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Ms. Anne McGeachin  
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#### **ED 4 disposal of non-current assets and presentation of discontinued operations**

Dear Ms. McGeachin

We welcome very much the opportunity to comment on the above-mentioned draft and support the IASB's and FASB's efforts to achieve convergence. For reasons which are explained in our replies to your specific questions, we nevertheless believe that ED 4 leans excessively on FAS 144 to the detriment of quality. We would therefore very much prefer to retain the present approaches of IAS 16, 35 and 36 while adapting them to take account of some of the strong points of FAS 144: we would hope that the IASB could then convince the FASB of the merits of this approach in order to achieve greater convergence. In particular we would prefer to see a less prescriptive and more principle-based approach to these topics in the interest of relevance and reliability. Also, more appropriate solutions than offered in the draft are needed for situations of assets etc. held for sale but continuing in use, including for joint ventures and associated companies. Lastly, in our view, the change from the term "net selling price" to "fair value less cost to sell" would be a retrograde step due to the lower level of clarity.

#### **Q1. Classification of non-current assets held for sale**

We agree with your proposal to classify separately non-current assets held for sale as it gives the user more useful information for assessing the timing and amount of future cash flows and gives a fairer presentation of current/non-current positions in the balance sheet. However, we believe that:

- The criteria for such classification are excessively prescriptive. The key criterion is, Is a sale highly probable? All other rules listed in Appendix B should be rather illustrative of that high probability rather than prescriptive. As an example of how too black-and-white criteria can reduce the meaningfulness of financial statements we point to situations in the pharmaceutical industry where product rights may be sold but, because of the time needed for technology transfer, registrations and certifications, the seller has to continue to produce

the product for the buyer under (say) a 2-year supply agreement. Delay of classification as “held for sale” through too rigid a definition would reduce the usefulness of the financial statements and not reflect the economic substance of the generally much more significant product rights.

- Using such a key principle as the criterion would also avoid the arbitrariness of a 12-month rule and its concomitant detailed exceptions. Any sale whose outcome is expected to occur at a later date would need to be well documented and, if material, explained in the notes. As you have clearly appreciated, regulatory requirements often lead to protracted sale-process periods, so it would be helpful to avoid arbitrary, impractical rules in this respect.
- Keeping the guidelines (amended as necessary) within IAS 16 and/or 36, as we recommend, would avoid the considerable practical problems in classification which would arise from the proposals in respect of assets held for sale but still in active use. (See also Q2 below).
- We recommend that you reconsider whether abandoned assets could not be included in this separate balance sheet category, to ensure greater consistency of approach. This would be straightforward if you adopt our recommendation of amending IAS 16 and 36 rather than creating a separate new standard. Also, a definition of “abandoned asset” would be helpful.
- Amendment of IAS 16 and 36 would also avoid the potential inconsistencies with regard to the inclusion of goodwill, assets held under financial leases and construction contracts. If it is nevertheless decided to proceed with a separate standard, the congruence of that standard with IAS 36 in respect of scoping these items in or out, and the guidance on the treatment of goodwill, which appears to show some inconsistencies within ED 4, should also be carefully reviewed.

## **Q2. Measurement of non-current assets classified as held for sale**

In our view the proposals are inappropriate in respect of assets held for sale but still in active use. The guidance in IAS 16 and 36 should remain in effect. The IAS 36 approach makes much more economic sense. We believe it wrong to stop depreciation of such assets while they are still in active use. The requirements of IAS 16 and 36 ensure that the use of the assets is properly reflected in the income statement and in the balance sheet. Also, stopping depreciation would produce misleading distortions of production costs at the detailed level of accounting and management financial reporting systems. Depreciation should only cease when an asset or group of assets is withdrawn from active use.

We also believe that the Board should rethink the position in respect of joint ventures and associated companies which fall into the held-for-sale category. If we have understood the proposals correctly, such units would cease to be accounted for by the equity method or proportionate consolidation method and their value reduced to fair value less cost to sell. In our view this would be quite incorrect for the following reasons:

- until disposal, such units continue to be held in joint control or with significant influence as part of the entity’s activities, so their results should continue to be reflected in those of the entity, on the same basis as previously;

- continuing to apply the existing accounting method for the joint venture or associated company would be more consistent with the treatment of subsidiaries

If the proposals were to go forward in their present form, we would suggest that the allocation of any impairment loss on a disposal group should be conformed to IAS 36 (revised), which does not appear to be the case at present, and an illustrative example included of how this allocation is to be done as this is not clear from ED 4, para. 14.

### **Q3. Disposal groups**

While generally supporting the approach proposed, which we would like to see reflected in IAS 36 rather than in a separate standard, we would like to make the following points:

- The approach taken on goodwill seems somewhat confusing (see also our response on Q1. above).
- The definition of “disposal group” in Appendix A talks of “to be disposed of, by sale or otherwise...” The last two words need precision: see also our response to Q1. above in respect of scrapping and abandonment.

### **Q4. Newly acquired assets**

We support the approach proposed, but not for the pragmatic reasons given in the Basis for Conclusions. We believe that the values assigned in purchase accounting should reflect the value to the business, and the proposal achieves this.

### **Q5. Revalued assets**

We are generally in agreement but find the guidance rather confusing and recommend providing an example to illustrate what is required. Also, we have some doubts about the requirements in B8, which we believe should be checked for internal consistency with ED 4’s principal measurement requirement.

### **Q6. Removal of the exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale**

While we appreciate that the consolidation of such subsidiaries can be justified in terms of the entity having control during the period through to disposal, we find that the current approach is preferable as it excludes from results elements which will not form part of continuing performance and thus provides users with a clearer basis for predicting future flows. (As such subsidiaries have not been part of continuing operations, it is also inappropriate to regard them as discontinued).

#### **Q7. Presentation of non-current assets held for sale**

We agree with the proposal to show separately in the balance sheet. However, we believe that a net presentation of assets and liabilities for a disposal group would be preferable to the proposed gross presentation. This is because, in contrast to the superficially analogous situation on partially recoverable provisions (IAS 37, para. 53), the net assets will be sold as a bundle to the buyer - so the conditions for netting assets and liabilities are met. Also, the resulting single amount is more meaningful for the user than two separated gross amounts and more fairly reflects the economic substance of the situation. Finally, a net presentation of assets and liabilities for a disposal group would also be consistent with the presentation of a single pre-tax amount for discontinued operations in the income statement, as we advise under Q9. below However, one aspect on which we would appreciate further research is that of “confidentiality”. By definition, if a single amount is shown in the balance sheet as “held for sale”, the prospective buyer is provided with information which is potentially to his advantage and, therefore, to the disadvantage of the entity. This situation is similar to the problem encountered on litigation provisions but is potentially more acute insofar as there are often several litigation provisions which can be combined while assets held for sale are more likely to stand alone. The possibility to combine “non-current assets held for sale” with “other current assets” in such circumstances would be helpfully pragmatic.

#### **Q 8. Classification as a discontinued operation**

We are strongly of the opinion that the ED 4 “component” definition sets the “threshold” for discontinued operations too low and does not represent an improvement on the present IAS 35 criteria, which we prefer to broadly retain.

Separating out discontinued operations is designed to enhance the income statement’s predictive value. They should therefore be defined as significant changes in the scope of operations which will influence the sensitivity of the entity to external economic segmental factors. They should result from strategic decisions only and exclude the results of more tactical rationalisation and cost-cutting decisions which the “components” approach would not be able to filter out. We therefore believe that a disposal group should qualify as a discontinued operation only if it meets the IAS 35 criterion of being “a separate major line of business or geographical area of operations”. We are particularly concerned that a lower threshold would be result in discontinued operations being reported much more frequently - almost a recurring item - even if the scope of the entity’s operations has not significantly changed in business or financial terms. Also, the consequent restatements would become almost a permanent feature, destroying continuity and confusing the user of the financial statements.

We appreciate that our preferred solution would diverge rather than converge from US GAAP but are of the opinion that the present IAS 35 approach is more relevant and helpful to the user and thus a better solution.

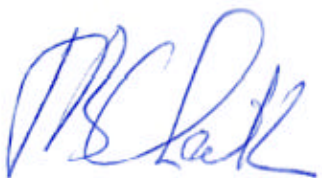
**Q9. Presentation of a discontinued operation**

We believe that the presentation of a single after-tax amount for discontinued operations on the face of the income statement with a breakdown in the notes would best meet the objectives of comparability, understandability and relevance without losing valuable detailed information.

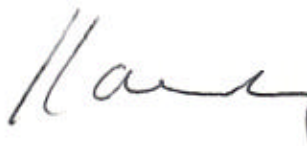
With regard to the comment in BC55, it is perhaps worth mentioning that this idea from the “Reporting Performance” project is one of the few ideas in that project to enjoy fairly universal support, as far as we can ascertain.

Yours sincerely

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