

12 February 2008

Status: Exposure draft

Effective date:

Not implemented

Accounting impact:

Proposed changes to IFRS 1 and IAS 27



International Financial Reporting Bulletin

IASB publishes revised proposals for determining the cost of investment in separate financial statements

Background

On 13 December 2007, the International Accounting Standards Board (IASB) published for public comment a revised exposure draft of proposed amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* and IAS 27 *Consolidated and Separate Financial Statements*.

The exposure draft *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* was developed in response to comments received by the IASB on a related exposure draft that was published in January 2007.

In the light of comments received on that exposure draft and following further consultation with interested parties, the IASB has reconsidered and further revised its original proposals.

The new proposals are intended to address 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 International Financial Reporting Standards (IFRSs) cannot, in some circumstances, be achieved without undue cost or effort. This might create a barrier to the adoption of IFRSs by entities in their separate financial statements.

The proposals also address enquiries received about the measurement of cost in the separate financial statements of a new parent entity.

Proposed amendments to IFRS 1

Deemed Cost

The exposure draft proposes to allow an entity at its date of transition to IFRSs in its separate financial statements to use a deemed cost to account for its investment in a subsidiary, jointly controlled entity or associate.

The exposure draft proposes that an entity may choose as the deemed cost of such investments either:

- the 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;

- the carrying amount of the investment under previous GAAP at the date of transition.

The choice of using deemed cost and, if so, which deemed cost option to use is made separately for each investment.

The proposals would not be available for investments that are classified as held for sale or are included as part of a disposal group that is classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

Proposed amendments to IAS 27

Cost Method

The proposals in the exposure draft would delete the definition of the 'cost method' from IAS 27, thus removing the requirement to deduct distributions received from pre-acquisition profits from the cost of investment.

Instead, the proposals amend IAS 27 to require an investor to:

- recognise as income, dividends received from a subsidiary, jointly controlled entity or associate in the investor's separate financial statements; BUT
- requires the investor to test that related investment for impairment in accordance with IAS 36 *Impairment of Assets*.

The proposed deletion of the cost method could remove a significant barrier that has deterred some companies from adopting IFRSs in their separate financial statements.

Formation of a new parent

The exposure draft proposes changes to the accounting for an investment in a subsidiary, in a new parent entity's separate financial statements where:

- a parent company or a single entity (an existing entity) decides to reorganise its operating structure by forming a new parent entity, such that the existing entity becomes a wholly-owned subsidiary of the new parent; and
- the new parent is formed in a manner that does not change:
 - the relative ownership interests of the owners of the existing entity; or
 - the equity, assets and liabilities of the group.

The exposure draft proposes that the new parent should measure the cost of its investment using the carrying amounts of the equity, assets and liabilities of the existing entity at the date when the new parent is formed.

Proposed Transitional Arrangements

The exposure draft proposes that the amendments to IFRS 1 and IAS 27 are applied prospectively, but that earlier application would be permitted.

Action required Although the proposals in the exposure draft are not yet available for implementation, companies should consider these potential future changes in order to assist with their planning. However, companies are strongly advised that, before taking any decision to adopt IFRS in their individual financial statements, they should check the associated tax consequences and consider the time and cost involved in obtaining information for, and preparing, the cash flow statement and additional disclosures that would be required in these financial statements.



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