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Deloitte global IFRS leadership team

IFRS global office

Global IFRS leader
Ken Wild
kwild@deloitte.co.uk

IFRS centres of excellence

Americas
D. J. Gannon
iasplusamericas@deloitte.com

Asia-Pacific

Hong Kong
Stephen Taylor
iasplus@deloitte.com.hk

Melbourne
Bruce Porter
iasplus@deloitte.com.au

Europe-Africa

Johannesburg
Graeme Berry
iasplus@deloitte.co.za

Copenhagen
Jan Peter Larsen
dk_iasplus@deloitte.dk

London
Veronica Poole
iasplus@deloitte.co.uk

Paris
Laurence Rivat
iasplus@deloitte.fr

IFRIC releases draft Interpretations on accounting for distributions and contributions

On 17 January 2008, the International Financial Reporting Interpretations Committee (IFRIC) issued two new draft Interpretations:

- IFRIC Draft Interpretation D23: Distributions of Non-cash Assets to Owners – which addresses the accounting by entities that distribute non-cash assets as dividends to their owners; and
- IFRIC Draft Interpretation D24: Customer Contributions – which gives guidance on the accounting for the receipt of contributions of property, plant and equipment (or cash) that must be used to provide access to a supply of goods or services to customers.

The IFRIC invites comments on these draft Interpretations by 25 April 2008.

Distributions of non-cash assets to owners

The proposals in D23 are summarised below. If implemented, the key impact of these proposals would be on entities whose accounting policy has been to recognise distributions of non-cash assets to owners at amounts other than fair value (e.g. at the carrying amount of the asset distributed). Those entities would be required to measure the distribution at fair value and to recognise a gain when the fair value of the asset to be distributed is higher than its carrying amount. The proposed accounting would also result in a larger debit to retained earnings on the initial recognition of the dividend payable, and a larger liability.

Background

An entity may distribute assets other than cash as dividends to its owners acting in their capacity as owners. International Financial Reporting Standards (IFRSs) do not currently address how such non-cash distributions to owners should be measured.

The draft Interpretation addresses the following issues:

- how an entity should measure an obligation to distribute non-cash assets to its owners (the dividend payable); and
- when an entity settles the dividend payable, how it should account for any difference between the carrying amount of the assets distributed and the provision for the dividend payable.

Scope

The draft Interpretation applies to:

- distributions of non-cash assets, and
- distributions that give owners a choice of receiving either non-cash assets or a cash alternative,

for which all owners of the same class of equity instruments are treated equally.

The draft Interpretation does not apply to a distribution of an asset that is ultimately controlled by the same parent entity before and after the distribution (i.e. a non-cash distribution within the same group).

Measurement of the dividend payable

The draft Interpretation proposes that when an entity has an obligation to distribute assets to its owners, it should measure the liability for the dividend payable in accordance with IAS 37 **Provisions, Contingent Liabilities and Contingent Assets**. IAS 37 requires an entity to measure a liability at the best estimate of the expenditure required to settle or transfer the present obligation. The draft Interpretation states that to apply the requirements in IAS 37 to the measurement of the dividend payable, an entity should consider the fair value of the assets to be distributed. If an entity gives its owners a choice of receiving either a non-cash asset or a cash alternative, the entity should estimate the dividend payable by considering both the fair value of each alternative and the associated probability of owners selecting each alternative.

Accounting for any difference

The draft Interpretation proposes that when an entity settles the dividend payable, it should recognise the difference, if any, between the carrying amount of the assets distributed and the carrying amount of the dividend payable as a gain or loss in profit or loss.

Example

An entity wishes to distribute to its owners land with a carrying amount of CU20 million (determined under IAS 16's cost model). The fair value of the land is CU30 million. At the date it enters into an obligation to make the distribution, the entity recognises a liability for CU30 million and debits equity with the same amount, as follows:

		CUm	CUm
DR	Equity (retained earnings)	30	
CR	Liabilities (dividend payable)		30

On settlement of the liability, the following entries would be required:

		CUm	CUm
DR	Liabilities (dividend payable)	30	
CR	Land		20
CR	Profit or loss (gain on distribution of asset)		10

If the fair value of the property changes between the date on which the dividend is declared and the date of settlement, the liability is remeasured through equity (retained earnings) and, on settlement, profit or loss is affected.

Continuing the previous example, if the fair value of the land has increased to CU32m on the date of settlement, the net effect is to debit to retained earnings an additional CU2m and to increase the gain on distribution of the asset from CU10m to CU12m.

Customer contributions

The proposals in D24 are summarised below. If implemented, the key impact of these proposals would be that entities that have not previously recognised contributed assets would begin (prospectively) to recognise increased property, plant and equipment and revenue. Entities that have previously recognised revenue immediately on the receipt of a contributed asset might be required to recognise revenue over a longer period (again, prospectively).

Background

In some industries, a customer may be required to contribute an asset (or cash towards the construction or acquisition of an asset) that is then used to provide access to an ongoing supply of goods or services to the customer. For example, a property developer may be required to install an electricity substation to service a new housing development that must then be contributed to the supplier operating the electricity network. The supplier must use the asset to provide access to electricity to the future homeowners.

The draft Interpretation provides guidance for the supplying entity on the accounting for the receipt of such contributions, in particular:

- whether the contribution gives rise to an asset of the entity receiving the contribution, and at what amount any such asset should be initially recognised;
- if a customer contribution is recorded at fair value on initial recognition, how the resulting credit is accounted for; and
- how an entity should account for the receipt of a cash contribution.

Scope

The draft Interpretation applies to all situations in which an entity (the access provider) receives an item of property, plant and equipment (or cash it is required to use to construct or acquire an item of property, plant and equipment) that must be used to provide access to a supply of goods or services.

D24 specifically applies only to contributions of property, plant and equipment or cash. Contributions of intangible assets such as patents, research findings or software are not addressed.

Recognition of a customer contribution as an asset

Under D24's proposals, when an entity receives a customer contribution, it would be required to assess whether the contribution qualifies for recognition as an asset. If the customer contribution does qualify for recognition as an asset, it would be recognised as property, plant and equipment and initially measured at fair value.

Obligation to provide access to a supply of goods or services

An entity that receives a customer contribution usually has an obligation to provide access to a supply of goods or services. The draft Interpretation proposes that this obligation should be recognised and measured at the fair value of the contribution received. The obligation would be reduced and revenue recognised as access to the supply of goods or services is provided.

The period over which revenue would be recognised is the period over which the entity has an obligation to continue to provide access to a supply of goods or services using the contributed asset. The period of the obligation may be shorter, but never longer, than the useful economic life of the asset.

Determining whether the ongoing arrangement contains a lease

An entity that receives a customer contribution would be required to assess whether the ongoing arrangement to provide access to a supply of goods or services using that asset contains a lease, in accordance with IAS 17 **Leases** and IFRIC 4 **Determining whether an Arrangement contains a Lease**, and to account for the arrangement as appropriate.

Accounting for a cash contribution

A cash contribution is a payment of cash to an entity to acquire or construct an item of property, plant and equipment that the entity must use to provide access to a supply of goods or services to the customer.

Where the asset to be acquired or constructed will meet the criteria to be recognised as property, plant and equipment, consistent with above discussion, the asset would be accounted for in accordance with IAS 16. If not, the entity would be required to account for the cash contribution as proceeds for providing the asset to the customer, applying IAS 11 **Construction Contracts** or IAS 18 **Revenue** as appropriate.

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