OFFICE OF THE
CONTROLLER AND AUDITOR-GENERAL
Te Mana Arotake

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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
UNITED KINGDOM

Dear Sir

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

We are pleased to provide comments on ED 4 Disposal of Non-Current Assets and Presentation of Discontinued Operations (ED 4).

We strongly disagree with the proposal that assets classified as held for sale are not depreciated. Apart from this, in general we agree with the proposals in ED 4. Our responses to the questions in the Invitation to Comment are set out in the appendix.

If you have any questions concerning our comments, please contact Todd Beardsworth (+64 4 917 1590) or Sanel Tomlinson (+64 4 917 1601).

Yours faithfully

Kevin Simpkins
Deputy Controller and Auditor-General

Cc New Zealand Financial Reporting Standards Board

Level 5, 48 Mulgrave Street, PO Box 3928, Wellington, New Zealand
Telephone: 64-4-917 1500 – Facsimile: 64-4-917 1549

APPENDIX

RESPONSES TO QUESTIONS IN INVITATION TO COMMENT

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

We agree with the proposal to separately identify non-current assets held for sale on the face of the balance sheet.

However, we disagree with the proposal that non-current assets to be abandoned are not included in this classification. One could argue that non-current assets to be abandoned before the end of the economic lives are basically held for sale at nil. The same reason supporting the separate classification of non-current assets held for sale (i.e. information value to users of the financial statements) also supports the separate classification of non-current assets to be abandoned. Therefore, a category "assets to be retired from active use", to cover both assets held for sale and assets to be abandoned before the end of the economic lives, would be more appropriate.

We note an internal inconsistency in the criteria set out in paragraph B1. How can a sale be highly probable (d) if an active plan to sell/locate a buyer has only been initiated (c)? In our view the plan should already be activated. We believe tightening the criterion in (c) would remove the necessity for the exemption in paragraph B2(c).

If an asset is acquired with the intention of disposal, wouldn't that be "for trading purposes" – definition of a current asset subparagraph (b)? The whole intention behind the purchase is speculative in nature – How could such assets be regarded as non-current?

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?

We agree with the proposal to measure non-current assets classified as held for sale at the lower of carrying amount and fair value less costs to sell/net selling price.

However, we strongly disagree with the proposal that such assets are not depreciated. Depreciation is a measure of consumption of an asset. It would therefore be conceptually wrong to not reflect the benefits consumed through the use of the asset in the income statement. Therefore, if non-current assets held for sale are still being used in the operations of the entity, we believe they must continue to be depreciated.

The phrase "fair value less costs to sell" introduces a new "name" for a concept that is already well understood – net selling price. Introducing the new phrase is not only unnecessary, it also impacts the readability of the standard. We note the proposed consequential amendment to IAS 36. However, adoption of this new term also impacts the definition of "recoverable amount" and therefore requires amendment throughout the suite of standards. We don't believe it is necessary to demonstrate convergence with SFAS 144 by adopting its terminology (paragraph BC59).

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?

We agree with the majority of proposals in respect of disposal groups. However, we do not support the requirement in paragraph 14 that the impairment loss resulting from the write down of a disposal group only be allocated to the non-current assets within the scope of ED 4. This requirement is inconsistent with the requirements of IAS 36 and there does not seem to be a good reason to support departing from the requirements of IAS 36.

There are also some aspects in the body of the standard that are not clear and cause concern:

- *Under IAS 36 cash-generating units to which goodwill are allocated "represent the smallest cash-generating unit to which a portion of the carrying amount of the goodwill can be allocated on a reasonable and consistent basis." How can goodwill be included in a disposal group if the disposal group is only part of a cash-generating unit?*
- *The wording in paragraph 3 indicates that the measurement requirements of the standard only apply to a disposal group as a whole when it includes an asset within the scope of ED 4. However, paragraph 8 applies the measurement requirements to a disposal group without reference to it including an asset within the scope of ED 4. We suggest this possible anomaly be resolved by deleting the phrase "If a non-current asset covered by this [draft] IFRS is part of a disposal group," in paragraph 3.*
- *ED 4 does not include any requirements in respect of the measurement of liabilities that form part of a disposal group – maybe paragraph 11 could be extended to also include liabilities.*
- *It is not clear from paragraph 14 that the impairment loss (subsequent gain) recognised for a disposal group should be offset against the carrying amount*

of the assets <u>after</u> the measurement requirements of the standard were applied, i.e. the assets should first be measured using the requirements of the standard, then the disposal group should be measured using the requirements of the standard and any resulting impairment loss (subsequent gain) offset against the assets.

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?

We agree with the proposal. However, we disagree with the proposed consequential amendment to IFRS X Business Combinations. Non-current assets acquired in a business combination that meet the criteria for held for sale must first be measured at fair value in order to determine the goodwill. It can then be written down to fair value less costs to sell. If the two step approach is not followed, it will result in goodwill being overstated because the costs to sell will be locked into goodwill. Given the current proposals in respect of goodwill it could result in the "costs to sell" write down never being charged to the income statement.

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?

We agree with the proposal.

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?

We support the proposal to remove the exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale. We suggest that it be clarified (maybe with an example) how the requirements of ED 4 would work in the case of subsidiaries acquired and held for sale. Our understanding is that the investment would be presented as a held for sale asset in the parent's financial statements and the individual assets and liabilities of the subsidiary would be presented under the requirements of a disposal group in the consolidated financial statements.

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?

We agree with the presentation proposals. However refer to our concerns set out under question 1 in respect of sub classifications within each category of the balance sheet.

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?

We agree with the proposals. Although discontinued operations would be reported more frequently and for smaller units, they would still be subject to the test for materiality.

We note that the proposed definition will not include operations to be abandoned or alternatively transferred between group entities. We believe users need to be informed regarding discontinued operations regardless of the mode of discontinuation, i.e. whether by sale or abandonment or transfer. We suggest a requirement based on IAS 35 paragraph 6 be included in the final standard to deal with this issue.

In respect of the question on convergence, we do not consider convergence to be the ultimate goal when developing standards. The highest level goal should be improving the quality of information reported to users.

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?

We support the presentation on the face of the income statement.

Other comments

1. The cross-reference in paragraph B4 to paragraph 28(a) should be to paragraph 29(a).

2. Highly probable: We fail to see the need to introduce yet another term to define the level of certainty required for a particular test. Trying to define the levels of certainty for each test in the Standard is not necessary in a principles-based environment.

3. ED 4 contains a number of significant cross-references to Appendix B. Most of these cross-referenced requirements are essential to the understanding of the proposed standard and should be incorporated into the body of the Standard. Incorporating these requirements would greatly improve the understandability of the standard.

4. We believe paragraph 10 should be limited to the circumstances set out in paragraph B2.