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1049 Brussels

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Dear Mr Holmquist

Adoption of IFRIC 17 *Distributions of Non-cash Assets to Owners*

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards, we are pleased to provide our opinion on the adoption of IFRIC 17 *Distributions of Non-cash Assets to Owners* (IFRIC 17), which was published in November 2008. The interpretation was proposed in a draft interpretation on which EFRAG commented.

International Financial Reporting Standards do not provide specific guidance on the accounting treatment of distributions to owners. Although there are no significant issues concerning the accounting treatment of cash dividends—which are probably the most common type of distributions made to the owners of an entity—there are a number of issues that arise concerning distributions of non-cash assets to owners and IFRIC 17 seeks to address some of those issues. To summarise, IFRIC 17 requires that:

- (a) the liability for a dividend payable shall be recognised when the dividend has been appropriately authorised and is no longer at the discretion of the entity;
- (b) the liability to distribute a non-cash asset to an owner shall be measured at the fair value of the assets to be distributed, and shall re-measure the carrying amount of the liability at the end of each reporting period if the fair value of the assets to be distributed has changed; and
- (c) the entity shall recognise the difference between the amount of the liability and the carrying amount of the assets in profit and loss.

IFRIC 17 becomes effective for annual periods beginning on or after 1 July 2009, with earlier application permitted.

EFRAG has carried out an evaluation of IFRIC 17. As part of that process, EFRAG issued an initial evaluation of IFRIC 17 against the EU endorsement criteria for public comment and, when finalising its advice and the content of this letter, it took the comments received in response into account. EFRAG's evaluation is based on input from standard setters, market participants and other interested parties, and its discussions of technical matters are open to the public.

EFRAG's endorsement advice on IFRIC 17

EFRAG supports IFRIC 17 and has concluded that it meets the requirements of Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards in that:

- it is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and
- it meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

For the reasons given above, EFRAG believes that it is in the European interest to adopt IFRIC 17 and, accordingly, EFRAG recommends its adoption. EFRAG's reasoning is explained in the attached 'Appendix 1 – Basis for Conclusions'.

Two EFRAG members have concerns about IFRIC 17 that cause those members to believe that EFRAG should not recommend IFRIC 17 for endorsement. The reasoning of those members is explained in the attached 'Appendix 2—Dissenting View'.

On behalf of the members of EFRAG, I should be happy to discuss our advice with you, other officials of the EU Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

APPENDIX 1 BASIS FOR CONCLUSIONS

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on IFRIC 17 Distributions of Non-cash Assets to Owners (IFRIC 17).

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity as a contributor to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as adviser to the European Commission on endorsement of the final IFRS or Interpretation on the issue.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the European endorsement criteria, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

- 1 When evaluating IFRIC 17, EFRAG asked itself four questions:
 - (a) Is there an issue that needs to be addressed?
 - (b) If there is an issue that needs to be addressed, is an Interpretation an appropriate way of addressing it?
 - (c) Is IFRIC 17 a correct interpretation of existing IFRS?
 - (d) Does the accounting that results from the application of the IFRIC meet the criteria for EU endorsement?
- 2 Having formed tentative views on the issues and prepared an initial evaluation, EFRAG issued that initial evaluation for comment on 14 March 2009 and asked for comments on it by 1 May 2009. EFRAG has considered all the comments received in response to this invitation, and the main comments received are dealt with in the discussion in this appendix.

IS THERE AN ISSUE THAT NEEDS TO BE ADDRESSED?

- 3 EFRAG understands that at present there is significant diversity in practice on how to account for distributions of non-cash assets to the owners of an entity. Although EFRAG is of the view that distributions of non-cash assets do not occur on a regular basis—these are very specific transactions that only occur when certain significant events take place within an organisation—it understands that, when they do occur, the amounts involved can be significant. EFRAG agrees that this diversity is undesirable and is an issue that needs to be addressed.

IS AN INTERPRETATION AN APPROPRIATE WAY OF ADDRESSING IT?

- 4 The diversity results because existing IFRS lack specific guidance on how to account for distributions to owners and, as a consequence, different interpretations have evolved. EFRAG is of the view that in cases where an inconsistency in accounting practice is caused by differing interpretations of one or more existing standards it will generally be appropriate to deal with the issue by means of an Interpretation.

- 5 As explained below, the Interpretation has a limited scope and applies only to some distributions of non-cash assets to owners acting in their capacity as owners. Those distributions are the ones for which the IFRIC thought the accounting was most diverse in practice. One implication of this is that uncertainty—and some diversity in practice—will remain for those distributions to owners not covered by the scope of IFRIC 17.
- 6 IFRIC 17 does not apply to common control transactions as defined by IFRSs, i.e. transactions undertaken within the same group. The IASB has a project on common control transactions which is likely to consider guidance on distributions to owners within the same group. EFRAG has considered whether it is premature for the IFRIC to be developing guidance on how to account for distributions to owners which are not common control transactions bearing in mind that the IASB will need to consider the accounting for other types of distributions that occur within the same group of entities. However, the project is currently inactive and it will be several years before that project will result in a standard. If the IFRIC could not act in the meantime, that would mean several years of diversity in accounting practice and a lack of comparability for those transactions addressed in IFRIC 17.
- 7 IFRIC 17 contains amendments to existing standards (IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and IAS 10 *Events after the Reporting Date*). EFRAG believes that, generally speaking, amendments to standards should be made through the IASB's processes rather than through the IFRIC's processes, primarily because it believes that the IASB's due process is more extensive. However, it believes it is acceptable for more minor changes to standards—such as the amendments being made in this case—to be made by the IFRIC.

Conclusion

- 8 Having taken the above considerations into account, EFRAG has concluded that an Interpretation is an appropriate way of addressing the uncertainties described above relating to accounting for some distributions of non-cash assets to owners.

IS IFRIC 17 A CORRECT INTERPRETATION OF EXISTING IFRS?

- 9 EFRAG has considered whether IFRIC 17 is a correct interpretation of existing IFRS literature. IFRIC 17 addresses three main issues involving distributions of non-cash assets to owners.
 - (a) When should a liability for a dividend payable be recognised?
 - (b) How should the liability be measured initially and subsequently?
 - (c) How should any difference between the amount of the liability and the carrying amount of the assets to be distributed be accounted for when the liability is settled?

Each of these issues is discussed below. The application of IFRIC 17 by analogy is then discussed.

When should a liability for a dividend payable be recognised?

- 10 The Interpretation clarifies that a liability for a distribution to owners is only recognised on the date when it is appropriately authorised and is no longer at the discretion of the entity making the distribution—in other words when all the parties that are required by

law to approve a distribution to owners have done so. IFRIC 17 notes that such 'approval' can vary from jurisdiction to jurisdiction, and should be assessed accordingly.

- 11 Although existing IFRS literature does not specifically provide guidance on the accounting for distributions to owners, EFRAG believes that it is well understood that the entity must have an obligation before it can recognise a liability for that distribution. The Interpretation clarifies this point and indeed, by amending IAS 10 in the way it has, reinforces the message.

Conclusion

- 12 In EFRAG's view, the clarification provided in IFRIC 17 is a correct interpretation of existing IFRS.

How should the liability be measured initially and subsequently?

Initial measurement

- 13 IFRIC 17 states that, when a liability for a distribution of non-cash assets is recognised initially, it shall be measured at the fair value of the assets to be distributed. IFRIC 17 (paragraph 12) further clarifies that, if an entity gives its owners a choice of receiving a non-cash asset or a cash alternative, the entity will need to consider the probabilities of occurrence of the choices the owners can elect and their respective fair values when estimating the fair value of the liability.
- 14 As previously explained, existing IFRS literature does not provide guidance on how an entity should measure liabilities arising on non-cash distributions to owners. In practice IAS 37 and IAS 39 are considered helpful. The IFRIC noted that the guidance set out in IAS 37 and IAS 39 can be relevant to measuring liabilities for dividends payable and that the most relevant standard will depend on the type of asset being distributed. An issue however is that the two standards require different measurement attributes to be applied to the liabilities that fall within their scope; the objective of the guidance in IFRIC 17 is to ensure that all liabilities for non-cash distributions within the scope of IFRIC 17 are measured the same way—at the fair value of the assets that will be used to settle that liability.
- 15 EFRAG agrees with IFRIC's view that liabilities arising on non-cash distributions do not fit comfortably within the scope of any existing IFRS. EFRAG further agrees that, all other things being equal, an objective should be to ensure that all such liabilities are measured in the same way and at an amount that reflects the value of the asset being distributed. EFRAG notes that measuring all such liabilities at the fair value of the assets to be distributed is a way of meeting that objective.
- 16 For the above reason, EFRAG believes that, all other things being equal, IFRIC 17's requirements for the initial measurement of liabilities for the distribution of non-cash assets to owners are a reasonable interpretation of existing IFRS.

Subsequent measurement

- 17 IFRIC 17 requires that, at the end of each reporting period before the liability is settled and at the date it is settled, the liability shall be remeasured to the fair value at that reporting date of the asset to be distributed. It also requires that any change in the amount of the liability is recognised in equity (which is where the initial liability for the dividends payable was charged). The IFRIC explains that other IFRSs - for example

IAS 37 *Provisions, Contingent liabilities and Contingent Assets* - require an entity to remeasure liabilities at the end of each reporting period. Specifically, under IAS 37 an entity is required to adjust the carrying amount of a liability to reflect the best estimate of the liability. IAS 37 further explains that the best estimate represents the amount that an entity would rationally pay to settle an obligation at the balance sheet date or transfer it to a third party at the time.

- 18 Some EFRAG members were concerned at this requirement to remeasure the liability at each reporting period and on the date the liability is settled. In their view, the amount of the liability should be measured at the value of the assets to be distributed at the date of the decision to declare and appropriately authorise the distribution, because that represents the amount of the entity's obligation. In their view, it can be argued (when considering dividends in kind with no cash alternative) that the subsequent measurement of the liabilities is not necessary as an entity cannot settle the dividend obligation other than by delivering the assets and is not permitted to pay someone to assume the obligation—therefore there is no basis to revise the estimate. These EFRAG members believe that, on this basis, the liability can be measured at the cost of settling the obligation, and the cost to the entity is the fair value of the assets at the date the dividend was declared and appropriately authorised.
- 19 However, the majority of EFRAG members believe that, all other things being equal, the objective should be to measure the liability for the distribution based on the value of the assets that will be distributed; and that therefore, if the value of the assets changes, so should the value of the liability until it is settled.

The accounting mismatch

- 20 In addition to clarifying how IFRS should be applied to distributions of non-cash assets to owners, IFRIC 17 amends the scope of IFRS 5 to include non-current assets or disposal groups held for distribution to owners so that the measurement requirements in IFRS 5 apply to those assets. As a result, if the fair value of the assets less the costs to distribute the asset is higher than its carrying amount, IFRIC 17 will result in the liability to distribute the asset being measured at the asset's fair value while the asset being distributed would remain at its (lower) carrying amount. Thus, IFRIC 17 could create an 'accounting mismatch' in the financial statements of the entity undertaking the distribution if the recognition and settlement of the liability fall into different accounting periods.
- 21 IFRIC 17 explains that the mismatch is a consequence of IFRSs applying different measurement attributes for assets and liabilities at different times with different triggers for remeasurement. It could also be the result of different recognition requirements. (For example, if it is a business that is being transferred—as would be the case in a spin-off transaction—the liability will need to reflect the fair value of the business, which could include internally-generated goodwill and intangible assets that will not be recognised under existing IFRS.)
- 22 This accounting mismatch concerned most EFRAG members, albeit to varying degrees. Those EFRAG members believe that a key objective of the accounting for an obligation to distribute non-cash assets to owners is to measure the assets and the liability at the same amount. Some believe it is a more important objective than measuring the liability based on the value of the assets to be distributed.
- 23 EFRAG notes that an accounting mismatch will arise only when the assets are not carried at fair value and in the relatively short period between the date the liability is recognised and the date it is settled. It also notes that in practice entities will generally

arrange distribution transactions so that the period between when the liability arises and when the liability is settled is as short as possible and that the recognition and settlement of the liability do not fall within different reporting periods. Furthermore, EFRAG understands that distributions within the scope of IFRIC 17 do not occur frequently.

- 24 For the reasons explained above, on balance the majority of EFRAG members concluded that in this case the accounting mismatch, though a concern, is not sufficient reason to recommend non-endorsement.

Legal matters

- 25 In some legal jurisdictions within Europe, there are legal constraints limiting the amount of a dividend to available profits. When a liability to distribute non-cash assets to owners is measured at an amount that is greater than the carrying amount of the assets to be distributed, it will in effect mean that profits (i.e. the increase in the value of the asset above cost) are being distributed that have not yet been recognised. Such a situation can result in insufficient profits being available to carry out the distribution. Of course, on settlement those profits will be recognised.
- 26 EFRAG agrees that, because an entity will need to consider the laws and regulations imposed by the relevant jurisdiction under which it operates before it considers a proposal to distribute a dividend, it is possible that in some cases the requirements in IFRIC 17 might mean that an entity is no longer able to make a distribution that it would have been able to make before IFRIC 17 was applicable. However, in EFRAG's view, this is not something for the IFRIC to resolve.

Conclusion

- 27 For the reasons stated above, EFRAG's view is that the way a liability for a distribution of a non-cash asset is measured in IFRIC 17 is, on balance, a reasonable interpretation of existing IFRS.

How should any difference between the amount of the liability and the carrying amount of the assets to be distributed be accounted for when the liability is settled?

- 28 When an entity settles the liability for the distribution, the entity will derecognise both the liability and the assets being distributed. IFRIC 17 requires that at that time any difference between the amount of the liability and the carrying amount of the assets distributed should be recognised in profit and loss. The Interpretation explains that the carrying amount of the assets would not normally be greater than the liability for the distribution because of the recognition of impairment losses required by other IFRSs, so the 'difference' will generally be a credit balance.
- 29 The IFRIC's reasoning is that the difference arises not because of the distribution transaction but because of an increase in the value of the assets arising from the performance of those assets. As such, the difference is not part of a transaction with the owners in their capacity as owners; rather it is a cumulative gain on the assets that is being recognised on derecognition of the asset. The IFRIC therefore believed the credit balance should be recognised in the same way as if the entity would sell the asset and distribute the proceeds to its owners—in profit and loss (in accordance with paragraphs 68 and 71 of IAS 16).

Conclusion

- 30 The majority of members agree with IFRIC 17's conclusions. However, a minority disagree, believing that the distribution of assets to an entity's owners represents a non-reciprocal transaction between an entity and its owners in their capacity as equity holders, which is different to generating a gain from a sale to a third party. In their view, the entity is in effect receiving nothing in return for the distribution and gains should not arise in such circumstances. However, on balance these EFRAG members concluded that this concern is not sufficiently significant to cause them to recommend non-endorsement of IFRIC 17.

Applying IFRIC 17 by analogy

- 31 Although the scope of IFRIC 17 is in theory limited to certain distributions to owners, interpretations of this kind are always available for application by analogy. Some EFRAG members were concerned the guidance in IFRIC 17 might be applied by analogy to situations in which the accounting that would result from the application of IFRIC 17 might be less acceptable.
- 32 However, the majority of EFRAG members believe that application by analogy is a question of judgement and of the facts and circumstances of individual transactions—after all, a piece of IFRS literature should be applied by analogy only when it is applicable—and that question cannot be answered universally for all types of arrangements.

Overall conclusion

- 33 Having taken into account all the arguments discussed above, EFRAG's view is that IFRIC 17 is, on balance, a reasonable interpretation of existing IFRS.

DOES THE ACCOUNTING THAT RESULTS FROM THE APPLICATION OF IFRIC 17 MEET THE CRITERIA FOR EU ENDORSEMENT?

- 34 Finally, EFRAG asked itself whether it believed that the information resulting from the application of IFRIC 17 would meet the criteria for EU endorsement; in other words, that:
- (a) it is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and
 - (b) it meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG also considered whether it would be in the European interest to adopt the Interpretation.

Relevance

- 35 According to the Framework, information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations. EFRAG considered whether IFRIC 17 would result in the provision of relevant information; information that has predictive value, confirmatory value or both.

- 36 As explained earlier, the majority of EFRAG members believe that the accounting required by IFRIC 17 represents a reasonable interpretation of existing IFRS. It results in a liability being recognised as soon as an obligation to transfer non-cash assets to owners has been accepted; it requires that liability to be measured at an amount that reflects the up-to-date value of the assets to be distributed; and it requires the change in the value of the asset to be recognised in profit or loss, thereby offsetting over time the change in the value of the liability since it was incurred. It thus results in relevant information being provided to users.

Reliability

- 37 EFRAG also considered the reliability of the information that will be provided by applying IFRIC 17. The Framework explains that information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent.
- 38 In EFRAG's view, the main issue here is whether the requirement that fair value be used to measure the liability to distribute non-cash assets would lead to difficulties in estimation and, as a consequence, unreliable information being presented in the financial statements.
- 39 EFRAG believes that the reliability issues that arise when estimating the fair value of liabilities under IFRIC 17 are similar to those that arise under other IFRS literature, and it did not consider the requirements in IFRIC 17 to be more onerous than those in other existing IFRS literature.

Comparability

- 40 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.
- 41 The IFRIC's objective in issuing IFRIC 17 was to eliminate the current diversity in practice in the accounting for certain distributions of non-cash assets to owners. In EFRAG's view IFRIC 17 will provide information that is more comparable than hitherto and ensures that users of financial statements can compare like with like.

Understandability

- 42 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.
- 43 The majority of EFRAG members believe that the information provided by applying IFRIC 17 is understandable as it provides information that is relevant to users of financial statements and ensures that transactions that are economically similar are accounted for in a similar and transparent way. In addition, IFRIC 17 should help ensure that meaningful information is provided about the sometimes complex transactions that fall within its scope; information that will be useful to users in assessing the value an entity is giving away in the form of a distribution to its owners.

True and Fair

- 44 For the reasons set out above, the majority of EFRAG members see no reason to conclude that IFRIC 17 is inconsistent with the true and fair view requirement.

European Interest

- 45 EFRAG considered whether adoption of the Interpretation might cause those entities that are using a different approach currently to incur costs in excess of the benefits expected from applying the accounting IFRIC 17 requires. Its assessment is that, although the implementation of IFRIC 17 would involve some costs, they are likely to be outweighed by the benefits arising from its implementation.

Conclusion

- 46 After considering all the above arguments, the majority of EFRAG members have concluded that, on balance, IFRIC 17 satisfies the criteria for EU endorsement and EFRAG should therefore recommend its endorsement.

Appendix 2 Dissenting Views

The views of two EFRAG members who voted against recommending endorsement of IFRIC 17 are explained in this appendix.

- 1 Two EFRAG members (Ms Anna Sirocka and Mr Alan Dangerfield) believe that IFRIC 17 should not be endorsed for use in the European Union and therefore dissent from EFRAG's decision to recommend its endorsement. Their views are explained in the paragraphs below.
- 2 Ms Sirocka and Mr Dangerfield believe that IFRIC 17 should not be endorsed for use in the European Union because they believe aspects of IFRIC 17 do not meet the endorsement criteria. Those aspects are:
 - (a) The accounting mismatch that can arise from the application of IFRIC 17. This concern is explained further in paragraph 3 below.
 - (b) The requirement to remeasure at each reporting date the liability arising from the obligation to distribute non-cash assets to owners. This concern is explained further in paragraph 4 below.
- 3 Mr Dangerfield believes that a set of accounting requirements that have the effect of creating an accounting mismatch and recognising gains when assets are distributed in exchange for nothing results in the relevance and understandability criteria not being met. He believes that, for information to be meaningful and understandable, the statement of financial position should show the same amounts for the liability and the corresponding asset. The accounting required in IFRIC 17 does not do that. He further believes that:
 - (a) the information that would result from such accounting would not be understandable because changes in the value of the liability will be reported but the offsetting changes in the value of the asset will not be. This will distort the entity's equity, which is a crucial element in financial reporting (for returns ratios, covenants etc);
 - (b) the information that would result from such accounting would not be relevant, because users of financial statements are likely to disregard the gains reported in profit or loss as a result of applying IFRIC 17 because they know there will be offsetting losses that will be recognised in later accounting periods; and
 - (c) if there are no benefits to users arising from such an accounting treatment, it is unlikely that the ongoing cost to be incurred by preparers to remeasure the liability at each reporting date and on the date the liability is settled will be offset by benefits.
- 4 Ms Sirocka disagrees with the requirement in IFRIC 17 to remeasure the liability at each reporting date until the liability is settled and on the date of settlement. In her view this is not required by existing IFRSs in situations which involve an entity settling a liability by delivering a non-cash asset, nor is it required in order to provide decision-useful information. She is concerned that the accounting in IFRIC 17 might be applied by analogy to situations for which the accounting in IFRIC 17 might not be appropriate.