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International Accounting Standards Board

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Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: **September 2007, London**

Project: ***At the time an entity makes the distributions*, how should any difference between the carrying amount of the dividends payable and the carrying amount(s) of the assets distributed be accounted for? (Agenda Paper 2B)**

THE PURPOSE OF THIS PAPER

1. Paper 2A discusses how an entity should initially and subsequently measures its dividends payable in accordance with IFRSs. This paper considers another time– that is, the time the entity makes the distributions.

2. When an entity settles its dividends payable by distributing its assets to its equity holders, it should *remove* the dividends payable from its balance sheet. This is clearly because the entity has settled the dividends payable.

3. Similarly, when an entity distributes its assets, it should, in most cases, remove the assets concerned from its balance sheet. This is because the entity has lost control over and the economic benefits derived from the assets concerned. The

following IFRS literature requires an entity to derecognise an asset when it does not expect future economic benefits from the asset:

- Paragraph 67(b) of IAS 16 *Property, Plant and Equipment* requires the carrying amount of an item of property, plant and equipment to be derecognised when no future economic benefits are expected from its use or disposal.

- Paragraph 112(b) of IAS 38 *Intangible Assets* requires an intangible asset to be derecognised when no future economic benefits are expected from its use or disposal.

- Paragraph 17 of IAS 39 requires an entity to derecognise a financial asset when, and only when: (a) the contractual right to the cash flows from the financial asset expire; or (b) it transfers the financial asset as set out in paragraphs 18 and 19 of IAS 39 and the transfer qualifies for derecognition in accordance with paragraph 20 of IAS 39.

4. However, when an entity distributes some ownership interests in its subsidiary to its equity holders and retains the controlling interest in the subsidiary, the entity does not remove the ownership interest distributed from its consolidated balance sheet. Instead, it adjusts the carrying amount of the non-controlling interests (or the minority interests).

5. Therefore, this paper discusses:

   - how any difference between the carrying amount of the dividends payable and the carrying amounts of the assets concerned should be accounted for, when an entity derecognises both at the time of the distribution; and

   - how any difference between the carrying amount of the dividends payable and the adjustment to the carrying amount of the non-controlling interest should be accounted for when an entity distributes some ownership interests in its subsidiary to its equity holders and retains the controlling interest in the subsidiary at the time of distribution. The discussion in this paper makes reference to the requirements in revised IAS 27 *Consolidated and Separate Financial Statements*[1].

WHERE SHOULD THE DIFFERENCE GO?

Situation 1 - A situation in which an entity *loses control over* the assets distributed (ie the entity derecognises the assets distributed)

6. Under Situation 1, the entity derecognises both the carrying amounts of the dividends payable and the carrying amount of the assets distributed.

7. In the staff's view, the carrying amounts of the assets distributed would not be greater than the carrying amount of the dividends payable. Paper 2D discusses whether an entity should apply IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* to the assets to be distributed at the time it declares the distributions. Consequently, when the entity derecognises the dividends payable and the assets concerned, there is normally a credit entry to be made.

8. A credit amount arises due to:

   - An increase in the carrying amount of a liability;
   - A decrease in the carrying amount of an asset;
   - A contribution from the equity holders of an entity; or
   - Income that represents increases in economic benefits in the form of inflows or enhancements of assets or decreases of liabilities (see paragraph 69 of the Framework).

9. The credit amount that arises at the time the entity makes the distributions is clearly ***not*** attributable to the first three items described in paragraph 8. Indeed, the credit amount arises as a result of the settlement of the dividends payable – that is, the derecognition of a liability.

[1] [Sentence omitted from observer note].

10. Paragraph 92 of the Framework states: ‘Income is recognised in the ***income statement*** when an increase in future economic benefits related to an increase in an asset or ***a decrease of a liability*** has arisen that can be measured reliably.’

11. Based on these requirements, the staff believes that the credit balance arising at the time an entity settles its dividends payable should be recognised in profit or loss.

12. Such an accounting treatment is also consistent with the following:

- When an entity realises an asset through a disposal, any gain or loss on the disposal is recognised in profit or loss.

- Any difference between the carrying amount of the dividends payable and the carrying amounts of the assets distributed represents the cumulative unrecognised increases in economic benefits of the assets distributed. Until the entity distributes the assets to its equity holders, that difference reflects the performance of the entity and belongs to the entity. Therefore, such a difference should be recognised in profit or loss when the assets are distributed.

Questions for the IFRIC

13. Does the IFRIC agree that any difference between the carrying amount of the dividends payable and the carrying amounts of the assets derecognised should be recognised in profit or loss? If not, why not?

14. If the IFRIC believes that the difference should not be recognised in profit or loss, where does the IFRIC believe the difference should be recognised? Why?

Situation 2 - A situation in which an entity distributes some ownership interests of its subsidiary to its equity holders *but still has control* over the subsidiary after the distributions

15. It is important to differentiate between Situation 1 and Situation 2: In Situation 1, the entity loses control over the assets distributed while, in Situation 2, the entity does not lose control over the subsidiary.

16. In addition, in Situation 2, the subsidiary's individual assets and liabilities are ***not derecognised*** in the consolidated financial statements of the entity. Instead, the carrying amount of the non-controlling interests is adjusted. However, in Situation 1, the entity derecognises the assets distributed.

17. Due to these differences, the staff considers Situation 1 and Situation 2 separately.

18. The discussion below focuses on the ***consolidated financial statements*** of an entity that makes the distributions.

19. Current IFRSs do not address how any difference between the carrying amount of the dividends payable and the adjustment to the carrying amount of the non-controlling interests should be accounted for. Recently, the Board approved a revised version of IAS 27[2] that includes the following requirements: [The following sentences omitted from observer note].

20. [Paragraph omitted from observer note].

21. [Paragraph omitted from observer note].

Question for the IFRIC

22. Does the IFRIC agree that any difference between the carrying amount of the dividends payable and the adjustment to the carrying amount of the non-controlling interest should be recognised directly in equity in accordance with revised IAS 27?

[2] [Sentence omitted from observer note.]