EFRAG

European Financial Reporting Advisory Group

6 June 2008

D23 Comment Letters
International Financial Reporting Interpretations Board
30 Cannon Street
London EC4M 6XH
UK

Dear Sir/Madam,

IFRIC D23 *Distributions of Non-cash assets to Owners*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the IFRIC Draft Interpretation D23 *Distributions of Non-cash assets to owners.* This letter is submitted in EFRAG's capacity of contributing to the IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive IFRS and IFRIC.

D23 addresses the following two issues:

(a) How an entity should measure an obligation to distribute non-cash assets to its owners in their capacity as owners (i.e. a liability for a dividend payable).

(b) When an entity settles such a liability how should it account for the difference, if any, between the carrying amount distributed and the amount recorded for the dividend payable.

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.

D23 proposes that an entity measures the liability for the dividend payable in accordance with IAS 37 *Provisions, Contingent Liabilities and Assets*, and requires the fair value of the assets to be distributed to be considered in measuring the liability. D23 also proposes that the liability be subsequently re-measured at each reporting date, with changes in its value recognised in equity. When the liability is settled and the assets are distributed and de-recognised, any difference between the carrying amount of the assets and the liability would be recognised in profit and loss.

D23 addresses all types of distributions to owners of non-cash assets that are unconditional and non-reciprocal transactions, other than distributions of assets to another entity within the same group and distributions that are not made equally to all owners of the same class of equity instruments.

Our main comments on the proposed interpretation are as follows:

(a) Our analysis is that in D23, rather than attempting to apply IAS 37 directly to distributions of non-cash assets to owners, the IFRIC has attempted to determine the most appropriate way of measuring liabilities for distributions of non-cash assets to owners and has concluded that the most appropriate way of measuring such liabilities is to apply the measuring requirements described in IAS 37.

In our view if existing IFRS is amended to enable assets being distributed in a non-cash distribution to owners to be measured at their fair value, it would be appropriate for the Interpretation to require entities to measure liabilities by applying the measuring requirements described in IAS 37. However, if existing IFRS is not amended in that way, it would not be appropriate and we would suggest instead that the liabilities are measured by reference to the assets' book value.

(b) Our view on remeasuring the liability is broadly the same. We would agree though that:

- if the liability *is* remeasured, changes in the amount of the liability should be recognised in equity; and
- on the date the liability is settled, the liability should be remeasured by applying IAS 37's measurement requirements at the distribution date of the asset being distributed, with changes in the amount of the liability recognised in equity.

(c) We agree that the difference between the carrying amount of the asset and the amount of the liability for the dividend payable should be recognised in profit or loss.

Our detailed comments are set out in the appendix to this letter.

If you would like further clarification of the points raised in this letter, please do not hesitate to contact Isabel Batista or me.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

APPENDIX—EFRAG'S DETAILED COMMENTS ON D23 (INCLUDING ITS RESPONSES TO THE QUESTIONS ASKED)

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

Paragraph 9 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 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 this proposal? If not, do you agree that dividends payable should be addressed by a single standard? Why? What alternative do you propose?*

Does IAS 37 apply directly to distributions of non-cash assets to owners or is D23 applying 'by analogy'?

1 We believe that, in order to answer question 1, it is first necessary to consider whether the liabilities that arise in the context of distributions of non-cash assets to owners fall within the scope of any existing IFRS because if they do that IFRS should be applied. If existing IFRS do not provide an answer, one needs to consider what the appropriate accounting should be.

2 Although we do not think that is controversial, we have struggled when evaluating D23 to understand the approach the IFRIC is applying. For example, paragraph 9 of the consensus states that these liabilities shall be measured "in accordance with IAS 37". On the face of it, that seems to imply that IFRIC has concluded either that the liabilities fall within the scope of IAS 37 and no other standard or that they fall within the scope of IAS 37 and some other standard or standards but either all applicable standards require the same measurement basis (the IAS 37 basis) or IAS 37 for some reason takes precedence. However:

(a) a liability to pay a cash dividend clearly does not fall within the scope of IAS 37, because there is no uncertainty as to timing or amount. Indeed, many, including EFRAG, believe that liabilities to pay non-cash assets as dividends are also not within the scope of IAS 37 for the same reason. Whether such liabilities are within the scope of IAS 39 will depend on whether there is a contractual obligation (often there is a legal obligation but no contractual obligation) and on whether the contractual obligation is to deliver the 'right kind' of asset.

(b) the Basis for Conclusions does not argue that IAS 37 has, for liabilities to distribute non-cash assets to owners, some sort of precedence over other standards. Instead, the Basis simply talks (in BC14) of the IFRIC deciding that "all dividends payable should be measured in accordance with a single standard."

3 For all these reasons we have concluded that the IFRIC has concluded that IAS 37 does not apply <u>directly</u> to distributions of non-cash assets to owners. We think it has to follow that, when paragraph 9 of the consensus states that these liabilities shall be measured "in accordance with IAS 37", IAS 37 is being applied by analogy. In other words, that the IFRIC has concluded that measuring such liabilities in the way described in IAS 37 is the most appropriate way to account for them. We think this should be made clear in D23. We have used this conclusion as the basis for our discussion in paragraphs 4 - 11 below.

Is the most appropriate way to measure liabilities for distributions of non-cash assets to owners the IAS 37 way?

4 If IFRIC is in D23 attempting to determine the most appropriate way of measuring liabilities for distributions of non-cash assets to owners—rather than interpreting existing IFRS—in order to answer question 1 one needs to ask whether one agrees that the most appropriate way of measuring such liabilities is to apply the measurement requirements described in IAS 37.

5 We think there should be two objectives when accounting for a liability to transfer an asset to another party. The first objective is that the financial statements should reflect the true value of the transfer. The second is that the relationship between the asset to be transferred and the liability to transfer the asset should be faithfully represented in the financial statements.

6 The existence of these two objectives would not be an issue were entities free to measure the asset to be transferred at an amount that reflects its value, because that would mean that the asset and liability could be measured at the same amount and both objectives would be met. However, if existing requirements prevent both objectives from being met—as they will often do in this case—it is necessary to ask which objective should have precedence. EFRAG believes that the second objective (ie to faithfully represent the relationship between the asset being transferred and the liability to transfer the asset) should be given precedence, because otherwise an 'accounting mismatch' will arise.

7 We have heard it argued that, although this accounting mismatch might be an issue in theory, it is not an issue in practice because entities will generally organise things so that the period between when the liability arises and when the distribution is made is as short as possible, thereby limiting the period over which a mismatch might develop. However:

(a) the mismatch could arise on initial recognition of the liability if the asset is not being measured at an amount that reflects its value at the date the liability is recognised

(b) although we accept that the extent of the mismatch can often be managed in the way described, we believe that the existence of even a theoretical accounting mismatch shows that the accounting being proposed is wrong.

8 We have also heard it argued that the existence of the mismatch is unimportant because it is only a balance sheet mismatch. We believe that all accounting mismatches reduce the usefulness of the information provided.

9 Based on the above, EFRAG's view is as follows.

(a) If existing IFRS (probably IFRS 5 *Non-current Assets Held for sale and Discontinued Operations*) is amended at the same time that the Interpretation is issued to enable assets being distributed in a non-cash distribution to owners to be measured at their fair value, it would be appropriate for the Interpretation to require entities to measure liabilities "to distribute non-cash assets as dividends to its owners in accordance with IAS 37". (Please note that this does not mean that we agree that the best estimate attribute in IAS 37 is necessarily the same thing as fair value in other circumstances. See paragraph 11 below.)

(b) However, if existing IFRS is not amended in that way, it would not be appropriate. We would suggest instead that the liabilities are measured by reference to the assets' book value until the settlement date (see paragraph 10(b) below), with the fair value disclosed in the notes. Our preference though would be (a).

Remeasuring the liability

10 Paragraph 11 of D23 requires an entity to remeasure the liability at each subsequent reporting period and at the date when the liability is settled, with changes in the amount of the liability recognised in equity. Following the logic set out in paragraphs 4 to 9 of this appendix, EFRAG's view is that:

(a) if existing IFRS is amended at the same time that the Interpretation is issued to enable assets being distributed in a non-cash distribution to owners to be remeasured at their fair value, we agree it would be appropriate for the Interpretation to require entities to remeasure the liability at each subsequent reporting period—with changes in the amount of the liability recognised in equity. However, if existing IFRS is not amended in that way, it would not be appropriate; instead, the liability should in our view continue to be measured by reference to the assets' book value.

(b) on the date the liability is settled, the liability should be remeasured in accordance with IAS 37—and the asset to be distributed should be remeasured at its fair value—and changes in the amount of the liability should be recognised in equity.

Other, related comments

11 Putting the above (very important issue) to one side, we also have a concern about how the guidance in D23 might be interpreted in circumstances that do not involve a transaction to distribute non-cash assets to an entity's owners.

(a) 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.

(b) For example we have been told that some entities are interpreting IAS 37 to require that liabilities to deliver allowances equal to emissions of greenhouse gases be measured based on the carrying amounts of the corresponding intangible assets (being the emission rights granted by the relevant authorities). If the IFRIC is interpreting IAS 37 to require those liabilities to be measured at fair value, this would concern us because the accounting of emission liabilities being applied by those entities could be prohibited.

We think the Interpretation should be amended to make it clear that there is no intention in D23 to imply the IAS 37 best estimate is always fair value.

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 settled 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 and loss. Paragraphs B28-B43 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 (BC44). Which view do you support and why?

12 Paragraph 12 of D23 proposes that, when an entity settles the dividend payable, it should recognise the difference, if any, between the carrying amount of the asset and the carrying amount of the liability (for the dividend payable) in profit and loss. It is also made clear in the Basis of D23 that there was a significant minority of IFRIC members who believed paragraph 12 was wrong and the difference should be treated as an owner change in equity and therefore recognised directly in equity.

13 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.

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?*

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?

14 As already mentioned, we believe it is essential—if liabilities are to be measured in the way described in D23—that existing IFRS is amended at the same time to enable assets being distributed in a non-cash distribution to owners to be measured at their fair value. We think this is probably best done by amending IFRS 5.

15 We recognise that, in a set of principle-based standards, it would probably not be appropriate to amend IFRS 5 to require some assets to be measured one way and some others to be measured another way unless a difference of substance is involved. However, we believe a difference of substance *does* exist: in the case of assets held for sale under a plan to sell, the entity has only a commitment to sell, and none of the terms of the future exchange transaction has been agreed; whereas in the case of non-cash distributions, the entity has an obligation to distribute the assets concerned and all the terms of the non-reciprocal asset transfer involved have been settled.

16 We believe IFRS 5 should apply to non-cash assets to be distributed to owners only if and when an obligation exists to distribute them, because it is only from that date that the difference of substance arises and existing IFRS is unsatisfactory.

17 To answer questions (b) and (c), we believe that, in the case of non-cash assets held for distribution to owners, the date on which a commitment is entered into and the date on which an obligation is incurred are the same.

Other comments

PARAGRAPH 3 – SCOPE

18 D23 applies to distributions of non-cash assets to owners that give rise to a liability. In our view it will not always be the case that such a distribution will involve a liability; sometimes the decision might result not in the recognition of a liability but in the derecognition of the asset. We think furthermore that the issues that arise when there is a liability and asset to be distributed are different from those that arise when there is no liability and the asset has been derecognised. For those reasons we would encourage IFRIC to make it clear in paragraph 3 that the Interpretation applies only to distributions of non-cash assets to owners that give rise to a liability.

19 We have a second comment about the scope paragraph. Paragraph 3 of D23 proposes that the Interpretation be applied to unconditional non-reciprocal distributions of non-cash assets by an entity to its owners and to similar distributions that give owners a cash alternative. The IFRIC provides no guidance as to how 'unconditional' might be defined or in which circumstances a distribution is 'unconditional'. To us it seems likely that due to the very nature of the transactions that involve distributions to owners, entities might need to consider the features of the transaction in order to decide whether the distribution is 'unconditional'. What might be useful, we think, is for the IFRIC to provide some indicators on how 'unconditional' might be interpreted in D23.

LANGUAGE

20 We note that the language of D23 assumes that either an asset or a group of assets is being distributed. In fact, it will often be the case that a bundle of assets and liabilities (including tax effects) will be being distributed. We think it would be helpful to amend the wording in some way to acknowledge this.