audit commission

Jenny Carter
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London
WC1X 8AL

27 October 2003

REF:

Dear Ms Carter

FRED 32: DISPOSAL OF NON-CURRENT ASSETS AND PRESENTATION OF DISCONTINUED OPERATIONS

Please find attached a response from the Audit Commission to this consultation.

If you have any queries, or would like further information about the Audit Commission, please do not hesitate to contact me.

Yours sincerely

Jonathan Reid

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Manager, Technical Development
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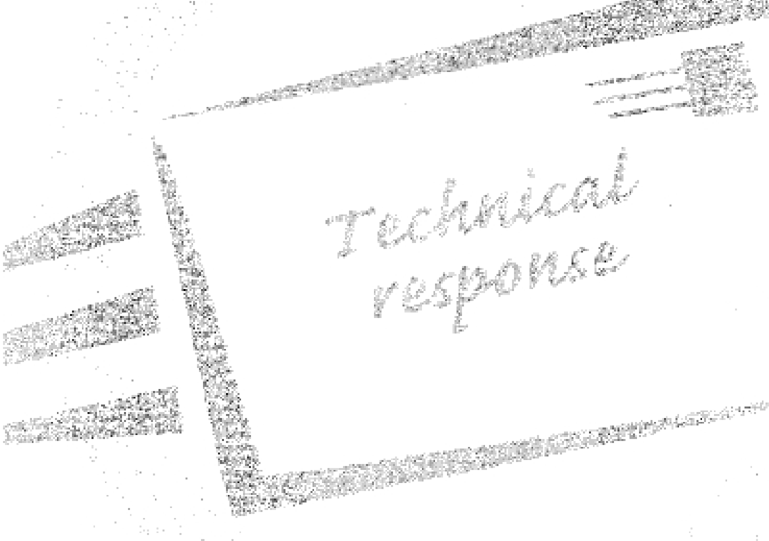
technical response



FRED 32: Disposal of Non-current Assets and Presentation of Discontinued Operations

Audit Commission
response to the ASB
Exposure Draft

audit
commission

Public audit is an essential element in the process of accountability for public money and makes an important contribution to the stewardship of public resources and the corporate governance of public services. The Audit Commission (the Commission) was established as an independent body in 1983 and has statutory responsibilities, amongst other things, for:

- **appointing auditors to local government and NHS bodies that spend some £120 billion of public money annually;**
- **setting the required standards for its appointed auditors, and regulating the quality of audits;**
- **making arrangements for certifying government grant claims and returns;**
- **undertaking or promoting comparative and other studies to promote the economy, efficiency and effectiveness of local government and NHS services;**
- **defining local government performance indicators;**
- **receiving and, where appropriate, following up information received from 'whistleblowers' in local government and NHS bodies under the Public Interest Disclosure Act 1998; and**
- **carrying out best value inspections of certain local government services and functions.**

The Commission appoints auditors to local government and NHS bodies from within the Commission and from private firms of auditors. Once appointed, auditors carry out their statutory and other responsibilities, and exercise their professional judgement, independently of the Commission.

Any comments on the issues raised by this response should be addressed to:

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1. INTRODUCTION

1 The Audit Commission ('the Commission') welcomes the opportunity to comment on the Exposure Draft *Disposal of Non-current Assets and Presentation of Discontinued Operations.* The Commission has long supports the Board in its work on taking forward convergence between the Board's own UK Financial Reporting Standards ('FRSs') and the International Accounting Standards Board's ('IASB') International Financial Reporting Standards ('IFRSs'). This has been given added impetus by the decision of the European Community to require the adoption of IFRSs from 2005 by listed entities.

2 The form and content of public sector accounting in England is determined by HM Treasury, supported by the advice of the Financial Reporting Advisory Board ('FRAB'). The current framework of financial reporting developed by the Treasury places an emphasis on ensuring that the financial reporting practices of the public sector follow UK Generally Accepted Accounting Practice ('GAAP'), so far as this is appropriate. As UK GAAP converges with international practice, it is likely that UK public sector reporting will also converge with international practice. It is on this basis that we have prepared a response to the Exposure Draft.

2. GENERAL COMMENTS

3 The Exposure Draft sets out clearly the intention to move forward the process of convergence between IFRSs and the standards promulgated by the US Financial Accounting Standards Board. We recognise that this convergence project is a key element in ensuring the widespread adoption of IFRSs. We note also that this Exposure Draft only consults on certain of the differences between IFRSs and US GAAP, leaving the more complex issues for later discussion. We consider that this is a useful, pragmatic approach to working towards convergence. Our sole area of concern, in this respect, is that the proposals are all for change in the IFRS, with – it would appear – no corresponding proposals for changes in the US equivalent standard. It is widely accepted that US financial reporting standards are more rule-based than those in the UK and, to a degree, the international standards promulgated by the IASB. We would ask the Board, therefore, to work with the IASB to ensure that convergence does not lead to the gradual introduction of rule-based standards in the IFRSs as this would be likely to lessen the efficacy of the principles-based approach thus far adopted. We note, in this regard, the dissenting opinions of the IASB included in their consultation material.

4 However, having considered the proposed IFRS in some detail, we consider that it is likely to provide a considerable amount of useful information to users of financial statements.

APPENDIX 1

Reference	Consultation Question	Commission Response
ASB1	Do you agree with the proposal to issue a new standard on disposal of non-current assets and discontinued operations when IASB issues its new IFRS?	Yes. The Audit Commission supports the Board's work on convergence between UK Financial Reporting Standards and those promulgated by the IASB.
IASB1	The Exposure Draft proposes that non-current assets should be classified as assets held for sale if specified criteria are met. Assets so classified may be required to be measured differently and presented separately 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?	The Commission considers that the classification of non-current assets held for sale does enable additional information to be provided for users. However, we concur with the alternative view of the second IASB board member on the use of the classification 'held for sale.' This view holds that a separate classification 'non-current assets retired from active use' would draw a more appropriate and objective distinction than the classification 'held for sale.' If an alternative classification were to be employed, we would prefer this to be entitled 'non-current assets not in active use.' This classification bears some similarities to the classification of surplus assets which is already a requirement for local authorities in the *Code of Practice for Local Authority Accounting in the UK: A Statement of Recommended Practice*. The Commission is represented on the Accounting and Auditing Standards Panel of the Chartered Institute of Public Finance Accountants, and we have seen their proposed response to the Board. This contains several observations about the specific difficulties which may arise in the local authority sector in respect of houses sold under the 'right to buy' arrangements. The Commission concurs with these observations.

IASB2	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. Is this measurement basis appropriate for non-current assets classified as held for sale?	The Commission agrees that the lower of carrying amount and fair value less amounts to sell is an appropriate measurement basis for non-current assets classified as held for sale. Although at the point of classification the decision has clearly been made to dispose of the asset, we consider that there may be some valuable information for the user in publishing the 'value in use' of the asset(s) in question. This would enable the user to evaluate the efficacy or otherwise of the decision to dispose of the asset(s). We suggest that the standard may provide some discretion to make this information available. We do, however, have some concerns over the proposals that non-current assets classified as being held for sale should not be depreciated, irrespective of whether they continued to be used operationally. The Commission recognises the conceptual strengths of the argument put forward by the IASB (particularly in the basis for conclusions) and considers that the 'requirements' set out in Appendix B to the [draft] standard will ensure that the classification is not abused. However, the Commission is not persuaded that this is the optimum approach. The carrying value and the fair value of the asset are likely to be affected by further consumption of economic benefits prior to sale, and the consumption of these benefits should be accounted for through a depreciation charge. One suggestion may be that this information is made available through a disclosure note to the accounts.

IASB3	The Exposure Draft proposes that assets and liabilities to be disposed of together in a single transaction should be treated as a disposal group. The measurement basis 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 value of the non-current assets in the disposal group. Is this appropriate? If not, why not?	Subject to the comments made above in relation to IASB 2 and 3. The Commission considers that that it is appropriate to consider assets and liabilities as a 'disposal group' as outlined in the Exposure Draft. The Commission also considers that the proposed measurement basis is appropriate.
IASB4	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. It therefore proposes a consequential amendment to [draft] IFRS X *Business Combinations* 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 an initial recognition appropriate? If not, why not?	The Commission has considered the discussion on this issue in the *Basis for Conclusions* and considers that this is persuasive. We consider that there may not be a significant number of situations where entities in the public sector will acquire assets meeting the criteria to be classified as held for sale. However, we note that one example where this may arise is in respect of the Local Improvement Finance Trust ('LIFT') schemes being developed across the UK health sector. One of the options for setting up the scheme allows for the purchase of premises by local health bodies from General Practitioners, with the intention to sell this on in due course to the LIFT company.
IASB5	The Exposure Draft proposes that, for revaluing 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	The Commission agrees with this approach and the proposed accounting treatments. However, in a number of circumstances public sector bodies are provided with support or assistance with disposal costs (for example, the power of offset in

	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. Is this appropriate? If not, why not?	certain circumstances in local government). This may mean that the treatment of costs to sell and subsequent changes in costs to sell will not be appropriate.
IASB6	The Exposure Draft proposes a consequential amendment to draft IAS 27 *Consolidated and Separate Financial Statements* to remove the exemption from consolidation from subsidiaries acquired and held exclusively with a view to resale. Is the removal of this exemption appropriate? If not, why not?	The Commission does not consider it appropriate to comment on this proposal. It would be extremely rare for public sector bodies to acquire a subsidiary and to hold it as exclusively for resale. We note, however, that this is a logical next step if the proposed treatment for assets and disposal groups is agreed.
IASB7	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. Is this presentation appropriate?	The Commission agrees that this presentation is appropriate. The principle of non-offset runs through a number of Financial Reporting Standards and the Commission considers it to be important. Given the likely level of detail to be required where an entity has a significant number of disposal groups or assets, the Commission would expect this information to be supplemented with adequate detail in the Notes to the Accounts.
IASB8	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	The Commission did not consider the extant UK FRS 3 requirements, which echo the requirements of IAS 35, in relation to discontinued operations to be in need of amendment. However, the Commission also recognises the importance of convergence between

	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. 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 reported 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 be made to the criteria to be made, 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 classification of the operations and cash flows) appropriate? If not, what criteria would suggest and why?	the IASB and the US Financial Accounting Standards Board. Therefore, we agree that the proposals for the classification of a discontinued operation are important. The Commission accepts that this could lead to relatively small units being classed as discontinued. It should be possible for a balance to be obtained between excessive detail and useful information for the users of financial statements on the rationale and purpose of discontinuing certain activities. The Commission considers that the process of restating comparatives each year where entities report discontinued operations regularly is likely to an expensive and time-consuming process. However, as this is another area where public sector bodies are unlikely to have a significant number of transactions, and it is right that the Board should take soundings from the private sector and other key stakeholders. As indicated above, the Commission considers that convergence is a key policy outcome and welcomes the attempts of the Board to obtain this. Therefore, the Commission would not prefer an amendment to the criteria to be made for this particular [standard]. The other aspects of the criteria developed in the Exposure Draft are appropriate.

IASB9	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. 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 Commission considers that the details of discontinued operations should be shown on the face of the income statement. The ASB has, over the years, worked to develop the income statement as a comprehensive statement of income (and, indeed, the IASB is piloting a comprehensive income statement approach). Full disclosure on the face of the income statement should assist the user in gaining an understanding of the likely impact of discontinued operations on future results. However, where appropriate, additional information should be provided in a note to the accounts.