PricewaterhouseCoopers LLP
Southwark Towers
32 London Bridge Street
London SE1 9SY
Telephone +44 (0) 20 7583 5000
Facsimile +44 (0) 20 7822 4652

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

23 October 2003

Dear Sir David,

IASB Exposure Draft 4 ***Disposal of Non-current Assets and Presentation of Discontinued Operations***

We are responding to your invitation to comment on the above draft interpretation on behalf of the worldwide organisation and Global IFRS Board of PricewaterhouseCoopers.

Overall Comments

Convergence

We support the convergence of accounting standards around the world, but convergence should be towards the highest quality solutions. We believe that high quality solutions are dependent upon the use of high-level principles that are applied consistently to a wide range of components of financial statements and are not achieved by the use of many detailed sets of rules. A specific objective should be to reduce rather than increase the number of different categories of assets to which different recognition or measurement principles are applied.

Unfortunately, we consider that ED 4 contains a rules-based solution that is unduly complicated. It creates more categories of assets, introduces a new definition to IFRS of a "disposal group", combines this with components of an entity, and introduces the term "highly probable" that is not defined in other IAS or in the equivalent FASB standard.

Deferral of proposals

These proposals should be deferred until the Board has more time to consider how to reduce the complexity and increase the clarity of the standard. The existing requirements of IFRS are not causing substantial problems in practice and the benefits of convergence in this area in the short term do not appear to us to be substantial. In view of the very pressing agenda that the Board has between now and March 2005 we believe that it should defer further consideration of these issues until late 2005 or even 2006.

An alternative interim approach to measurement

We believe that the existing standards are currently sufficient for the purposes of measuring individual non-current assets classified as held for sale on a reasonably reliable basis. However, if the Board believes that there is scope for misinterpretation over measurement, IAS 36 could be clarified to make clear that value in use and net selling price will generally arrive at substantially the same outcome where non-current assets or businesses are held for sale and could be amended to replace the term net selling price with fair value less costs to sell (see also Question 2 below). Finally additional clarity could be obtained by a cross-reference to the requirements in IAS 36 for the allocation of an impairment loss.

Proposed medium-term solution

Criteria for initial recognition
The proposed criteria for non-current assets or disposal groups to be classified as held for sale are time consuming and in some cases difficult to apply in practice. In particular, identifying the first date on which all criteria a) to f) of B1 are met is unduly complex. If the Board rethinks its approach, the key requirements for classification/reclassification to held for sale should be conformed with principles and terminology in other IASB material. We believe they can be reduced to:

1. management with due authority has started to implement a plan to sell (consistent with the principles of IAS 37.72) and
2. that completion of the sale is “virtually certain” (consistent with IAS 37), although if the Board intends to drop this term from IAS 37, we suggest that they adopt the term

"highly probable", but we see this as arising when something is highly likely to occur (see also Question 1 below).

Considerable confusion will result from the introduction of new definitions of probable and highly probable (which is used but not defined in IAS 39.142), particularly as the term highly probable is intended to be equivalent to the term "likely to occur" used in FAS 144. The Board needs to get early agreement with FASB over the selection of a small range of terms that are intended to be used to assist the exercise of judgement by preparers and auditors. Both Boards should then revisit all of their existing standards to conform the language used. If the Board intends to continue with the term highly probable in this standard, it should be on the basis that FASB will amend its comparable standard.

Depreciation
It is appropriate for depreciation to cease on assets that are held for sale, but only when those assets are not being used by the business. If an asset continues to be used it should continue to be depreciated. Depreciation is a measure of the consumption of an asset, and while that asset is in use it is being consumed by the business. The standard should be clear whether the useful life and the residual value of the assets should be re-assessed once the assets are classified as held for sale on a consistent basis with the IAS 16 revised.

Terminology for groups of assets
As we commented in our response to ED 3, there is a need to distinguish between the acquisition of a business and the acquisition of a collection of assets or a collection of assets and liabilities. We recommended that a definition for a business be developed. We believe that there should be consistency of thinking in developing standards for acquisitions and standards for disposals. Thus the approach should be developed based on 1) individual assets or collections of assets, and 2) businesses held for sale. The concepts of disposal groups and components of an entity add considerable additional complexity and should be removed.

Other comments

Measurement project
The Board has embarked on a project to look at measurement of assets and liabilities. We believe that such a project is very necessary and strongly support it having a high profile on the Board's agenda as soon as the 2005 package of standards has been addressed. Until the Measurement project has been completed, agreed with FASB and subject to full due process, the Board should avoid proposing different measurement terms in exposure drafts.

Guidance for determining fair values

As we have commented in our response to ED 3 and will be commenting in our response to ED 5, the Board needs to provide more guidance to support the definition of fair value. We understand that the Board is revising the guidance on fair value within the revision to IAS 39 and will provide more detail in relation to the business combinations project. Clarity is needed in a number of areas including when to take into account:

- portfolio effects rather than just considering individual assets
- specific groups of counterparties rather than a generic market participant
- implicit contractual terms, such as renewal options

In relation to assets and businesses held for disposal, fair value should be the best estimate of the expected net disposal proceeds.

Continuing with the ED4 proposals

If the Board decides to continue with the approach in ED 4 that creates additional classifications, the structure and the clarity of the complete standard will need to be improved to help readers through the considerable complexity that it introduces. In this environment it would be easier to read if the different categories of assets/groups of assets are considered in turn, covering:

a. non-current assets;
b. disposal groups that are not components of an entity;
c. disposal groups that are components of an entity;
d. investments in subsidiaries and associates held for sale.

The standard should also clarify that the IAS 36 guidance should be followed for the allocation of any impairment loss (see also Question 2 below), even though this will perpetuate a difference with US GAAP.

There are a number of differences in scope between ED 4 and FAS 144 as shown in BC 9. If the Board decides not to rethink the approach at this time, it should seek to remove these scope differences at this stage, and return to this topic in a joint project with FASB. That project should have the objective of simplification of existing standards through the reduction of the number of asset categories, the number of different measurement bases and the number of different terms used to describe a reclassification or re-measurement point and converging the underlying impairment tests.

<u>Questions 1 – 9 from ED 4</u>

Question 1 – Classification of non-current assets held for sale

Does the separate classification of non-current assets held for sale enable additional information to be provided to users?

Yes, we believe that disclosing all assets held for sale in a consistent way will provide useful additional information for users. We, however, do not agree with the need to create more categories of assets (i.e. a component of an entity).

Do you agree with the classification being made?

No, we do not agree with the proposals.

The proposed criteria for non-current assets or disposal groups to be classified as held for sale are time consuming and in some cases difficult to apply in practice. In particular, identifying the first date on which all criteria a) to f) of B1 are met is unduly complex. If the Board rethinks its approach, the key requirements for classification/reclassification to held for sale should be conformed with the principles and terminology in other IASB material. We believe they can be reduced to:

1. management with due authority has started to implement a plan to sell (consistent with the principles of IAS 37.72); and,
2. that completion of the sale is "virtually certain" (consistent with IAS 37), although if the Board intends to drop this term from IAS 37, we suggest that they adopt the term "highly probable" but we would see this as arising when something is highly likely to occur.

Classification of assets as held for sale should be restricted to situations where the entity has established a reliable estimate of the expected proceeds and the likely acquirer. We believe this is possible when the conditions identified above are present.

Question 2 – Measurement of non-current assets classified as held for sale

ED 4 proposes that non-current assets classified as held for sale should be measured at the lower of the carrying amount and fair value less costs to sell. Is this appropriate?

Yes. However, the existing IFRS guidance can already be applied to the situations when the assets are held for sale. We agree with the proposal to replace the term 'net selling price' with the term 'fair value less costs to sell' in IAS 36.

We also consider that the treatment should be the same both for the assets that were and were not previously impaired. Paragraph 12 (b) currently requires impairment losses that arise prior to an asset's classification as held for sale to be considered. In such cases, when impairment reverses subsequent to the asset being classified as held for sale, this treatment could result in a carrying value being in excess of the principles stated in paragraph 8 of ED 4. Those principles require valuation at the lower of carrying value 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?

No.

We agree that a depreciable asset that is no longer in use in the business should not be depreciated since no consumption is taking place.

However, depreciable assets that are for sale but are still being used within a business, whether classified as held for sale or not, should continue to be depreciated. The standard should be clear whether the useful life and the residual value of the assets should be re-assessed once the assets are classified as held for sale on a basis consistent with IAS 16 revised.

Question 3 – Disposal groups

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. Is this appropriate?

Yes. We believe that disposals should be considered in the context of individual and groups of assets and in relation to businesses. We believe that businesses that are being considered for disposal must comprise one or more cash generating units to which IAS 36 should be applied.

The standard should clearly state that the IAS 36 guidance should be followed for the allocation of any impairment loss (see also Question 2 above), even though this will perpetuate a difference with US GAAP. An illustrative example of an allocation of an impairment loss within a disposal group, which includes goodwill, should be provided.

Question 4 – Newly acquired assets

The ED 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 C 13 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 values less costs to sell on initial recognition appropriate?

No, we believe that initial recognition of assets should be consistent with each of the relevant individual standards (including amended IAS 22 as currently proposed by ED 4). For example, the initial recognition of a tangible fixed asset should initially be measured at its cost. This asset, when it meets the criteria of ED 4, is subsequently classified as held for sale and measured at fair value less costs to sell.

We also consider that the standard should provide a clarification as to the fair value less selling costs in the following scenario for a non-current asset:

- A company acquired an asset for 100.
- It plans to sell the asset in its existing condition in the retail market for 130.
- The current wholesale market price is 85.
- Selling costs are 10.

It is not apparent whether the fair value should be based on the wholesale or retail price. This is an example of where the Board needs to develop appropriate guidance to support the determination of the fair value of assets, portfolios of assets and liabilities and of businesses. We have commented above on the need to undertake a project to address the use of fair value measurement on a comprehensive and not piecemeal basis. The guidance should be consistent with the guidance in the improved IAS 39.

Question 5 – Revalued assets

ED 4 proposes that, for revalued assets, impairment losses arising from the write-down on 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. Is this appropriate?

No. We believe that the treatment of the assets that were revalued or impaired before the reclassification as held for sale should not be different from the treatment of the assets that were not previously revalued or impaired. The treatment of individual assets should not be different from the treatment of disposal groups.

If the Board continues with the proposed approach, we have the following comments:

Increases in fair value of individual assets
The basis of measurement expressed in this question does not seem to be consistent with that described in paragraph 8 of ED 4 (also in paragraph B8 of Appendix B), which says that "An entity shall measure a non-current asset classified as held for sale at the *lower* of its carrying amount and fair value less costs to sell".

The text of paragraph 8 of ED 4 should be clarified. We suggest it read as follows: "An entity shall measure a non-current asset classified as held for sale at the lower of its carrying amount [<u>at the time when the asset is originally classified as held for sale</u>] and fair value less costs to sell. This will ensure consistency in subsequent measurement of different types of assets irrespective of whether they were previously revalued or impaired".

Decreases in fair value of individual assets
Paragraph 12 and Appendix B6 and B7 that address the treatment of impairment at the point of the initial classification of previously revalued assets as held for sale (B6) and subsequent decreases in fair value less costs to sell (B7) appear to be inconsistent. In B6 impairment is recorded in the income statement, while the subsequent decreases in fair value (B7) are treated as revaluation decreases if the assets were revalued before their classification as held for sale. The treatment of the initial impairment should be consistent with B7 (and also with the principles described at the moment in Question 5 to ED 4).

Following the overall approach being proposed, paragraph B8 of Appendix B should also be revised. We believe it should state that upward revaluations of the individual assets shall not exceed their original carrying amounts.

Disposal groups
The standard should state that any previous revaluations of individual assets within the disposal group do not need to be considered. This would be a simpler approach consistent with the concept that the disposal group needs to be considered as a whole.

Costs to sell and any subsequent changes in costs to sell are proposed to be recognised in the income statement. Is this appropriate?

Yes, we agree with the proposed treatment of decreases in fair value and also with the treatment of any subsequent changes in costs to sell. Costs to sell and subsequent changes in costs to sell should be recognised in the income statement where the non-current asset or disposal group's fair value less costs to sell is lower than its carrying value.

Question 6 – Removal of the exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale

ED 4 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 appropriate?

Yes, we agree conceptually with the proposed amendment.

Question 7 – Presentation of non-current assets held for sale

ED 4 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. Is this presentation appropriate?

Yes, we agree with separate presentation. This enables users to identify the assets that will not continue to be used by the group.

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?

Yes, we support separately reporting the assets and liabilities.

Question 8 – Classification as a discontinued operation

Are you satisfied that the criteria for classification as a discontinued operation are appropriate?

No, we would prefer to keep the existing IAS 35 approach, i.e. 'major component', until the Board has undertaken a more fundamental review of the principles that should support the recognition, measurement and disclosure of all assets and liabilities and businesses held for disposal.

We note that the EITF in the US intends to develop a model for evaluating (a) which cash flows are to be considered in determining whether cash flows have been or will be eliminated and (b) what types of continuing involvement constitute significant involvement. The Board should consider the outcome of this project to ensure convergence.

How important is convergence to you?

We support the convergence of accounting standards around the world, however convergence should be towards the highest quality solutions. We believe that high quality solutions are dependent upon the use of high-level principles that are applied consistently to a wide range of components of financial statements and are not achieved by the use of many detailed sets of rules.

In the first part of this letter we have identified a number of issues where convergence is a key objective, including the terminology that is used by both Boards.

Question 9 – Presentation of discontinued operations

ED 4 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 the 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?

We support the first approach and not the alternative approach. We do not believe there should be an option.

It is important that the proposed approach and disclosures for the discontinued operations are consistent with the IASB's approach in IAS 14, Segment Reporting, and in the Improvements to IAS project.

Other Comments on the ED

We have the following additional comments on the detailed proposals:

1. Paragraph 2 – financial liabilities included in the scope of IAS 39 should be separately excluded from the scope of ED 4.

2. Paragraph 2 – Scope of ED 4 – should clarify whether equity investments covered by IAS 28 are excluded from the scope of ED 4.

3. Paragraph 2 – Scope of ED 4 – the text in the paragraph should clarify that these assets (and liabilities) are included when assessing the carrying value and fair value less costs to sell of a disposal group in its entirety.

4. Paragraph 2(e) – Scope exemption in respect of financial assets arising under leases – clarification is needed if the assets held under finance leases (by a lessee) or assets leased out under operating leases (by a lessor) fall under the scope of ED 4.

5. Paragraph 3 – should clarify that current and non-current assets and liabilities can form part of a disposal group.

6. Paragraph 5 – Appendix B – the guidance in the appendix should be reduced and included as part of the standard rather than as an appendix.

7. Paragraph 5 – 'Sale transactions include exchanges of non-current assets for other non-current assets' – this sentence should be clarified as we consider that it refers to non-similar assets only. An exchange of similar assets would not be considered as sale according to the existing IAS 18.12, and it does not appear either that any consequential amendments were made to IAS 18 as a result of the Improvements project (IAS 16).

8. Paragraph 5 – The second sentence should be modified to state that non-monetary exchanges should only include exchanges recognised at fair value: 'Sale transactions include exchanges <u>at fair value</u> of non-current assets for other non-current assets.'

9. Paragraph 12 – Current ED 4 does not explain which assets can be considered as 'revalued under another IFRS': is this limited to revaluations involving revaluation

reserves (e.g. IAS 16 and IAS 38) or does it also extend to revaluations through the income statement?

10. Paragraph 17 – Changes to a plan of a sale – current ED 4 does not explain the appropriate treatment for any restatement of comparatives. Additional guidance in the form of an illustrative example is required.

11. Paragraph 23 and Appendix A, Defined Terms – Definition of a discontinued operation should be expanded to 'the entity will have no significant continuing involvement *to the degree usually associated with ownership* in that component after its disposal.' This expanded definition will be consistent with the principles in IAS 18.14. Illustrative examples of the situations where these criteria are or are not met should be given.

12. Paragraph 29 – ED 4 should require specific disclosures regarding the determination of fair values to be consistent with the requirements of other standards.

13. Paragraph 31 – For practical reasons ED 4 should include transitional provisions for transactions initiated before the effective date of the standard.

14. Appendix A – Defined terms – The definitions should come from the overall Glossary of Terms to IFRS.

15. Appendix A – The definition of a component of an entity leaves some doubt as to the inter-relationship with disposal groups and cash generating units (IAS 36). We believe it is worth expanding on the definition in a separate Appendix to the standard.

16. Appendix A – Definition of a current asset and the *-note at the bottom – it is not clear how they reconcile. Are the non-current assets that are expected to be realised in the next twelve months current assets or not?

17. Appendix A – The standard should clearly state if assets held for sale not expected to be realised within the next twelve months should be classified as current or non-current.

18. Appendix A - The definition of 'fair value' should include reference to the available fair value hierarchy in IAS 39 and IAS 41.

19. Appendix B – paragraph B3 – not only the requirement in B1 (d) but also the requirement in paragraph B1 (a) should be met before a held for sale classification is made. In this way provided that at the time of the acquisition the management authority and commitment for a disposal exists and the sale is highly probable then a held for sale classification would be appropriate.

20. Appendix B – paragraph B4 – reference is made to paragraph 28(a). Correct reference should be to paragraph 29(a), there being no paragraph 28(a).

21. Appendix C – paragraph C1 – it should also include reference to the current liabilities that are part of a disposal group.

22. Basis for Conclusions on ED 4 – Appendix B – Table of concordance – item 15 should read 'Gain or loss from sale'.

oooOOOOooo

If you have any questions about in relation to this letter please do not hesitate to contact Jochen Pape, Chair of the PwC Global IFRS Board (49 211 981 2905), or Simon Wray (44 207 804 47705).

Yours faithfully

PricewaterhouseCoopers