

IFRS Briefing Sheet

Exposure Draft of *Proposed Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards and IAS 27 Consolidated and Separate Financial Statements – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*

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This IFRS Briefing Sheet summarises the International Accounting Standards Board's (IASB) Exposure Draft (ED) of *Proposed Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards and IAS 27 Consolidated and Separate Financial Statements – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*, which was published on 13 December 2007.

This ED is a re-exposure of the January 2007 ED of *Proposed Amendments to IFRS 1 – Cost of an Investment in a Subsidiary* (the January 2007 ED).

Background

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

IFRS 1 provides an exemption from restating business combinations that occurred before the date of transition to International Financial Reporting Standards (IFRSs). However, this exemption does not apply to establishing the cost of investments in subsidiaries, jointly controlled entities

and associates in the separate IFRS financial statements of a parent.

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

The ED proposes that an entity that is a first-time adopter of IFRSs be permitted, but not required, to measure the cost of its investments in subsidiaries, jointly controlled entities or associates at a "deemed cost" in its separate financial statements.

The amendments in the ED differ from those that were proposed in the January 2007 ED by proposing:

- a different deemed cost approach
- that dividends received from a subsidiary, jointly controlled entity or associate be recognised as income in the separate financial statements of the investor
- new guidance on accounting for the formation of a new parent.

Proposed Changes to January 2007 ED

Deemed Cost

The ED proposes to amend IFRS 1 to allow an entity, at its date of transition to IFRSs in its separate financial statements, to use a deemed cost to measure the cost of an investment in

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a subsidiary, jointly controlled entity or associate, determined using either:

- fair value, determined in accordance with IAS 39; or
- the previous GAAP carrying amount of the investment at the entity's date of transition to IFRSs.

The determination of deemed cost described above differs from that which was included in the January 2007 ED. Deemed cost in the January 2007 ED was determined using either the entity's interest in the carrying amount of the net assets of the subsidiary, based on the carrying amounts in the subsidiary's IFRS balance sheet (net assets under IFRSs); or the fair value of the entity's investment in the subsidiary.

The IASB's decision to allow first-time adopters the ability to use "the previous GAAP carrying amount of the investment" approach as opposed to "the net assets under IFRSs" approach to determine deemed cost at transition date was based on comments received from respondents that the latter approach was too onerous for entities adopting IFRSs.

The ED also proposes to extend the scope of the deemed cost exemption to include investments in jointly controlled entities and associates; in the January 2007 ED, the deemed cost exemption was limited to investments in subsidiaries.

Consistent with the January 2007 ED, an entity would be able to choose whether to use the deemed cost exemption on an individual basis for each investment in a subsidiary, jointly

controlled entity or associate.

Dividends Received from a Subsidiary, Jointly Controlled Entity or Associate

In accordance with IAS 27, under the "cost method" an investor recognises income from an investment only to the extent that it receives distributions from accumulated profits of an investee arising after the date of acquisition. Distributions received 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.

The January 2007 ED proposed to provide an exemption on transition to IFRSs from restating the retained earnings of a subsidiary at the date of transition for the purpose of applying the cost method. However, based on comments received from respondents, the IASB concluded that the current wording in IAS 27 creates difficulties in certain jurisdictions when applying the proposed relief, as IAS 27 makes specific reference to retained earnings as the means of making the assessment that a return on investment should be deducted from the carrying amount of the investment under the cost method.

As a result, the ED proposes to remove the definition of "cost method" provided in IAS 27 and require dividends received by an investor from a subsidiary, jointly controlled entity or associate to be recognised as income in the separate financial statements of the investor.

In addition, the ED proposes that if an investor accounts for its investment in

a subsidiary, jointly controlled entity or associate at cost, then an impairment test is required if the investor received dividend income from that investment during the reporting period, regardless of whether any indicators of impairment exist.

Formation of a New Parent

The ED includes new guidance on accounting for the formation of a new parent as part of the reorganisation of an existing entity when the existing entity becomes a wholly-owned subsidiary of the new parent, and the interests of shareholders are not affected in the reorganisation.

The ED proposes that the new parent measure the cost of the investment in the subsidiary using the carrying amounts of the equity, assets and liabilities in the separate financial statements of the existing entity at the date of the formation.

Effective Date

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

Response to the IASB

The IASB has invited comments on the ED by 26 February 2008.

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

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