CIPFA RESPONSE TO FRED 32 DISPOSAL OF NON-CURRENT ASSETS AND PRESENTATION OF DISCONTINUED OPERATIONS

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CIPFA

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1. INTRODUCTION

1.1. CIPFA welcomes the opportunity to comment on FRED 32 *Disposal of Non-current Assets and Presentation of Discontinued Operations*. The exposure draft has been reviewed by members of the CIPFA Secretariat and the Accounting and Auditing Standards Panel. The comments made have been approved by the Accounting and Auditing Standards Panel. CIPFA would like to comment on the questions set out in the exposure draft and also on some other issues related to the structure and presentation of the discussion paper.

2. GENERAL COMMENTS

2.1. CIPFA supports the convergence agenda being adopted by the Accounting Standards Board and the short term convergence programme being progressed between the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) in the US. However CIFPA does have some concerns that the difficulties the IASB is facing in converging with FASB may force the IASB into compromises that do not result in the best possible accounting solutions.

3. PARTICULAR ISSUES ON WHICH COMMENTS WERE INVITED BY ASB

Question ASB 1

3.1. Do you agree with the proposal to issue a new UK standard on disposal of non-current assets and discontinued operations when the IASB issues its new IFRS?

3.1.1. Yes, CIPFA is fully supportive of the ASB programme to converge UK standards with IFRSs and therefore agrees that the ASB needs to address the issued raised in the IASB's exposure draft. However in terms of the UK standards it would perhaps be more logical to include the requirements in respect of disposal of non-current assets within FRS 15 *Tangible fixed assets* and the requirements in respect of discontinued operations within *FRS 3 Reporting financial performance.*

Question IASB 1

3.2. The exposure draft proposes that non-current assets should be classified as assets held for sale if the 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?

3.2.1. CIPFA considers that the separate classification of non-current assets held for sale does enable additional information to be provided for users. However CIPFA is swayed by the alternative view of the second Board member that a separate classification 'non-current assets retired from active use' would draw a more appropriate and objective distinction that the 'held for sale' classification. If this alternative classification were to be used, CIPFA would prefer 'non-current assets not in active use' to be the terminology used. This classification is similar to the classification of surplus assets which is already a requirement of the *Code of Practice for Local Authority Accounting in the UK: A Statement of Recommended Practice* (the LA SORP). Surplus assets are separately disclosed on the balance sheet and carried at market value.

3.2.2. There is a danger, particularly in the local authority sector, that adopting the 'held for sale' classification could result in excessive disclosures. It is debatable whether council houses to be sold under 'right to buy' legislation would qualify as assets 'held for sale under the criteria listed in Appendix B. If the FRED was intended to apply to the sale of such assets then, to disclose the notes required by paragraph 29 (a) of the FRED, would result in an excessive number of disclosures for many authorities who sell a large number of properties individually each year under 'right to buy'. Arguably in this circumstance there is some value to users in disclosing the total value (see answer to IASB 2 below for issues in relation to valuing 'right to buy' sales) of the council houses held for sale separately in the balance sheet but it is difficult to see how disclosures in relation to the facts and circumstances leading to each disposal, and the effects and timing of each disposal could be justified. It is presumed that the normal precepts of materiality would apply and therefore preparers would not be expected to disclose the details of each disposal if not material. However in certain circumstances it may be appropriate to group like assets held for sale, e.g. council houses, where the assets are not material individually but are material in aggregate.

Question IASB 2

3.3. 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 is also proposed 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? If not, why not?

3.3.1. CIPFA agrees that the measurement basis is appropriate in principle. Valuing at the lower of carrying value and fair value less costs to sell is equivalent to forcing a review for impairment, except where value in use is higher than NRV. Since the assets in question are 'held for sale' and therefore a decision has already been made to recover their value through sale rather than use, 'value in use' does seem incidental or irrelevant.

3.3.2. However in terms of providing information for users then users should be interested to know if an asset which has been designated as 'held for sale' would generate more economic benefits through use than sale. It may therefore be more beneficial in terms of information for users if the entity were forced to undertake an impairment review. If the 'value in use' were less than net realisable value then the end result would be the same as under the FRED 32 proposals. If the 'value in use' was more, but the entity still wants to sell the asset, then the FRED 32 treatment could still be adopted but the entity should be obliged to explain the rationale behind this decision to users. Providing this information would allow users of the financial statements to ask questions and form a view on the decisions taken by the entity. Appropriate disclosures should be made to support the entity's decision to sell the asset despite having a higher value in use.

3.3.3. There are, however, some specific public sector implications to be considered in relation to the use of fair value. Fair value assumes an arms length transaction entered into by willing parties. As referred to in 3.2.2 above, local authorities are not willing parties with regard to sales of council houses under 'right to buy' legislation. Local authorities are obliged to sell council houses at a substantial discount and therefore the buyer will not be paying fair value. Therefore if council houses to be sold are to considered as 'held for sale' in accordance with Appendix B of the FRED, then fair value does not seem appropriate in this context, particularly once the asset qualifies as 'held for sale'. A more appropriate value to disclose would perhaps be the actual negotiated value less the statutory discount to be applied.

3.3.4. CIPFA also supports the measurement basis required if the decision to sell is reversed. However adjusting for depreciation and amortisation at the point the decision is reversed, while vital, may result in charges relating to the consumption of the economic benefit of the asset being made in a different period to that in which the economic benefits were received. This would only really be an issue where the entity had continued to use the asset operationally after the reclassification to 'held for sale'.

3.3.5. CIPFA does not agree with the notion that assets 'held for sale' are not to be depreciated irrespective of whether those assets are still being used operationally. Under the current proposed treatment in FRED 32, increases in prices could be masking the fact that the carrying value and also the fair value of the asset is being affected by further consumption of its economic benefits prior to sale. If it is being consumed surely it should be depreciated.

3.3.6. An alternative approach that could be considered would be to leave the asset at its carrying value but disclose it as 'held for sale' and in notes give fair value less costs of sale. Entities could be required to check for impairment on designation of an asset as 'held for sale' to ensure that the asset is not held above its recoverable amount in the balance sheet.

IASB 3

3.4. 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 value of the non-current assets in the disposal group.

Is this appropriate? If not, why not?

3.4.1. CIPFA agrees that this is appropriate subject to the comments made above in respect of IASB 2 and 3.

IASB 4

3.5. 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 on initial recognition appropriate? If not, why not?

3.5.1. CIPFA agrees that measurement at fair value less costs to sell on initial recognition is appropriate.

IASB 5

3.6. 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.

Is this appropriate? If not, why not?

3.6.1. CIPFA agrees that this treatment is appropriate however this will have important adverse implications for local government where there are specific powers to allow certain costs of disposal to be offset against capital receipts. Charging such costs to revenue would have implications for budgets and it is therefore likely a statutory override would be applied for local government.

IASB 6

3.7. 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.

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

3.7.1. CIPFA is not convinced that it is necessary to align the treatment of entities acquired and held for resale with individual assets held for sale and disposal groups although there is no conceptual reason for opposing this. However this is not likely to be an issue in the public sector as it is unlikely that subsidiaries would be acquired and held exclusively with a view to resale.

IASB 7

3.8. The Exposure Draft proposes that non-current assets 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? If not, why not?

3.8.1. While CIPFA agrees that this is an appropriate presentation, as it is consistent with the principle of not offsetting assets and liabilities, we are concerned that it could lead to a significant increase in the information disclosed on the face of the balance sheet. As an alternative the original SFAS 144 wording could be reinstated to allow the opportunity for reporting entities to provide this information by way of the notes to the accounts.

IASB 8

3.9. 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 of 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 would lead to the comparatives being restated ever year. Do you agree that this is appropriate?

3.9.1. CIPFA does not agree that this is appropriate. Restating comparatives every year would create excessive work load and create confusion for users.

Would you prefer an amendment 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 view?

3.9.2. CIPFA would prefer an amendment to be made along the lines of the suggestion given above. Convergence is important but not if it results in unnecessarily onerous accounting standards.

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?

3.9.3. CIPFA agrees that the other aspects of the criteria are appropriate.

IASB 9

3.10. 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?

3.10.1. Giving the breakdown in the notes would avoid cluttering the main financial statements. However CIPFA considers that the options could be left in the standard and therefore the entity could decide the approach that is more appropriate for their users. The full disclosure suggested in the FRED would be best practice and preferable in the majority of circumstances.

4. FURTHER COMMENTS

4.1. Structure and presentation of the Exposure Draft

4.1.1. Given that the contents of Appendix B are integral to the requirements of the FRED (as stated in Appendix B), it seems strange that this information should be contained in an appendix rather than in the main body of the FRED. It would seem more appropriate to include this information in the main body of the standard.

4.2. Clarity regarding the scope of the Exposure Draft

4.2.1. The Exposure Draft would be easier to follow if there was a clear statement of what assets the Exposure Draft applies to. Currently paragraph 2 lists five exemptions including references to more under IAS 39. It would be helpful if, as a point of principle, this standard (and any other standards) set out to which assets it applies rather than solely those to which it does not apply.

4.3. Application to other sectors

4.3.1. It would be helpful if the Exposure Draft did not refer to company specific requirements since the standard will be applied to other types of entity. Paragraph 28 could be amended to use more generic language such as "...under appropriate headings, whether statutory or other."