is an exemption in IFRS 1). This is because a parent would need to recreate the IFRSs statement of financial position at the date of acquisition in order to determine pre-acquisition profits. This task may involve subjective, and potentially selective, use of hindsight that would diminish the relevance and reliability of the information. In many circumstances, this would be a time consuming and difficult process and in some cases it would be impossible (as it would involve making judgements about the fair values of the assets and liabilities of a subsidiary at the time of acquisition).
42. Due to the difficulties involved in recalculating these profits, the Board directed the staff to explore the impact of providing relief that removes the

difficulties in determining the split between pre- and post-acquisition accumulated profits.⁶

Staff analysis

43. The staff explored various methods of relief from having to restate the pre- and post-acquisition accumulated profits of a subsidiary for the purposes of the cost method of IAS 27. The staff believe that the most effective method of relief would be an amendment to IFRS 1. By providing relief in this manner, the application of IAS 27 would not be affected.⁷

Deeming pre- and post-acquisition accumulated profits on transition to IFRSs

44. On transition to IFRSs, the split (or dividing line) between pre- or post-acquisition accumulated profits could be determined with reference to a rule. The staff explored three rules that would alleviate the need to recalculate the pre- and post-acquisition accumulated profits of a subsidiary on transition to IFRSs. These were to:
- Deem all accumulated profits (ie IFRS-compliant profits) of a subsidiary at the date of transition to be pre-acquisition;
 - Deem all accumulated profits (ie IFRS-compliant profits) of a subsidiary at the date of transition to be post-acquisition;
 - Roll over the pre-acquisition profits from the previous national GAAP on transition.⁸

⁶ This relief would only be available in respect of post-transition distributions from subsidiaries acquired prior to the parent's transition to IFRSs.

⁷ The staff had considered changing the cost method in IAS 27. However, it was considered to be out of the scope of this project as it will be reviewed as part of the consolidations project.

⁸ The difference between the IFRS-compliant accumulated profits of the subsidiary and the pre-acquisition profits under national GAAP would be the IFRS-compliant post-acquisition profits.

Deem all accumulated profits of a subsidiary to be pre-acquisition on transition

45. Deeming the accumulated profits of a subsidiary as pre-acquisition on transition to IFRSs for the purposes of the cost method in IAS 27 would be the equivalent of resetting the acquisition date of the subsidiary in line with the IFRSs transition date of the parent. The effect of this would be to treat any distributions received by a parent from a subsidiary's accumulated profits earned prior to the parent's transition to IFRSs as a return of the amount invested and a credit to the cost of investment.
46. Whilst this initially seems punitive to any parent that has a subsidiary with accumulated profits earned prior to the transition to IFRSs, it needs to be considered in the broader context.⁹
47. If a parent applied the 'net asset' relief from restating the cost of the investment in accordance with IAS 27 (discussed in 'Cost of an investment in a subsidiary on transition to IFRSs' above in paragraphs 4-34) it will have aligned the cost of the investment in the subsidiary with the subsidiary's net asset position. In many cases, this will result in an increase to the cost of the investment in the subsidiary.¹⁰ This increase to the cost of the investment on transition will create a corresponding credit to the accumulated profits of the parent. The increase in accumulated profits of the parent would be equivalent (broadly) to the profits that were earned post-acquisition by the subsidiary (calculated in accordance with IFRSs) prior to its parent's transition to IFRSs.¹¹

⁹ This rule would prevent distributions from both pre- and post-acquisition accumulated profits earned by the subsidiary prior to the parent's transition to IFRSs being recognised as income.

¹⁰ Continued losses would already have resulted in a write-down of the cost of the investment under national GAAP in most cases.

¹¹ If all post-acquisition profits of the subsidiary had been distributed to the parent, the effect on the parent's accumulated profits would be similar.

48. In some circumstances (such as when merger relief has been used), there may be a credit to the accumulated profits of the parent entity greater than the accumulated profits earned by a subsidiary after acquisition. This anomaly could only be resolved by using the previous national GAAP cost of a subsidiary as a deemed cost (as there would not be a credit to accumulated profits using that method). [Where merger relief was used, a parent was able to record distributions from the pre-acquisition accumulated profits of a subsidiary as income under national GAAP. [Sentences not reproduced in observer notes.]]
49. Deeming the accumulated profits of a subsidiary to be pre-acquisition, for the purposes of the cost method in IAS 27, will also prevent a parent entity from ‘double counting’ the profits of the subsidiary should it use the ‘net asset’ relief. To explain:
- In many cases a parent will recognise an increase to accumulated profits when the cost of the investment in a subsidiary is restated on transition (in accordance with the relief from restating the cost of the investment in a subsidiary in accordance with IAS 27).
 - A further increase to accumulated profits would be recognised if a distribution received from the subsidiary’s pre-transition accumulated profits were to be treated as income. In this scenario, the parent entity would recognise an increase to its accumulated profits twice as a result of the profits earned by a subsidiary post-acquisition but prior to the parent’s transition to IFRSs.

50. This rule is simple to apply and allows a parent to recognise the profits of its subsidiaries without recalculating the split between pre- and post-acquisition profits of the subsidiary. It also prevents potential ‘double counting’ of profits when a parent entity has applied the relief from restating the cost of the investment.
51. The significant disadvantage of this rule is that all distributions received by a subsidiary from pre-transition profits would be recorded as a return of the amount invested in the separate financial statements of a parent.¹² This may mask the true performance in the statement of financial performance of the parent. However, other statements such as the cash flow statement will provide information relevant to users of the parent’s separate financial statements.
52. This rule will have a similar effect if applied in conjunction with the ‘fair value’ relief. However, it would be punitive to first time adopters that had not used relief from restating the cost of an investment in a subsidiary as it would treat all distributions from the pre-transition profits of the subsidiary as a return of the amount invested in the separate financial statements of the parent.

Deem all accumulated profits of a subsidiary to be post-acquisition on transition

53. As an alternative, on transition to IFRSs, the accumulated profits of a subsidiary could be deemed to be post-acquisition for the purposes of the cost method in IAS 27. This would effectively require all distributions of a subsidiary to be recognised as income in the separate financial statements of the parent.
54. This rule would be simple to apply and require minimal cost (staff resources) to implement. However, its major shortfall is that it would allow distributions paid out of what could be pre-acquisition accumulated profits (if the pre-acquisition accumulated profits of the subsidiary had been restated in accordance with IFRSs) to be recognised as income in the statement of financial performance of the parent. The need to perform an impairment test

¹² There is no impact on the amount of accumulated profits available for distribution by the parent (as the parent has the initial credit to accumulated profits resulting from the restatement of the cost of the investment).

on the cost of an investment in a subsidiary would ensure that distributions were not made in excess of the underlying value of the subsidiary.

55. Further, by treating all pre-transition accumulated profits as post-acquisition for the purposes of the cost method in IAS 27, a parent that uses the relief from restating cost may be able to ‘double count’ the profits of the subsidiary (this issue is described in paragraph 49).

Roll over the pre-acquisition profits from the previous national GAAP on transition

56. The staff also considered the possibility of using the amount of pre-acquisition accumulated profits from the previous national GAAP as the pre-acquisition accumulated profits amount in accordance with IFRSs for the purposes of the cost method in IAS 27. This would effectively roll over the pre-acquisition accumulated profits amount from the previous national GAAP.
57. The rule would be simple to apply and have a minimal cost (staff resources) of implementation. Whilst the previous national GAAP pre-acquisition accumulated profits would not always be equivalent to the pre-acquisition accumulated profits calculated in accordance with IFRSs, they should be roughly aligned if the basic accrual accounting underlying the two GAAPs is similar.
58. As with the rule that would deem all pre-transition accumulated profits as post-acquisition (discussed above), this rule may allow a parent to recognise income from distributions received from a subsidiary’s pre-acquisition IFRS-compliant accumulated profits (although to a lesser degree).¹³ Further, it may also allow a parent to ‘double count’ the profits of the subsidiary (this issue is described in paragraph 49) if it had used a form of relief from restating cost (ie ‘net asset’ or ‘fair value’).

Summary of Analysis and Staff Recommendation

59. Of these potential rules, the staff believes that deeming all profits of a subsidiary as pre-acquisition at the date of the parent’s transition to IFRSs

¹³ As the pre-acquisition accumulated profits of the subsidiary had not been restated in accordance with IFRSs, distributions that are post-acquisition under national GAAP may, because of differences in timing of recognition under IFRSs, be made from the pre-acquisition accumulated profits of the subsidiary (calculated in accordance with IFRSs).

would be the best option for parents that have used relief from restating cost. This rule allows a parent to recognise any increase in the value of the subsidiary (either in the net asset or the fair value depending on which method of relief is used) without recalculating the split between pre- and post-acquisition accumulated profits. It also prevents potential ‘double counting’ of profits when a parent entity has applied the relief from restating the cost of the investment in a subsidiary.

60. This was not the case with the two other potential rules (using the national GAAP pre-acquisition accumulated profits and deeming all accumulated profits to be post-acquisition). Each of these rules would allow a parent to record an increase in accumulated profits when applying the relief from restating cost, in addition to allowing pre-transition profits (or part thereof) to be recorded as income. It was for this reason that staff considered these rules were not suitable.
61. The staff believe that where relief from restating cost has not been used, that using the national GAAP pre-acquisition accumulated profits at the date of the parent’s transition to IFRSs would be the best option as it provides a reasonable basis for determining the pre-acquisition profits and does not significantly disadvantage a first-time adopter.

62. The staff recommend that:

- if a parent applies the relief from restating the cost of an investment in a subsidiary in accordance with IAS 27 on transition to IFRSs, the accumulated profits of the subsidiary at that date are deemed to be pre-acquisition profits for the purposes of the cost method in IAS 27.
- if a parent does not use the relief from restating the cost of an investment in a subsidiary in accordance with IAS 27 on transition to IFRSs, the pre-acquisition accumulated profits of the subsidiary under the previous national GAAP at that date are deemed to be the pre-acquisition profits for the purpose of IAS 27.

63. **Does the Board agree?**