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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street, London EC4M 6XH, United Kingdom

Dear Sir David:

**ED 4 *Disposal of Non-current Assets and Presentation of Discontinued Operations***

The global organization of Ernst & Young is pleased to comment on ED4, *Disposal of Non-current Assets and Presentation of Discontinued Operations* (ED4). While we generally support the objective of convergence of accounting principles around the world and in particular between International Financial Reporting Standards (IFRS) and accounting principles generally accepted in the United States (US GAAP), we do not believe in convergence purely for the sake of convergence. Instead, as the IASB appropriately states in paragraph BC 3, the result of convergence should be the issuance of the highest quality solutions, borrowing from the best principles and concepts in both bodies of accounting principles. In addition, we do not agree with the assumption stated in paragraph BC 3 that the standard setting body that has most recently considered a topic necessarily will have developed the highest quality solution. Solutions of a standard-setting body must necessarily be reached in the context of its existing literature. Therefore a solution that is appropriate for one standard-setting body may be inappropriate for other standard setters whose existing standards and conceptual frameworks differ.

We do not believe that the IASB has achieved its goal of producing the highest quality solution. Certain guidance contained in ED 4 appears (based upon comments in the Basis for Conclusions) to have been concluded solely to achieve convergence with US GAAP, in particular Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (FAS 144). These conclusions neither appear to focus on the context in which FAS 144 was required in US GAAP, nor on consistency with the current body of IAS. In addition, the IASB does not appear to have considered experience in implementing FAS 144 in the US, including whether its application indeed has improved the information provided to the users of financial statements.

Further, although the IASB is seeking to achieve convergence with US GAAP in ED 4, we believe that existing IAS (specifically, IAS 36 (1998), *Impairment of Assets* (IAS 36), and IAS 37, *Provisions, Contingent Liabilities and Contingent Assets* (IAS 37)), often will produce results consistent with FAS 144. Applying the current requirements of IAS 36 to assets to be disposed of would result in their being reported at fair value less costs to dispose when such amounts are less than the assets' carrying amounts. That measurement is similar to the measurement required by FAS 144, except that under FAS 144 assets would no longer be depreciated, while under IAS 36, such assets continue to be depreciated. (As discussed in our response to Question 2, we believe that a model that continues to depreciate/amortize assets that are "held for sale" but that continue to be used in production is a superior model and therefore do not believe that converging to the measurement criteria in FAS 144 is appropriate.)

We also disagree with the presumption that FAS 144 is the highest quality solution with respect to the definition of discontinued operations. IAS 35 (1998), *Discontinuing Operations* (IAS 35), currently defines a discontinuing operation as generally equivalent to a segment as defined in IAS 14 (revised 1997), *Segment Reporting* (IAS 14), which we believe to be an appropriate definition and level for discontinuing operation presentation and disclosure. ED 4's Basis for Conclusions appears to have placed a preponderance of emphasis for the IASB's decision to abandon the concepts and definitions in IAS 35, in favor of the discontinued operations criteria of FAS 144, on the usefulness of information provided to the users of the financial statements. We agree that displaying discontinued operations separately on the face of the income statement is appropriate in certain circumstances, and we agree that, from a user perspective, when considered in isolation, more detailed information is generally better. However, we do not believe that the IASB has appropriately weighed the other qualitative characteristics of the Framework, such as understandability and balance between benefit and cost, into its decision. These characteristics may be difficult to measure without field-testing. And, in the absence of field-testing, we question whether the IASB is truly in a position to conclude that the discontinuing operations criteria of IAS 35 should be adjusted to result in the identification and presentation of more discontinued operations.

In assessing whether a fundamental change to IAS 35 is warranted, the IASB should consider the results experienced by users and preparers that have implemented FAS 144. In our view, experience in the US suggests that the threshold for identifying and reporting discontinued operations has proven to be too low. In addition, certain industries have found that application of FAS 144 has required continuous restatements of income statements, which only serves to confuse the readers of the financial statements. This has proven especially true in the real estate industry, in which a building often qualifies as a discontinued operation. Given the complexity of the resulting financial statements and the cost to preparers of continuously restating financial statements, we do not believe that this is the highest quality solution. The lack of understandability and balance between benefit and cost outweigh the utility of disclosing more but smaller discontinued operations. We therefore believe that ED 4 should revert to the definition of a discontinued operation contained in IAS 35.

Finally, although we do not object in concept to the separate classification of "held for sale" assets or "disposal groups," we believe that the IASB has put forth rules-based criteria (Appendix B) for determining whether such assets or groups of assets are "held for sale," which are not underpinned by an overriding classification principle. This is contrary to the IASB's stated aim of issuing principles-based standards as discussed in the alternative view of the first Board member.

In summary, we do not believe that the IASB will achieve major incremental benefit in converging the measurement requirements of long-lived assets "held for sale" under IAS and US GAAP. We do not believe that the present criteria for displaying discontinuing operations under IAS 35 is in need of revision. In addition, the concepts in ED 4 that we could support such as the classification of assets or disposal groups as held for sale, are rules-based as opposed to principles-based. Finally, although we support the concept of convergence of global accounting standards to the highest quality solution, we question the need to issue a new IFRS that seems solely driven by a need to converge with US GAAP, particularly in light of our view that FAS 144 is not a superior answer. Therefore, we do not support the issuance of ED 4.

Much remains to be accomplished by the IASB prior to the first time adoption of IFRS by EU listed companies in 2005. Against this background, this aspect of convergence should not be a current priority of the IASB. If the IASB continues to believe that the principles embodied in ED 4 are worthy of consideration, it should delay pursuit of a final standard at this time and should instead spend its time on other matters that are essential for 2005 application of IFRS in the EU. It could then examine the accounting for, and presentation of, discontinued operations in more detail, giving due consideration to the practical experience gained in applying FAS 144, to ultimately develop an international standard that is truly of the highest quality.

However, if the IASB believes that it should finalize ED4 in the short-term, certain aspects of the ED must be revised. In particular, we believe that assets “held for sale” should continue to be depreciated, and the criteria for determining disposal units and discontinued operations should be conformed to the guidance in paragraph 2 of IAS 35 so as not to require inordinate restatements that will only lead to confusing users of the financial statements.

Our responses to your detailed questions are included in the appendix to this letter.

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We would be pleased to discuss our views with the IASB or staff at its convenience. Please contact David Lindsell at 0207 951 4463.

Yours very truly,

Ernst & Young

**Appendix**

**Ernst & Young Global comments on ED 4 Disposal of Non-current Assets and Presentation of Discontinued Operations (the "ED")**

Q1. **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?*

As noted in our covering letter, we do not support a final standard based on ED 4. However, if the IASB continues forward and issues a standard based on ED 4, as a matter of principle, we would support the separate classification of assets as "held for sale" when the specified criteria have been met in a future standard because we believe that it will provide financial statement users with better information with which to assess the results of the entity's continuing operations and the potential timing and amount of future cash flows with respect to those operations and the proceeds (if any) from the sale of these operations. The usefulness of this disclosure will outweigh other of the qualitative characteristics as set forth in the Framework. In addition, it achieves the desired convergence with Statement of Financial Accounting Standards No. 144: *Accounting for the Impairment or Disposal of Long-Lived Assets (FAS 144)*. However, as discussed in our response to Q2, we do not believe that the measurement criteria currently employed in IAS 36 and IAS 37 need to be adjusted as proposed in ED 4. Instead, we advocate a separate presentation in the balance sheet of such assets or disposal groups retaining their current measurement criteria.

However, in defining assets "held for sale," in our view the Board has resorted to a rules based approach in its Application Supplement in Appendix B of ED 4. We assume, from reading the alternative view of the first Board member that this was done to prevent abuses of the use of management intent. We do not agree with the need to do this given that the current impairment criteria of IAS 36 for long-lived assets are based on management intent. We are not aware of abuses in this area and therefore do not believe that a shift to more rules-based criteria for determining management's intent is necessary. In addition, it is a departure from the Board's stated aim of producing principles-based standards.

Q2. **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?*

We do not agree with the measurement requirements of ED 4 that appear to be the result of the desire to converge with FAS 144. While we support the goal of convergence where possible, we do not believe it should be done at any expense. In this case, we do not see the need to introduce new measurement criteria when, except for the cessation of depreciation and amortization of assets "held for sale," the result of applying the existing guidance in IAS 36 and IAS 37 to assets (or asset groups) identified for sale should result in virtually the same results as the requirements contained in ED 4. Indeed, consistent with the alternative views of the first and second Board members, we believe that it is inappropriate to cease the depreciation/amortization of assets "held for sale." Such assets, while classified as held for sale, have not necessarily been abandoned and, therefore, the costs associated with such assets should continue to be included in the determination of the entity's net income. We believe that the current application of IAS provides for a similar result as ED 4, but allows for the continued depreciation and amortization of such assets.

We understand that theoretically, the costs of utilizing such assets will be recognized as a diminution in their fair value, but are not convinced that theory will translate into reality. If the IASB disregards our objection to the proposed new measurement standard, we suggest that assets held for sale and not abandoned should continue to be depreciated/amortized and a charge should then be taken to adjust the assets to fair value based on current depreciated/amortized cost. Finally, we believe that in order to calculate the results of operations related to assets or disposal groups held for sale, management must continue to use historic cost based information for purposes of determining allocable overhead costs that included depreciation and amortization. Requiring entities to continuously adjust such amounts will require additional costs for questionable benefits.

Q3. **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 noted in our covering letter, we disagree with the issuance of ED 4 in its entirety. However, if the IASB continues forward with the issuance of a final statement based on ED 4, we would agree with the concept of aggregating assets and liabilities that are to be disposed of together in a single transaction and treating them as a "disposal group." We believe that this concept is necessary so as to ensure that if it is management's intent to dispose of a group of assets in a single transaction, the aggregate fair values of the individual long-lived assets constituting the group used to determine whether an asset is impaired under IAS 36 do not exceed the fair value of the group as a whole.

Q4. **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?*

Assuming the IASB moves forward and issues a standard based on ED 4, we would agree that it is appropriate that newly purchased 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. Regardless of whether an asset has been held for a period of time prior to the decision to dispose of it, or whether it is purchased with the intention of immediate disposal the measurement basis of any asset classified as "held for sale" should be consistent.

Q5. **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?*

Assuming the IASB moves forward and issues a standard based on ED 4, we would agree that the costs to sell and subsequent changes in such costs should be recognized in the income statement in all cases because we believe that they are integral to determining fair value upon which ED 4 requires the determination of impairment charges. However, *if we understand the question*, the bigger issue is whether the change in fair value not attributable to costs to sell that are being deferred as a valuation allowance in accordance with other IFRSs should also be required to be recognized in the income statement. In our view, any asset subject to this standard as a result of it being included in a "disposal group" should be accounted for in a similar manner and therefore any revaluation adjustment that has not been recognized on an asset that is part of a disposal group should be required to be recognized when management has determined that it will sell the asset (whether alone or as part of a "disposal group").

Q6. **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?*

It is our understanding that prior to the consequential amendment to draft IAS 27 *Consolidated Financial Statements and Accounting For Investments in Subsidiaries* (draft IAS 27), a subsidiary acquired with the view to resale (within one-year) would be recorded as a net asset (one line) and held at fair value (less cost to sell as proposed in the final draft of IAS 39) with unrealized gains and losses taken to the income statement. However, if in a business combination, separate assets and liabilities acquired were to be held with a view to resale (within one year) they would be required to be shown as a gross asset and liability (assuming they were part of the same disposal group) and accounted for at the lower of fair value less costs to sell or original cost. If the IASB continues forward with the issuance of ED 4 (as noted above, we disagree with the issuance of ED 4), as a matter of principle, we would agree that the measurement basis should be consistent regardless of what form the net assets take (individual vs. a subsidiary) and therefore, agree with the consequential amendment to IAS 27 to require that subsidiaries acquired with a view to resale be accounted for at the lower of fair value less costs to sell or original cost.

However, if the IASB moves forward with the issuance of ED 4 contrary to our views, we believe that ED 4 should be amended to allow for the net balance sheet presentation of assets and liabilities acquired with a view to resale that comprise a "disposal group" whether they be individual assets or held in a subsidiary. While we agree with gross presentation for those assets that are not newly acquired, in the case of newly acquired assets with the view to resale, such net assets were never integral to the historical operations of the entity and, therefore, we do not believe that a gross balance sheet presentation provides any benefit to the users of the financial statements. We therefore disagree with the draft amendment to IAS 27 that would remove the exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale.

Q7. **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?*

Assuming the IASB moves forward and issues a standard based on ED 4, we would agree with the separate presentation of non-current assets and liabilities in the balance sheet. There is no basis for presenting these amounts net in a single amount and such a presentation would defeat the purpose of providing users with better information related to assets to be sold as well as continuing operations. We note that in the context of convergence, the proposal is consistent with FAS 144.

Q8. **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:*

- *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*
- *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?*

**Ernst & Young Global comments on ED 4 Disposal of Non-current Assets and Presentation of Discontinued Operations (the "ED")**

As indicated in our cover letter we do not agree with the proposed ED 4. We are not convinced that the IASB has properly weighed all aspects of the qualitative characteristics of financial statements that are included in the Framework. We believe that the Board has placed undue emphasis on the usefulness criterion, while failing to address understandability and balance of cost/benefit characteristics. We cannot argue that more information is not better and therefore agree that in certain circumstances the more information presented on the face of the income statement the better. However, this must have limits as the Framework appropriately envisages. In this case, we believe that the understandability of the financial statements, in particular for the majority of financial statement readers who are relatively unsophisticated, would be severely hindered by continuous restatements that may be required if the proposed definition of a discontinued operation is used in a final statement. In addition, we believe that preparers of financial statements may be unduly burdened by such continuous restatements. Our beliefs are based in the experience of applying the criteria of FAS 144 in certain industries for companies currently reporting under U.S. GAAP. Therefore, while we agree that the display of discontinued operations separately on the income statement is appropriate in certain circumstances, we do not agree with the low level of operations required in ED 4. Instead, we would rather limit such disclosure to those operations that are of such significance that they may warrant separate segment disclosures under IAS 14. Therefore, we believe that the current level of operations as required in current IAS 35 is generally the appropriate level to disclose discontinued operations. In this regard, we strongly object to the redefinition of a discontinued operation in ED 4 and believe that IAS 35 should be left in place as is.

Q9. **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 premise of separately displaying income statement data for discontinued operations is that it is no longer relevant for the users when analyzing the results of the continuing operations of the entity. If this is indeed the case, we do not believe that discontinued operations are of such import that a user would find the more detailed income statement components on the face of the income statement useful and as such, the alternative approach of presenting a single amount, profit after tax, with a breakdown of the amount in the footnotes would be preferable.

**Other**

**Ernst & Young Global comments on ED 4 Disposal of Non-current Assets and Presentation of Discontinued Operations (the "ED")**

We strongly object to the requirements of paragraph B4 of ED 4. The IASB appears to believe that there providing separate discontinued operations disclosures is so important that ED 4 has adopted a much broader definition of a discontinued operation than that contained in IAS 35. While we take issue with the level of operations that will be disclosed, we agree that displaying discontinued operations separately on the face of the income statement is useful. If this information is of such import, we fail to understand why a user would not find the information useful, regardless of when the decision was made to discontinue the operation. If the Board feels that the disclosure of such information in the notes to the financial statements suffices in such situations, we question the need to disclose discontinued operations on the face of the income statement in any circumstance.

In paragraphs BC51 and BC52, the Board explains its decision on this matter. We understand the desire to more narrowly define the time period for which an entity can report a discontinued operation. However, we do not believe that this translates into failing to report it simply because the event that caused it to be discontinued occurred after the balance sheet date. This is not a matter of recognition or measurement and should not be treated as such. Instead, we believe that this is simply a matter of good disclosure and that the current requirements of IAS 35 paragraph 29 should be maintained with a view of developing the highest quality standards as opposed to what appears to be a desire to converge with current U.S. GAAP on this issue.