STAFF PAPER

14 – 15 May 2013

IFRS Interpretations Committee Meeting

IFRS IC March 2013

Project	**Tentative agenda decision**
Paper topic	IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*—classification as held for sale in conjunction with a planned IPO

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Introduction

1. In March 2013, the IFRS Interpretations Committee (the Interpretations Committee) discussed a request from the European Securities and Markets Authority (ESMA) regarding the application of the guidance in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

2. More specifically, the Interpretations Committee was asked to clarify the application of the guidance in IFRS 5 regarding the classification of a disposal group as held for sale in conjunction with a planned initial public offering (IPO), but where the prospectus has not yet been approved by the securities regulator.[1]

3. The question addressed to the Interpretations Committee was:

   - Would a disposal group qualify as held for sale before the prospectus is approved by the securities regulator, assuming that all of the other criteria in IFRS 5 have been fulfilled?

4. Our analysis of this issue was included in Agenda Paper 12 of March 2013.

[1] The Interpretations Committee was also asked to clarify the case of a change in a disposal plan from a plan to sell a division, by means of an initial public offering to a plan to spin-off a division and distribute a dividend in kind to its shareholders. This issue is analysed in Agenda Paper 20B of May 2013.

5. At the March 2013 meeting the Interpretations Committee had a preliminary discussion of the issue described above, but directed the staff to do additional research on the general issues raised during the discussion and present some further analysis, including a recommendation, at a future Interpretations Committee meeting.

6. The Interpretations Committee also directed the staff to bring a summary of the outreach performed with national accounting standard-setters (ie the International Forum of Accounting Standard Setters (IFASS)) and a securities regulator (IOSCO) that the staff had performed on the issue raised by the submitter. This summary is presented in Agenda Paper 20C of May 2013.

7. The original submission is also reproduced in Agenda Paper 20C of May 2013.

Purpose of the paper

8. The purpose of this paper is to:

   (a) provide an analysis of the guidance in IFRS 5 regarding the classification of a non-current asset (or disposal group) as held for sale;

   (b) present an assessment of the issue analysed against the Interpretations Committee's agenda criteria;

   (c) make a recommendation that the Interpretations Committee should not take this issue onto its agenda (we have set out our proposed wording for the proposed tentative agenda decision in Appendix A); and

   (d) ask the Interpretations Committee whether it agrees with the staff recommendation.

Introduction

Summary of our preliminary analysis in March 2013

9. At the March 2013 meeting we presented an assessment of the facts and circumstances described in the fact pattern that was submitted against the criteria

set in paragraphs 6–9 of IFRS 5 to determine whether the approval of a prospectus by the competent securities regulator is a condition that is required for the disposal plan to qualify as held for sale.[2]

10. On the basis of this preliminary analysis, we determined that the sale of the disposal group described in the fact pattern could <u>not</u> be considered *highly probable*. This is because we noted that some of the relevant actions required so that the disposal plan could be *highly probable*, did not seem to be accomplished before the prospectus approval, such as:

    (a) an initiation of an active programme to locate a buyer and complete the plan; and

    (b) actively marketing the disposal group for sale at a price that is reasonable in relation to its current fair value.

11. We were of the view that once the prospectus was in place and approved by a competent authority, all of the actions necessary to consider a sale *highly probable* could be then accomplished.

12. At the March 2013 meeting, a majority of members from the Interpretations Committee disagreed with the staff conclusions because they thought that held-for-sale accounting should not be prohibited only because of the lack of prospectus approval.

13. After our discussion at the March 2013 meeting, we did some follow-up with some members of the Interpretations Committee to have a better understanding of their views.

14. Some members noted that in the case of an IPO, some of the criteria in paragraphs 6–9 can be met before the approval of the prospectus, such as management's commitment to sale, or the expectation by management that the sale can be completed within one year, which in their view are relevant elements in the classification as held for sale.

[2] For information purposes only, the original submission can be found in Appendix C of this paper.

15. Moreover, some members held the view that legal and regulatory requirements would fit into “terms that are usual and customary for sales of such assets” in accordance with paragraph 7 of IFRS 5. So even though, in some jurisdictions the approval of the prospectus is more than an “administrative step”, they think that if the prospectus complies with legal and regulatory requirements then there is no reason to believe that the approval would not be obtained by the competent authority.

16. Consequently, they are of the view that facts and circumstances should be analysed for each particular case to consider whether a disposal group that meets the requirements in IFRS 5 can be classified as held for sale.

Our analysis in this agenda paper

17. In this paper our analysis is more generic that in our previous paper (refer to Agenda Paper 12 of March 2013). Our objective in this paper is to analyse two views in the application of the guidance in IFRS 5 in regards to the assessment of the criteria in paragraphs 6–9 for the classification of a non-current asset (or disposal group) as held for sale, in conjunction with a planned IPO.

18. We will refer to particular aspects of the fact pattern that was originally submitted when it is relevant to our discussion and for illustration purposes only, but we will not seek to conclude on that specific fact pattern.

Staff analysis

Current guidance in IFRS

19. Paragraph 7 of IFRS 5 sets the following two requirements for the classification of a non-current asset (or disposal group) as held for sale (emphasis added):

    (a) the non-current asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such non-current assets (or disposal groups); and

(b) its sale must be *highly probable*. Appendix A of IFRS 5 defines:

    (i) *highly probable* as: "significantly more likely than probable"; and

    (ii) probable as: "more likely than not".

20. The issues raised in the submission related to the assessment of the sale as being *highly probable*, rather than the assessment of whether the disposal group is available for sale in its present condition. Accordingly, our analysis in this paper focuses on the assessment of whether the sale is *highly probable*.

21. Paragraph 8 of IFRS 5 provides the following specific criteria that should be met for the sale to be *highly probable*:

(a) the appropriate level of management must be committed to a plan to sell the asset (or disposal group);

(b) an active programme to locate a buyer and complete the plan must have been initiated;

(c) the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value;

(d) the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification, except as permitted by paragraph 9;

(e) actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn; and

(f) the probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the sale is *highly probable*.

22. Paragraph 9 of IFRS 5 clarifies that "events or circumstances may extend the period to complete the sale beyond one year". This extension might not preclude

the classification of a non-current asset (or disposal group) as held for sale if the delay is caused by events that are beyond the entity's control and sufficient evidence indicates that the entity is still committed to its plan to sell.

Views identified

23. We have identified two views in applying the guidance of paragraphs 6–9 of IFRS 5 for the classification of a non-current asset (or disposal group) as held for sale:

    (a) **View A**—the entity's assessment to determine whether a non-current asset (or disposal group) can be classified as held for sale is **event-driven.**

    (b) **View B**—the entity's assessment to determine whether a non-current asset (or disposal group) can be classified as held for sale is **probability-driven.**

View A—the entity's held-for-sale assessment is event-driven

24. Supporters of this view think that a non-current asset (or disposal group) is classified as held for sale only after every aspect in paragraphs 6–9 is met.

25. They think that IFRS 5 does not require or permit the use of a probability assessment of some of the individual criteria in reaching the overall assessment that the sale is *highly probable*.

26. They view the criteria in paragraphs 6–9 as the minimum requirements (ie a hurdle) that must be passed in order to conclude that the sale as a whole is *highly probable*. In other words, the criteria constitute specific application guidance on how to assess if the sale is *highly probable*.

27. Supporters of View A consider the following as "absolute criteria", which in their view must be accomplished before the entity can classify a non-current asset (or disposal group) as held for sale:

(a) the appropriate level of management must be committed to a plan to sell the asset (or disposal group);

(b) an active programme to locate a buyer and complete the plan must have been initiated; and

(c) the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value.

28. Whereas they think that the following criteria are assessed on a probability basis because they relate to future events:

(a) the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification, except as permitted by paragraph 9;

(b) actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn; and

(c) the probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the sale is *highly probable*.

29. They think that their view is supported by the way the guidance in paragraph 8 of IFRS 5 is written (emphasis added):

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

probability of shareholders' approval (if required in the jurisdiction) **should** be considered as part of the assessment of whether the sale is *highly probable*.

How would View A be applied to the fact pattern submitted?

30. In terms of what the supporters of View A consider as "absolute criteria" we think that they would question the following:

(a) Is there enough evidence of management commitment? For example,

(i) has a public announcement been made and what is the nature of the commitments made by management in that public announcement?

(b) Has an active programme to locate a buyer and complete the plan been initiated? For example,

(i) is there evidence of the existence of a sufficiently detailed plan that demonstrates all steps needed to achieve sale, including specifics about how buyers will be found, who will be involved (ie both internal management, external sales agents, etc)?

(ii) are steps set out in a sales plan clear, specific and sufficient to achieve a sale on a timely basis?

(iii) has management initiated that plan, ie started to implement that plan?

(c) Is the disposal group actively marketed for sale at a price that that is reasonable in relation to its current fair value? For example,

(i) has management identified a target price or price range for the disposal group, and what steps has management taken in order to conclude that the target price/price range is reasonable?

(ii) is the sales plan already been implemented and potential buyers being approached and prices being discussed?

31. In relation to paragraph 30 above, we think that an important question that supporters of this view would consider is which activities would reflect that a disposal group is "actively marketed". For instance, a relevant question to ask is:

    (a) What would the marketing effort include? Would it include:

        (i) direct approaches to institutional investors?;

        (ii) marketing via the prospectus?; or

        (iii) both an approach to institutional investors and marketing via a prospectus?;

    (b) Would the relative number of shares expected to be purchased by institutional investors compared with those sold to retail investors via the prospectus affect this assessment?

32. Another related question to consider would be:

    (a) Which part does the prospectus play in the transaction?

        (i) is it a main vehicle to achieve the sale (ie it is the main sales document)? or

        (ii) is it the official document to market the transaction?

    (b) In terms of obtaining the prospectus approval by the competent authority, management could question:

        (i) What is management's experience of receiving approval in the past for the issue of a prospectus? What has been the basis for rejection by a securities regulator?

        (ii) What are the risks and sensitivities associated with this particular proposed IPO that might cause the securities regulator to look more or less favourably on the issue of this prospectus?

33. Accordingly, management in its assessment about whether a sale is *highly probable* should consider the relevance of the approval of the prospectus.

34. On the other hand, we think that what proponents of View A would assess on a "probability basis" would be:

(a) Has an assessment been completed about the probability that the sale will be completed within 12 months in the light of the progress made on the criteria described above (ie paragraph 30 of this agenda paper)

(b) Has an assessment been completed in the light of progress made on the criteria described above (ie paragraph 30 of this agenda paper) and the steps remaining to complete the sales programme about the probability that the sale will be completed without significant change to the plan?

(c) Has an assessment been made in the light of the progress made on the criteria described above (ie paragraph 30 of this agenda paper), of the likelihood that shareholders will approve the transaction?

View B—the entity's assessment is probability-driven

35. Supporters of this view also assess the criteria in paragraphs 6–9 of IFRS 5 for a transaction to qualify as held for sale, but in making this assessment their goal is to reach an overall conclusion about whether the sale is *highly probable*. In this respect, paragraphs 6 –7 state that (emphasis added):

> 6 An entity shall classify a non-current asset (or disposal group) as held for sale **if its carrying amount will be recovered principally through a sale transaction** rather than through continuing use.
>
> 7 For this to be the case, the asset (or disposal group) must be available for immediate sale in its present condition **subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be *highly probable***.

36. In their view an entity should assess the probability of the criteria in paragraphs 6–9 being achieved by analysing:

(a) all facts and circumstances surrounding the sale of the non-current asset (or disposal group); and

(b) the mode of disposal.

37. Consequently, in their view, IFRS 5 sets an overall assessment objective that the sale must be *highly probable*. Consequently the application of the guidance in IFRS 5 requires an assessment of the possibility of occurrence of the criteria in paragraphs 6 –9 in determining whether, or not, a non-current asset (or disposal group) qualifies as held for sale, based on specific facts and circumstances and/or the specific fact pattern.

38. In addition, supporters of this view observe that IFRS 5 does not set out precise details on how to assess legal and regulatory requirements which differ from jurisdiction to jurisdiction (for example, obtaining financing, getting approval to the disposal and other).

39. They note that the reason why none of those steps have been articulated in the guidance in IFRS 5 is because legal and regulatory requirements would fit into "terms that are usual and customary for sales of such assets" in accordance with paragraph 7.

40. Consequently, in their view an entity should make a judgement about the *highly probable* assessment considering what is usual and customary for a sale. For example, derived from this assessment an entity might determine that the completion of a regulatory requirement (ie such as the approval of a prospectus) is a usual part of the legal process of a sale and will not consider it as a determinant for judging whether a sale is *highly probable* or not.

41. Moreover, proponents of this view note that because legal and contractual regulations might differ depending on the jurisdiction, it would be difficult to generalise whether (or how and which) contractual and regulatory steps might prevent an entity from concluding that a sale is *highly probable*. For example, a jurisdiction might require more documentation (and not only a prospectus) to be approved by the competent authority before the sale and, consequently, some might judge that held-for-sale accounting would not apply until that additional documentation is authorised in those jurisdictions.

42. As we mention above the focus of this view should be to make an overall assessment and reach an overall conclusion about whether the sale is *highly probable*.

How would View B be applied to the fact pattern submitted?

43. We think that supporters of this view would also apply their judgement in applying the criteria in paragraphs 6-9 in helping management make the overall judgement of whether the sale is *highly probable*.

44. However, as opposed to View A, supporters of View B will not consider certain aspects of the *highly probable* assessment as more relevant or essential than the others. In turn, their assessment is based on an overall judgement of all the criteria in paragraphs 6 –9 without considering any single criteria as a pre-requisite.

45. For example in the assessment of the first three criteria in paragraph 8 of IFRS 5, supporters of View B would assess:

   (a) the level of management's commitment to the disposal. For example,

      (i) one entity could judge that meeting with its outside investors, monitoring market conditions, contacting prospective institutional buyers or publicly announcing its intention to sell, are actions to consider that management is committed to a plan to sell.

   (b) the progress made to date in undertaking a programme to locate a buyer and the probability of completing it. For example,

      (i) an entity could determine that a sales plan is relevant step in this process and another entity could consider that approaching potential buyers is the relevant step.

   (c) the progress made to date in actively marketing the disposal group at reasonable price and the probability of completing this process. For example:

      (i) an entity could have assessed the sale price prior to the approval of the prospectus.

46. The assessments described in paragraph 45 would then be considered with the assessments of the other criteria (refer to paragraph 34) in order to conclude overall whether the disposal was *highly probable*.

Our view

47. We think that judgement is involved in both **View A** and **View B** because both approaches would require making probability assessments. However, under **View A**, some of the criteria are considered essential to meet the *highly probable* criteria. Conversely, under **View B**, all the criteria are assessed using a probability approach.

48. We support **View A** because we think it would drive greater consistency in the classification of a non-current asset (or disposal group) as held for sale. This is because View A has the potential to limit the range of outcomes from the assessments made by identifying:

    (a) the hurdles that have to be overcome in order to qualify for classification as held for sale (ie the “absolute criteria”); and

    (b) the aspects for which judgment is needed (ie criteria analysed under a “probability basis”).

49. We do not think that an amendment is needed to clarify the application of the held for sale criteria in IFRS 5 in paragraphs 6 –9 because these criteria are adequate and guide management’s judgement to conclude whether a sale is *highly probable*. As we have mentioned before:

    (a) some criteria must be met, whereas,

    (b) other criteria must be assessed under a probability basis.

50. We also think that is not necessary to explicitly state in IFRS 5 that the criteria within the *highly probable* assessment are subject to management’s judgement. Instead, we think that this is already implicit in the Standard. Consequently, we are not recommending any further amendment to the guidance in IFRS 5.

Agenda criteria assessment

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

Agenda criteria[3]

We should address issues (5.16):	
that have widespread effect and have, or are expected to have, a material effect on those affected.	The feedback from the outreach received from standard-setters and regulators, showed inconclusive results about whether or not the issue is widespread (refer to Agenda Paper 20C of May 2013).
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods.	N/A
that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial Reporting*.	**Yes.** We think that an amendment to IFRS 5 is not needed to clarify the application of the held for sale criteria in IFRS 5 in paragraphs 6 –9 because these criteria are adequate and guide management's judgement to conclude whether a sale is highly probable. We think that: (a) some criteria must be met; whereas, (b) some other criteria must be assessed under a probability basis.
In addition:	
Can the Interpretations Committee address this issue in an efficient manner (5.17).	N/A
Will it be effective for a reasonable time period (5.21)? Only take on the topic of a forthcoming Standard if short-term improvements are justified.	N/A

[3] These criteria can be found in the IFRS Foundation Due Process Handbook as indicated in the paragraphs below.

Staff recommendation

52. On the basis of our assessment of the Interpretations Committee's agenda criteria, and also on our analysis in this paper, we recommend that the Interpretations Committee should not take the issue analysed in this paper (ie the classification as held for sale in conjunction with a planned IPO) into its agenda.

53. We have set out proposed wording for a tentative agenda decision in **Appendix A**.

Questions for the Interpretations Committee

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with our recommendation not to take this issue onto the agenda? 2. Does the Interpretations Committee agree with the wording for the tentative agenda decision shown in Appendix A?

Appendix A—Tentative agenda decision

A1. We propose the following wording for the tentative agenda decision:

IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*—classification in conjunction with a planned IPO, but where the prospectus has not been approved by the securities regulator

The Interpretations Committee received a request to clarify the application of the guidance in IFRS 5 regarding the classification of a non-current asset (or disposal group) as held for sale, in the case of a disposal plan that is intended to be achieved by means of an initial public offering (IPO), but where the prospectus (ie legal document with an initial offer) has not been approved by the securities regulator. The submitter requests the Interpretations Committee to clarify whether the disposal group would qualify as held for sale before the prospectus is approved by the securities regulator, assuming that all of the other criteria in IFRS 5 have been fulfilled.

The Interpretations Committee noted that an entity should apply the guidance in paragraphs 6–9 to determine whether a non-current asset (or a disposal group) is available for immediate sale and to determine whether the sale is *highly probable*.

The Interpretations Committee observed that the following criteria in paragraph 8 of IFRS 5 must be met in order to conclude that the disposal is *highly probable*:

(a) the appropriate level of management must be committed to a plan to sell the asset (or disposal group);

(b) an active programme to locate a buyer and complete the plan must have been initiated; and

(c) the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value.

The Interpretations Committee observed that the following criteria in paragraph 8 of IFRS 5 must be assessed on a probability basis:

(d) the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification (except as permitted by paragraph 9);

(e) actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn; and

(f) the probability of shareholders' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the sale is *highly probable*.

The Interpretations Committee observed that an entity should make an assessment of whether a disposal of a non-current asset or disposal group by means of an IPO must meet criteria (a) to (c) above, and that a probability assessment must be made for criteria (d) to (f) in order to conclude overall whether the disposal is *highly probable*.

On the basis of the analysis above, the Interpretations Committee determined that, in the light of the existing IFRS requirements, sufficient guidance exists and that neither an Interpretation nor an amendment to a Standard was necessary and consequently [decided] not to add this issue to its agenda.