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Dear Sir David

## **ED 4 Disposal of Non-Current Assets and Presentation of Discontinued Operations**

We appreciate the opportunity to comment on ED 4 *Disposal of Non-current Assets and Presentation of Discontinued Operations*.

### **General Remarks:**

We generally support the IASB's and the FASB's joint efforts to improve the comparability of financial statements by way of converging their financial reporting requirements for discontinued operations. The convergence initiative is a big step forward to a single set of high quality standards accepted worldwide. Regardless of our critical comments set out below, we generally support the initiative.

Our main concerns about ED 4 refer to the following issues:

- Assets or disposal groups to be abandoned:

In accordance with IAS 35, the initial disclosure of a discontinuing operation depends on a binding sale agreement or, whichever occurs earlier, the approval and announcement of a detailed, formal plan for discontinuance. In contrast, ED 4 proposes that a component of an entity is classified as discontinued operation when the entity has actually disposed of the operation, or when the operation meets the criteria to be classified as held for sale. A component to be abandoned

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is therefore presented as discontinued operation at the date when it has been disposed of. Since we consider information about disposals by sale as well as other than by sale as very important, particularly with regard to providing users with relevant information which give the ability to appraise an entity's future performance, we do not agree with the proposed requirement that a disposal other than by sale should not be presented before the disposal has been completed. In our opinion IAS 35 meets the requirements of decision useful information about discontinuance better than ED 4 because IAS 35 provides disclosure about both sale and abandonment very early, when a detailed formal plan has been adopted and announced or when the entity has already contracted for the disposal. We are therefore seriously concerned that there is no other reason for replacing IAS 35 by ED 4 than the convergence with US GAAP.

- Classification of assets held for sale:

We consider the extension of the scope beyond the disposal of components of an entity to assets as unfavourable. We are concerned that a separate presentation of an asset or cash-generating unit held for sale will lead to an information overload rather than to an enhancement in decision usefulness. Whilst the distinction of discontinuing and continuing operations improves the users' ability to make projections of the entity's future cash-flows, earnings-generating capacity, and financial position, including assets held for sale in the scope focuses the user's attention on the asset disposal rather than on the continuing operations. Furthermore, the criteria in Appendix B, paragraph B2 of ED 4 seem to be very prescriptive; we therefore suggest including more principles-based requirements in the main body of the standard instead of the Appendix.

- Ceasing the depreciation (or amortisation):

When an asset is held for sale, recognising depreciation in the period of disposal depends on whether the asset will still produce revenues. When the asset will not be used until the disposal date and will not produce any revenue, it seems to be inappropriate to allocate costs by depreciating. In contrast, if the asset is still used until the sale becomes effective, the cost, i.e. depreciation, should be recognised as well as the related revenues. Whether or not the depreciation of an asset will be ceased should depend on its use in the current business rather than on a sale agreement. In our opinion a criterion such as *retired from active use* is more appropriate than *held for sale*. Since the depreciation affects the profit and loss of the ordinary activities as well as the profit and loss from the disposal, ceasing the depreciation will lead to a distortion of the profit and loss in the period in which the



assets have been classified as held for sale. Furthermore, we see an inconsistency with IAS 16 as paragraph 52 of [draft] IAS 16 requires that the depreciation of an asset should *not* cease when the asset becomes temporarily idle or is retired from active use and held for disposal unless the asset's depreciable amount has been allocated fully.

- Beyond the treatment of depreciation in [draft] IAS 16 we have identified another inconsistency with IAS 36 regarding the allocation of an impairment loss. IAS 36 requires allocating an impairment loss first to goodwill which is excluded from the scope of ED 4.

Moreover, as paragraph 60 of [draft] IAS 16 requires an impairment test under IAS 36, we wonder whether assets and disposal groups designated as held for sale have to be impaired anyway in accordance with IAS 36 and whether, therefore, the requirements of ED 4 on an impairment test may be redundant.

We are generally of the opinion, that, adopting US GAAP, the IASB provides with ED 4 a highly rules-based standard which contradicts the Board's intention to create a set of principles-based standards and which is not consistent with the concept of IFRS. We are of the opinion that even within the convergence initiative an improvement of the requirements on discontinuing/ discontinued operations in IAS 35 would have been sufficient whilst other issues related to an asset disposal are already dealt with in IAS 16 and IAS 36 adequately or rather could have been dealt with by adding requirements in the relevant standards. We believe that implementing ED 4 into the IFRS system will be a step backwards on the way towards a conceptually sound system of principles-based accounting standards.

Although we generally support the convergence initiative we do not consider the proposed treatments of the issues discussed above as appropriate.

**Question 1 – Classification of non-current assets held for sale:**

The Exposure Draft proposes that non-current assets should be classified as assets held for sale if specified criteria are met. (See paragraph 4 and 5 and Appendix B.) Assets so classified may be required to be measured differently (see question 2) and presented separately (see question 7) from other non-current assets.

Does the separate classification of non-current assets held for sale enable additional information to be provided to users? Do you agree with the classification being made? If not, why not?



**GASB's comment:**

We generally appreciate that the IASB requires the presentation of discontinuances on the face of the balance sheet. In our view a presentation of assets to be disposed of would also be permitted and reasonable within the section of current assets instead of non-current assets. A separate presentation within the current assets would require a regrouping of an asset held for sale from non-current to current.

Requirements for disposal groups are missing in this context. We would prefer more guidance on the presentation of disposal groups because a disposal group includes non-current assets as well as current assets. The presentation of the group within the section of non-current assets seems, however, to be inappropriate.

In principal, we regard an extension of the scope beyond the presentation of discontinued/ discontinuing operations as undesirable. We are concerned that the classification of assets, or cash-generating units, as held for sale and the consequential revaluation of those assets will result in an information overload as ED 4 proposes very extensive disclosure about assets or disposal groups which in our opinion are not predominantly relevant for users. The segregated presentation of discontinuing and continuing operations should provide users with disclosures about disposals but the primary objective set out in IAS 35 is to enable users to project the entity's future performance, i.e. the continuing operations. We are therefore seriously concerned that the scope of ED 4 focuses on the assets to be disposed of rather than on the continuing operations. An extension of the scope to assets held for sale could however be reasonable in the case that a single asset is significant for the entity's business such as a major line of business and that, in addition, short-term effects on the entity's cash flows are expected from the disposal. In that case we would however consider the information required in IAS 35 as more decision useful.

Regardless of our critical comment on the concept of ED 4 we suggest to include assets held for sale criteria, as they are key requirements, into the main body of the standard instead of the Appendix. The criteria in Appendix B paragraph B1 are, however, from our point of view very prescriptive and it seems to be very difficult to meet all criteria simultaneously. We essentially consider two criteria as appropriate: The asset or disposal group is available for immediate sale and the management commits itself to a plan to sell the asset or disposal group.



Furthermore, the held for sale criterion B1 (d) “highly probable” is still inconsistent. We wonder why the Board intends to apply a terminology that is neither consistent with IFRS nor with US GAAP. With regard to the objectives of the convergence initiative we would encourage the Board to reconsider the held for sale criteria and come to a more consistent solution on the basis of a principles-based approach.

We understand and support the Board’s intention to eliminate management intended accounting policies; but the inconsistencies of the held for sale criteria and of the Exposure Draft in general result from the elimination of disposals other than by sale. We can see neither added decision usefulness nor more relevance and reliability and we therefore recommend once again requiring the presentation of a disposal of assets or groups of assets independent on whether they will be sold or abandoned.

### ***Question 2 – Measurement of non-current assets classified as held for sale***

The Exposure Draft proposes that non-current assets classified as held for sale should be measured at the lower of carrying amount and fair value less costs to sell. It also proposes that non-current assets classified as held for sale should not be depreciated. (See paragraphs 8-16.)

Is this measurement basis appropriate for non-current assets classified as held for sale? If not, why not?

#### **GASB’s comment:**

Within the proposed assets held for sale concept, a fair value measurement seems to be consistent. However, we are still concerned that the depreciation of an asset classified as held for sale will cease although it is still used in the ongoing business until the sale becomes effective. In a fair value concept depreciation does not exist because the fair value shows the balance of cash inflows and cash outflows. Thus, the amortisation of cost is considered in the fair value and an allocation over the periods is redundant. As ED 4 proposes a measurement only at the *lower* of carrying amount and fair value less selling cost, in the case that the fair value exceeds the carrying amount and the asset is still used, the earnings related to this asset will be considered in the income statement whilst the cost, i.e. the depreciation, remains unaccounted for. We regard, however, that solution as highly inconsistent and recommend therefore redrafting the proposed fair value measurement in connection with the ceasing



of the depreciation. We also refer back to our comment in the general remarks.

### **Question 3 – Disposal groups**

The Exposure Draft proposes that assets and liabilities that are to be disposed of together in a single transaction should be treated as a disposal group. The measurement basis proposed for non-current assets classified as held for sale would be applied to the group as a whole and any resulting impairment loss would reduce the carrying amount of the non-current assets in the disposal group. (See paragraph 3.)

Is this appropriate? If not, why not?

#### **GASB's comment:**

We generally agree with the allocation of an impairment loss on assets and liabilities related to a disposal group. But as pointed out in the general remarks the proposed allocation method in ED 4 is inconsistent with the method required in IAS 36. According to IAS 36 an impairment loss should be allocated first to goodwill which is excluded explicitly from the scope of ED 4. As we regard the treatment of an impairment loss under IAS 36 as appropriate, we suggest confirming the requirement of IAS 36.

In addition we are of the opinion that the scopes of disposal groups, cash-generating units and discontinued operations are not well-defined. In accordance with paragraph 3, a disposal group may be a “group of cash-generating units, a single cash-generating unit, or part of a cash-generating unit”. In IAS 36 paragraph 5, a cash-generating unit is defined as “smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets”. Thus, a part of a cash-generating unit may also be a single asset. It is not clear to us whether a disposal group is a unit ranking higher than a cash-generating unit and whether such a unit comprising assets and liabilities is necessary in addition to cash-generating unit. The interrelation between disposal group and discontinued operation is also unclear particularly since a discontinued operation as defined in ED 4 may also be a part of a cash-generating unit, i.e. a single asset (see below our comment to Question 8). We therefore suggest reconsidering the definitions and including some examples.



#### **Question 4 – Newly acquired assets**

The Exposure Draft proposes that newly acquired assets that meet the criteria to be classified as held for sale should be measured at fair value less costs to sell on initial recognition (see paragraph 9). It therefore proposes a consequential amendment to [draft] IFRS X Business Combinations (See paragraph C13 of Appendix C) so that non-current assets acquired as part of a business combination that meet the criteria to be classified as held for sale would be measured at fair value less costs to sell on initial recognition, rather than at fair value as currently required.

Is measurement at fair value less costs to sell on initial recognition appropriate? If not, why not?

##### **GASB's comment:**

We agree that a newly acquired asset that meets the criteria to be classified as held for sale should be measured at fair value less costs to sell on initial recognition. We consider a consequential amendment to [draft] IFRS X Business Combinations appropriate. We however would like to point out that the depreciation has also to be ceased when a newly acquired asset is retired from active use and expected selling cost has to be deducted.

#### **Question 5 – Revalued assets**

The Exposure Draft proposes that, for revalued assets, impairment losses arising from the write-down of assets (or disposal groups) to fair value less costs to sell (and subsequent gains) should be treated as revaluation decreases (and revaluation increases) in accordance with the standard under which the assets were revalued, except to the extent that the losses (or gains) arise from the recognition of costs to sell. Costs to sell and any subsequent changes in costs to sell are proposed to be recognised in the income statement. (See paragraphs B6-B8 of Appendix B.)

Is this appropriate? If not, why not?

##### **GASB's comment:**

We regard the requirement for revalued assets within the proposed conception as appropriate because this ensures a consistent treatment for assets accounted for under the cost model as well as under the revaluation method.





**Question 6 – Removal of the exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale**

The Exposure Draft proposes a consequential amendment to [draft] IAS 27 *Consolidated and Separate Financial Statements* to remove the exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale. (See paragraph C3 of Appendix C and paragraphs BC39 and BC40 of the Basis for Conclusions.)

Is the removal of this exemption appropriate? If not, why not?

**GASB's comment:**

As the exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale is not an issue of ED 4, this issue should be addressed in [draft] IAS 27.

**Question 7 – Presentation of non-current assets held for sale**

The Exposure Draft proposes that non-current assets classified as held for sale, and assets and liabilities in a disposal group classified as held for sale, should be presented separately in the balance sheet. The assets and liabilities of a disposal group classified as held for sale should not be offset and presented as a single amount. (See paragraph 28.)

Is this presentation appropriate? If not, why not?

**GASB's comment:**

As we assume that paragraph 28 proposes to allow an aggregation to major classes of assets rather than requiring the presentation of each single asset classified as held for sale on the face of the balance sheet, we agree with the Board's proposals on the presentation of non-current assets held for sale.

**Question 8 – Classification as a discontinued operation**

The Exposure Draft proposes that a discontinued operation should be a component of an entity that either has been disposed of, or is classified as held for sale, and:

- (a) the operations and cash flows of that component have been, or will be, eliminated from the ongoing operations of the entity as a result of its disposal, and





- (b) the entity will have no significant continuing involvement in that component after its disposal.

A component of an entity may be a cash-generating unit or any group of cash-generating units. (See paragraphs 22 and 23.)

These criteria could lead to relatively small units being classified as discontinued (subject to their materiality). Some entities may also regularly sell (and buy) operations that would be classified as discontinued operations, resulting in discontinued operations being reported every year. This, in turn, will lead to the comparatives being restated every year.

- (1) Do you agree that this is appropriate?
- (2) Would you prefer an amendment to the criteria to be made, for example adding a requirement adapted from IAS 35 *Discontinuing Operations* that a discontinued operation shall be a separate major line of business or geographical area of operations, even though this would not converge with SFAS 144 *Accounting for the Impairment or Disposal of Long-lived Assets*?
- (3) How important is convergence in your preference?
- (4) Are the other aspects of these criteria for classification as a discontinued operation (for example, the elimination of the operations and cash flows) appropriate? If not, what criteria would you suggest, and why?

**GASB's comment:**

- (1) We explicitly support that the Board has included in the definition that the entity will have no significant continuing involvement in a component after its disposal. However, we believe a more precise definition or (at least) further guidance regarding the criterion of "significant involvement" might be appropriate. We would like to point out potential inconsistencies with other IFRS, as the IASB has decided deleting the approach of continuing involvement in IAS 39.

We also believe the scope of a "discontinued operation" being too broad. As mentioned in our answer to question 3, we believe that including cash generating units under the definition of IAS 36 extends its scope to virtually each asset, presuming materiality of the asset. By referring to cash generating units, the distinction between assets held for sale and discontinued operations fades. In our opinion a broad definition of a discontinued opera-



tion does not provide further information, but rather causes an unnecessary information overload for (potential) investors and a more extensive effort for preparers. Furthermore we believe it is not clear whether there is a difference between the definition of disposal group on the one side and discontinued operations on the other, or whether the latter has been introduced for Income Statement's purposes only. We suggest providing a clarification of this matter.

- (2) We would prefer to retain the definition of “discontinuing operations” provided under IAS 35. Even though this gives rise to divergences between ED 4 and SFAS 144, we still believe the reasons mentioned under (1) give evidence to support this concept.
- (3) Against the background of efficient capital markets and the need for internationally accepted, high quality accounting standards the convergence of IFRS and US GAAP is fundamental. This holds true also due to the importance of the capital market of the United States. However, despite the relevance of convergence the IASB's main objective is to generate high quality standards. Therefore the objectively better solution should be implemented on each issue. It cannot always be assumed that the standard setter who has last reviewed and dealt with an issue necessarily provides the better solution. This reasoning does not consider possible differences in connotations or discrepancies in concepts due to the very casuistic concept US GAAP are based on. Therefore implementing guidelines into a different system might generate a suboptimal outcome. In our opinion the definition of discontinuing operations under IAS 35 should be retained because, as aforementioned, in our view an extension of the scope on smaller components of an entity does not necessarily generate superior information. However, ED 4 should be more principles-based.
- (4) We refer to our arguments in regard to the definition of a discontinued operation and our recommendation to implement a definition consistent with IAS 35.

### ***Question 9 – Presentation of a discontinued operation***

The Exposure Draft proposes that the revenue, expenses, pre-tax profit or loss of discontinued operations and any related tax expense should be presented separately on the face of the income statement. (See paragraph 24.) An alternative approach would be to present a single amount, profit after tax, for discontinued operations on the face of the income statement with a breakdown into the above components given in the notes.



Which approach do you prefer, and why?

**GASB's comment:**

We generally support the Board's proposal to present revenue, expenses, pre-tax profit or loss of discontinued operations and any related tax expense separately on the face of the income statement. However, we would favour the option to present a single amount for discontinued operations on the face of the income statement with additional information about the above components in the notes as alternative treatment.

In addition, a link to the pre-tax profit and loss from ordinary activities and to total assets/ liabilities is missing as well as the interrelation to segment reporting. Thus, we would encourage the Board to require the presentation of segregated information about discontinued operation also in the segment reporting.

If you would like any clarification of these comments please contact me.

Yours sincerely,

Prof. Dr. Klaus Pohle  
President