STAFF PAPER

14 – 15 May 2013

IFRS Interpretations Committee Meeting

IFRS IC March 2013

Project	**IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations***		
Paper topic	**Summary of outreach request:** Classification as held for sale in conjunction with a planned IPO and change of disposal method		
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Introduction

1. At the May 2013 Interpretations Committee meeting, the IFRS Interpretations Committee ('the Interpretations Committee') will discuss two requests 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*. More specifically, the Interpretations Committee was asked to clarify:

   (a) 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. This issue is analysed in Agenda Paper 20A of May 2013; and

   (b) the application of the guidance in IFRS 5 regarding the case of a change in a disposal plan from a plan to sell a division 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.

2. The original submission is reproduced in **Appendix A** of this paper.

3. At the March 2013 meeting 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.

Purpose of this paper

4. The objective of this paper is to provide a summary of the outreach responses received on the issues described in paragraph 1 of this paper.

Outreach request

5. We asked IOSCO and national standard-setters to provide us with information on whether the issues raised in the submission:

   (a) are widespread and have practical relevance; and

   (b) indicate that there are significant divergent interpretations (either emerging or existing in practice).

6. We asked the following questions:

   - <u>Question 1 (Q1).</u> Is the sale of an asset (or disposal group), either by means of an IPO or by a distribution of a dividend-in-kind to the shareholders, common or relevant in your jurisdiction?

   - <u>Question 2 (Q2).</u> Is a change in a disposal method (ie from a plan that previously qualified as held for sale to a plan that involves a spin- off and issue of a dividend–in-kind) common or relevant in your jurisdiction?

   - <u>Question 3 (Q3).</u> If yes to Q1 and Q2, what is the prevalent approach in your jurisdiction to account for these transactions? If you see diversity in practice in that accounting, please explain how.

Responses from national standard-setters and regulators

7. We received responses from:

   (a) one regulator; and

   (b) twelve national standard-setters.

8. We summarise the results of the outreach in the following paragraphs. The views expressed below are informal opinions from national standard-setters and regulators. They do not reflect the formal views of those organisations.

Responses received from the regulator

9. The regulator provided us with a summary of the responses received from the IOSCO members who had replied to the outreach request.

10. In response to **Q1**, one IOSCO member observed that the classification of an asset (or disposal group) as held for sale would be subject to the regulator's view as to whether the review and approval process for the IPO is substantive or not.

11. In response to **Q2**, IOSCO members noted that they have not identified changes in a disposal method in their jurisdictions.

12. In response to **Q3**, one IOSCO member noted that a change from a plan to sell to a plan to spin off and distribute a dividend to shareholders would be considered a significant change to the disposal plan, because in their view the held for sale criteria in IFRS 5 would need to be reassessed.

Responses received from national standard-setters

13. The geographical breakdown for the responses received from national standard-setters is as follows:

Geographical region	**Number of respondents**
Americas	3
Asia/Oceania	3
Africa	1
Europe	5
Total respondents	**12**

14. With respect to **Q1**, on whether the sale of an asset or disposal group either by means of an IPO or by distribution of a dividend-in-kind is common or relevant in their jurisdiction, respondents noted the following**:**

   (a) two respondents noted that in their jurisdictions such transactions are very common or relevant;

   (b) two respondents noted that those transactions are relatively common, but one pointed out that it is difficult to estimate how common;

   (c) two respondents noted that in their jurisdiction the sale of an asset (or disposal group) by means of distribution is common but is not commonly performed by means of an IPO;

   (d) five respondents noted that those transactions are *not* common, but one noted that those transactions are nevertheless relevant; and

   (e) one respondent pointed out that it was unsure whether those transactions were prevalent or whether there was diversity in practice.

15. With respect to **Q2**, on whether a change in a disposal method, from a plan to sell a division to a plan to spin off a division and distribute a dividend- in-kind, is common or relevant, respondents noted the following:

   (a) nine out of twelve respondents noted that the change of plan referred in the outreach request is *not* common;

   (b) two respondents noted that this change of plan is common; and

   (c) one respondent pointed out that it was unsure whether those transactions were prevalent or whether there was diversity in practice.

16. With respect to **Q3**, one respondent thinks that a plan to sell in conjunction with an IPO would require prospectus approval and note that this approval is critical in determining whether the sale would be considered highly probable.

17. Two other respondents think that if (based on the analysis of specific facts and circumstances) the approval of the prospectus is almost certain, then this should

not be considered as an obstacle to deciding that a sale would be highly probable. These respondents think that the following facts might help an entity assess that a prospectus approval is highly probable:

(a) the likelihood of the prospectus being approved in a particular jurisdiction; and

(b) their level of involvement in the prospectus preparation and in the discussions with the regulator.

18. In addition, one respondent observed that a classification of an asset (or disposal group) as held for sale or as held for distribution requires the continuous assessment of relevant criteria in IFRS 5 and would involve the use of judgement.

19. This respondent also observes that the change in disposal method referred to would not be considered a change to a plan of sale in accordance with paragraphs 26 and 27 of IFRS 5 and that the same measurement principles would apply regardless of the classification as held for sale or as held for distribution.

20. One respondent noted that the Interpretations Committee should not express any view on any specific fact pattern, because the analysis of any fact pattern requires the use of professional judgement and is based on specific facts and circumstances. In this respect this respondent noted that:

(a) regulatory environments are different in each jurisdiction; and

(b) obtaining regulatory approval would depend on many factors that need to be assessed.

Conclusion

21. The results of our outreach request showed some inconclusive results regarding how common or relevant the sale of an asset or disposal group either by means of an IPO or by distribution of a dividend-in-kind actually is. This is because we observed that half of the respondents think that these transactions are common or relevant in their jurisdiction while the other half of the respondents think that those transactions are not common.

22. Because of this fact, we were unable to confirm whether the fact pattern described in the submission (ie the classification of a disposal group as held for sale in conjunction with a planned initial public offering, but where the prospectus has not yet been approved by the securities regulator) is widespread or whether there are significant divergent interpretations (either emerging or existing in practice). Responses received also seem to indicate that there is a jurisdictional pattern and that these transactions appear to be common in certain countries.

23. We also observed that a majority of respondents think that a change in a disposal method, from a plan to sell a division to a plan to spin off a division and distribute a dividend- in-kind, is not common or relevant in practice. Consequently, the feedback from the outreach indicates that this change of plan, as described in the submission, is not widespread and consequently there are no significant divergent interpretations (either emerging or existing in practice).

24. We noticed, however, that there is a common view among those respondents who expressed their views about the accounting for a change in a disposal method that a change in a disposal method (from a plan to sell to a plan to spin off a division and distribute a dividend-in-kind) would not represent a change to a plan of sale in accordance with the guidance in paragraph 26 in IFRS 5.

Question for the Interpretations Committee

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Does the Interpretations Committee have any questions regarding the summary of the outreach responses?

Appendix A—Submission

A1 We received the following request. All information has been copied without modification.

Agenda item request: Discontinued operations - Change in disposal method

20 February 2013

Dear Mr Upton,

The European Securities and Markets Authority (ESMA) is an independent EU Authority that contributes to enhancing the protection of investors and promoting stable and well-functioning financial markets in the European Union (EU). ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. ESMA contributes to the regulation of financial services firms with a pan-European reach, either through direct supervision or through the active co-ordination of national supervisory activity.

As a result of the review of the financial statements carried out by national competent authorities and ESMA's co-ordination activities, we have identified an issue related to the application of IFRS 5 – Non-current Assets Held for Sale and Discontinued Operations, which we would like to bring to the attention of the IFRS Interpretations Committee for further consideration.

A detailed description of the case is set out in the appendix to this letter.

We would be happy to further discuss this issue with you.

Yours sincerely,

Steven Maijoor

Chair ESMA

Julie Galbo

Chair ESMA's Corporate Reporting Standing Committee

APPENDIX – DETAILED DESCRIPTION OF THE ISSUE

1. Enforcers have identified divergent practices regarding the impact of a change in disposal method on the classification of assets held for sale in accordance with IFRS 5, as illustrated in the example below.

Description of the issue

2. Entity A has a December fiscal yearend and prepares its annual consolidated financial statements in accordance with IFRS.

3. On 30 June 20X1 Entity A's Board of Directors approved a plan to dispose of its profitable Division B by way of an initial public offering (IPO) planned to be completed by the end of the January 20X2. Entity A initiated internal IPO preparations for the sale of Division B including the preparation of regulatory and sales documents and engaging external advisors. In preparing for the IPO the business activities of Division B were separated into a distinct legal entity. Entity A did not file documents with its regulators, yet management communicated regularly its plans to the public. It believed that approval of the prospectus was highly probable. It determined internal price ranges but has not publicly announced an offering price. Various third-party analysts commented on their estimated market value of Division B. Entity A classified Division B as a discontinued operation in its interim financial statements as of 30 June 20X1 with consequential changes to the presentation of the statement of comprehensive income. Entity A classified the disposal group's net assets as held for sale and discontinued depreciating Division B's non-current assets.

4. During the second half of 20X1 market conditions declined. As of 31 December, 20X1 Entity A de-termined that the disposal of Division B by way of an IPO was no longer feasible as initially sched-uled. The IPO was still intended to be completed within 12 months of the original classification as discontinued operations. As of 31 December 20X1 Entity A re-evaluated the criteria in IFRS 5 and continued to classify Division B as a discontinued operation. It asserted that it was still committed to the disposal of Division B through an IPO during the first half of 20X2. Entity A also asserted that it believed that market conditions would improve and enable Entity A to sell Division B by way of an IPO. Entity A continued to update its documents to be filed with its securities regulator, meet weekly with its outside advisors, and monitored market conditions. It has not filed any offering documents with its securities regulator. Although Entity A was not permitted by law to contact prospective non-institutional buyers until after it receives regulatory approval, it may contact institutional buyers. It has re-evaluated internal price ranges and has still not announced an offering price publicly.

5. On June 30 20X2, one year after the original designation of Division B as held for sale, Entity A again reassesses the market and confirms its intention to dispose of Division B; however, management has now decided that an IPO was less likely. Instead, Division B

will be spun off and distributed to its shareholders by means of a dividend-in-kind. The Division B shares would then be listed separately on the stock exchange. Thus, both alternatives will be pursued.

6. Since a spin-off to shareholders is now also being considered, Entity A treats the classification of discontinued operations as a change to the plan of sale (IFRS 5, paragraph 26) and in the second half of 20X2 recognizes any depreciation, amortisation or revaluations that would have been recognised had the disposal group not been classified as held for sale. Nevertheless, the classification of the disposal group as discontinued operations (or “held for distribution to owners”) remains since the spin off (or IPO) is expected to be complete within the next 12 months (IFRS 5 paragraph 12).

Discussion

7. This issue is divided into two parts corresponding to the two year-end balance sheets dates, 31 December 20X1 and 20X2 for which annual financial statements were prepared.

Analysis as of 31 December 20X1

8. One criterion in IFRS 5 paragraph 8 requires that the disposal group be actively marketed in order for it to be classified as held for sale. Would Division B qualify as held for sale in the annual financial statements as of 31 December 20X1 before the prospectus is approved assuming all the other criteria in IFRS 5 have been fulfilled?

View 1

9. Proponents of View 1 believe that Division B would not qualify as held for sale as of 31 December 20X1 since, without an approved prospectus, the disposal group is not being actively marketed. In addition, without a predefined price it cannot be ascertained whether the sales price is reasonable compared with its current fair value.

View 2

10. Supporters of View 2 believe that an approval for a prospectus is not a mandatory condition in order to classify a disposal group that will be sold by means of an IPO as held for sale. Entity A initiated internal IPO preparations for the sale of Division B investing significant time and resources into the preparation of regulatory and sales documents and engaging external advisors. It has not filed documents with its regulators but it assesses the prospectus’ approval to be highly probable. Management has regularly communicated its plans to the public. It is permitted by law to contact prospective institutional buyers before it receives regulatory approval, which the entity also did. Entity A continues to update its documents to be filed with its regulator, meet weekly with its outside advisors, and monitor market conditions.

11. Likewise, as with a direct sale of an asset, the final price is usually the result of a negotiation process (or in connection with an IPO, the book-building process) and not necessarily presented by the seller to the buyer at the beginning of the negotiations. Thus, having a final price included in a prospectus is not mandatory in order to classify a disposal group which is to be sold via IPO to qualify as held for sale. Entity A has determined and continues to evaluate internal price ranges and various third-party analysts have commented on their estimated market value of Division B.

Analysis as of 31 December 20X2

12. Due to unfavourable market conditions (finance crisis etc.), the IPO was less likely. If the IPO is not feasible, management has decided to spin off Division B and issue a dividend-in-kind to the shareholders. The Division B shares would then be listed on the stock exchange. Does the change in disposal method to a plan that previously qualified as held for sale under IFRS 5 constitute a change in plan as outlined in IFRS 5 paragraph 26?

View 1

13. IFRS 5 paragraphs 7 to 9 of address the sale of a disposal group while paragraph 12A relates to the disposal through a dividend in kind. Paragraphs 7 to 9 are similar but not identical to paragraph 12A and thus, differentiating between the types of disposal is critical. Both types of transactions are inherently different since a dividend-in-kind does not generate a cash flow for Entity A whereas an IPO does. In addition, the management board can approve an IPO whereas a spin-off must be approved by the shareholders. Proponents of View 1 believe that a classification as discontinued operations can either be based on a sales scenario or on a dividend-in-kind scenario, but alternating between the two qualifies as a significant change in plan (IFRS 5 paragraph 8) and thus, the guidance in IFRS 5 paragraph 26 must be followed.

View 2

14. IFRS 5 does not define the required level of detail necessary in a disposal plan. Additionally, it does not define whether the plan relates specifically to the method used to dispose of the group or, for example, to the composition of the disposal group. In both the sale and the dividend-in-kind scenarios management's intention to dispose of the disposal group remains unchanged. Only the method of disposal has changed. IFRS 5 paragraph 5A also clarifies that the classification, presentation and measurement requirement in IFRS 5 applicable to a disposal group that is classified as held for sale also apply to a disposal group that is classified as held for distribution to owners. Regardless to whether the disposal group is sold through an IPO or spun off to shareholders, the disposal group will be removed from Entity A. The entity will not principally recover the book value of the disposal group through continuing use (IFRS 5 paragraph 6).

15. Treating the alternative disposal method as a change of plan effectively leads to a reversal of the initial held for sale classification of Division B followed by an immediate re-classification of the same disposal group again as held for sale.

16. Had management defined both alternatives at the onset of the disposal deliberations, no change in the disposal plan would have occurred. As stated in IFRS 5 paragraph 5A, the requirements in IFRS 5 apply to both a sale and a distribution to owners. Thus, expanding the disposal plan to include a dividend-in-kind would not represent a significant change in plan, assuming the criteria in IFRS 5 are otherwise fulfilled.

17. If a disposal does not occur within 12 months of the original designation as held for sale, the entity is required to take actions necessary to respond to the circumstances that were previously considered unlikely and that led to the postponement of the original 12-month disposal target (IFRS 5, Appendix B (c)). Adding the possibility of a spin-off of the division as an alternative mean of disposal of Division B qualifies as an action taken in response to those circumstances. Thus, by adding a different disposal method, the entity is complying with IFRS 5 Appendix B(c) and the designation as held-for-sale should not have been suspended.

Request

18. Is the approval of prospectus necessary to qualify Division B as held for sale in the annual financial statements as at 31 December 20X1 in light of the various legal restrictions?

19. Assuming all the criteria of IFRS 5 has previously been fulfilled (independent from the response to the first question), should a change in the disposal method from an IPO to a dividend-in-kind qualify as a change in disposal plan as discussed in IFRS 5 paragraph 26.