



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS
IN ENGLAND AND WALES

9 May 2008

Our ref: ICAEW Rep 59/08

Your ref:

Mr. Stig Enevoldsen
Chairman
Technical Expert Group
EFRAG
Avenue des Arts 13-14
B-1000 BRUXELLES

By email: commentletter@efrag.org

Dear Stig

IFRIC D23 - DISTRIBUTIONS OF NON-CASH ASSETS TO OWNERS

The Institute of Chartered Accountants in England and Wales (the ICAEW) welcomes the opportunity to comment on EFRAG's draft response to the International Financial Reporting Interpretations Committee (IFRIC) Draft Interpretation D23 *Distributions of Non-cash Assets to Owners*, published in April 2008.

We do not support the proposed Interpretation. We accept that views are divided on the issue, and that the proposals will have their supporters. However, there is insufficient agreement on the right approach for the IFRIC to make an 'interpretation' at this time. We are content to account for distributions of non-cash assets to owners at book value, which is a simple and straightforward approach that provides useful information to users. It is generally accepted practice in many jurisdictions, including the UK, where it is regarded as a perfectly appropriate treatment. (See paragraph 4 of our response to the IFRIC.)

Unlike EFRAG, we do not 'broadly agree that IAS 37 is the most appropriate standard to apply to measure the liability for the dividend payable'. This is because the distribution does not meet the definition of a provision - 'a liability of uncertain timing or amount'. Furthermore, fair valuing at the balance sheet date, as required under the proposals, is not currently a feature of IAS 37. Moreover, the IFRIC has not resolved the tensions with IAS 32, which defines a financial liability and governs the timing of the recognition of a distribution. (See paragraphs 16 - 18 of our response to the IFRIC.)

We set out below our responses to the two specific questions to constituents.

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. Question to EFRAG's constituents: Do you share EFRAG's concerns about this accounting mismatch?.

We are very concerned about this accounting mismatch, which is one of the reasons why we believe that accounting at book value is preferable.

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

We believe that accounting at book value is an acceptable treatment, in which case there would be no difference to account for.

We discuss in paragraphs 5 - 10 of the attached response to the IFRIC the issues arising if fair values are applied as in the proposals. We have grave concerns about recognising a so-called 'profit' when the company has received nothing in return for the asset. As economic benefits do not flow to the entity, it is difficult to see that there is any gain to recognise. However, if the non-cash distribution is seen as two transactions - that is, as equivalent to the sale of the asset followed by the payment of a cash dividend - different accounting might result. Moreover, we accept that there is a view that the notional 'gain' arises through management's actions and decisions, in that they are able to satisfy a liability to shareholders by giving them an asset whose fair value equates to what would have had to be paid in cash.

Where such a gain should be reported is, as identified by EFRAG, problematic, and there were divergent views among our Financial Reporting Committee. The majority view was that if a difference were to be recognised, it should be recognised in equity in line with the arguments in paragraph BC 44. (See paragraph 19 of our response to the IFRIC.)

Our response to the IFRIC, which gives further explanations of our views, is attached. Please contact me if you would like to discuss any of the points we have raised.

Yours sincerely



Desmond Wright
Senior Manager, Corporate Reporting
Direct dial: +44 (0) 20 7920 8527
Email: desmond.wright@icaew.com



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS
IN ENGLAND AND WALES

30 April 2008

Our ref: ICAEW Rep 58/08

Your ref:

The International Financial Reporting Interpretations Committee
30 Cannon Street
London, EC4M 6XH

By email: ifric@iasb.org

Dear Sir

DISTRIBUTIONS OF NON-CASH ASSETS TO OWNERS

The Institute of Chartered Accountants in England and Wales (the Institute) is pleased to respond to your request for comments on International Financial Reporting Interpretations Committee Draft Interpretation D23 *Distributions of Non-cash Assets to Owners*, published in January 2008.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours faithfully

Desmond Wright
Senior Manager, Corporate Reporting
T +44 (0)20 7920 8527
F +44 (0)20 7638 6009
E desmond.wright@icaew.com



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS
IN ENGLAND AND WALES

ICAEW Representation

ICAEW REP 58/08

DISTRIBUTIONS OF NON-CASH ASSETS TO OWNERS

Memorandum of comment submitted in April 2008 by The Institute of Chartered Accountants in England and Wales, in response to International Financial Reporting Interpretations Committee Draft Interpretation D23 *Distributions of Non-cash Assets to Owners*, published in January 2008.

Contents	Paragraph
Introduction	1
Who we are	2 - 3
Major points	4 - 15
Answers to specific questions	16 - 25

INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the Institute) welcomes the opportunity to comment on the International Financial Reporting Interpretations Committee Draft Interpretation D23 *Distributions of Non-cash Assets to Owners*, published in January 2008.

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

MAJOR POINTS

Opposition to the proposals

4. We do not support the proposed Interpretation. We accept that views are divided on the issue, and that the proposals will have their supporters. However, there is insufficient agreement on the right approach for the IFRIC to make an 'interpretation' at this time - that is, before the principles underpinning the distinction between equity and liabilities and the accounting for common control transactions have been established. Distributions of non-cash assets to owners are accounted for at book value in many jurisdictions, including the UK, where this has been generally accepted practice for many years without drawing criticism. This approach is simple and straightforward and provides useful information to users.

Recognition of the 'profit' or 'loss'

5. We have grave concerns about recognising a so-called 'profit' when the company has received nothing in return for the asset. As economic benefits do not flow to the entity, it is difficult to see that there is any gain to recognise. However, we accept that there is a view that the notional 'gain' arises through management's actions and decisions in the sense that they have satisfied a dividend promised to shareholders by giving them an asset whose fair value equates to what would have had to be paid in cash had that been the nature of the distribution, and therefore disclosing it provides useful information for users. Where such a gain should be reported is, we believe, more problematic.
6. In the present state of international GAAP, we believe a distribution is a transaction with owners, and so should be dealt with through equity rather than profit or loss. We trust that the IFRIC will withdraw these proposals, but

if it is determined to press ahead we believe that in the absence of a properly articulated comprehensive income statement and finalisation of the debt/equity project, the difference arising should be dealt with in equity.

7. In our view, much of the dissension about what constitutes the correct accounting arises from whether a non-cash distribution is viewed as one transaction or two (ie, whether the non-cash distribution involves the creation of a liability settled by the distribution of an asset or is instead an obligation to distribute the specific asset). If the transaction is the creation of a liability settled by the distribution of an asset, then the settlement could be seen as being equivalent to the sale of the asset followed by the payment of a cash dividend. We can see that the 'two transactions' view might lead to different accounting.
8. This divergence is further emphasised when considering the nature of the distribution. A very common example would be the demerger of part of a group, in which the shares of the subsidiary are distributed pro rata to the parent's shareholders. In such circumstances, the same shareholders ultimately own the same assets, but the assets are merely represented by two shareholdings. It is difficult to see a demerger of this kind as anything other than a single transaction, or that measuring it at fair values provides any useful information to investors.
9. In the case of a demerger, if a gain is to be booked at all (which we do not believe it should be), we note that it should not be booked later than the liability. To recognise the gain later would understate net assets temporarily. The fact that the gain and distribution must be simultaneous reinforces the view that this is no more than a grossing up of a single transaction (not the separate creation and settlement of a liability).
10. Different considerations arise when the transaction involves the distribution of, say, an item of property, plant and equipment. In these circumstances it might be reasonable to achieve consistency by requiring the asset to be remeasured to fair value when the liability is recognised, although it is not clear how this can be achieved under existing accounting standards. But in the case of a demerger, any such revaluation would relate to unrecognised goodwill.

Fair values

11. The proposals are an unnecessary and unhelpful extension of fair value accounting. There is no pressing demand for this from users of financial statements. We see no reason to measure a specific non-cash asset at fair value when it is not carried at fair value by the company. It is more appropriate for the measurement to reflect the carrying amount of the non-cash asset. The effect of applying fair values will be to report the holding gain inherent in the assets at the very time when the company is committed to relinquishing the asset via a distribution.

Cost-benefits

12. We note that the distribution of an asset that is ultimately controlled by the same parent entity before and after the distribution is scoped out of the proposed Interpretation. We understand the reasoning behind this. However, the effect will be to create needlessly different accounting inside and outside

the group. Moreover, we fear that establishing this treatment for transactions outside the group will create pressure to account in the same way intra-group, which would be highly undesirable.

13. As noted in paragraph 8 et seq above, a typical example of distributing non-cash assets to owners is a demerger of part of a group. It is difficult to find an argument for incurring what may be significant costs to have the subsidiary being demerged valued when there is no benefit to the shareholders, who continue to hold exactly what they held before, but now separated into two shareholdings.

Role of the IFRIC

14. We question whether this issue falls to the IFRIC to deal with, given the absence of IASB literature on transactions with owners on which to base an interpretation. Indeed, the decision to deal with the issue through IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, is an implied admission of this lack, given that it deals with the different issue of carrying value recovered through a sale. As noted in paragraph 4 above, it is premature to address this issue until the principles underpinning the distinction between equity and liabilities and the accounting for common control transactions have been established.
15. We note that the proposals do not converge with US GAAP and will in fact create a GAAP difference. Under US GAAP (APB 29 *Accounting for Nonmonetary Transactions*) spin-offs (demergers) are accounted for at book value, subject to impairment considerations.

RESPONSES TO SPECIFIC QUESTIONS

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?

16. We do not agree with the proposal. IAS 37 is not the relevant standard, because the distribution does not meet the definition of a provision - 'a liability of uncertain timing or amount'. Moreover, fair valuing at the balance sheet date, as required under the proposals, is not currently a feature of IAS 37.
17. We do not regard it as axiomatic that all dividends payable should be dealt with in a single standard. In any event, we do not believe that it is for IFRIC to make this decision, which should be made by the Board in the light of decisions about the distinction between equity and liabilities and how to account for common control transactions. We do accept that all distributions have the same purpose regardless of the types of assets to be distributed.

We also agree with the principle that all dividends payable should be measured consistently, by which we mean the amount should reflect the carrying value of the assets used to pay it..

18. If the IFRIC is determined to proceed with the proposed interpretation, it will be necessary to:
- (a) distinguish why the liability to pay the dividend does not fall within the definition of a financial liability in paragraph 11 of IAS 32 *Financial Instruments: Presentation*; and
 - (b) explain why the liability for the distribution is recognised earlier than permitted by paragraph AG13 of IAS 32, which makes clear that a liability is only assumed when there is a legal obligation to the shareholders to make a distribution (which indicates a tension with IAS 37 and a constructive obligation approach); and

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?

19. As noted above in paragraph 4, we believe that accounting at book value is an acceptable treatment, which would result in there being no difference to account for. If fair values are applied as in the proposals, we are opposed to recognising the difference in profit or loss. If a difference is recognised, we agree with the arguments in BC 44, which point to recognising the difference in equity.

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?

20. As we point out in paragraph 14 above, IFRS 5 is not the appropriate standard to deal with distributions to owners, because the carrying value of assets held for such distributions will not be recovered principally through a

sale. The assets are not sold, nor is their carrying value recovered in any way: they are being given away to shareholders, who own them before and after the transaction.

21. The proposal to apply IFRS 5 seems to be based on the idea that the carrying value of the assets will no longer be recovered principally through continuing use (see paragraph BC 46). However, following this principle, it would not just be assets held for distributions to owners that come within the scope of IFRS 5, but also, for example, assets held for scrapping (ie, held for disposal for nil proceeds).
22. Given that IFRS 5 should not apply in the case of a dividend commitment or other obligation to distribute assets, the assets will remain at carrying value. Carrying value depends on the nature of the asset involved. In the case of a non-cash financial asset, the carrying value will be measured at fair value under IAS 39 *Financial Instruments: Recognition and Measurement*. In practice, in the case of, say, a demerger, there may be a basket of financial and non-financial assets.

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?**
23. If IFRS 5 is to be applied, it should be at the commitment date. However, this will not be the date at which the obligation arises. Paragraph AG13 of IAS 32 is clear that a liability is created for a distribution when a company formally acts to make one and the company becomes legally obligated to the shareholders to do so.
 24. Under UK law, declaration of a distribution by the directors does not create a legal obligation on the company. That does not happen until the distribution is declared by the company in general meeting; or in the case of an interim dividend authorised under the company's constitution, when the dividend is paid or settled.
 25. We do not believe that additional indicators should be brought into IFRS 5.

© The Institute of Chartered Accountants in England and Wales 2008

All rights reserved.

This document may be reproduced without specific permission, in whole or part, free of charge and in any format or medium, subject to the conditions that:

it is reproduced accurately and not used in a misleading context;
the source of the extract or document, and the copyright of The Institute of Chartered Accountants in England and Wales, is acknowledged; and
the title of the document and the reference number (ICAEW Rep 58/08) are quoted.

Where third-party copyright material has been identified application for permission must be made to the copyright holder.

www.icaew.com