



Technical Accounting Alert

Amendments to AASB 1 and AASB 127 – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate

Introduction

The IASB has issued amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* and IAS 27 *Consolidated and Separate Financial Statements*, entitled *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* ('the Amendments').

The AASB issued an identical amendment as AASB 2008 – 7 in July 2008.

Overview

The amendments affect only the separate financial statements of a parent entity or investor. The main changes are:

- the introduction of a 'deemed cost' exemption into AASB 101 for first-time adopters of IFRS when measuring the cost of an investment in a subsidiary, jointly controlled entity or associate;
- the removal of AASB 127's requirement to deduct pre-acquisition dividends from the cost of an investment in subsidiary, jointly controlled entity or associate in profit or loss in the separate financial statements of the investor entity; and
- new requirements on accounting for the formation of a new parent

A brief discussion of each of these changes follows:

Deemed cost exemption

The Amendments allow an entity that is a first-time adopter of IFRS to use a 'deemed cost' when measuring an investment in a subsidiary, jointly controlled entity or associate on transition to IFRS. This deemed cost can be determined using either fair value in accordance with AASB 139 *Financial Instruments: Recognition and Measurement* at the entity's date of transition to IFRS or a previous GAAP carrying amount at that date.

An entity is able to choose whether to use the deemed cost exemption on an item-by-item basis for each investment in a subsidiary, jointly controlled entity or associate.

Grant Thornton Australia note that this is unlikely to have any significant impact in Australia given that reporting entities are currently operating under the IFRS regime.

Pre-acquisition dividends in the separate financial statements of the investor entity

The Amendments delete the definition of the 'cost method' in AASB 127. Cost (or, alternatively, AASB 139) will still be used for measuring investments in subsidiaries in the separate financial statements of the parent but that term will have its usual meaning. The same change applies to investments in jointly controlled entities or associates.

More specifically, dividends received out of the investee's pre-acquisition profits will no longer be deducted from cost in the parent or investor's separate financial statements. Instead, dividends receivable will be recorded as income but may also give rise to impairment of the

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investment. AASB 136 *Impairment of Assets* has been amended to include the following as specific **indicators** that the investment may be impaired:

- the carrying amount of an investment in a subsidiary, jointly controlled entity or associate in the separate financial statements of the investor entity exceeds the carrying amounts in the consolidated financial statements of the investee's net assets, including associated goodwill
- a dividend receivable or received exceeds the total comprehensive income of the subsidiary, jointly controlled entity or associate in the period the dividend is declared.

Previously a parent entity recognised income from the investment only to the extent that it received distributions from accumulated profits of an investee arising after the date of acquisition. Distributions received in excess of such profits were regarded as a recovery of the investment and were recognised as a reduction of the cost of the investment. This requirement has given rise to practical problems in determining whether dividends relate to pre- or post-acquisition profits.

Formation of a new parent

The Amendments introduce new guidance on accounting when a parent reorganises the structure of its group by establishing a new entity as its parent and the interests of shareholders are not affected. In such a situation, the new parent shall measure cost at the carrying amount of its share of the equity items shown in the separate financial statements of the original parent at the date of the reorganisation.

Effective date

The Amendments shall be applied for annual periods beginning on or after 1 January 2009.

Specific transition provisions for each amendment and each consequential amendment are specified in AASB 101.47K, AASB 127.45B and 45C, AASB 118.38 and AASB 136.140D.

Further information

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