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Our ref RB – IASB respons

Your ref ED 4-Non-current assets

16 October 2003

Dear Ms. McGeachin

ED4 – Disposal of Non-current Assets and Presentation of Discontinued Operations

On behalf of AWG Plc, I am writing to comment on the IASB's Exposure Draft 4.

Generally we agree with the IASB's conclusions. We set out our detailed answers to the questions posed as an appendix to this letter, however our main points are as follows:

We are supportive of the decision to report separately the assets of disposal groups and also other non-current assets held for sale.

However we are concerned with the proposed intention not to depreciate assets within a disposal group. We believe that this is not appropriate as the assets are still being used and traded and the period in which this occurs could be for a prolonged period of time. The results of the disposal group should be reported under normal accounting requirements. We do not believe that fair value accounting is appropriate just because the disposal group is being held for sale.

Generally we are concerned that not all the issues relating to disposal groups have been adequately dealt with and that some inconsistencies have developed with other standards as a consequence. The Exposure Draft as whole appears to have been drafted with non-current assets in mind, with disposal groups added as something of an afterthought.

We are also concerned that elements of the standard are becoming more rules based rather than principles based.

If you would like to discuss any of the points raised in this letter further, please contact me.

Yours sincerely

Roz Ball
Financial Controls Manager

Question 1

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 (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?

Answer

We agree with the overall proposal to classify non-current assets (or disposal groups) held-for-sale, as defined by paragraphs 4 and 5 and Appendix B of the Exposure Draft, because it improves the information available to users of financial statements in assessing the timing and amount of future cash flows.

We consider that it would be better if Appendix B were part of the main standard instead of being separated even though it states that the Appendix forms part of the standard. Also the requirements of the Appendix are very prescriptive rather than being principles based. We think that more principle based language should be used throughout the Standard.

Some items that meet the definition of an asset held for sale are items where there is solely an asset for asset exchange rather than a sale. We therefore support a distinction between swaps of similar assets that have a similar use in the same line of business (and have a similar value). We consider that these items should be treated differently and excluded from the Standard.

Question 2

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 paragraph 8-16).

Is this measurement basis appropriate for non-current assets classified as held for sale? If not, why not?

Answer

We believe that it is conceptually wrong to cease depreciation/amortisation while assets are still in active use. In particular the current proposal leads to an inappropriate accounting when an entity decides to dispose of a division and this meets the held for sale criteria. Even though the assets of such a held for sale division are being used until divesture this would not be reflected in the income statement.

There appears to be an inconsistency between this proposal and the requirements of IAS 36. The allocation of the impairment loss of a disposal group to the assets within the scope of the Standard i.e. not goodwill etc., is not consistent with the allocation method in IAS 36. We do not support there being a different treatment between the two Standards.

Question 3

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?

Answer

We refer to our response to question 2 above.

We find the wording of paragraph 2 somewhat confusing in that it specifically scopes out goodwill. However, in the last sentence scopes in disposal groups apparently including goodwill. Assuming this is what is intended it would be helpful to clarify the point by explaining the last sentence with an explanation of the different treatments.

As impairment of goodwill within a disposal group is ruled out by the Exposure Draft, it is unclear how any impairment of a disposal group should be allocated. Impairment of fixed assets appears inappropriate in these circumstances. The Exposure Draft as a whole appears to have been drafted with non-current assets in mind, with disposal groups added as something of an afterthought.

Question 4

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 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 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?

Answer

Subject to our comments on 1 and 2 above we support the Board's consequential amendment to draft IFRS X Business Combinations because it ensures that non-current assets that meet the criteria to be classified as held for sale will be measured on a consistent basis, independently from how they were acquired.

Question 5

The Exposure Draft proposes that, for revalued assets, impairment losses arising from the write-down of assets impairment losses arising for 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?

Answer

We do not support the view taken in B8. According to paragraph 8 any subsequent increase in fair value shall be recognised to its full extent and treated as a revaluation increase in accordance with the Standard under which the assets were revalued before their classification as held for sale. We believe that this treatment is inconsistent with the principal measurement requirement that a non-current asset shall be measured at the lower of its carrying amount and fair value less costs to sell. Therefore we recommend that the Board amend Paragraph B8 accordingly.

Question 6.

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 BC 40 of the Basis for Conclusions).

Is the removal of this exemption appropriate? If not, why not?

Answer

We agree with the Board's proposal.

Question 7

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?

Answer

We agree with the Board's proposal to present separately in the balance sheet non-current assets classified as held for sale and assets and liabilities in a disposal group classified as held for sale because it improves the information available to users of financial statements in assessing the timing and amount of future cash flows.

We support the view that assets and liabilities of a disposal group classified as held for sale should not be offset.

It is unclear however, whether the Board's intention is to require assets and liabilities in a disposal group to be shown as a total for assets and a total for liabilities, or separately on a line-by-line basis. We believe the Board should clarify its intention and consider including a worked example in the IFRS.

Question 8

The Exposure Draft proposes that a discontinued operation should be a component of equity 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 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 should 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 there 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?

Answer

Our concern is that by defining the component as a cash-generating unit this could lead to some companies having such items every year with continual comparative restatements. In a retail environment a cash generating unit would be a store. In a large retail group a company could be opening and closing units all the time. The disclosure of this would not necessarily help the reader as only the closing units would be identified and not the new units replacing them.

Whilst we believe the disclosure of information on discontinuing businesses is of relevance to the user it has to improve the overall understanding. We therefore consider that the guidance should be less prescriptive and that materiality should have more bearing on the disclosure, particularly if the approach adopted is that only one line is shown on the face of the profit and loss account, profit after tax, for the discontinued activity.

We do not consider that convergence of itself should be a driving measure. The most appropriate accounting should be the driver when drafting or improving existing Standards.

Question 9 –

The Exposure Draft 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. (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?

Answer

The advantage of showing all the details on the face of the profit and loss account is that this information is clearly visible and the user can quickly ascertain the ongoing business performance. The disadvantage is that the face of the profit and loss account can become quite complicated and although this could currently be overcome through the use of a columnar approach this may not be appropriate going forward.

It is not clear from the proposed alternative exactly how this would operate as by inserting only one profit after tax line it would appear that the intention would be for all the other lines in the profit and loss to be on an ongoing basis only with a single entry in the profit and loss account for the discontinued business. The notes would then give the total sales for the entity including the sales of the disposal group.

Also we assume all the entries in relation to any revaluation on classification as held for sale would be included in the proposed one line number. The notes would therefore have to give reasonably detailed analysis to extract all the relevant data.

The disadvantage of this would be that the profit and loss account would not give all the information in relation to the group's result as a whole. Therefore this approach, although having the advantage of simplicity, would not be our preferred approach.

It could also potentially give a misleading impact of the disposal upon the group. Initially a disposal will convert operating profit into interest income on the cash generated on the disposal. The removal of all the results of the disposal group to a line below ongoing profit after tax in the comparatives, whilst the interest income in the current year includes the impact of the cash generated on disposal would not properly reflect the true impact of the disposal. Practically it would not be possible to reflect the interest *income into the disposal line as the cash proceeds could be reinvested or repaid to shareholders or other funders and it might not be possible to calculate this impact with any degree of reliability.*

The current practice of disclosing the turnover and operating profit impact of discontinued activities therefore gives a reasonable amount of information to enable the user to assess the impact on the underlying trading of the group. The inclusion of a total result before tax then gives an indication of the overall performance of the group after the disposal.