Deutsches Rechnungslegungs Standards Committee e.V.
Accounting Standards Committee of Germany
Der Standardisierungsrat

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Mr Stig Enevoldson
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Berlin, 19 April 2007

Dear Stig

EFRAG Draft Comment letter: Exposure Draft of Proposed Amendments to IFRS 1 First-time Adoption of International Financial and Reporting Standards: Cost of an Investment in a Subsidiary

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on EFRAG's draft comment letter on the Exposure Draft of Proposed Amendments to IFRS 1 First-time Adoption of International Financial and Reporting Standards: Cost of an investment in a subsidiary. The GASB appreciates the opportunity to comment EFRAG´s draft comment letter.

In paragraph 3 of the EFRAG´s draft comment letter EFRAG concerns that clarification is need whether the IFRS numbers are based on the consolidated or separate financial statement and whether consolidation adjustments such as accounting policy adjustments should be included or not when a subsidiary becomes first-time adopter later than its parent. The GASB do see the issue that the carrying amount of a subsidiary can be determined differently according to the option of IFRS 1 paragraph 24 a and b. Therefore, there is not only one set of IFRS numbers that could pertain to the subsidiary. However, the numbers are determined by exercising the option by the entity.

Hence, the GASB´s view of the text *"in the subsidiary´s balance sheet* (ED amend IFRS Appendix B paragraph B5)" would be referring to single financial statements. The GASB does not think that the text refers to the IFRS numbers of consolidated financial statements even if the IFRS numbers in the separate financial statement were taken from the consolidated financial statement. There could be cases when the numbers of separate financial statements would be the same as the numbers according to the subsidiary´s portion of the consolidated financial statements. The GASB does not think clarification is necessary. However, the GASB believes a clarification that the numbers of the subsidiary´s balance sheet referring to its separate financial statements would not be harmful.

Furthermore, EFRAG requests in paragraph 4 of its draft comment letter clarification whether the carrying amount requires any effects arising from consolidation adjustments such as accounting policy adjustments and the business combination, i.e. whether the measurement is determined on a “separate” or a “consolidated” basis, when a parent becomes a first-time adopter later than its subsidiary. As explained above the GASB does not think clarification is necessary. However, the GASB believes a clarification would not be harmful.

The detailed GASB´s analysis of the Exposure Draft of Proposed Amendments to IFRS 1 First-time Adoption of International Financial and Reporting Standards: Cost of an investment in a subsidiary which has been sent to the IASB is set out in the appendix.

If you would like any clarification of these comments do not hesitate to contact me.

Yours sincerely

Prof. Dr. Harald Wiedmann
President

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Sir David Tweedie
Chairman of the
International Accounting Standards Board
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Berlin, 19 April 2007

Dear Sir David

Exposure Draft of Proposed Amendments to IFRS 1 First-time Adoption of International Financial and Reporting Standards: Cost of an Investment in a Subsidiary

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on the Exposure Draft of Proposed Amendments to IFRS 1 First-time Adoption of International Financial and Reporting Standards: Cost of an investment in a subsidiary. The GASB appreciates the opportunity to comment on the proposals.

The GASB supports the efforts of the IASB to grant some relief from the requirements in IAS 27 Consolidated and Separate Financial Statements on the first-time adoption to IFRS of a parent. The relief relates to the initial determination of the cost of an investment in a subsidiary according to IAS 27 in the first separate financial statement under IFRS. The GASB is aware that in some circumstance it could be difficult to adopt IAS 27. Therefore, the GASB welcomes the relief on the requirements in principle.

However, the proposed amendments to IFRS 1 do not provide relief determining the initial cost of a subsidiary for many parents as we explain in detail in appendix A question 1. Therefore, the GASB suggests adding another alternative permitting the cost determined under previous GAAP as deemed cost for IFRS purposes. This alternative could be restricted to such cases where the approach to determine cost under previous GAAP follows the same general principles as IAS 27, e.g. effects of a tax-driven accounting should be excluded.

In addition, the GASB appreciates providing relief on the classification of accumulated profits in pre- and post-acquisition profits. However, the GASB proposes in line with its recommendation to the initial cost permitting classifying the pre-acquisition profits in accordance with previous GAAP as explained in the preceding paragraph.

The proposed amendments to IFRS 1 provide relief only to the accounting for investments in subsidiaries. However, according to IAS 27.37 (a) the cost method is also applicable to investments in jointly controlled entities and associates. The GASB believes that it is worth considering extending the scope of the proposed amendments to investments in such entities.

The detailed comments of the GASB on the questions to the Exposure Draft of Proposed Amendments to IFRS 1 First-time Adoption of International Financial and Reporting Standards are set out in the appendix.

If you would like any clarification of these comments do not hesitate to contact me.

Yours sincerely

Prof. Dr. Harald Wiedmann
President

Appendix: GASB´s Comments on ED of Proposed Amendments to IFRS 1 First-time Adoption of International Financial and Reporting Standards: Cost of an Investment in a Subsidiary

Question 1

IAS 27 requires a parent, in its separate financial statements, to account for an investment in a subsidiary either at cost or at fair value (in accordance with IAS 39 Financial Instruments: Recognition and Measurement). However, the Board believes that in some cases, on first-time adoption of IFRSs, the difficulties in determining cost in accordance with IAS 27 exceed the benefit to users.
This Exposure Draft proposes to allow a parent, at its date of transition to IFRSs, to use a deemed cost for an investment in a subsidiary. The deemed cost would be determined using either the carrying amount of the net assets of the subsidiary, or its fair value, at that date. Is this appropriate? If not, why?

The GASB welcomes granting relief on the requirements of IAS 27 to determine the cost of an investment in a subsidiary in the first separate financial statements of a parent. However, the proposed amendments to IFRS 1 do not provide relief for many parents determining the initial cost of a subsidiary for the following reasons:

1. The ED allows a parent company determining the cost of an investment in a subsidiary using the net assets of the subsidiary as deemed cost. The net assets of the subsidiary are the carrying amounts of the assets and liabilities in the balance sheet of the subsidiary in accordance with IFRS at the date of transition of the parent company. The GASB concerns cases in which the previous purchase price paid by the parent will include a derivative goodwill: The net assets on the balance sheet of the subsidiary regularly do not include that goodwill. Therefore, some parents would have to recognise their investment in the subsidiary in the first separate financial statements under IFRS at an amount significantly lower than the paid purchase price in such cases. Although we acknowledge the net asset approach could be a relief we do not support this approach due to this misleading presentation.

   A theoretical solution to that problem might be a modification of the net asset approach by adding the amount of the goodwill which is measured according to the requirements of IFRS 1 appendix B or the amount under IFRS 3 if IFRS 3 is applied retrospectively. However, in many situations it may be impossible or burdensome to identify the goodwill of each subsidiary. Therefore, the GASB believes that this modification would not provide effectively relief for many parents.

   Another issue concerning the net asset approach arises when the net assets are negative. In such case it is not feasible to recognise a negative amount for the investment. Therefore, the standard should clarify that the deemed cost of the investment in a subsidiary should be zero if the net assets are negative.

2. The ED proposes as an alternative to the net asset approach the use of the investment's fair value as deemed cost. Determining the fair value can be very costly and time-consuming. A parent would need multi-year forecasts on subsidiary level to create a discounted cash flow model for each subsidiary. Therefore, the GASB does not agree that using the fair value as deemed cost provides effective relief from the retrospective application of IAS 27.

As explained above in the GASB´s view, using the net assets or the fair value as deemed cost either results in a misleading presentation or is costly. For that reason, the GASB suggests to add another alternative by permitting the use of the cost determined under previous GAAP as deemed cost. Although the use of the fair value or the net assets as deemed cost would provide an informational advantage at the date of transition in comparison to the previous purchase price of the subsidiary which is usually used in accordance with IAS 27 or previous GAAP, this informational advantage would diminish over time because any deemed cost would less represent the amount of the current net assets or the current fair value over time due to the fact that the cost method does not allow a subsequent remeasurement.

The alternative permitting the cost measured under previous GAAP could be limited to such cases where the approach to determine cost under previous GAAP follows the same general principles as IAS 27, e.g. effects of a tax-driven accounting should be excluded. This restriction would avoid the recognition of nominal values which are used to measure cost under particular national GAAP. Allowing cost under previous GAAP as deemed cost under IFRS would also be consistent with the requirements of the current IFRS 1 in respect of business combinations. According to IFRS 1 Appendix B a first-time adopter may keep the amounts of the goodwill measured by previous GAAP in principle.

Question 2

The cost method in IAS 27 requires a parent to recognise distributions from a subsidiary as a reduction in the cost of the investment to the extent they are received from the subsidiary's pre-acquisition profits. This may require a parent, in some cases, to restate the subsidiary's pre-acquisition accumulated profits in accordance with IFRSs.
Such a restatement would be tantamount to restating the original business combination, requiring judgements by management about past conditions after the outcome of the transaction is known.
This Exposure Draft proposes a simplified approach to determining the pre-acquisition accumulated profits of a subsidiary for the purpose of the cost-method in IAS 27. Is this appropriate? If not, why?

The GASB appreciates providing relief on the classification of accumulated profits in pre- and post-acquisition profits.

If a parent company makes use of the relief measuring an investment in a subsidiary using the deemed cost the parent company shall treat all accumulated profits of the subsidiary under IFRS as pre-acquisition accumulated profits. This requirement is consistent with the proposed options restating the cost of the investment in a subsidiary (net assets or fair value as deemed cost). Deeming all accumulated profits on transition to IFRS as pre-acquisition would be the equivalent of resetting the acquisition date of the subsidiary at the date of transition to IFRS. This requirement would avoid a "double accounting" in the accumulated profits of the parent company by restating the cost of the investment in the amount of net assets or fair value and the distributed profits after the transition date.

However, the GASB holds a different view regarding its proposal outlined above to allow cost determined under previous GAAP as deemed cost. In this case deeming all accumulated profits on transition to IFRS as pre-acquisition would be a penalty for many companies as the profits earned between the acquisition and the transition date cannot be recognised as income when they are distributed to the parent company after the transition date. Therefore, the GASB recommends permitting a classification of pre-acquisition profits in accordance with previous GAAP if previous GAAP is used as deemed cost.