



The South African Institute of Chartered Accountants

25 April 2008

D23 Comment Letters
International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
United Kingdom

Dear Sir/Madam

**SAICA SUBMISSION ON IFRIC DRAFT INTERPRETATION D23 –
*DISTRIBUTIONS OF NON-CASH ASSETS TO OWNERS***

In response to your request for comments on the IFRIC Draft Interpretation D23 – *Distributions of Non-cash Assets to Owners*, we have attached the comment letter prepared by The South African Institute of Chartered Accountants (SAICA). Please note that SAICA is not only a professional body, but also secretariat for the Accounting Practices Board (APB), the official standard-setting body in South Africa. The SAICA comment letter results from deliberations of the Accounting Practices Committee (APC), which is the technical advisory body to the APB.

We would like to thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact me should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph
Project Director – Accounting

cc: Moses Kgosana (Chairman of the Accounting Practices Board)
Prof Alex Watson (Chairman of the Accounting Practices Committee)

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GENERAL COMMENTS

We welcome the IFRIC's decision to address the accounting for distributions of non-cash assets to owners acting in their capacity as owners. Subject to the detailed matters raised below, SAICA is supportive that the topics covered in this exposure draft are being addressed by the IFRIC.

Paragraph 3 refers to “*unconditional non-reciprocal*” distributions:

- The term “*non-reciprocal*” is not defined in the draft Interpretation or in any other Standard or Interpretation. We propose that the IFRIC provide guidance by incorporating a definition of this term to assist in identifying non-reciprocal distributions envisaged in the draft Interpretation - for example, would a sale of an asset for substantially less than fair value (e.g. a building worth \$1 million that is sold to shareholders for \$100) be a reciprocal or a non-reciprocal transaction?
- It is also unclear whether “*unconditional*” would require the consent of all parties involved or only a legal majority and whether this is a legal concept or whether and how ‘substance over form’ would play a part.

Paragraph 4 states that the draft Interpretation applies to distributions in which all owners of the same class of equity instruments are treated **equally**. However, in the case of distributions that give owners a choice of receiving either non-cash assets or a cash alternative as referred to in paragraph 3(b), the owners may not be treated equally as the alternatives will not necessarily have the same value. We propose that the IFRIC clarify the wording in paragraph 4 to ensure that it includes distributions that give all owners the **same choice** (of receiving either non-cash assets or a cash alternative, even if these have different values) i.e. the equality should relate to the **choices offered** and not to the **values** involved.

We propose that the scope exclusion in paragraph 5 should not apply to partly-owned subsidiaries as it could result in a scenario where the portion of the distribution relating to the minority interest is within the scope of the draft Interpretation, but the portion of the distribution relating to the controlling party is not within the scope of the draft Interpretation.

We support the inclusion of an illustrative example to assist in the understanding and application of the principles in the draft Interpretation. We note however that the illustrative example addresses a simplistic situation and we propose that the IFRIC consider broadening the example to incorporate some further principles that are addressed in the draft Interpretation. These could be:

- a scenario where fair values change between the declaration and distribution dates;
- the inclusion of a minority interest; and/or
- having a reporting date between the declaration and settlement date (to illustrate the re-measurement and adjustment of the dividend distribution as discussed in paragraph 10 of the draft Interpretation).

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In support of the position taken by the IFRIC we believe that the current literature, in IAS 10 – *Events after the Reporting Period*, already establishes the point that dividends declared before balance sheet date **give rise to liabilities under IAS 37 – Provisions, Contingent Liabilities and Contingent Assets** (and not IAS 39 – *Financial Instruments: Recognition and Measurement*). We suggest that the IFRIC refer to this in support of requiring the application of IAS 37 for non-cash distributions as well:

- Paragraph 13 and BC4 of IAS 10 states that where dividends are declared after the balance sheet date, but before the financial statements are authorised for issue, the dividends are not recognised as a liability at the balance sheet date because undeclared dividends do not meet the criteria of a present obligation in IAS 37.
- Although the discussion focuses on why particular circumstances do **not** give rise to liabilities, we believe that the converse would hold true.
- As part of IAS 10, the Board also discussed whether or not an entity's past practice of paying dividends could be considered a constructive obligation and the Board concluded that such practices do not give rise to a liability (an IAS 37 liability) to pay dividends.

SPECIFIC COMMENTS

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 IFRIC's decision that the measurement of the liability to distribute non-cash assets to owners should be based on IAS 37 *Provisions, Contingent liabilities and Contingent assets*, rather than IAS 39 *Financial Instruments: Recognition and Measurement*, for the reasons provided in BC13 – BC16 in the draft Interpretation. Some commentators were particularly convinced by the uncertainty of the amount and/or timing.

Alternative view (a minority of respondents supported the alternative view)

These respondents believe that distributions of non-cash assets to owners are transactions with equity holders in their capacity as equity holders. They argue that IAS 37 and IAS 39 provide guidance on how to account for transactions entered into with third parties in the normal course of business and not to transactions with equity holders. At distribution date, the entity's intention is not to create a liability, but rather to account for

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a transaction with equity holders. The supporters of this view are therefore of the opinion that neither IAS 37 nor IAS 39 is the appropriate standard to measure the distribution of non-cash assets to owners and that the distribution should therefore be measured at the carrying value of the asset(s) distributed.

Proponents of the alternative view disagree with proposing to hold ‘a higher standard’ to transactions with shareholders that result in profits or losses based on fair values. Their argument is based on the fact that profits and losses on transactions entered into with third parties are based on proceeds, regardless of whether these differ to the fair values.

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 BC28–BC43 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 IFRIC’s view that the difference between the carrying amount of the dividend payable and the non-cash assets distributed be recognised in profit and loss. This is based on our support for the view that the distribution (the declaration of the dividend and the measurement thereof) and settlement of the liability (the disposal of the asset and the measurement thereof) are two separate transactions.

The difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable, in our view, represents an appreciation in the value of the assets that has not been recognised until the date of the settlement of the distribution obligation. This should therefore be recognised in profit and loss, as opposed to a balance that occurred as result of transactions with equity owners, which should be accounted for directly in equity.

Furthermore, we are of the view that the draft Interpretation needs to clarify the treatment of fair value changes between the date of declaration and the date of distribution, i.e. that the fair value changes are accounted for in equity. We are of the view that this needs to be clarified in the body of the draft Interpretation because re-measurements of IAS 37 obligations would typically go to profit or loss. This is currently discussed in the Basis for Conclusions, but is not addressed in the main body of the draft Interpretation.

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Alternative view (a minority of respondents supported the alternative view)

These respondents argued that the difference between the carrying amount of the assets distributed and the dividend payable should be accounted for directly in equity. Supporters of this view suggest that the distribution, whether for cash or non-cash assets, represents a transaction with equity holders and as such should be disclosed in the statement of changes in equity. The distribution and settlement of the liability are viewed as one transaction and therefore the difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable recognised on distribution date is not income as defined in the framework, as it relates to a transaction with equity holders.

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 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 (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?

We agree that IFRS 5 should be applied to non-current assets that are held for distribution to owners and therefore support the necessary steps to make this happen.

We note, however, that IFRS 5 would only include disclosure requirements for **non-current assets** held for sale (or distribution to owners) and disposal groups. The **non-cash assets** referred to in the draft Interpretation include current assets held for distribution to owners and these will not be within the scope of IFRS 5 and therefore separate disclosure will not be required. We recommend that disclosure be required for current assets which do not form part of a disposal group, but which are held for distribution as we believe that this will provide useful information to the users.

*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?*

Application of IFRS 5 should commence when the entity is committed to make a distribution and not only when it has an obligation to distribute the assets, to inform the market or the users of the financial statements how the entity's financial position will be affected by the decision to distribute non-cash assets to its owners.

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(b) *Do you think there is a difference between those dates?*

Yes. Commitment date could be defined as the date that the appropriate level of management are committed to distribute the non-cash assets to owners and could differ from the obligation date, which could be the date at which shareholder approval has been granted.

(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?*

Refer to (b) above for our view on the difference between commitment date and the date the entity has an obligation to distribute the assets.

We would support the inclusion of indicators such as:

- the assets need to be available for distribution in their current condition;
- that the distribution is highly probable;
- that commitment date is when management are irrevocably committed to the distribution (this date is not necessarily the date of shareholder approval).

As a general point around disclosures, it appears that no disclosure is required for declarations before year end that are outside the scope of IFRS 5. We suggest that some disclosure be considered as we believe that this will provide useful information to the users.

EDITORIAL COMMENTS

Paragraph 8 and 15

Different jurisdictions have different legal rules around dividend declarations and we believe that the term “*declares a distribution*” in paragraph 8 is unclear. Similarly in paragraph 15 the phrase “... *declares a dividend to distribute a non-cash asset...*” is unclear. We suggest wording similar to ‘... becomes irrevocably committed to a distribution...’.

Paragraph 10

Use of the phrase “... *an entity shall consider the fair value...*” has been read by some to imply that the draft Interpretation would not **require** the use of fair value. Accordingly we suggest that this be changed to ‘...an entity shall measure the obligation at the best estimate of the fair value of the asset to be distributed’.

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Paragraph 11

For clarity, we suggest that the paragraph conclude as follows: ‘... as adjustments to the amount of the distribution **i.e. in equity**’.

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