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Project **Tentative agenda decision**

Topic **IFRS 5 – write-down of a disposal group**

Introduction

Objective of this paper

1. The objective of this paper is to document the staff's analysis and recommendation on the issue. As such, this paper:

   (a) provides background information on this issue;

   (b) analyses the alternatives;

   (c) provides preliminary agenda criteria assessment;

   (d) makes a staff recommendation on the tentative agenda decision; and

   (e) asks the IFRIC whether they agree with the staff recommendation.

Background (requirements for scope and measurement for a disposal group)

2. IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* paragraph 4 states "The group may include any assets and any liabilities of the entity, including current assets, current liabilities and assets excluded by paragraph 5 from the measurement requirements of this IFRS. If a non-current asset within the scope of the measurement requirements of this IFRS is part of a disposal group, the measurement requirements of this IFRS apply to the group as a whole, so that the group is measured at the lower of its carrying amount and fair value less costs to sell."

3. The requirements for initial measurement for the individual assets and liabilities within the disposal group are set out in IFRS 5 paragraph 18; "Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group)

shall be measured in accordance with applicable IFRSs." For subsequent measurement for the individual assets and liabilities within the disposal group, IFRS 5 paragraph 19 states "On subsequent remeasurement of a disposal group, the carrying amounts of any assets and liabilities that are not within the scope of the measurement requirements of this IFRS, but are included in a disposal group classified as held for sale, shall be remeasured in accordance with applicable IFRSs before the fair value less costs to sell of the disposal group is remeasured."

4. For recognition of impairment losses of a disposal group, IFRS 5 paragraph 23 states: "The impairment loss (or any subsequent gain) recognised for a disposal group shall reduce (or increase) the carrying amount of the non-current assets in the group that are within the scope of the measurement requirements of this IFRS, in the order of allocation set out in paragraphs 104(a) and (b) and 122 of IAS 36 (as revised in 2004)." Guidance on Implementing IFRS 5 (Example 10) illustrates the allocation of an impairment loss to a disposal group. An entity shall not depreciate (or amortise) a non-current asset while it is classified as held for sale or while it is part of a disposal group classified as held for sale (IFRS5.25).

Submission

5. In May 2009, the IFRIC received a request to add to the IFRIC agenda an issue with respect to the write-down of a disposal group to the lower of its fair value less costs to sell and its carrying amount when the write-down exceeds the carrying amount of non-current assets. The submission provides a specific example in which the increase in the fair value of a liability within the disposal group is identified (see paragraph B8).

6. The full text of the agenda request has been included as Appendix B.

Staff Analysis

Alternative views identified by the submitter

7. The submission points out four alternative views:

VIEW 1 - Limit the recognised loss to non-current assets only

VIEW 2 - Limit the recognised loss to net assets of the disposal group

VIEW 3 - Limit the recognised loss to total assets of the disposal group

VIEW 4 - Limit the recognised loss to the non-current assets and recognise a liability for the excess to ensure that disposal group is measured at fair value less costs to sell

Three step approach

8. In the staff's view, IFRS 5 generally requires three steps to account for an impairment loss of a disposal group (see Appendix A for a flow chart):

   Step 1: the individual "scoped-out" assets and liabilities that are included in a disposal group are remeasured in accordance with applicable IFRSs (IFRS 5.19).

   Step 2: the fair value less costs to sell of the disposal group is determined "as a group" and any impairment loss is identified (IFRS 5.19).

   Step 3: any impairment loss of the disposal group as a whole identified in step 2 is allocated to goodwill then to the "scoped-in" non-current assets on a pro rata basis (IFRS5.23).

Application of three steps to the submitter's example

9. The staff applies these steps to the submitter's example (ie. a liability in a disposal group is a financial liability within the scope of IAS 39) in the following paragraphs.

10. **Step 1**: The issued debt in the example should be measured in accordance with applicable IFRSs. The fair value of borrowing is significantly higher than book value because entity B has fixed rate borrowings with a fair value greatly in excess of the amortised cost carrying amount. As the issued debt is a financial liability as defined in IAS 32 and therefore within the scope of IAS 39, the debt should continue to be measured at amortised cost using the effective interest method, unless the debt is classified as a financial liability at fair value through profit or loss (IAS39.47).

11. **Step 2:** IFRS 5.19 requires the disposal group as a whole to be remeasured at the fair value less costs to sell of the group. In the submitter's example, the fair value change of a financial debt could trigger remeasument of the disposal group. However, IFRS 5 is not clear on how to account for an impairment loss of a disposal group when a fair value change in a financial liability triggers an impairment of the disposal group as a whole (remember that a fair value change

in a financial liability is not recognised except for the fair value through profit or loss financial liability in Step 1). Therefore, the staff recommend that the IFRIC refer this issue to the Board to clarify how to account for an impairment loss of a disposal group when a fair value change in a financial liability triggers an impairment of a disposal group as a whole.

Question 1 for the IFRIC
Does the IFRIC agree with the staff analysis in paragraphs 9-11? Does the IFRIC agree with the staff recommendation to refer this issue to the Board to clarify how a fair value change in a financial liability within the scope of IAS 39 should be taken into account when an impairment loss of a disposal group is measured? If so, how would you like to recommend to amend IFRS 5?

12. **Step 3:** IFRS 5.23 requires the impairment loss of the disposal group to be allocated first to goodwill and then the "scoped-in" non-current assets on a pro-rata basis. Accordingly, in the example*, if the fair value change in the financial liability should be considered when an impairment of the disposal group is measured in Step 2*, non-current assets should be reduced to zero and a liability should be recognised at 40 **(View 4).**

13. However, the staff questions if allocation of the impairment loss to the scoped-in assets is meaningful for the users because in the example the decline in value of the net assets of the group is obviously due to the fair value change of the scoped-out liabilities. The current version of IFRS 5.23 does not refer to IAS 36 paragraph 105. IAS 36.105 states:

"In allocating an impairment loss in accordance with paragraph 104, an entity shall not reduce the carrying amount of an asset below the highest of:

(a) its fair value less costs to sell (if determinable);

(b) its value in use (if determinable); and

(c) zero.

The amount of the impairment loss that would otherwise have been allocated to the asset shall be allocated pro rata to the other assets of the unit (group of units)."

14. The staff also notes that assets within a disposal group are presented in one line on the statement of financial position (see IG Example 12). Therefore, the staff anticipates that allocation of the impairment loss to each asset within a disposal group would not provide additional information to the users of financial statements.

15. Accordingly the staff recommend that the IFRIC also refer this issue to the Board with a recommendation that IFRS 5 paragraph 23 should be amended to additionally refer to paragraph 105 of IAS 36. If such an amendment is made, in the example, no assets should be reduced to zero and only a liability should be recognised at 160.

Question 2 for the IFRIC
Does the IFRIC agree with the staff recommendation that this issue be referred to the Board with a recommendation that the Board amend IFRS 5 paragraph 23 as noted in paragraphs 13-15?

Agenda criteria assessment

16. The staff's preliminary assessment of the agenda criteria is as follows:

(a) *Is the issue widespread and practical?*
Yes. In the staff's view, the issue could arise in many jurisdictions and is likely to have practical application in the current environment.

(b) *Does the issue involve significantly divergent interpretations (either emerging or already existing in practice)?*
Yes. As illustrated by the submission, the issue could involve significantly divergent interpretations.

(c) *Would financial reporting be improved through elimination of the diversity?*
Yes. The staff anticipate possible diversity in practice as stated in (b).

(d) *Is the issue sufficiently narrow in scope to be capable of interpretation within the confines of IFRSs and the Framework for the Preparation and Presentation of Financial Statements, but not so narrow that it is inefficient to apply the interpretation process?*
No. The issue seems to be too narrow to develop an interpretation.

(e) *If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project? (The IFRIC will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the IFRIC would require to complete its due process.)*
N/A. There are no planned or current IASB projects that the issue relates to.

17. Based on the assessment of the agenda criteria in paragraph 16, the staff recommends that IFRIC not add the issue to its agenda but recommend that the Board amend IFRS 5 as a part of Annual Improvement process.

Question 3 for the IFRIC
1. Does the IFRIC agree that the issue should not be added to the agenda but referred to the Board to amend IFRS 5 as a part of Annual Improvement project? 2. Does the IFRIC have any comments on the proposed wording for the tentative agenda decision in Appendix C? 3. Does the IFRIC have any comments on the proposed wording for the amendment to IFRS5 in Appendix D?

Appendix A – Flowchart for impairment of a disposal group

Step 1: individual "scoped-out" assets and liabilities that are included in a disposal group are remeasured in accordance with applicable IFRSs (IFRS 5.19).

Step 2: the fair value less costs to sell of the disposal group is determined "as a group" and any impairment loss identified (IFRS 5.19).

Step 3: Impairment loss identified in step 2 is allocated to goodwill and "scoped in" non-current assets on a pro-rata basis (IFRS5.23).

Reduce goodwill and the scoped-in non-current assets

Note: This chart stands for *general* requirements by the *current* IFRS5.

Appendix B – IFRIC potential Agenda Item Request

B1. The staff received the following IFRIC agenda request. All information has been copied without modification by the staff.

B2. Suggested agenda item: Write-down of a disposal group to the lower of its fair value less costs to sell and its carrying amount where the write-down exceeds the carrying amount of non-current assets.

B3. It has come to our attention that there are differences of opinion concerning the application of paragraphs 20 to 25 of IFRS 5 where the amount of impairment loss for a disposal group exceeds the carrying amount of non-current assets to which that loss is allocated in accordance with paragraph 23.

The issue:

B4. Paragraph 23 states: "The impairment loss (or any subsequent gain) recognised for a disposal group shall reduce (or increase) the carrying amount of the non-current assets in the group that are within the scope of the measurement requirements of this IFRS, in the order of allocation set out in paragraphs 104(a) and (b) and 122 of IAS 36 (as revised in 2004)."

B5. The general approach in IFRS 5 seems to be a portfolio approach to measurement of disposal groups held for sale. The disposal group must be measured at the lower of its carrying amount and fair value less costs to sell, irrespective of the effect of any allocation of impairment loss on the carrying amounts of the individual assets and liabilities that make up that disposal group. In short, as the disposal group is to be sold, the carrying amounts of the individual assets and liabilities are not relevant; it is the net value of the group which is relevant. In fact, IFRS 5's presentation requirements reflect this portfolio approach to measurement: the assets and liabilities of the disposal group are collapsed into two lines in the balance sheet, 'non-current assets classified as held for sale' and 'liabilities directly associated with non-current assets classified as held for sale', enabling the user of the financial statements to assess separately the value of the disposal group to the business. As the disposal group is being sold, this measurement represents an exit value rather than a value-in-use.

B6. IFRS 5 is silent, however, on the recognition of the impairment loss where the amount of this loss exceeds the non-current assets within its measurement scope. Depending on how preparers and auditors interpret IFRS 5's requirements, different conclusions will be reached as to how to account for this scenario.

B7. **Example**

Entity A intends to sell one of its subsidiaries, entity B. Entity A's intended sale of B meets the IFRS 5 criteria for classification of B (the disposal group) as held for sale. Entity B is a service organisation with few non-current assets. The carrying amount of entity B's net assets subsequent to the application of all IFRSs other than IFRS 5 is CU130. For IFRS 5 measurement purposes, the fair value less costs to sell (FVLCTS) is determined to be CU-30, being the fair value of entity B's net assets of CU-20 and costs to sell of CU10. (This is significantly lower than book value because entity B has fixed rate borrowings with a fair value greatly in excess of the amortised cost carrying amount.)

B8. The individual carrying amounts and respective fair values of entity B's assets and liabilities are as follows:

	Carrying Amount (CU)	Fair Value (CU)
Intangible assets	0	0
Property, plant and equipment	120	120
Cash and cash equivalents	170	170
	290	290
Issued debt - current portion	50	50
Issued debt - non-current portion	110	260
	160	310
Net assets	130	(20)

B9. Therefore, in accordance with IFRS 5, entity A's disposal group (entity B) should be should be impaired. How much should be recognised as an impairment of the disposal group in accordance with IFRS 5?

Current practice:

VIEW 1 - Limit loss to non-current assets only

B10. It is appropriate to reduce the carrying amount of an asset below its individual FVLCTS. However, in accordance with IFRS 5.23 the impairment loss recognised reduces only the carrying amounts of non-current assets within the disposal group. Therefore, in the above example, the impairment loss recognised is limited to the carrying amount of property, plant and equipment, ie CU 120.

VIEW 2 - Limit loss to net assets of disposal group

B11. It is appropriate to reduce the carrying amount of an asset below its individual FVLCTS. However, the carrying amount of the disposal group as a whole should not be reduced below zero. Consequently, any impairment loss is limited to the carrying amount of the disposal group, ie CU 130 in the above example.

VIEW 3 - Limit loss to total assets

B12. It is appropriate to reduce the carrying amount of an asset below its individual FVLCTS. The impairment loss can be allocated to all assets in the disposal group, including current assets. However, IFRS 5 only relates to the measurement of assets within a disposal group. An additional liability should only be recognised if the definition of a liability in accordance with IAS 37 is met, ie if there is a present obligation arising from a past event where an outflow of resources is probable. Thus, to the extent that the impairment loss exceeds the carrying amount of total assets in the disposal group, no additional liability is recognised. Therefore, in the above example, the full impairment loss of CU 160 (fair value write down of CU 150 and costs to sell of CU 10) is recognised. This is allocated against the non-current assets first (CU 120) and then to the current assets included within the disposal group (resulting in a write down of cash and cash equivalents by CU 40).

VIEW 4 - Limit loss to non-current assets and recognise liability for excess to ensure that disposal group is at fair value less costs to sell

B13. It is appropriate to reduce the carrying amount of an asset below its individual FVLCTS. In accordance with IFRS 5(23), the impairment loss should only be allocated to non-current assets within the disposal group. In other words, current assets should not be written down. However, IFRS 5 requires that the disposal group is measured at the lower of its carrying amount and its FVLCTS. Therefore, although the definition of a liability in accordance with IAS 37 is not met, where the impairment loss exceeds the carrying value of non-current assets in the disposal group, an additional liability should be recognised. In the above example, an impairment of CU 160 (ie to fair value less costs to sell) is recognised, reducing the non-current assets to zero and resulting in recognition of a liability of CU 40.

Reasons for the IFRIC to address the issue:

B14. We believe there would be benefit for preparers, auditors and users of financial statements if IFRIC provided guidance on this issue.

[Appendix C and D have been omitted from this Observer note]