Submission of Comments by the AASB to the IASB

AUSTRALIAN ACCOUNTING STANDARDS BOARD

IASB

International Accounting Standards Board

Exposure Draft

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

Comments to be received by 24 October 2003

INVITATION TO COMMENT

In response to the IASB Invitation to comment, the Australian Accounting Standards Board has prepared the following submission addressing the specific questions asked and commenting on the proposals in IASB ED 4.

The AASB supports the short-term convergence program between the IASB and the FASB, and generally supports the proposals in ED 4 to achieve convergence with SFAS 144 "Disposal of Long-Lived Assets". The AASB's most significant concerns regarding ED 4 relate to:

- timing of disclosing information on discontinued operations when compared to the current requirements of IAS 35 "Discontinuing Operations";
- mandating the classification of held for sale assets as non-current; and
- the treatment of revalued non-current assets on their classification as held for sale.

[Draft] International Financial Reporting Standard IFRS X

Disposal of Non-current Assets and Presentation of Discontinued Operations

INVITATION TO COMMENT

The International Accounting Standards Board invites comments on any aspect of this Exposure Draft of its proposed IFRS *Disposal of Non-current Assets and Presentation of Discontinued Operations.* It would particularly welcome answers to the questions set out below. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale, and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing so as to be received no later than 24 October 2003.

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 wth the classification being made? If not, why not?

The AASB prefers entities to make a distinction between non-current assets that are active and non-current assets that are retired from active use because it shows non-current assets are being used by the entity in its operations and there is no convincing reason why active assets are accounted for differently based on whether or not they are held for sale. However, the AASB believes that in the interests of the IASB and US convergence on this issue and in light of our comments on the measurement basis in question 2 below, the proposed classification in ED 4 is supported.

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 AASB believes that non-current assets held for sale which are still in active use should be depreciated / amortised because, while the asset is in active use its economic benefits are being consumed by the entity. Conversely, the AASB agrees that non-current assets held for sale that have been retired from active use should cease to be depreciated / amortised because their economic benefits are no longer being consumed.

The AASB notes that the proposed treatment will introduce an inconsistency in the measurement requirements for active assets that are held for sale (which are not depreciated) and active assets that will be abandoned (where the asset will continue to be depreciated), although it is acknowledged that any depreciation on abandoned assets may not be material.

However, the AASB supports ceasing depreciation / amortisation on all held for sale assets given that the IASB is moving towards a position in IAS 16 "Property, Plant and Equipment" that will require an entity to keep its residual values up to date. This will have the effect that there will not be a material difference between the measurement requirements under ED 4 and fair valued assets under IAS 16. The AASB agrees with paragraphs BC22 and BC23 of the Basis for Conclusions dealing with this issue.

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?

The AASB agrees with the proposed treatment of disposal groups.

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?

The AASB agrees with the proposed measurement requirements for newly acquired assets that are held for sale.

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?

The AASB is concerned that the wording in paragraph B6 that sets out the treatment of impairment losses in relation to revalued assets that are held for sale does not achieve its intended purpose. Paragraph B6 requires any asset that is carried at a revalued amount under another IFRS to be revalued under that IFRS immediately before it is classified as held for sale and measured at fair value less costs to sell under this [draft] Standard. Revaluation under IAS 16 “Property, Plant and Equipment” involves measurement at fair value, without deduction for costs to sell.

The AASB agrees that any fair value adjustments before a non-current asset is classified as held for sale should be recognised in accordance with the IAS 16 (or other IFRS) requirements. IAS 16 requires upward fair value adjustments on revalued property, plant and equipment to be recognised in the asset revaluation reserve (or in the income statement where it is reversing a previous decrement taken to the income statement), and any downward fair value adjustment would be recognised as a decrease in the asset revaluation reserve relating to the individual asset (or in the income statement when a asset revaluation reserve does not exist in respect of the asset).

In recognising the held for sale asset under the proposals of ED 4, an impairment loss would be recognised for the difference between the fair value of the asset and the fair value less costs to sell the asset (i.e. net fair value). In many situations, the difference between the two values would solely be attributable to the costs to sell (the transaction costs). Consequently under ED 4, an impairment loss equal to the transaction costs would be recognised in the income statement upon recognising a non-current asset as held for sale. The AASB agrees with this treatment and recommend that in measuring held for sale assets under this [draft] Standard, that transaction costs attributable to the held for sale asset are immediately recognised in the income statement.

However, there are a number of situations where the fair value of an asset determined in accordance with IAS 16 would differ from the net fair value that is part of the measurement provisions under this [draft] Standard. These situations arise, for example, if an entity has specialised equipment where the fair value has previously been determined based on the depreciated replacement cost of the asset, but on disposal of the asset the net fair value may be determined as its scrap value. Given the IASB’s move towards requiring an entity to keep the residual values of non-current assets accounted for in accordance with IAS 16, the difference between the fair values may not be material. However, in this situation, it is arguable that paragraph B6 would require any difference arising from the different approaches used to determine fair value under each Standard to be treated as an impairment loss and recognised immediately in the income statement. The AASB believes that the intent of paragraph B6 is to only have transaction costs expensed in the income statement and have changes in the fair value of property, plant and equipment treated in accordance with the requirements of IAS 16. Paragraphs B7 and B8 require subsequent changes in fair value to be accounted for in accordance with IAS 16, however these paragraphs do not seem to apply for fair value changes on the initial recognition of property, plant and equipment as held for sale.

The AASB recommends that paragraph B6 should clearly state that changes in the fair value of a non-current asset at the time the non-current asset is classified as held for sale should be treated in accordance with the requirements of the Standard under which the non-current asset was revalued before its classification as held for sale.

The AASB also notes the inconsistency that may arise in situations where, for the purposes of revaluing the property, plant and equipment under IAS 16, IAS 16 may require IAS 36 "Impairment of Assets" to be applied. Under IAS 36, the recoverable amount is determined as the higher of net selling price and value in use. In circumstances where the recoverable amount is based on net selling price, IAS 36 would require the impairment loss to be accounted for in accordance with IAS 16. This has the potential for transaction costs to be recognised as a reduction in the asset revaluation reserve, rather than through the income statement, as proposed in ED 4. The AASB recommends that this inconsistency should be rectified in the Standard arising from ED 4 through a consequential amendment to IAS 36.

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?

The AASB agrees with the proposal to remove the exemption in IAS 27. Removal of the exemption would be consistent with the current Australian requirements in AASB 1024 "Consolidated Accounts" and is consistent with AASB comments to the IASB on the improvements to IAS 27.

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?

The AASB agrees with the proposal for assets held for sale to be presented separately in the balance sheet and not to allow assets and liabilities within a disposal group to be offset because it provides more useful information to users in assessing the intended disposal. As currently proposed in paragraph 28, the AASB recommends that entities should be provided with a choice to present the major classes of assets and liabilities classified as held for sale on the face of the balance sheet or in the notes to the financial statements. This is on the basis that the circumstances of each entity may vary considerably and each entity should be able to use the presentation that best suits those circumstances.

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?

The AASB agrees with the broader definition of a discontinued operation compared to IAS 35 as it assist users in analysing the continuing operations of an entity, and for convergence with SFAS 144.

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?

The AASB recommends that entities should be allowed a choice to present discontinued operations as a single line item on the face of the income statement with disaggregation in the notes to the financial statements or to present the disaggregation of discontinued operations on the face of the income statement. In some circumstances, requiring entities to disaggregate discontinued operations on the face may result in a clutter on the face of the statement and a user of the financial report would lose focus on the important information – income from continuing operations. Each individual entity is in the best position to decide where the information should be presented to enhance understandability of the financial report.

Other comments

Timing of disclosure of a discontinued operation

The AASB acknowledges that the ED 4 proposals delay the requirements in disclosing a discontinued operation when compared to the current requirements of AASB 1042 "Discontinuing Operations" and IAS 35 "Discontinuing Operations". Under AASB 1042 and IAS 35, an operation is to be 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. However, ED 4 classifies an operation as discontinued at the date the entity has actually disposed of or abandons the operation, or when the operation meets the criteria to be classified as held for sale. The change in the requirements from "discontinuing" to "discontinued" defers the timing of classification as a discontinued operation, and it will no longer be recognised from the point where an initial disclosure event occurs. The AASB is somewhat surprised that specific comment was not sought on this particular change, as it considered a major change. The AASB is 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 and IAS 35 have more merit than the proposal in ED 4. If the IASB is to create a Standard based on ED 4, the AASB would recommend that the Standard require a narrative disclosure on when an "initial disclosure event" has occurred.

Classification of held for sale assets as current rather than non-current

The AASB notes that the IASB has tentatively agreed in the Improvements project that the definition of a current asset will be amended so that it does not include non-current assets that are expected to be realised in the next twelve months. The AASB believes that the classification of held for sale assets as current or non-current should be subject to the same criteria as other assets. In the majority of circumstances, held for sale assets will be sold (realised) in the next twelve months, and should be classified as current assets. However, in circumstances where events or circumstances extend the period to complete the sale beyond one year (as set out in paragraph B2), then it would be appropriate to classify these held for sale assets as non-current.

In addition, specifically requiring held for sale non-current assets to be classified as non-current does not provide reliable information for users of accounts who would be concerned about when an entity is to realise cash. For example, entities with an operating cycle of greater than a year and that intend to dispose of a held for sale asset in a week or 12 months would be required to classify a held for sale asset as non-current despite the fact that the entity will realise the asset within its operating cycle. In this circumstance it would not be appropriate to classify the held for sale asset as non-current.

In Australia, the definition of current asset in AASB 1040 "Statement of Financial Position" which is equivalent to the current IAS 1 "Presentation of Financial Statements" definition, requires entities intending to dispose of non-current assets within the next twelve months to classify them as current assets. However, to date, there have been no specific rules regarding the circumstances when the intention to dispose is sufficient to result in classification of the asset as current. The AASB believes that the notion of "held for sale" will fill this gap.

Editorial

Content in the Application supplement

The AASB considers that the principles in ED 4 rely heavily on the rules set out in the Application supplement in order to operate. The AASB acknowledges that the IASB is attempting to create a principle based Standard but have problems in doing so under the IASB / FASB convergence project, where the relevant FASB Standard may be considered to be rules based. The AASB recommends incorporating Appendix B into the body of the Standard to produce a more readable Standard. Requirements of essentially the same nature seem to be included in the Standard itself and the Appendix. For example, paragraph 12 of the [draft] Standard sets out the requirements for recognising the impairment losses and subsequent gains for assets that have not been revalued before classification as held for sale, however the corresponding requirements for assets that have been revalued before classification as held for sale are set out in Appendix B paragraphs B5-B8, as referred to in paragraph 13 of the [draft] Standard.

Assets to be Abandoned

Paragraph 6 of the [draft] Standard prohibits non-current assets to be abandoned from being recognised as held for sale assets. The AASB recommends that the [draft] Standard should include further commentary to help sharpen the distinction between "abandoned assets" and "held for sale assets". It would be useful for the [draft] Standard to contain a definition of "abandoned" to assist in the classification of assets.

Other minor editorial comments

Paragraph	**Comment**
Title	The title of the [draft] Standard only refers to the disposal of non-current assets, however the [draft] Standard contains the requirements for both assets and their associated liabilities through the concept of a disposal group.
Paragraph 1	It is recommended that the objective paragraph contain a specific reference to abandoned assets because the [draft] Standard contains requirements for these assets.
Paragraph 2	The reference to "and to disposal groups as set out in paragraph 3" under items (a) – (e) could be read that disposal groups are excluded from the requirements of the [draft] Standard. It is suggested that paragraph 2 be amended to read "This [draft] IFRS applies to all recognised non-current assets of an entity, including disposal groups as set out in paragraph 3, except:".
Paragraphs 22 - 23	The AASB believe that the order of these paragraphs should be reversed to provide a more logical flow.
Appendix A	Paragraph B2 which sets out exceptions in which non-current assets can be classified as held for sale despite meeting the one-year requirement. Paragraph B2(a) makes a reference to a "firm purchase commitment", as defined in Appendix A as "an agreement with an unrelated party, binding on both parties and usually legally enforceable, that (a) specifies all significant terms, including the price and timing or the transactions, and (b) includes a disincentive for nonperformance that is sufficiently large to make performance highly probable". This definition is premised on there being an unrelated party. Is it intended that a firm purchase commitment cannot exist with a related party? If this is the intent, this should be clearly stated.
Paragraph B4	This paragraph cross-refers to paragraph 28(a). The reference should be to paragraph 29(a).
Appendix C	This Appendix makes consequential amendments to a number of Standards, for example IAS 16, which set out the measurement requirements for different types of non-current assets. The amendments proposed by ED 4 exclude non-current assets that are "held for sale" assets in accordance with ED 4 from being treated in accordance with the requirements the particular Standard. However, paragraphs B7 and B8 propose that some of the requirements in the particular Standard should be used. What is the status of these requirements, given that held for sale assets are excluded from such requirements?