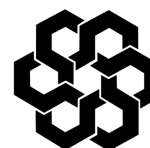

30 Cannon Street, London EC4M 6XH, United Kingdom
Phone: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: http://www.iasb.org

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: **16 April 2008, London**

Project: **Amendments to IFRS 5**

Subject: **Measurement and discontinued operations (Agenda Paper 7)**

INTRODUCTION

1. The IASB and the FASB (collectively, "the Boards") have previously made the following decisions:

   (1) In their joint project on business combinations, the Boards decided that non-current assets held for sale should be measured at *fair value,* rather than at *fair value less costs to sell.*

   (2) In their joint project on financial statement presentation, the Boards decided to develop a converged definition of *discontinued operations* and require converged disclosures related to disposals of components of an entity.

2. The IASB's project on amendments to IFRS 5 will address these two issues that potentially lead to amendments to IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations,* with the expectation that a single Exposure Draft would be issued for the two issues. For ease of reference, issues related to (1) in the preceding paragraph will be referred to as the "measurement portion" of the project and issues

related to (2) in the preceding paragraph will be referred to as the "discontinued operations portion" of the project.

3. The FASB will be addressing these two issues that potentially lead to amendments to FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* in two separate projects, namely the "Measuring Assets Held for Sale" project and the "Reporting Discontinued Operations" project.

4. [This paragraph is not reproduced in the observer notes.]

5. The objectives of this meeting are:
   (1) For the measurement portion, determine the scope of the project; and
   (2) For the discontinued operations portion, confirm the tentative decisions to date and resolve the remaining issues to be addressed.

MEASUREMENT PORTION

Background

6. In their joint project on business combinations, the Boards decided that non-current assets held for sale (including those that do not relate to business combinations) should be measured at *fair value* rather than *fair value less costs to sell.* However, the Boards noted that they need to provide an opportunity for constituents to comment on this decision and, in the revised business combination standards (namely, IFRS 3 *Business Combinations* (revised 2008) and FASB Statement No. 141, *Business Combinations* (revised 2007)), the Boards decided to allow a temporary exception to the measurement principle of fair value until IFRS 5 and Statement 144 were amended.

7. In the revised business combination standards, the Boards noted that they intend to make the amendments to IFRS 5 (that is, the measurement portion of this project) and Statement 144 effective at the same time the revised business combination standards become effective. IFRS 3 (revised 2008) is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009, with earlier application permitted. Statement 141(R) is effective for business combinations for which the acquisition date is on or after the beginning of the first annual period beginning on or after 15 December 2008, with earlier application prohibited.

Scope of the Measurement Portion of the Project

8. The initial motivation for undertaking this portion of the project is that the Boards decided to change the measurement attribute for non-current assets held for sale from *fair value less costs to sell* to *fair value*.

9. The major reason for making this change was to avoid the recognition of the so-called *Day 2 Losses* that would be recognised if non-current assets held for sale were measured at *fair value* on Day 1 of the business combination and measured at *fair value less costs to sell* in accordance with IFRS 5 on Day 2. In their Exposure Drafts that led to the revised business combination standards, the Boards proposed non-current assets held for sale to be measured at *fair value less costs to sell* on Day 1 of the business combination (as an exception to the measurement principle) to avoid the recognition of *Day 2 Losses*. However, during their redeliberations, the Boards decided to eliminate this measurement exception and instead change IFRS 5 so that all non-current assets held for sale would be measured at *fair value* and thus no *Day 2 Losses* would be recognised. The Boards concluded that disposal costs should be excluded from the measure of assets held for sale.

10. There are three other situations where the term *fair value less costs to sell* is used in IFRSs. Those are:
    (a) In IAS 2 *Inventories,* commodity broker-traders are exempted from applying the measurement requirements in IAS 2 if they measure their inventories at *fair value less costs to sell*.
    (b) In IAS 36 *Impairment of Assets,* the term *recoverable amount* is defined as the higher of *fair value less costs to sell* and value in use.
    (c) In IAS 41 *Agriculture,* biological assets and agricultural produce are required to be measured at *fair value less estimated point-of-sale costs*[1].

11. The staff would like the Board to decide whether the amendments to the above standards should be considered in the scope of the measurement portion of the project. The following paragraphs provide background information for each of these standards.

[1] In its annual improvements project, the Board has decided to change the term *fair value less estimated point-of-sale costs* to *fair value less costs to sell*. This change is not intended to change the practice of how biological assets and agricultural produce are measured.

IAS 2: Inventories Held by Commodity Broker-Traders

12. IAS 2 states that the measurement requirements in IAS 2 do not apply to inventories held by commodity broker-traders who measure their inventories at *fair value less costs to sell*. The Basis for Conclusions in IAS 2 states that the Board was convinced that it was established practice for broker-traders to follow a mark-to-market approach rather than to value these inventories at net realisable value and, accordingly, decided to provide a scope exception if commodity broker-traders measure their inventories at *fair value less costs to sell*. When inventories are measured at *fair value less costs to sell*, changes in *fair value less costs to sell* are required to be recognised in profit or loss in the period of change.

13. The staff notes that the *Day 2 Losses* issue would arise when inventories measured at *fair value less costs to sell* are involved in a business combination. The revised business combination standards do not provide an exception for the measurement of inventories held by commodity broker-traders. Accordingly, if a commodity broker-dealer acquires inventories in a business combination, they would be measured at *fair value* on Day 1, and if the commodity broker-dealer applies the measurement exception in IAS 2 on Day 2, those inventories would be measured at *fair value less costs to sell costs*, thus resulting in *Day 2 Losses*.

14. If the Board prefers to avoid the recognition of *Day 2 Losses*, the Board can either:
    (a) amend IFRS 3 (revised 2008) and provide a measurement exception for inventories acquired by commodity broker-dealers in a business combination and require them to be measured at *fair value less costs to sell*; or
    (b) amend IAS 2 and require inventories held by commodity broker-dealers to be measured at *fair value* at all times.

15. Under U.S. GAAP, inventories with units that are interchangeable, have immediate marketability at quoted prices, and are difficult to obtain appropriate costs (such as gold and silver) are permitted to be measured at their quoted prices less the expenditures to be incurred in disposal. However, entities have applied this guidance in very limited cases. The FASB is currently undertaking a project on accounting for trading inventory and, in that project, the FASB has tentatively decided to require mark-to-market accounting if the entity is trading the inventory. These trading inventories are required to be measured at *fair value*, and the changes in *fair value* are

required to be recognised in net income in the period of change. The fair values do not need to be readily determinable.

16. While both Boards refer to the term "mark-to-market accounting", the IASB has concluded that assets should be measured at *fair value less costs to sell* and the FASB has tentatively concluded that assets should be measured at *fair value*. The Board may prefer to address the measurement of inventories held by commodity broker-dealers together and seek convergence in this area.

IAS 36: Recoverable Amount

17. IAS 36 states that the *recoverable amount* of an asset or a cash-generating unit is the higher of its *fair value less cost to sell* and its *value in use*. The *recoverable amount* reflects the amount to be recovered through sale (which is represented by *fair value less costs to sell*) or use (which is represented by *value in use*).

18. Non-current assets held for sale, by definition, are expected to be recovered through sale of the asset. The Boards decided that the measurement attribute for non-current assets held for sale should be *fair value*. It follows that the recoverable amount of an asset should be determined as the higher of its *fair value* and its *value in use* in order to maintain internal consistency within IFRSs.

19. The change in the definition of *recoverable amount* is likely to lead to a significant change in practice because it would change how impairment losses are calculated. The change would reduce the impairment losses to be recognised.

20. There are significant differences in the impairment standards of both Boards, and the change to IAS 36 from this project would not eliminate those differences. The Boards may prefer to change the measurement attribute for non-current assets held for sale in their project to converge their impairment standards.

IAS 41: Biological Assets and Agricultural Produce

21. IAS 41 requires biological assets[2] and agricultural produce to be measured at *fair value less estimated point-of-sale costs*[3].

22. The treatment of point-of-sale costs was discussed when IAS 41 was issued by the IASC. The Basis for Conclusions in IAS 41 states:

> B24 Some argue that point-of-sale costs should not be deducted in a fair value model. They argue that fair value less estimated point-of-sale costs would be a biased estimate of markets' estimate of future cash flows, because point-of-sale cost would in effect be recognised as an expense twice if the acquirer pays point-of-sale costs on acquisition; once related to the initial acquisition of biological assets and once related to the immediate measurement at fair value less estimated point-of-sale costs. This would occur even when point-of-sale costs would not be incurred until a future period or would not be paid at all for a bearer biological asset that will not be sold.
>
> B25 On the other hand, some believe that point-of-sale costs should be deducted in a fair value model. They believe that the carrying amount of an asset should represent the economic benefits that are expected to flow from the asset. They argue that fair value less estimated point-of-sale costs would represent the market's estimate of the economic benefits that are expected to flow to the entity from that asset at the balance sheet date. They also argue that failure to deduct estimated point-of-sale costs could result in a loss being deferred until a sale occurs.
>
> B26 The Board concluded that fair value less estimated point-of-sale costs is a more relevant measurement of biological assets, acknowledging that, in particular, failure to deduct estimated point-of-sale costs could result in a loss being deferred.

23. The staff notes that the *Day 2 Losses* issue would arise when a biological asset or agricultural produce is involved in a business combination. The revised business combination standards do not provide an exception for the measurement of biological assets and agricultural produce. Accordingly, biological assets and agricultural produce acquired in a business combination would be measured at *fair value* on Day 1, and by applying IAS 41 on Day 2, those biological assets and agricultural produce

[2] IAS 41 permits an entity to measure biological assets at cost less accumulated depreciation and accumulated impairment losses, if on initial recognition an entity determines that fair value cannot be measured reliably.

[3] See footnote 1.

would be measured at *fair value less estimated point-of-sale costs*, thus resulting in *Day 2 Losses*.

24. If the Board prefers to avoid the recognition of *Day 2 Losses*, the Board can either:
    (a) amend IFRS 3 (revised 2008) and provide a measurement exception for biological assets and agricultural produce acquired in a business combination and require them to be measured at *fair value less costs to sell*; or
    (b) amend IAS 41 and require biological assets and agricultural produce to be measured at *fair value* at all times.

Staff Analysis and Recommendation

25. The staff is of the view that the potential issues to be addressed by the Board in this portion of the project can be summarised as follows:

    Issue 1: Whether the measurement attribute for non-current assets held for sale should be changed from *fair value less costs to sell* to *fair value*.
    Issue 2: Whether the scope exception related to commodity broker-traders should be changed from those who measure their inventories at *fair value less costs to sell* to those who measure their inventories at *fair value.*
    Issue 3: Whether the definition of *recoverable amount* should be changed from the higher of *fair value less costs to sell* and value in use to the higher of *fair value* and value in use.
    Issue 4: Whether the measurement attribute for biological assets and agricultural produce should be changed from *fair value less estimated point-of-sale costs* to *fair value*.

26. The staff is of the view that Issues 1 and 3 should be addressed together because addressing only either Issue is likely to create internal inconsistencies within IFRSs. Issues 2 and Issue 4 need to be addressed if the Board prefers to avoid the recognition of *Day 2 Losses* in a business combination. Accordingly, the staff is of the view that all of these Issues need to be addressed by the Board at some point of time.

27. However, if all of these Issues were to be addressed in this portion of this project, the staff is concerned that the scope would become too broad to argue that it is a consequence of the Board's decision in the business combinations project. The staff's understanding is that this project does not need to go through the formal agenda decision process because it was spun off from existing projects. Extending the scope might cause some constituents to argue that it is more than a spin-off project and thus may raise due process concerns.

28. [This paragraph is not reproduced in the observer notes.[4]]

29. [This paragraph is not reproduced in the observer notes.]

30. For the reasons stated above, the staff recommends that the Board drop this portion of the project and maintain the "temporary" measurement exception in IFRS 3 (revised 2008) for the time being.

Question for the Board:

1. ***Which Issues presented in paragraph 25, if any, should be addressed in the measurement portion of this project?***

DISCONTINUED OPERATIONS PORTION

Background

31. At their respective January 2007 Board meetings discussing financial statement presentation, the Boards tentatively decided to converge the definition of *discontinued operations.* The Boards decided that a discontinued component of an entity would be reported in the discontinued operations section of the financial statements only if that component meets the definition of an *operating segment,* as defined in IFRS 8 *Operating Segments*. Based on this decision, the Boards tentatively agreed to the following converged definition of *discontinued operations*:

    A component of an entity that has been (or will be) disposed of and meets the definition of an operating segment under IFRS 8 would be reported as a discontinued operation on the face of the financial statements.

32. The Boards also decided at their respective January 2007 Board meetings that an entity would be required to disclose in the notes to the financial statements disaggregated financial information for both (a) a discontinued component of an entity reported as a discontinued operation in the financial statements and (b) a discontinued component of an entity reported in continuing operations because it did not meet the definition of an *operating segment.* The Boards tentatively agreed to require the following disclosure for all components of an entity that have been (or will be) disposed of:

[4] [This footnote is not reproduced in the observer notes.]

(a) The major classes of revenues and expenses, including impairments, interest, depreciation and amortisation expense, and minority interest.

(b) The major classes of cash flows (operating, investing, and financing).

(c) The major classes of assets and liabilities.

(d) The nature of the disposal activities and the use of the proceeds from the disposal activities.

These disclosures would be required for all periods presented.

33. At their respective April 2007 Board Meetings, the Boards agreed to address the guidance for reporting discontinued operations and any related disclosure issues separately from the financial statement presentation project. Both Boards recognised that it would be more expedient to address the reporting issues created by current discontinued operations guidance through a separate project. Both Boards also agreed to pursue this as a separate project only if it is conducted as a joint project.

34. At that time, the FASB also indicated that it preferred not to complete the project before the exposure period for the forthcoming financial statement presentation Preliminary Views document ended to allow the Board an opportunity to identify potential conflicts between the guidance in the discontinued operations project and the financial statement presentation project. However, the FASB subsequently decided to accelerate the discontinued operations project rather than waiting to finalise the project until after the exposure period for the financial statement presentation Preliminary Views document. Currently, the financial statement presentation project team expects to issue its Preliminary Views document in June 2008. The proposed public comment period for that document is six months (that is, the comment period is expected to end in December 2008).

35. [This paragraph is not reproduced in the observer notes.]

Question for the Board:

2. Does the Board continue to agree with the tentative decisions made to date?

Remaining Issues

36. The staff is of the view that most of the major decisions related to the discontinued operations portion of the project already have been made. The following paragraphs discuss the remaining issues.

37. As noted in paragraph 2, the staff envisions a single Exposure Draft for amendments to IFRS 5. The following discussions assume that the Board agrees with the staff recommendation to drop the measurement portion of the project.

Disclosures Related to Subsidiaries Acquired and Held Exclusively with a View to Resale

38. When the Board initially issued IFRS 5, the Board decided the following:

    (a) IAS 27 *Consolidated and Separate Financial Statements* should remove the exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale (that is, such subsidiaries would be consolidated and their assets and liabilities would be measured at *fair value less costs to sell*);

    (b) Newly acquired subsidiaries that meet the criteria to be classified as held for sale should always be classified as discontinued operations; and

    (c) The disclosure of the analyses of the amounts presented on the face of the balance sheet and income statement, that would otherwise be required in accordance with IFRS 5, would not be required for newly acquired subsidiaries.

39. Subsidiaries acquired and held exclusively with a view to resale would meet the definition of a *component of an entity*. However, those subsidiaries would meet the converged definition of a *discontinued operation* only when they also meet the definition of an *operating segment*. The question is whether an exception similar to that currently in IFRS 5 should apply to the disclosure requirements discussed in paragraph 32.

40. The Board decided not to require the note disclosures when it initially issued IFRS 5 because that could potentially involve the entity having to obtain significantly more information. The proposed disclosures related to components of an entity that have been (or will be) disposed of are also likely to require an entity having to obtain significantly more information. Accordingly, the staff recommends that the Board provide an exemption from disclosure related to components of an entity that have been (or will be) disposed of for subsidiaries acquired and held exclusively with a view to resale.

Question for the Board:

3. Does the Board agree that disclosures related to components of an entity that have been (or will be) disposed of should not be required for subsidiaries acquired and held exclusively with a view to resale?

Transition

41. The staff recommends that the amendments to IFRS 5 related to discontinued operations should be applied prospectively with one exception:

> The amount presented on the face of the statement of comprehensive income in accordance with paragraph 33(a) of IFRS 5 should be restated based on the revised definition of *discontinued operations* for all periods presented. If an entity reclassifies its amounts reported in prior periods, it should disclose that fact and the amounts reclassified.

This exception would not change the disclosures required for prior periods (that is, an entity would be required to provide the disclosures required prior to the amendments for prior periods, regardless of whether the amounts are reclassified).

42. The staff acknowledges that, in general, retrospective application is desirable because it provides comparability and consistency. However, the staff is of the view that an entity may face difficulties in obtaining the information to apply the amendments retrospectively for note disclosures. This is particularly the case for disclosures related to components of an entity that have been (or will be) disposed of but did not meet the definition of discontinued operations in prior periods. Accordingly, the staff is of the view that an entity should apply the revised definition of discontinued operations retrospectively for the purposes of reporting the amount on the statement of comprehensive income and provide the revised disclosures prospectively.

43. [This paragraph is not reproduced in the observer notes.]

Question for the Board:

4. Does the Board agree with the proposed transition in paragraph 41?

Comment Period

44. The normal comment period for an IASB exposure draft is 120 days. The staff is of the view that a 120-day comment period would be sufficient for the Exposure Draft and, therefore, recommends a 120-day comment period.

45. [This paragraph is not reproduced in the observer notes.]

Question for the Board:

5. ***Does the Board agree with a 120-day comment period for the Exposure Draft?***

Effective Date

46. The following timetable summarises the staff's expectations regarding the time needed to issue the final amendments to IFRS 5 and Statement 144. The timetable assumes that both Boards agree to drop the measurement portion of the project.

    [The table is not reproduced in the observer notes.]

47. As indicated in the timetable, the staff plans to issue the final amendments to IFRS 5 in December 2008. Under that plan, the staff recommends that the effective date be 1 January 2010.

48. The staff is of the view that an entity should apply the amendments as of the beginning of its fiscal year. The staff also recommends that earlier application should be permitted.

49. [This paragraph is not reproduced in the observer notes.]

Questions for the Board:

6. ***Does the Board agree with the proposed effective date?***

7. ***Does the Board agree that earlier application should be permitted?***

Permission to Proceed with Pre-ballot Draft of an Exposure Draft

50. If the Board agrees to drop the measurement portion of this project, the staff would like to seek permission to proceed with a pre-ballot draft of an Exposure Draft.

Question for the Board:

8. ***(If the Board agrees to drop the measurement portion of the project) Does the Board want the staff to proceed with a pre-ballot draft of an Exposure Draft?***

51. If the Board does not agree to drop the measurement portion of this project, the staff will reconsider the project plan and discuss the issues related to the measurement portion in future meetings.

APPENDIX

[The Appendix is not reproduced in the observer notes.]