30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: www.iasb.org

International Accounting Standards Board

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.
These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting:	**18 July 2007, London**
Project:	**Annual improvements process**
Subject:	**Plan to sell the controlling interest in a subsidiary (Agenda paper 5A)**

Background

1. The IFRIC was asked to provide guidance on applying IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* when an entity is committed to a plan to sell the controlling interest in a subsidiary. The request considered situations in which the entity retained a non-controlling interest in its former subsidiary, taking the form of either an investment in an associate, an investment in a joint venture or a financial asset. The submitter raised four issues relating to the consolidated financial statements of the entity:

   - What triggers classification of the subsidiary's assets and liabilities as held for sale under IFRS 5?
   - When classification as held for sale is required, should all the subsidiary's assets and liabilities be classified as held for sale or only the proportion to be sold?
   - Is classification as discontinued operations relevant when the entity plans to retain a significant influence over its former subsidiary after the sale?

- After the sale, how should the remaining non-controlling equity investment be measured?

2. At its May 2007 meeting, the IFRIC made the following tentative decisions:

   - in considering the first two issues, the IFRIC noted that paragraph 6 of IFRS 5 states: 'An entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use' [emphasis added]. The IFRIC tentatively decided to recommend to the Board that IFRS 5 be amended to clarify whether the criteria for classification as held for sale are met for all a subsidiary's assets and liabilities when the parent is committed to a plan that involves loss of control over the subsidiary. The IFRIC believed that IFRS 5 should be amended so that being committed to a plan involving loss of control over a subsidiary should trigger classification as held for sale of all those assets and liabilities.

   - On the third issue, the IFRIC noted that a disposal group classified as held for sale will also be a discontinued operation if the criteria of paragraph 32 of IFRS 5 are met. The IFRIC considered that this guidance was sufficient and divergence in practice should not develop. The IFRIC also noted that IFRS/US GAAP differences are likely to arise until a common definition of discontinued operations is adopted with a consistent approach to continuing involvement. For these reasons, the IFRIC tentatively decided not to address the issue.

   - The IFRIC noted that the last issue is being considered in the Board's joint project on Business Combinations and, therefore, tentatively decided not to address that issue.

3. At its July meeting, the IFRIC should confirm its decision. The staff will inform the Board at the July Board meeting of any change in such decision. However, the staff felt that IFRIC members broadly supported an amendment to IFRS 5 to clarify the classification criteria so that it could proceed with a proposal to the Board.

Staff analysis

4. The staff presents its analysis as follows:
   - Section 1: Are criteria for classification as held for sale met?
   - Section 2: What should be classified as held for sale when criteria are met?
   - Section 3: Update on the FASB's project on a similar issue

Section 1 - Are criteria for classification as held for sale met?

5. When issuing IFRS 5, the Board concluded that providing information about assets and groups of assets and liabilities to be disposed of is of benefit to users of financial statements (see BC 17). Such information should assist users in assessing the timing, amount and uncertainty of future cash flows.

6. IFRS 5 paragraph 2 (scope) states that the classification and presentation requirements of IFRS 5 apply to all non-current assets and to <u>all</u> disposal groups of an entity and requires an entity to classify them as held for sale when criteria set out in paragraphs 6 to 12 are met.

7. In particular, paragraph 6 of IFRS 5 states that "An entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered <u>principally</u> through a sale transaction rather than through continuing use". (emphasis added)

8. The staff is aware that this paragraph and the term "principally" are interpreted in two different ways:
   - View 1: being committed to a plan involving loss of control over a subsidiary is the triggering event for the classification as held for sale.
   - View 2: "principally through a sale" means that the majority of the interest in the subsidiary has to be disposed of to meet the criteria for classification as held for sale.

Arguments in favour of view 1

9. Supporters of view 1 argue that IAS 27 defines control and requires a parent to consolidate a subsidiary until control is lost. Loss of control is a significant event that changes the nature of the entity’s interest in the assets and liabilities of the subsidiary because the parent-subsidiary relationship ceases to exist. An investment in a subsidiary is therefore economically different from a non-controlling equity investment. The notion of control is crucial because what is to be sold is the controlling interest in exchange for a non-controlling interest, rather than merely a portion of assets and liabilities. Therefore, when the parent has a plan to sell the controlling interest of a subsidiary, even if disposal is only partial, classification as held for sale is relevant during the held-for-sale period.

10. This approach is also consistent with the decisions of the Board taken in the course of the project on Business Combinations phase II in which gaining or losing control is an event that changes the nature of the entity’s interest.

Arguments in favour of view 2

11. Those supporting view 2 are concerned that only a fraction of ownership change could trigger classification as held for sale while the entity keep significant influence or jointly control its former subsidiary. For this reason, presenting a disposal group is not appropriate. They mainly have a US GAAP approach for discontinued operations (see section 3 of this paper).

12. However, the staff note the existing US GAAP / IFRS difference in respect of discontinued operations (paragraph 2 of this paper).

Main differences between these two views

13. These two views would differ for instance when a parent has an initial interest of 60% and plans to sell 20% of its subsidiary. Under view 1, being committed to a plan involving loss of control over the subsidiary would trigger classification as held for sale whereas under view 2, selling 20% would not represent the majority of the interest in the subsidiary (more than 30%). In addition, a parent can lose control of a subsidiary without a change in absolute or relative ownership levels, for example as a result of a contractual agreement.

14. These two views would also differ when a parent is committed to a plan to partially dispose of its interest in a subsidiary and, after the partial disposal, will jointly control its former subsidiary. Under view 1, the parent being committed to a plan to lose control over its subsidiary would trigger classification as held for sale, because joint control is not control and losing control is a significant event, regardless of the accounting treatment after disposal (e.g. equity accounting or proportionate consolidation). Under view 2, the planned sale would not represent the majority of the interest in the subsidiary. Therefore, the assets and liabilities of the subsidiary would not be classified as a disposal group.

Section 2 - What should be classified as held for sale when criteria are met?

15. The staff is aware of two different views on what should be classified as held for sale when criteria are met:

    - A subsidiary that is to be disposed of meets the definition of a disposal group as defined by IFRS 5 and therefore, all its assets and liabilities should be classified as held for sale until the disposal;
    - Only the proportion that is to be sold should be classified as held for sale.

16. The staff note that, consistent with view 1 in the first section, being committed to a plan involving loss of control of a subsidiary should trigger classification as held for sale of **<u>all</u>** the subsidiary's assets and liabilities.

17. IFRS 5 introduces the concept of a disposal group, which is defined as being "a group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. ….". IFRS 5.4 explains further:

    Sometimes an entity disposes of a group of assets, possibly with some directly associated liabilities, together in a single transaction. Such a disposal group may be a group of cash-generating units, a single cash-generating unit, or part of a cash-generating unit.

18. Therefore, a subsidiary to be disposed of, even partially, meets the definition of a disposal group. This is because a subsidiary is a group of identifiable assets and liabilities. What will be transferred in the transaction is the control of the group of assets rather than a portion of each individual asset. On disposal, all the subsidiary's assets and liabilities will be derecognised and a non-controlling

interest will be recognised. This view is consistent with consolidation procedures set out in IAS 27 under which proportionate consolidation is not permitted.

Section 3 – Update on the FASB's project on a similar issue

19. The staff is aware that the FASB Staff have issued the Proposed FSP FAS 144-c with a comment dead line of 15 December 2006 which deals with a similar issue. (emphasis added):

> 3. <u>An entity shall classify the entire long-lived asset as held-for-sale and cease depreciating the long-lived asset once the long-lived asset meets the held-for-sale criteria even if the entity plans to account for its direct or indirect interest in the long-lived asset under the equity method of accounting.</u> When the entity obtains an equity method investment, the entity will apply existing literature to determine how to account for its equity method investment. This FSP does not change the accounting for investments in joint ventures or equity method investments and whether a new basis of accounting should be applied. The Board concluded that depreciating a long-lived asset once the long-lived asset meets the held-for-sale criteria is inconsistent with FASB Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. <u>As discussed in paragraphs B83 and B84 of that Statement, the Board concluded that accounting for an asset classified as held-for-sale is a process of valuation rather than allocation, making depreciation inconsistent with the process of valuation.</u> [Emphasis added]

20. The FASB received four comment letters[1], all from audit firms. Three of them expressed concerns that the criteria for classification as held for sale would not be met because the entity retains a significant influence of the asset. Some of the arguments supporting this view are the following:

   - "The level of negotiations required for the selling entity to retain significant influence over the asset(s) being sold are such that they would call into question a conclusion that the asset(s) is available for immediate sale." Therefore, criterion 30(b) of FAS 144 would not be met: "The asset (disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (disposal groups).
   - "only a fraction of ownership change could lead to a switch to equity method accounting. Classifying an asset as held-for-sale when only a percentage of that asset is sold does not appear to be consistent with the principles of FAS

[1] See the comment letters posted on the FASB website http://www.fasb.org/ocl/fasb-getletters.php?project=FSPFAS144C

144 as we do not believe this would qualify for recognition as a completed sale as contemplated by paragraph 30d. Additionally, it seems counter-intuitive to cease depreciation while the asset is held-for-sale only to resume depreciation through the application of the equity method of accounting once the partial sale is completed”

21. These three respondents mainly favour classification as held and used with continued depreciation rather than held for sale. They also raise questions about measurement issues for the non-controlling interest remaining after the sale as the Proposed FSP does not address these measurement issues.

22. At the March 2007 Technical Application and Implementation Activities (TA&I) Committee meeting, Committee members redeliberated the Proposed FSP FAS 144-c. The TA&I Committee reaffirmed the view of the Proposed FSP that “An entity shall classify the entire long-lived asset as held-for-sale and cease depreciating the long-lived asset once the long-lived asset meets the held-for-sale criteria even if the entity plans to account for its direct or indirect interest in the long-lived asset under the equity method of accounting”.

23. The TA&I Committee will not proceed with this project until the FASB Board’s project on NCI is completed.

Staff recommendation

24. The staff support view 1 and recommend amending IFRS 5 to clarify that, an entity that is committed to a plan involving loss of control of a subsidiary should classify the assets and liabilities of its subsidiary as held for sale, regardless of whether the entity retains a non-controlling interest after the sale. This amendment would enhance consistency within IFRS, especially with the new Standard on Business Combinations in which gaining or losing control is an event that changes the nature of the entity's interest.

25. Questions to the Board:

- Do you agree with the staff recommendation?
- If yes, do you have any comment of the proposed wording set out in the appendix of this paper?

Appendix: drafting reflecting view 1

Classification of non-current assets (or disposal groups) as held for sale

6 **An entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.**

7 For this to be the case, the asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be *highly probable*.

8 For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification, except as permitted by paragraph 9, and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

8A <u>An entity that is committed to a plan to sell a subsidiary involving loss of control of that subsidiary shall classify the assets and liabilities of that subsidiary as held for sale, regardless of whether the entity retains a non-controlling interest in its former subsidiary after the sale.</u>

…

Basis for Conclusions on Proposed Amendments to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

This Basis for Conclusions accompanies, but is not part of, the draft amendments.

BC1 The Board considered situations in which an entity is committed to a plan to sell the controlling interest in a subsidiary and, after the sale, retains a non-controlling interest in its former subsidiary. The Board considered the issue of classification as held for sale.

BC2 The Board noted that paragraph 6 of IFRS 5 states that "An entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use". The Board also noted that IAS 27 *Consolidated and Separate Financial Statements* defines control and requires a parent to consolidate a subsidiary until control is lost.

BC3 The Board believed that loss of control is a significant event that changes the nature of the entity's interest held because the parent-subsidiary relationship ceases to exist. An investment in a subsidiary is therefore economically different from a non-controlling equity investment. Because gain or loss of control triggers re-measurement under IAS 27 and IFRS 3, being committed to lose control over a subsidiary should trigger classification of the assets and liabilities of that subsidiary as held for sale.

BC4 The Board also noted that the assets and liabilities of the subsidiary meet the definition of a disposal group in accordance with paragraph 4 of IFRS 5. Therefore, all the assets and liabilities should be classified as held for sale and not merely the portion to be disposed of. On disposal, when control is lost, all the subsidiary's assets and liabilities are derecognised and a non-controlling interest is recognised.

BC5 Therefore, the Board concluded that an entity that is committed to a plan to sell a subsidiary involving loss of control of that subsidiary shall classify the assets and liabilities of that subsidiary as held for sale, regardless of whether the entity retains a non-controlling interest in its former subsidiary after the sale.