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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 2) – Question 3 and when to recognise liabilities (Agenda Paper 3B)**

Introduction

1 This paper provides an analysis of the comments on the proposals covered by question 3 in D23 *Distribution of Non-cash Assets to Owners* and includes staff recommendations for the next step.

2 Further, this paper provides a staff recommendation for the timing of recognition of liabilities.

Comments, staff analysis and staff recommendation

Should IFRS 5 apply?

Question 3 Whether an entity should apply the requirements in IFRS 5 to non-current assets held for distribution to owners

3 Both the Board and the IFRIC concluded that the requirements in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* should be applied to non-current assets held for distribution to owners as well as to non-current assets held for sale.

4 A large majority of commentators agree with the proposal. A few disagree.

"We do not believe that IFRS 5 requirements would in general be appropriate. Firstly, applying IFRS 5 to assets committed to be distributed but still being used by the entity would in our view lead to a distortion of economic reality as their depreciation would cease. Secondly, in many circumstances the value defined by IFRS 5 will often still result in a mismatch between asset and liability (if the latter were at fair value.) We also considered whether the assets involved should be transferred to a single current heading in the balance sheet: we concluded, however, that this information is better given as a disclosure, rather than changing the presentation of assets generally still being used in the entity's operations."(CL32 SwissHoldings)

" IFRS 5 is not the appropriate standard to deal with distributions to owners, because the carrying value of assets held for such distributions will not be recovered principally through a sale. The assets are not sold, nor is their carrying value recovered in any way: they are being given away to shareholders, who own them before and after the transaction."(CL48 ICAEW)

Staff analysis and recommendation

5 The IFRIC concluded that the carrying amount of the assets will no longer be recovered principally through continuing use. The IFRIC decided that the information required by IFRS 5 is important to users of financial statements regardless of the form of the disposal transaction (BC46 in D23).

6 Some commentators are concerned that the assets to be distributed may still be in use and thus the application of IFRS 5 would not be appropriate. This is because they think that assets being used should continue to be depreciated and that the carrying value of assets held for such distributions will not be recovered principally through a sale. Many respondents to the ED preceding IFRS 5 expressed similar concerns. However, there is no difference in this respect between assets that will be sold and assets that will be distributed.

7 The staff noted that the respondents who have such concerns supported viewing the distribution as an equity transaction in response to Question 2. However, the staff is of the view that distribution of the assets has the same economic consequences to the entity as sale of the assets – the value will not be recovered through use.

8 Therefore, the staff is of the view that IFRS 5 should be applied to the distribution of assets to owners. The staff recommend that IFRS 5 be amended to make it applicable to such distributions. The staff originally suggested that IFRS 5 would be applied by analogy and that relevant disclosures could be included in the Interpretation. However, the IFRIC concluded that IFRS 5 required amendment because IFRS 5 was being applied very strictly in practice – nothing but a sale would ever be considered.

Question for the IFRIC

9 Do you agree with the staff recommendation in paragraph 8?

When to apply IFRS 5

10 The Board noted that IFRS 5 requires an entity to classify a non-current asset as held for sale when the sale is highly probable and the entity is *committed* to a plan to sell. For assets held for distribution to owners, this raises the following three questions:

a) Should an entity apply IFRS 5 when it is committed to make a distribution or when it has an obligation to distribute the assets?
b) Do you think there is a difference between those dates?
c) If there is a difference between the dates and you think that an entity should apply IFRS 5 at the commitment date, what is the difference? What indicators should be included in IFRS 5 to help an entity to determine that date?

11 In response to question (a), a large majority of commentators are of the view that an entity should apply IFRS 5 when it is committed to make a distribution. A few commentators prefer when it has an obligation to distribute the assets. A similar small number of commentators are of the view that commitment date and obligation are same.

"We believe an entity should apply IFRS 5 when it is committed to making a distribution. In terms of IFRS 5 the classification of a non-current asset held for sale is made when the carrying amount will be recovered principally through a sale transaction and not through use. IFRS 5.7 states that this is when the sale is highly probable and the asset must be available for immediate sale in its present condition. IFRS 5.8 states that for a sale to be highly probable the entity must be committed to a plan to sell. By applying IFRS 5 from the date when the entity is committed to distribute the non-current asset there will be consistent treatment of sales of non-current assets and distributions of non-current assets."(CL8 FirstRand Banking Group)

12 In response to question (b), significant numbers of commentators are of the view that there is a difference between the commitment date and the obligation date.

"We believe that commitment date as defined by IFRS 5 and obligation date are different as a commitment date involves management's or owners' intention while an obligation is legally binding. We would expect that the commitment date will come earlier than the obligation date. Normally we would not expect a considerable time gap between these two dates." (CL37 Pricewaterhouse Coopers)

"If IFRS 5 is to be applied, it should be at the commitment date. However, this will not be the date at which the obligation arises. Paragraph AG13 of IAS 32 is clear that a liability is created for a distribution when a company formally acts to make one and the company becomes legally obligated to the shareholders to do so. Under UK law, declaration of a distribution by the directors does not create a legal obligation on the company. That does not happen until the distribution is declared by the company in general meeting; or in the case of an interim dividend authorised under the company's constitution, when the dividend is paid or settled."(CL48 ICAEW)

13 However, some commentators are of the view that there is no difference between the commitment date and the obligation date.

"We also believe that, in general, the time at which an entity is committed to distributing assets to owners is the point in time when the dividend is declared and the entity is thereby obligated to distribute the assets. There are several reasons why an entity may be committed to dispose of assets by sale some time prior to being obligated to dispose of the assets (which would require a sales agreement). Time may be required to put the asset into suitable condition to be saleable. Time may be also required to find a purchaser and further time to negotiate the terms of sale. These factors do not generally apply to the distribution of assets to owners. Any discussions between the entity and the owners about a proposed distribution

are about <u>whether</u> to distribute the assets and until that is decided the entity cannot be committed to distribute them." (CL3 AcSB)

14 In response to question (c), some commentators propose examples that could be used as indicators:

"the AC would consider that when the directors commit and propose a dividend for authorisation by the shareholders they should assess whether they consider that authorisation to be highly probable and if they do, then it would meet the definition set out in IFRS 5." (CL27 ICAI)

"We believe that IFRS 5, if amended, should list specific indicators for classifying assets as held for distribution. Such indicators may include the following:

- *Assets are available for immediate distribution in their current condition (incl. there are no legal restrictions to make the distribution)*
- *Owners have committed to a plan to distribute the assets*
- *The distribution is expected to be completed within 1 year*
- *Changes to the plan to distribute the assets are unlikely"*

(CL37 Pricewaterhouse Coopers)

"An entity becomes committed when:1) the appropriate level of management are committed to distribute the non-cash assets 2) shareholders' approval is highly probable." (CL49 National Australia Bank)

Staff analysis and recommendation

15 As a result of the comment letter analysis, the staff noted that, in many jurisdictions, shareholder approval is required to make a distribution and therefore in such jurisdictions, there could be a difference between the commitment date (ie the date when the dividend is committed by management) and the obligation date (ie the date when the dividend is approved by the shareholders if legally required in the jurisdiction). The staff also noted that some commentators think that, even in such jurisdictions, any discussions between the entity and the owners about a proposed

distribution are about whether to distribute the assets and until that is decided the entity cannot be committed to distribute them.

16 Therefore, the staff propose that IFRS 5 should be applied at the commitment date at which time the assets must be available for immediate distribution in their present condition and the distribution must be *highly probable*. For the distribution to be highly probable the appropriate level of management must be committed to the plan to distribute the assets and the plan must have been initiated. In addition, the distribution should be expected to be completed within one year from the date of classification, except as permitted by IFRS5 paragraph 9, and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

17 Further, the staff propose that the probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the distribution is highly probable.

Question for the IFRIC

18 Do you agree with the staff recommendations in paragraph 16 and 17?

When to recognise liabilities

19 D23 does not address when an entity should recognise a liability for a distribution. D23 says that applicable IFRSs and the Framework provide guidance on when an entity should recognise such a liability. Some commentators ask the IFRIC to clarify when to recognise the liability.

20 The staff notes that IAS 10 paragraph 13 says that “If dividends are declared (ie the dividends are appropriately authorised and no longer at the discretion of the entity) after the reporting period but before the financial statements are authorised for

issue, the dividends are not recognised as a liability at the end of the reporting period."

21 Some commentators state that in many jurisdictions people think that the entity has discretion until the shareholders approve the dividend. Therefore, they think there is a conflict between "declared" and the phrase in the bracket in IAS 10 paragraph 13, especially when they read "declared *by management but before the shareholders' approval* ".

22 The staff believes that once management (or the board of directors) declare dividends they do not have any real ability to withdraw the declaration, although the shareholders have the ultimate power to decide whether a dividend should be paid in many jurisdictions.

23 Therefore, the staff is of the view that the liability to make the distribution should be recognised:

a) when declaration of the dividend by management is approved by the shareholders, if the jurisdiction legally requires such approval and the declaration of the dividend is no longer at the discretion of the entity, or

b) when the dividend is declared by management, if the jurisdiction does not legally require shareholder approval and the declaration of the dividend is no longer at the discretion of the entity.

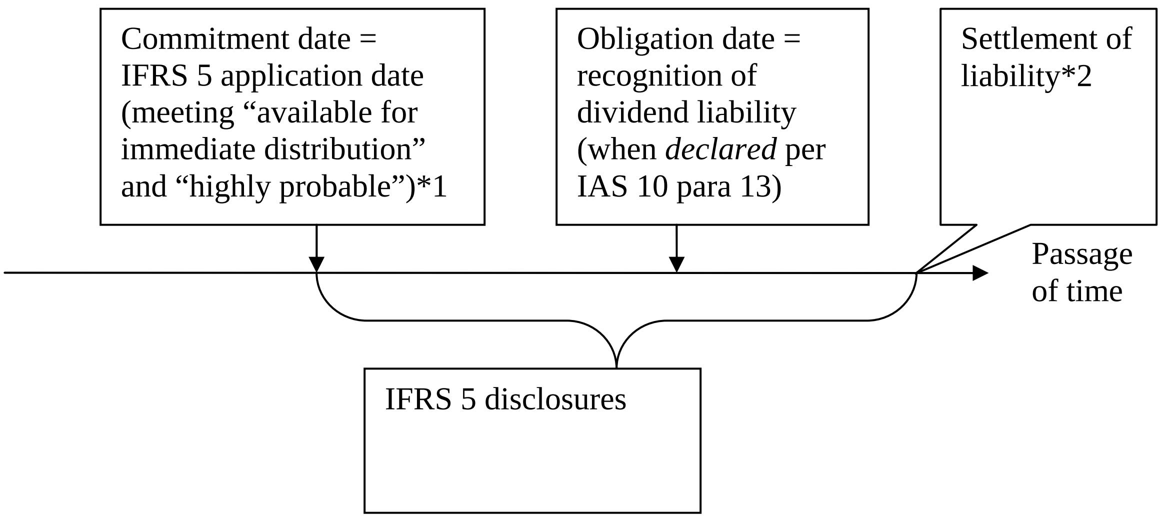
This should be included in the final interpretation.

Question for the IFRIC

24	Do you agree with staff recommendation in paragraph 23?

Appendix

The staff summarise the interaction between IFRS 5 disclosure requirements and the key timing of the distribution (ie commitment date, obligation date and settlement date).



*1 Recognise loss by applying lower of carrying amount and fair value less any costs to distribute
*2 Recognise any gain on settlement of dividend payable