IFRS

STAFF PAPER

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IFRS Interpretations Committee Meeting

Project	**New item for initial consideration**
Paper topic	IFRS 1 *First-time Adoption of International Financial Reporting Standards*—Subsidiary as a first-time adopter

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Introduction

1. The IFRS Interpretations Committee (the Committee) received a request to clarify the accounting applied by a subsidiary that becomes a first-time adopter of IFRS Standards later than its parent. More specifically, the request asks whether, applying paragraph D16 of IFRS 1 *First-time Adoption of International Financial Reporting Standards*, the subsidiary is permitted to recognise cumulative translation differences (CTD) at the amount that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRSs.

2. The objective of this paper is to:

   (a) provide the Committee with a summary of the request and the staff's analysis; and

   (b) ask the Committee whether it agrees with the staff recommendation not to add the issue to its agenda.

Structure of the paper

3. This paper includes:

(a) background information;

(b) staff analysis; and

(c) staff recommendation.

4. The paper has two appendices:

(a) Appendix A—Proposed wording of the tentative agenda decision; and

(b) Appendix B—Submission.

Background information

Requirements in IFRS 1 relevant to the request

5. IFRS 1 provides first-time adopters with some exemptions in preparing their first IFRS financial statements. Paragraphs D12–D13 provide an exemption relating to CTD:

> D12 IAS 21 requires an entity:
>
> (a) to recognise some translation differences in other comprehensive income and accumulate these in a separate component of equity; and
>
> (b) on disposal of a foreign operation, to reclassify the cumulative translation difference for that foreign operation (including, if applicable, gains and losses on related hedges) from equity to profit or loss as part of the gain or loss on disposal.
>
> D13 However, a first-time adopter need not comply with these requirements for cumulative translation differences that existed at the date of transition to IFRSs. If a first-time adopter uses this exemption:
>
> (a) the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to IFRSs; and

(b) the gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to IFRSs and shall include later translation differences.

6. Paragraph D16 of IFRS 1 provides a subsidiary adopting IFRS Standards later than its parent with an option to measure its assets and liabilities at either:

   (a) the carrying amounts that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRSs, excluding adjustments made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary; or

   (b) the carrying amounts required by other requirements in IFRS 1.

Issue submitted

7. The fact pattern in the submission is as follows:

   (a) Entity P, a parent entity, was a first-time adopter with a date of transition to IFRSs of 1 April 2012.

   (b) On 1 April 2012, Entity P applied paragraph D13(a) of IFRS 1. Accordingly, Entity P deemed the CTD for all foreign operations to be zero on that date.

   (c) Entity S, a foreign subsidiary of Entity P, later became a first-time adopter with a date of transition to IFRSs of 1 April 2016.

   (d) Entity S has its own foreign operations for which it recognises CTD.

   (e) Since 1 April 2012, Entity S has reported its CTD to Entity P for consolidation purposes, calculated based on Entity P's date of transition to IFRSs. To illustrate, we have assumed that Entity S's CTD reported to Entity P on 1 April 2016 is CU100. CU100 represents the translation differences that Entity S has accumulated in a separate component of equity since 1 April 2012, when Entity P deemed its CTD to be zero.

8. The request asks whether paragraph D16(a) of IFRS 1 would permit Entity S to recognise CTD in equity of CU100 on 1 April 2016 (its date of transition to IFRSs)—ie calculated based on Entity P's date of transition to IFRSs of 1 April 2012.

9. The submitter has observed the following two views:

   (a) View 1—paragraph D16(a) of IFRS 1 does not apply to CTD; and

   (b) View 2—paragraph D16(a) of IFRS 1 can be applied to CTD.

View 1—paragraph D16(a) of IFRS 1 does not apply to CTD

10. In the example described in paragraph 7 of this paper, View 1 does not permit Entity S to recognise CTD of CU100 on 1 April 2016. Instead, Entity S applies paragraphs D12–D13 of IFRS 1, and recognises CTD of either zero or the amount of CTD that Entity S would have recognised had it always applied IAS 21 (ie on a retrospective basis).

11. Proponents of this view say that paragraph D16 explicitly states that its requirements apply only when the subsidiary measures its *assets and liabilities*. CTD is neither an asset nor a liability—it is a component of equity. Accordingly, paragraph D16(a) does not apply when measuring CTD.

View 2—paragraph D16(a) can be applied to CTD

12. In the example described in paragraph 7 of this paper, View 2 permits Entity S to recognise CTD of CU100 on 1 April 2016.

13. Proponents of this view say that a subsidiary can apply paragraph D16(a) to components of equity (for example, CTD), as well as its assets and liabilities, for the following reasons:

   (a) as explained in paragraphs BC60 and BC62 of IFRS 1, the objective of the exemption provided in paragraph D16(a) is to ease practical problems that a subsidiary would otherwise face—without such an exemption, a subsidiary would have to keep two parallel sets of accounting records for CTD;

   (b) because equity is the residual interest in the assets after deducting an entity's liabilities, it would be reasonable to apply the same approach to components of equity as is applied to assets and liabilities; and

(c) the main relief provided in paragraph D16(a) is to allow a subsidiary to use the parent's date of transition to IFRSs when the subsidiary prepares its first IFRS financial statements. That relief should include components of equity.

Staff analysis

Application of the requirements in IFRS Standards

14. We think that, applying IFRS 1, a subsidiary that adopts IFRS Standards later than its parent is not permitted to measure CTD at its date of transition to IFRSs, based on the amount reported to its parent (ie View 1 described in paragraphs 10-11 of this paper). This is because paragraph D16 specifically mentions assets and liabilities, but not equity (*emphasis added*):

> If a subsidiary becomes a first-time adopter later than its parent, the subsidiary shall, in its financial statements, measure its *assets and liabilities* at either […]

15. Paragraph BC63 of IFRS 1 also explains the rational for providing this exemption only within the context of assets and liabilities (*emphasis added*):

> In finalising the IFRS, the Board simplified the description of the exemption for a subsidiary that adopts IFRSs after its parent. In accordance with the IFRS, the subsidiary may measure its *assets and liabilities* at the carrying amounts that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRSs, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary

16. Moreover, we think that paragraph D16(a) IFRS 1 is not applicable to components of equity by analogy. This is because paragraph 18 of IFRS 1 explicitly prohibits applying exemptions contained in IFRS 1 by analogy to other items.

17. On the basis of this analysis, we are of the view that the requirements in paragraph D16(a) of IFRS 1 apply only to the measurement of assets and liabilities.

Accordingly, when a subsidiary that adopts IFRS Standards later than its parent prepares its first IFRS financial statements, the subsidiary applies paragraphs D12-D13 of IFRS 1 to CTD. Applying those paragraphs, at its date of transition to IFRSs, the subsidiary recognises CTD either of zero or on a retrospective basis.

Did the Board intend the exemption in paragraph D16(a) of IFRS 1 to apply to CTD?

What did the Board intend?

18. Paragraphs BC59–BC60 and BC62 of IFRS 1 explain the purpose of providing the exemption in paragraph D16. Paragraphs BC60 and BC62 say the following:

> BC60 In developing [the Exposure Draft that preceded the issuance of IFRS 1], the Board concluded that a requirement to keep two parallel sets of records would be burdensome and not be beneficial to users. Therefore, the [Exposure Draft] proposed that a subsidiary would not be treated as a first-time adopter for recognition and measurement purposes…
>
> BC62 ...the Board retained the exemption [proposed in the ED] because it will ease some practical problems. Although the exemption does not eliminate all differences between the subsidiary's financial statements and a group reporting package, it does reduce them…

19. Those words alone might suggest that the Board intended to provide relief from retaining parallel sets of records for components of equity, such as CTD, as well as assets and liabilities. For this reason, we investigated further.

20. The Exposure Draft *First-time Application of International Financial Reporting Standards*, published in 2002, included the following proposal relating to the exemption now included in paragraph D16 (*emphasis added*):

> …to avoid restatement of IFRS measurements already reported to the parent, the subsidiary is not treated as a first-time adopter *for recognition and measurement purposes* […]

21. The proposal in the Exposure Draft did not seem to limit the application of the exemption to only the assets and liabilities of the subsidiary because it referred more

generally to recognition and measurement. Nonetheless, the final requirements in IFRS 1 refer only to assets and liabilities. Paragraph BC63 of IFRS 1 says only that 'in finalising the IFRS, the Board simplified the description of the exemption', but does not explain the reason for the change between the proposed requirements and the final requirements in this respect. Having read previous Board papers and discussed with project staff, we have been unable to identify anything further.

22. Consequently, there is no evidence to conclude that, in finalising the requirements, the Board intended anything other than what the requirements in paragraph D16 say.

Who would benefit from an exemption for CTD?

23. If the exemption in paragraph D16(a) of IFRS 1 could be applied to CTD, an entity would be in a position to use that CTD exemption only if it meets all of the following conditions:

    (a) the entity is a subsidiary of a parent that has already adopted IFRS Standards.

    (b) the entity has foreign operations for which it recognises CTD.

    (c) the entity prepares consolidated financial statements.

    (d) the entity's parent applied paragraph D13 of IFRS 1 at the parent's date of transition to IFRSs.

    (e) the entity adopts IFRS Standards. This might be the result of the following, for example:

        (i) the entity voluntarily adopts IFRS Standards;

        (ii) a jurisdiction newly adopts IFRS Standards, and the entity is therefore required to prepare IFRS financial statements; or

        (iii) the entity becomes listed in a jurisdiction in which listed entities are required to prepare IFRS financial statements.

    (f) the entity chooses not to report the CTD on a retrospective basis when it prepares its first IFRS financial statements.

24. Given the number of conditions to be met, we would expect relatively few entities to be in a position to benefit from any exemption for CTD.

Is it burdensome to apply the existing requirements?

25. Applying the existing requirements in IFRS 1, as noted above, a subsidiary applies paragraphs D12-D13 of IFRS 1 and recognises CTD either at zero or on a retrospective basis at its date of transition to IFRSs. Applying either approach, the subsidiary would have to maintain two sets of records relating to CTD—one for its consolidated financial statements and one for its parent's consolidated financial statements.

26. However, unlike maintaining two sets of records for some assets and liabilities, we think the cost and effort to maintain two sets of records relating to CTD would not be overly burdensome. This is because, until the date of disposal of a foreign operation, any difference is simply a static 'day-1' difference, reflecting the amount of CTD reported to the parent at the subsidiary's date of transition to IFRSs. In the example in paragraph 7 of this paper, this would be CU100. That difference would not change after the subsidiary's date of transition to IFRSs until the date that the subsidiary disposes of a foreign operation (when the subsidiary would reclassify some of the CTD to profit or loss).

Staff conclusion

27. We do not recommend proposing a change to IFRS 1 to specifically allow an entity to apply the exemption in paragraph D16 to CTD, on the grounds that:

    (a) there is no evidence to conclude that the Board intended anything other than what the requirements in paragraph D16 of IFRS 1 say;

    (b) we think applying the existing requirements in IFRS 1 in this respect is not overly burdensome; and

    (c) we would expect relatively few entities to benefit from any such change.

Staff recommendation, having considered the Committee's agenda criteria

28. We think that our conclusion described in paragraph 17 of the paper reflects the application of IFRS 1. In our view, the requirements in IFRS 1 provide an adequate

basis for a subsidiary to determine how to measure CTD at its date of transition to IFRSs.

29. For the reasons noted in paragraph 27 of the paper, we also recommend that the Board does not amend IFRS 1 to specifically allow an entity to apply paragraph D16 to CTD.

30. Consequently, we recommend that the Committee does not add this issue to its agenda.

Questions for the Committee

1. Does the Committee agree with the staff recommendation not to add this issue to its agenda?
2. Does the Committee have any comments on the proposed wording of the tentative agenda decision outlined in Appendix A to this paper?

Appendix a—Proposed wording of the tentative agenda decision

IFRS 1 *First-time Adoption of International Financial Reporting*—Subsidiary as a first-time adopter

The IFRS Interpretations Committee (the Committee) received a request to clarify the accounting applied by a subsidiary that becomes a first-time adopter of IFRS Standards later than its parent. The subsidiary has foreign operations, on which it accumulates translation differences in a separate component of equity. The request asks whether, applying paragraph D16 of IFRS 1 *First-time Adoption of International Financial Reporting Standards*, the subsidiary is permitted to recognise cumulative translation differences at the amount that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRSs.

Paragraph D16 of IFRS 1 provides a subsidiary that becomes a first-time adopter of IFRS Standards later than its parent with an exemption regarding the measurement of its assets and liabilities. Translation differences that the subsidiary accumulates in a separate component of equity are neither an asset nor a liability. Accordingly, the Committee concluded that paragraph D16 of IFRS 1 does not permit the subsidiary to recognise cumulative translation differences at the amount that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRSs.

The Committee also concluded that the subsidiary cannot apply the exemption in paragraph D16 of IFRS 1 to cumulative translation differences by analogy—paragraph 18 of IFRS 1 explicitly prohibits an entity from applying the exemptions in IFRS 1 by analogy to other items.

Accordingly, when the subsidiary becomes a first-time adopter of IFRS Standards, the subsidiary accounts for currency translation differences applying paragraphs D12-D13 of IFRS 1. These require the subsidiary to recognise cumulative translation differences either at zero or on a retrospective basis at its date of transition to IFRSs.

The Committee concluded that the requirements in IFRS Standards provide an adequate basis for a first-time adopter to determine how to account for cumulative translation differences.

In the light of existing requirements in IFRS Standards, the Committee [determined] that neither an IFRIC Interpretation nor an amendment to a Standard was necessary. Consequently, the Committee [decided] not to add this issue to its agenda.

Appendix B—Submission

IFRS Interpretations Committee Potential Agenda Item Request

Issue:
Use of exemption in IFRS1.D16(a) by a subsidiary which becomes a first-time adopter later than its parent.

Background:
Entity P operates trading and investment activities globally with more than a thousand subsidiaries and affiliates over the world. Entity S, one of subsidiaries of Entity P, also operates trading activities globally and has a number of its own foreign operations.
Entity S becomes a first- time adopter at the transition date of 1st April 2016, four years later than Entity P, its parent. Entity P became a first-time adopter at the transition date of 1st April 2012 and adopted the exemption in IFRS 1.D13(a) for cumulative translation differences, deemed to be zero for all foreign operations including those of Entity S. Entity S has been reporting its internal reporting package to Entity P in the previous periods using IFRSs without externally presenting a full set of financial statements in accordance with IFRSs. To date, in the reporting package, Entity S has quarterly reported to Entity P its cumulative translation differences accumulated since Entity P's date of transition to IFRSs.

Current practice:
Entity S measures its component of equity (including cumulative translation differences) as well as assets and liabilities as of the transition date at the carrying amounts that would be included in Entity P's consolidated financial statements based on the Entity P's date of transition to IFRSs by applying the exemption in IFRS1.D16(a).
Such measurement is consistent with the requirements and basis for conclusions of IFRS1 for the following reasons:
(i) in accordance with IFRS1.BC60 and BC62, the Board's intention is not to make an entity to keep two parallel sets of records but to permit measurement that is already used in the consolidated financial statements of the parent;
(ii) as equity is the residual interest in the assets of the entity after deducting all its liabilities according to the Conceptual Framework, it is reasonable to measure component of equity as well as assets and liabilities on the same basis;
(iii) as the carrying amounts of assets and liabilities included in Entity P's consolidated financial statements reflect the impact of exemptions in IFRS1 applied by Entity P at its date of transition to IFRSs, the impact of applying IFRS1.D13(a) shall also be reflected in Entity S's component of equity.

Reasons for the IFRS IC to address the issue:
We found that there is a different view in practice, which argues that IFRS1.D16(a) does not apply to component of equity because of the wording of the requirement, and therefore allows Entity S to measure only its assets and liabilities at the carrying amounts that would be included in Entity P's consolidated financial statements. In applying this view, Entity S could either;
(i) measure the component of equity at the carrying amounts required by IFRSs based on Entity S's date of transition to IFRSs, 1st April 2016; or
(ii) deem cumulative translation differences for all foreign operations to be zero at Entity S's date of transition to IFRSs, 1st April 2016 by applying the exemption in IFRS1.D13(a); or

(iii) change Entity S's date of transition to IFRSs to 1st April 2012, the parent's date of transition to IFRSs, and prepares all the financial statements according to IFRSs from that date.

We understand that views held by global accounting firms are not necessarily consistent on this issue. We believe that the diversity in interpretations arises due to the ambiguity of the requirements in IFRS1.D16(a), and due to the unclear interaction between IFRS1.D16(a) and D13.
Accordingly, we request the IFRS Interpretations Committee to clarify whether IFRS1.D16(a) applies to components of equity, including the interaction between IFRS1.D16(a) and D13.

Evaluation of criteria for agenda item request:
(a) Is the issue widespread and has, or is expected to have, a material effect on those affected?

Yes. The issue is expected to have material effect because all the subsidiaries which become first- time adopter later than their parents will be affected. As many of the global enterprises apply IFRSs, and as countries that require or permit domestic companies to apply IFRSs are increasing continuously, potential numbers of subsidiaries of global enterprises that may apply IFRSs in the future are increasing.

(b) Would financial reporting be improved through the elimination, or reduction, of diverse reporting methods?

Yes. Financial reporting will be improved by clarifying the above issue because the current diverged practice makes financial information less comparable.

(c) Can the issue be resolved efficiently within the confines of IFRSs and the Conceptual Framework for Financial Reporting?

Yes. The issue can be resolved without amending IFRSs or Conceptual Framework except clarification of IFRS1.

(d) Is the issue sufficiently narrow in scope that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process?

Yes. The scope of the issue is limited to IFRS1.D16(a) and D13 but the effect of clarification expected to be material as described in the above.

(e) Will the solution developed by the Interpretations Committee be effective for a reasonable time period? The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified.

Yes. We understand that currently there is no plan to address this issue in a forthcoming Standard.

Evaluation of criteria for annual improvement:
In addition to the implementation and maintenance criteria, an annual improvement should:

(a) Replace unclear wording; Provide missing guidance; or Correct minor unintended consequences, oversights or conflict.

Yes. We think that an amendment would correct minor unintended consequences or oversights with regard to the application of paragraph D16 or D13 of IFRS1.

(b) Not change an existing principle or propose a new principle.

Yes. We think that an amendment does not change an existing principle, nor does it relate to a new principle.

(c) Not be so fundamental that the IASB will have to meet several times to conclude.

Yes. We think that such an amendment would be a clarification of requirements in paragraph D16 or D13 of IFRS1. Consequently, we do not consider it to be so fundamental that the Board will have to meet several times to conclude.