EFRAG
European Financial Reporting Advisory Group

DRAFT COMMENT LETTER
Comments should be received by 9 May 2008 and be sent to Commentletter@efrag.org

xx May 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.

We broadly agree that IAS 37 is the most appropriate standard to apply to measure the liability for the dividend payable. However, we have several significant concerns regarding the proposals in D23. Our main concerns can be summarised as follows:

(a) It seems to have been assumed in D23 that the decision to distribute the non-cash asset results in a liability. We think that that will not necessarily be the case; we think that in some cases the announcement of or decision to distribute the non-cash asset to owners will result not in the recognition of a liability but in the derecognition of the asset. For that reason, we think D23 should start by asking whether a liability has arisen. In our views the issues that arise and the way they need to be addressed will differ depending on the answer.

(b) We agree that, in the case of the liabilities addressed in D23, the 'best estimate' measurement attribute that IAS 37 requires to be used means that the fair value of the non-cash asset being distributed needs to be considered in measuring the liabilities (if any) should be. However, we do not accept that IAS 37's best estimate measurement attribute is necessarily the same as fair value in other circumstances. We think the IFRIC should make it clear that that is not what it is suggesting.

(c) We are concerned about the accounting mismatch the approach proposed will create (because any liability recognised will be measured at an amount based on the fair value of the assets to be distributed, while the assets will often continue to be recognised at their carrying amount until distributed). In our view this accounting mismatch needs to be resolved before D23 is finalised.

(d) Finally, EFRAG is divided on where the difference between the carrying amount of the asset and the amount of the liability for the dividend payable should be recognised when the liability is settled. Some EFRAG members believe that a transaction to distribute non-cash assets to an entity's owners is a transaction between an entity and its owners, and as a result should not impact the profit and loss as proposed in D23. Others believe that, although the distribution of the assets to owners triggers the recognition of the value increase, it is not the cause of it. It arises as a result of an event that is not a transaction with an owner and should therefore 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?

IS THERE A LIABILITY THAT OUGHT TO BE RECOGNISED?

1 It seems to us that the assumption that underlies D23 is that the decision to distribute the non-cash asset results in a liability. We think however that sometimes the decision might result not in the recognition of a liability but in the derecognition of the asset. Therefore, rather than start by asking how should the liability be measured, we think that it should start by asking whether the entity has a liability?

2 In our view, the way a distribution of a non-cash asset ought to be accounted for will largely depend on whether it has a liability that it needs to recognise (and therefore is still recognising the asset to be distributed). Furthermore, 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 start its analysis of the subject in its final interpretation by addressing the question of whether there is a liability at all.

3 In order to prepare this letter, we have studied the material in existing IFRS on the derecognition of assets that are not financial assets, and think it would benefit from some clarification. We recognise that the Board's staff has been carrying out some research on derecognition, but any clarification of the existing standards on the subject seems a long way away. We think it would therefore be helpful if some additional guidance could be provided on the derecognition of non-cash assets held for distribution to owners. For example, when the distribution is announced it is necessary to consider whether a liability needs to be recognised and when the asset should be derecognised.

(a) Recognising a liability is about establishing whether the entity has an obligation that meets the definition of a liability and the liability recognition criteria. Principally that is about determining whether an obligation of the right type exists.

(b) On the other hand, if the asset to be distributed is an item of PP&E, determining the moment at which the PP&E should be derecognised involves applying the derecognition criteria set out in IAS 16 and IAS 18, which are largely based on the transfer of risks and rewards and control. (For example, IAS 16, paragraph 67 requires an asset to be derecognised when the asset is disposed of or when no future economic benefits are expected from its use or disposal. We believe that criteria will sometimes be met when the distribution is promised.) If a financial asset is involved, the derecognition criteria of IAS 39 need to be applied, which is involved a series of different test based again around risks and rewards and control. If the distribution is being used to achieve a demerger, the derecognition criteria for the net assets of the subsidiary being demerged will be based on when control of the subsidiary is lost.

In other words, although the criteria that need to be met to recognise a liability will be the same regardless of the type of asset to be distributed, the asset derecognition criteria will vary depending on the type of asset. This makes it difficult for entities to determine whether there is a liability to recognise (and an asset to continue to recognise) or whether the asset should be derecognised (and no liability recognised). We think additional guidance is needed to help entities to apply IFRS in a consistent way to such situations.

MEASURING THE LIABILITY

4 As we have explained in the previous section, we think that often there may be no liability to recognise when a distribution of non-cash assets to owners is being made. However, we recognise that there will be instances when the criteria for derecognition are not met at the date the dividend is declared, and consequently an entity will need to recognise a liability to distribute the asset concerned.

5 We broadly agree that when an entity has a liability arising from a distribution of a non-cash asset, the entity should measure the liability for the dividend payable in accordance with one single standard and that the most appropriate standard to apply is IAS 37, regardless of the types of assets to be distributed.

6 We understand that the accounting objective in the case of distributions of non-cash assets to owners is to ensure that an entity accounts properly for the economic value it is giving to its owners. We support this objective. Paragraph 36 of IAS 37 requires an entity to measure a liability at the best estimate of the expenditure incurred to settle the obligation. In BC18, the IFRIC explains that the carrying amount of the assets to be distributed might not represent the best estimate of the expenditure required to settle the obligation. It also says that the fair value of the assets to be distributed is relevant in determining the value of the liability. We support this conclusion in the context of non-cash dividends.

7 However, we have some concerns on 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 IFRIC was suggesting in D23 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 suggest the IFRIC clarify the matter in the Interpretation by making it clear that in circumstances not addressed in D23 something other than fair value will sometimes be appropriate.

8 As we have already mentioned, we are not convinced that there will always be a liability when there is a distribution of non-cash assets to owners. However, we also accept that the entity probably will sometimes have a liability. We are concerned, that under the accounting proposed in D23, whilst the liability will be measured at an amount based on the fair value of the asset, the asset will be measured at a different amount, thereby creating an accounting mismatch.

(a) This mismatch could arise on initial recognition of the liability if the asset is not being measured at fair value at the date the liability is recognised. A mismatch could arise subsequently if the asset's fair value changes but the asset is not being remeasured. Of course, if existing IFRS allow the asset to be remeasured, a mismatch in the balance sheet could be avoided, but existing IFRS in many cases will prohibit such remeasurements so a mismatch on the balance sheet could arise.

(b) We are also concerned that this lack of symmetry on the balance sheet might create a reporting mismatch, because whilst some gains and losses are recognised in equity (the remeasurement of the dividend payable as proposed in paragraph 11 of D23) while others are recognised in profit and loss (for instance amortisation and impairment in accordance with the relevant standards).

9 These potential differences between the amounts at which liabilities and the assets are measured in the financial statements are a consequence of different measurement attributes that existing IFRS require to be applied. We recognise that such differences cannot be resolved in an Interpretation; an amendment to one or more standards is needed. However, we do not think that makes the accounting mismatch any more acceptable.

10 We recognise that it could be argued that a significant mismatch will seldom occur - because the period between when the dividends are declared and when they are settled will generally be a short period. However, that will not always be the case and is not, in EFRAG's view, sufficient reason to accept the mismatch.

11 On balance, we believe that this accounting mismatch issue is sufficiently concerning that it needs to be resolved before the IFRIC proceeds with the Interpretation.

Question to EFRAG's constituents

Do you share EFRAG's concerns about this accounting mismatch?

12 EFRAG has given some consideration as to how the accounting mismatch that that D23 would create might best be resolved.

13 We think the solution lies in being able under IFRS to remeasure the assets to be distributed. In our response to Question 3 (see below), we recommend that the IASB consider amending IFRS 5 *Non-current Assets Held for sale and Discontinued Operations* to permit an entity to remeasure non-cash assets held for distribution to owners to an amount that is equal to the amount of the liability so that the assets concerned 'match' the liability.

14 In this context it is worth noting that the standards that address how assets and liabilities are measured typically address exchange transactions. A distribution to an owner in the capacity as owner is not an exchange transaction and as a result the principles that apply to exchange transactions are not necessarily appropriate to account for non-exchange transactions. For example, existing IFRS set out how to account for assets that are sold, but not how to account for assets that are donated for no consideration. In practice different ways are applied to account for donated assets.

15 Furthermore, we believe that the transaction to distribute assets to owners encompasses an economic interdependency between the liability for the obligation towards the owner and the corresponding asset(s) – because it is that asset that will be used to settle that obligation.

16 An alternative way of resolving the mismatch might be to amend IAS 37 to allow the liabilities to be measured at the carrying amount of the assets to be distributed. However, this would mean that what seems to be the objective behind D23 – to show the value being given to owners – will probably not be met.

REMEASURING THE LIABILITY

17 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.

18 Under IAS 37 a liability is required to be remeasured at each balance sheet date so that it reflects the current best estimate. As a result we agree that the requirement to remeasure the liability is a correct interpretation of how a liability under IAS 37 ought to be measured after it is initially recognised. We also agree that the remeasurement should be accounted for an adjustment to the distribution and recognised in equity, consistent with the way the distribution was initially accounted for.

19 However, we are concerned that remeasuring the liability might broaden our concerns on the accounting mismatch we have described in the paragraphs above. Once again, we recommend that the IASB and IFRIC further explore alternatives to resolve the accounting mismatch.

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?

20 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.

21 As explained in BC29, the difference will generally represent a credit balance because the carrying amount of the assets distributed would not normally be greater that the carrying amount of the liability.

22 With respect to *where* the difference should be recognised, the IFRIC discusses two accounting views in D23:

(a) View 1: The view proposed in D23, paragraph 12 - explained in BC28-BC43.

(b) View 2: The alternative view - explained in BC44 of D23.

23 EFRAG members too have different views on this issue.

24 The EFRAG members who support view 1 argue that:

(a) 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). As a result it seems right to account for the distribution of the asset in the same way.

(b) furthermore, the increase in the value of the asset does not meet the definition of an owner change in equity; it is income and should be recognised in profit and loss. The distribution of the assets to owners triggers the recognition of the value increase, but it is not the cause of it. This is explained by the IFRIC in BC31.

25 On the other hand, those EFRAG members who support view 2 argue that:

(a) distributing a non-cash asset to an owner is not the same as distributing the proceeds from the asset, had the asset been sold to a third party. As such, the argument in (a) is inappropriate.

(b) the transaction to distribute a dividend represents a single transaction between an entity and its owners, and thus not income-effective. In their view, an increase in the value of the asset that arises from a transaction with an owner ought to be recognised in equity. Under existing standards, it is clear that when an entity disposes of an asset to a third party in an exchange transaction, the difference between the carrying amount of the asset and the proceeds is recognised in profit and loss.

However, the distributions addressed in D23 are non-exchange transactions with owners, not with third parties.

Question to EFRAG's constituents
Which view do you support and why?

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?

26 IFRS 5 applies to assets (or disposal groups) for which the carrying amount of the assets will be recovered principally through a sale transaction rather than through continuing use. We accept that when an entity has decided to distribute an asset the entity has in effect 'designated' the asset as 'available' for distribution to owners, in which case the asset will not be recovered through continuing use. For that reason, we believe that IFRS 5 could be applied by analogy to address assets that will be distributed to owners.

27 However, as previously explained we are concerned about the accounting mismatch that might be created because of the way D23 proposes the liability to be measured. Bringing non-cash assets that are to be distributed to owners within the scope of IFRS 5 as currently drafted will not help to resolve that mismatch. However, if IFRS 5 were to be amended to require an entity to remeasure the asset to be distributed to equal the amount of the liability our main concerns with the proposals in D23 would be resolved.

28 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. We believe however that 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. For that reason, we believe (assuming IFRS 5 is amended in the way described in the preceding paragraphs), 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.

29 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. That is because management does not have the authority to decide to distribute non-cash assets to owners, so an entity cannot be committed to make a distribution at the time management prepares a distribution proposal. The entity is committed (and obligated) to make the distribution only when the shareholders take that decision.

Other comments

PARAGRAPH 3 – SCOPE

30 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.