THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

26 February 2008

Our ref: ICAEW Rep 21/08

Your ref:

Sir David Tweedie
Chairman
International Accounting Standards Board
First Floor
30 Cannon Street
London EC4M 6XH

By email: commentletters@iasb.org

Dear David

AMENDMENTS TO IFRS 1 AND IAS 27

The Institute of Chartered Accountants in England and Wales is pleased to respond to your request for comments on the 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', published in December 2007.

Please contact me if you would like to discuss any of the points raised in the attached response.

Yours sincerely

Desmond Wright

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THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW Representation

ICAEW REP 21/08

AMENDMENTS TO IFRS 1 AND IAS 27

Memorandum of comment submitted in February 2008 by The Institute of Chartered Accountants in England and Wales, in response to the International Accounting Standards Board 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', published in December 2007.

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on the exposure draft of proposed Amendments to IFRS 1 *First-time Adoption of International Financial Reporting standards a*nd IAS 27 *Consolidated and Separate Financial Statements* - 'Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate', published by the International Accounting Standards Board in December 2007.

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

MAJOR POINTS

Support for the proposals

4. We very much welcome the proposals in the Exposure Draft, which will in many cases serve to ease the burden on preparers of adopting IFRS. We appreciate the time and trouble the Board has spent on this issue, to the extent of issuing a second exposure draft which we believe offers a substantial improvement on the previous proposals.

Automatic impairment testing on receipt of a dividend

5. We do not agree that, on receipt of a dividend from a subsidiary etc, there should be an automatic requirement to test the related investment for impairment. Requiring an impairment test of the investment in any period in which a dividend is paid seems to us to be unnecessarily onerous, as dividends are paid very frequently within groups (see paragraph 9 below).

Formation of a new parent

6. Paragraph 37A of the draft amendments to IAS 27 proposes that in applying paragraph 37(a) of IAS 27 to the formation of a new parent, the new parent should measure cost using the carrying amounts in the separate financial statements of the existing entity at the date of the formation. This will cause problems in jurisdictions such as the EU in the common circumstances in which the share capital issued by the new parent exceeds the net assets in the existing company. We suggest that paragraph 37A should therefore be deleted (see paragraph 11 below).

RESPONSES TO SPECIFIC QUESTIONS

Question 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 an 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 or the previous GAAP carrying amount of the investment at the entity's date of transition to IFRSs (see paragraphs 23A and 23B of the draft amendments to IFRS 1 and paragraphs BC8–BC13 of the Basis for Conclusions).

Question 1 **Do you agree with the two deemed cost options as they are described in this exposure draft? If not, why?**

7. We agree. Allowing a choice between previous GAAP carrying amount and fair value as deemed cost is a practical and conceptually sound solution to what has proved to be a difficult problem for many groups. We are very pleased that the Board has adopted this approach.

Question 2—Change in scope

The exposure draft proposes that the deemed cost option should be available for the initial measurement of investments in jointly controlled entities and associates when an entity adopts IFRSs in its separate financial statements (see paragraph BC14 of the Basis for Conclusions).

Question 2 **Do you agree with the proposal to allow the deemed cost option for investments in jointly controlled entities and associates? If not, why?**

8. We agree. We pointed out in our submission to the previous exposure draft on this topic that identical issues arise in practice in relation to associates and jointly controlled entities as arise in relation to subsidiaries. We are pleased that the Board has accepted this point.

Questions 3 and 4—Cost method

The exposure draft proposes to delete the definition of the 'cost method' from IAS 27. Additionally, the exposure draft proposes to amend IAS 27 to require an investor to recognise as income dividends received from a subsidiary, jointly controlled entity or associate in its separate financial statements. The receipt of this dividend requires the investor to test its related investment for impairment in accordance with IAS 36 *Impairment of Assets* (see paragraphs 4 and 37B of the draft amendments to IAS 27 and paragraphs BC15–BC20 of the Basis for Conclusions).

Question 3 **Do you agree with the proposal to delete the definition of the cost method from IAS 27? If not, why?**

9. We agree. We have previously discussed with IASB staff various problems arising from application of the cost method, and we agree with the analysis in the Basis for Conclusions. Recognising dividends as income is conceptually

sound, eliminates many problems that can arise in practice, and will reduce the record-keeping burden for companies.

Question 4 **Do you agree with the proposed requirement for an investor to recognise as income dividends received from a subsidiary, jointly controlled entity or associate and the consequential requirement to test the related investment for impairment? If not, why?**

10. We agree with the proposed requirement to recognise dividends received as income, but we do not agree that there should be an automatic requirement to test the related investment for impairment.

11. We understand that the Board would want to avoid systematic overstatement of investments in subsidiaries in the separate financial statements of the investor. However, requiring an impairment test of the investment in any period in which a dividend is paid seems to us to be unnecessarily onerous; dividends are paid very frequently within groups - potentially several times a year. We note that IAS 36 as it stands requires an impairment test whenever there is an indication that an asset may have been impaired. The proposed amendment to IAS 36.10 would have the effect of imposing a mandatory impairment test whenever a dividend is received even if there is no indication of impairment.. In reality, however, dividends do not normally lead to impairments, and we believe that this should be the default assumption.

12. We suggest that an impairment test should only be required if, in addition to the other IAS 36.12 indications, there is something unusual attaching to the payment of the dividend; for example:

- it is paid shortly after the acquisition;
- it is large in the context of performance in the current period; or
- it is significantly larger than previous dividends customarily paid by the company.

Question 5—Formation of a new parent

The exposure draft proposes that in applying paragraph 37(a) of IAS 27 to the formation of a new parent, the new parent should measure cost using the carrying amounts in the separate financial statements of the existing entity at the date of the formation (see paragraph 37A of the draft amendments to IAS 27 and paragraphs BC21 and BC22 of the Basis for Conclusions).

Question 5 **Do you agree with the proposed requirement that, in applying paragraph 37(a) of IAS 27, a new parent should measure cost using the carrying amounts of the existing entity? If not, why?**

13. We disagree. This appears to be no more than a short-term solution to a specific problem in certain jurisdictions. However, we believe that it will cause problems in other jurisdictions - not least the EU - in the common circumstances in which the share capital issued by the new parent exceeds the net assets in the existing company. Pending the outcome of the wider conceptual debate due to take place on business combinations under common control, we suggest that the Board should defer dealing with this

issue. Paragraph 37A should therefore be deleted. If the Board is anxious to address this issue immediately, we suggest that the standard should allow both existing amounts and fair value.

Question 6—Transition

The exposure draft proposes that the amendments to IFRS 1 and IAS 27 shall be applied prospectively.

***Question 6* Do you agree that prospective application of the proposed amendments to IFRS 1 and IAS 27 is appropriate? If not, why?**

14. We suggest that entities should also be given the option of retrospective application.

OTHER POINTS

Dividends received and receivable

15. Paragraph 37B states that an investor shall recognise dividends 'received' from a subsidiary etc, whereas IAS 18.30(c) states that 'dividends shall be recognised when the shareholder's right to receive payment is established' - ie, when the dividend is *receivable*. We suggest that paragraph 37B should be aligned with IAS 18.

Amendments to other IFRSs

16. We agree with the consequential amendments to other IFRSs, with the exception of:

(a) the proposed amendment to IAS 36. As set out in paragraphs 8-10 above, we do not agree with the requirement to test the investment In a subsidiary for impairment if a dividend is paid in the period, irrespective of whether there is any indication of impairment; and

(b) the proposed amendment to IAS 21. We agree that deleting the sentence has the benefit of removing a rule in order to leave some flexibility. However, we perceive that there may be a problem where a subsidiary is wound down and its capital repaid in the form of a dividend, because there will be no mechanism to recycle the exchange difference from the currency translation reserve. We suggest that this could be addressed by retaining the first part of the sentence and deleting the words 'for example when the dividend is paid out of pre-acquisition profits'.

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