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Ms Anne McGeachin
Project Manager
International Accounting Standards Board
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27 November 2003

Dear Anne

ED 4 'Disposal of Non-current Assets and Presentation of Discontinued Operations'

I set out below, and in the attached note, the views of the UK Accounting Standards Board (ASB) on ED 4 'Disposal of Non-current Assets and Presentation of Discontinued Operations'. As you will be aware, the ASB issued the IASB's draft standard in the UK in the form of a FRED on which it invited comments. We have passed to you all the letters we have received in response. This letter and the attached note reflect the views of the ASB, and make no attempt to summarise the responses received.

The ASB does not support the main aspects of the IASB proposals in the exposure draft. In particular, it believes:

- the 'held for sale' criteria introduce unnecessary reliance on management intent, and require detailed anti-abuse rules, which could be avoided by a more objective classification such as 'retired from active use' (see answer to IASB Question 1);
- tangible fixed assets that continue to be used by a business should, in principle, be subject to depreciation, regardless of whether they are expected to be sold or not (see answer to IASB Question 2);
- a stricter definition of discontinued operations should be adopted, relating to both their timing and the size/nature of their components (see answer to IASB Question 8).



Whilst we note that this project stems from the important work on convergence with US GAAP, we would suggest that the topic could be better progressed in conjunction with the 'Reporting Comprehensive Income' project (see also our answer to Question 9). Although we recognise that this would postpone the issue of a new standard on this subject, in the context of IASB's current agenda, we do not believe that this would be of concern.

If you have any questions concerning this letter, or would like any further information on the comments made, please contact either Jenny Carter (020 7611 9712) or myself on 020 7611 9705.

Yours sincerely

A handwritten signature in cursive script, appearing to read 'Andrew Lennard'.

Andrew Lennard
Director of Operations



The UK ASB's comments on ED 4

IASB Question 1 – classification as 'held for sale'

The ASB does not agree with the classification 'held for sale'. It does not appear to represent a principled approach to standard-setting and introduces unnecessary reliance on management intent. We agree with the alternative views of certain Board members published in the ED that a classification such as 'retired from active use' would be more appropriate.

Further, these proposals draw no distinction between assets that will be replaced and those that will not. Therefore it is possible, in some circumstances, that the disclosure of assets, or disposal groups, held for sale will give a misleading impression that the business is contracting, when this may not be the case once replacement is taken into account.

We believe that adopting the classification 'retired from active use' would enable the IASB to eliminate many of the related measurement proposals, with which we also disagree. Indeed, in the context of assets 'retired from active use' any necessary changes to current measurement requirements could probably be effected by relatively small amendments to existing IASs (eg amending IAS 36 to clarify that retirement from active use is a trigger for an impairment test).

IASB Question 2 – measurement of assets 'held for sale'

We do not agree with the proposed measurement basis for assets held for sale. In particular, we believe that, in principle, such assets should be depreciated. Depreciation reflects the cost of the use of tangible fixed assets in the operating profit for the period. Therefore, if assets are being used by the business, depreciation should be charged to reflect the consumption of economic benefits by the entity regardless of whether assets are held for sale.

We earlier commented, in response to the proposed amendments to IAS 16 'Property, Plant and Equipment', that determining the depreciable amount of an asset using current estimates of its residual value resulted in a distortion to depreciation. This distortion will be compounded when the disposal of an asset is expected shortly after the reporting date (or within the following year). Overall this has the effect of replacing on-going depreciation with an impairment loss on classification as 'held for sale', which gives the impression



that revenue is earned at nil expense, with a one-off loss (or even a gain) generated in its place.

IASB Question 8 – definition of discontinued operations

Level at which operations are reported as discontinued

The ASB notes that the IASB's proposals will lead to more frequent reporting of discontinued operations, which will relate to smaller components of an entity than would currently be reported as discontinued.

The objective of reporting discontinued operations should be to assist users in assessing current financial performance and forming a basis for predicting future performance. In respect of the latter it should focus on strategic/material changes.

It is not clear that the IASB's proposals will provide particularly useful information because the existence of discontinued operations will not necessarily indicate a strategic decision to change the size or focus of operations. For example, where an entity regularly sells assets or components which it then replaces, their use or results during the period could be included in discontinued operations, whereas, in our view, it should be reported within continuing operations.

Timing of recognition of discontinued operations

Based on the proposed definition of a discontinued operation, as including components that are held for sale, it is possible that a component will be reported as discontinued, but then subsequently not be sold and revert back to continuing operations.

To have most predictive value the activities must have ceased already: otherwise, in the event that a component were not sold, the information could give a misleading indication of future performance. Indeed permitting components 'held for sale' to be classified as discontinued seems to provide opportunities for abuse by potentially reporting less profitable activities as discontinued, but reclassifying them as continuing once they become more profitable again.

The Board also notes that the IASB describes *discontinued* operations as including components that are *expected to be* disposed of within 12 months. 'Discontinued' implies that the relevant operations have already ceased, and



therefore there appears to be an inconsistency between the term and its definition. We would suggest that, if the IASB retains its proposed definition, it should consider changing the title to *discontinuing* operations.

Preferable approach

A preferable approach, in our opinion, would be to require a component to be classified as discontinued when, as a result of a strategic decision, an entity has withdrawn from a particular market (whether a class of business or geographical) or experienced a material reduction in turnover in one of its continuing markets.

As a result the ASB would urge the IASB to adopt a definition for discontinued operations that requires the sale or termination to be completed and to have had a material effect on the nature and focus of the reporting entity's operations, representing a material reduction in its operating facilities.

IASB Question 9 – presentation of discontinued operations

We support the proposal to require separate presentation, on the face of the performance statement, of the revenue and expenses and the pre-tax profit/loss of discontinued operations. Our preference is for such items to be disclosed under the headings to which they relate and for totals of revenue, expenses and pre-tax profit/loss to be given. This will be particularly important if the IASB's proposed, low level, definition of discontinued operations is retained.

However, as in some circumstances, the income tax expense related to the discontinued operation can be determined only arbitrarily, further consideration should be given to the value of this allocation.

The most appropriate long-term solution for the presentation of discontinued operations should be determined as a result of the 'Reporting comprehensive income' project.