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ED 152 sub 4

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Professor David Boymal
The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

8 May 2007

Dear David

Exposure Draft ED 152 Proposed Amendments to AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* – Cost of an Investment in a Subsidiary

I am enclosing a copy of the PricewaterhouseCoopers response to the IASB Exposure Draft of Proposed Amendments to AASB 1 *First-time Adoption of International Financial Reporting Standards* – Cost of an Investment in a Subsidiary. As a member of the PricewaterhouseCoopers network of firms, our comments on the matters raised in the International Accounting Standards Board (IASB) exposure draft have been considered in the firm's response to the IASB.

The response indicates we support the IASB's proposal to amend IFRS 1, as one of the main factors preventing further adoption of IFRS in some territories is the effect of the requirement in IAS 27 to measure investments in subsidiaries at cost and to determine the split between pre- and post-acquisition profits. We believe an exemption to provide a practical solution to these problems will be beneficial and elements of the IASB's proposals are helpful. However, we believe the IASB should allow entities to use previous GAAP carrying value as deemed cost.

We support the AASB's policy of bringing Australian Equivalents to International Financial Reporting Standards more into line with International Financial Reporting Standards. Accordingly, we believe AASB 1 should be amended to be equivalent to the revised IFRS 1, if the IASB amends the standards as a result of these proposals.

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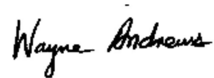
We would welcome the opportunity to discuss our views at your convenience. Please contact me on (02) 8266 8099 or Sue Whitechurch on (02) 8266 7543 if you would like to discuss this further.

Yours sincerely



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Mr. Jeff Singleton
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

27 April 2007

Dear Mr Singleton:

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

We are responding to your invitation to comment on the above Exposure Draft on behalf of PricewaterhouseCoopers.

Following extensive consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on the exposure draft. ‘PricewaterhouseCoopers’ refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We support the IASB’s objective of promoting the use of a single set of high quality accounting standards that may be used by companies across the globe. A significant constituency of potential IFRS adopters is entities that prepare separate financial statements. One of the main factors preventing further adoption of IFRS in some territories is the effect of the requirement in IAS 27 to measure investments in subsidiaries at cost and to determine the split between pre- and post-acquisition profits. An exemption to provide a practical solution to these problems will be beneficial and we believe will result in further IFRS adoption.

Elements of the proposals are helpful. We believe, however, that the Board should allow entities to use previous GAAP carrying value as deemed cost. This would be consistent with the Board’s approach in other parts of IFRS 1 (for example assets acquired in a business combination measured at cost, under IFRS 1.B2 (e)) It would also be consistent with the Board’s reasoning in the exposure draft for allowing entities to use previous GAAP pre-acquisition profits (in BC9). This method would be straightforward to apply and would not have a negative impact on an entity’s ability to pay dividends. This is likely to lead to many more companies considering adoption of IFRS.

We note that the Board rejected the use of a previous GAAP deemed cost, stating that it would provide less useful information than the other two methods proposed, and we acknowledge that a previous GAAP carrying amount may not be cost as defined by IAS 27. However, in many cases previous GAAP carrying value is a relevant cost-based measure to the group, even if not to the current holding company.

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For example, under UK law the application of group reconstruction relief had the effect of requiring subsidiaries, acquired by way of shares from another group company, to be recorded at the historical cost previously recorded by the selling group company. The arrangement was designed to recognise capital maintenance principles and so prevent the carrying amount of an investment in a subsidiary being reduced on transfer from one group company to another.

We support the use of fair value as deemed cost, consistent with other reliefs available on first-time adoption. We note that the use of a previous valuation is already permitted by IFRS 1.19. Therefore, the Board could cross-refer to paragraphs 16-19 of IFRS 1.

If the Board decides to accept our proposal for a previous GAAP carrying value deemed cost, we propose that net asset value deemed cost is removed. In many groups no consolidated information will have been prepared at an intermediate parent entity level. Accordingly, applying net asset value as deemed cost will be difficult and costly in many cases. In addition, in some circumstances net asset value will be lower than the previous GAAP carrying value, which may result in entities having to use fair value as deemed cost in order to avoid recording a debit in equity.

We support the Board’s proposals regarding determination of pre-acquisition profits. As set out in the Appendix to this letter, we believe it would be useful to provide additional guidance on how to determine post-acquisition profits at the date of transition.

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If you have any questions in relation to this letter please do not hesitate to contact John Brendon (020 7804 4816) or Ian Wright (020 7804 3300).

Yours faithfully

PricewaterhouseCoopers LLP

Appendix A

Detailed response to the questions posed within the IASB Exposure Draft - Amendments to IFRS 1 First-time Adoption of International Financial 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 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?

We agree with the proposal to allow a fair value deemed cost to be used as an alternative to restating cost in accordance with IAS 27. We note that the use of a previous GAAP revaluation or an event-driven valuation is already permitted by IFRS1.19 and the Board could clarify this by a cross-reference from the section on cost of investment in a subsidiary to IFRS 1.16-19.

We believe that the Board should remove the net asset value as deemed cost exemption and should allow a previous GAAP carrying amount as deemed cost, for the reasons set out in our covering letter.

If the Board proceeds with its proposed exemptions it will need to consider certain issues:

1) Interaction with the consolidation exemption at IFRS 1.B2 (j) - there may be situations where a parent restates the cost of its subsidiaries using the proposed exemption and later prepares IFRS consolidated financial statements. If the cost of a subsidiary is restated to net asset value there may be no goodwill when the subsidiary is consolidated. Conversely, if fair value as deemed cost is used internally generated goodwill would be recognised when the subsidiary is consolidated.

2) How net assets as deemed cost should be applied when a subsidiary has net liabilities.

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?

If an entity uses a fair value or net asset value as deemed cost we agree with the proposed exemption in paragraph B6(a) on the assumption that any credit recognised in equity when the investment is restated to fair value or net asset value is a profit which, if paid further up the group, would result in income. Paragraph BC8 appears to support this assumption but we believe this should be stated explicitly in the basis for conclusions. We also agree with the proposals in paragraph B6 (b).

If the Board accepts a previous GAAP carrying amount as deemed cost it will need to provide guidance on how to calculate post acquisition profits at the date of transition. Our view is:

- Entities that can determine pre-acquisition profits in accordance with IAS 27 should do so.
- Entities that are not able to determine pre-acquisition profits in accordance with IAS 27 should be allowed to treat all retained profits as post-acquisition at the date of transition up to the maximum amount that could be distributed without resulting in an impairment of the cost of the investment.

The logic for this approach is that the previous GAAP carrying amount will represent a cost based measure in most cases. If a dividend results in the impairment of that cost then it implies that it has been paid out of pre-acquisition profits. The approach is practical to apply at transition and will prevent there being an incremental negative effect on the ability of groups to make distributions to shareholders. Preparation of separate financial statements is mainly driven by local legal and distributable profits requirements. Allowing some flexibility in the determination of pre-acquisition profits is likely to encourage more companies to adopt IFRS.

Other comments

Presentation of the proposed amendments

The Exposure Draft considers that the proposed amendment will be included in Appendix B of IFRS 1 First-time Adoption of International Financial Reporting Standards dealing with business combinations. We believe that it would be more appropriate to have a separate section in IFRS 1 (for example, Appendix C on preparing separate financial statements on first time adoption) as different principles apply to the preparation of separate financial statements.

We are also concerned that if the exemption is included in Appendix B of IFRS 1, the provisions of paragraph B3 will apply, and that entities that have restated business combinations in their consolidated financial statements will be forced to restate the cost of investments in subsidiaries. Moving this exemption would clarify that this is not intended, and also that the proposed exemption is not meant to apply to the cost of investment in associates and joint ventures.

Pre-acquisition profits

Paragraph IG31A says that the net assets of a subsidiary are those of the group where the subsidiary is the parent. This could imply that pre-acquisition profits of an investee are also those of the investee group. Our view is that this prejudges future Board discussions on separate financial statements and the application of the cost method. The Board should make it clear that paragraph IG31A is only for the purposes of determining the net asset value and not for any other purpose.

BC5 of the ED states '...If the parent acquired a subsidiary before the parent's date of transition to IFRS's, the parent might need to know the subsidiary's pre-acquisition accumulated profits under IFRSs for the purpose of the cost method'. This would imply that pre- and post-acquisition profits are calculated on an IFRS basis. This should be removed by deleting “under IFRSs'” since BC5 is making different point.