IAS 32, IAS 33 and IFRIC 17: Dividend Reinvestment Plans

Extract, IFRS Discussion Group Report on Meeting – September 11, 2014

Many companies in Canada have dividend reinvestment plans (referred to as "DRIPs"). Although the features may vary from plan to plan, some common features include the following:

- Calculating the number of shares to be issued based on dividing the cash dividend declared by 95 per cent of a volume weighted average share price. The shareholders effectively receive a premium of five per cent over the cash dividend.
- Selection of a cash, versus share, option is usually required prior to a dividend record date and this date in most cases precedes the balance sheet date (i.e., it is often known at the quarter-end balance sheet date how many shareholders have elected to receive shares).

Issue 1: Should a liability be accrued for the dividend payable as a whole or only for the amount expected to be settled in cash?

As the dividend will be settled in a variable number of shares, it appears that a liability for the entire dividend should be accrued at the balance sheet date (i.e., at that date the entity has an obligation to deliver cash or a variable number of shares). Recording at least the cash equivalent of the obligation seems consistent with practice.

The Group's Discussion

Group members did not express alternative views about recording the cash equivalent of the obligation.

Issue 2: Should the liability include a five per cent premium for amounts to be settled in shares and should amounts ultimately credited to equity be based on the fair value of the shares on the settlement date?

View 2A – Yes.

At the balance sheet date, the entity has a liability to deliver a variable number of shares to those who elected to participate in the DRIP. The liability qualifies as a financial liability under IAS 32 *Financial Instruments: Presentation* and should be recorded at fair value on initial recognition. The fair value of the liability should incorporate the expected value of the shares to be delivered based on level 1 trading prices and should not incorporate any discount for liquidity or transaction costs.

Source: www.frascanada.ca/ifrs-discussion-group

This view is consistent with guidance in IFRIC 17 *Distributions of Non-cash Assets to Owners*, which indicates that where a dividend has a cash and non-cash alternative, the fair value of each alternative and the probability that it will be selected should be factored into the amount recorded as a liability. Even though IFRIC 17 does not apply directly because it is intended to address distributions of "non-cash assets" such as property, plant and equipment rather than equity instruments, it can provide a useful analogy. In the November 2007 meeting, the IFRS Interpretations Committee noted that IFRIC 17 is not intended to cover dividend reinvestment plans. However, it is unclear whether that discussion contemplated dividend reinvestment plans where a discount to market price was present.

Under this view, the arrangement is not in substance a rights offering because the shareholders simply receive shares when electing to participate in the dividend reinvestment plan. They don't actually receive cash that they then reinvest. Further, the variable number of shares to be delivered would preclude a rights offering from meeting the fixed number of shares for a fixed amount of cash classification as required to qualify as equity in accordance with IAS 32.

View 2B – No.

The arrangement should be viewed as a "rights offering". The substance of the arrangement is that all shareholders receive (notionally) the cash dividend and they all have an ability to elect to participate in a rights offering at less than market price of the shares. IAS 33 *Earnings per Share* discusses the accounting for rights issues, including the requirement to apply the accounting retrospectively to all periods presented in the financial statements.

View 2C – Policy choice.

There is either a policy choice between View 2A and View 2B, or the facts and circumstances of a particular arrangement should determine whether it is viewed as a rights offering or an arrangement involving a financial liability.

The Group's Discussion

The majority of Group members supported View 2A. Some Group members thought the analogy to a "rights offering" appeared reasonable but noted that consideration should be given to how material the five per cent premium amount would be.

Issue 3: Assuming the shares are recorded at their fair value on issuance, how should any difference between the liability accrued at the balance sheet date and the ultimate settlement amount be recorded?

View 3A – Adjustment to equity.

The arrangement is a transaction with owners and, therefore, does not meet *The Conceptual Framework* for Financial Reporting definitions of income or expense. The guidance in IFRIC 17 that allows for remeasurements of non-cash distribution liabilities through equity is relevant and may be applied by analogy.

View 3B – Profit or loss.

The arrangement should be accounted for as an “other liability” under IAS 39 and any remeasurements of that liability should be recorded in profit or loss as a financing charge.

The Group’s Discussion

A few Group members who commented on this issue supported View 3B because there is sufficient guidance in IAS 39 that subsequent remeasurements of a financial liability should be recorded in profit or loss.

Issue 4: Are views affected when the units are classified as equity because of the puttables amendment (for example, certain trusts /real estate investment trusts)?

The underlying units are presented as equity, but the definition of financial liability in IAS 32 does not consider such units as equity for other purposes (for example, the application of IAS 33).

The Group’s Discussion

Group members did not express alternative views.

Issue 5: Certain plans are structured as “Share Dividend Plans” rather than dividend reinvestment plans. The typical Share Dividend Plan enables shareholders to receive their dividends directly in the form of common shares, which are issued at a five percent discount from the prevailing market price (as opposed to reinvesting cash dividends). Is the accounting for such plans subject to different considerations than for dividend reinvestment plans?

Although these plans differ in form, the substance appears to be the same as a dividend reinvestment plan and, therefore, consistent accounting should apply.

The Group’s Discussion

Group members did not express alternative views.

Overall, the Group noted that consideration should be given to the materiality of the premium associated with a dividend reinvestment plan. If the relevant IFRS guidance is not followed because the impact is determined to be immaterial to the users of financial statements, the analysis in support of that treatment should be documented.

The Group’s discussion raises awareness about this item. The Group did not recommend any further action be taken on this item.