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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **21 June 2007, London**

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

Subject: **Comment Letter Summary and Preliminary Planning (Agenda paper 10)**

INTRODUCTION

1. The Board issued its exposure draft [ED] Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards Cost of an Investment in a Subsidiary* in January 2007. The comment period ended on 27 April 2007 and the Board received 47 comment letters.

2. The staff has now reviewed those comment letters. At the June meeting, the staff will ask the Board to consider the main points raised in the comment letters and:

   (a) affirm the project objective;

   (b) approve the initial staff assessment of matters for which the staff:

      (i) will undertake additional research and ask the Boards to reconsider, or

(ii) expect to present to the Board for reaffirmation without additional research; and

(c) approve the staff's provisional project plan for the redeliberations.

3. The paper is divided into two sections:

(a) Confirming the project objective

(b) Provisional project plan

4. Agenda Paper 10A is a summary of the main issues raised by respondents to the ED; it also includes a tabular breakdown of respondents by type and geographic area. The staff will incorporate and expand on the comments in this summary as the specific issues are addressed in redeliberations.

SECTION 1: CONFIRMING THE PROJECT OBJECTIVE

5. The Board's initial objective in issuing the ED was to provide relief to first-time adopters from the IFRS 1 requirement to measure the cost of an investment in a subsidiary in accordance with the guidance established in IAS 27. The proposed relief was granted because the Board believed that, in some cases, the difficulties in determining cost in accordance with IAS 27 exceeded the benefit to users. If the cost/benefit impediment was alleviated, the Board believed preparers would have an increased incentive to use IFRSs in preparing separate (as opposed to consolidated) financial statements.

6. In addition to the challenge described above, entities transitioning to IFRSs are experiencing practical difficulty complying with IAS 27's requirement that dividends received by a parent from a subsidiary must be designated as paid from pre-acquisition profits or post-acquisition profits. To make the designation, a parent may be required 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.

7. To mitigate this issue, the Board expanded the scope of the project to include a simplified approach to determining the pre-acquisition accumulated profits of a subsidiary for the purpose of applying the cost method in IAS 27 at first-time adoption of IFRSs.

8. Most respondents broadly agree with the objective of providing relief to first-time adopters of IFRSs from the requirement to measure the cost of an investment in a subsidiary in accordance with IAS 27. However, very few respondents agree with the substance of the relief in the ED. There are two primary themes to their objections:

   (a) Many respondents would prefer deemed cost to be the carrying amount of the subsidiary calculated in accordance with previous national GAAP either instead of or in conjunction with the relief offered in the ED.

   (b) Respondents are unconvinced by the language in the Basis for Conclusions indicating why previous national GAAP was dismissed as a viable option for deemed cost.

9. Most respondents also agree with the objective of providing first-time adopters of IFRSs with relief from determining the pre-acquisition accumulated profits of a subsidiary for the purpose of applying the cost method in IAS 27. However more respondents support the designation of accumulated profits as post-acquisition than pre-acquisition.

10. The staff notes the comments indicating the relief proposed in the ED has missed its mark. Several respondents contend that any solution resulting in a reduction of the carrying amount of the subsidiary as it is reflected in the separate financial statements of the parent is unworkable, regardless of how easy the proposed relief is to apply.

11. A parallel issue for respondents is the treatment of dividend income in IAS 27, specifically the requirement to account differently for dividends sourced from pre-acquisition profits and post-acquisition profits. Respondents argue that, in situations where a restatement of cost under IFRS is not practical but where the subsidiary retains distributable profits under its previous national GAAP,

such profits would become “locked in” if they are deemed to be pre-acquisition profits.

12. The common thread running through many of these comment letters is, unless previous national GAAP is permitted as deemed cost for an investment in a subsidiary and accumulated profits are designated as post-acquisition, the constituency for which the relief in the ED is intended will decline to use it. These respondents indicate that the risk of “trapping dividends” and thereby preventing distribution to owners outweighs any cost/benefit provided by the ED.

SECTION 2: PROVISIONAL PROJECT TIMETABLE

13. A provisional project timetable is outlined below. In compiling this timetable the staff gave priority to decisions involving the project objective and scope. [Sentence omitted from observer note].

14. The timetable identifies the Board meeting at which the staff expects to introduce each of the identified topics based on their current assessment. If considered necessary, the staff will request Board time for additional follow-up sessions which may also impact the overall timetable.

15. [Timetable omitted from observer note].