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International Accounting Standards Board
30 Cannon Street
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Attention: Anne McGeachin, Project Manager

22/10/2003

ED 4 - DISPOSAL OF NON-CURRENT ASSETS AND PRESENTATION OF DISCONTINUED OPERATIONS

Dear Ms. McGeachin

We welcome very much the opportunity to comment on the above-mentioned draft. We note that the ED4 proposals have been kept as close as possible to the exact text of FAS 144. We do strongly support the IASB's and FASB's efforts to achieve convergence. However, we also consider it vital that new IFRSs represent the highest quality possible accounting solutions. In our view, it is increasingly recognised that US GAAP, while being of extremely high quality in many areas, does not always offer the best available solution to every accounting issue. In this letter, we have therefore suggested certain changes to the approach taken in ED 4. We would prefer to retain the present approaches of IAS 16, 35 and 36 while adapting them to take account of some of the strong points of FAS 144: we would hope that the IASB could then convince the FASB of the merits of this approach in order to achieve greater convergence. In particular we would prefer to see a less prescriptive and more principle-based approach to these topics in the interest of relevance and reliability. Also, more appropriate solutions are needed for assets classified as held for sale but still in active use, and for joint ventures and associated companies which are part of a disposal group. Lastly, in our view, the difference, if any, between the term "net selling price" used in IAS 36 and the term "fair value less cost to sell" used in ED 4 should be clarified.

Q1. Classification of non-current assets held for sale

We agree with your proposal to classify separately non-current assets held for sale, because it allows the user of the financial statements to assess the timing and amount of future cash flows, and gives a fairer presentation of current/non-current positions in the balance sheet. However, the criteria listed in Appendix B which must be met before the asset(s) or disposal group qualify for such classification are prescriptive and rule-based. The key criterion is: "Is a sale highly probable?". Any other criteria should be included for illustrative rather than prescriptive reasons . We understand that the IASB would not favour classifications based on management intentions. However, Appendix B contains a rule, that a completed sale must be expected to be achieved within 12 months of the date the assets are classified as held for sale. This rule is subject to narrowly defined restrictions. In our view, this is likely to conflict with the objective of providing relevant information to users, because there will be some planned disposals which will fail to meet the criteria merely because of technicalities.

Any sale whose outcome is expected to occur after more than 12 months would need to be well documented and, if material, the decision to classify as held for sale would need to be explained in the notes to the financial statements.

We recommend that you reconsider whether abandoned assets could not be included in this separate balance sheet category, to ensure greater consistency of approach. This would be straightforward if you adopt our recommendation of amending IAS 16 and 36 rather than creating a separate new standard. A definition of abandonment would also be helpful.

We would also point out that, where a joint venture accounted for by proportional consolidation is part of a disposal group, considerable balance sheet reclassifications are implied by the new ED4 requirement. As US GAAP does not permit proportional consolidation, and therefore this point may not have been fully considered by US GAAP standard setters, we are unsure whether copying FAS 144 into IFRS provides an adequate solution to this particular issue.

Q2. Measurement of non-current assets classified as held for sale

We disagree strongly with the requirement in paragraph 16 of the ED that "*an entity shall not depreciate or amortise a non-current asset while it is classified as held for sale or while it is part of a disposal group classified as held for sale*". In our view, it would be inappropriate to stop depreciating assets which are still in active use. If the sale process is protracted, the fair value of the assets held for sale (or disposal group) will still continue to decline because of the continued consumption of economic benefits by the entity. This fact is directly relevant to the measurement of assets or disposal groups if their fair value less costs to sell is lower than their carrying amount when reclassified. However, even if carrying amount is lower at this point, in our view, it would be wrong in principle and misleading to users of the financial statements not to reflect the consumption of economic benefits through depreciation and amortisation. If depreciation and amortization ceased, the reported results of operations of disposal groups held for sale would increase in the last months in which the reporting entity owns them. Prospective buyers of the assets held for sale would be unable to rely on the information given in the financial statements to indicate the performance of the assets. The reliability and credibility of the financial statements would be reduced, because users could not depend on the financial statements to represent faithfully the results of operations. The guidance in IAS 16 and 36 ensure that the use of the assets is properly reflected in the income statement, and should remain in effect.

We also believe that the Board should rethink the position in respect of joint ventures and associated companies which fall into the held-for-sale category. If we have understood the proposals correctly, such units would cease to be accounted for by the equity method or proportionate consolidation method at the date of reclassification as held for sale, and their value would be reduced to fair value less cost to sell. In our view this would be quite incorrect for the following reasons:

- such units' fair value less cost to sell could differ significantly from the much more relevant recoverable value determined under IAS 36, as the latter properly takes into account the cash flows which the entity expects to generate from continuing use and which form the basis for the results from these activities until disposal. These results would not be reported under the proposals in ED 4;

- until disposal, such units continue to be held in joint control or with significant influence as part of the entity's activities, so their results should continue to be reflected in those of the entity, on the same basis as previously. Continuing to apply the existing accounting method for the joint venture or associated company would be more consistent with the proposed treatment of subsidiaries which form part of a disposal group.

If the proposals were to go forward in their present form, we would also suggest that the allocation of any impairment loss on a disposal group should be conformed to IAS 36 (revised), under which impairment is charged against goodwill first. As goodwill is scoped out of ED 4, the allocation requirement in paragraph 14 of the ED, as worded, appears to conflict with the IAS 36 requirement. An illustrative example should be included of how this allocation is to be done as this is not clear from ED 4, para. 14.

Q3. Disposal groups

While generally supporting the approach proposed, which we would like to see reflected in IAS 36 rather than in a separate standard, we would like to make the following points:

- The approach taken on goodwill seems somewhat confusing (see also our response on Q1. above).
- The definition of “disposal group” in Appendix A contains the words “to be disposed of, by sale or otherwise...” The last two words need clarification: see also our response to Q1. above in respect of scrapping and abandonment.

Q4. Newly acquired assets

We support the approach proposed.

Q5. Revalued assets

We are generally in agreement but find the guidance rather confusing, and recommend providing an example to illustrate what is required. Also, we have some doubts about the requirements in B8, which we believe should be checked for internal consistency with ED 4’s principal measurement requirement. Because US GAAP does not permit revaluations, this point may not have been considered when preparing and issuing FAS 144.

Q6. Removal of the exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale

We understand this proposal to imply that these subsidiaries would be consolidated and then classified as held for sale and discontinued operations. As such subsidiaries will never have been classified within continuing operations, it is in our view inappropriate to describe them as discontinued. We understand the argument that such subsidiaries should be consolidated because the entity has control during the period through to disposal. However, in our view a mandatory requirement to dispose of a subsidiary, imposed for example by competition authorities, does severely restrict the economic benefits that the entity can derive from it. Therefore, in our view there are also sound arguments in favour of maintaining the current exemption.

Q7. Presentation of non-current assets held for sale

We agree with the proposal to show these separately in the balance sheet. However, we believe that a net presentation of assets and liabilities for a disposal group would be preferable to the proposed gross presentation. This is because the net assets will be sold as a bundle to the buyer – so the conditions for netting assets and liabilities are met. Also, the resulting single amount is more meaningful for the user than two separated gross amounts and more fairly reflects the economic substance of the situation. Finally, a net presentation of assets and liabilities for a disposal group would also be consistent with our advocated presentation of a single post-tax amount for discontinued operations in the income statement (see response to Q9. below). Details of assets and liabilities included in the net amount could be given in the notes to the financial statements without any loss of clarity or quality for those users interested in this information.

However, one aspect on which we would appreciate the IASB conducting further research is that of “commercial confidentiality”. If an entity has to report in its balance sheet a separately identifiable amount or amounts as “held for sale”, and in the same time has to report an impairment loss in its income statement in respect of the asset or disposal group, the prospective buyer or buyers are provided with information about the reporting entity’s assessment of the fair value of the asset or disposal group. They can turn this information potentially to their advantage, and therefore to the disadvantage of the reporting entity and its shareholders, during sale negotiations. The interests of two different groups of users of the financial statements – the entity’s shareholders on the one hand and prospective buyers of the assets on the other – are diametrically opposed on this issue, and the financial statements cannot be aligned with both. We believe that the interests of the entity’s shareholders should come first. The possibility to combine “non-current assets held for sale” with “other current assets” in such circumstances would be helpfully pragmatic.

Q8. Classification as a discontinued operation

We are strongly of the opinion that the ED 4 “component” definition sets the “threshold” for discontinued operations too low and does not represent an improvement on the present IAS 35 criteria, which we prefer to broadly retain. Separating out discontinued operations is designed to enhance the income statement’s predictive value. They should therefore be defined as significant changes in the scope of operations which will influence the sensitivity of the entity to external economic segmental factors. They should result from strategic decisions only, and should exclude the results of more tactical rationalisation and cost-cutting decisions which the “components” approach would not be able to filter out. We therefore believe that a disposal group should qualify as a discontinued operation only if it meets the IAS 35 criterion of being “a separate major line of business or geographical area of operations”. We are particularly concerned that a lower threshold would be result in discontinued operations being reported much more frequently – almost a recurring item – even if the scope of the entity’s operations has not significantly changed in business or financial terms. Also, the consequent restatements would become almost a permanent feature, destroying continuity and confusing the user of the financial statements.

We appreciate that our preferred solution may be interpreted as diverging from rather than converging with US GAAP, but are convinced that on this particular issue, the present IAS 35 approach is more relevant and helpful to the user and thus a better solution.

In our view, it is unwise to include a criterion of “no significant continuing involvement” in the requirements to be met before an operation can be classified as discontinued, as proposed in paragraph 23 (b) of the ED. The term “significant continuing involvement” is not defined in the ED. It is quite normal in many industries for the seller of a business to have some continuing relationship with that business and their purchaser after the sale. For example, shared services previously provided while the disposed business or businesses were part of the selling reporting entity are sometimes continued for a period until the purchaser can fully integrate the businesses into its own organization. Also, in industry sectors where intellectual property is important, because of the time needed for technology transfer, registrations and certifications, the seller often has to continue to manufacture for the buyer under (say) a 2-year supply agreement. Delay of classification as “held for sale”, through applying the literal meaning of the words “no significant continuing involvement”, would not reflect the economic substance of a sale transaction which has transferred control of the businesses, together with risks and rewards, to the purchaser.

Q9. Presentation of a discontinued operation

We believe that the presentation of a single after-tax amount for discontinued operations on the face of the income statement would best meet the objectives of comparability, understandability and relevance without losing valuable detailed information, which could be given in the notes to the financial statements.

We also note that our above proposal is convergent with the required US GAAP presentation, whereas the ED4 proposals, which would require separate presentation of four elements - revenue, expenses, pre-tax profit and income tax expense – on the face of the income statement - are not. In our view, the full benefits of convergence are obtained if disclosure requirements as well as accounting requirements are converged. With regard to the comment in BC55, it is perhaps worth mentioning that this idea from the "Reporting Performance" project is one of the few ideas in that project to enjoy fairly universal support, as far as we can ascertain.

We would also observe that, under the proposals in the ED, operations held for sale will often need to be reported as discontinued in financial statements which are issued before the sale has occurred. As regards the wording of the financial statement heading, "Operations to be discontinued" would be a more accurate description than "Discontinued operations" in those circumstances. As ED 4 envisages that "discontinued operations" might become continuing operations again if a plan of sale is changed (paragraph 26), we fear that inaccurate wording may mislead some users of the financial statements.

Yours Sincerely,

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