ED 4 Disposal of Non-current assets and Presentation of Discontinued operations

General comments

We welcome very much the opportunity to comment on the above-mentioned exposure draft and support the IASB's and FASB's efforts to achieve convergence. For reasons which are explained in our replies to your specific questions, we nevertheless believe that ED 4 leans too heavily on FAS 144 to the detriment of quality. We would therefore very much prefer to **retain the present approaches** of IAS 16, IAS 35 and IAS 36 while adapting them to take into account some of the stronger aspects of FAS 144: we would hope that the IASB could then convince the FASB of the merits of such an approach in order to achieve greater convergence. In particular, we would prefer to see a **less prescriptive and more principle-based approach** to these topics in the interest of relevance and reliability.

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?

Draft response

We agree with the IASB proposal to classify separately non-current assets 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.

However, the criteria used for such a classification are extremely prescriptive and therefore we encourage the Board to use a more principle-based approach. Instead of applying detailed rules as to whether an asset be classified as held for sale, the *key criterion* should rather be: *Is this sale highly probable?* Consequently, all the rules listed in App. B should rather be illustrative of *that* high probability instead of being purely prescriptive

- using such a key principle *as the criterion* would also avoid the arbitrariness of a 12-month rule and its concomitant detailed exceptions. Any sale whose outcome is expected to occur at a later date would need to be well documented and, if material, explained in the notes. As you have clearly appreciated, regulatory requirements often lead to protracted sale-process periods, so it would be helpful to avoid arbitrary, impractical rules in this respect;
- keeping the guidelines (amended as necessary) within IAS 16 and IAS 36, as we recommend, would avoid the considerable practical problems in classification which would arise from the proposals in respect of assets held for sale but *still in active use*; (please see question 2 below)
- an amendment of IAS 16 and IAS 36 would also avoid the potential inconsistencies with regard to the inclusion of goodwill, assets held under financial leases (IAS 17) and construction contracts (IAS 11). If it is nevertheless decided to proceed with a separate

standard, the congruence of those standards with IAS 36 in respect of scoping these items in or out, and the guidance on the treatment of goodwill, which appears to show some inconsistencies within ED 4, should also be carefully reviewed; and

- we recommend that you reconsider whether abandoned (i.e. scrapped) assets could not also be included in this separate balance sheet category to ensure greater consistency of approach. This would be straightforward if you adopt our recommendation of amending IAS 16 and IAS 36 rather than creating a separate new standard.

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?

Draft response

In our view the proposals are inappropriate in respect of assets held for sale ***but still in active use*****.** The guidance in IAS 16 and IAS 36 should therefore remain intact (i.e. at the higher of net selling price and value in use). It appears to us totally incorrect to base the valuation of such assets solely on their net selling price. Similarly, we believe it wrong to stop depreciation of such assets while they are still in active use. The requirements of IAS 16 and IAS 36 ensure that the use of the assets is properly reflected in the income statement as well as in the balance sheet. Also, stopping depreciation would produce misleading distortions of production costs at the detailed level of accounting and management financial reporting systems. Depreciation should only cease when an asset or group of assets is withdrawn from active use.

However, should the proposals go forward in their present form, we would suggest that the allocation of any impairment loss on a disposal group should be conformed to IAS 36, which does not appear to be the case at present, including an illustrative example of how this allocation is to be done as this is not at all clear from ED 4, para. 14.

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?

Draft response

While generally supporting the approach proposed, which we would prefer to see reflected in IAS 36 rather than in a separate standard, we would like to make the following comments:

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We find the wording of paragraph 2 somewhat confusing in that it specifically scopes out goodwill but in the last sentence scopes in disposal groups, which includes 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 (please see question 2 above).

Also, the definition of a "disposal group" in App. A talks of "to be disposed of, by sale or otherwise, ..." The last two words need precision: presumably disposal by scrapping or abandonment should not fall under the definition.

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?

Draft response

Subject to our comments raised in our answers to question 1 and 2 above, we support the Board's proposed 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 - 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?

Draft response

We are generally in agreement but find the guidance rather confusing and recommend providing an example to illustrate what is actually required.

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?

Draft response

We agree with the proposal.

<u>Question 7 - Presentation of non-current assets held for sale</u>

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?

Draft response

We agree with the proposal to show separately assets and liabilities classified as held for sale in the balance sheet. However, we believe that a net presentation of assets and liabilities for a disposal group would be preferable to the proposed gross presentation. This is because, in contrast to the superficially analogous situation on partially recoverable provisions (IAS 37, para. 53), the net assets will be sold as a bundle to the same buyer – so the conditions for netting assets and liabilities are met. Also, the resulting single amount is more meaningful for the user than two separated gross amounts and more fairly reflects the economic substance of the situation. Finally, such a net presentation of assets and liabilities for a disposal group would also be consistent with the presentation of a single after-tax amount for discontinued operations on the face of the income statement as discussed further in question 9 below.

However, one aspect on which we would appreciate further research is that of "confidentiality". By definition, if a single amount is shown in the balance sheet as "held for sale", the prospective buyer is provided with information which is potentially to his advantage and, therefore, to the disadvantage of the entity. This situation is similar to the problem encountered on litigation provisions but is potentially more acute insofar as there are often several litigation provisions which can be combined while assets held for sale are more likely to stand alone.

<u>Question 8 - Classification as a discontinued operation</u>

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?

Draft response

We are strongly of the opinion that the ED 4 “component” definition sets the “threshold” for discontinued operations too low and does not represent an improvement on the present IAS 35 criteria, which we prefer to broadly retain.

Separating out discontinued operations is designed to enhance the income statement’s predictive value. They should therefore be defined as significant changes in the scope of operations which will influence the sensitivity of the entity to external economic segmental factors. This should result from strategic decisions only and exclude the results of more tactical rationalisation and cost-cutting decisions which the “components” approach would not be able to filter out. We therefore believe that a disposal group should qualify as a discontinued operation only if it meets the IAS 35 criterion of being “a separate major line of business or geographical area of operations”. We are particularly concerned that a lower threshold would result in discontinued operations being reported much more frequently – almost a recurring item – even if the scope of the entity’s operations has not significantly changed in business or financial terms. Also, the consequent restatements would become almost a permanent feature, destroying continuity and confusing the user of the financial statements.

We appreciate that our preferred solution would diverge rather than converge with US GAAP but are of the opinion that the present IAS 35 approach is more relevant and helpful to the user and thus provides a better solution.

<u>Question 9 - Presentation of a discontinued operation</u>

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?

Draft response

We believe that the presentation of a single after-tax amount for discontinued operations on the face of the income statement with a breakdown in the notes would best meet the objectives of comparability, understandability and relevance without losing valuable detailed information.

With regards to the comment in BC55, it is perhaps worth mentioning that this idea from the "Reporting Performance" project is one of the few ideas in that project to enjoy fairly universal support, as far as we can ascertain.

Other comments

Under App. C5 an entity is required to stop proportionately consolidating a joint venture and apply the provisions of ED 4 (i.e. to measure the investment at the *lower of* its carrying amount and fair value less costs to sell - para. 8) from the moment it has been classified as held for sale, even if it was *not acquired* and held exclusively with a view to its subsequent disposal within 12 months from the date of acquisition. This proposed treatment we find inappropriate for the following pertinent reasons:

- as with a fully consolidated subsidiary, we believe it is more appropriate to proportionately consolidate a joint venture as it is still part of the operating activities of an entity, albeit a discontinued operation;
- this alternative proposal would also be consistent with the treatment being applied to fully consolidated subsidiaries;
- such a treatment under ED 4 would result in discontinued operations not being comparable year-on-year; and
- applying a quasi-fair value model to such entities would in effect be prejudging a project on joint ventures which is currently subject to intense debate.

Clearly, after a joint venture has been proportionately consolidated, it will still be necessary to test it for impairment under para. 8, with an impairment loss (if any) recognized in addition to discontinued operations generated by that joint venture.

However, should the Board decide to carry on with its proposed treatment with respect to both investments in associates and joint ventures, we suggest, in order to be consistent, that the same treatment is *also applied* to fully consolidated subsidiaries i.e. by retaining para. 13 under ED *IAS 27* which specifically requires that a subsidiary be excluded from consolidation where control is intended to be temporary.