



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

Topic **Moving Forward**

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## Introduction

1. In April 2009, the staff presented a paper that discussed the definition of discontinued operations, based on the comments received on the Exposure Draft, *Discontinued Operations: Proposed Amendments to IFRS 5*, and the proposed FASB Staff Position (FSP) FAS 144-d, *Amending the Criteria for Reporting Discontinued Operations* (hereinafter 'the EDs').
2. At the 15 April 2009 Education Session, FASB Board members developed an additional alternative that would possibly:
  - (a) eliminate the requirement to present discontinued operations (except for businesses that meet the criteria to be classified as held for sale on acquisition) on the face of the statement of comprehensive income; and
  - (b) require disclosures for all components of an entity that have been disposed of or classified as held for sale, for the items proposed in the Exposure Draft and the proposed FSP, for all periods presented.

FASB Board members stated that they would like to understand users' views regarding this alternative before further deliberating this issue, and directed the staff to reach out to users to obtain feedback on this alternative.

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This paper has been prepared by the technical staff of the IASB for the purposes of discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper and do not purport to represent the views of any individual members of the Board or the IASB.

Decisions made by the Board are reported in IASB *Update*.

Official pronouncements of the IASB are published only after the Board has completed its full due process, including appropriate public consultation and formal voting procedures.

3. At the April 2009 IASB Board meeting, the IASB agreed to explore this alternative.

### **Objectives of this Paper**

4. The objectives of this paper are:
  - (a) to summarize the input from users; and
  - (b) to discuss how to move forward in this project.

### **Summary of Input from Users**

5. The staff performed outreach with several users of both IFRSs financial statements and U.S. GAAP financial statements to seek their views on the presentation of discontinued operations. The following paragraphs provide a summary of the input from users.

#### ***General***

6. Users of IFRSs financial statements and U.S. GAAP financial statements did not see a fundamental problem in their respective reporting of discontinued operations on the face of the statement of comprehensive income, even though the definitions differed between the Boards. They did, however, note that enhanced disclosure could help their analyses.

#### ***Presentation of Discontinued Operations on the Face of the Statement of Comprehensive Income***

7. All users of U.S. GAAP financial statements the staff spoke with stated that discontinued operations should be presented separately on the face of the statement of comprehensive income. These users noted that, although all of the information provided in the notes is necessary to conduct a thorough analysis, it is important to obtain ‘heads-up’ information regarding discontinued operations

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from the face of the statement of comprehensive income, which usually becomes available before the notes. Users of U.S. GAAP financial statements also noted that although the statement of comprehensive income should provide a summary of what is included in detail in the notes to the financial statements, significant events that occurred during the period (for example, discontinuing a major line of business) should be apparent on the face of the statement of comprehensive income. This feedback is consistent with earlier extensive outreach performed by the FASB staff with users of U.S. GAAP financial statements in 2006.

8. Users of IFRSs financial statements were split as to whether discontinued operations should be presented separately on the face of the statement of comprehensive income. Comments from users who think it is necessary to present discontinued operations on the face of the statement of comprehensive income provided reasons similar to those provided by users of U.S. GAAP financial statements. Comments from users who think it is unnecessary to present discontinued operations on the face of the statement of comprehensive income included the following:
  - (a) Users typically perform their detailed modelling by segment and, therefore, aggregated information regarding discontinued operations on the face of the statement of comprehensive income is not useful. Rather, it would be more useful to disaggregate information regarding discontinued operations to the segment level.
  - (b) The reporting of discontinued operations was not required in many jurisdictions prior to their adoption of IFRSs, but users of financial statements did not face difficulty in conducting their analyses without such information.
9. The Discussion Paper, *Preliminary Views on Financial Statement Presentation*, asked whether discontinued operations should be presented as a separate section

in the proposed model. Based on a quick review of the comments received on this Discussion Paper, a majority of respondents seem to support the presentation of a separate 'discontinued operations' section.

***Definition of Discontinued Operations***

10. Users of IFRSs financial statements and U.S. GAAP financial statements who supported having a definition of a discontinued operation were split on how to actually define it.
11. Some users supported the view that the reporting of discontinued operations should not rely on the judgment of management and suggested that the definition of discontinued operations be based on one of the following concepts that already exist in accounting literature:
  - (a) component of an entity (as defined in IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, and FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*); or
  - (b) reporting unit (as defined in FASB Statement No. 142, *Goodwill and Other Intangible Assets*).
12. Other users noted that the reporting of discontinued operations would need to rely on the judgment of management to a certain extent and suggested that the definition of discontinued operations be based on one of the following:
  - (a) a component of an entity that represents a strategic shift in the entity's operations; or
  - (b) a significant component of an entity.

These users noted that an entity would need to justify its basis for presenting discontinued operations as such.

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13. U.S. GAAP users generally agreed that ‘continuing involvement’ should not be part of the definition of discontinued operations. These users acknowledged that in many cases it is natural for an entity to have some continuing involvement with a discontinued operation while it is being disposed of or held for sale, and concluded that such continuing involvement should not prevent the entity from reporting those operations as discontinued.

### ***Interaction with Segment Reporting***

14. All users of U.S. GAAP financial statements that the staff spoke with and most users of IFRSs financial statements did not support the notion of reporting a discontinued operation as a separate ‘segment’ in the segment disclosures because segment information currently required under U.S. GAAP or IFRSs is based on internal reporting amounts, which may or may not be based on GAAP measures.
15. However, several users of IFRSs financial statements stated that the reporting of a discontinued operation as a separate ‘segment’ in the segment disclosures is an interesting idea that is worth exploring. These users did not think that segment reporting information should be changed so that all amounts reported would be based on GAAP; they noted that a reconciliation from the information provided in segment disclosures to the information on the face of the statement of comprehensive income should suffice.

### ***Disclosures***

16. Almost all users of IFRSs financial statements and U.S. GAAP financial statements supported the disclosures of items proposed in the EDs<sup>1</sup> for all

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<sup>1</sup> The EDs proposed the disclosure of the following items:

components of an entity that have been disposed of or classified as held for sale. Moreover, these users noted that the disclosures for prior periods should be re-presented so that the disclosures relate to all components of an entity that have been disposed of or classified as held for sale by the end of the period for the latest period presented. These users noted that disclosures provided today were not detailed enough to assess the financial effect of significant disposal activities on an entity's major income and expense line items and that information for prior periods is also necessary to assess the financial trends.

## **Staff Analysis and Recommendation**

### ***Presentation of discontinued operations on the face of the statement of comprehensive income***

17. The staff thinks there is not enough support from users to eliminate the presentation of discontinued operations from the face of the statement of comprehensive income.
18. One of the reasons the FASB decided to explore an alternative that would eliminate the presentation of discontinued operations from the statement of comprehensive income was that it was difficult to define discontinued operations in a practical manner. However, as discussed later in this paper, the staff thinks a converged definition can be developed.

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- (a) the profit or loss, together with major income and expense items constituting that profit or loss, including impairments, interest, depreciation and amortization;
  - (b) whether the profit or loss in (a) is presented in continuing operations or in discontinued operations;
  - (c) if the component of an entity includes a non-controlling interest, the profit or loss attributable to the owners of the parent; and
  - (d) the major classes of cash flows.

19. As noted earlier, some users were interested in exploring the possibility of presenting a discontinued operation as a separate 'segment' in the segment disclosures. However, the staff thinks this would be challenging because, in addition to having to define discontinued operations, the Boards would need to decide how to reconcile (a) discontinued operation disclosures based on GAAP measures and (b) segment disclosures which may or may not be based on GAAP measures.

***Definition of discontinued operations***

20. Respondents to the EDs were generally comfortable with the number of items that would be reported as discontinued operations when the definition of discontinued operations was based on an operating segment. However, respondents noted the following shortcomings to the proposal in the EDs:

- (a) Because an entity can decide on the size of each operating segment, some entities may have operating segments that are very small. As a result, discontinued operations may include too many items and thus provide information with limited usefulness. For example, in certain instances in the real estate industry, each individual property often is an operating segment.
- (b) A strict application of the operating segment criteria may lead to misleading results. For example, if an entity disposed all of the assets and liabilities of an operating segment except for one asset, one may argue that such disposal would not meet the definition of a discontinued operation. Moreover, if an entity disposed of an operating segment and some corporate assets as part of a single co-ordinated plan, one may argue that the effects of the disposal of the operating segment would be

presented as a discontinued operation but the effects of the disposal of the corporate assets would be presented within continuing 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 *Operating Segments* requires that the entity determine which set of components constitutes the operating segments by reference to the core principle and FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*, requires that the entity present operating segments based on products and services. Respondents said that a disposal of a component from a set that is not used for reporting operating segments should also be considered a discontinued operation.

21. In response to the concerns raised by constituents in the preceding paragraph, the staff thinks the following clarifications regarding ‘operating segment’ need to be made if that concept is to be used for the purposes of presenting discontinued operations:

- (1) When an entity is structured as a matrix form of organization, the disposal of a component from a set that is not used for reporting operating segments should also be considered a disposal of an operating segment. For example, if an entity structured as a matrix form of organization (based on product line and geographical area) presents segment disclosures based on product line but disposes of a component of an entity related to a geographical area, for the purposes of presenting



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discontinued operations, that disposal should also be considered a disposal of an operating segment.

- (2) An operating segment is considered to be disposed of or classified as held for sale if substantially all of the assets and liabilities within that segment are disposed of or classified as held for sale. For example, if an entity disposes of an operating segment except for a few immaterial assets and liabilities that are part of that segment, such disposal should be considered a disposal of an operating segment.
- (3) The disposal of assets and liabilities that are related to the disposal of an operating segment (but are not part of that segment) should be included in a discontinued operation if such disposal is part of a single co-ordinated plan.

22. With this clarification, the staff considered the following Alternatives regarding the definition of a discontinued operation:

Alternative A: A discontinued operation is a component of an entity whose disposal of, or classification to held for sale, represents a strategic shift in the entity's operations.

Alternative B: A discontinued operation is an operating segment whose disposal of, or classification to held for sale, represents a strategic shift in the entity's operations.

Alternative C: A discontinued operation is a significant operating segment disposed of or classified as held for sale. An entity applies judgement in deciding whether the disposed operating segment is significant. In determining whether a disposed operating

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segment is a significant operating segment, an entity may choose not to present the disposed operating segment in discontinued operations if it does not meet the quantitative thresholds in the segment reporting standards.

23. Alternatives A and B rely on the concept of strategic shift. This is consistent with the view supported by the many respondents to the EDs who stated that the disposal of a component of an entity should be reported in discontinued operations only when it represents a strategic shift in the entity's operations.
24. The number of items reported in discontinued operations under Alternative A is unpredictable because such determination would depend on whether the entity views each disposal of a component of an entity as representing a strategic shift. Accordingly, Alternative A may be inconsistent with the view of many respondents to the EDs who stated that the number of items that would be reported as discontinued operations under the proposals in the EDs was appropriate.
25. Alternative B alleviates some of that concern by requiring that a discontinued operation cannot be smaller than an operating segment (with the clarifications presented in paragraph 21). However, that restriction might be considered a drawback under the 'strategic shift' principle because the disposal of a component of an entity that is smaller than an operating segment may clearly represent a strategic shift in the entity's operations.
26. Alternative C also requires that a discontinued operation cannot be smaller than an operating segment (with the clarifications presented in paragraph 21) but does not rely on the strategic shift concept. Proponents of Alternative C note that it is difficult to define 'strategic shift' and that relying on this concept is likely to

provide too much discretion to management and thus comparability across entities would be impaired.

27. Rather, Alternative C uses significance as the driver for reporting discontinued operations. Although it uses an operating segment (with the clarifications in paragraph 21) as the starting point, Alternative C requires an entity to apply judgment in whether deciding whether the disposed operating segment is significant. In determining whether a disposed operating segment is a significant operating segment, an entity may choose not to present the disposed operating segment in discontinued operations if it does not meet the quantitative thresholds in the Boards' segment reporting standards<sup>2</sup>.
28. The Boards' segment reporting standards also state that operating segments that do not meet any of the quantitative thresholds may be considered reportable, and separately disclosed, if management believes that information about the segment would be useful to users of the financial statements. In line with this thinking, Alternative C does not prohibit an entity from reporting a disposed operating segment in discontinued operations when it does not meet the quantitative thresholds, provided that an entity determines that the disposed operating
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<sup>2</sup> Both IFRS 8 and Statement 131 state that quantitative thresholds are met if any of the following applies:

- (a) Its reported revenue, including both sales to external customers and intersegment sales or transfers, is 10 percent or more of the combined revenue, internal and external, of all operating segments.
- (b) The absolute amount of its reported profit or loss is 10 percent or more of the greater, in absolute amounts, of (i) the combined reported profit of all operating segments that did not report a loss and (ii) the combined reported loss of all operating segments that reported a loss.
- (c) Its assets are 10 percent or more of the combined assets of all operating segments.

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segment is a significant operating segment. An entity would be required to disclose its policy of determining significant operating segments.

29. The staff recommends Alternative C (with the clarifications related to operating segments in paragraph 21). It is based on the proposals in the EDs and addresses the concerns raised by constituents. All of the Alternatives the staff considered would require judgment of management. However, the staff thinks it would be difficult to operationalize the strategic shift concept.

### **Disclosures**

30. Almost all users of IFRSs financial statements and U.S. GAAP financial statements supported the disclosures of items proposed in the EDs for all components of an entity that have been disposed of or classified as held for sale. Moreover, these users noted that the disclosures for prior periods should be re-presented so that the disclosures relate to all components of an entity that have been disposed of or classified as held for sale by the end of the period for the latest period presented.
31. However, many preparers, auditors, and national standard-setters have noted that the proposed disclosures were onerous, even if disclosures for prior periods were not re-presented<sup>3</sup>. These respondents noted that, if the same disclosures are required for both items that do and do not meet the definition of discontinued operations, the Boards have defined discontinued operations incorrectly or are requiring too much disclosure.

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<sup>3</sup> Comparative information would be required under IAS 1, *Presentation of Financial Statements*, even if disclosures for prior periods are not required to be re-presented.

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32. The staff recommends that disclosures should be required for all components of an entity that have been disposed of or classified as held for sale. As for re-presenting information for prior periods, the staff considered the following alternatives:

Alternative A: Disclosures for prior periods would be required to be re-presented for all components of an entity.

Alternative B: Disclosures for prior periods would be required to be re-presented only for those that meet the definition of a discontinued operation.

33. The staff recommends Alternative B. The staff thinks that a distinction between discontinued operations and other components of an entity that are disposed of or classified to held for sale should be made based on whether the effects on comprehensive income are so significant that they warrant re-presentation of disclosure for prior periods. Alternative B makes this distinction, whereas Alternative A does not.

34. In the deliberations that led to the EDs, the Boards agreed that they would continue to remain silent on whether disclosures could be aggregated for certain components of an entity that either have been disposed of or are classified as held for sale. The intent of remaining silent was to allow preparers and auditors to decide on a level of aggregation that results in disclosures proportionate to the significance of the disposal to the entity. However, many constituents have repeatedly asked the Boards to provide some guidance.

35. The staff thinks the Boards can include guidance similar to that included in IFRS 3, *Business Combinations* (as revised in 2008) and FASB Statement No. 141 (revised 2007), *Business Combinations*:

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- (a) Information should be provided individually for each material component of an entity that has been disposed of or classified as held for sale.
- (b) Information should be provided in aggregate for immaterial components of an entity that have been disposed of or classified as held for sale that are material collectively.

The staff thinks that this guidance should alleviate the concerns of those who regarded the disclosure proposals in the ED as too onerous. The staff thinks it is hard to argue that disclosure of material items is onerous.

### ***Re-exposure of proposals***

- 36. The staff thinks the staff recommendations in this paper are improvements to the proposals in the EDs, which are based on the comments received from constituents on the EDs. The staff thinks there is little new information that can be gained from re-exposure and thus re-exposure of the proposals is unnecessary.

#### **Questions for the Boards**

1. Do the Boards agree that discontinued operations should continue to be presented on the face of the statement of comprehensive income?
2. Do the Boards agree that the following clarifications should be made, for the purposes of presenting discontinued operations, if the operating segment concept is to be used?
  - (1) When an entity is structured as a matrix form of organization, the disposal of a component from a set that is not used for reporting operating segments should also be considered a disposal of an operating segment.

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- (2) An operating segment is considered to be disposed of or classified as held for sale if substantially all of the assets and liabilities within that segment are disposed of or classified as held for sale.
  - (3) The disposal of assets and liabilities related to the disposal of an operating segment (but those assets and liabilities are not part of that segment) should be included in a discontinued operation if such disposal is part of a single co-ordinated plan.
3. Do the Boards agree that a discontinued operation should be defined as a significant operating segment (with the clarification in Question 2) that either has been disposed of or classified as held for sale? If so, do the Boards agree that, in determining whether a disposed operating segment is a significant operating segment, an entity may choose not to present the disposed operating segment in discontinued operations if it does not meet the quantitative thresholds in the Boards' segment reporting standards?
4. Do the Boards agree that disclosures of items proposed in the Exposure Draft should be required for all components of an entity?
5. Do the Boards agree that the disclosures for prior periods should be required to be re-presented for all discontinued operations (rather than all components of an entity)?
6. Do the Boards agree that disclosures should be provided individually for material items but in the aggregate for immaterial items that are collectively material?
7. Do the Boards agree that re-exposure of the proposals is unnecessary?