Institute of
CHARTERED ACCOUNTANTS
of New Zealand

17 November 2003

Anne McGeachin
Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Anne

Comments on ED 4 Disposal of non-current assets and presentation of discontinued operations

The Financial Reporting Standards Board (FRSB) is pleased to make the following comments on ED 4.

In general, the FRSB supports the proposals as set out in ED-4. This response includes, where appropriate, comments received from our constituents when ED 4 was simultaneously exposed in New Zealand.

Question 1 – Classification of non-current assets held for sale
The Exposure Draft proposes that non-current assets should be classified as assets held for sale if specified criteria are met. (See paragraphs 4 and 5 and Appendix B.) Assets so classified may be required to be measured differently (see question 2) and presented separately (see question 7) from other non-current assets.
Does the separate classification of non-current assets held for sale enable additional information to be provided to users? Do you agree with the classification being made? If not, why not?

The FRSB supports the proposal that non-current assets be classified as assets held for sale if specified criteria are met and that assets so classified may be required to be measured differently and presented separately from other non-current assets. The FRSB considers that the separate classification of non-current assets held for sale enables additional information to be provided to users. The FRSB has the following additional comments.

While the ED identifies the class of assets as "held for sale", it is silent on whether these should be classified and disclosed as current or non-current assets. The FRSB suggests that assets held for sale be designated as "current" or "non current" as appropriate. While the presumption and the criteria set out in Appendix B are that such assets will be disposed of within a year, some assets may take more than one year to dispose of. The FRSB considers that differentiating held for sale assets between current and non-current enables additional information to be provided to users of the information.

The ED deals with assets held for sale and focuses on the information on cash flows to be derived from the sale of the assets. The ED excludes operations to be abandoned. It presumably also excludes assets that are transferred between group entities. The FRSB considers that the reasons for the separate classification of assets held for sale also applies to assets abandoned (or to be abandoned) and assets transferred (or to be transferred) where the relevant decision has been and criteria similar to those in Appendix B have been met. Users need information on the disposal of non-current assets and discontinued operations regardless of the mode of discontinuation, i.e. whether by sale or abandonment or transfer. Although abandonment and transfer of assets can take place in both profit-oriented and public benefit entities, it is particularly relevant to the latter where operations are frequently transferred between agencies. While there will not be any impact on the group financial statements, operations abandoned (or to be abandoned) and assets transferred (or to be transferred) should be reflected in the individual entity's financial statements as discontinued operations. Separate financial statements are required to be prepared and made available by almost all controlled public sector entities and the issue is very significant for these entities. The FRSB suggests that a requirement based on paragraph 6 of IAS 35 be included in the final standard to deal with this issue.

The FRSB notes an inconsistency in the criteria set out in paragraph B1 of Appendix B. It seems inconsistent for a sale to be "highly probable" (B1(d)) if an active plan to sell/locate a buyer has only been initiated (B1(c)). The FRSB suggests the tightening up of para B1(c) by changing "are initiated" to "has been activated". It considers that the tightening of the criterion in (c) would limit the cases that might arise under B2(c).

In relation to assets acquired with the intention of disposal, the FRSB considers that such assets would fall within the definition of a current asset as being acquired "for trading purposes" (subparagraph (b) of Appendix A). It seems unusual for the purchaser to adopt the seller's classification of the assets as non-current in its own financial statements when it acquired the assets with the intention of disposal and the FRSB questions the rationale for regarding such assets as non-current.

The FRSB also suggests that the IASB considers extending the disclosures in paragraph 29 of the ED to include a description of the non-current asset or disposal group that is held for sale. It considers that this information provides additional useful information to the users.

Question 2 – Measurement of non-current assets classified as held for sale

The Exposure Draft proposes that non-current assets classified as held for sale should be measured at the lower of carrying amount and fair value less costs to sell. It also proposes that non-current assets classified as held for sale should not be depreciated. (See paragraphs 8-16.)

Is this measurement basis appropriate for non-current assets classified as held for sale? If not, why not?

The FRSB agrees with the proposal to measure non-current assets classified as held for sale at the lower of carrying amount and fair value less costs to sell.

However, the FRSB disagrees with the proposal that non-current assets classified as held for sale should not be depreciated. It considers that depreciation is a measure of consumption of an asset and it would be conceptually inconsistent to not reflect the benefits consumed through the use of the asset in the income statement. The FRSB considers that if non-current assets held for sale are still being used in the operations of the entity, they must continue to be depreciated.

The FRSB notes that the phrase "fair value less costs to sell" introduces a new "name" for a concept that is already well understood – net selling price. It considers that introducing the new phrase is unnecessary and affects the readability of the standard. It notes the proposed consequential amendment to IAS 36 but considers that adoption of this new term has implications for the definition of "recoverable amount" and therefore requires amendment throughout other relevant standards. The FRSB does not consider it necessary to demonstrate convergence with SFAS 144 by adopting its terminology.

Question 3 – Disposal groups
The Exposure Draft proposes that assets and liabilities that are to be disposed of together in a single transaction should be treated as a disposal group. The measurement basis proposed for non-current assets classified as held for sale would be applied to the group as a whole and any resulting impairment loss would reduce the carrying amount of the non-current assets in the disposal group. (See paragraph 3.)
Is this appropriate? If not, why not?

The FRSB supports the concept of a disposal group and its measurement basis.

Under ED 4, disposal groups and discontinued operations may include non-current liabilities, current assets and/or current liabilities. The FRSB suggests that the IASB considers whether this should be made clearer in paragraph 3 of ED 4.

Under IAS 36 cash-generating units to which goodwill are allocated "represent the smallest cash-generating unit to which a portion of the carrying amount of the goodwill can be allocated on a reasonable and consistent basis." However, under paragraph 3 of the ED, a disposal group can be "part of a cash-generating unit". It is unclear how goodwill is to be included in a disposal group if the disposal group is only part of a cash-generating unit. The FRSB suggests that the IASB limits the definition of a disposal group to a cash generating unit or a group of cash generating units (and not include "parts" of generating units) by deleting the offending phrase from paragraph 3 and amending the definition of a "disposal group" to be no smaller than a cash generating unit.

The wording in paragraph 3 indicates that the measurement requirements of the standard only apply to a disposal group as a whole when it includes an asset within the scope of ED 4. However, paragraph 8 applies the measurement requirements to a disposal group without reference to it including an asset within the scope of ED 4. The FRSB suggests this possible anomaly be resolved by deleting the phrase "If a non-current asset covered by this [draft] IFRS is part of a disposal group," in paragraph 3. If the intention of the IASB is that such groups must include a non-current asset, it suggests that the definition of "disposal group" be amended to reflect this.

ED 4 does not include any requirements in respect of the measurement of liabilities that form part of a disposal group. The FRSB suggests that the proposed standard be extended to include the necessary requirements in respect of liabilities.

It is not clear from paragraph 14 that the impairment loss (subsequent gain) recognised for a disposal group should be offset against the carrying amount of the assets after the measurement requirements of the other standards were applied, i.e. the assets should first be measured using the requirements of the other standards, then the disposal group should be measured using the requirements of ED 4 and any resulting impairment loss (subsequent gain) offset against the assets. The FRSB suggests that paragraph 14 be clarified to state that the impairment loss (subsequent gain) recognised for a disposal group should be offset against the carrying amount of the assets after the measurement requirements of the other standards are applied.

IASB Question 4 – Newly acquired assets

The Exposure Draft proposes that newly acquired assets that meet the criteria to be classified as held for sale should be measured at fair value less costs to sell on initial recognition (see paragraph 9). It therefore proposes a consequential amendment to [draft] IFRS X Business Combinations (see paragraph C13 of Appendix C) so that non-current assets acquired as part of a business combination that meet the criteria to be classified as held for sale would be measured at fair value less costs to sell on initial recognition, rather than at fair value as currently required.

Is measurement at fair value less costs to sell on initial recognition appropriate? If not, why not?

The FRSB supports the proposed measurement basis for newly acquired assets.

In addition, it suggests that the "rare circumstances" in paragraph 10 be limited to those set out in paragraph B2.

Question 5 – Revalued assets

The Exposure Draft proposes that, for revalued assets, impairment losses arising from the write-down of assets (or disposal groups) to fair value less costs to sell (and subsequent gains) should be treated as revaluation decreases (and revaluation increases) in accordance with the standard under which the assets were revalued, except to the extent that the losses (or gains) arise from the recognition of costs to sell. Costs to sell and any subsequent changes in costs to sell are proposed to be recognised in the income statement. (See paragraphs B6-B8 of Appendix B.) Is this appropriate? If not, why not?

The FRSB supports the proposed treatment on revalued assets.

Question 6 – Removal of the exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale

The Exposure Draft proposes a consequential amendment to draft IAS 27 Consolidated and Separate Financial Statements to remove the exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale.

(See paragraph C3 of Appendix C and paragraphs BC39 and BC40 of the Basis for Conclusions.)
Is the removal of this exemption appropriate? If not, why not?

The FRSB does not support the proposed removal of the exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale. It considers that requiring subsidiaries acquired and held exclusively with a view to resale to be inconsistent with the disposal group concept and the proposal not to depreciate the assets.

The FRSB also notes that there is a potential inconsistency between the proposed treatment of subsidiaries and the treatment of associates acquired and held with a view to resale. While subsidiaries acquired with an intention of resale are required to be consolidated, the consequential amendments (Appendix C, paragraph C4) state that associates acquired with an intention of resale should not be equity accounted but should be fair valued in accordance with IAS 39 Financial Instruments: Recognition and Measurement. It considers that the IASB may wish to consider whether there should be consistent accounting treatment for both subsidiaries and associates acquired with the intention of resale.

Question 7 – Presentation of non-current assets held for sale
The Exposure Draft proposes that non-current assets classified as held for sale, and assets and liabilities in a disposal group classified as held for sale, should be presented separately in the balance sheet. The assets and liabilities of a disposal group classified as held for sale should not be offset and presented as a single amount. (See paragraph 28.)
Is this presentation appropriate? If not, why not?

The FRSB supports the proposal that non-current assets classified as held for sale, and assets and liabilities in a disposal group classified as held for sale, should be presented separately in the balance sheet and that no set-off should be allowed. The FRSB believes that this presentation enhances the usefulness of the balance sheet information for users of the financial statements. While at the measurement date, management's intention may be clear in relation to the assets and liabilities comprising the disposal group, the subsequent negotiation of their disposal may not achieve that effect. Separate presentation provides information that is useful to users in the context of that uncertainty.

Question 8 – Classification as a discontinued operation
The Exposure Draft proposes that a discontinued operation should be a component of an entity that either has been disposed of, or is classified as held for sale, and: (a) the operations and cash flows of that component have been, or will be, eliminated from the ongoing operations of the entity as a result of its disposal, and (b) the entity will have no significant continuing involvement in that component after its disposal. A component of an entity may be a cash-generating unit or any group of cash-generating units. (See paragraphs 22 and 23.) These criteria could lead to relatively small units being classified as discontinued (subject to their materiality). Some entities may also regularly sell (and buy) operations that would be classified as discontinued operations, resulting in discontinued operations being presented every year. This, in turn, will lead to the comparatives being restated every year. Do you

agree that this is appropriate?
Would you prefer an amendment to the criteria, for example adding a requirement adapted from IAS 35 Discontinuing Operations that a discontinued operation shall be a separate major line of business or geographical area of operations, even though this would not converge with SFAS 144 Accounting for the Impairment or Disposal of Long-Lived Assets. How important is convergence in your preference?
Are the other aspects of these criteria for classification as a discontinued operation (for example, the elimination of the operations and cash flows) appropriate? If not, what criteria would you suggest, and why?

The FRSB prefers the criteria from IAS 35 for a discontinued operation to be a separate major line of business or geographical area of operations. While the concept of materiality already should ensure that very small units are not treated in this manner, the proposed standard could lead to small units being treated as discontinued operations. In relation to applying the proposed standard in New Zealand, the frequency of public sector operations changing (as policy and politicians change) could well render the disclosure unhelpful and onerous – the confusion to users does outweigh the benefits of widening the definition of discontinued activity. A similar situation could arise for investment companies applying the proposed standard.

While the FRSB considers convergence with SFAS to be important, this is not considered to be imperative. The FRSB does not consider convergence to be the ultimate goal when developing standards. Rather, the goal should be to improve the quality of information reported to users.

Question 9 – Presentation of a discontinued operation
The Exposure Draft proposes that the revenue, expenses, pre-tax profit or loss of discontinued operations and any related tax expense should be presented separately on the face of the income statement. (See paragraph 24.) An alternative approach would be to present a single amount, profit after tax, for discontinued operations on the face of the income statement with a breakdown into the above components given in the notes.
Which approach do you prefer, and why?

The FRSB considers it important to ensure that revenues and expenses are disclosed. The FRSB is ambivalent as to where the detail is presented and considers that entities should be the best judge of whether the detailed disclosures are made on the face of the income statement or in the notes. The FRSB prefers that the proposed standard retain some flexibility with regard to placement of the disclosures.

Other Comments

The FRSB notes the use of the term "highly probable". It does not see the need to introduce yet another term to define the level of certainty required for a particular test. Trying to define the levels of certainty for each test in the standard is not necessary in a principles-based environment.

ED 4 contains a number of significant cross-references to Appendix B. Most of these cross-referenced requirements are essential to the understanding of the proposed standard and should be incorporated into the body of the standard. Incorporating these requirements would greatly improve the understandability of the standard.

The cross-reference in paragraph B4 to paragraph 28(a) should be to paragraph 29(a).

Yours sincerely

Tony van Zijl
Chair – Financial Reporting Standards Board