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Project	**Annual Improvements to IFRS Standards 2018-2020**
Paper topic	Subsidiary as a First-time Adopter (Amendment to IFRS 1): Analysis of feedback

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Introduction

1. As discussed in Agenda Paper 12E, this paper analyses feedback on *Subsidiary as a First-time Adopter* (Proposed amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*) included in the Exposure Draft *Annual Improvements to IFRS Standards 2018–2020*. The proposed amendment would require a subsidiary that elects to apply paragraph D16(a) of IFRS 1 to measure cumulative translation differences (CTD) using the amount reported by the parent, based on the parent's date of transition to IFRSs.

2. We recommend that the Board amend IFRS 1 to permit, rather than require, such a subsidiary to measure CTD for all foreign operations using the amount reported by the parent.

Structure of the paper

3. This paper is structured as follows:

   (a) background (paragraph 5);

   (b) summary of feedback (paragraphs 6–8);

   (c) staff analysis (paragraphs 9–29); and

   (d) staff recommendation (paragraph 30).

4. There are two appendices to this paper:

   (a) Appendix A—Analysis of other matters; and

   (b) Appendix B—Excerpts from IFRS 1.

Background

5. Paragraphs BC1–BC3 of the proposed amendment state:

> BC1 Paragraph D16(a) of IFRS 1[1] […] provides a subsidiary that becomes a first-time adopter of IFRS Standards later than its parent with an exemption relating to the measurement of its assets and liabilities. Paragraph BC60 of IFRS 1[1] explains that the Board provided this exemption so that a subsidiary would not have to keep two parallel sets of accounting records based on different dates of transition to IFRSs.
>
> BC2 Paragraph D16(a) applies only to assets and liabilities and not to components of equity. In addition, the relief in D16(a) is an exemption and exemptions in IFRS 1 cannot be applied by analogy to other items. Accordingly, a subsidiary that becomes a first-time adopter later than its parent would apply paragraphs D12-D13 of IFRS 1[1] to [CTDs] at its date of transition to IFRSs. Applying these paragraphs, the subsidiary might be required to keep two parallel sets of accounting records for [CTDs] based on different dates of transition to IFRSs. The Board received a request to extend the exemption in paragraph D16(a) to cumulative translation differences reported by a subsidiary that becomes a first-time adopter later than its parent.
>
> BC3 Based on the rationale in paragraph BC60 of IFRS 1, the Board proposes that measurement of the subsidiary's [CTDs] be subject to the exemption provided by paragraph D16(a). The Board concluded that extending the exemption to [CTDs] would reduce costs for first-time adopters without being detrimental to

[1] See appendix B to this paper.

> users of financial statements. This is because IFRS 1 already provides an exemption relating to [CTDs] and, thus, extending the exemption in paragraph D16(a) would not diminish the relevance of information reported by a subsidiary that becomes a first-time adopter later than its parent….[2]

Summary of feedback

6. Forty-six respondents comment on the proposed amendment to IFRS 1—almost all respondents agree with the proposed amendment for the reasons outlined in the Basis for Conclusions. Nonetheless, some respondents express concerns about particular aspects of the proposed amendment, including:

   (a) requiring measurement of CTD using the amount reported by the parent (paragraphs 9–23); and

   (b) entities outside the scope of IFRS 1 (paragraphs 24–28).

7. CPA Ireland disagrees with the proposed amendment—it expresses concerns similar to those noted in paragraph 6(a) above.

8. Further details on these matters, together with our analysis, is presented below.

Staff analysis

Requiring measurement of CTD using the amount reported by the parent

Feedback

9. The proposed amendment to IFRS 1 would require a subsidiary applying paragraph D16(a) of IFRS 1 to measure CTD using the amount reported by the parent, based on the parent's date of transition to IFRSs (if no adjustments were made for consolidation

[2] The exemption in paragraph D16(a) of IFRS 1 is also available to an associate or joint venture that becomes a first-time adopter later than the entity that has significant influence or joint control over it. For ease of reference, our analysis in this paper refers only to subsidiaries—however, it applies equally to such an associate and joint venture.

procedures and for the effects of the business combination in which the parent acquired the subsidiary).[3] Appendix B to this paper reproduces paragraph D16 of IFRS 1, and related paragraphs in the Basis for Conclusions on IFRS 1.

10. Some respondents suggest that the Board permit, rather than require, a subsidiary that applies paragraph D16(a) to measure CTD using the amount reported by the parent. In other words, a subsidiary applying paragraph D16(a) should be given an option to either:

    (a) measure CTD using the amount reported by the parent;

    (b) apply the exemption in paragraph D13 of IFRS 1—ie measure CTD for all foreign operations at zero at the subsidiary's date of transition to IFRSs[4]; or

    (c) measure CTD by retrospectively applying the requirements in IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

11. For example, Deloitte says:

> …an entity that applies IFRS 1.D16(a) to measure its assets and liabilities should be allowed to measure its cumulative translation difference either using IFRS 1.D16(a) or using IFRS 1.D13. We believe that this choice should be available because in some circumstances, it may be difficult for a subsidiary (or associate or joint venture) to establish the cumulative translation difference based on the amounts included in the parent's consolidated financial statements, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary. This may be the case, for example, if the functional currency of the subsidiary is not the same as that of its parent. Such an option would appear appropriate since it would ease the practical difficulties that may be associated with

[3] For ease of reference, we use 'amount reported by the parent' to refer to the 'amount reported by the parent 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'.

[4] Appendix B to this paper reproduces paragraphs D12-D13 of IFRS 1, and related paragraphs in the Basis for Conclusions on IFRS 1.

> determining the cumulative translation difference without significantly diminishing the relevance of the information reported by the entity (the option of recognising cumulative translation difference at zero being available already in IFRS 1).

12. Similarly, the Japanese Institute of Certified Public Accountants also says there are situations in which it is easier for a subsidiary as a first-time adopter to recognise CTD at zero, instead of using the amount reported by the parent. It says:

> Let's say, for example, that a parent, its subsidiary and sub-subsidiary have different functional currencies. If the parent elects to consolidate the sub-subsidiary using the direct method, there is no need for the subsidiary to calculate any translation differences between the functional currency of the sub-subsidiary and the reporting currency of the subsidiary itself. Accordingly, if first-time adopters are required to follow the Board's proposal and measure cumulative translation differences using the amounts reported by the parent, the subsidiary would have to go through another consolidation procedure that requires additional cost and burden. Furthermore, note that the same process should be followed when a subsidiary established through divestitures or other demerger transactions has a different functional currency.

13. In addition, the Accounting Standards Board of Japan says:

> Based on paragraph BC54 of IFRS 1[5], our understanding is that paragraph D13 of IFRS 1 permits a first-time adopter to reset the CTDs at zero at the date of transition to IFRSs so that the first-time adopter could keep control of the CTDs for each foreign operation and appropriately transfer the CTDs to the income statement when the foreign operation is disposed of. We believe that this treatment not only reduces the practical burden on the first-time adopter but also improves the benefits to users from the viewpoint of transparency and comparability.

[5] See Appendix B to this paper.

Accordingly, we think it is appropriate to maintain the current exemption to reset the CTDs at zero at the subsidiary's date of transition to IFRSs.

Staff analysis

Why the Board did not provide an option

14. In developing the proposed amendment, the Board considered whether to require, or permit, a subsidiary that applies paragraph D16(a) of IFRS 1 to measure CTD using amounts reported by the parent. The Board decided to require a subsidiary to measure CTD using the amount reported by the parent because:

(a) doing so would be consistent with the existing requirement in paragraph D16(a). If a subsidiary applies paragraph D16(a), the subsidiary has to measure all its assets and liabilities based on its parent's date of transition to IFRSs. It cannot choose the assets and liabilities to which it applies the exemption in paragraph D16(a)—it is an 'all or nothing' exemption. Accordingly, any relief proposed should be an incremental layer of the relief already provided in paragraph D16(a).

(b) the reason for any amendment to IFRS 1 would be to remove a potential difference in the amount of CTD reported by a subsidiary and its parent, in order to reduce complexity and alleviate practical concerns that such a subsidiary might otherwise have.

(c) providing an option is likely to be unnecessary. The Board thought it unlikely that a subsidiary applying paragraph D16(a) would voluntarily elect to have a difference in CTD between its financial statements and its parent's consolidated financial statements. Such a subsidiary would presumably have chosen to apply the exemption in paragraph D16(a) to eliminate potential differences.

Situations in which using CTD reported by parent could be burdensome

15. Having considered the information received from respondents, we agree that in some situations it could be burdensome to require entities that apply paragraph D16(a) to measure CTD using the amount reported by the parent. This could be the case, for

example, when a parent and a subsidiary have different presentation currencies[6] and the parent uses the direct method of consolidation to reflect the results and financial position of its subsidiaries. In this situation, the results and financial position of the subsidiary's foreign operations might be reported directly to the parent, and the subsidiary itself may not have previously calculated CTD in respect of those foreign operations.

16. Paragraph 41 of IAS 21 states (emphasis added):

> The exchange differences […] result from:
>
> (a) translating income and expenses at the *exchange rates at the dates of the transactions* and assets and liabilities at the *closing rate*.
>
> (b) translating the opening net assets at a closing rate that differs from the *previous closing rate*. …

17. CTD reflects the accumulation of these exchange differences. In the situation described in paragraph 15, requiring the subsidiary to calculate CTD using the amount reported by the parent would require the subsidiary to go back to the parent's date of transition to IFRSs and reconstruct the CTD (applying paragraph 41 of IAS 21) from that date until the subsidiary's date of transition to IFRSs. The same situation would not arise when measuring assets and liabilities using amounts reported by the parent—this is because, applying the requirements in IAS 21, the subsidiary would simply apply the applicable closing rate to translate those amounts.

18. As a consequence, there could be some situations in which a subsidiary that applies paragraph D16(a) might find it burdensome to measure CTD using the amount reported by its parent. Such a subsidiary might benefit from applying the exemption in paragraph D13 to measure CTD for all foreign operations at zero at its date of transition to IFRSs.

[6] In our analysis, we assume that the presentation currencies of both the parent and the subsidiary are not the currencies of a hyperinflationary economy.

Effect on proposed amendment

19. Based on our analysis, if the Board decides to finalise the amendment to IFRS 1, we would recommend that it permit, rather than require, a subsidiary that applies paragraph D16(a) to measure CTD using the amount reported by the parent. This is because it would appear inappropriate to potentially increase costs for some subsidiaries as a consequence of amending IFRS 1 to provide cost relief for others.

20. Nonetheless, the information provided by respondents indicates that there is less benefit from amending IFRS 1 than the Board had anticipated when it proposed the amendment. Had the Board been aware that only some subsidiaries that apply paragraph D16(a) would benefit from the amendment, the Board may have concluded that the expected benefits would not outweigh the costs of undertaking standard-setting. We note that the Board's original analysis had highlighted that the cost of keeping two sets of records regarding CTD would not be very significant for a subsidiary because any difference in CTD at the subsidiary's date of transition to IFRSs would remain constant until it disposes of the foreign operation. We have therefore considered whether the expected benefits of amending IFRS 1 would outweigh the costs of doing so given the new information provided by respondents.

21. The generally positive feedback received from respondents regarding the amendment would suggest that, on balance, the expected benefits would outweigh the cost. Although the amendment would provide relief to fewer subsidiaries than initially expected, it would continue to provide relief to subsidiaries that have the same presentation currency as that of their parent. In particular, those subsidiaries would not be required to keep two parallel sets of records solely because of amounts reported for CTD—as explained in paragraph BC60 of IFRS 1, the exemption in D16(a) is designed to eliminate the requirement for a subsidiary to keep two parallel sets of accounting records. We also understand that, in many cases, subsidiaries have the same presentation currency as that of their parent.

22. Importantly, we also note that the amendment is not expected to be detrimental to users of financial statements. This is because IFRS 1 already provides an exemption relating to CTD and, thus, extending that exemption is not expected to diminish the

relevance of information reported by a subsidiary that becomes a first-time adopter later than its parent.

Conclusion

23. On balance we recommend that the Board permit, rather than require, a subsidiary applying paragraph D16(a) of IFRS 1 to measure CTD for all foreign operations using amounts reported by the parent.

Entities outside the scope of IFRS 1

Background

24. Paragraph BC5 of the Exposure Draft states:

> The Board considered, but decided against, permitting or requiring entities that previously applied IFRS 1 [entities outside the scope of IFRS 1] to apply the proposed amendment. This is because doing so would:
>
> (a) provide no additional cost relief for entities. A subsidiary that previously applied IFRS 1 would already have calculated any difference between the amount it reports as [CTD] and the amount reported in its parent's consolidated financial statements. That difference would not change until the parent disposes of part, or all, of its investment in the subsidiary.
>
> (b) potentially confuse users of financial statements. Users would not expect entities that already apply IFRS Standards to be affected by an amendment to IFRS 1—a Standard that applies only when first adopting IFRS Standards.

Feedback

25. Three respondents disagree with the Board's decision and suggest permitting entities outside the scope of IFRS 1 to apply the proposed amendment—this is so that those entities do not have to keep two parallel sets of accounting records. BusinessEurope and SwissHoldings say allowing such a subsidiary to recognise a one-off adjustment within equity to align CTD with the amount reported by its parent would be less

confusing than the outcome that might result from applying the existing requirements in IFRS Standards—ie an outcome in which a subsidiary reports a gain or loss from a disposal of a particular foreign operation at an amount different from that reported by its parent in respect of that same disposal. BDO says requiring specific disclosures could avoid any potential for confusion in this respect.

26. KPMG says referring to entities that 'previously applied IFRS 1' could have unintended consequences for some entities that might have applied IFRS Standards in a previous period but whose most recent annual financial statements did not contain an explicit and unreserved statement of compliance with IFRS Standards. This is because, applying paragraph 4A of IFRS 1, such entities are permitted to apply IFRS 1.

Staff analysis

27. We continue to support the Board's decision not to permit entities outside the scope of IFRS 1 to apply the amendment to IFRS 1 for the reasons discussed in paragraph BC5 of the proposed amendment (see paragraph 24 of this paper). Only three respondents suggest permitting entities outside the scope of IFRS 1 to apply this amendment—in our view, these respondents have not provided information beyond that already considered by the Board in developing the proposed amendment. The Board proposed the amendment to extend the cost relief already provided in IFRS 1—it did not propose the amendment because of possible differences in the gain or loss recognised by the parent and its subsidiary on disposal of a foreign operation.

28. We agree with KPMG that referring to entities that 'previously applied IFRS 1' might have unintended consequences. To the extent the wording in paragraph BC5 of the proposed amendment is carried forward to the Basis for Conclusions on IFRS 1, we will amend the drafting to avoid such consequences.

Other matters

29. Appendix A to this paper summarises other matters raised by the respondents together with our analysis and recommendations.

Staff recommendation

30. We recommend that the Board amend IFRS 1 to permit, rather than require, a subsidiary that elects to apply paragraph D16(a) of IFRS 1 to measure CTD for all foreign operations using the amount reported by the parent, based on the parent's date of transition to IFRSs. This recommendation also applies to associates and joint ventures that elect to apply paragraph D16(a) of IFRS 1.

Question 1 for the Board
Does the Board agree with our recommendation in paragraph 30 of this paper?

Appendix A—Analysis of other matters

Matter	**Staff analysis and recommendation**
A. Extending exemption to other components of equity	
Two respondents disagree with the Board's decision not to extend the scope of the amendment to components of equity other than CTD (for example, hedging reserves and revaluation surplus for property, plant and equipment). EY also says the wording in paragraph BC4 of the proposed amendment could have unintended consequences if read to apply to assets and liabilities, and not only components of equity.	*We recommend no change in this respect.* At its December 2017 meeting, the Board considered whether to extend the scope of the amendment to other components of equity (AP12C of the Board's December 2017 meeting), but decided not to do so. Paragraph BC4 of the proposed amendment explains the Board's rationale for this decision and states: …The Board concluded that extending the exemption in paragraph D16(a) to other components of equity is unnecessary because, for example, no difference between the amounts reported by a subsidiary and its parent would arise for those components, or a subsidiary would be able to avoid any potential difference by applying (or not applying) some exemptions in IFRS 1. Respondents have not provided information beyond that previously considered by the Board in this respect. To the extent wording from paragraph BC4 is carried forward to the Basis for Conclusions on IFRS 1, we will consider how best to draft the wording.

Matter	**Staff analysis and recommendation**
B. Scope of CTD subject to exemption	
The Mexican Financial Reporting Standards Board (CINIF) suggests clarifying whether any CTD arising from the subsidiary itself (for example, CTD resulting from translation of the subsidiary's own results and financial position into a different presentation currency) is subject to the proposed amendment.	*We recommend clarifying this in any final amendment.* In our view, the amendment should refer to CTD relating to the subsidiary's foreign operations. This is consistent with the exemption in paragraph D13, which refers to CTD 'for all foreign operations'.
C. Request for other clarifications	
Some respondents suggest providing additional clarifications. For example: 1. The South African Institute of Chartered Accountants suggests clarifying which amount an associate or joint venture should use when multiple investors have significant influence or joint control over the associate or joint venture. 2. The Malaysian Accounting Standards Board suggests extending the exemption to a subsidiary that becomes a first-time adopter of IFRS Standards at the same time as its parent. 3. The Thailand Federation of Accounting Professions suggests providing an option to recognise	*We recommend no change in this respect.* In our view, these requests go beyond the scope of the proposed amendment.

Matter	Staff analysis and recommendation
assets, liabilities and CTD at the carrying amounts included in the parent's latest consolidated financial statements.	
D. Other suggestions	
1. EY suggests amending Example 8 in the Guidance on implementing IFRS 1 which accompanies, but is not part of, IFRS 1. This example illustrates the application of the requirements in paragraph D16(a). 2. A few respondents provided drafting suggestions on the proposed amendment.	To the extent relevant, we will consider these suggestions when drafting any final amendment.

Appendix B—Excerpts from IFRS 1

B1. Paragraphs D12–D13 of IFRS 1 state:

> 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.

B2. Paragraph D16 of IFRS 1 states:

> 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:
>
> (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, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary (this election is not available to a subsidiary of an investment entity,

as defined in IFRS 10, that is required to be measured at fair value through profit or loss); or

(b) the carrying amounts required by the rest of this IFRS, based on the subsidiary's date of transition to IFRSs…

A similar election is available to an associate or joint venture that becomes a first-time adopter later than an entity that has significant influence or joint control over it.

B3. Paragraphs BC53–BC55 of IFRS 1 explain the Board's rationale for the exemption in paragraph D13. These paragraphs state:

> BC53 IAS 21 […] requires an entity to classify some cumulative translation differences (CTDs) relating to a net investment in a foreign operation as a separate component of equity. The entity transfers the CTDs to the income statement on subsequent disposal of the foreign operation. The proposals in ED 1 would have permitted a first-time adopter to use the CTDs in accordance with previous GAAP as the deemed CTDs in accordance with IFRSs if reconstructing CTDs would have involved undue cost or effort.
>
> BC54 Some respondents to ED 1 argued that it would be more transparent and comparable to exempt an entity from the requirement to identify CTDs at the date of transition to IFRSs, for the following reasons:
>
> (a) An entity might know the aggregate CTDs, but might not know the amount for each subsidiary. If so, it could not transfer that amount to the income statement on disposal of that subsidiary. This would defeat the objective of identifying CTDs as a separate component of equity.
>
> (b) The amount of CTDs in accordance with previous GAAP might be inappropriate as it might be affected by adjustments made on transition to IFRSs to assets and liabilities of foreign entities.
>
> BC55 The Board found these arguments persuasive. Therefore, a first-time adopter need not identify the CTDs at the date of

transition to IFRSs (paragraphs D12 and D13 of the IFRS). The first-time adopter need not show that identifying the CTDs would involve undue cost or effort.

B4. Paragraphs BC59–BC60 of IFRS 1 explain the Board's rationale for the exemption in paragraph D16(a). These paragraphs state:

> BC59 A subsidiary may have reported to its parent in the previous period using IFRSs without presenting a full set of financial statements in accordance with IFRSs. If the subsidiary subsequently begins to present financial statements that contain an explicit and unreserved statement of compliance with IFRSs, it becomes a first-time adopter at that time. This might compel the subsidiary to keep two parallel sets of accounting records based on different dates of transition to IFRSs, because some measurements in accordance with the IFRS depend on the date of transition to IFRSs.
>
> BC60 In developing ED 1, the Board concluded that a requirement to keep two parallel sets of records would be burdensome and not be beneficial to users. Therefore, ED 1 proposed that a subsidiary would not be treated as a first-time adopter for recognition and measurement purposes if the subsidiary was consolidated in IFRS financial statements for the previous period and all owners of the minority interests consented.[17]

[17] In January 2008 the IASB issued an amended IAS 27 *Consolidated and Separate Financial Statements*, which amended 'minority interests' to 'non-controlling interests'. The consolidation requirements in IAS 27 were superseded by IFRS 10 Consolidated Financial Statements issued in May 2011. The term 'non-controlling interests' and the requirements for non-controlling interests were not changed.