

Mr Robert Garnett
Chairman
International Financial Reporting Interpretations Committee
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25 April 2008

Dear Mr Garnett,

IFRIC Draft Interpretation D23 *Distributions of Non-cash Assets to Owners*

Deloitte Touche Tohmatsu is pleased to comment on the International Financial Reporting Interpretations Committee's (the IFRIC's) Draft Interpretation D23 *Distributions of Non-cash Assets to Owners*.

We agree with and support the consensus proposed in the Draft Interpretation to measure a liability to distribute non-cash assets as dividends to its owners at fair value, with any difference between the fair value of the liability and the carrying amount of the non-cash assets being recognised in profit or loss. We also agree that the entity should apply the requirements of IFRS 5 to non-current assets held for distribution to owners. However, we have a number of concerns with the consensus which are outlined in our detailed responses to the specific questions for comment in Appendix A. In addition, we have included further comments and concerns on other aspects of the draft Interpretation in Appendix B to this letter.

Our key concern with the proposals outlined in the draft Interpretation is that 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 *Provisions, Contingent Liabilities and Contingent Assets*. This is because we do not believe that the distribution payable meets the definition of a provision in that Standard, i.e. the distribution is not a liability of uncertain timing or amount, because both elements are known at the time the distribution is declared. Indeed, we do not believe that measurement of the distribution payable 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 believe that this fundamental principle is that the liability to distribute non-cash assets to owners (the dividend payable) should be measured at fair value because this provides the most relevant information to

users of the financial statements. This principle is consistent both with those Standards which address other wide categories of liabilities (such as IAS 37 and IAS 39) and the Framework, and its use may be seen as required by the hierarchy set out in IAS 8.

Finally, whilst we agree with the proposal to measure the dividend payable at the fair value of the non-cash assets to be distributed, we are concerned that the interpretation does not contain an exemption where fair value cannot be measured reliably.

If you have any questions concerning our comments, please contact Ken Wild in London at +44 (0)20 7007 0907.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Ken Wild', written over a horizontal line.

Ken Wild
Global IFRS Leader

Appendix A: Response to Invitation to Comment on D23 *Distributions of Non-cash Assets to Owners*

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

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.

Do you agree with the proposal? If not, do you agree that all dividends payable should be addressed by a single standard? Why? What alternative would you propose?

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. IAS 37.10 defines a provision as ‘a liability of uncertain timing or amount’. We do not believe that a dividend payable (either cash or non-cash) meets the definition of a provision as it is currently defined by IAS 37. We acknowledge that the Board is currently considering amendments to IAS 37 such that IAS 37 would apply to ‘all non-financial liabilities, except: (a) those resulting from executory contracts, unless the contract is onerous; and (b) those within the scope of another Standard’ (IAS 37 ED, para. 2). However, the IAS 37 project is not expected to be completed until at least 2009 and the role of the IFRIC is to consider issues within the context of the *current* IFRSs and IASB Framework. On this basis we do not believe that the IFRIC should require the application of IAS 37 to dividends payable. Further, we are unable to find any support within the draft Interpretation as to *why* the IFRIC believes the application of IAS 37 is appropriate.

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 believe that this fundamental principle is that the liability to distribute non-cash assets to owners (the dividend payable) should be measured at fair value because this provides the most relevant information to users of the financial statements. This principle is consistent both with those Standards which address other wide categories of liabilities (such as IAS 37 and IAS 39) and the Framework, and its use may be seen as required by the hierarchy set out in IAS 8. We, therefore, do not believe that there is any requirement for the IFRIC Interpretation on this issue to specify the application of one or more Standards to apply this principle.

Further, developing an Interpretation that requires the application of a specific Standard that would otherwise not apply by definition does not serve to interpret current IFRSs, rather it *conflicts* with the underlying Standards that it is purporting to interpret. This is highlighted by the IFRIC in its basis of conclusions where it is stated that ‘...[IAS 39] covers some but not all obligations that require an entity to delivery non-cash assets to another entity...’ (BC16). As the interpretation is intended to apply to all non-cash distributions, requiring the application of IAS 37 to such obligations that are also in the scope of IAS 39 conflicts with the requirements of IAS 39.

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.

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.

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. Paragraphs BD28-BD 43 of the Basis for Conclusions explain the reasons for this proposal. The Basis for Conclusions also includes an alternative view that the difference should be recognised directly in equity (see paragraph BC44).

Which view do you support and why?

We support the view 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 as an item of comprehensive income. We do not support the view that the credit balance arises from a transaction of an entity's owners acting in their capacity as owners.

We agree that the credit balance should be recognised in profit or loss. We concur with the arguments presented in the Basis of Conclusions, including the assertion that IAS 1.88 states: 'An entity shall recognise all items of income and expense in a period in profit or loss unless an IFRS requires or permits otherwise.' We consider this to be a compelling argument that income should be recognised in profit or loss unless it qualifies, *by exception*, to be recognised outside profit or loss in accordance with other IFRSs.

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

Both the Board and the IFRIC concluded that the requirements of 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 (see paragraphs BC45-BC48 of the Basis for Conclusions).

Do you agree that an entity should apply IFRS 5 to non-current assets that are held for distribution to owners? If not, why and what alternative would you propose?

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 (emphasis added). 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?**

Although we do not believe that the requirements of IFRS 5 would be required to apply to such transactions very often, we support the proposal that entities should apply the requirements in IFRS

5 to non-current assets held for distribution to owners. We would also encourage the Board to reconsider the requirements of IFRS 5 as part of a broader review of the Standard.

We also believe that the Board should consider an amendment to IFRS 5 such that all assets that an entity is committed to distribute, which have a lower carrying amount than their 'fair value less costs to distribute', are required to be measured at fair value less costs to distribute as from the date the dividend obligation is recognised. Where these assets continue to be measured at a carrying amount lower than fair value less costs to distribute and the obligation to distribute is measured at fair value, this presentation has the appearance that a dividend is being paid out of profits to be earned in future periods. In the absence of such an amendment to IFRS 5, the application of the draft Interpretation could result in the recognition of a gain on settlement of the dividend obligation in a different period to that in which the related reduction in retained earnings is recognised (for example, where the obligation to distribute is recognised at reporting date but the distribution only takes place after reporting date). We believe that amending IFRS 5 for these scenarios would provide more useful information for users in assessing the financial performance of an entity. Finally, it would be useful for the IFRIC to confirm that 'fair value less costs to sell' for a non-cash distribution is 'fair value less costs to distribute'.

Question 3(a)

If the requirements of IFRS 5 were to be applied to non-current assets (disposal groups) held for distribution to owners, we believe that the same test should be applied as currently applies to non-current assets (or disposal groups) held for sale. That is, the appropriate level of management must be committed to the distribution. Further, we believe that for a dividend distribution, the appropriate level of management will in certain cases be the shareholders because management will be unable to commit the entity to the distribution without the shareholders' approval, as in many jurisdictions, dividends are required to be substantively authorised by the shareholders.

Prior to this commitment date, we do not believe that the entity has any obligation to distribute non-cash assets as a dividend. Therefore, we believe there should be no difference between the date of commitment and date of obligation.

We further note that in many circumstances this commitment will occur after the year-end. In accordance with IAS 10, such dividends are not recognised as a liability at the balance sheet date. As the entity is not committed prior to this date, the requirements of IFRS 5 would also not be applicable. Consequently, the requirements of IFRS 5 would only apply in very limited circumstances where substantive shareholder approval had been obtained prior to year-end and the non-cash asset was yet to be distributed.

Question 3(b)

We believe that, in this context, the commitment date and obligation date are the same.

Question 3(c)

Not applicable.

Appendix B: Additional comments on D23

Distributions of Non-cash Assets to Owners

Scope

We believe there is overlap between the proposals in the draft Interpretation and the common control project currently being undertaken by the Board. It would be useful if the Basis for Conclusions explained how the draft Interpretation interacts with the common control project. We also note that the draft Interpretation will only ever apply to the ultimate parent company within a group as all other transactions involving non-cash distributions will be controlled by the same parent entity before and after the distribution. 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 (to avoid doubt about whether or not these are included in scope).

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. On the same issue, we would like to point out that if these transactions are within the scope of the Interpretation, further guidance will be required. For example, guidance will be required on how to identify which of the two entities is considered to have distributed the other and therefore which entity is required to recognise the gain on distribution.

We also suggest that the scope of the Interpretation be modified to either exclude the distributions of non-cash assets for which fair value cannot be measured reliably (for example, unquoted equity instruments), or, alternatively, provide an exemption to fair value in the same circumstances as the existing IAS 39 fair value exemption. Unquoted equity instruments are considered in IAS 39 where it is noted that in certain cases it is impossible to value such shares reliably.

In addition, we have concerns with respect to paragraph 4 that the draft Interpretation applies only to distributions in which all owners of the same class of equity instruments are treated equally. In practice some distributions of similar value but not exactly equal to the proportionate interest of the shareholders will be made to shareholders in their capacity as owners, i.e. there is no exchange transaction. We believe that these distributions should not be scoped out of the draft Interpretation.

Further, the meaning of paragraph 5 is unclear where a distribution of shares is made to the parent and the non-controlling interest as to whether it is just the distribution to the parent that is excluded or the entire distribution to both the parent and the non-controlling interest that is excluded from the scope of the draft Interpretation. This issue arises because the shares being distributed are no longer within the control of the group and therefore appear to be scoped out of the draft Interpretation. We suggest that the treatment of such transactions be clarified in the final Interpretation.

Terminology

The terms non-cash asset and dividend payable are not defined IFRS terms. We recommend that these terms be defined within the Interpretation.

Consensus

Paragraph 10 states that "to apply the requirements in IAS 37 to measure a dividend payable, an entity shall consider the fair value of the asset to be distributed." We believe that the use of the word 'consider' is ambiguous and therefore we recommend that the wording be amended consistently with our other recommendations that "the dividend payable shall be measured at the fair value of the asset to be distributed."

Presentation and disclosures

We do not believe that the IFRIC should impose disclosure requirements without a cross reference to an existing Standard. For example, paragraph 13 of the draft Interpretation could be reworded to require such disclosure in accordance with IAS 1.85.

In addition, paragraph 15 could be referred to IFRS 5.41 which (in part) requires disclosure of:

- (a) a description of the non-current asset (or disposal group); and
- (b) a description of the fact and circumstances of the sale, or leading to the expected disposal, and the expected manner and timing of that disposal.

We do not support the requirement in paragraph 13 that "an entity shall disclose the difference described in paragraph 12 as a separate line item in profit or loss". We are unclear why suggest disclosure is required where fair value changes of items such as investment properties are not required to be disclosed on the face of the income statement.

We also do not support the requirement in paragraph 15(c) to disclose the estimated fair value of the assets to be distributed at the end of the reporting period. If a dividend obligation arises after the balance sheet date but before the financial statements are issued, this requirement would be onerous as the entity would need to determine fair value twice: at the end of the reporting period and when the dividend obligation arises. If a dividend obligation arises before the balance sheet date, the proposed disclosure would not provide additional information as the dividend liability would already reflect the fair value of the assets to be distributed and this amount would be disclosed anyway.

Consistent with the requirement in IAS 16.68 to present the gain or loss on derecognition of an item of property, plant and equipment in profit and loss with such gain not classified as revenue, the IFRIC should also include a specific requirement in the Interpretation prohibiting the presentation of the gain arising from the distribution on a gross basis, i.e. disclosing separately the fair value of the obligation settled and the carrying value of the non-cash asset distributed, as we do not believe that such presentation would be appropriate.

Basis for conclusions

Also we believe that Basis for conclusions paragraph B5 needs to be more specific in terms of whether or not an analogy can be drawn to this IFRIC for transactions that have some features of distributions but may be more in the nature of exchange transactions. Many frequent in-kind distributions will in fact be transactions scoped out of the Interpretation. It would be useful to know whether it would be appropriate (or if it would be prohibited) to draw analogy to this IFRIC in determining the accounting treatment.

In addition, we note that BC23 considers whether the cost of determining the fair value of the distribution outweighs the benefits. It states that the IFRIC concluded that the benefits outweigh the costs because an entity would be required to determine the fair value of the assets only once at the time of distribution. This appears to be incorrect and contradicts BC26 as the fair value of the distribution would need to also be determined at year-end, if still not distributed, and again at the date of settlement.