IASB Meeting | Agenda reference 4B

Staff Paper

Date: April 2009

Project: **Discontinued Operations (Amendments to IFRS 5)**

Topic: **Comment Letter Summary**

Introduction

1. The comment period on the Exposure Draft (ED), *Discontinued Operations: Proposed Amendments to IFRS 5*, ended on 23 January 2009.

2. The Board received 62 comment letters, grouped by constituent type in the following table:

Constituent Type	**Number**	**Percent**
Academics	1	2
Investors/Analysts/Users	1	2
Preparers	15	24
Accounting firms	8	13
Professional organizations	14	22
National standard-setters	17	27
Governments/Regulators	5	8
Individuals	1	2
Total	**62**	**100**

3. Responses received, classified by geographical region can be summarised as follows:

Region	**Number**	**Percent**
Europe	36	58
Americas	5	8
Asia-Pacific	11	18
Africa	2	3
Multi-regional	8	13
Total	**62**	**100**

4. This paper summarises the comments received from constituents. It does not include any staff analysis of the validity or importance of the comments.

Definition of a Discontinued Operation

Proposal

5. The ED proposed changing the definition of a discontinued operations so that it is a component of an entity that:

   (a) is an *operating segment* (as that term is defined in IFRS 8 *Operating Segments*) and either has been disposed of or is classified as held for sale, or

   (b) is a *business* (as that term is defined in IFRS 3 *Business Combinations* (as revised in 2008)) that meets the criteria to be classified as held for sale on acquisition.

6. The ED proposed that a disposal activity should be presented as a discontinued operation only when an entity has made a shift in its operations. Moreover, the Board decided that a definition of discontinued operations based on operating segments, as defined in IFRS 8, best captures a strategic shift in the entity's operations because the determination of operating segments is based on how the chief operating decision maker makes decisions about allocating resources and assessing performance.

Reference to **Operating Segments**

7. Some of the respondents were supportive of the reference to *operating segments* (as defined in IFRS 8) in the proposed definition of discontinued operations. These respondents stated that the proposed definition leads to reporting discontinued operations when there is a strategic shift in the entity's operations and that using an already converged concept reduces subjectivity and complexity.

8. Some respondents who disagreed with the Board's proposal suggested the following alternatives for improving the definition of discontinued operations:

   (a) The definition should refer to reportable segments and significant operating segments.

   (b) Only operating segments that meet one of the quantitative thresholds in IFRS 8 should be included in the definition.

9. Other respondents who disagreed with the proposed definition noted that there was an inconsistency between the Board's rationale to report discontinued operations when there is a *strategic shift* in the entity's business and the Board's decision to adopt the *operating segment* concept. Several respondents noted that

the definition currently used in IFRS 5 is more consistent with the *strategic shift* concept and suggested that no change be made.

10. Yet other respondents who disagreed with the Board's proposal suggested the Board to use the *strategic shift* concept as the general principle for reporting discontinued operations. These respondents noted the following:

    (a) Using the *operating segment* concept is rules-based and using the *strategic shift* concept is more principles-based. For example, if an entity disposed all the assets and liabilities of an operating segment except for one asset, in their view, such disposal would not be viewed as a discontinued operation. The effects of the disposal would be presented within continuing operations in the statement of comprehensive income and thus would not result in providing useful information.

    (b) Because an entity can decide on the size of each operating segment, some entities may have operating segments that are so small their size that they do not represent a strategic shift. For example, in the real estate industry, it is not uncommon that each property is an operating segment. Accordingly, the proposed definition does not necessary lead to the conclusion that the number of items reported as discontinued operations would decrease. Other entities may have operating segments that are so large in their size that certain significant disposal activities will not be reported as discontinued operations.

    (c) When an entity is structured as a matrix form of organization and the chief operating decision maker regularly reviews the operating results of both sets of components (for example, by product line and by geographical area), IFRS 8 requires that the entity determine which set of components constitutes the operating segments by reference to the core principle. When an entity selects product lines in terms of reporting operating segments, it should not be excluded from reporting the disposal or classification as held for sale of a geographical area as discontinued operations.

    (d) Because the *operating segment* concept is a classification criterion and not a measurement criterion, using this concept does not make it any easier for an entity to ascertain the figures to be reported.

11. One respondent added that the Board could use the *strategic shift* concept combined with a rebuttable presumption that the disposal of an operating segment represents a strategic shift. Another respondent suggested that a disposal of a component of an entity that is reviewed regularly by management for the purpose of goodwill impairment testing may well represent an indicator of a strategic shift in operations.

12. One respondent stated that the definition of discontinued operations should be based on components of an entity that were disposed of or were classified as

held for sale. This would be consistent with the current definition in Statement 144.

13. One respondent stated that, regardless of the definition chosen, the management approach should be used to determine discontinued operations because it is the management that establishes the strategic objectives of the entity.

14. A few respondents asked the Board to clarify that the review of a component's operating information by the entity's chief operating decision maker in order to make decisions about the disposal of that component does not cause the component to become an operating segment, if the component otherwise was not an operating segment. These respondents noted that this does not constitute a *regular* review of operating results by the chief operating decision maker for the purpose of making decisions about resources to be allocated to the segment and assess its performance contemplated in the definition of an operating segment.

15. A few respondents noted that the *strategic shift* concept and the proposed definition were inconsistent but preferred the *operating segment* concept be retained and the references to *strategic shift* be deleted.

16. Some respondents asked the Board to clarify whether operating segments in the proposed definitions referred to segments *before* or *after* aggregation. Most of these respondents had interpreted the proposal to be *before* aggregation.

17. One respondent suggested that an entity should also be required to consider the following criteria in paragraph 42 of Statement 144:

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

    (b) the entity will not have any significant involvement in the operations of the component after the disposal transaction.

18. Another respondent suggested that only the second criteria in the preceding paragraph be included in the definition.

19. One respondent noted that it disagreed with the proposed definition of discontinued operations because it does not meet the needs of public sector entities that are not primarily established to conduct business activities, such as government not-for-profit organizations. This respondent noted that the

proposed definition refers to operating segments that conduct business activities but most public sector entities are not primarily established to conduct business activities.

A* Business *that Meets the Criteria to be Classified as Held for Sale on Acquisition

20. Most respondents agreed with the Board's proposal that a *business* (as defined in IFRS 3 (as revised in 2008)) that meets the criteria to be classified as held for sale on acquisition would meet the definition of a discontinued operation.

21. One respondent stated that businesses that meet the criteria to be classified as held for sale on acquisition should not be classified as held for sale discontinued operations of the entity because they do not represent strategic shifts and that they never formed part of an entity's continuing operations.

Applicability to Entities Not Required to Apply IFRS 8

22. The ED proposed that an entity should determine whether the component of an entity meets the definition of an operating segment regardless of whether it is required to apply IFRS 8.

23. Most respondents agreed with the Board and noted that it is feasible for an entity that is not required to apply IFRS 8 to determine whether a component meets the definition of an operating segment. These respondents noted that the reporting of discontinued operations should not differ based on whether an entity is required to apply IFRS 8 or not.

24. Some respondents noted that it is not unprecedented for an entity that is not required to apply IFRS 8 to determine whether a component meets the definition of an operating segment. That is, paragraph 80 of IAS 36 *Impairment of Assets* requires an entity to determine that a cash generating unit is not larger than an *operating segment* as defined in IFRS 8 for the purposes of impairment testing of goodwill acquired in a business combination.

25. Several respondents noted that it was awkward to refer to a standard that some entities are not required to apply. One respondent noted that had the Board simply referred to *operating segment* in the definition of discontinued operations, applying the hierarchy of standards as per IAS 8 *Accounting*

Policies, Changes in Accounting Estimates and Errors would lead the entity to consider IFRS 8.

26. A few respondents were concerned that some not-for-profit entities that apply IFRSs may have difficulty in applying the *operating segment* concept. One respondent noted that paragraph 118 of FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, indicates that the FASB decided to exclude not-for-profit organizations from the scope of that Statement, in part, because "there are likely to be unique characteristics of some of those entities… which the Board has not studied." [1] This respondent suggested that the Board examine the potential unique issues involved in identifying operating segments for not-for-profit entities before requiring those entities apply the *operating segment* concept. Another respondent suggested the Board to consider the proposal by the New Zealand Financial Reporting Standards Board[2].

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[1] In the Proposed FSP, the FASB proposed the following guidance for not-for-profit organizations:

> 17. Not-for-profit entities shall apply the provisions of this FSP with the following modifications:
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> a. References to a business of businesses should be replaced with references to a nonprofit activity or nonprofit activities.[1]
> b. References to an income statement should be replaced with references to a statement of activities (or statement of changes in net assets or statement of operations).
> c. References to profit or loss should be replaced with references to changes in net assets.
> d. References to income from continuing operations before income taxes should be replaced with income from continuing operations.
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> [1] A *nonprofit activity* is defined as an integral set of activities and assets that is capable of being conducted and managed for the purpose of providing benefits, other than goods or services at a profit or profit equivalent, as a fulfilment of an organization's purpose or mission (for example, goods or services to beneficiaries, customers, or members). As with a not-for-profit organization, a nonprofit activity possesses characteristics that distinguish it from a business or a for-profit business entity. A nonprofit activity often is, but need not be, a separate legal entity.

[2] The Financial Reporting Standards Board of the New Zealand Institute of Chartered Accountants proposed the following additional guidance for public benefit entities (http://www.nzica.com/AM/Downloads/StdsPolicy/ED_DiscontinuedOperations_RequestComment.pdf):

business	In the context of this standard, "business" also includes an integrated set of activities that is capable of being conducted or managed for the primary objective of providing goods or services for community or social benefit, rather than a financial return.
operating segment	In the context of part (a) of the definition of an operating segment, business activities also includes an integrated set of activities that is capable of being conducted or managed for the primary objective of

27. Several respondents noted that the question regarding feasibility would no longer be relevant if the Board decided not to refer to *operating segments* (as defined in IFRS 8) but adopted a principles-based approach, such as referring to the *strategic shift* concept, as discussed earlier.

28. A few respondents noted that, if an entity is not required to apply IFRS 8 and, therefore, does not provide segment information in the notes, it should also be exempted from reporting discontinued operations.

Amounts Presented for Discontinued Operations

29. The ED proposed that the amounts presented for discontinued operations should be based on the amounts presented in the statement of comprehensive income, even if segment information disclosed to comply with IFRS 8 includes different amounts that are reported to the chief operating decision maker.

30. Almost all respondents agreed with this proposal.

Disclosure Requirements

Proposal

31. The ED proposed that it would require three types of disclosures:

    (a) Those related to discontinued operations (proposed paragraph 33)

    (b) Those related to components of an entity that has been either disposed of or classified as held for sale regardless of whether it is presented as a discontinued operation or within continuing operations (proposed paragraph 41A)

    (c) Those related to a non-current (or disposal group) that has been either classified as held for sale or sold (proposed paragraphs 38 and 41)

    The proposed disclosure requirements are reproduced in the Appendix of Agenda Paper 4A.

Disclosure of Components of an Entity that Has Been Either Disposed of or Classified as Held for Sale

32. Some respondents agreed with the Board's proposal. Many respondents disagreed and stated that the requirement was onerous for preparers and had

providing goods or services for community or social benefit, rather than a financial return.

limited usefulness to users. One respondent stated that the additional disclosure requirements will not be overly burdensome from a preparer's perspective but questioned the value of information to users.

33. Some respondents stated that the disclosure requirements should relate only to discontinued operations and that if disclosure was required for components of an entity that has been either disposed of or classified as held for sale, the Board has not defined discontinued operations appropriately. These respondents argued that, if the information does not warrant presentation on the face of the financial statements, it should not be required in the notes and suggested that the proposed disclosure requirements apply only to discontinued operations. One respondent stated that if users consider that valuable information is lost by requiring disclosures for discontinued operations only, the Board could consider developing disclosure requirements using the principles in IFRS 3 (as revised in 2008).

34. One respondent suggested that the proposed disclosures in proposed paragraph 41A be required only for cash generating units that are significant to an entity's operations.

35. One respondent suggested the Board to clarify that the disclosure requirements in proposed paragraph 41A would be required for all periods presented. This respondent stated that the information would be useful to investors in assessing financial trends, particularly if the revised definition of discontinued operations results in a reduction in the number of items presented as discontinued.

36. A few respondents disagreed with the Board's proposal to subsume former paragraphs 33(c) and (d) into proposed paragraphs 41A(c) and (d). One respondent stated that it would significantly increase the burden on preparers. Another respondent stated that by deleting the items from paragraph 33, the disclosures will no longer be subject to paragraph 34A, which requires re-presentation of information for prior periods. This respondent suggested that paragraphs 33(c) and (d) be retained but discontinued operations be exempted from providing information in proposed paragraph 41A.

Disclosure Exemptions for* Businesses *that Meet the Criteria to be Classified as Held for Sale on Acquisition

37. The ED proposed that businesses that meet the criteria to be classified as held for sale on acquisition should be provided disclosure exemptions.

38. Most respondents to the ED agreed with the Board's proposal. One respondent agreed but asked the Board to exempt such businesses from disclosing the "reportable segment to which the non-current asset (or disposal group) is presented in accordance with IFRS 8" in proposed paragraph 41(d).

39. One respondent disagreed and stated that the information to be disclosed is readily available. Another respondent noted that a business may be classified as held for sale on acquisition over several quarters or fiscal periods and argued that users would benefit from the ability to compare information among quarters or fiscal periods.

Guidance on Aggregation

40. Several respondents asked the Board to clarify whether the disclosures are permitted on an aggregate basis for all disposed components, or whether it is required for all individual components. A few of these respondents asked the Board to clarify, if aggregation is permitted, whether components classified in discontinued and continuing operations could be aggregated. One respondent suggested that the Board require disclosure for discontinued and continuing operations presented separately.

Transition and Effective Date

Transition

41. The ED proposed that an entity would be required to apply the propose changes prospectively with one exception: the amounts in the statement of comprehensive income (or in the separate income statement) should be reclassified on the basis of the revised definition of discontinued operations for all periods presented. Earlier application would be permitted. The FASB had proposed retrospective application in its proposed FSP.

42. Most respondents agreed with the proposed transition. Some respondents disagreed with the proposal and suggested that all requirements in the ED be applied prospectively. These respondents noted the following:

(a) Including in continuing operations items that have previously been reported as discontinued would not result in providing useful information.

(b) The items reported as discontinued operations in prior periods would be disposed of within a year and, therefore, there will be no long-lasting effects of items not meeting the new definition.

43. Several respondents noted that, if the disclosure requirements were to be required only for those that meet the definition of discontinued operations (rather than all components of an entity that have been or will be disposed of), it might be possible to require retrospective application.

Effective Date

44. The ED did not specify an effective date. One respondent suggested that the Board indicate the proposed time between the issuance of the standard and the date the application of the standard becomes mandatory.

45. Several respondents noted that the Board had plans to amend IFRS 5 in three separate projects, namely (1) the discontinued operations project, (2) IFRIC Interpretation 17 *Distributions of Non-cash Assets to Owners* and (3) the annual improvements projects. These respondents urged the Board to coordinate the effective dates of these changes so that there would not be multiple versions of IFRS 5 in a relatively short time period.

46. The FASB's Proposed FSP proposed that the requirements be applied retrospectively for fiscal years beginning after 15 December 2009 and interim periods within those fiscal years. One respondent noted that having the same effective date would allow sufficient time for preparers using IFRSs to implement the revised standard.

Other Comments

47. The following paragraphs summarise other significant comments (excluding editorial suggestions) on the ED raised by respondents.

Fundamental Reconsideration of Reporting Discontinued Operations

48. Several respondents noted that the Board should fundamentally reconsider the reporting discontinued operations. In particular, these respondents disagreed with the current guidance in IFRS 5 which accounts for assets to be abandoned and assets to be sold differently.

49. A few respondents preferred the approach used in IAS 35 *Discontinued Operations,* which was superseded by IFRS 5.

Scope of IFRS 5 and Statement 144

50. Several respondents noted that there will continue to be differences in reporting discontinued operations because of the scope differences between IFRS 5 and Statement 144. These respondents noted that Statement 144 excludes equity method investments from its scope whereas IFRS 5 does not.

Definition of Operating Segment

51. One respondent suggested the Board to reconsider the definition of an *operating segment* (which refers to *business activities*) in light of the definition of *business* in IFRS 3 (as revised in 2008). This respondent suggested the Board to either (a) delete references to *revenues* in the definition of an *operating segment* because business activities are not required to generate revenues to meet the definition of a *business* or (b) delete the term *business* in the definition of an operating segment so that the definition would simply refer to *activities*.

Disclosure of Continuing Cash Flows

52. A few respondents stated that an entity should provide guidance regarding the presentation of transactions between the continuing entity and the disposed component of an entity. One respondent suggested the Board to consider paragraph 17 of EITF Issue No. 03-13, *Applying the Conditions in Paragraph 42 of FASB Statement No. 144 in Determining Whether to report Discontinued Operations*[3].

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[3] Paragraph 17 of EITF Issue No. 03-13 states:

> The following information should be disclosed in the notes to the financial statements for each discontinued operation that generates future cash flows: (a) the nature of the activities that give rise to continuing future cash flows, (b) the period

Presentation of Assets Held for Sale

53. One respondent noted that the assets held for sale line item in the statement of financial position could include assets held for sale that relate to both continuing operations and discontinued operations. This respondent suggested that the Board require separate presentation for assets held for sale that relate to continuing operations and those that relate to discontinued operations.

OCI Items Related to Assets Held for Sale

54. One respondent suggested the Board to consider requiring an entity to present separately other comprehensive income (OCI) items related to discontinued operations in the statement of comprehensive income.

55. Another respondent suggested the Board to reconsider the requirement to present accumulated OCI related to non-current assets (or disposal groups) that are classified as held for sale but do not meet the definition of a discontinued operations separately. This respondent noted that the usefulness of this information is limited because neither profit or loss nor other equity items of the non-current asset (or disposal group) is presented separately in the statement of comprehensive income (or the separate income statement) and the statement of financial position. This respondent asked the Boards to revisit Example 12 in the Implementation Guidance.

Unrealized Gains and Losses Related to Discontinued Operations

56. One respondent suggested that the Board require an entity to disclose the unrealized gains and losses related to discontinued operations and to reconcile

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of time continuing cash flows are expected to be generated, and (c) the principal factors used to conclude that the expected continuing cash flows are not direct cash flows of the disposed component. Additionally, for each discontinued operation in which the ongoing entity will engage in a "continuation of activities" with the disposed component after its disposal for which the amounts presented in continuing operations after the disposal transaction include a continuation of revenues and expenses that were intercompany transactions (eliminated in consolidated financial statements) before the disposal transaction, intercompany amounts before the disposal transaction, intercompany amounts before the disposal transaction should be disclosed for all periods presented. The types of continuing involvement, if any, that the entity will have after the disposal transaction should be disclosed. That information should be disclosed in the period in which operations are initially classified as discontinued.

the amounts to the amounts presented in the statement of comprehensive income.

Current Assets and Liabilities included in Disposal Groups

57. Paragraph 23 of IFRS 5 states that impairment loss recognized for a disposal group shall reduce the carrying amount of the non-current assets of the group that are within the scope of IFRS 5, in the order of allocation set out in paragraphs 104(a) and (b) and 122 of IAS 36. In certain circumstances, all non-current assets included in the scope of IFRS 5 would be valued at zero, while the net carrying amount of the current assets and liabilities included in the disposal still exceeds the fair value less costs to sell of the group (This could happen when the market value takes into account risks or contingent liabilities which cannot be accounted for under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*).

58. One respondent noted that there seems to exist divergence in practice in the way this kind of situation is accounted for and asked the Board to clarify whether the additional impairment should be allocated to the current assets in the disposal group so that the net carrying amount of the group equals its fair value less costs to sell, or whether the difference should not be accounted for (but additional disclosures would be required).

Measurement of a **Business** *that Meets the Criteria to be Classified as Held for Sale on Acquisition*

59. One respondent suggested the Board to consider providing further relief from detailed acquisition accounting for a business that meets the criteria to be classified as held for sale on acquisition. This respondent stated that the Board should allow entities to report the assets and liabilities of a business that meets the criteria to be classified as held for sale on acquisition as a single net line item in the statement of financial position, which would be measured at fair value less costs to sell in its entirety. This respondent also noted that the apparent “shortcut” method illustrated in Example 13 of the Illustration Guidance to IFRS 5 was not part of the standard and in any event was not explicit in exempting an entity from applying the measurement requirements of standards other than IFRS 5 to assets within the disposal group that are outside the measurement

scope of IFRS 5. In this respondent's view, retaining the requirements to present separately assets and liabilities held for sale, and to report net income or loss from discontinued operations computed in accordance with the standards for comprehensive income did not provide relief from acquisition accounting.

60. Another respondent noted that Example 13 was misleading because the acquisition price was higher than the net value of the acquired assets and liabilities. This respondent asked the Board to clarify that this was not necessarily the case and that, if possible, another Example that illustrates the case where the acquisition price was lower than the net value of the acquired assets and liabilities be included in IFRS 5.

Amendments to IFRS 1

61. A few respondents stated that the difficulty of providing the proposed disclosures would apply to first-time adopters of IFRS 1 *First-time Adoption of International Financial Reporting Standards.* These respondents noted that, without an amendment to IFRS 1, first-time adopters will be required to obtain the information to provide the disclosures for the year of transition (that is, the year prior to adoption of IFRSs) and, therefore, suggested that an amendment be made to IFRS 1 to provide transitional relief.

Wording in IFRS and US GAAP

62. One respondent asked the Boards to use the same wording when expressing the same concept so that the resulting standards would not have unnecessary differences in their drafting. This respondent noted that this would reduce the likelihood of unintended implementation differences in the future. This respondent suggested that, if it was not possible to use the same words where the Boards intend for the same meaning, the Basis for Conclusions should expressly state that the Boards did not expect the accounting to be different, and the reasons for using different words.