

17 September 2008

**Status:** Final

**Effective date:**

Accounting periods commencing on or after 1 January 2009 (although earlier adoption is permitted)

**Accounting impact:**

Changes to accounting for the cost of investment and the recognition of dividends in relation to investments in subsidiaries, jointly controlled entities and associates in separate (parent company) financial statements



# International Financial Reporting Bulletin

Amendments to IFRS regarding the cost of an investment in a subsidiary, jointly controlled entity or associate

## Background

On 22 May 2008 the International Accounting Standards Board (IASB) published amendments to International Financial Reporting Standard 1 *First-time adoption of International Financial Reporting Standards* (IFRS 1) and International Accounting Standard 27 *Consolidated and Separate Financial Statements* (IAS 27).

These amendments deal with the measurement of the cost of an investment in subsidiaries, jointly controlled entities and associates. The December 2007 exposure draft *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* was covered by International Financial Reporting Bulletin 2008/06.

## Amendments to IFRS 1

The amendments to IFRS 1 allow an entity (that is a first time adopter of IFRS) that measures, in its separate (company only) financial statements, its investments in subsidiaries, jointly controlled entities or associates at cost at its date of transition to use either cost in accordance with IAS 27, or a deemed cost in accordance with IFRS 1. This is relevant for companies in a number of jurisdictions, as IFRS has in many cases been adopted by companies only in their consolidated financial statements, with local GAAP being retained for the purposes of the individual company financial statements.

### *Deemed cost*

Following the amendments to IFRS 1, the deemed cost of an investment in subsidiaries, jointly controlled entities or associates is either:

- (a) fair value of the investment at the date of transition, which would be determined in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*; or
- (b) the carrying amount of the investment under previous GAAP at the date of transition.

A first time-adopter may choose either of the above to measure its investment in each subsidiary, jointly controlled entity or associate that it elects to measure at deemed cost.

Where a first-time adopter has elected to use a deemed cost at the date of transition then in its separate financial statements it shall disclose:

- the aggregate deemed cost of those investments for which deemed cost is their previous GAAP carrying amount;
- the aggregate deemed cost of those investments for which deemed cost is fair value at the date of transition to IFRS; and
- the aggregate adjustment to the carrying amount reported under its previous GAAP.

The above amendments are considered to address previous concerns that retrospectively determining cost in accordance with IAS 27 (which is the fair value of consideration given in exchange for the subsidiary, whether in the form of cash, shares or otherwise) on first-time adoption of IFRS could not, in some circumstances, be achieved without undue cost or effort.

### **Amendments to IAS 27**

#### *Removal of the cost method in IAS 27*

Recognition of dividends from investments  
in a subsidiary, jointly controlled entity or  
associate

The amendments to IAS 27 remove the definition of the cost method of accounting for an investment in a subsidiary, jointly controlled entity or associate. This has the effect of removing the requirement to deduct distributions received that arise from pre-acquisition profits from the cost of the investment.

Instead, an investor will be required to recognise as income, dividends received from a subsidiary, jointly controlled entity or associate in the investor's separate financial statements when its right to receive the dividend is established. The receipt of these dividends may give rise to a requirement to review the related investment for impairment (see below).

Related amendments to IAS 18 and IAS 21

Amendments have been made to IAS 18 *Revenue* to remove the distinction between dividends paid from pre-acquisition profits and those paid from post-acquisition profits so that the accounting for dividends received from entities that are not subsidiaries, jointly controlled entities or associates, is consistent with the amendments to IAS 27.

A similar type of amendment has been made to IAS 21 *The Effects of Changes in Foreign Exchange Rates* so that dividends arising from a foreign operation are treated consistently with the amendments to IAS 27.

Impairment of investments in a subsidiary,  
jointly controlled entity or associate

IAS 36 *Impairment of Assets* has been amended.

Indicators of impairment, requiring an assessment as to whether a full impairment review is required, now include the recognition of a dividend from an investment in a subsidiary, jointly controlled entity or associate where there is also evidence available that:

- the carrying amount of the investment in the separate financial statements exceeds the carrying amounts in the consolidated financial statements of the investee's net assets, including the associated goodwill; or
- the dividend exceeds the total comprehensive income (see below) of the subsidiary, jointly controlled entity or associate in the period the dividend is declared.

In accordance with IAS 1 (Revised 2007) *Presentation of Financial Statements* total comprehensive income is defined as the change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners.

*Formation of new parent*

The amendments to IAS 27 also address the initial measurement of cost in the separate financial statements of a new parent formed as the result of a specific type of group reorganisation.

When a parent reorganises the structure of its group by establishing a new entity as its parent and this new parent elects to measure the cost of the investment in the subsidiary at cost in accordance with IAS 27, then that cost will be measured as the new parent's share of the carrying value of the equity items as shown in the separate financial statements of the original parent at the date of the reorganisation, as long as the following criteria are met:

- (a) the new parent obtains control of the original parent by issuing equity instruments in exchange for existing equity instruments of the original parent;
- (b) the assets and liabilities of the new group and the original group are the same immediately before and after the reorganisation; and
- (c) the owners of the original parent before the reorganisation have the same absolute and relative interest in the net assets of the original group and the new group immediately before and after the reorganisation.

IAS 27 is also amended so that the above provisions also apply to the measurement of the cost of investment when an entity that is not a parent, establishes a new entity as its parent.

## Effective date and transitional arrangements

### *Amendments to IFRS 1*

The amendments to IFRS 1 apply to annual periods beginning on or after 1 January 2009, with earlier application being permitted. Where the amendments are applied to an earlier period that fact should be disclosed.

### *Amendments to IAS 27*

The amendments to IAS 27 are to be applied prospectively for annual periods beginning on or after 1 January 2009, with earlier application being permitted. Where the amendments are applied to an earlier period that fact should be disclosed.

Where an entity applies the amendments to IAS 27 to an earlier period, it is required to apply the related amendments to IAS 18, IAS 21 and IAS 36 at the same time.

Whilst the amendments to IAS 27 are generally to be applied prospectively, an entity may apply the requirements for the formation of a new parent retrospectively. When this amendment is applied retrospectively to a particular re-organisation, any such later re-organisations should also be restated.

Entities that are required to prepare their financial statements in accordance with IFRS as endorsed for use in the European Union (EU) will not be able to adopt the above amendments to IFRS 1 and IAS 27 (including the related amendments to IAS 18, IAS 21 and IAS 36) until these amendments are so endorsed. It is currently anticipated that this will be in the first quarter of 2009.

## Action required

The amendments to IFRS 1 simplify the determination of the cost of investment in subsidiaries, jointly controlled entity or associates at the date of transition in the separate financial statements of an entity. The changes remove a potentially significant barrier that has deterred some entities from adopting IFRSs in their separate financial statements.

However, entities are encouraged, before taking any decision to adopt IFRS in their separate financial statements, to confirm any associated tax consequences and consider the time and cost involved in obtaining information for, and preparing, any additional statements or disclosures that would be required in such financial statements.