30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
E-mail: iasb@iasb.org Website: www.iasb.org

International
Accounting Standards
Board

This observer note is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. Views expressed in this document are identified by the staff as a basis for the discussion at the IFRIC meeting. This document does not represent an official position of the IFRIC. Decisions of the IFRIC are determined only after extensive deliberation and due process. IFRIC positions are set out in Interpretations.

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: **July 2008, London**

Project: **D23 *Distribution of Non-cash Assets to Owners* – Comment Letter Analysis (part 1) – General and Questions 1&2 (Agenda Paper 3A)**

Introduction

1 This paper provides an overview of the comment letter analysis on the proposals (for general comments and the comments to the individual questions 1 and 2) in D23 *Distribution of Non-cash Assets to Owners* with staff recommendations for the next steps the IFRIC should take in this project.

2 The staff's approach to the redeliberations is to ask the IFRIC to reconsider its conclusions on the fundamental issues before considering minor and drafting issues. If the IFRIC confirms the approach for the next step in this meeting, the staff will present the remainder of the issues and a revised interpretation for approval in September.

Overview of comments

3 The IFRIC received 56 comment letters. The commentators' views on the individual questions are summarised in the following paragraphs.

Question 1 Specifying how an entity should measure a liability for a dividend payable (dividend payable)

4 Paragraph 9 of the draft Interpretation proposes that an entity should measure a liability to distribute non-cash assets to its owners in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The IFRIC concluded that all dividends payable, regardless of the types of assets to be distributed, should be addressed by a single standard.

5 36 commentators agree with the proposal, while 15 commentators disagree. Among those who disagree with the proposal, 2 commentators agree with a single standard. However, 9 commentators disagree with a single standard.

6 The staff noted comments on the best estimate measurement attribute in IAS 37.

"In our view, the best estimate measurement attribute in IAS 37 is not necessarily the same as fair value; in some circumstances it might be interpreted to be something else. We would be concerned if the implication of D23 was that the measurement attribute in IAS 37 should always be interpreted to be fair value. " (CL55 EFRAG)

7 Some of those who disagree with the a single standard propose that an entity should measure a liability for a dividend payable in accordance with both IAS 37 (for distribution of non-financial assets) and IAS 39 (for distribution of financial assets).

"Assuming that a dividend payable may be interpreted as a contractual obligation, a dividend payable has to be classified as a financial liability in terms

of IAS 32.11 if the obligation has to be settled by delivering non-cash financial assets - just as is the case with ordinary cash distributions. These liabilities must be accounted for according to IAS 39." (CL4 Institut der Wirtschaftspruefer in Deutschland e.V.)

8 Some propose that IFRIC should require a liability for a dividend to be fair valued without specifying standards.

"We agree with the proposal within the draft Interpretation that a liability to distribute non-cash assets to owners should be measured at fair value, regardless of the types of assets to be distributed. However, we do not agree with the proposal that such distributions are addressed by a single Standard. We do not agree that when an entity enters into an obligation to distribute non-cash assets to its owners, the measurement of that liability falls within the scope of IAS 37. We do not believe that measurement of such a liability falls clearly within the scope of any specific Standard. Accordingly, we believe that the IFRIC should address the issue of measurement of the dividend payable by outlining the fundamental principle in the draft Interpretation. We therefore strongly recommend that IFRIC amend the draft Interpretation to require an entity to measure a liability to distribute non-cash assets as dividends to its owners at fair value without specifying the Standard to be applied to such measurement." (CL31 Deloitte Touche Tohmatsu)

Question 2 Specifying how any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable should be accounted for when an entity settles the dividend payable

9 Paragraph 12 of the draft Interpretation proposes that, when the dividend payable is settled, any difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable should be recognised in profit or loss. The Basis for Conclusions also includes an alternative view that the difference should be recognised directly in equity.

10 33 commentators support that this difference should be recognised in profit and loss mainly due to the reasons set out in the Basis for Conclusions.

"We support the view as we think that approach is most in line with the entity concept. That is, from perspective of the accounting entity, the nature of a gain realised by the distribution to its owners is the same as a gain realised in a sales transaction with independent parties." (CL26 Den norske Revisorforening)

" We also feel that such an accounting treatment will ensure consistency between an entity that has revalued its assets through profit or loss (investment properties at fair value with changes in fair value recognised in profit or loss, derivatives used as fair value hedge instruments instead of cash flow hedge instruments, etc.). Not recognising such an effect in profit or loss would also raise the question of the recycling of the gain or loss related to the financial assets available for sale and accounted for in other comprehensive income. IAS 39 states that at the time the assets are derecognised, the cumulative gain or loss previously recognised in equity is reclassified in profit or loss. We feel that IAS 39 does not allow for exemption to the recycling requirements." (CL30 Conseil National de la Comptabilité (CNC))

"EFRAG believes that paragraph 12 of D23 is the correct approach.
(a) The distribution of the assets to owners triggers the recognition of the value increase, but it is not the cause of the value increase.
(b) The increase in the value of the asset does not meet the definition of an owner change in equity. Rather, it meets the definition of income and should be recognised in profit and loss.
(c) If the entity had chosen to sell the asset and distribute the proceeds it would recognise the difference between the proceeds and the carrying amount of the assets in profit and loss (in accordance with IAS 16.68 and IAS 16.71). It seems right to account for the distribution of the asset in the same way." (CL55 EFRAG)

11 10 commentators support the view that this difference should be recognised in Equity mainly due to the reasons set out in the Basis for Conclusions.

"The majority of the AIC members support view 2 (The alternative view - as explained in D23.BC44) and argue that the distribution of a dividend (non-cash asset) represents a transaction between an entity and its owners. According to paragraph 70(b) of the Framework and IAS 1.106(c) (revised 2007), such transactions between an entity and its owners do not represent expense but rather need to be reflected in equity" (CL29 German Accounting Standards Committee (DRSC))

"From a purely technical standpoint we consider the arguments for recognition in profit or loss (at BC28-BC43) or in equity (at BC44) finely balanced. However, we are not convinced that recording income or (less commonly) an expense on distributions to owners results in useful information in practice. The fact that the recognised income or expense is not derived from an arm's length sale raises another concern over the reliability of the amounts. Finally, we are sympathetic to the alternative view expressed at BC44 that the 'credit balance' does not meet the definition of income in the Framework."(CL5 Grant Thornton International)

12 4 commentators propose that transactions should be measured at book value. They also propose that additional disclosure about the fair value of the assets distributed should be required.

"We believe that a distribution to shareholders, whether in cash or in kind is one non-exchange transaction with shareholders, to be recognised as an equity transaction. As such, we also disagree with the alternative view proposed in BC 44. Rather we propose that the transaction is accounted for at its carrying value with additional disclosure about the fair value of the assets involved." (CL23 Ernst & Young)

> *"Distributions of non-cash assets to owners are accounted for at book value in many jurisdictions, including the UK, where this has been generally accepted practice for many years without drawing criticism. This approach is simple and straightforward and provides useful information to users. …we believe that accounting at book value is an acceptable treatment, which would result in there being no difference to account for." (CL48 Institute of Chartered Accountants in England & Wales (ICAEW))*

Staff analysis

13 Although a majority of commentators support all the individual questions, some commentators expressed serious general concerns as well as concerns about the scope.

14 The balance of this paper addresses the following key concerns expressed by respondents:

- General concerns
- Concerns about the scope
- Concerns about Q1 and Q2

General concerns

15 Some commentators express serious general concerns. They do not support the IFRIC's proposals in general. They recommend that the IFRIC discontinue this project. Instead, they propose that the Board should deal with the project as part of its existing common control project.

> *"We believe that the accounting for non-cash assets to owners in their capacity as*

owners is an area with diversity in practice for which agreed principles should be developed. However, we do not support the IFRIC's proposals and we recommend that the IFRIC discontinue this project. Instead, we believe that the International Accounting Standards Board (the Board) should deal with the project as part of its existing common control project; there also is a link to the reporting entity phase of the Board's conceptual framework project." (CL24, KPMG)

"The underlying issue as to how to account for transactions with shareholders is broad but the scope of interpretation is narrow. And the foundation needed to develop an accounting treatment for transactions with owners, including non-cash distributions has not been developed. Therefore, we recommend that the issue be removed from the IFRIC agenda and the broader issue be addressed by the IASB in a more comprehensive process. We further observe that the IASB has recently included common control transactions on its agenda and that this project will consider the accounting for demergers, such as a spin-off of a subsidiary or business. Based on our experience, spin-offs are the most common example of non-cash distributions to owners found in practice. As the IASB is expected to address this matter as part of its common control transactions project, any conclusion reached should be consistent with the conclusions reached in the more comprehensive project referred to above." (CL37, Pricewaterhouse Coopers)

16 The staff acknowledges that the Board has recently added a common control transactions project to its agenda and that this project might consider the accounting for demergers, such as a spin-off of a subsidiary or business. However, the common control transactions project is now in its preliminary planning stage. Generally speaking, a Board project needs at least a few years to complete all required due process steps. The IFRIC as well as many correspondents recognise that the accounting for non-cash assets to owners in their capacity as owners is an area with diversity in practice due to lack of existing IFRS literatures, and therefore support including this project on its agenda.

"We agree that accounting for distributions of non-cash assets to owners is an area of diversity in practice and therefore support the IFRIC's decision to develop guidance. In our experience such distributions are accounted for in at least three different ways in accordance with existing IFRSs:

- *at the carrying amounts of the assets distributed;*
- *at the fair value of the assets, with any difference between fair value and carrying value recognised in equity;*
- *at the fair value of the assets, with any difference between fair value and carrying value recognised in profit or loss." (CL5 Grant Thornton International)*

"EFRAG agrees that existing IFRS lacks guidance on the accounting for distributions of non-cash assets to owners. We therefore support the IFRIC in its efforts to develop interpretative guidance on the issues addressed." (CL55 EFRAG)

17 The staff notes that the Board approved the release of the draft Interpretation, although it has recently added the common control transactions project to its agenda. The staff also notes that unless there is an agreement among shareholders, demerger transactions in which the shares of group entities are distributed to shareholders do not meet the definition of common control transactions in IFRS 3.

18 Therefore, the staff is of the view that the IFRIC should continue this project to provide guidance under current IFRS literature to reduce the divergence existing in practice.

Concerns about the scope

19 Some commentators express concerns about the narrow scope of the interpretation. They anticipate that as a result of the defined scope, the interpretation is likely to apply to a very limited number of transactions.

> *"It would be useful if the Basis for Conclusions explained how the draft Interpretation interacts with the common control project. We would like the scope specifically to indicate, at least in the Basis for Conclusions, that this Standard would apply to spin-offs effected through distributions. We would also like clarification as to whether a split-off (i.e. a transaction where a company is split into two separate entities, with the shareholders tendering their old shares in exchange for separate shares of the two new entities) would be covered by the Interpretation."(CL31 Deloitte Touche Tohmatsu)*

> *"While we understand the reasons for limiting the scope of this interpretation (particularly in light of the common control project that the Board is now involved in), we have concerns that it will be applied by analogy to situations without a direct prohibition on doing so. We also note that as a result of the scope, the interpretation is likely to apply to a very limited number of transactions." (CL23 Ernst & Young)*

20 In response to the commentators' concerns, the staff is of the view that the scope of the Interpretation should be expanded by removing the scope limitation for common control transactions (ie paragraph 5 of D23).

Key concerns about fair value measurement of the liability and using a single standard to measure dividends payable (Question 1 and Question 2)

21 Although a majority of commentators support the proposal for the individual questions (ie Question 1 and Question 2), some commentators expressed strong concerns as noted in the “overview of comments” section. In particular, IAS 37 does not clearly require fair value measurement of liabilities. Also, measurement of the liability at fair value may result in a measurement mismatch with the asset to be distributed (a so-called “accounting mismatch” exists in shareholders’ equity until distribution). Commentators acknowledge that this is not likely to be an issue in practice as the entities will generally organise the distribution to shorten the period between declaration and settlement.

22 Some commentators agree with the D23 proposal to measure liabilities at the fair value of the assets to be distributed only if IFRS 5 is amended to permit all assets to be distributed to be fair valued when the liability is recognised. If IFRS 5 is not amended in that way, they propose that the liabilities be measured at the carrying value of the assets to be distributed until the settlement date with the fair value disclosure in the notes.

23 The staff also acknowledges that many who support fair value measurement of the dividends payable do not support using IAS 37 or any other specific Standard as a basis for determining the measurement. These commentators believe that the IFRIC should consider possible measurement bases and specify the one that in its view is the most appropriate. The staff notes that the commentators are concerned that the implication of D23 might be that the measurement attribute in IAS 37 should always be interpreted to be fair value. This was obviously not the intention of D23 as that question is part of the Board’s project to amend IAS 37.

24 The staff agrees with commentators who have concerns about the IFRIC attempting to resolve the issues in this Interpretation in the light of the Board's recent amendment to IFRS 1 and IAS 27 on the cost of new parents/subsidiaries and its active projects on IAS 37, liabilities and equity and common control transactions.

25 In response to these key concerns, the staff proposes that the IFRIC modify the conclusions in the Interpretation to permit an entity to choose either of the following treatments as an accounting policy:

a) Recognise the dividend liability at the fair value of the assets to be distributed when declared and recognise profit or loss for the difference between the book value and fair value of the assets when they are distributed.

b) Recognise the dividend liability at the book value of the assets to be distributed when declared, and disclose the fair value of the assets to be distributed.

26 The staff believe that this approach might be well balance the urgent need to mitigate the divergence existing in the practice and the current lack of a clear direction from the current IFRS literature.

27 The staff do not propose adopting the alternative view set out in the BC44, and as supported by some commentators. Most commentators agreed with the conclusions set out in the Basis for Conclusions of D23:

a) The distribution of the assets to owners is a transaction with owners as owners and it results in a change in equity. It may also trigger the recognition of the value increase in the assets. However, the increase in the value of the asset does not meet the definition of an owner change in equity in accordance with IAS 1. Rather, it meets the definition of income and should be recognised in profit and loss.

b) If the entity had chosen to sell the asset and distribute the proceeds of the sale it would recognise the difference between the proceeds and the carrying amount of the assets in profit and loss (in accordance with various standards covering non-financial assets). It seems right to account for the substance of the asset distribution in the same way.

c) IAS 39 states that at the time the assets are derecognised, the cumulative gain or loss previously recognised in equity is reclassified in profit or loss. IAS 39 does not provide any exemption from these requirements if the assets are distributed to owners. It does not seem right to have different accounting consequences depending on which type of asset is distributed.

d) The *Framework* notes that the future economic benefits embodied in an asset may flow to the entity in a number of ways. For example, an asset may be: (a) used singly or in combination with other assets in the production of goods or services to be sold by the entity; (b) exchanged for other assets; (c) used to settle a liability; *(d) or distributed to the owners of the entity.*

Disclosure

28 The staff did not identify any serious concerns about the disclosure requirements proposed in paragraphs 13 to15 of D23. However, the staff is of the view that paragraph 14 of D23 (ie disclosures required by IAS 37 paragraphs 84 and 85, such as the carrying amount of liability at the beginning and end of the period, increases made in the period) should be amended. The disclosures should be required without reference to IAS 37 if the IFRIC accepts the staff recommendation regarding liability measurement as noted in paragraph 25 of this paper.

Summary of staff recommendations

Change in the approach for the next step

29 As stated in paragraphs 20, 25 and 28, the staff recommends that the IFRIC:

- continue the project. In the staff's view the divergence in practice warrants providing guidance before the various related Board projects can be completed.

- remove the scope limitation for common control transactions (ie paragraph 5 of Draft Interpretation D23). This recommendation is dependent on acceptance of the proposal to permit an accounting policy choice for the measurement of the dividend liability.

- permit an entity an accounting policy choice to measure non-cash distributions at the fair value or carrying value of the assets to be distributed as described in paragraph 25. An entity should be permitted to choose different policies for common control and third party transactions.

- keep the disclosures proposed in paragraphs 13 and 15 of D23) and amend paragraph 14.

Question for the IFRIC

30 Do you agree with staff recommendations in paragraph 29?