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THE VOICE OF BUSINESS

INTERNATIONAL ACCOUNTING STANDARDS BOARD

ED4 Disposal of non-current assets and presentation of discontinued operations

CBI RESPONSE **October 2003**

I INTRODUCTION AND SUMMARY OF CBI RESPONSE

1. The CBI welcomes the opportunity to respond to the Board's consultation.

2. We support, in principle, the aims of the IASB and FASB to converge accounting standards on the basis of the superior standard. However, we do not support ED 4 as we are not convinced that it represents convergence to the better standard. On practical grounds, we are also not convinced that the issues the ED addresses are significant accounting differences with US GAAP that need to be addressed before 2005.

3. We do not believe that ED 4 will produce a better accounting standard because:

    - It introduces a new measurement basis, lower of carrying value and fair value less disposal costs, which is inconsistent with the measurement basis for financial assets, investment properties and impaired assets. There seems no urgency to do this before the measurement project determines the appropriate bases for measurement more generally.

    - It is a rules based standard, requiring a list of criteria to be met before an item can be classified as a held for sale. This is contrary to the thrust of IFRS. In addition, SFAS 144 has only recently been introduced and it is not yet clear whether it is capable of consistent and practical application.

    - It could result in many insignificant disposals being treated as discontinued operations. This will increase the amount of accounting restatements to the detriment of the clarity of financial reporting.

    - It would prevent depreciation being charged on assets held for disposal even if they are still being used by the businesses. This seems contrary to basic accounting principles.

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4. Any new Standard should also have regard to the Board's proposals for a new comprehensive income statement. However at this time the outcome of the Board's project and its proposals are not yet known. Therefore, there seems no urgency to issue a standard before 2005.

5. Any standard resulting from ED4 will also need to be addressed in the context of the application of IFRS 1 regarding first time application.

7. We set out below our responses to the specific consultation questions.

II RESPONSES TO CONSULTATION QUESTIONS

IASB 1: **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 criteria set out in Appendix B are very prescriptive and such prescription is inconsistent with what a principles – based standard should be. If such prescription is necessary, it would also be better set out in paragraph 5 itself, rather than an appendix.

In our view assets should be classified as held for sale as soon as, and only if, a sale is highly probable, such as when a public announcement to that effect is made. We do not agree with an arbitrary twelve month limit. Whilst the accounting treatments should apply to all the assets held for sale, the disclosure requirements should only apply to discrete business segments.

IASB 2: **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 cost 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?

We consider that assets held for sale do not need specific measurement requirements. The present requirements in IAS 16, IAS 38 and IAS 36 are more than adequate.

CBI members are also strongly of the view that depreciation should not cease when assets are still in active use, but only when withdrawn from active use.

According to IAS 16 and IAS 38, the sale decision may have an impact on the useful life of the asset. According to IAS 36, the sale decision is an indicator that the asset may be impaired and hence calls for an immediate impairment test.

ED4 needs to be clearer on the interaction between its requirements and those in IAS 36, as the latter refers to "plans to discontinue" as evidence of impairment and the consequences of impairment are different between the two.

In addition, there may be circumstances where disclosure of fair value that the company expects to receive may be commercially sensitive. This issue is not addressed in ED 4.

IASB 3: **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 value of the non-current assets in the disposal group. (See paragraph 3.)**
Is this appropriate? If not, why not?

According to Paragraph 3 of ED4 a disposal group may be a group of cash generating units, a single cash generating unit or part of a cash generating unit.
We consider that it is sufficient to use the existing definition of a cash generating unit which is contained in IAS 36.

Paragraph 14 of ED4 requires certain non – current assets (including goodwill) forming part of a disposal group to be measured in accordance with other applicable IAS, with any impairment loss on the value of the disposal group allocated only against the carrying amount of those non – current assets that are within the scope of the standard.

However the proposals and explanations in paragraphs BC 27 – 29 are unclear, differ from IAS 36 (which would not apply to assets subject to ED4 by virtue of paragraphs C8 – C9) and may produce misleading results. Impairment should be addressed in any new standard based on ED4 solely by reference to the existing requirements of IAS 36.

IASB 4: **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 as currently required.**
Is measurement at fair value less costs to sell on initial recognition appropriate? If not, why not?

As explained above, we do not consider it necessary or appropriate to provide new measurement rules for this category of assets.

IASB 5: **The Exposure Draft proposes that, for re-valued 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 B6B8 of Appendix B.)**
Is this appropriate? If not, why not?

As explained above, we do not consider it necessary or appropriate to provide new measurement rules for this category of assets.

IASB 6: **The Exposure Draft proposes a consequential amendment to draft IAS 27 *Consolidated and Separate Financial Statement* 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 removal of this exemption appropriate? If not, why not?

We do not agree with the removal of the exemption from consolidation for subsidiaries acquired.

For example, if a disposal group has just been acquired as part of a larger group, and is to be sold, perhaps as a regulatory requirement, the key issue is what are the expected net proceeds, and this should be the basis for valuing it, and its carrying value as a single item in the balance sheet. To require temporary consolidation, with disclosure of all the consequent details, is excessive and does not provide useful information.

IASB 7: **The Exposure Draft proposes that non-current assets classified as held for sale, and assets and liabilities of 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?

Yes.

IASB 8: The Exposure Draft proposes that a discontinued operation should be 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 entity may also regularly sell (and buy) operations that would be classified as discontinued operations, resulting in discontinued operations being reported 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 to be made, for example adding a requirement adapted from IAS 35 *Discontinuing Operations* that a discontinued operation shall be separate major line of business or geographical area of operations, even though this would not converge with SFAS 144 *Accounting for the Impairment of Disposal of Long-Lived Assets.* How important is convergence in your preference?

Are the other aspects of these criteria's 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?

Separating out discontinued operations is designed to enhance the income statement's predictive value. Discontinued operations should therefore be defined as significant changes in scope of operations , such as to influence the sensitivity of the entity to external economic segmental factors. Discontinued operations should result from strategic decisions only, whereas disposal groups that fit the component decision may arise from rationalisation and cost – cutting decisions.

We therefore believe that a disposal group qualifies as discontinued operations only if it meets the IAS 35 criterion, that is if it "represents a separate major line of business or geographical area of operations".

We disagree with the proposal that introducing a definition of a "component" constitutes an improvement in the current definition and criteria for discontinued operations in the present IAS 35. The definition would result in many groups reporting discontinued operations every year and having to restate the prior year comparative figures which would be confusing to shareholders and users of accounts.

IASB 9: **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?

If discontinued operations were defined as in IAS 35 as relating to a separate major line of business or geographical area of operations, then we agree that there should be disaggregated disclosure on the face of the income statement. However, if the IASB pursues a definition of discontinued operations that will result in insignificant disposals being treated as discontinued operations, then we consider that the alternative approach is preferable. This would allow companies to choose to make additional, disaggregated disclosure for significant discontinued operations. Detailed items of income and expenditure related to discontinued operations could be provided in the notes, but we remain of the view that disclosure requirements should only be necessary if they are material.

We note that compliance with paragraph 81(h) of IAS 12 could prove difficult for small discontinued operations where the tax related to the ongoing operations can only be allocated on a relatively arbitrary basis.