IFRS™

STAFF PAPER

May 2015

IFRS Interpretations Committee Meeting

Project	**IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations***
Paper topic	Presentation of intragroup transactions between continuing and discontinued operations

CONTACT(S) Takashi Yamagami tyamagami@ifrs.org +44 (0)20 7246 6410

Introduction

1. The IFRS Interpretations Committee ('the Interpretations Committee') received a request to clarify various aspects of the requirements in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* relating to the measurement, presentation and disclosure aspects of IFRS 5. There are four issues in the submission, which can be found in Appendix B—Submission in Agenda Paper 3 for this meeting, as follows:[1][2]

   (a) Issue 2—how to present intragroup transactions between continuing and discontinued operation;

   (b) Issue 3—applicability of the disclosure requirements in IFRS 12 *Disclosure of Interests in Other Entities* to a subsidiary classified as held for sale;

[1] The designation of the issues in this paper is consistent with the designation used in Agenda Paper 3 for this meeting.

[2] Issue 1, which is not included in the new submission, relates to the scope of the held-for-sale classification, which the Interpretations Committee discussed over the last few meetings and is also scheduled to be discussed at this meeting.

(c) Issue 4—to what extent an impairment loss can be allocated to non-current assets within a disposal group; and

(d) Issue 5—how to apply the presentation requirements, in the case of a change to a plan, to a disposal group that consists of both a subsidiary and other non-current assets when there has been a change to a plan.

2. The objective of this Agenda Paper is to provide the Interpretations Committee with a summary of Issue 2, and the staff's analysis and recommendation.

3. This paper provides:

(a) summary of the issue;

(b) staff technical analysis;

(c) summary of the outreach result;

(d) agenda criteria assessment; and

(e) staff recommendation.

Summary of the issue

4. Paragraph 30 of IFRS 5 requires an entity to present and disclose information that enables users of the financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets (or disposal groups).

5. The issue relates to whether and how to eliminate transactions between continuing and discontinued operations on the face of the statement of profit or loss and other comprehensive income, when there are significant transactions between them.

6. The submitter of the issue notes that current practice is mixed in this respect as follows:

(a) View 1—eliminate intragroup transactions without any adjustments;

(b) View 2—eliminate intragroup transactions, but make adjustments to reflect how transactions between continuing or discontinued operations will be reflected in continuing operations going forward; and

(c) View 3—do not eliminate intragroup transactions.

View 1—eliminate intragroup transactions without any adjustments

7. Proponents of this view argue that nothing in IFRS 5 overrides the consolidation requirements in IFRS 10, *Consolidated Financial Statements*, and that consequently, full elimination of intragroup transactions in accordance with paragraph B86 of IFRS 10 is necessary. They would claim that as a result, continuing operations and discontinued operations should show only transactions with counterparties external to the group.

8. They also argue that information reflecting expected ongoing relationships of continuing and discontinued operations should be disclosed in the notes to financial statements if such information is useful in understanding the effects of the discontinued operations. This is because paragraph 30 of IFRS 5 states that an entity should 'present and disclose' information relating to discontinued operations. They would claim that it is not limited to presentation of information on the face of the statement of profit or loss and other comprehensive income, but that the information can be disclosed in the notes to the financial statements.

View 2—eliminate intragroup transactions, but make adjustments to reflect how transactions between continuing or discontinued operations will be reflected in continuing operations going forward

9. Proponents of this view argue that the information presented on the face of the statement of profit or loss and other comprehensive income in which significant intragroup transactions between continuing and discontinued operations are eliminated in full does not provide useful information to users of financial statements. They would claim that this is not consistent with the requirement in paragraph 30 of IFRS 5, which requires provision of information that 'enables users of the financial statements to evaluate the

financial effects of discontinued operations and disposals of non-current assets (or disposal groups)'.

10. They also argue that in the absence of clear guidance in IFRS 5 as to how to achieve the objective in paragraph 30 of IFRS 5 (eg how to deal with elimination of intragroup transactions between continuing and discontinued operations), an entity should use judgement to determine an appropriate way to present information based on the facts and circumstances. They would claim that information provided this way should be consistent with the requirements in IAS 1 *Presentation of Financial Statements*, regarding fair presentation and relevant, comparable, and understandable information when determining which approach to use.

View 3—do not eliminate intragroup transactions *eliminate intragroup transactions*

11. Proponents of this view hold similar views by proponents of View 2, except that the proponents of this view would treat discontinued operations as if they had already been disposed of. Consequently, they would view transactions between continuing and discontinued operations as third party transactions.

Illustration of each view

12. Provided below is a set of fact patterns for the purpose of illustrating presentation under each view[3]:

    (a) Entity X operates in the clothing industry. Entity X owns Entity Y, which makes fabric and also owns Entity Z, which makes clothes. Entity Z buys fabric from Entity Y, and uses the fabric to manufacture clothes. Consequently, there have been substantial intercompany transactions between the two business areas.

[3] This fact pattern and presentation under each view was previously included in Appendix B of Staff Paper 9B for the Interpretations Committee's meeting in March 2015.

(b) The fabric manufacturing business (ie Entity Y) was sold to a third party as of 30 November 20X3. Consequently, Entity X's financial statement of 20X3 classifies and presents the fabric manufacturing business as discontinued operations. The comparative figures for 20X2 have been restated. At the time of the sale of the fabric business, Entity Z agreed to continue to buy fabric from Entity Y.

(c) The following figures represent the results of operations of Entity Y and Entity Z on a stand-alone basis as well as the group total. Note that Entity Z's cost of goods sold includes costs of CU450[4] relating to purchases from third parties and CU1,950 relating to purchases from Entity Y.

(Unit: CU)	Entity Y	Entity Z	Elimination	Group
Revenue	1,950	2,250	1,950	2,250
Cost of goods sold	1,500	2,400	1,950	1,950
Operating profit/loss	450	-150	0	300

Presentation under View 1

13. Based on the fact pattern mentioned in paragraph 12, the presentation under View 1 would suggest the following presentation:

(Unit: CU)	Entity Y	Entity Z	Group
Revenue	0	2,250	2,250
Cost of goods sold	1,500	450	450
Operating profit/loss	-1,500	1,800	1,800
Loss from discontinued operations			-1,500
Profit for the year			300

14. Under this presentation, intragroup sales and purchases are eliminated against Entity Y and Entity Z, respectively. A consequence of this is that the amounts in the statement of profit or loss and other comprehensive income show only those transactions with counterparties external to the group.

[4] In this paper, monetary amounts are denominated in 'currency units (CU)'.

Presentation under View 2

15. Based on the fact pattern mentioned in paragraph 12, the presentation under View 2 would suggest the following presentation:

(Unit: CU)	Entity Y	Entity Z	Group
Revenue	0	2,250	2,250
Cost of goods sold	-450	2,400	2,400
Operating profit/loss	450	-150	-150
Profit from discontinued operations			450
Profit for the year			300

16. Under this presentation, intragroup sales and purchases are both eliminated against Entity Y in order to achieve an 'as-if presentation' of the continuing operations. That is, it reflects, on the face of the statement of profit or loss and other comprehensive income, the expected effects of future transactions between Entity Y and Entity Z.

Presentation under View 3

17. Based on the fact pattern mentioned in paragraph 12, the presentation under View 3 would suggest the following presentation:

(Unit: CU)	Entity Y	Entity Z	Group
Revenue	1,950	2,250	2,250
Cost of goods sold	1,500	2,400	2,400
Operating profit/loss	450	-150	-150
Profit from discontinued operations			450
Profit for the year			300

18. Under this presentation, there is no elimination of intragroup transactions. Note that this presentation does not change the consolidated profit for the year, compared with the presentation under View 2. Consequently, this presentation also attempts to achieve an 'as-if presentation' of the continuing operations.

Staff technical analysis

19. We note that paragraph 30 of IFRS 5 requires provision of information that is useful in assessing the financial effects of discontinued operations and disposals of non-current assets (or disposal groups). However, we note that there is no specific guidance in that Standard in relation to how to achieve the objective in paragraph 30 of IFRS 5 (eg how to deal with elimination of intragroup transactions between continuing and discontinued operations).

20. Having said that, we also note that nothing in IFRS 5 or IAS 1 overrides the consolidation requirements in IFRS 10, which leads us to believe that there have to be some forms of elimination entries dealing with the transactions between continuing and discontinued operations. Consequently, we are of the view that the presentation under View 3 (ie no elimination) would not be acceptable.

Which entities should elimination entries be recorded against?

21. As noted in paragraph 19 of this paper, there is no specific guidance in IFRS 5 on how to deal with elimination of intragroup transactions between continuing and discontinued transactions.

22. We also note that IFRS 10 does not specifically address against which entity elimination entries have to be made. Paragraph B86 of IFRS 10 states:

> Consolidated financial statements:
>
> […]
>
> (c) eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full). […]

23. However, we note that paragraph B86 of IFRS 10 requires elimination of intragroup transactions, rather than intragroup profit, because it requires the elimination in full of, among other things, intragroup income and expenses. We infer from this requirement that an entity needs to eliminate intragroup

sales only against the internal selling party and needs to eliminate intragroup purchases only against the internal purchasing party. This is because it is the internal selling party that has intragroup income, and it is the internal purchasing party that has internal expenses.

24. We note that the presentation under View 2 does not attribute intragroup transactions to the respective selling and purchasing parties as suggested in paragraph 23 of this paper. Consequently, we are of the view that the presentation under View 2 would not meet the requirements of IFRS 10.

25. On the basis of our analysis, we are of the view that the presentation under View 1 would be the only way to meet the requirements in IFRS 10 and reflect elimination of intragroup transactions between continuing and discontinued operations in the statement of profit or loss and other comprehensive income.

26. However, we are troubled by this result because we think that the results of View 2 provide more useful information to users of the financial statements.

Requirements in US GAAP

27. We think that it is worthwhile looking at the requirements in US GAAP in this respect, because IFRS 5 is based on the equivalent US GAAP guidance.

28. We note that the US national standard-setter, the Financial Accounting Standards Board ('FASB') recently issued ASU 2014-08 *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment* to amend the requirements in relation to discontinued operations. This Standard is effective for public business entities from annual periods beginning on or after 15 December 2014, and interim periods within those years.[5]

29. Before the amendment, paragraph 205-20-45-1 defined discontinued operations as follows:

> The results of operations of a component of an entity that either has been disposed of or is classified as held

[5] Paragraph 205-20-65-1.

> for sale under the requirements of paragraph 360-10-45-9, shall be reported in discontinued operations in accordance with paragraph 205-20-45-3 if both of the following conditions are met:
>
> a. The operations and cash flows of the component have been (or will be) eliminated from the ongoing operations of the entity as a result of the disposal transaction.
>
> b. The entity will not have any significant continuing involvement in the operations of the component after the disposal transaction.

30. As a consequence of the issue of ASU 2014-08, the definition of discontinued operations changed to the following[6]:

> A disposal of a component of an entity or a group of components of an entity shall be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results when any of the following occurs:
>
> a. The component of an entity or group of components of an entity meets the criteria in paragraph 205-20-45-1E to be classified as held for sale.
>
> b. The component of an entity or group of components of an entity is disposed of by sale.
>
> c. The component of an entity or group of components of an entity is disposed of other than by sale in accordance with paragraph 360-10-45-15 (for example, by abandonment or in a distribution to owners in a spinoff).

[6] Paragraph 205-20-45-1-B.

31. We note that the criteria relating to continuing involvement and ongoing cash flows that had existed in the old definition were removed and that the new definition became more similar to the definition of discontinued operations in IFRS 5.

32. We note that there was also no specific guidance in US GAAP in terms of how to deal with elimination of intragroup transactions between continuing and discontinued operations. Nevertheless, we are of the view that the previous requirements in US GAAP may not have caused significant issues relating to the issue considered in this paper. This is because if the continuing operations are expected to have significant transactions with the component of an entity after the disposal, then the component would be less likely to meet the definition of discontinued operations because of the criteria relating to continuing involvement and ongoing cash flows.

33. With respect to the disclosure requirements in relation to discontinued operations in US GAAP, we note that there are some disclosure requirements that only exist in US GAAP. Paragraph 205-20-50-4B states in part:

> An entity shall disclose the following in the notes to financial statements for each discontinued operation in which the entity retains significant continuing involvement after the disposal date:
>
> a. A description of the nature of the activities that give rise to the continuing involvement.
>
> b. The period of time during which the involvement is expected to continue.
>
> c. For all periods presented, both of the following:
>
> 1. The amount of any cash inflows or outflows from or to the discontinued operation after the disposal transaction
>
> 2. Revenues or expenses presented, if any, in continuing operations after the disposal transaction that before the disposal transaction were eliminated in

consolidated financial statements as intra-entity transactions.

d. […]

34. We are of the view that the disclosure requirement in paragraph 205-20-50-4B c.2 seems to imply that an entity should eliminate transactions between continuing and discontinued operations, as suggested by the presentation approach under View 1. Consequently, we are of the view that the requirements in US GAAP are consistent with our conclusion noted in paragraph 25 of this paper (ie View 1).

Should the presentation under View 2 (ie 'as-if' presentation) be permitted in the statement of profit or loss and other comprehensive income?

35. As noted in paragraph 25 of this paper, we are of the view that under current IFRSs, View 1 (ie full elimination without any adjustments) is required in order to meet the elimination requirements of IFRS 10. We also note that entities are not precluded from providing information under View 2, if it is disclosed as additional information *in the notes* to the financial statements.

36. However, we are concerned that information provided under View 1 in the statement of profit or loss and other comprehensive income may not result in the most useful information for assessing the financial effects of discontinued operations. This is because if an entity expects to continue transactions with discontinued operations after the disposal of such operations, the effects of such transactions will be reported under the continuing operations after the disposal, while those transactions are eliminated before the disposal, which results in non-comparable information across reporting periods. We think that the presentation under View 2 could provide more relevant and useful information than the presentation under View 1, because the former presentation provides comparable information across reporting periods. The presentation under View 2 is also useful in assessing an entity's ability to generate cash flows in future periods.

37. Furthermore, we note that the objective of providing information relating to discontinued operations is more consistent with the presentation approach under View 2. This is because the objective of separate presentation of continuing operations and discontinued operations in the statement of profit or loss and other comprehensive income is to provide information that is useful in assessing the prospects for future net cash inflows to an entity. Paragraph BC62 of IFRS 5 states in this respect:

> Paragraph 12 of the *Framework*[14] states that the objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions. Paragraph 15 of the *Framework* goes on to state that the economic decisions that are taken by users of financial statements require an evaluation of the ability of an entity to generate cash and cash equivalents. Separately highlighting the results of discontinued operations provides users with information that is relevant in assessing the ongoing ability of the entity to generate cash flows.
>
> [14] References to the *Framework* are to IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework with the Conceptual Framework for Financial Reporting*. Paragraphs 12 and 15 were superseded by Chapter 1 of the *Conceptual Framework*.

38. Consequently, we are of the view that it would be an improvement to the Standard if we were to amend it to require 'as-if' presentation, as suggested under View 2, in the statement of profit or loss and other comprehensive income.

Summary of the outreach results

39. We have performed outreach with members of the International Forum of Accounting Standard Setters (IFASS), 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 they are?

    (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.

40. We received 17 responses from 10 IFASS members, five global accounting firms and two securities regulator.

41. By region, responses were received from two securities regulator, five global accounting firms and 10 jurisdictions (six jurisdictions from Asia and Oceania, two from Europe, and two from North America). The views received represent informal opinions and do not reflect the formal views of those organisations.

Responses with respect to Question 1

42. About half of the respondents stated that the issue is common, while two respondents stated that the issue is not common in their jurisdictions. One of the respondents who said that this was a common issue commented that of the issues being considered by the Interpretations Committee, this is the most common issue in practice. Another respondent who stated that this issue is common also commented that sometimes amounts at stake are very significant.

Responses with respect to Question 2

43. Of the respondents who stated that the issue is common, one respondent commented that the predominant accounting treatment in its jurisdiction is

consistent with View 1, while another respondent saw View 2 being the predominant accounting treatment. The latter respondent commented that in its jurisdiction View 1 seemed to be the slightly preferred approach in the past, but it has changed towards View 2 being mostly applied now. Other respondents who stated that the issue is common commented that the practice is mixed.

44. One respondent also noted that accounting literature (eg the accounting manuals of large firms) are divergent on this issue. A few respondents were of the view that presentation under different views would be acceptable, depending on entities' facts and circumstances.

Responses with respect to Question 3

45. Six respondents stated that there is diversity in practice 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.	**Yes,** in our outreach activity, overall, many respondents said that the issue is common.
in which financial reporting would be improved through the elimination, or reduction, of diverse reporting methods.	**Yes,** as shown in the outreach result, there is diversity in practice with respect to this issue. We think that addressing the issue will contribute to improvements of information presented in financial statements.
that can be resolved efficiently within the confines of existing IFRS and the *Conceptual Framework for Financial Reporting*.	**Yes,** the issue is limited to presentation of intragroup transactions between continuing and discontinued operations.
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*)?	**Yes,** as stated above, this issue is limited to presentation of discontinued operations. We think that amending the Standard to address the issue will lead to comparable information across entities and will also result in more meaning information in the statement of profit or loss and other comprehensive income.
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).	**Yes,** there is no project on IFRS 5, nor is such project planned overlapping this issue.

Summary and staff recommendation

46. A summary of our analysis is that:

    (a) There are no requirements or guidance in IFRS 5 or IAS 1 that override the consolidation requirements in IFRS 10. Consequently, an entity is required to eliminate intragroup transactions in full without any adjustments between continuing and discontinued operations (ie View 1).

    (b) Entities are not precluded from disclosing information under View 2 if it is disclosed *in the notes* to the financial statements.

    (c) Nevertheless, we are of the view that it would be an improvement to the Standard if we were to amend it to permit 'as-if' presentation in the statement of profit or loss and other comprehensive income, because it would lead to provision of more relevant and comparable information.

47. Consequently, if the Interpretations Committee agrees with the staff analysis summarised in paragraph 46, we recommend that the Interpretations Committee should bring the issue to the attention of the IASB and ask whether the IASB agrees with its conclusion on the issue, and if so, whether the IASB would like us to address the issue further.

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff analysis as summarised in paragraph 46? 2. Does the Interpretations Committee agree with the staff recommendation as summarised in paragraph 47?