BRITISH AIRWAYS

FAO – Jenny Carter
Accounting Standards Board
Holborn Hall
100 Gray's Inn Road
London WC1X 8AL

31 October 2003

Dear Sirs,

**FRED 32- Disposal of Non-Current Assets and Presentation of Discontinued Operations**

We enclose our comments on the proposals included in the exposure draft including responses to the questions included in the preface.

In general terms whilst we agree with the principle of convergence of accounting practices, we have concerns over the nature of some of the suggested proposals included within the exposure draft. In particular we welcome the cooperation between the International Accounting Standards Board and the US standards setters, however we are concerned that the effect may be to reduce the usefulness of financial statements to the users of accounts. We are also concerned over the commercial sensitivity over some of the disclosures that would be required.

We have limited our responses to questions where we have specific comment; where we have no issue with the proposal, we have not included a response.

Our responses to the detailed questions are as follows:

**ASB1** **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?**

We agree with the principle of convergence to improve the comparability of accounts between different accounting jurisdictions however we are opposed to implementing a new UK standard ahead of the adoption of all International Financial Reporting Standards (IFRS) on 1 January 2005. We therefore believe that the implementation of a new UK standard should commence no earlier than the required date for EU listed companies to adopt IFRS.

**IASB1** **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 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?**

We believe that additional useful information is provided to users of financial statements by disclosing the value of assets held for sale separately from those in use in the ongoing operations. However, we have concerns over both the measurement criteria set out in the Exposure Draft (see IASB2 below) and the potential timing of the identification of assets held for sale.

We believe that the current disclosures of assets no longer in use and held for resale provide meaningful information by distinguishing those assets which form a part of the ongoing operation in future periods and those for which no further economic value will be derived other than from re-sale. Furthermore, FRS 11 – Impairment of Fixed Assets and Goodwill requires assets to be carried at the lower of carrying value and recoverable amount (the higher of net realisable value and value in use). In effect therefore the accounting treatment of non-current assets taken out of service for re-sale is broadly similar between the Exposure Draft and current requirements.

Our concern is that the Exposure Draft extends this treatment to assets that remain in use within the ongoing operations of the business. Of the criteria set out to establish whether an asset should be classified as held for sale or not, we believe the key criteria is whether or not it is highly probable the transaction will qualify for recognition as a sale within 12 months. However, whilst this requirement will considerably reduce the number of potential sales that would require reclassification, there is still potential that management decisions could change in relation to the commitment to sell the asset. This could result in reclassification between balance sheet headings and profit and loss account volatility without providing additional meaningful information to users of accounts.

We believe that this could be avoided by extending the stage at which a sale should reach before it would require to be reclassified as an asset held for sale (for example, from a mere plan to sell to a requirement for a firm commitment or contractual obligation) or by shortening the period in which the completion of the sale is considered highly probable.

**IASB2 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. Is this measurement basis appropriate for non-current assets classified as held for sale? If not, why not?**

As we stated above we believe that the Exposure Draft does not change the current measurement requirements for assets that are held for sale and are no longer used within the business. These must currently be measured at the lower of carrying amount and fair value less costs to sell. Our concern is that the proposals contained within the Exposure Draft would apply this measurement basis to assets at a much earlier stage of a sale process.

We believe there are two difficulties within the proposal to measure an asset that has continued use within the business prior to sale at fair value less costs to sell:

(a) An impairment review of the carrying value of a non current asset assesses the future cashflows attaching to that asset – in the case of an asset where a sale is planned but the asset will continue to be used, these will comprise the net cashflows from using the asset up until the date of sale and the sale proceeds less costs to sell. However, the exposure draft proposals to value an asset held for sale are based only on the market value less costs to sell. We believe this approach understates the value of the asset at the time the decision to sell is made by ignoring the future value to be generated from using the asset.

(b) Furthermore, by effectively recognising the depreciation charges between the date the decision to sell is made and the expected date of sale (through measuring the asset at fair value at the date of sale) and thereafter ceasing to depreciate the asset, the result will be a mismatch between the benefits from using the asset until the date of sale and the costs.

In addition, we are concerned over the potential volatility that will result from measuring non current assets when a sale is highly probable rather than when a firm commitment or binding agreement is entered into. Under the Exposure Draft, where a sale does not proceed the asset must be restored to the lower of original carrying value (adjusted for the depreciation which would have been charged) or its recoverable amount (which will include its value in use). The adjustment that results to the carrying amount would be reported through the profit and loss account. This could lead to volatile charges and credits reported through the profit and loss account unrelated to the underlying performance of the business.

**IASB3 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?**

We believe the concerns expressed above in relation to the timing of the requirement to measure and recognise a non current asset held for sale also apply to the measurement of a disposal group. We are also concerned specifically about the approach taken to the recognition of any resulting impairment loss.

We believe such an approach would be problematic where a disposal group is made up of a low value of non current assets (for example, where the majority of the disposal group's assets are leased) and its remaining net assets comprise current assets and related liabilities. In such a situation the consideration received less costs to sell could be less than the carrying value of the net assets. It could also be possible that negative consideration could be incurred. We believe that the Exposure Draft would require this resultant impairment loss to be reported against the non current assets and could result in a negative value.

This would result in the overall non current assets of the business being understated by an impairment of the net current assets of the disposal group. Such a result does not produce a meaningful analysis for users of financial statements.

Finally, we are concerned about the potential commercially sensitive information that would be required to be disclosed under the Exposure Draft for both non current assets and disposal groups held for sale. This would be particularly true where the an original sale did not proceed and an alternative buyer had to be sought.

**IASB7 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. Is this presentation appropriate? If not, why not?**

We do not believe the separate classification of assets held for sale should be shown on the face of the balance sheet. We believe the information could adequately be disclosed through a note to the financial statement and therefore a choice should be provided to allow presentation on either the face of the balance sheet or in a note to the financial statements.

**IASB8 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 cashflows 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.**

**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, will lead to the comparatives being restated every year. Do you agree that this is appropriate? Would you prefer an amendment to the criteria to be made, for example adding a requirement from IAS35 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 cashflows) appropriate? If not, what criteria would you suggest, and why?**

We believe that only material discontinued operations should be disclosed. We do not believe that it is helpful or meaningful to the users of financial statements to have separate presentation and restatement of comparatives for small components even if they can be separately identifiable. We believe the materiality threshold contained in IAS 35 should be retained even though this does not achieve full convergence with SFAS 144. We believe it is more important to aim for convergence on measurement criteria than to converge on disclosure requirements, and in either case the usefulness of the financial statements should not be sacrificed.

We are unclear as to the requirement that there should be no significant continuing involvement in the discontinued operation. Where a majority share in a subsidiary undertaking is sold resulting in a reclassification of the investment as an associated undertaking, significant influence would continue but the operations and cahflows have been eliminated from the ongoing operation. This would appear to be excluded as a discontinued operation (although it would potentially be a disposal group).

Similarly, where an investment is sold in its entirety but a significant contractual relationship continues (eg as a supplier or a customer), this investment would also appear to be excluded as a discontinued operation.

In both examples we believe that it is meaningful to users to identify the impact of such disposals on the financial statements where they may be a separate major line of business or geographical area of operations. We believe the significant continuing involvement should be separately discussed by way of additional disclosures.

**IASB9 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?**

We do not believe the separate classification of discontinued operations should be shown on the face of the profit and loss account in full. We believe the information could adequately be disclosed through a note to the financial statement and therefore a choice should be provided to allow presentation on either the face of the profit and loss account or in a note to the financial statements.

**Conclusion**

In conclusion, whilst we reaffirm our general support for international convergence of accounting requirements to improve comparability of financial statements we have raised concerns about a piecemeal transition process. We prefer the alternative approach of full adoption in 2005 with the current focus being on improving IAS and planning for its implementation.

Our specific concerns on FRED 32 can be summarised as follows:

- That a sale must only be highly probable to occur within one year to trigger the requirement for separate presentation as an asset or disposal group held for sale. We believe that either a firm commitment or sale agreement should exist, or a shorter period until the expected sale or the asset has been taken out of service is appropriate;
- We are concerned that recognising the fair value at the date the sale is highly probable and ceasing depreciation from that point will lead to the risk of increased P&L volatility and fail to match costs with benefits from the continued use of the asset;
- We are concerned at the effect on the overall carrying value of non current assets by taking the full amount of any impairment of a disposal group against its non current assets;
- We are concerned that some of the disclosures required could be commercially sensitive during a sale process; and
- We believe the materiality requirements of IAS 35 in relation to the definition of discontinued operations should be retained and that further clarity is required on significant continuing involvement.

We encourage the ASB and IASB to reconsider the exposure draft in light of our comments above.

Yours sincerely

John Rishton
*Chief Financial Officer*