Non-current assets and presentation of discontinued operations (ED4) – Comments to SAICA

The comments below represent the view of the FirstRand Banking Group.

Question 1

Yes, the separate classification provides an indication of assets where the intent is to recoup the investment through sale (short-term in nature) in comparison with use (longer-term in nature). As such, it provides an indication of timing of future cash flows, which is useful.

Question 2

The measurement basis is appropriate. The fact that depreciation is suspended on such assets is appropriate given the fact that entity will not recoup value through future use, but through sale.

However, we are of the opinion that the measurement basis can be refined. In our view, the classification of an asset as held for sale, by its very nature, indicates intent to recoup the value of the asset through sale, not use.

This is reinforced by the strict criteria in Appendix B (refer B2) for classification of assets in this class, as well as in the basis for conclusion section (refer BC13). Although not trading in nature, we are of the opinion that these assets are similar to those classified as "Available for sale" in terms of IAS 39/AC133.

We are of the opinion that it would be more appropriate to measure non-current assets held for sale at fair value less cost to sell, as an only option (please refer bold section in question 4 for proviso to this statement).

Question 3

Refer to comments in bold section below in question 4.

Additionally, where a disposal group includes both non-current assets available for sale, as well as other assets, including financial instruments that may fall under IAS39/AC133, paragraph 2 of the draft statement specifically excludes these assets from the measurement basis in the proposed statement. This is reinforced by the requirements set out in paragraph 11.

In the event that a disposal group consists of one non-current asset held for sale, and other financial assets as contemplated in IAS39/AC133, the application of paragraph 3 will effectively result in the following:

- In measuring the fair value less cost to sell of the disposal group, the assumption must be that the cost to sell is in respect of the disposal group, and not the held for sale asset only. In effect, this will then mean that the cost to sell of all the assets in the disposal group has been taken into account, albeit being allocated to the non-current asset held for sale only.

- The results, for example, in trading instruments under IAS39/AC133, being value at fair value *less cost to sell*, and not fair value (irrespective of the fact that the cost to sell is not actually allocated to the carrying value of these assets).
- A further consequence is that given the above scenario, the impairment loss described and the treatment of this against the non-current asset, results in the non-current asset being carried at a value lower than its fair value *less cost to sell* – we agree that this is correct in terms of the proposed wording of the statement, but it appears illogical and not reflective of the true fair value of the non-current asset (and its future cash flows).

We would recommend that the fair value of the disposal group be determined based on the underlying values of the components only (refer paragraph 11-14), to avoid the scenario described above.

Question 4

It is appropriate in the context of this proposed statement in isolation (refer bold section below). If the recommended change in question 2 is not made, newly acquired assets will be treated/measured differently (on acquisition) from assets already held. There seems to be no reasonable justification for this. The recommended change set out in question 2 would bring the treatment/measurement for assets held in line with the proposed treatment/measurement for new assets.

We also support the consequential change in the IFRS on Business Combinations. It would be nonsensical not to be consistent in the treatment. It must be highlighted that there will be an analogous situation where in a business combination, non-current assets held for sale will be valued at fair value *less cost to sell*, where trading assets or available for sale assets as defined in IAS39/AC133, will be carried at fair value only.

This does raise the following problem:
IAS39/AC133 paragraph 78 indicates that financial instruments held for trading will initially be recognised at a value, which includes transaction cost – subsequent measurement at fair value excludes potential transaction costs on the sale.

The result of this is that there is asymmetrical treatment/measurement between trading instrument and non-current assets held for sale. We do not understand why, hypothetically, an identical asset which is trading in nature, and one that is non-trading held for sale, will not be measured on the same basis i.e. taking into account the cost of sale (or not).

We recommend that all non-current assets available for sale be measured at subsequent measurement, at fair value only, to be in line with the treatment of fair value instruments under IAS39/AC133.

Question 5

No comment.

Question 6

The removal of the exemption raises the possibility of significant practical difficulty for institutions such as banks where a cession of shares takes place to perfect the bank's security under a lending arrangement.
The proposed amendment would result in the consolidation of the underlying counter-party where the bank obtains "control" pursuant to exercise of the cession arrangement. Furthermore, in terms of the proposed treatment under ED4, where the bank has the intention to dispose of the shares obtained in the short term (which will almost always be the case), the "subsidiary" will qualify as a disposal group held for sale.

This will result in the subsidiary/disposal group being valued at lower of carrying value or fair value less cost to sell. Non-current assets will be consolidated as a one line item on the same basis, with other assets and liabilities of the disposal group/subsidiary consolidated at values consistent with the applicable IFRS thereto.

A further consequence would be that the subsidiary/disposal group would have to be disclosed as a discontinued operation.

We are of the opinion that this result will not add to the understanding of or presentation and comparability of results.

We recommend that the exemption in IFRS27/AC132 be retained, and that such "subsidiaries" be treated in accordance with the requirements of AC133/IAS39.

Question 7

Yes, the proposed presentation in the balance sheet is appropriate. Again, it provides the user with additional information to determine the timing and amount of future cash flows.

Question 8

We are concerned with the requirements set out for classification of discontinued operations, and the impact the proposed classification will have on comparable disclosure from year to year.

The following points are pertinent:

We agree with the proposed change relating to timing of classification. This has the positive effect of only using the classification where more certainty exists with regard to an affected disposal. It also removes any possibility of manipulation that may have been possible in terms of the current test to identify a discontinued operation.

We agree with expanding the definition to include assets that meet the criteria for classification as held for sale, as this enhances the ability of users to identify timing of and amount of future cash flows.

We are, however, of the opinion that the proposed new definition of a discontinued operation is to onerous. Meaningful information is provided where a discontinued operation is separated and disclosed to allow the user the opportunity to ascertain sustainable cash flows in the future. Although the "subject to materiality" test is mentioned, this is open to interpretation. Furthermore, we are of the opinion that for either entity specific or consolidated group accounts, the existing definition of a major line of business or geographical area of business provides the correct quantum of, and quality useable information.

The biggest problem we foresee in using the proposed “component of an enterprise” approach is that it will not necessarily enhance disclosure usefulness, whilst significantly increasing complexity because of the sheer volume of operations that may be caught in the net (subject to the materiality test).

The use of the proposed materiality test, brings one back to a situation that is not dissimilar from the current situation – if a component under the proposed new test is deemed not material, it will not be disclosed – if it is material in context of the entity or group being reported on, then, in terms of the existing test, it would most probably also have been of sufficient size and importance to have been classified as a discontinued operation. The materiality test also introduces further management discretion, which may hamper comparability between entities.

For this reason, we fail to see how disclosure will be improved by the new proposals.

We feel that convergence with SFAS144 on this issue is not of paramount importance. The board should rather attempt through the proposed changes to enhance the usability of financial information – in our opinion, this proposed change would not achieve this goal.

Question 9

We prefer the use of a single line disclosure on the face of the income statement, with detailed additional disclosure in the notes.

The primary components of the statutory accounts provide the user with high-level summarised information, which can be evaluated at a glance without significant manipulation. To do this, information should be presented on a basis that allows the user the opportunity to identify main categories of information, and broad operational performance. A one-line disclosure in respect of discontinued operations achieves this goal.

The proposed disclosure detail on the face of the income statement will lead to additional complexity and “clutter” in disclosure. The notes to the financial statements are consistently used for dissemination of detail information on specific line items of the four primary reports. This allows the preparor the opportunity to expand on disclosure over and above the minimum required where the situation merits additional disclosure.

The proposed treatment, in our view, will diminish disclosure efficiency. We do not see any reason why discontinued operations’ detailed disclosure should be pulled onto the face of the income statement – it can be argued that this provides more prominence to this aspect of a business, than the continuing operations (and in fact, for a user who does not have the need or inclination to evaluate the detailed notes to the financial statements, this will be the case).

The “one-line” treatment is further compatible with the proposed treatment of discontinued operations in terms of the project in respect of the new “comprehensive” income statement that is currently being evaluated.