IFRS™

STAFF PAPER

November 2014

IFRS Interpretations Committee Meeting

Project	**IFRS 5** ***Non-current Assets Held for Sale and Discontinued Operations***
Paper topic	Issues relating to the requirements for scope and presentation in IFRS 5

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Introduction

1. At its meeting in September 2014, the IFRS Interpretations Committee ('the Interpretations Committee') considered the next steps to address a number of issues relating to IFRS 5 *Non–current Assets Held for Sale and Discontinued Operations*, which include two issues that were discussed over several meetings, two other issues that the IASB discussed but were put on hold and three new issues that have yet to be brought to the Interpretations Committee[1]. At that meeting, the Interpretations Committee decided to discuss the new issues before deciding how to proceed.

2. The new issues are included in a submission in which the submitter raised several topics, classifying them as six categories as follows:

   (a) (Topic 1) Scope;

   (b) (Topic 2) Classification as 'held for sale';

[1] Refer to the section of Items on the current agenda of IFRIC *Update* for September 2014 (IFRIC-Update-September-2014.pdf) and Agenda Papers 3 to 3E for the September Interpretations Committee meeting (Agenda paper 3, Agenda Paper 3A, Agenda Paper 3B, Agenda Paper 3C, Agenda Paper 3D, Agenda Paper 3E).

(c) (Topic 3) Changes to a plan of sale;

(d) (Topic 4) Definition of a major line of business;

(e) (Topic 5) Unit of account; and

(f) (Topic 6) Impairment.

3. The submitter noted that the IASB and the Interpretations Committee, at their meetings, had already discussed some of the topics raised in the submission. The submitter noted that it had included those topics in order to provide a comprehensive overview of the issues identified in practice on the application and/or enforcement of IFRS 5.

4. Among these topics, Topics 1 and 4 are new ones that the Interpretations Committee has not discussed at its meetings. Accordingly, this paper will only consider Topics 1 and 4, and denote these topics in this paper as follows:

(a) (Issue 1) Scope; and

(b) (Issue 2) Definition of a major line of business.

Summary of the issues

Issue 1: Scope

5. The submitter included the following two issues in the category of Issue 1:

(a) (Issue 1A[2]) Do certain cases of 'loss of control of a subsidiary' meet the criteria for classifying the subsidiary as held for sale in IFRS 5[3]?

(b) (Issue 1B[2]) Is IFRS 5 applicable to a disposal group consisting mainly or entirely of financial instruments?

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[2] In this paper, we de note the issues as Issues 1A and 1B.

[3] Paragraph 6 of IFRS 5 states that: "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." (emphasis added)

(Issue 1A) Do some cases of 'loss of control of a subsidiary' meet the criteria for classifying the subsidiary as held for sale in IFRS 5?

6. The submitter identified three cases that result in a loss of control of a subsidiary and asked whether the 'loss of control of a subsidiary' in those cases meets the criteria set out in IFRS 5 for classifying a disposal group as held for sale. The three cases are as follows.

Case 1.1[4]*—Dilution*

7. Entity A controls Entity B having a 67 per cent interest in Entity B[5]. Before the year-end, Entity B issues new shares that are fully subscribed by a new investor (Entity C). Following the increase in share capital, Entity A retains an interest of 44 per cent in Entity B (representing 44 per cent of voting rights)[6]. At the same time, Entities A and C sign an agreement providing new governance rules over Entity B, on the basis of which Entity A is no longer represented on Entity B's Board or in its management. Accordingly, Entity C controls Entity B[7].

8. Entity A argues that its decision not to subscribe to the issuance of new shares is equivalent to a decision to partly dispose of its interest in Entity B and therefore meets the criteria for the classification of held for sale in IFRS 5[8].

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[4] In this paper, we denote Case 1.1, 1.2 and 1.3 instead of Case 1, 2 and 3 as described in the submission in order to distinguish Cases in Issue 2.

[5] The submitter clarified after the submission that Entity A controls Entity B although the formal submission does not specify this fact.

[6] The submitter clarified after the submission that Entity has 44 per cent of voting rights changing the statement in the formal submission that Entity has 30 per cent of voting rights.

[7] The submitter clarified after the submission that Entity C controls Entity B by acquiring the new shares issued by Entity B.

[8] The submitter clarified, after the submission, the meaning of paragraph 8 of the submission as attached in Appendix B of this paper. The submitter said that paragraph 8 of the submission is the argument of the entity in the case justifying why IFRS 5 should be applied to the case of dilution.

Case 1.2—Call option held by a non-controlling shareholder

9. At 31 December 20X1, Entity A controls Subsidiary S by owning 75 per cent of its shares. Entity B owns the remaining 25 per cent of the shares and has a call option on the shares owned by Entity A. The call option is deep in the money and is exercisable starting from 30 September 20X2. On that basis, Entity B expects to take control over Subsidiary S on 30 September 20X2 and Entity A expects to lose control, cease consolidation of Subsidiary S and account for its investment using the equity method[9].

Case 1.3–Modification of the shareholders' agreement

10. Entity A controls Subsidiary S on the basis of an agreement with the other three shareholders. The agreement gives Entity A the right to have nine out of the twelve members of the Board of Directors. In November 20X1, Entity A and the other shareholders decide not to renew the agreement ending in July 20X2. On that basis, Entity A will lose control in July 20X2.

Three views identified by the submitter

11. The submitter notes that there could be three views on this issue as follows:

    (a) (View 1) the subsidiaries (ie the disposal group) in the three cases should **not** be classified as held for sale;

    (b) (View 2) the subsidiaries (ie the disposal group) in the three cases should be classified as held for sale; and

    (c) (View 3) the classification of the subsidiaries (ie the disposal group) may differ depending on each case.

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[9] The submitter clarified after the submission that the call option is exercisable from 30 September 20X2 until 30 September 20X5 for three years and therefore even if Entity B does not exercise the call option on 30 September 20X2, Entity A loses its control because the call option would be considered as potential voting rights in accordance with IFRS 10 *Consolidated Financial Statements*.

12. According to the submitter, View 1 is that in defining the criteria to classify non-current assets (or a disposal group) as held for sale, paragraphs 6–8 of IFRS 5 refer only to "sale" transactions. Hence, the 'loss of control' achieved without involving a sale is not within the scope of IFRS 5, which should not be applied to such assets.

13. View 2 is that paragraph 5A of IFRS 5 should be applied by analogy to situations of 'loss of control' in the three cases. Paragraph 5A of IFRS 5 reads as follows:

> 5A The classification, presentation and measurement requirements in this IFRS applicable to a non-current asset (or disposal group) that is classified as held for sale apply also to a non-current asset (or disposal group) that is classified as *held for distribution to owners* acting in their capacity as owners (held for distribution to owners). (emphasis added)

14. With regard to View 3, the submitter stated as follows:

    (a) Some argue that IFRS 5 applies to Case 1 because:

        (i) the case of dilution is not addressed by any other IFRSs (neither IFRS 3 *Business Combinations* nor IAS 27 *Consolidated Financial Statements*); and

        (ii) the decision to issue new shares, which took place under the control of entity A, together with entity A's decision to not subscribe to the issuance of new shares is a change in the investment strategy of the issuer, which implies that the entity agrees with the dilution and the loss of control. This is economically similar to a decision to sell shares while retaining a continuing interest in the entity.

    (b) However, in Case 2, the decision to exercise the call option is not taken by the entity. It could, therefore, be argued that the criterion "the appropriate level of management is committed to a plan to sell the

asset (or disposal group)" in paragraph 8 of IFRS 5 is not met and that management is not directly involved in a plan to sell.

(c) In Case 3, some believe that IFRS 5 leaves room for interpretation. This is because it might be argued that the view that IFRS 5 applies only when an actual sale occurs is not consistent with the principles in IFRS 3 and IFRS 27, which consider that loss of control is a significant event which results in derecognition of all assets and liabilities, even in the absence of a transaction.

(Issue 1B) Is IFRS 5 applicable to a disposal group consisting mainly or entirely of financial instruments?

15. The submitter notes a potential conflict between paragraphs 4 and 5 of IFRS 5:

(a) paragraph 4 of IFRS 5 state that the disposal group may include any assets and liabilities and requires the disposal group to be measured in accordance with IFRS 5; but

(b) on the other hand, paragraph 5 of IFRS 5 states that financial assets are excluded from its scope for measurement purposes.

16. The submitter thinks that it is unclear whether IFRS 5 applies to disposal groups that consist mainly, or fully, of financial assets. The submitter thinks this issue is particularly relevant if it is expected that the disposal groups will be sold at loss (ie their fair value is lower than the carrying amount). The submitter states that in such situations, applying the requirement in paragraph 5 of IFRS 5 would imply that the loss is recognised only when the sale effectively occurs; this conflicts with the measurement principles set out in IFRS 5 for disposal groups that require measurement at fair value less costs to sell (FVLCTS) at the date of classification as a 'disposal group'.

Issue 2: Definition of a 'major line of business'

17. The submitter notes that paragraph 32 of IFRS 5 refers to the notion of 'a separate line of business or geographical area of operations' when providing

the criteria for meeting the definition of a 'discontinued operation'. However, it notes that IFRS 5 does not define what should be considered as a 'separate major line of business'. Consequently, the interpretation of 'separate major line of business' varies depending on cases. The submitter provided three cases.

Case 2.1[10]*–disposal groups in the same operating segment*

18. An entity disposed of three subsidiaries from the same operating segment. The entity treated these subsidiaries as being a 'major line of business' according to paragraph 32 of IFRS 5 and classified them as 'discontinued operations' in accordance with IFRS 5. It therefore disclosed a single line item for the losses made by the subsidiaries over the period.

Case 2.2–disposal groups in different operating segments

19. An entity disposed of several subsidiaries, which included:
    (a) a subsidiary in Country A;
    (b) a subsidiary in Country B; and
    (c) several subsidiaries in Country C.

20. In accordance with IFRS *8 Operating Segments*, the entity classifies the subsidiaries in Countries A and C separately as operating segments, while the subsidiary in Country B is included in another operating segment.

21. The entity considered that only the subsidiaries in Countries A and C qualify as 'major lines of business' according to paragraph 32 of IFRS 5 and disclosed separately the result from these subsidiaries.

[10] In this paper, we denote Case 2.1, 2.2 and 2.3 instead of Case 1, 2 and 3 as described in the submission in order to distinguish Cases in Issue 1A.

Case 2.3–consideration of the size of unit

22. An entity disposed of one subsidiary that had been previously disclosed as a separate operating segment. In considering the requirements of paragraph 32 of IFRS 5, the entity assessed the impact of the disposal on its results. It also took into account that the group continues to operate other businesses in that geographical region and the same type of business in other geographical regions.

23. The entity also took into account paragraph BC69 of IFRS 5, which makes reference to the fact that in reaching its conclusions on this issue, the IASB concluded that the application of the definition of a discontinued operation in SFAS 144 would give rise to the classification of units that were too small, thus indicating that only operations which were of a significant magnitude were intended to constitute a 'major' operation. Consequently, the entity did not disclose the subsidiary as a 'major' line of business or geographical area of operations for the purposes of IFRS 5.

Staff analysis

Issue 1A: Do some cases of 'loss of control of a subsidiary' in the submission meet the criteria for classifying the subsidiary as held for sale in IFRS 5?

Overview

24. Issue 1A is about whether some cases of 'loss of control of a subsidiary' meet the criteria for classifying the subsidiary as held for sale set out in IFRS 5. The submission provided the following three cases:

    (a) Case 1.1—Dilution;

    (b) Case 1.2—Call option given to a non–controlling shareholder; and

    (c) Case 1.3—Modification of the shareholders' agreement.

25. The full description of these cases is included in the *Summary of the issues* section of this paper and will also be presented below when analysing each case.

26. First, we note that the basic objective of IFRS 5 in terms of the classification of assets could be described as requiring that an entity should treat assets that are to be disposed of differently from other assets, focusing on whether the carrying amount of those assets will be recovered through disposal rather than through continuing use. IFRS 5 then sets out a number of criteria that are designed to establish that a recovery of the carrying amount of those assets through disposal is highly probable.

27. Second, we note the phrase 'by sale or otherwise' that is used in the definition of 'disposal group' in IFRS 5[11]. We also note that IFRS 5 provides two cases

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[11] The definition of disposal group in IFRS 5 is as follows:

> a group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. The group includes goodwill acquired in a business combination if the group is a cash-generating unit to which goodwill has been allocated in accordance with the requirements of paragraphs 80–87 of IAS 36 Impairment of Assets (as revised in 2004) or if it is an operation within such a cash–generating unit.

of a disposal 'by otherwise' rather than 'by sale', which are 'distribution to owners' as noted in paragraph 5A of IFRS 5 and 'loss of control of a subsidiary' as noted in paragraph 8A of IFRS 5. Paragraph 8A of IFRS 5 is as follows.[12]

> 8A An entity that is committed to a sale plan involving loss of control of a subsidiary shall classify all the assets and liabilities of that subsidiary as held for sale when the criteria set out in paragraphs 6–8 are met, regardless of whether the entity will retain a non-controlling interest in its former subsidiary after the sale.

28. We think that we can distinguish between 'a sale plan' and 'loss of control of a subsidiary' as used in paragraph 8A of IFRS 5. We think that there could be a 'loss of control of a subsidiary' either with a sale plan or without a sale plan. Accordingly, we think that paragraph 8A would only apply to cases in which a 'loss of control of a subsidiary' takes place with a sale plan.

29. In addition, paragraph 8A requires 'a sale plan involving loss of control of a subsidiary' to meet the criteria set out in paragraphs 6 to 8, which are as follows.

> **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*.
>
> 8 For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active programme to locate a

[12] Paragraph 8A of IFRS 5 was added through *Improvements to IFRSs* published in 2008.

> buyer and complete the plan must have been initiated. Further, the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, 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, and 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. 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.

30. Our observations therefore can be summarised thus:

    (a) a loss of control of a subsidiary without a sale plan does not qualify for the requirements for 'held for sale' in IFRS 5; and

    (b) a loss of control of a subsidiary with a sale plan qualifies for the requirements for held for sale in IFRS 5 if a sale plan meets the criteria described in paragraphs 6–8 of IFRS 5.

31. On the basis of our observations, we will examine each case in the submission below.

Case 1.1—Dilution

32. The submission describes Case 1.1 as follows[13]:

> Entity A controls Entity B by having a 67 per cent interest in Entity B. Before the year-end, Entity B issues new shares which are fully subscribed by a new investor (Entity C). Following the increase in share capital, Entity A retains an interest of 44 per cent in Entity B (representing 44 per cent of voting rights). At the

[13] Some parts of the submission in this paragraph have been modified from the original submission. The modifications and the reason for the modifications can be referred to the description for Case 1.1 in the section *Summary of the issues* in this paper.

same time, Entities A and C sign an agreement providing new governance rules over Entity B, based on which Entity A is no longer represented in the Entity B's Board and its management. Accordingly, Entity C controls Entity B.

Entity A argues that its decision not to subscribe to the issuance of new shares is equivalent to a decision to partly dispose of its interest in Entity B and therefore meets the criteria for the classification of held for sale in IFRS 5.

Examination 1: When does Entity A assess the classification of held for sale?

33. First, we think that it is necessary to clarify at what point of time Entity A assesses the classification of held for sale. Entity A would make assessment for the classification of held for sale when it is committed to a sale plan involving loss of control of Entity B and before the event of an actual disposal (ie losing its control of Entity B) occurs. In this regard, we note that Entity A loses control of Entity B when Entity C fully subscribes to the new shares according to the submission. However, the submission does not clarify when Entity A is committed to a sale plan[14].

34. In this regard, we note that when Entity B offers new shares, Entity A, the controlling entity of Entity B, would generally have a pre-emption right to subscribe to those shares. We also note that unless Entity A foregoes that right, the new shares would not be marketed to other entities. We therefore think that Entity A would assess the classification of held for sale after it decides not to subscribe to the new shares that will be issued by Entity B.

Examination 2: Does Entity A have a sale plan that meets the criteria for held for sale?

[14] For the purpose of this examination (ie Examination 1), we assume that Entity A has a sale plan involving loss of control of Entity B. Examination 2 will deal with the issue with regard to a 'sale plan'.

35. On the basis of Examination 1 above, our next examination addresses whether Entity A has a sale plan and if so, whether the sale plan meets the criteria for held for sale in paragraph 6–8 of IFRS 5.

36. We first note that losing control of a subsidiary through a 'dilution' is equivalent to a 'sale' because the entity would recognise its investment retained in the former subsidiary while derecognising the assets and liabilities of the (former) subsidiary.

37. Then, to examine whether there is a 'sale plan' that meets the criteria for held for sale, we note the argument of Entity A in the submission. The argument is that: 'its decision not to subscribe to the issuance of new shares issued by Entity B is equivalent to a sale plan involving loss of control of Entity B, and that this sale plan meets the criteria for the classification of held for sale as set out in paragraphs 6–8 of IFRS 5'.

38. Paragraph 8 of IFRS 5 requires an entity to be 'committed to a sale plan' and there should be an 'active programme to locate a buyer'. We think that the fact that Entity A decided not to subscribe to the issuance of new shares does not provide sufficient information as to whether or not it is 'committed to a sale plan' and there is an 'active programme to locate a buyer'. This is because such a decision may be an internal decision and may not have been put into a concrete plan yet. However, we think that the act of offering shares for sale could qualify as an 'active programme to locate a buyer' depending on the steps or actions taken to find a buyer for the shares.

39. Consequently, we think that the classification of held for sale would depend on additional facts.

Case 1.2—Call option given to a non–controlling shareholder

40. The submission describes Case 1.2 as follows:

> At 31 December 20X1, Entity A controls Subsidiary S by owning 75 per cent of its shares. Entity B owns the remaining 25 percent of the shares and has a call option on the shares owned by Entity A. The call option is deep in the money and is exercisable

> starting from 30 September 20X2 until 30 September 20X5[15]. On that basis, Entity B expects to take control over Subsidiary S on 30 September 20X2 and Entity A expects to lose control, cease consolidation of Subsidiary S and account for its investment using the equity method.

41. We think that entering into the call option in this case would be a 'sale' plan because Entity A would dispose of assets and liabilities (of Subsidiary S) and there is a specific buyer (ie Entity B). We also think that the existence of the call option would indicate that Entity A meets one criterion in paragraph 8 of IFRS 5 that "the appropriate level of management is committed to a plan to sell the asset (or disposal group)" because entering into the call option means that Entity A enters into a 'binding' agreement with a specific buyer (ie Entity B).

42. However, we note that whether or not Entity A will sell Subsidiary S depends on Entity B's decision to exercise the call option. Also Entity B's decision to exercise the call option would depend on price levels (ie the market price of the assets and liabilities of Subsidiary S) during the exercisable period. In other words, the sale would be beyond Entity A's control. Accordingly, we think that the sale may not be 'completed within one year from the date of classification', as described in paragraph 8 of IFRS 5.

43. In this regard, we note that paragraph 9 of IFRS 5 provides an exception to the criterion of 'completion of sale within one year' and paragraph B1 further explains the case in paragraph 9 of IFRS 5. These two paragraphs are as follows:

> 9 Events or circumstances may extend the period to complete the sale beyond one year. An extension of the period required to complete a sale does not preclude an

[15] The submitter clarified after the submission that the call option is exercisable from 30 September 20X2 until 30 September 20X5 for three years and therefore even if Entity B does not exercise the call option on 30 September 20X2, Entity A would lose its control if the call option is considered as potential voting rights in accordance with IFRS 10 *Consolidated Financial Statements*.

asset (or disposal group) from being classified as held for sale if the delay is caused by events or circumstances beyond the entity's control and there is sufficient evidence that the entity remains committed to its plan to sell the asset (or disposal group). This will be the case when the criteria in Appendix B are met.

B1 As noted in paragraph 9, an extension of the period required to complete a sale does not preclude an asset (or disposal group) from being classified as held for sale if the delay is caused by events or circumstances beyond the entity's control and there is sufficient evidence that the entity remains committed to its plan to sell the asset (or disposal group). An exception to the one-year requirement in paragraph 8 shall therefore apply in the following situations in which such events or circumstances arise:

(a) at the date an entity commits itself to a plan to sell a non-current asset (or disposal group) it reasonably expects that others (not a buyer) will impose conditions on the transfer of the asset (or disposal group) that will extend the period required to complete the sale, and:

(i) actions necessary to respond to those conditions cannot be initiated until after a *firm purchase commitment* is obtained, and

(ii) a firm purchase commitment is highly probable within one year.

(b) an entity obtains a firm purchase commitment and, as a result, a buyer or others unexpectedly impose conditions on the transfer of a non-current asset (or disposal group) previously classified as held for sale that will extend the period required to complete the sale, and:

(i) timely actions necessary to respond to the conditions have been taken, and

(ii) a favourable resolution of the delaying factors is expected.

(c) during the initial one-year period, circumstances arise that were previously considered unlikely and, as a result, a non-current asset (or disposal group) previously classified as held for sale is not sold by the end of that period, and:

(i) during the initial one-year period the entity took action necessary to respond to the change in circumstances,

(ii) the non-current asset (or disposal group) is being actively marketed at a price that is reasonable, given the change in circumstances, and

(iii) the criteria in paragraphs 7 and 8 are met.

44. We think that a call option does not meet the 'events and circumstances that may extend the period to complete the sale beyond one year' as noted by Paragraphs 9 and B1 of IFRS 5. This is because paragraph B1 describes the 'events and circumstances' as those in which 'others (not a buyer) will impose conditions on the transfer of the asset (or disposal group) that will extend the period required to complete the sale'. Accordingly, we think that the call option in this case would not meet the criterion of 'completion of sale within one year' in paragraph 8 of IFRS 5.

45. Furthermore, even if the call option is considered to be the 'events and circumstances' as in paragraphs 9 and B1 of IFRS 5, we think that our analysis would not change. The reason is as follows:

(a) paragraphs 9 and B1 imply that entering into a *firm purchase commitment* within one year is a necessary condition for a sale plan being qualified for the classification as held for sale where 'events and circumstances beyond the entity's control' may extend the period to complete the sale beyond one year;

(b) the submission does not provide information that Entities A and B will enter into a firm purchase commitment within one year; and

(c) therefore, the existence of the call option contract would not be a sufficient condition for the classification of held for sale.

46. Consequently, we think that Entity A would not be able to classify Entity B (ie the disposal group) as held for sale only on the basis of the existence of a call option that is deep in the money.

47. Meanwhile, apart from the classification of held for sale, if the fair values of the assets and liabilities of Subsidiary S are less than their carrying amounts, the difference between the exercise price of the call option and the fair value would be accounted for in accordance with IAS *37 Provisions, Contingent Liabilities and Contingent Assets*. In other words, Entity A would recognise an impairment loss for that amount before establishing a separate provision for an onerous contract in accordance with paragraph 69 of IAS 37[16].

Case 1.3—Modification of the shareholders' agreement

48. The submission describes Case 1.3 as follows:

> Entity A controls Subsidiary S on the basis of an agreement with the other three shareholders. The agreement gives Entity A the right to have nine out of the twelve members of the Board of Directors. In November 20X1, Entity A and the other shareholders decided not to renew the agreement ending in July 20X2. On that basis, Entity A will lose control in July 20X2.

49. We think that this case is a case of 'loss of control without a sale plan' as noted above in the section *Overview* in Staff analysis, because 'a decision not to renew the agreement to have the members of the Board of Directors in

[16] Paragraph 69 of IAS 37 states that: Before a separate provision for an onerous contract is established, an entity recognises any impairment loss that has occurred on assets dedicated to that contract (see IAS 36).

Subsidiary S' would not lead to a 'sale' (ie a disposal of interests in Subsidiary S).

50. Consequently, we think that Case 1.3 would not meet the condition in paragraph 8A of IFRS 5, which requires an entity to be committed to a sale plan involving loss of control of a subsidiary, and therefore Entity A would not classify Subsidiary S (ie the disposal group) as held for sale.

Summary of analysis of Issue 1A

51. As for Case 1.1, 'the decision not to subscribe to the new shares issued by Entity B' does not provide sufficient information as to whether it would constitute a sale plan that meets the criteria set out in paragraphs 6–8 of IFRS 5. Additional facts would be required to determine whether Entity A should classify Entity B as held for sale including obtaining an understanding of what steps are taken to find a buyer for shares that have been offered for sale.

52. As for Case 1.2, the call option would not meet all of the criteria set out in paragraphs 6–8 of IFRS 5 and therefore Entity A would not be able to classify Entity B as held for sale.

53. As for Case 1.3, an entity would not classify the subsidiary as held for sale because it is a case of 'loss of control without a sale plan', which conflicts with the requirement in paragraph 8A of IFRS 5.

Issue 1B: Is IFRS 5 applicable to a disposal group consisting mainly or entirely of financial instruments?

54. Issue 1B is about whether IFRS 5 applies to a disposal group mainly, or entirely, consisting of financial instruments.

55. We think that it is necessary to look at this issue separately, first from the point of view of the classification requirements and then from the point of view of the measurement requirements.

Classification requirements

56. Paragraph 4 of IFRS 5 states that "(…) 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. (…)". This means that any types of assets and liabilities could be included in a disposal group, regardless of whether they are excluded from the measurement requirements of IFRS 5. After that, the disposal group would be classified as held for sale if it meets the criteria set out in paragraphs 6–14 of IFRS 5.

57. Consequently, a disposal group mainly, or entirely, consisting of financial instruments would be classified as held for sale if it meets the criteria set out in paragraphs 6–14 of IFRS 5, although as stated in paragraph 5 of IFRS 5, financial assets are excluded from the measurement requirements of IFRS 5.

Measurement requirements

58. With regard to the measurement requirements, we note the submitter's statement that this issue is particularly relevant if it is expected that the disposal group mainly consisting of financial instruments will be sold at loss (ie the fair value is lower than the carrying amount). The submitter stated that "in such situations, applying the requirement in paragraph 5 of IFRS 5 would imply that the loss is recognised only when the sale effectively occurs. This conflicts with the measurement principles set out in IFRS 5 for disposal groups that require measurement at fair value less cost to sell (FVLCTS) at the date of classification as a 'disposal group'".

59. To clarify the submitter's concern, suppose that an entity has a disposal group that consists entirely of financial instruments; the financial instruments in the disposal group are measured at amortised cost in accordance with IFRS 9 *Financial Instruments*; and the fair values of those instruments amount to less than the amortised cost. In this situation, paragraph 20–25 of IFRS 5 suggest that the entity would recognise an impairment loss of the disposal group. However, the question arises as to whether the disposal group should be

measured at FVLCTS, because in the submitter's view, paragraph 23 could be read to imply that the impairment loss should only reduce the carrying amount of the non–current assets in the group that are within the scope of the measurement requirements of IFRS 5.

60. We think that this measurement issue is another case of the issue of how to recognise an impairment loss when the impairment loss exceeds the carrying amount of non–current assets in the disposal group. This was one of the two issues that the Interpretations Committee discussed at its meetings in September 2013 and 2014. As mentioned in the Introduction of this paper, the Interpretations Committee, at its meeting in September 2014, decided to discuss new issues (ie the issues raised in this paper) before deciding how to proceed with old issues, which include the issues that it discussed in September 2013.

61. Consequently, we think that this (measurement) issue would need to be addressed within the context of the issue that the Interpretations Committee discussed at its meetings in September 2013 and 2014.

Issue 2: Definition of a major line of business

62. Issue 2 is about how to interpret the definition of 'discontinued operation', especially with regard to the notion of 'separate major line of business or geographical area of operations' as described in paragraph 32 of IFRS 5. The submitter, illustrating three cases (ie Cases 2.1 to 2.3 in the *Summary of the issues* section of this paper), showed that the notion of 'separate major line of business or geographical area of operations' can be interpreted differently depending on how an entity associates that notion with the definition of 'operating segment' as defined in IFRS 8.

63. We note that Issue 2 relates to a topic that is currently on hold under the IASB's project on financial statement presentation, which was reported in the staff paper (ie as Topic A in Agenda Paper 3B) presented to the September 2014 Interpretations Committee meeting. We stated in that staff paper that the IASB had issued an Exposure Draft in 2008 (IFRS 5 ED in 2008) to change

the definition of discontinued operations so that it was consistent with the definition of operating segment used in IFRS 8, but did not proceed further.

64. In this regard, we note the Basis for Conclusions of IFRS 5 ED in 2008, that explains the reasons for having proposed those changes as follows.

> BC7 The boards propose to use an operating segment, as that term is defined in IFRS 8 *Operating Segments* and FASB Statement No. 131 *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131), as the criterion to determine whether a component of an entity that has been disposed of or is classified as held for sale should be presented in discontinued operations. The boards made this decision for the following reasons.
>
> (a) Some users of financial statements have indicated that a disposal activity should be presented as a discontinued operation only when an entity has made a strategic shift in its operations. Because the determination of operating segments is based on how the chief operating decision maker makes decisions about allocating resources and assessing performance, disposal of an operating segment would most likely indicate a strategic shift in an entity's operations.
>
> (b) A definition that refers to a 'major line of business' and 'geographical area' could be subjective.
>
> (c) Entities within the scope of IFRS 8 and SFAS 131 already need to identify their operating segments. Therefore, using operating segments as the criterion would simplify the determination of what should be presented in discontinued operations. Moreover, IFRS 8 and SFAS 131 have a common definition of operating segments.

65. We think that paragraph BC7 of IFRS 5 ED in 2008 gives an indication as to how the notion of 'separate major line of business or geographical area of operations' should be understood in IFRS 5. Because the proposed

amendments in IFRS 5 ED in 2008 have not been finalised, we think that the definition of discontinued operation in IFRS 5 is not necessarily linked to the definition of operating segment as defined in IFRS 8. We also think that an entity would exercise judgement in determining whether a discontinued operation represents a 'separate major line of business or geographical area of operation'.

66. Consequently, we think that it would be difficult to determine the appropriateness of the presentation of a discontinued operation in Cases 2.1–2.3 solely on the basis of the descriptions in the submission. This is because those descriptions only deal with the circumstances in terms of operating segments. We also think that the Interpretations Committee needs to take into account this issue when deciding how to proceed with other (old) IFRS 5 issues, as discussed in its September 2014 meeting.

Summary of outreach conducted

67. We have performed an outreach with the IFASS (International Forum of Accounting Standard Setters) members, securities regulators and global accounting firms. Specifically, we asked:

    (a) **(Question 1)** Are these issues common or prevalent in your jurisdiction? If yes, please provide us with qualitative or quantitative information about how common it is?

    (b) **(Question 2)** When faced with these issues, what is the prevalent practice applied in your jurisdiction in what circumstance and why?

    (c) **(Question 3)** Did you observe diversity in practice? If so, please explain how and why the accounting is diversified

68. We received nineteen responses from eleven IFASS members, seven global accounting firms and one securities regulator.

69. By region, responses were received from seven global accounting firms and from twelve jurisdictions (seven juridictions from Asia and Oceania, three from Europe, one from Africa and one from North America). The views

received represent informal opinions and do not reflect the formal views of those organisations.

Responses with regard to Question 1

70. With regard to Issues 1A and 1B, a majority said that the issue is not common . However, among the global accounting firms, the views were split on whether the issue is common: three global accounting frims said that it is common, while four accounting firms were not explicit or said that although they encountered the circumstances as noted by the submission, those circumstances did not frequently lead to an issue[17].

71. Meanwhile, a few respondents pointed out that IFRS 5 does not povide clear guidance on these issues.

72. With regard to Issue 2, almost all respondents said that the issue is not common although some acknowledged that they encountered similar circumstances as noted by the submission. However, one respondent said that Issue 2 is the most common issue in its jurisdiction when applying IFRS 5.

Responses with regard to Question 2

73. With regard to Issue 1A, a few respondents said all the three cases (ie Case 1.1, 1.2 and 1.3 in this paper) would lead to the classification of held for sale in accordance with IFRS 5. Some other respondents said that IFRS 5 does not provide explicit guidance on this issue and therefore judgement is required. Specifically, there were mixed views on the appropriate accounting depending on Cases 1.1–1.3: for example, one respondent mentioned that a preparer in its jurisdiction said that only Cases 1.1 and 1.3 would lead to the classification of

[17] In addition, one accounting firm provided another case in addition to the three cases that have been identified by the submission. The additional case it provided is: "two companies decide to create a common entity with a 50/50 interest. Each shareholder contributes some subsidiaries or other controlled assets to the new entity. Those contributions are measured at fair value. Due to the fact that both shareholders will have a joint control over that new entity, each shareholder will lose control over the contributed assets."

held for sale; another respondent said that only Case 1.1 and 1.2 would lead to the classification of held for sale; another respondent said that only Case 1.1 would lead to the classification of held for sale.

74. With regard to Issue 1B, some respondents said that it is a 'measurement' issue rather than a 'scope' issue. Among these respondents, some said that no impairment loss would be recognised on financial assets in the disposal group in accordance with IFRS 5, and some others said that IFRS 5 is not clear on how to deal with this measurement issue.

75. With regard to Issue 2, some respondents noted that judgement is required and therefore there would be different interpretations. One respondent said that it had applied the test of whether there are any remaining operations when determining whether something qualifies as a seaprate major line of business.

Responses with regard to Question 3

76. With regard to Issue 1A, a few respondents explicitly commented that there is no diversity. Only one respondent stated that diversity is an issue, while some respondents said that different accounting would reflect different economic substance of transactions.

77. With regard to Issue 1B, some said that there is diversity in how to allocate impairment loss, referring to potential conflict requirements in IFRS 5.

78. With regard to Issue 2, some said that diversity is an issue, while some others said that diversity is due to the fact that judgement is required.

Other comment

79. One respondent requested that the IASB should address another issue which relates to the presentation of a discontinued operation in accordance with IFRS 5. The issue is how to deal with significant transactions between the continuing operations and the discontinued operations in presenting a discontinued operation. Specifically speaking, the issue is about whether there should be no elimination of transactions between the continuing operations and

the discontineud operations (ie an ‘as if’ presentation) or there should be the same elimination as under IFRS 10. The respondent said that it encountered diversity with respect to this issue.

Agenda criteria assessment

Agenda criteria	
We should address issues (see paragraph 5.16 of the *IFRS Foundation Due Process Handbook*):	
that have widespread effect and have, or are expected to have, a material effect on those affected.	In our outreach activity, overall, a majority of respondents said that Issues 1A and 1B are not widespread. However, the feedback from global accounting firms indicates that there are mixed views for Issues 1A and 1B. Consequently, the outreach has not given a clear indication about whether or not the issue is common. However, we do not think that it is necessary to take these issues onto the agenda because we think that the current requirements of IFRS are sufficient as we showed in our staff analysis of this paper. For Issue 2, almost all respondents of our outreach commented that the issue is not widespread.
in which financial reporting would be improved through the elimination, or reduction, of diverse reporting methods.	For Issues 1A, feedback from outreach activity does not indicate that diversity is an issue in most jurisdictions. For Issue 1B, some respondents of our outreach pointed out that the requirements in IFRS 5 are not clear. These comments are consistent with those relating to the (old) issue (ie write-down of disposal group) that the Interpretations Committee discussed in its September 2013 meeting. Consequently, as analysed in this paper, we think that Issue 1B should be addressed in the context of that (old) issue. For Issue 2, feedback from outreach activity indicates that judgement is required and therefore is thought to lead to diversity. We think that we may need to consider whether reducing diversity would improve financial reporting. Consequently, as analysed in this paper, we think that Issue 2 should be considered in the context of the issue that is on hold under the IASB’s project on financial statement presentation, which was reported to the September 2014 Interpretations Committee meeting.
that can be resolved efficiently within the confines of existing IFRS and the *Conceptual Framework for Financial Reporting*.	As mentioned above, we think that Issues 1B and 2 need to be considered in the context of the (old) issues that the Interpretations Committee identified and discussed in its prior meetings.
In addition:	

Agenda criteria	
Is the issue sufficiently narrow in scope that the Interpretations Committee can address it in an efficient manner, but not so narrow that it is not cost-effective for it to undertake the due process that would be required when making changes to IFRS (see paragraph 5.17 of the *IFRS Foundation Due Process Handbook*)?	**NA**
Will the solution developed by the Interpretations Committee be effective for a reasonable time period (see paragraph 5.21 of the *IFRS Foundation Due Process Handbook*)? (The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified).	**NA**

Summary and staff recommendation

80. A summary of our analysis is that:

    (a) **(Issue 1A)** Our analysis of whether or not the fact patterns in the three cases would lead to classification as held for sale are as follows:

        (i) in Case 1.1 (dilution), The act of offering shares for sale could meet the criteria set out in paragraphs 6–8 of IFRS 5 depending on the steps or actions taken to find a buyer for the shares. The classification of held for sale would therefore depend on additional facts;

        (ii) in Case 1.2 (call option given to a non-controlling shareholder), we think that the call option would not meet all of the criteria set out in paragraphs 6–8 of IFRS 5 and therefore would not lead to the classification of held for sale. This is because the exercisable period of call option extends beyond one year and therefore would not meet the criterion of 'completing the sale within one year from the date of classification'; and

        (iii) in Case 1.3 (modification of the shareholders' agreement), we think that it is a case of 'loss of control without a sale plan', which would not meet the requirements in paragraph 8A of

IFRS 5, and therefore would not lead to the classification of held for sale;

(b) **(Issue 1B)** a disposal group mainly, or entirely, consisting of financial instruments would meet the classification requirements for held for sale that are set out in IFRS 5. In terms of the measurement requirements for held for sale, we think that this issue is another case of one of the (old) issues that the Interpretations Committee discussed in September 2013 and 2014; and

(c) **(Issue 2)** this issue is about how to interpret the definition of 'discontinued operation' in terms of the concept of 'operating segment' in IFRS 8. We think it also relates to one of the (old) issues, which are currently on hold under the IASB's project on financial statement presentation, which was reported to the September 2014 Interpretations Committee meeting.

81. On the basis of our analysis, we recommend that the Interpretations Committee:

(a) should not add Issue 1A to its agenda; and

(b) should consider Issues 1B and 2 when deciding how to proceed with the (old) issues that the Interpretations Committee considered in its September 2014 meeting.

82. We have set out proposed wording for tentative agenda decision relating to issue 1A in **Appendix A.**

Questions for Interpretations Committee
1. Does the Interpretations Committee agree with the staff analysis as summarised above (ie paragraph 80)? 2. Does the Interpretations Committee agree with the staff recommendation as described above (ie paragraph 81)?

Appendix A—Proposed wording for tentative agenda decision

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

IFRS 5 *Non-current Assets Held for Sale Discontinued Operations*—Applicability of IFRS 5 on some cases involving 'loss of control of a subsidiary'

The Interpretations Committee discussed whether the requirements of IFRS 5 *Non-Current Assets Held for Sale Discontinued Operations* should apply to some cases involving 'loss of control of a subsidiary' and therefore whether those cases should lead to the classification of held for sale. The cases that the Interpretations Committee discussed are summarised as follows:

- Case 1—An entity decided not to subscribe to the issuance of new shares issued by its subsidiary and subsequently, the entity loses control of the subsidiary when the new shares are subscribed to by a non-controlling shareholder of the subsidiary (ie dilution);
- Case 2—An entity wrote a call option that gives a non-controlling shareholder of the entity's subsidiary a right to acquire the entity's shares of the subsidiary; the call option is deep in the money and exercisable within one year and extending to three years at the time of the assessment of the classification of held for sale.
- Case 3—An entity had an agreement with other shareholders that gave the entity the right to have a majority of members of the Board of Directors in its subsidiary; and the agreement allowed the entity to have control of the subsidiary. The entity and the other shareholders decided not to renew the agreement and subsequently, it loses control of the subsidiary within one year.

The Interpretations Committee, referring to paragraph 8A of IFRS 5, noted that there could be a 'loss of control of a subsidiary' without a 'sale plan' and a 'loss of control of a subsidiary' with a 'sale plan'. It noted that:

- a 'loss of control of a subsidiary' without a 'sale plan' would not meet the requirement in paragraph 8A of IFRS 5 for the classification of

held for sale; and

- a 'loss of control of a subsidiary' with a 'sale plan' would qualify for the requirements for the classification of held for sale if a 'sale plan' meets the criteria described in paragraphs 6–8 of IFRS 5.

The Interpretations Committee noted that:

- in Case 1, The act of offering shares for sale could meet the criteria set out in paragraphs 6–8 of IFRS 5 depending on the steps or actions taken to find a buyer for the shares. The classification of held for sale would therefore depend on additional facts;
- the call option in Case 2 would be considered as a 'sale plan' but would not meet all of the criteria set out in paragraphs 6–8 of IFRS 5 because of the dates through which the option could be exercisable extended beyond one year; and
- Case 3 would be a case of 'loss of control without a sale plan' and therefore would not meet the requirement in paragraph 8A of IFRS 5.

On the basis of the analysis above, the Interpretations Committee concluded that, in the light of the existing requirements of IFRS 5, sufficient guidance exists and that neither an Interpretation nor an amendment to a Standard was necessary. Consequently, the Interpretations Committee [decided] not to add this issue to its agenda.

Appendix B—Submission

Submission

(with the submitter's information made anonymous)

Wayne Upton
Chairman of IFRS IC
Cannon Street 30
London EC4M 6XH

Agenda item request: Issues related to the application of IFRS 5 - Non-current assets held for sale and discontinued operations

Dear Mr Upton,

[The submitter's information]

We have identified several issues related to the application of IFRS 5 - *Non-current assets and discontinued operations,* which we would like to bring to the attention of the IFRS Interpretations Committee for further consideration. We are aware that the IASB and the IFRS IC discussed during its recent meetings some of the issues linked to the ones raised in this letter. We have included them in the letter in order to provide the IASB with a comprehensive overview of the issues identified in practice on the application and/or enforcement of IFRS 5.

A detailed description of the issues is set out in the appendix to this letter. Please do not hesitate to contact us should you wish to discuss any of the issues we hereby raise.

[The submitter's information]

Appendix

IFRS 5 – *NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS*

1. [The submitter] has identified several issues concerning the application of IFRS 5 on the classification and measurement of non-current assets and discontinued operations.

2. [The submitter] is concerned that the absence of certain definitions in IFRS 5, together with the lack of implementation guidance gives a lot of flexibility to entities when classifying and measuring non-current assets held for sale and discontinued operations, and this may impair the comparability and understandability of financial statements.

3. In this paper, [the submitter] has provided some examples to illustrate the concerns mentioned above. They are grouped based on the nature of the matters raised:
    a. Scope
    b. Classification as “held for sale”
    c. Changes to a plan of sale
    d. Definition of a major line of business
    e. Unit of account
    f. Impairment

a) Scope

4. [The submitter] has identified divergence in the application of IFRS 5 in relation to both the nature of the transaction which triggered a loss of control and the types of assets included in a disposal group.

a.i) Loss of control over non-current assets or disposal groups

5. Paragraph 6 of IFRS 5 states that *“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.”* [emphasis added]. Paragraph 5A of IFRS 5 indicates that IFRS 5 also applies to a non-current asset (or disposal group) that is classified as held for distribution to owners acting in their capacity as owners.

6. Enforcers have identified the following examples of IFRS 5 being applied to other transactions than formally sales that result in substance in a loss of control: dilution, exercise of call options or modification of a shareholders’ agreement.

Case 1 - Dilution

7. Issuer A has a 67% interest in entity B. Before the year-end, entity B issues new shares which are fully subscribed by a new investor (entity C). Following the increase in share capital, issuer A retains an interest of 44% in entity B (representing 30% of voting rights). At the same time, entities A and C sign an agreement providing new governance rules over entity B, based on which issuer A is no longer represented in the entity B’s Board and its management.

8. Issuer A considers that its decision to not subscribe to the issuance of new shares is equivalent to a decision of disinvestment in entity B, such that the investment in entity B will not be recovered principally through the continuing use of the asset.

Case 2 - Call option given to a non-controlling shareholder

9. At 31/12/N, issuer A controls subsidiary S by owning 75% of its shares. Entity B owns the remaining 25% of the shares and has a call option on the shares owned by issuer A. The call option is deeply in the money and is exercisable starting with 30/09/N+1. On that basis, entity B expects to take control over subsidiary S on 30/09/N+1 and issuer A expects to lose control, cease consolidation of subsidiary S and account for its investment using the equity method.

Case 3 - Modification of the shareholders' agreement

10. Issuer A controls subsidiary S on the basis of an agreement with the other three shareholders. The agreement gives issuer A the right to have nine out of the twelve members of the Board of Directors. In November N, issuer A and the other shareholders decided to not renew the agreement ending in July N+i. On that basis, issuer A will lose control in July N+i.

11. [The submitter] has identified different views on how the situations described above should be accounted for, based on whether the situations were considered to be within or outside the scope of IFRS 5.

12. ***View 1:*** In defining the criteria to classify non-current assets as held for sale, paragraphs 6-8 of IFRS 5 refer only to "sale" transactions. Hence, the loss of control achieved without involving a sale is not covered by IFRS 5, which should not be applied to such cases.

13. ***View*** 2: Paragraph 5A of IFRS 5 should be applied by analogy to situations of loss of control following a dilution, modification of the shareholders' agreement or call option becoming exercisable.

14. Furthermore, there are differing views on each of the transactions other than sale that result in a loss of control, despite the fact that they might capture the same underlying economic outcome. [The submitter] questions whether the underlying economic outcome should not be depicted consistently in the financial statements notwithstanding the event triggering the loss of control.

15. For example, some argue that in Case 1, the loss of control by dilution, IFRS 5 should apply because:

    the case of dilution is not addressed by any other IFRS (neither IFRS 3 -*Business Combinations,* nor IAS 27 - *Consolidated Financial Statements*); *and*

    the decision to not subscribe to the issuance of new shares is a change in the investment strategy of the issuer implying that the issuer agrees with the dilution and the loss of control, which economically is similar to a decision to sell shares while retaining a continuing interest in the entity.

16. However, in the case of a loss of control due to exercise of a call option given to a third party as referred to in Case 2 above, the decision to exercise or not is not taken by the issuer. It could, therefore, be argued that the criterion "the appropriate level of management is committed to a plan to sell the asset (or disposal group)" from paragraph 8 of IFRS 5 is not met and that management is not directly involved in a plan to sell.

17. In the case of a loss a control following a change in the shareholders' agreement as referred in case 3 above, some believe that IFRS leaves room for interpretation. It might be argued that the view that IFRS 5 applies only when an actual sale occurs is not consistent with the principles in IFRS 3 and IAS 27 which consider that loss of control is a significant event which results in de-recognition of all assets and liabilities, even in the absence of a transaction.

a.2) Disposal groups consisting mainly of financial instruments

18. Another issue related to the scope of IFRS 5 has been identified for financial institutions for which disposal groups mainly, or fully, consist of financial instruments sold at loss IFRS 5 excludes from its measurement basis financial assets within the scope of IAS 39 - *Financial instruments: Recognition and measurement.*

19. *Appendix A of IFRS 5 defines a disposal group as "a* group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction". *Paragraph 4 of IFRS 5 states that "[...]* 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."

20. While paragraph 4 of IFRS 5 requires the disposal group to be measured according to its provisions, paragraph 5 of IFRS 5 states that financial assets are scoped out for measurement purposes. Therefore, it is not clear whether IFRS 5 applies to disposal groups that consist mainly of financial assets, which is particularly relevant if it is expected that the disposal groups will be sold at loss. In such situations, applying the requirement in paragraph 5 of IFRS 5 would imply that the loss is recognised only when the sale effectively occurs. This conflicts with the measurement principles set out in IFRS 5 for disposal groups that require measurement at fair value less cost to sell at the date of classification as a "disposal group".

b) Classification as "held-for-sale"

21. Paragraph 7 of IFRS 5 provides the criteria to be met before an asset or disposal group is classified as held for sale by defining two elements: availability for immediate sale in its present condition subject only to terms that are usual and customary for sales and that the sale must be highly probable. Paragraph 8 of IFRS 5 provides further guidance on the notion of "highly probable" and the requirements to meet this criterion include the following: the management must be committed to a plan to sell, the asset must be actively marketed for sale at a reasonable price, and an active programme to locate a buyer must exist. It also clarifies that subject to certain exceptions, the sale is expected within one year from the date of classification and actions required to complete the sale indicate that the plan will not be significantly changed or withdrawn.

22. [The submitter] notes that since there are no definitions, guidance or examples that illustrate what can be understood by "actively marketed for sale at a price that is reasonable in relation to its current fair value", the notions of "highly probable" and "an active programme to locate a buyer" may lead to different interpretations.

23. [The submitter] has already submitted to the IFRS IC a letter on the issue related to application of these requirements to an initial public offer. The following example illustrates further possible application of these concepts (provided that other transactions triggering loss of control, other than sale, are in the scope of IFRS 5 as illustrated in View 2 in Section a.i) of this letter).

Illustrative example

24. The issuer owns a 95% interest in entity S. In March N, the issuer granted to a non-controlling shareholder the right to buy all its shares in S through a call option exercisable between February N+2 and June N+4. The price is the higher of the amount determined through the adjusted net assets method and the price that would ensure a 22% to 25% return on the investment to the issuer, depending on the exercise date. The issue arises in relation to the application of IFRS 5 at the reporting date 30/06/N+1.

25. ***View 1:*** The issuer should recognise its share in the subsidiary as a non-current asset held-for-sale, because:

    the call option is exercisable from February N+2 onwards, which is less than 12 months after the end of the reporting period. Therefore, in accordance with the consolidation requirements in IAS 27, the issuer will lose control over the subsidiary as it is highly probable that the option will be exercised;

    it is highly probable that the issuer will not recover the carrying amount of the subsidiary through continuing use;

    classification as held-for-sale is useful information to users of the financial statements.

26. ***View 2:*** The issuer should not recognise its share in the subsidiary as non-current asset held-for-sale because:

    the call option does not meet the overall objective of “commitment to sell” by the issuer's management;

    the subsidiary is not available for immediate sale, as the exercise price of the option needs to ensure a return of investment of 22-25%;

    the price is not reasonable in relation to its current fair value.

c) Changes to a plan of sale

27. Paragraph 8 of IFRS 5 requires a period of no more than one year from the date of classification for an issuer to complete a sale. Paragraph 9 of IFRS 5 provides an exception to this rule (as further detailed by Appendix B of IFRS 5) provided that the entity can demonstrate that the delay is caused by circumstances outside the entity’s control and there is sufficient evidence that the entity remains committed to its plan to sell the asset.

28. However, as the standard does not provide any further guidance for determining a reasonable time limit to the period that it can remain acceptable to consider that the held-for-sale criteria are still met, significant judgement is applied in practice, with a potential adverse impact in terms of comparability. [The submitter] has submitted to the IFRS IC separately a specific issue related to a change in disposal method and notes that an amendment will be proposed in this area. [The submitter] fully supports the IFRS IC’s proposal and would like to illustrate some aspects related to this issue with the example included below.

Illustrative example

29. In its interim financial statements as of 30/06/N+2, the issuer classified certain property, plant and equipment as "Non-current Assets held for sale" based on management's commitment to dispose of those assets. The issuer has not succeeded selling the assets, mainly because of a downturn in the commercial and residential property market. Consequently, the issuer continued to classify the assets as held-for-sale and measured them at fair value less cost to sell for the next three reporting periods.

30. ***View*** 1: The issuer justified the accounting treatment based on the following facts:

    the assets were available for immediate sale since September N+i as they were not in use by the entity since that date;

    from 30/06/N+2, when the management took the decision to sell the assets, the issuer expected that the "carrying amount would be recovered principally through a sale transaction rather than through continuing use" and the sale was expected to be "highly probable";

    the property was actively marketed since 30/06/N+2 for a reasonable price compared with similar transactions;

    the extent and duration of the downturn in the market was unexpected and beyond the issuer's control;

    each reporting period the issuer took the necessary actions to respond to the change in circumstances (i.e. the continued downturn in the property market) by reducing the amount it was willing to accept for the property to a price that was reasonable at each reporting date.

31. ***View 2:*** After the one year period the assets should have ceased to be classified as held for sale. Although paragraph 9 of IFRS 5, allows extending the one year period, the circumstances when the extended period may be applied are restricted to instances where a sale agreement exists and the delay is solely due to completion of the agreement. The criteria for the sale to be "highly probable" have still to be met. In the case of the issuer, the extended period of three years to actively market the asset and locate a buyer and the continued depressed state of the commercial property market could be seen as a strongly indicator that the sale was no longer "highly probable".

d) Definition of a major line of business

32. In providing the criteria for meeting the definition of a "discontinued operation", paragraph 32 of IFRS 5 refers to the notion of "a separate line of business or geographical area of operations". However, IFRS 5 does not define what should be considered as a "separate major line of business". As part of enforcement activities, enforcers have identified differences in the application of IFRS 5 to this concept as illustrated in the following cases.

Case 1

33. The issuer disposed of three subsidiaries from the same operating segment during the reporting period. In its financial statements, the issuer treated these three subsidiaries as being a "major lines of business" according to paragraph 32 of IFRS 5, and classified them as "discontinued operations". It disclosed, therefore, in its statement of comprehensive income, a single line item for the losses made by the subsidiaries over the period and disclosed a separate line - "net result before discontinued operations".

Case 2

34. The issuer disposed of several subsidiaries during the period. These subsidiaries included a subsidiary in country A, a subsidiary in country B and several subsidiaries operating in Country C. The issuer had operating segments, as defined in IFRS 8 - *Operating Segments,* based on geographical areas. Country A and C's subsidiaries were disclosed separately as operating segments while the subsidiary in country B was included in another operating segment.

35. The issuer considered that only a separate reporting area could qualify as a major geographical area of operations and should be disclosed as discontinued operations. Therefore, it considered that only country A and C's subsidiaries qualify as "major lines of business" according to IFRS 5 and classified them as "discontinued operations". In its statement of comprehensive income, the issuer disclosed separately the result from these subsidiaries. The result of country B's subsidiary was included in the consolidated operating result.

Case 3

36. The issuer disposed of one subsidiary in a geographical area that had been previously disclosed as a separate operating segment on the basis that the Chief Operating Decision Making (CODM) considered its results and activities separately. In considering the requirements of paragraph 32 of IFRS 5, the issuer assessed the impact of the disposal on its results and also that the group continues to operate other businesses in that geographical region and the same type of business in other different geographical regions.

37. The issuer took also into account paragraph BC69 of IFRS 5 which makes reference to the fact that in reaching its conclusion on this issue, the IASB concluded that the application of the US accounting standard definition of a discontinued operation would give rise to the classification of units that were too small, thus indicating that only operations which were of a significant magnitude were intended to constitute a "major" operation.

38. Therefore, despite the fact that the operation was disclosed as an operating segment for IFRS 8 purposes, the issuer concluded that it did not represent a "major" line of business or geographic area of operations for IFRS 5 purposes.

e) Unit of Account

39. Paragraph 8A of IFRS 5 states that, "an entity that is committed to a sale plan involving loss of control of a subsidiary shall classify all the assets and liabilities of that subsidiary as held for sale when the criteria set out in paragraphs 6-8 are met, regardless of whether the entity will retain a non-controlling interest in its former subsidiary after the sale."

40. Paragraph 15 of IFRS 5 defines the measurement basis for assets classified as held for sale by stating that, "an entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell."

41. However, it is not clear if the measurement basis defined should be applied to all assets and liabilities regardless of whether the entity retains a non-controlling interest and whether the entity shall measure its non-controlling interest taking into account a control premium in transactions when there is a loss of control. It is also not clear if an entity can apply different measurement techniques for the parts disposed and retained.

42. Taking into account its enforcement activities, [The submitter] believes that the unit of account is an important issue that need to be addressed in IFRS 5.

43. [The submitter] notes that the IASB is currently discussing the questions related to the unit of account for financial assets that are investments in subsidiaries, joint ventures and associates measured at fair value in accordance with IFRS 13 - *Fair Value Measurement.* In this context, the interaction with the unit of account for IFRS 5 purposes might be considered.

Illustrative example

44. The issuer holds 100% of the shares of subsidiary A, which constitutes a major line of business for the issuer. In June N, as part of a change in the strategy of its business, the issuer engaged in a plan to dispose of 51% of its shares in the subsidiary. At 30/09/N, the issuer signed an agreement for the sale of 51% of shares in the subsidiary, with the sale expected to be effective before the year end.

45. The issuer classified all assets and liabilities of the subsidiary as held for sale and presented them as a discontinued operation. When applying the measurement principles of IFRS 5, the issuer split the disposal group in two components:
   - One component corresponding to the 49% interest retained by the issuer, in which the issuer calculated the "fair value less costs to sell" based on a discounted cash-flows (DCF) model, as evaluated by an independent appraiser;
   - One component corresponding to the 51% interest to be sold for which the issuer considered the contractual transaction price as being the "fair value less costs to sell". The price of the transaction was determined for the purpose of the sale by another independent appraiser. This value was higher than the value derived from the DCF method, because it included amongst other things, a control premium.

46. As the sum of the values of the two components of the disposal group was lower than its carrying amount before classification as held for sale, the issuer recognised an impairment loss.

47. However, had the issuer measured its holding based on the valuation done to determine the sale, the results of the impairment and the amount recognised in the financial statements on the 49% interest retained would have been different.

f) Impairment

48. The requirement of paragraph 15 of IFRS 5 to measure a non-current asset or disposal group held-for-sale at the lower of the carrying amount and fair value less costs to sell may require recognition of an impairment loss, which, in certain circumstances, may subsequently be reversed. According to paragraph 19 of IFRS 5, assets and liabilities that are outside of IFRS 5 scope shall be measured in accordance to the IFRS applicable for those items. Afterwards, an entity shall recognise an initial or subsequent write-down for any excess of the carrying amount over fair value less costs to sell as required by paragraph 20 of IFRS 5.

49. IFRS 5 paragraph 23 indicates that, "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 IAS 36".

50. The different measurement requirements in paragraphs 15 and 23 of IFRS 5 seem to conflict as it is possible that the required impairment loss exceeds the carrying value of the non-current assets within the scope of the standard's measurement rules. The issue was already brought to the IFRS IC's attention which referred it to the IASB in 2009. As this issue has not been addressed by the IASB and diversity in practice continued to exist in this area, the IFRS IC discussed this issue again in September 2013. [The submitter] is of the view that additional guidance is needed in order to address existing diversity in practice stemming from the different measurement requirements in IFRS 5.

Illustrative example

51. In December N, the issuer's Board has decided to sell one of its business divisions. In its financial statements for the year end, this business division was presented as a disposal group. Immediately before classifying the disposal group as held-for-sale, the carrying amounts of the assets in the group were measured in accordance with the applicable IFRS. Depreciation and amortisation charges were recognised with regard to the non-current assets of the disposal group and the carrying amounts of the current assets of the disposal group were adjusted to take into account doubtful receivables and obsolete stock.

52. When classifying the division as held-for-sale, the carrying amount of the non-current assets within the scope of IFRS 5 was lower than the amount by which the disposal group's carrying amount exceeded its fair value less costs to sell. In the absence of a specific accounting treatment under IFRS 5, the issuer decided to recognise a separate liability for the adjustment to fair value less costs to sell.