D23 sub 1

New South Wales
TREASURY

Professor David Boymal
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Contact: D. McHugh
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Our Reference:
Your Reference:

7 April 2008

Dear Professor Boymal

Comments on IFRIC Draft Interpretation D23 'Distribution of Non-Cash Assets to Owners'

New South Wales Treasury welcomes the opportunity to provide comments on the above Draft Interpretation. A copy of the submission provided to the International Financial Reporting Interpretations Committee is attached.

If you have any queries regarding these comments, please contact me on (02) 9228 3019 or Dianne McHugh on (02) 9228 5340.

Yours faithfully

Robert Williams

Robert Williams
for Secretary

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New South Wales
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Mr Robert Garnett
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Committee of the International Accounting Standards Board
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Telephone: (02) 9228 5340
Our Reference:
Your Reference:

7 April 2008

Dear Mr Garnett

Comments on IFRIC Draft Interpretation D23 'Distribution of Non-Cash Assets to Owners'

New South Wales Treasury welcomes the opportunity to make a submission on the above Draft Interpretation. Detailed comments are attached.

NSW Treasury strongly believes that both the dividend payable and the asset to be distributed should be measured at fair value. This is necessary to ensure consistent and transparent fair value treatment. Therefore, we have the following main concerns with the Draft Interpretation:

- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* does not clearly require fair value measurement of the dividend payable.
- It potentially creates an accounting mismatch between the asset to be distributed and the dividend payable, by only recognising any gain from the difference between the dividend payable and the carrying amount of the asset, on settlement of the dividend.
- It fundamentally changes the scope of IFRS 5 *Non-current assets Held for Sale and Discontinued Operations* and raises application difficulties, including the relationship between fair value in IFRS 5 and IAS 36 *Impairment of Assets*.
- Although excluded from scope, by analogy, it may create a precedent for the treatment of common control transactions.

Many of these issues are indicative of the tension in the accounting standards between cost and fair value measurement. This requires a more fundamental and consistent approach across the Standards and *Framework*.

If you have any queries regarding these comments, please contact me on 612 9228 3019 or Dianne McHugh on 612 9228 5340.

Yours faithfully

Robert Williams

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for Secretary

NSW TREASURY COMMENTS
IFRIC DRAFT INTERPRETATION D23
'DISTRIBUTION OF NON-CASH ASSETS TO OWNERS'

Question 1 Specifying how an entity should measure a liability for a dividend payable

NSW Treasury believes that an entity should measure a liability for a dividend payable at the fair value of the assets to be distributed. However, we believe that the Draft Interpretation falls short of fair value measurement as it only provides that an entity "...shall *consider* the fair value of the asset to be distributed" (para 10) (italics added).

We do not believe that application of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* will necessarily result in fair value measurement. IAS 37 does not use the term 'fair value' and instead provides that the best estimate of the expenditure required to settle a liability is either (para 37):

- The amount that an entity would rationally pay to settle the obligation at the end of the reporting period; or
- The amount that an entity would pay to transfer the obligation to a third party at the end of the reporting period.

These two options potentially give rise to two different results. This is because para (a) is entity specific and para (b) is market determined. IAS 37 does not give guidance to which of these two options takes precedence.

On this basis, we prefer that the Draft Interpretation takes precedence over both IAS 37 and IAS 39 *Financial Instruments: Recognition and Measurement* and explicitly *requires* fair value measurement using the fair value of the asset to be distributed (on initial and subsequent measurement). Reference should also be made to the various accounting standards which provide guidance on 'fair value', including IAS 16 *Property, Plant and Equipment*. The Basis for Conclusions could still explain that this outcome is broadly consistent with the principles of both IAS 37 and IAS 39.

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

NSW Treasury believes that when a dividend payable is recognised, the related asset should also be measured at fair value. Any adjustment to the carrying amount should be recognised through profit or loss or through an asset revaluation reserve (e.g. where the asset is measured using the revaluation model under IAS 16). This is appropriate, as the present obligation to make a distribution of an asset crystallises any unrealised gains / loss not previously recognised, which also reflects the performance of the entity.

We believe that measurement of the asset to be distributed should be recognised at fair value at the same time as the dividend payable for a number of reasons:

- It prevents an accounting mismatch i.e. by measuring the liability and related asset both at fair value.
- It is consistent with IAS 39 which allows fair value measurement where it eliminates or significantly reduces a measurement or recognition inconsistency (IAS 39, para 9).
- For the same reasons that it is important to recognise the dividend payable at the fair value of the assets to be distributed, it is also important to recognise the asset at fair value; i.e. to reflect the value of the assets distributed (refer Basis for Conclusions, para BC19).
- It is consistent with the principle of IFRS 3 *Business Combinations*, which requires any assets and liabilities transferred to be recognised at "fair value" to the transferee.
- It could also be applied to common control transactions i.e. by ensuring consistent and transparent fair value treatment by both the transferor and transferee.

Finally, the Draft Interpretation does not contemplate that an entity has adopted the revaluation model, in accordance with IAS 16. As this is an option available under the Standards, this should be explicitly addressed.

Question 3 Whether an entity should apply the requirements in IFRS 5 to non current assets held for distributions to owners

NSW Treasury does not agree that IFRS 5 *Non-current assets held for sale and discontinued operations* should apply for distributions of non-cash assets to owners. This is because of the following reasons:

- It fundamentally changes the purpose of IFRS 5 which is meant to address assets held for sale i.e. where the carrying amount of an asset will be recovered through a sale transaction rather than through continuing use.
- It will result in a measurement inconsistency i.e. IFRS 5 only requires measurement at the *lower* of carrying amount and fair value less costs to sell; while the dividend payable will be measured at fair value.
- It could establish a precedent for common control transactions which would prevent transparent and consistent fair value treatment of the transferred asset by both the transferor and transferee.
- In practice, it would be difficult to determine at what point the asset should be classified as 'held for distribution', other than at the point where there is a present obligation. This would represent a departure from the IFRS 5 principles which are not linked to the recognition of the present obligation.
- The meaning of 'fair value' in IFRS 5 and its relationship with IAS 36 *Impairment of Assets* is unclear. That is, it may be difficult to apply a concept of an 'impairment loss' (per IFRS 5, para 20) to an asset that will be distributed at nil consideration. This is particularly so, as the IAS 36 concept of 'fair value' assumes the availability of market evidence, which may not always exist for assets held for distribution (i.e. depreciated replacement cost is not referred to in IAS 36). This is further discussed under 'other comments' below.

Instead, as discussed above, NSW Treasury believes that when a dividend payable is recognised, the assets to be distributed should also be recognised at fair value on that date (and subsequently). This is a simpler approach which ensures greater transparency and consistency in treatment.

Other comments

Use of the term 'distributions'

NSW Treasury believes that the Draft Interpretation should consistently refer to 'distributions', or at least make clear whether the Interpretation is intended to cover both returns *on* investment (dividends) and returns *of* investment. Instead, the Draft Interpretation uses the term 'distributions' and 'dividends' interchangeably, without acknowledging that a distribution can also include a return *of* investment (e.g. refer para 2 of the Draft which states that distributions to owners are 'commonly referred to as dividends').

Use of the term 'fair value'

The Draft Interpretation directly refers to the term 'fair value' and also proposes to apply IFRS 5 requirements. However, as discussed, in the comments to question 3 above, the concept of 'fair value', is not explained in IFRS 5; nor is it explained in IAS 37.

In particular, application of the term 'fair value' and 'impairment' to an asset to be distributed at nil consideration requires further discussion, to ensure that there is no possible interpretation that fair value is nil (because of the absence of consideration or market evidence). It needs to be made clear that fair value also encompasses the notion of depreciated replacement cost, consistent with IAS 16.