The South African Institute of Chartered Accountants

#59225

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Dear Anne

EXPOSURE DRAFT 4 - *DISPOSAL OF NON-CURRENT ASSETS AND PRESENTATION OF DISCONTINUED OPERATIONS*

In response to your request for comments on the exposure draft on disposal of non-current assets and presentation of discontinued operations, I attach the comment letter prepared by the South African Institute of Chartered Accountants (SAICA). Please note that SAICA is not only a professional body, but is also secretariat for the Accounting Practices Board (APB), the official accounting standard setting body in South Africa.

We thank you for the opportunity to provide comments on this document. We have, in addition to our response to the questions raised, also included general comments on aspects not specifically dealt with in the questions.

Please do not hesitate to contact me should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph
Project Director: Standards

cc: Peter Wilmot (Chairman of the Accounting Practices Board)
Pat Smit (Chairman of the Accounting Practices Committee)

GENERAL COMMENTS

Introduction

The South African Institute of Chartered Accountants does not support this draft International Financial Reporting Standard (IFRS) as the entire standard is based on management's intention and not on sound accounting principles, creating the opportunity for manipulation and introducing uncertainty (intention to use/sell/abandon is not always clear).

Whilst we understand the IASB's intention to converge with US GAAP, where appropriate, we believe that this standard should be given low priority. The accounting treatment proposed in this draft IFRS sits uncomfortably in the existing IFRS Framework and we are not persuaded that it leads to an improvement of the current IFRS for the following reasons:

- IAS 36 - *Impairment of Assets,* adequately deals with the need to adjust the carrying amount of assets held for sale.
- IAS 35 - *Discontinuing Operations,* in our opinion, deals more appropriately with discontinued and discontinuing operations than the proposals in this draft IFRS.

Despite our lack of support of this document, should the IASB decide to issue this draft IFRS, we have given our detailed comments below and to each question, which we hope will at least be taken into account in amending the final IFRS.

Disposal of non-current assets

Our major area of concern is that this draft IFRS introduces a whole new class of asset. It further requires application of rules to this class of assets that is different to those that are applied to other non-current assets.

This draft IFRS assumes that all entities classify assets and liabilities as either current or non-current. This classification is not compulsory, as IAS 1 - *Presentation of Financial Statements,* also allows a liquidity presentation, which might complicate the application of this standard.

Presentation of discontinued operations

We are not in favour of the proposal that relatively small components may be classified as discontinued operations, as it is our view that this will not provide useful information to the users of the financial statements. Furthermore, this draft IFRS deals with the presentation and disclosure of discontinued operations, but not with the measurement thereof (in this regard the draft has been interpreted differently and is therefore unclear). One may assume that a discontinued operation will usually consist of one or more disposal group(s) and/or non-current asset(s) held for sale and that the proposed IFRS therefore addresses the measurement of these assets and disposal groups individually, but this conclusion should rather be clearly indicated in the text of the standard.

A problem also arises if the discontinued operation is to be abandoned, as the measurement principles of the proposed IFRS will then not apply. Under these circumstances guidance should be given in the standard on the relevant IFRS that would govern measurement (eg IAS 19 - *Employee benefits*, IAS 36 - *Impairment of assets* and IAS 37: *Provisions, contingent liabilities and contingent assets*).

Relationship between categories

It is recommended that a diagram should be presented indicating the relationship between non-current assets held for sale, disposal groups held for sale and discontinued operations, as the distinction between the different areas is unclear in the draft IFRS. The illustrative examples do not address this either. An area that should be dealt with is at what stage does a disposal group become a discontinued operation, or vice versa.

SPECIFIC COMMENTS

Paragraph 3

This paragraph states that *"The measurement of the individual assets and liabilities within the disposal group is set out in paragraphs 11 and 14."* Neither paragraph 11 nor paragraph 14 makes any reference to the measurement of liabilities (both current and non-current).

Paragraph 6

According to this paragraph the carrying amount of an abandoned asset *"will be recovered principally through continuing use"*. We regard this as misleading as an abandoned asset will no longer be used. It will be more correct to state that the carrying amount of the asset "will not be recovered through sale".

Paragraph 15

Elaboration on the phrase *"date of sale"* is necessary. This may be similar to the following wording used in paragraph 58 of the improved IAS 16 - *"In determining the date of disposal of such an item, an entity applies the criteria in IAS 18, Revenue, for recognising revenue from sale of goods"*.

Paragraph 16

Paragraph 59 of the improved IAS 16 states that *"depreciation of an item of property, plant and equipment does not cease when it becomes temporarily idle or is retired from active use and held for disposal"*. This is not in line with the exposure draft, which proposes that depreciation should cease. This issue is however not addressed in Appendix C.

Paragraph 18

One of the proposed changes to IAS 36 is that impairment losses for goodwill should not be reversed. The question that arises in terms of paragraph 18 of the draft IFRS is, where there has been a change to a plan of sale for a disposal group, which had included goodwill, should this paragraph or IAS 36 be applied in relation to and goodwill in the disposal group?

Paragraph 21

We suggest that this paragraph should be more specific, as the current wording is too vague and it is unclear in its meaning.

Paragraph 26

This paragraph requires an entity to reclassify comparatives where a component of an entity is no longer classified as held for sale. This paragraph should require disclosure of the fact that comparative information has been reclassified.

Paragraph 29(a)

Paragraph 29 applies to a non-current asset or disposal group that has either been classified as held for sale or sold during the reporting period. Paragraph 29(a) however refers to the *"facts and circumstances leading to the expected disposal"* leaving the impression that this disclosure will only apply to expected disposals and not to disposals that took place during the year. The phrase should therefore read "facts and circumstances leading to the disposal and expected disposal".

It is not clear whether the disclosure requirements in paragraph 29(a) also apply to discontinued operations. Our understanding is that these requirements will apply if the operations to be discontinued include disposal groups or individual non-current assets held for sale or sold. However, it is possible to account for a discontinued operation without identifying any disposal groups, for example when the operations are to be abandoned. It is our understanding that the disclosure requirements of paragraph 29(a) will then not apply, and we therefore suggest that it should be clearly sated that these requirements apply to discontinued operations as well.

Appendix A

Regarding the definitions of probable and highly probable, a clearer distinction should be made. We suggest that criteria should be given to measure probability, together with appropriate examples to illustrate the difference.

Appendix B

As was suggested in our response to Question 1, the principles and requirements set out in this Appendix should form part of the standard.

Paragraph B4

The reference in this paragraph should be 29(a) and not 28(a).

Appendix C

As was indicated earlier, this appendix is not comprehensive enough.

Illustrative Examples

Additional examples should be provided which illustrate the format of the financial statements to specifically include:

- the presentation of discontinued operations;
- the presentation of non-current assets and disposal groups held for sale.

The existing examples should indicate more clearly whether the applicable criteria of Appendix B are met. A possible solution would be to group together all examples where the relevant criteria are met.

SPECIFIC COMMENTS ON QUESTIONS RAISED

Please note our general comments, that we do not support this draft IFRS and therefore our comments are given in the context that the Board decides to issue this IFRS nonetheless.

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 that this classification is necessary to enable fair presentation. The proposed criteria in Appendix B may however be difficult to meet, and as a result the classification may prove to be difficult in practice. Some of the criteria listed in Appendix B also need elaboration, for example, when does management have "*the authority to approve the action*" (paragraph B1(a)), and what is meant by "*an active programme*" (paragraph B1(c))?

Furthermore we feel very strongly that Appendix B dealing with, amongst others, the criteria to be met in order to be classified as held for sale, should be incorporated into the text of the standard, instead of being added as an Appendix.

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 lower of carrying amount and fair value less costs to sell is an appropriate measurement basis for non-current assets classified as held for sale, as this is in line with the concept of net selling price as per IAS 36 - *Impairment of assets*, provided that the asset is not used for an extensive period of time after reclassification. It is however of concern to us that there is no consistency in IFRS regarding the treatment of assets to be disposed of and that this Exposure Draft adds to this inconsistency. Financial assets held for trading are measured without taking disposal costs into account (presumably as the disposal costs of financial assets are considered to be insignificant), while non-current assets held for sale are measured net of disposal costs. Similarly the net realisable value of inventory is determined after deducting disposal costs. It is suggested that the measurement bases for all these assets should be similar and, if possible, that similar terminology should be used.

Measurement at fair value less costs to sell is also inconsistent with the Framework and the principles in IAS 37 - *Provisions, Contingent Liabilities and Contingent Assets.* Costs to sell would not otherwise meet the criteria for recognition as an expense/liability as it has not been incurred at the stage that the decision is made to dispose of the asset.

The concern around recognition of costs to sell also applies to Question 3 and 4.

According to paragraph 10 of the exposure draft, the costs to sell should be measured at their present value if the sale is expected to occur beyond one year. An issue that is not addressed is the unwinding of the discount factor. If the asset is measured at the end of each financial year at fair value less costs to sell, the increase in the disposal costs (due to passage of time) will be accounted for as an impairment loss and not as interest. We are of the opinion that this amount should rather be reflected as interest.

The proposal not to depreciate these assets is acceptable, as the recognition of depreciation may lead to a larger gain being recognised when the asset is eventually disposed of, because the difference between the carrying amount and the proceeds may be greater. The concern is however raised that profits might be manipulated by classifying assets as held-for-sale, thereby avoiding depreciation, and then reclassifying these assets in the next financial years.

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?

Although we are of the opinion this treatment is appropriate and also practical, further guidance is needed on the following issues:

- Whether it is necessary to apportion the impairment loss amongst the individual non-current assets included in the disposal group, and on which basis this apportionment should be done (if necessary).
- No treatment is suggested if the impairment loss exceeds the carrying amount of the non-current assets in the disposal group.
- As noted in our general comments, a diagram should be presented to indicate the relationship and distinction between disposal groups held for sale and discontinued operations.
- It is also not clear whether a disposal group may include current assets. Although paragraph 11 gives the impression that other assets (apart from non-current assets

held for sale) may form part of a disposal group, it is not clear whether there is any restriction on the categories of assets to be included.

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?

In terms of IASB 1, any asset held or acquired primarily for trading purposes is classified as a current asset. In our view this will include assets acquired with a view to their subsequent disposal, resulting in these assets automatically being classified as current assets. It appears that these assets fall outside the scope of this exposure draft and therefore the proposed treatment is not relevant.

There is no guidance on how the difference between the actual cost of the asset and its initial carrying amount should be accounted for. If one assumes that the asset was acquired at fair value, the only difference will be due to disposal costs and supposedly this difference should then be recognised in the income statement. The question arises as to how the difference should be accounted for if the asset was acquired at an amount significantly above or below its fair value (if acquired, say, at a forced sale auction). Should this amount be accounted for as goodwill or taken to the income statement? Although this issue is addressed to a certain extent in BC32 of the Basis for Conclusions, more explicit guidance should be given in the standard itself.

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?

Yes, we agree with this proposal, except for the requirement in B6 that any impairment loss arising on the reclassification of the asset should be recognised in the income statement.

This treatment will be correct if one assumes that the revaluation done immediately prior to reclassification was at fair value, as the only difference between the revaluation prior to reclassification and the value determined upon reclassification will be due to costs to sell, which should be recognised in the income statement. If the revaluation prior to reclassification was however done on another basis (for example discounted cash flows) a portion of the impairment loss should be accounted for as a revaluation decrease (ie recognised directly in equity).

There appears to be an inconsistency between the question put forward for comment and B6. There is uncertainty around what the draft IFRS actually requires, or where the draft IFRS requires revaluation decreases to be recorded. Question 5 is phrased such as that it appears that only costs to sell should be included in the income statement, whereas B6 suggests that any impairment loss would also be recognised in the income statement.

Perhaps this is best illustrated through an example:

Assume PPE with original cost of	400
Subsequently revalued to	800
Credit Revaluation Reserve	400
Impaired based on value in use	700 (Debit goes to Revaluation Reserve)
Fair value	650 (Subsequent impairment to get it to fair value: *Does this (50) debit go to the income statement or equity?)*
Cost to sell	50 (Recognised in income statement)

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 agree with this proposal. We believe that the exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale should remain, as accounting for the subsidiary in terms of IAS 39 - *Financial Instruments: Recognition and Measurement*, in these circumstances better reflects the economic reality of acquiring equity investments with a short term trading motive. The treatment envisages in the draft IFRS, namely consolidating the subsidiary, but measuring line items under the draft IFRS reflects less meaningful information than recognising the investment as a current trading item.

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 agree that these assets and liabilities should be presented separately in the balance sheet and that assets and liabilities should not be offset and presented as a single amount. In our view this addresses the problem of disclosing assets and liabilities where the impairment for a disposal group is not allocated to individual assets within the group.

The question however arises as to exactly where on the balance sheet these amounts should be presented, as IAS 1 currently provides for assets to be classified as either "current" or "non-current". We would prefer that this class of asset "held for sale" should be shown as current assets, as by definition they should be sold in the near future.

If the intention is that these assets and liabilities should form a new category between current and non-current, it should be clearly stated. Furthermore IAS 1 will have to be amended regarding the minimum information to be included on the face of the balance sheet in order to include assets and disposal groups held for sale. This will ensure that these assets are also presented separately in interim financial statements.

As a consequential amendment, the reconciliation's currently required by IAS 16 and IAS 38 should also be amended to include the movements due to assets being classified as held for sale, as well as for assets that no longer meet the criteria to qualify as held for sale.

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?

We strongly feel that this definition is a step backwards in accounting for discontinued operations and that the definition opens the door for abuse in that smaller units (smaller than as detailed in the current IAS 35 - *Discontinued Operations*) may be classified as discontinued operations (e.g. in a retail environment the closure of a store and the discontinuance of a product line may now be a discontinued operation. A store could be closed down and the revenue would be classified as discontinued. However, customers could now be buying from another store in the group within the same area and the revenue stream is therefore likely to continue). This new definition creates the opportunity to manipulate profits and at a later date reverse the decision and make retrospective adjustments. We feel that the current IFRS treatment, using the principles of IAS 35 is more sound.

The proposed IFRS will cause practical difficulties with an investment company that buys and sells investment properties on a regular basis.

It is also suggested that the definition of a cash-generating unit should be aligned with the final standard as proposed in ED 3 - *Business Combinations.*

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?

In our opinion it would be sufficient to present a single line item on the face of the income statement, with a breakdown in the notes to the financial statements. It should be made clear that where a single line item on the face of the income statement is provided, IAS 18 still requires all revenue to be disclosed, including revenue arising in the discontinued operation.

We feel that, in order to enable users of financial statements to make future predictions regarding the entity, similar information should be provided in respect of operations acquired during the year, especially if the results of these operations were included for less than the full reporting period.

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