



Australian Government

**Australian Accounting
Standards Board**

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Mr Robert Garnett
Chairman – IFRIC
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
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Dear Bob

Draft Interpretation D23
Distributions of Non-cash Assets to Owners

The Australian Accounting Standards Board (AASB) has considered the proposals in IFRIC Draft Interpretation D23 (D23) and is pleased to provide its views in respect of the proposals for consideration by the IFRIC.

The AASB notes that transactions involving distributions of non-cash assets to owners in their capacity as owners are often, in practice, common control transactions. Providing an interpretation, specifically for one particular type of transaction with owners, is arguably premature as it may pre-empt the outcome of the IASB's common control transactions project. In light of this, the AASB would prefer consideration of distributions of non-cash assets to owners to be dealt with as part of the common control transactions project, and for that project to be accelerated to provide a timely outcome. If the IFRIC proceeds with D23, the attached responses to the specific questions provide the AASB's views for consideration in finalising the draft Interpretation.

The AASB believes that the issue is mainly concerned with the treatment of a holding gain on assets held for distribution to owners and therefore an amendment only to IFRS 5 would adequately address the issue. Accordingly, the issue would be better resolved at a Standards level rather than at an Interpretations level.

The AASB questions some of the conclusions arrived at in D23 and considers that a stronger rationale is necessary to support the conclusions reached, specifically in respect of:

- (i) the explanation provided in paragraph BC15 of the Basis for Conclusions to D23, which states that IAS 39 *Financial Instruments: Recognition and Measurement* should not be used for measuring a dividend payable because it does not deal with non-contractual obligations or liabilities to distribute non-financial assets to owners; and

- (ii) the justification for the treatment of any difference between the carrying amount of the asset to be distributed and the dividend payable, which is not clearly supported by the current IFRS literature.

In addition, the AASB is concerned that D23 provides guidance that could be inappropriately used by analogy to other transactions. For example, the principles might be applied to Dividend Reinvestment Plans (DRP) whereby equity holders can elect to be paid in additional equity instead of receiving cash.

If you have any queries regarding any matters in this submission, please contact Natalie Batsakis (nbatsakis@aasb.com.au) or myself.

Yours sincerely

A handwritten signature in black ink, reading "David Boymal". The signature is written in a cursive, flowing style.

David Boymal
Chairman

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?

An asset versus liability perspective

The AASB notes that there are some jurisdictions or circumstances where a dividend payable might not be recognised when making a distribution of assets to owners. It would therefore be inappropriate to address the distribution of non-cash assets to owners from the perspective of the liability. The AASB believes that the issue would be better dealt with from the perspective of the asset rather than the liability. This could be achieved by amending IFRS 5, instead of issuing an interpretation and amending IFRS 5 as a consequence of D23. Amending IFRS 5 to require the holder of the asset that is to be distributed to owners to measure it at its fair value less costs to sell/distribute/transfer and treat the change in value in accordance with IFRS 5, could achieve the same outcome from the assets perspective as D23.

Appropriateness of IAS 37

If the liability perspective is adopted, whilst the simplest solution may be to address all liabilities arising from a distribution to equity holders using a single standard, the IFRIC's decision to use IAS 37 is not sufficiently justified in D23. This is particularly significant given IFRSs assume arms length exchange transactions, whereas a distribution of non-cash assets to owners is a non-reciprocal transaction with owners. Furthermore, we suggest that the implications of IAS 10.13 be addressed in the Basis for Conclusions.

The AASB is not convinced by the Basis for Conclusions in D23 that all liabilities to distribute non-cash assets to owners should be accounted for in accordance with IAS 37. In particular, the AASB is not convinced by the explanation provided in paragraph BC15 of the Basis for Conclusions to D23 which states that IAS 39 *Financial Instruments: Recognition and Measurement* should not be considered because it does not deal with non-contractual obligations or liabilities to distribute non-financial assets to owners. The AASB questions whether the nature of the asset (i.e. financial or non-financial) impacts the nature of the liability recorded and therefore whether IAS 39 should be used for recognising and measuring dividends payable where financial assets are to be distributed to owners. The recognition and measurement requirements of IAS 39 and IAS 37 differ and selecting one Standard over another in accounting for dividends payable would override the recognition and measurement principles of the other Standard. The AASB believes that this should be discussed and concluded upon in the Basis for Conclusions to D23.

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?

Given its liability perspective, the Draft Interpretation has generated debate regarding the appropriateness of recognising any difference between the carrying amount of the asset and the liability in the income statement on settlement of the liability. There are two opposing views that a distribution of assets to equity holders is either:

- (i) two transactions – being the sale of the asset and a distribution to equity holders of amounts received from the sale of the asset; or
- (ii) a single transaction – being a distribution of assets to equity holders in their capacity as owners.

The AASB acknowledges that there are arguments supporting each view.

The AASB considers that the current literature provides sufficient support for the recognition of the distribution of assets to equity holders within equity. Paragraph 75 of the *Framework for the Preparation and Presentation of Financial Statements (Framework)* discusses the concept of gains being an increase in economic benefits. The *Framework* requires information that faithfully represents the transaction to be presented in the financial statements, and therefore would require consideration to be given to the substance and economic reality of the transaction rather than its legal form. A distribution of assets to equity holders does not constitute an increase in economic benefits because it is a non-reciprocal transaction with equity holders in their capacity as owners (that is, the entity is not making a gain from a sale to a third party).

Furthermore, as discussed above, the distributions that are the subject of D23 may effectively include asset holding gains that arise over the period since the asset's recognition or most recent remeasurement or gains on assets previously not recognised. If these assets are intangibles or property, plant and equipment, then recognised holding gains that have been credited to equity are not recycled to the income statement on disposal of the asset. The AASB believes that the treatment of unrecognised holding gains of assets distributed to owners should be consistent with the treatment of recognised holding gains of assets (such as intangibles or property, plant and equipment) that have been remeasured prior to their disposal.

On the other hand the AASB acknowledges the arguments put forward in D23 to support the view that the transaction is no different from the entity selling the asset at its fair value, recognising a gain or loss on sale in the income statement and distributing amounts received from the sale of the asset to equity holders. However, this is a solution derived by analogy rather than a direct requirement of a standard.

Given the strength of the arguments for the opposing view to the Draft Interpretation, as noted above, the AASB suggests that a stronger rationale needs to be provided in the Basis for Conclusions, otherwise a rethink of the conclusion is warranted.

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 held for distribution to owners? If not, why and what alternative would you propose?

Consistent with the AASB view expressed under question 1 that an asset perspective rather than a liability perspective should be adopted, the AASB agrees with the proposal in the D23 that an asset that is to be distributed to owners should be accounted for in accordance with an amended IFRS 5 that would require the assets that are to be distributed to owners to be measured at fair value less costs to sell/distribute/transfer.

The Board noted that IFRS 5 requires an entity to classify a non-current assets 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?

The AASB considers that an entity should apply an amended IFRS 5 to the assets that are to be distributed when it is committed to make the distribution to its owners. An obligation may be subject to approval by management, the board or its shareholders, which gives rise to a difference between the date that is representative of the entity's commitment and when its obligation arises. The AASB does not believe that there would generally be a significant amount of time between these dates and therefore the value is unlikely to be materially

different. Therefore IFRS 5 should be applied at the commitment date to provide users of financial statements with the disclosures regarding the distribution such as the separate classification of assets that are to be distributed and a description of the facts and circumstances of the distribution.

Other comments

'Dividend' versus 'distribution'

Dividends are defined in paragraph 5(c) of IAS 18 as "...distributions of profits to holders of equity investments in proportion to their holdings of a particular class of capital." However, the term 'distribution' is not defined in IFRS literature.

The AASB questions the appropriateness of the use of the term 'dividend' in the context of distributing non-cash assets that are not payments from profits. The AASB believes that further consideration should be given to the appropriateness of using these terms ('dividends' and 'distributions'), either in isolation or interchangeably, without clarifying their meaning and determining their appropriateness in the context of D23.

The AASB also noted that some constituents raised this issue in their comments to the IASB in response to its Exposure Draft of Proposed Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* and IAS 27 *Consolidated and Separate Financial Statements* – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate.

Scope of D23

Paragraph 3(b) of D23 includes in its scope distributions that give owners a choice of receiving non-cash assets or a cash alternative. The AASB is concerned that this scope inadvertently includes transactions such as Dividend Reinvestment Plans (DRP) whereby equity holders can elect to be paid in additional equity instead of receiving cash. The AASB does not believe that the intention is to address the accounting treatment of such transactions and suggest that the IFRIC further clarify the types of transactions intended to be captured by the Interpretation.