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Sir David Tweedie
Chairman of the
International Accounting Standards Board
30 Cannon Street

London EC4M 6XH
United Kingdom

Düsseldorf, October 7, 2003
540/520

Dear Sir David

Re.: Exposure Draft ED 4: Disposal of Non-Current Assets and Presentation of Discontinued Operations

We appreciate the opportunity to comment on the Exposure Draft mentioned above and would like to submit our comments as follows:

General remarks:

The Exposure Draft ED 4 *Disposal of Non-Current Assets and Presentation of Discontinued Operations* is part of the short-term convergence project to reduce differences between IFRSs and US GAAP. Although we appreciate the intention of the project, we very much doubt that there is any need for a new international standard in this area. This Exposure Draft is very complicated, detailed and lacks consistency (see our comments below). Given the Board's conclusion that the measurement requirements of this Exposure Draft would often not involve a significant change from the requirements of existing or proposed IFRSs (BC 23) and, in our view, the superiority of the current IAS 35 over the proposed guidance in respect of discontinued operations, together with IAS 36 covering impairment of assets, including circumstances in which non-current assets are to be sold, we are of the opinion that amendments to current guidance are preferable to the issuance of a new standard.

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We strongly support the Board's intention to develop principles based standards. However, we think that the current Exposure Draft is in contrast to this idea, possibly because it is more or less a pure adoption of the requirements of US standard SFAS 144 *Accounting for the Impairment or Disposal of Long-Lived Assets.* We also have serious doubt with regard to the Board's consideration in BC 3, i.e. that for topics recently considered by the FASB or the IASB, there is an expectation that whichever board has more recently deliberated that topic will have the higher quality solution. In our opinion, this assumption remains to be proved in every single case.

In the current Exposure Draft the proposed accounting requirements on the disposal of non-current assets and the presentation of discontinued operations are separated and spread between the standard and Appendix B, which makes it difficult to read and introduces the risk that important aspects could be overlooked. As Appendix B contains essential rules, in particular on the classification of a non-current asset or disposal group as held for sale, we propose that the basic requirements be integrated into the standard, should the Board continue to see the need for a new standard. The remainder of Appendix B could become part of the Illustrative Examples or Implementation Guidance.

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?

We agree with the Board's general conclusion that providing information about non-current assets and groups of assets and liabilities to be disposed of (disposal groups) is of benefit to users of financial statements (BC 12). Nevertheless, the proposed classification of non-current assets held for sale creates practical problems, resulting from the complexity of the potentially necessary re-classifications of a multitude of individual assets. Such re-classifications of the *individual* assets will be necessary even when these form part of a disposal group, and are likely to require major modifications of preparers' EDP systems.

Additional pressure might be caused by the short-term implementation of the new rules: Since the proposed standard should normally be applied to the annual financial statements for 2005 which include comparatives for 2004, there would be very little time to realise the necessary changes given IASB's project timetable (IFRS in the first quarter of 2004) and the European endorsement process.

Furthermore, the classification criteria of Appendix B are subject to potential abuse despite being very specific, complicated and rules based.

In order to reduce complexity and to avoid an element of management intent or manipulation we would like to suggest a separate classification of assets that belong to one of the following two groups:

- 'assets retired from active use' and
- 'assets held for sale under a binding sale agreement'.

According to ED 4.5 sale transactions include exchanges of non-current assets for other non-current assets. In our view, an exchange of items of property, plant and equipment should not be measured at fair value and, thus, a realisation of revenues should not be considered when almost identical assets are exchanged without leading to a change in economic substance. Otherwise, the treatment proposed would lead to the realisation of revenue even though no transaction of economic substance had taken place (refer to our comment letter, dated 17 September 2002, on the Exposure Draft of Proposed Improvements to International Accounting Standards). Therefore, we contend that such transactions relating to non-current assets should not be treated as a sale. This is consistent with the Board's conclusion that an entity measures the acquired item at fair value unless either the exchange transaction lacks commercial substance, or the fair value of neither asset exchanged is reliably measurable (refer to IASB Update April 2003).

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?

In our opinion, there is no necessity for the proposed specific measurement requirements.

We do not agree that all non-current assets classified as held for sale should not be depreciated. For the sake of conceptual consistency the cost of all non-current assets that are still being used, whether defined as 'held and used' or 'held for sale', should be allocated by depreciation or amortisation over the period during which benefits are obtained from their use. This allocation should end when the assets concerned are retired from active use and only then.

Moreover, we believe that IAS 36 is an appropriate und sufficient means of measurement of impairments both when a non-current asset (or a disposal group) is still in use and when an asset is retired from active use.

IAS 36 requires a write-down to the recoverable amount, i.e. the higher of the value in use and net selling price (or fair value less costs to sell) in case of an impairment. In assessing whether there is any indication that an asset may be impaired, an entity should consider plans to dispose of an asset before the previously expected date (IAS 36.9). If there is no reason to believe that an asset's value in use materially exceeds its net selling price, the asset's recoverable amount may be taken to be its net selling price. This will often be the case for an asset held for disposal, because the value in use of an asset held for disposal will consist mainly of the net disposal proceeds, since the future cash flows from continuing use until disposal are likely to be negligible (IAS 36.18). Thus measurement of non-current assets classified as held for sale in accordance with IAS 36 is similar to that required under ED 4. If future cash inflows from continuing use until disposal are material, IAS 36 delivers more information by considering value in use, i.e. estimating the future cash flows to be derived from continuing use of the asset and from its ultimate disposal (IAS 36.26). This is not taken into account in ED 4 on the grounds that it is unlikely to be material. This may, of course, not always be the case. We therefore favour the treatment prescribed by IAS 36.

With respect to the probable future cash inflows of assets which are likely to be sold we suggest that additional disclosure requirements might be considered instead of the proposed specific measurement requirements: If the intention is that information is to be provided to enable the user to assess the timing and amount of future cash flows that result from the sale of assets (BC 12), measurement at the lower of carrying amount and fair value less costs to sell would not be the appropriate instrument to achieve this because fair value less costs to sell may well be higher than the carrying amount. In this case the future cash flow is not reflected in the balance sheet under the historical cost convention, which, in our opinion, should be retained for such assets. Besides, as noted above, fair value less costs to sell is only a rough indication of future cash flows when an asset held for sale is intended to be temporarily used.

The Basis for Conclusions mentions the intended requirement that an entity must keep its residual values up to date (BC 22). As we expressed in our comment letter, dated 17 September 2002, on the Exposure Draft of Proposed Improvements to International Accounting Standards we agree to the annual reassessment of residual values, but it should be made clear that such a review is not a detailed examination and that the review covers only the consideration of whether there are clear indications that the residual values are impaired. Procedures beyond this when there are no such indications arising from the review result in excessive effort and cost.

If the IASB does not intend to change the proposed measurement rules of ED 4, we would ask the Board to reconsider the guidance on gains for subsequent increases in fair value less costs to sell (ED 4.12 (b)):

- Recognising a gain for the reversal of an impairment that occurred before the classification of the asset as held for sale is not consistent with the measurement concept of paragraph 8 of the Exposure Draft, which states that the carrying amount (and not the historical cost) is the maximum amount, when the measurement concept of ED 4 becomes effective.

- Even if such gains for the reversal of an impairment under IAS 36 were considered appropriate, the increased carrying amount of an asset due to the reversal of an impairment loss should never exceed the carrying amount that would have been determined, net of amortisation or depreciation, had no impairment loss been recognised for the asset in prior years (IAS.36.102).

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?

As mentioned in our answer to question 2 we cannot identify any need for the proposed particular measurement requirements concerning non-current assets held for sale.

We would like to point out that the proposed concept of disposal groups is somewhat confusing with regard to the impairment rules and the allocation of an impairment loss. As we understand, the different requirements are connected as follows:

Under ED 4.11 the carrying amounts of any assets that are not covered by this draft IFRS, including goodwill, but are included in a disposal group (which may be a group of cash-generating units, a single cash-generating unit or part of a cash-generating unit, ED 4.3) classified as held for sale, shall be measured in accordance with other applicable IFRSs before the fair value less costs to sell of the disposal group is measured. Subsequently, any impairment loss recognised for the disposal group shall reduce the carrying amount of the non-current assets in the group that are included in the scope of the draft IFRS (ED 4.14).

Therefore, with regard to goodwill an impairment test according to IAS 36 is necessary before the above-mentioned impairment test under ED 4 takes place. The impairment test under IAS 36 considers both net selling price and value in use (as recoverable amount). Under IAS 36.88 an impairment loss for a cash-generating unit should first be allocated to reduce the carrying amount of the cash-generating unit's goodwill, then to other assets of the unit on a pro-rata basis. However, as far as non-current assets are concerned, in our view, such a pro-rata-allocation is not truly relevant in this case, because ED 4 is applicable to these assets in the next step.

We consider the following accounting treatment appropriate in the case of a group of assets and liabilities to be disposed of by sale (the 'disposal group') that, at present, is part of a cash-generating unit ('the CGU'). For ease of comprehension we have identified three steps:

(1) allocation of the previous carrying amounts of assets and liabilities between the disposal group and the remainder of the CGU that is not to be disposed of

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by sale. The previous carrying amount of goodwill should be allocated only to the remainder of the CGU.

(2) impairment test with respect to the remainder of the CGU that is not to be disposed of by sale (IAS 36.9).[Thus any write-down of goodwill falls entirely on the remaining elements of the CGU.]

(3) according to the concept of ED 4 impairment test with respect to the disposal group: measurement at the lower of carrying amount or fair value less costs to sell of the disposal group (in our view this is only appropriate when future cash flows from possible continuing use until disposal are negligible, otherwise the present value of future cash flows from continuing use also must be taken into account). Allocation of any impairment loss on a pro-rata basis.

Overall, taking into account IAS 36 we believe that ED 4 results in the application of unduly complex procedures in this area.

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?

We agree to the proposal with regard to Business Combinations in cases where the buyer did not intend to use the asset but to sell it immediately. In most cases, however, the assets acquired are used until sold and thus the buyer has also paid for the temporary use of, and the resulting cash inflows from the acquired asset. Accordingly the proposed measurement for newly acquired, but held for sale, assets, i.e. measurement on initial recognition at fair value less costs to sell, does not reflect the economic substance of such a transaction.

BC 30 mentions instances, other than Business Combinations, in which an entity acquires a non-current asset that meets the criteria to be classified as held for sale. Such transactions, except for trading activities, are uncommon in practice. The acquisition of assets for trading purposes does not lead to the recognition of non-current assets.

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 paragraph B6–B8 of Appendix B.)

Is this appropriate? If not, why not?

In general, we are of the opinion that no additional measurement concept is necessary (see our comments above).

The proposed mixed model of ‘revaluation’ and ‘assets held for sale’ results in difficult and confusing detailed rules. In our view, the main issue is the treatment of costs to sell and any future changes in such costs, which are to be charged to income. We would like to explain our understanding of the proposed accounting treatment in the following example:

	Case 1	Case 2
Amortised cost as of 31 Dec 01	100	100
Fair value as of 31 Dec 01	80	200
Revaluation surplus as of 31 Dec 01	0	100
Fair value on reclassification to 'held for sale'	70	180
Expense	10	0
Change in revaluation surplus	0	-20
Estimated costs to sell on reclassification to 'held for sale'	20	20
Expense	20	***20***
Change in revaluation surplus	0	***0***

With regard to case 2 we doubt that the estimated costs to sell should be recognised in the income statement, since the costs do not exceed the amount still held in the revaluation surplus. Showing an expense is inconsistent with the concept of revaluation as expressed in IAS 16.37 and 16.38. We cannot see any justification for a different accounting treatment concerning changes in fair value and costs to sell.

Furthermore, considering the balance between benefit and cost, the different accounting treatment for changes in fair value and changes in costs to sell seems to be inadequate.

Given the complicated details of this mixed model, an illustrative example would be helpful if the Board decides to stick to the measurement rules currently proposed. Such an illustrative example should include clarification of the necessary accounting entries with respect to the revaluation surplus.

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?

We do not consider the removal of this exception appropriate and therefore recommend that the exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale be retained. Our reasoning is, on the grounds of practicality, that consolidation und deconsolidation of temporary subsidiaries within a short period would require a lot of effort on the part of the preparers and also that this would result in many, sometimes minor changes in the group and group accounts respectively which might confuse rather than help the user. Furthermore, the focus of the IAS 27 exemption is on the subsidiary as a whole - in practice this meets the substance of the transactions in many cases - and not on individual assets and liabilities. In this context it is important to keep in mind that the information presented by assets measured at the lower of carrying amount and fair value less costs to sell is insufficient to enable the user to make an assessment of future cash flows (see above).

As such subsidiaries are currently accounted for in accordance with IAS 39, relevant information is already available to users of financial statements.

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?

We consider a separate presentation of assets that belong to one of the groups:

- 'assets retired from active use' <u>and</u>
- 'assets held for sale under a binding sale agreement'

as appropriate, because it improves the information available to users of financial statements (see question 1). In addition, a separate classification of all non-current assets held for sale and disposal groups would require many re-classifications throughout the year which, besides other advantages as outlined above, also supports our proposal to restrict the definition to the above two items.

We agree that assets and liabilities of a disposal group classified as held for sale should not be offset.

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?

In general, we do not consider ED 4 to be superior to the current IAS 35. Based on the discussions concerning ED 4, the necessary deliberations might result in some amendments to IAS 35, thus improving this standard.

In order to avoid the frequent re-classification of small units as discontinued and the ensuing restatement of comparative financial information, thus creating confusion for users, we prefer that the criteria for determining a discontinued operation should remain in line with the current IAS 35, as a separate major line of business or geographical area of operations, even though this would not converge with SFAS 144.

ED 4 classifies an operation as discontinued not before the date the entity has actually disposed of the operation, or when the operation meets the criteria to be classified as held for sale (ED 4.23). In our opinion, this requirement leads to a delayed reporting of reduced operations through abandonment and represents a setback compared with the current guidance in IAS 35 which classifies an operation as discontinuing at the earlier of (a) the entity entering into a binding sale agreement and (b) the board of directors approving and announcing a detailed formal disposal plan (IAS 35.16).

Moreover, a definition and further guidance would be needed regarding the criterion of 'continuing involvement' as stated in ED 4.23 (b). We believe that the Illustrative Example 9 provides insufficient clarification of this matter.

In our view, the Exposure Draft does not clarify whether a disposal group to be abandoned being a component of an entity must be presented as discontinued operations in accordance with ED 4.24

- at the date on which it ceases to be used (ED 4.6) or
- at the date it has been disposed of (ED 4.23),

provided that all other conditions are met.

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?

For the sake of clarity of presentation we clearly prefer a single amount, namely, profit after tax, for discontinued operations on the face of the income statement with a breakdown of its components provided in the notes.

Other comments:

We recommend that Appendix C be checked to establish whether additional amendments to other IFRSs, for example IAS 14, are necessary in order to achieve consistency.

The Exposure Draft uses the phrase 'highly probable' to converge the meaning with SFAS 144 and to avoid using the term 'probable' with different meanings in IFRSs. The Board regards the term 'highly probable' as implying a significantly higher probability than 'more likely than not' and as implying the same probability as the FASB's phrase 'likely to occur' (BC 57). We believe that convergence on this aspect can only be achieved if the FASB also commits itself to using the term 'highly probable' in the future. Otherwise a new area of terminological misunderstanding will be created.

We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely

Dr. Gross
Mitglied des geschäftsführenden Vorstands

Dr. Breker, WP StB
Fachleiter Rechnungslegung und Prüfung