

International Accounting Standards Board  
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Dear Sir/Madam

**Invitation to comment - IFRIC Draft Interpretation D23 Distribution of Non-Cash Assets to Owners**

Ernst & Young is pleased to submit its comments on the above Draft Interpretation. Overall we disagree with the proposed view in the interpretation. We believe that a distribution to shareholders, whether in cash or in kind is one non-exchange transaction with shareholders, to be recognised as an equity transaction. As such, we also disagree with the alternative view proposed in BC 44. Rather we propose that the transaction is accounted for at its carrying value with additional disclosure about the fair value of the assets involved. Appendix A provides further reasons for this view.

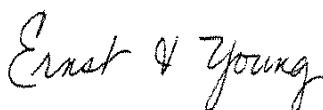
Should the IFRIC proceed with the approach outlined or the alternative view, we do have concerns which we believe need to be addressed, as detailed in Appendix A.

We also believe that the proposed treatment will increase the difficulty of adopting IFRS in the separate financial statements of entities located in some countries. Appendix B illustrates some of the difficulties generated by the application of the proposed treatment in the separate financial statements.

While we understand the reasons for limiting the scope of this interpretation (particularly in light of the common control project that the Board is now involved in), we have concerns that it will be applied by analogy to situations without a direct prohibition on doing so. We also note that as a result of the scope, the interpretation is likely to apply to a very limited number of transactions.

Should you wish to discuss the contents of this letter with us, please contact Lynda Tomkins on 020 7951 0241 at the above address, or Valerie Quint on 020 7951 3470.

Yours faithfully

A handwritten signature in cursive script that reads 'Ernst & Young'.

## **Appendix A - Responses to the specific questions raised in the Draft Interpretation**

### **Question 1 and 2 - Measurement of a liability for a dividend payable and Accounting for the difference between the assets' and the dividend's carrying amounts at the settlement date**

*Do you agree with the proposal to measure a liability to distribute non-cash assets to its owner in accordance with IAS 37 regardless of the types of assets to be distributed? If not, do you agree that all dividends payable should be addressed by a single standard? Why? What alternative would you propose?*

*The Draft Interpretation proposes that, at the settlement date, 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. The Basis for Conclusions also includes an alternative view that the difference should be recognised directly in equity. Which do you support and why?*

The draft Interpretation assumes that a single non-exchange transaction actually consists of two separate transactions, i.e. (i) a non-exchange transaction with shareholders and separately from that (ii) an exchange transaction settling a liability by giving up an asset. We do not believe this is the substance of a non-cash distribution. Nor do we believe a single event should be split into two to achieve a particular accounting if those two events are not already identifiable in the overall transaction. For the reasons stated in BC 44, we believe that it is more appropriate to view this as one transaction with shareholders, and account for this as a single equity transaction.

As the transaction is a transaction with shareholders, we do not believe that the **right** of a shareholder creates an obligation on the company. The entity is effectively creating a liability with itself (as the shareholders are acting in the capacity as shareholders). This is emphasised by the issues identified in points 1 and 2 discussed below, when trying to implement the proposed approach. As we believe there is no obligation, the real question becomes one of how the assets should be derecognised.

There is nothing within the Framework, IAS 16, nor IAS 38 to indicate that the asset should be derecognised at cost or fair value in a non-exchange transaction. Hence either option would appear to be appropriate. However, as it is a non-exchange transaction, this would result in a net decrease to equity at the carrying value of the asset. Recognising the transaction at book value would therefore be the easier approach to adopt. Additional disclosure about the fair value of the assets distributed should be required to indicate to the stakeholders the loss of 'economic value' to the entity

Should IFRIC proceed with the proposed view or the alternative view thereby creating a liability, we feel that additional matters need to be addressed as follows:

1. Existence of a liability. The draft interpretation intentionally does not address the issue of when a liability arises in such cases, however we believe it is an essential question to be answered if this approach is adopted. In a number of jurisdictions, dividends may be

declared by management and paid immediately (for example interim dividends). There are differences of opinion as to whether and when a liability arises in such cases. Some believe that no liability will ever be recognised, hence there will not be a liability to settle (and the requirements of the interpretation will not apply). Others believe that this is a simultaneous creation and settlement of the liability (and the requirements of the interpretation will apply). We believe that there is no substantive difference between these transactions and those situations where payment of the dividend occurs subsequent to its declaration, and hence clarity is needed as to when a liability is considered to arise.

This will require an assessment as to whether the declaration is sufficient to create an obligation on the entity. We have seen cases where management has subsequently reversed its decision after making a declaration, hence raising concerns that the declaration itself may not be sufficient.

2. Reversal of the decision. Settlement of a liability is considered to give rise to a gain or loss. We are concerned with the situation when the declaration may be subsequently reversed by management or the shareholders themselves. If a liability were created, this would effectively be in the nature of a 'waiver' of the liability, which would generally give rise to a gain or loss. However, we believe in this situation it is inappropriate to recognise a gain or loss, as it is still effectively a transaction with shareholders acting in their capacity as owners. That is, we effectively draw a distinction between a liability to shareholders and a liability to a third party, which is not evident in the draft interpretation.

While we support the IFRIC's approach to keep the accounting simple, and consider that IAS 37, applies to all dividends payable, we do not believe this is achievable without an amendment to both IAS 37 and IAS 39.

### **Questions 3 - Application of IFRS 5**

*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 the carrying amount of non-current assets held for distribution to owners will no longer be recovered principally through continued use. They are therefore comparable to non-current assets held for sale. However, for the reasons stated above, we do not believe that the measurement requirements of IFRS 5 are appropriate. Non-current assets held for distribution to owners are subject to an equity transaction which should not affect income. Therefore, the decision to distribute non-current assets should not by itself lead to an impairment loss. Moreover, the measurement requirements of IFRS 5 may require the asset to be measured at fair value less costs to sell, whereas there will be no costs to sell.

Rather than amending IFRS 5, we propose that specific disclosure requirements should be included in the final interpretation, and should be based on those stated in IFRS 5 paragraphs 41 and 42.

## Appendix B - Illustration of the difficulty to apply the draft interpretation in the separate financial statements

In many jurisdictions, the distribution of dividends is limited to the amount of recognised profits.

As the liability is created, equity is reduced. If there are insufficient profits recognised at that date - despite the fact that the assets fair value is greater than its carrying value - the regulation would not permit the dividend to be paid.

Alternatively, while there may be sufficient profits to create a liability for the dividend, subsequent increases in the fair value of the asset may result in there being insufficient profits by the time that the distribution is to be made - hence the regulation would not permit the dividend to be paid. This is illustrated in the following example:

	Year end	Declaration Date	Settlement Date
Distributable profits	1500	1500	1500
Distribution declared		<u>1400</u> 100 surplus	
Asset's carrying amount	1000		1000
Asset's fair value	1200	1400	<u>1600</u> 100 deficiency

In this case the 'declared' dividend (increased to 1600 at the time of settlement) is greater than the profits recognised to date, hence the entity will not be able to make the distribution. The profit of 600 is only recognised as result of the dividend payment itself (the settlement of the liability) hence cannot be taken into account in the calculation.