30 September 2003

CPA AUSTRALIA
ABN 64 008 392 452

CPA Centre
Level 28, 385 Bourke Street
Melbourne VIC Australia 3000
GPO Box 2820AA
Melbourne VIC Australia 3001
T +61 3 9606 9606
F +61 3 9670 8901
E vic@cpaaustralia.com.au
W www.cpaaustralia.com.au

Direct
T +61 3 9606 9689
F +61 3 9602 1163
M 0409 983 659
E Greg.Larsen@cpaaustralia.com.

Ms Anne McGeachin
Project Manager
International Accounting Standards Board
30 Cannon St
London EC4M 6XH
UNITED KINGDOM
By email: CommentLetters@iasb.org.uk

Dear Ms McGeachin

ED 4: Disposal of Non-Current Assets and Presentation of Discontinued Operations

General Comments

Introduction

CPA Australia, representing over 100,000 members, supports the revisions to IAS 35 'Discontinuing Operations' and the introduction of explicit reporting requirements for the disposal of non-current assets as proposed in ED 4 'Disposal of Non-current Assets and Presentation of Discontinued Operations'.

We are appreciative of the efforts being made by the IASB and FASB to achieve a number of short-term convergence objectives between the two international financial reporting languages. The release of ED 4 is a tangible sign of the progress being made to achieve convergence with the proposals achieving substantial convergence with the requirement of SFAS 144 'Accounting for the Impairment or Disposal of Long-lived Assets' relating to assets held for sale and discontinued operations. In the Australian context, the IASB and FASB convergence program imposes an additional degree of complexity as we work towards the adoption of international accounting standards by 2005.

The proposals in ED 4 will do much to achieve their stated objective of improving information about assets for sale and the disposal group, as well as discontinued operations. In relation to the latter, the proposals in ED 4 constitute a significant change to the recently issued IAS 35 'Discontinuing Operations'. In essence, the proposals in ED 4 constitute a new standard; we had not envisaged such an outcome, anticipating the IASB/FASB convergence program would lead to narrowly defined changes.

Convergence between specific IASB and FASB pronouncements is an important long-term project, but we believe that the priority must be given to having a stable platform of standards in place for 2005. Short-term convergence projects should not place this objective at risk in terms of the timely release of new and revised IFRS. Due to the volume and complexity of changes associated with the introduction of the stable platform, we believe that the IASB should be cognisant of accounting standards overload pressures facing preparers and users of financial reports as we move towards 2005.

The proposals in ED 4 tend to be very prescriptive in comparison to the existing IAS 35, reflecting the rules-based approach of the US jurisdiction. Care needs to be exercised to ensure that the resulting convergence standards are not overly prescriptive.

Specific Questions

Question 1 – Classification of non-current assets held for sale

The separate classification of non-current assets 'held for sale' provides new and relevant information for user decision-making, and therefore is supported. The separate classification of assets held for sale highlights those assets in the balance sheet that are to be disposed. The introduction of specific rules regarding the identification of 'assets held for sale', and their classification, measurement and disclosure will ensure greater consistency in financial reporting for such assets.

Question 2 – Measurement of non-current assets classified as held for sale

The proposal 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, is supported for the reasons stated in the basis for conclusions. The proposal that non-current assets classified as held for sale should not be depreciated, is also supported for the same reasons.

Question 3 – Disposal groups

The proposal that assets and liabilities that are to be disposed of together in a single transaction should be treated as a 'disposal group' is supported, as it reflects the underlying economic transaction.

Question 4 – Newly acquired assets

The proposal that newly acquired assets that meet the criteria of 'held for sale' should be measured at fair value less costs to sell on initial recognition is supported, as is the consequential amendment to Business Combinations standard.

Question 5 – Revalued assets

The proposal that for revalued assets, impairment losses arising from the write-down of assets to fair value less costs to sell, should be treated as revaluation decreases in accordance with the standard under which the assets were revalued, except to the extent that the losses arise from the recognition of costs to sell, is supported. The costs to sell, and any subsequent changes therein, are proposed to be recognised in the income statement is also supported.

Question 6 – Removal of the exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale

The proposed 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, is supported. The economic entity should reflect the transactions, assets and liabilities of entities it controls during the reporting period.

Question 7 – Presentation of non-current assets held for sale

The proposal that non-current assets be 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 is supported. The proposal that assets and liabilities of a disposal group classified as held for sale should not be offset is supported, as the definition of assets and liabilities are on a gross basis.

Question 8 – Classification as a discontinued operation

Under IAS 35 a discontinuing operation is not expected to occur frequently. ED 4 proposes a significant broadening of the existing definition of a discontinued operation. As a consequence, entities that regularly sell operations would now classify these as discontinued operations, resulting in discontinued operations being presented more regularly than under existing IAS standards with comparatives being restated every year. This more frequent reporting of discontinuing operations is supported, as well as the need to restate comparatives.

Under IAS 35, arguably the trigger for classification and disclosure of a discontinuing operation was set as too high a level, i.e., a separate major line of business or geographical area and this is 'not expected to occur frequently'. Under the proposals in ED 4, a discontinued operation will be reported more frequently. In terms of the objective of ED 4 (paragraph 1), the more frequent reporting of discontinued operations is likely to improve the information in the financial report about the effect of such decisions.

As to the proposal for an amendment to the criteria, e.g., adding a requirement adapted from IAS 35 'Discontinuing Operations' that a discontinued operation be a separate major line of business or geographical area of operations, is not supported. In terms of the stated objectives of ED 4, inter alia, to improve reporting of discontinued operations (paragraph 1), the broader threshold may achieve more frequent reporting of discontinuing operations. We are also mindful that reporting of discontinuing operations under the revised definition is also subject to the test of materiality.

Given the *long-term* importance of convergence of IASB and FASB accounting standards for international users of financial reports, similar topics should be addressed using highly similar methodology. The proposal to reintroduce a requirement from IAS 23 would see a significant departure on the definition of a discontinuing operation (under IASB 'infrequent' and FASB 'frequent') and subsequent reporting of such operations. Such a significant definitional difference in one of the earlier convergence projects jeopardise future convergence standards.

Convergence is important in our preference for the SFAS 144 approach, but we believe this approach better meets the objective of ED 4, and therefore the needs of users of financial reports. Convergence itself is not the ultimate goal; the process is about improving the quality of information available to users of financial reports with the conceptual framework playing an important role in this regard.

Question 9 – Presentation of a discontinued operation

ED 4 proposes that 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. An alternative approach is to present a single amount, profit after tax, for discontinued operations on the face of the income statement with a breakdown provided by notes. From a convergence perspective, the approach adopted should be consistent between the resulting IASB and FASB standards. We do not have a strong preference for either alternative, but we believe that if a choice is to be permitted, it must have regard to meeting user needs.

Other Comments on the Body of the Standard

Timing of Disclosure of a Discontinuing Operation

Under IAS 35 an operation is identified as discontinuing at the earlier of the entity entering into a binding sale agreement, and the board of directors approving and announcing a formal disposal plan. Under ED 4 an operation is classified as discontinued at the date the entity has actually disposed of the operation, or when the operation meets the criteria to be classified as held for sale. The timing of classification as a discontinued operation will be deferred as a discontinued operation, and will no longer be recognised from the point where an initial disclosure event occurs.

We are somewhat surprised that specific comment was not sought on this particular change, as it considered a major change. We are of the view that early communication of a discontinuing operation is in the best interest of users, and that the existing approach in IAS 35 has more merit than the proposal in ED 4. We believe that there is merit in the continued disclosure regarding the 'initial disclosure event'.

Non-Current Classification

Entities intending to dispose of non-current assets within the next twelve months generally classify such as current assets. Under the IASB improvements project, the definition of a current asset is likely to be amended to exclude non-current assets that are expected to be realised in the next twelve months. ED 4 reflects this proposal. The change will impact ratios that are based on an entity's current or non-current assets in the balance sheet. We are not convinced that assets for sale are appropriately classified as non-current assets.

Incorporation of Parts of Appendix B into the Standard

ED 4 contains a number of significant cross-references to Appendix B, for example paragraphs 5, 9 13, 17, 19, 20, and 29. Some of the cross-referenced material in the Appendix B 'Application Supplement' is essential to the understanding of the proposed standard and should be incorporated into the body of Standard, e.g., the five classification criteria for a non-current asset held for resale referred to in paragraph 5 but detailed in B.1. Other examples are the relationship between paragraph 9 and B.5, and paragraph 13 that contain a substantial cross-reference to B5-B8. The incorporation of such material into the body of the text would improve the flow of the proposed standard, and negate the need to consistently refer to the appendix.

Abandoned

Given the prohibition on classifying an 'abandoned' asset as a 'non-current asset held for sale', it is considered that further commentary should be added to help sharpen the distinction between the two. A definition of abandonment would also assist in the application of the classification process.

The objective of the standard (paragraph 1) should also contain a specific reference to abandoned assets, as this proposed standard contains requirements for such assets.

Discontinuing Operations

It is considered that the section on discontinuing operations would flow more logically if the order of paragraphs 22 and 23 were reversed. The current paragraph 23 describes a discontinuing operation as 'a discontinuing operation is component' and paragraph 22 commences with 'a component of an entity'.

Cross-referencing to other Standards

ED 4 contains a number of cross-references to other accounting standards. There is an inherent limitation in cross-referencing and, in particular cross-references to specific paragraphs of standards. A change to a cross-referenced standard can lead to a consequential change in this standard. Specific cross-referencing should be avoided.

Paragraph B4 contains a cross reference to paragraph 28(a); the reference should be to paragraph 29(a).

Comments on Appendix B 'Application Supplement'

B1 Classification of a Non-current Asset or Disposal

The first criteria to be met for classifying a non-current asset as held for disposal is 'management … commits itself to plan to sell'. This is an important test and needs to be supported by commentary to provide further guidance to preparers and auditors. Without such guidance, divergent reporting practices are likely to evolve.

Given that all six criteria need to be met for a non-current asset or a 'disposal group' to be classified as 'held for sale', including the requirement that the sale is 'highly probable', may well result in less frequency of disclosures than initially envisaged, and the deferral of such disclosures until the sale is virtually assured. This may deprive users of the information the proposed standard seeks to provide. We believe that there is a strong case to revise 'highly probable' to 'probable', with reliance placed on the other criteria providing comfort as to the eventuality of the outcome.

B2 The Exception

For the similar reasons to the above, it is considered that 'highly probable' in B2(a)(ii) should be replaced by 'probable'.

The defined term 'firm purchase commitment' is introduced. A firm purchase commitment is defined as 'an agreement with an unrelated party, binding on both parties and usually legally enforceable, that (a) specifies all significant items, and (b) includes a disincentive for non-performance that is sufficiently large to make performance highly probable'. Given that this definition is premised on there being an unrelated party, it is assumed that if the transaction is with a related party, that the exception cannot be applied. If this is the intent, it should be clearly stated.

Given the robustness of the definition itself, it is considered that reference to 'with an unrelated party' can be deleted without undermining the integrity of the requirement. Many transactions occur with related parties with these being subject to separate disclosure and substance assessments.

The External Reporting Centre of Excellence, on behalf of CPA Australia, has prepared this submission. Please contact Naomi Carroll, Policy Adviser, Accounting and Audit on (03) 9606 9872 or by email naomi.carroll@cpaaustralia.com.au should you have any queries concerning our submission.

Yours sincerely

Greg Larsen, FCPA
Chief Executive

c.c. R Picker, Chair AASB
N Carroll

30 September 2003

Ms Ruth Picker
Chair
Australian Accounting Standards Board
PO Box 204
Collins Street West
Melbourne VIC 8007
By email: standards@aasb.com.au

Dear Ruth

ED 117: Disposal of Non-Current Assets and Presentation of Discontinued Operations

General Comments

Introduction

CPA Australia supports the revisions to AASB 1042 'Discontinuing Operations' and the introduction of explicit reporting requirements for the disposal of non-current assets as proposed in ED 117 'Request for Comment on IASB 4 Disposal of Non-current Assets and Presentation of Discontinued Operations'.

We are of the view that proposals in ED 117 will do much to achieve their stated objective of improving information about assets for sale and the disposal group, as well as discontinued operations. In relation to the latter, the proposals in ED 117 constitute a significant change to the recently issued AASB 1042 'Discontinuing Operations' that was made in August 2000 and operative 1 July 2001. In essence, the proposals in ED 117 constitute a new standard; we had not envisaged such an outcome, anticipating the IASB/FASB convergence program to lead to narrowly defined changes.

We are appreciative of the efforts being made by the IASB and FASB to achieve a number of short-term convergence objectives between the two international financial reporting languages. The release of ED IASB 4 is a tangible sign of the progress being made to achieve convergence with the proposals achieving substantial convergence with the requirement of SFAS 144 'Accounting for the Impairment or Disposal of Long-lived Assets' relating to assets held for sale and discontinued operations. In the Australian context, the IASB and FASB convergence program imposes an additional degree of complexity as we work towards the adoption of international accounting standards by 2005.

The proposals in ED 117 tend to be very prescriptive in comparison to the existing AASB 1042 reflecting the rules-based approach of the US jurisdiction. Care needs to be exercised to ensure that the resulting convergence standards are not overly prescriptive.

Public Sector and Not-for Profit Entities

The proposals in ED 117 will in due course supersede the requirements in AASB 1042 'Discontinuing Operations' that has general application to the public and not-for-sectors. AASB 1042 contains various references to the application of discontinuing operations in a public sector context, e.g., paragraphs 1.1.2, 2.1, 2.2, 2.2.1-2.2.3, 5.1.5, and 5.1.14-5.1.15. Given the mandate of the IASB and FASB to set accounting standards for business entities, and the broader mandate of the AASB to set accounting standards for all reporting entities in the private, public and not-for-profit sectors, we are surprised that the AASB has not proposed specific amendments in the Australian context for non-corporate reporting entities.

Specific Questions

Question 1 – Classification of non-current assets held for sale

The separate classification of non-current assets 'held for sale' provides new and relevant information for user decision-making, and therefore is supported. The separate classification of assets held for sale highlights those assets in the statement of financial performance that are to be disposed of. The introduction of specific rules regarding the identification of 'assets held for sale', and their classification, measurement and disclosure will ensure greater consistency in financial reporting for such assets.

Question 2 – Measurement of non-current assets classified as held for sale

The proposal 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, is supported for the reasons stated in the basis for conclusions. The proposal that non-current assets classified as held for sale should not be depreciated is also supported, for the same reasons.

Question 3 – Disposal groups

The proposal that assets and liabilities that are to be disposed of together in a single transaction should be treated as a 'disposal group' is supported, as it reflects the underlying economic transaction.

Question 4 – Newly acquired assets

The proposal that newly acquired assets that meet the criteria of 'held for sale' should be measured at fair value less costs to sell on initial recognition is supported, as is the consequential amendment to Business Combinations standard.

Question 5 – Revalued assets

The proposal that for revalued assets, impairment losses arising from the write-down of assets to fair value less costs to sell, should be treated as revaluation decreases in accordance with the standard under which the assets were revalued, except to the extent that the losses arise from the recognition of costs to sell, is supported. The costs to sell, and any subsequent changes therein, are proposed to be recognised in the income statement is also supported.

Question 6 – Removal of the exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale

The proposed 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, is supported. The economic entity should reflect the transactions, assets and liabilities of entities it controls during the reporting period. Under the proposals in ED 117, a subsidiary acquired and held for resale would fall within the new requirements regarding disposal of non-current assets.

Under the Australian consolidation standard, there is no exemption from consolidation on the basis of a subsidiaries being held for resale. The proposal will result in convergence with Australian GAAP on this issue.

Question 7 – Presentation of non-current assets held for sale

The proposal that non-current assets be 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 is supported. The proposal that assets and liabilities of a disposal group classified as held for sale should not be offset is supported, as the definition of assets and liabilities are on a gross basis.

Question 8 – Classification as a discontinued operation

In AASB 1042 a discontinuing operation is not expected to occur frequently. ED 117 proposes a significant broadening of the existing definition of a discontinued operation. As a consequence, entities that regularly sell operations would now classify these as discontinued operations, resulting in discontinued operations being presented more regularly than under existing GAAP with comparatives being restated every year. This more frequent reporting of discontinuing operations is supported, as well as the need to restate comparatives.

Under AASB 1042, arguably the trigger for classification and disclosure of a discontinuing operation was set as too high a level, i.e., a separate major line of business or geographical area and this is ‘not expected to occur frequently’. Under the proposals in ED 117 a discontinued operation will be reported more frequently. In terms of the objective of ED 117 (paragraph 1), the more frequent reporting of discontinued operations is likely to improve the information in the financial report about the effect of such decisions.

As to the proposal for an amendment to the criteria, e.g., adding a requirement adapted from IAS 35 ‘Discontinuing Operations’ that a discontinued operation be a separate major line of business or geographical area of operations, is not supported. In terms of the stated objectives of ED 117, inter alia, to improve reporting of discontinued operations (paragraph 1), the broader threshold would be achieved by more frequent reporting of discontinuing operations. We are also mindful that reporting of discontinuing operations under the revised definition is also subject to the test of materiality.

Given the importance of convergence of IASB and FASB accounting standards for international users of financial reports, similar topics should be addressed using highly similar methodology. The proposal to reintroduce a requirement from IAS 23 would see a significant departure on the definition of a discontinuing operation (under IASB ‘infrequent’ and FASB ‘frequent’) and subsequent reporting of such operations. Such a significant definitional difference in one of the earlier convergence projects may jeopardise future convergence standards.

Convergence is important in our preference for the SFAS 144 approach, but we believe this approach better meets the objective of ED 117, and therefore the needs of users of financial reports. Convergence itself is not the ultimate goal; the process is about improving the quality of information available to users of financial reports with the conceptual framework playing an important role in this regard.

Question 9 – Presentation of a discontinued operation

ED 117 proposes that 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. An alternative approach is to present a single amount, profit after tax, for discontinued operations on the face of the income statement with a breakdown provided by notes. From a convergence perspective, the approach adopted should be consistent with the resulting IASB and FASB standards. We do not have a strong preference for either alternative, but we believe that if a choice is to be permitted, it must have regard to meeting user needs.

Other Comments on the Body of the Standard

Timing of Disclosure of a Discontinuing Operation

Under AASB 1042, an operation is classified as discontinuing at the earlier of the entity entering into a binding sale agreement, and the board of directors approving and announcing a formal disposal plan. Under ED 117 an operation is classified as discontinued at the date the entity has actually disposed of the operation, or when the operation meets the criteria to be classified as held for sale. The timing of classification as a discontinued operation will be deferred as a discontinued operation, and will no longer be recognised from the point where an initial disclosure event occurs. We are somewhat surprised that specific comment was not sought on this particular change, as it considered a major change. We are of the view that early communication of a discontinuing operation is in the best interests of users, and that the existing approach in AASB 1042 has more merit than the proposal in ED 117.

Non-Current Classification

Entities intending to dispose of non-current assets within the next twelve months generally classify such as current assets as defined in AASB 1040 'Statement of Financial Position. Under the IASB improvements project, the definition of a current asset is likely to be amended to exclude non-current assets that are expected to be realised in the next twelve months. ED 117 reflects this proposal. The change will impact ratios that are based on an entity's current or non-current assets in the statement of financial position. We are not convinced that assets for sale are appropriately classified as non-current assets.

Incorporation of Parts of Appendix B into the Standard

ED 117 contains a number of significant cross-references to Appendix B, for example paragraphs 5, 9 13, 17, 19, 20, and 29. Some of the cross-referenced material in the Appendix B 'Application Supplement' is essential to the understanding of the proposed standard and should be incorporated into the body of Standard, e.g., the five classification criteria for a non-current asset held for resale referred to in paragraph 5 but detailed in B.1. Other examples are the relationship between paragraph 9 and B.5, and paragraph 13 that contain a substantial cross-reference to B5-B8. The incorporation of such material into the body of the text would improve the flow of the proposed standard, and negate the need to consistently refer to the appendix.

Abandoned

Given the prohibition on classifying an 'abandoned' asset as a 'non-current asset held for sale', it is considered that further commentary should be added to help sharpen the distinction between the two. A definition of abandonment would also assist in the application of the classification process.

The objective of the standard (paragraph 1) should also contain a specific reference to abandoned assets as this proposed standard contains requirements for such assets.

Discontinuing Operations

It is considered that the section on discontinuing operations would flow more logically if the order of paragraphs 22 and 23 were reversed. The current paragraph 23 describes a discontinuing operation as 'a discontinuing operation is component' and paragraph 22 commences with 'a component of an entity'.

Illustrative Disclosures

AASB 1042 has a number of illustrative disclosures in appendix 1. The proposals in ED 117 contain no such disclosures. Illustrative disclosures are useful to both preparers and auditors.

Cross-referencing to other Standards

The exposure draft contains a number of cross-references to other accounting standards. There is an inherent limitation in cross-referencing and, in particular cross-references to specific paragraphs. A change to a cross-referenced standard can lead to a consequential change in this standard. Specific cross-referencing should be avoided.

Paragraph B4 contains a cross reference to paragraph 28(a); the reference should be to paragraph 29(a).

Comments on Appendix B 'Application Supplement'

B1 Classification of a Non-current Asset or Disposal

The first criteria to be met for classifying a non-current asset as held for disposal is 'management … commits itself to plan to sell'. This is an important test and needs to be supported by commentary to provide further guidance to preparers and auditors. Without such guidance, divergent reporting practices are likely to evolve.

Given that all six criteria need to be met for a non-current asset or a 'disposal group' to be classified as 'held for sale', including the requirement that the sale is 'highly probable', may well result in less frequent disclosures than initially envisaged may result, and the deferral of such disclosures until the sale is virtually assured. This may deprive users of the information the proposed standard seeks to provide. We believe that there is a strong case to revise 'highly probable' to 'probable.' with reliance placed on the other criteria providing comfort as to the eventuality of the outcome.

B2 The Exception

For the similar reasons to the above, it is considered that 'highly probable' in B2(a)(ii) should be replaced by 'probable'.

The defined term 'firm purchase commitment' is introduced. A firm purchase commitment is defined as 'an agreement with an unrelated party, binding on both parties and usually legally enforceable, that (a) specifies all significant items, and (b) includes a disincentive for non-performance that is sufficiently large to make performance highly probable'. Given that this definition is premised on there being an unrelated party, it is assumed that if the transaction is with a related party that the exception cannot be applied. If this is the intent, it should be clearly stated.

Given the robustness of the definition itself, it is considered that reference to 'with an unrelated party' can be deleted without undermining the integrity of the requirement. Many transactions occur with related parties with these being subject to separate disclosure and substance assessments.

Specific Matters for Comment in the Australian Context

Public Sector and Not-for-profit

AASB 1042 applies to governments, and to the public sector activities other than restructuring of administered administrative arrangements between government departments, and administrated activities of government departments. Given the application of AASB 1042 to the public sector, it is considered that the proposals would also have a specific application to the public and not-for-profit sectors. It is also envisaged that the AASB would provide commentary in the Australian reporting context, to address the application of proposals in ED 117 to the public and not-for-profit sectors as it has done in AASB 1042.

The introduction of specific Australian commentary after the release of the exposure draft questions the integrity of the due process.

Best Interests of the Australian Economy

CPA Australia considers that the adoption of international accounting standards is generally in the best interests of the Australian economy. Where IASB standards are converged with those of the FASB, the best interests are heightened.

The External Reporting Centre of Excellence, on behalf of CPA Australia, has prepared this submission. Please contact Naomi Carroll, Policy Adviser, Accounting and Audit on Tel: (03) 9606 9872 or by email naomi.carroll@cpaaustralia.com.au should you have any queries concerning our submission.

Yours sincerely

Greg Larsen, FCPA
Chief Executive

c.c. Naomi Carroll