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Dear Sir David

Exposure Draft (ED) 4 *Disposal of Non-current Assets and Presentation of Discontinued operations*

We appreciate the opportunity to respond to the International Accounting Standards Board's exposure draft of its proposed IFRS *Disposal of Non-current Assets and Presentation of Discontinued operations*. This letter expresses the views of KPMG International and its member firms. We apologise for the delay in responding and hope that this will not hinder the Board's consideration of our comments.

We believe that the IASB should defer consideration of this project until it has completed the other projects that are critical elements of the 2005 "stable platform". Our recommendation reflects our view that:

- we question whether the degree of convergence with US GAAP that is achieved warrants diversion of the Board's resources at this time;
- the changes proposed are unlikely to result in many changes in measurement; and
- there have not been significant practice issues in this area to date.

At present, IAS 36 *Impairment of assets* deals with the impairment of assets whether they are to be recovered from use or sale (or a combination) and IAS 35 *Discontinuing operations* deals with the presentation of discontinuing operations.

In terms of measurement, we believe that only in rare cases will the proposals in ED 4 lead to significant changes to amounts reported under the existing requirements of IAS 36. The main effect of the proposals would be to accelerate the recognition of any excess of value-in-use over net selling price of assets (or disposal groups) that are classified as held for sale. This is a change that itself leads to inconsistencies with the measurement and recognition requirements of other standards.

Whilst we see some merit in the separate disclosure of assets that are 'held for sale' we believe that, broadly, IAS 35 and 36 deal adequately with the accounting issues that arise.

Therefore, we do not believe that changes to the standards dealing with these areas is appropriate at this time, even if those changes achieve some convergence with US GAAP. Whilst we are supportive of convergence as a medium-term goal, we believe that the Board should focus on the completion of those projects essential to the 2005 transition. In light of the challenges already facing companies moving to IFRS in the near future, unnecessary changes to existing standards should be avoided within the 2005 time frame.

Accordingly, we would advise the IASB not to proceed further with this project at this time.

However, if the Board chooses to proceed, we set out below our main reservations concerning the proposals.

Summary of KPMG conclusions

- Principles-based standards

We are concerned at the approach proposed by the ED which is based substantially on rules and 'criteria' and represents a move away from the principles-based standards that the IASB is committed to developing. We have set out in our answer to question 1 (attached) an alternative approach to the identification of assets 'held for sale' that focuses more clearly on the underlying principle.

- Definition of a discontinued operation

We would prefer a requirement for a commitment to sell (similar to the existing test in IAS 35) rather than the proposed approach, which may be viewed as being based on management intent.

We consider that the proposed definition of a discontinued operation will result in a requirement to classify operations as discontinued that are not sufficiently significant to the disposing entity. As a result, the benefits of enhanced disclosure may not exceed the cost of complying with ED 4 – potentially, frequent restatements of primary financial statements.

The Board acknowledges this issue in its question 8. Before the Board proceeds with such a definition we would urge strongly that it considers the usefulness of such information and the cost of its preparation. In particular, the experience in the United States of the application of FAS 144 *Accounting for the impairment or disposal of long listed assets* and the benefits to users should be assessed. We consider that the balance might not be quite right in this respect and suggest that the definition be based, as it is now, on something closer to an IAS 14 segment, rather than a lower, level.

* * *

Within the context of our overall conclusion above, the balance of this letter summarises our major comments on the Board's decisions and on the proposed structure and wording of the draft standard.

Detailed comments on the exposure draft

The remainder of our comments are organised as two appendices to this main letter:

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Please contact Mark Vaessen at 020 7694 8089 or David Littleford at 020 7694 8083 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG

Appendix 1 – Responses to invitation to comment questions 1-9

Our responses (set out below) to the specific questions posed in the Exposure Draft are provided subject to our general concerns set out in our covering letter.

IASB Question 1

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 that separately classifying non-current assets whose carrying amount is to be recovered principally through a sale transaction rather than through continuing use provides additional, useful information about the entity's plans for those assets and the manner in which it intends to generate economic benefits (and cash) from those assets.

However, such a classification necessarily requires definition. The proposed standard establishes six criteria, all of which need to be met, in order to determine whether or not a non-current asset should be included within this classification. With the intended move towards principle-based standards, we are disappointed that the Board feels it necessary to supplement the general principle set out in paragraph 4 with detailed rules.

If the IASB decided to retain all the criteria in B1 as requirements, we believe it would be more appropriate to present these requirements as an integral part of the main standard, rather than relegated to an appendix.

However, we would prefer a different approach. We propose that the principle contained in paragraph 4 of the standard is met on the basis of the first of the criteria i.e. that management must 'commit itself to a plan to sell' (B1(a)). The remaining five criteria listed in B1 should be presented as examples which might help demonstrate management's commitment, rather than as additional criteria.

A separate issue arises as, given the six criteria listed in B1, it appears that a 'commitment to sell' a non-current asset under this proposed standard may be recognised at a different point than when an entity would recognise a provision for a restructuring.

First, a 'commitment to sell' under the proposed standard differs from a similar commitment under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, paragraph 78, which states that 'Even when an enterprise has taken a decision to sell an operation and announced that decision publicly, it cannot be committed to the sale until a purchaser has been identified and there is a binding sale agreement.'

Second, under IAS 37 a constructive obligation to restructure arises only when an enterprise has a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

We do not believe that the consistency and usefulness of IFRS, or IFRS based financial statements, will be enhanced by introducing inconsistencies in the timing of recognition of a restructuring provision and reclassification. These inconsistencies are likely to lead to some confusion as it is quite possible that a non-current asset to be disposed of as part of a restructuring programme is classified as 'held for sale' before a restructuring provision is recognised. We consider that the body of standards must be internally consistent. Further, as ED 4 introduces modifications to measurement of assets held for sale, this is not just an inconsistency of disclosure on the one hand and provision recognition on the other. It is, instead, inconsistency in recognition of a change in measurement basis.

The 'Basis for Conclusions' (BC11) notes that an alternative classification to 'assets held for sale' might be 'assets retired from active use'. We would support this suggestion in preference to proposals in ED 4 – some convergence with the US standard SFAS 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* is achieved and the classification would be based on existing concepts of commitment without realistic possibility of withdrawal rather than management's undisclosed intent and any inconsistencies in the definitions of this commitment would be removed.

IASB Question 2

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?

Had the trigger point for classification of a disposal group as held for sale been consistent with other standards (which, as noted in our response to question 1, it does not seem to be) we believe ED 4 helpful in clarifying that, in effect, measurement should be based on an IAS 36 net selling price model as the best reflection of expected cash flow.

However, if the recognition point remains as proposed, and therefore potentially sooner than under the principles of other standards, we disagree with this measurement basis, particularly for non-current assets which still are being used within the business, because of the resulting timing of the recognition of any impairment loss. Under the proposals, a loss would be recognised in the income statement at the point of re-classification of a non-current asset as an asset held for sale, i.e. as a result of management's intention to sell the asset. We do not believe that the entity has incurred any loss at this point if the asset continues to be used until the date of disposal, which might be considerably later and, as a result, the recoverable amount may be greater than the fair value less costs to sell.

Irrespective of the trigger point, we disagree with the proposal not to depreciate assets held for sale. As noted in our response to the IASB's Improvements project (re IAS 16 *Property, Plant and Equipment*) we believe that if assets continue to be used, even if designated as held for sale, they should continue to be depreciated. Depreciation is defined as 'the systematic allocation...of an asset over its useful economic life'. In our view, the useful life is the period of use – the entity is still receiving a benefit from the asset and therefore the cost of that use should be recognised until use ceases.

We are not persuaded by the arguments in BC18-23 that an equivalent 'cost' will be captured through the continued remeasurement of the non-current asset at fair value less costs to sell, as the remeasurement required by the proposed standard generally will be of a disposal group, not of the individual asset. We doubt whether the allocation of the remeasurement of this disposal group across the individual assets and liabilities of the group will achieve the suggested result.

IASB Question 3

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. (See paragraph 3.)

Is this appropriate? If not, why not?

See our response to Q2.

The proposed approach also would appear to lead to inappropriate carrying amounts for non-current assets within the scope of the proposed standard, if they are part of a disposal group which includes non-current assets outside the scope of the standard (e.g. financial instruments and goodwill). This is because the standard requires such assets to be re-measured on a different basis than the normal measurement basis for the individual assets in the disposal group and then any impairment loss of the disposal group as a whole to be attributed to the non-current assets within the scope of the standard.

As a further point, the scope of the proposed standard is unclear. A group of assets which is to be sold as a single transaction but which does not include any non-current assets would seem to fall within the scope of the definition of a disposal group set out in Appendix A. However, paragraphs 2 and 3 of the standard suggest that the standard applies only to disposal groups that contain a non-current asset. This interpretation is reinforced in paragraphs 8-14. The standard does not explain how to attribute any impairment loss arising on such a disposal group as a whole, as it refers only to allocation to non-current assets. If the project is continued, then this drafting should be clarified.

IASB Question 4

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?

While we have not identified any problems with this conclusion, we believe that it should be made as part of wider reconsideration of the measurement principles and method of allocation of purchase consideration required in a business combination.

IASB Question 5

The Exposure Draft proposes that for revalued assets, impairment losses arising from the writedown 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 B6B8 of Appendix B.)

Is this appropriate? If not, why not?

We believe that this treatment is appropriate as it is a consistent application of existing measurement principle in other standards and avoids creation of "special" accounting models on an exception basis.

IASB Question 6

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?

The removal of the exemption set out in IAS 27 *Consolidated financial statements and accounting for investments in subsidiaries* (paragraph 13) as proposed in ED 4 may have unintended consequences for the investment fund sector. We understand that such funds are typically "seeded" by a fund manager who will control the fund for a short period while the fund is marketed to investors. As shares or units are purchased by investors, the manager's interest is diluted until it is clearly below the level of control.

We suggest the Board give further consideration to whether, in these circumstances, measurement at fair value is preferable to consolidation of the fund. At the same time, the Board might consider whether fair value measurement might be applied to venture capital investments that are held for a period longer than 12 months.

IASB Question 7

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 believe that this treatment is appropriate. Under IFRS, offsetting assets and liabilities is limited to specific cases and no argument has been made that these should be extended to assets held for sale.

IASB Question 8

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, 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 adapted from IAS 35 Discontinued Operations that a discontinued operation shall be a 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?

The proposed definition will require entities to identify discontinued operations at a level significantly below segment level. It also may lead to frequent restatement of comparatives as (relatively) insignificant operations become discontinued.

The net effect is that entities face a significant increase in the amount of work required to prepare information whilst the benefit to the user may be perceived as small, non-existent or even that the changes are detrimental.

We believe that the cost-benefit balance should be reconsidered and would propose that the definition of "component" be narrowed somewhat, for example to be "one level lower" than the definition of a segment, so as to capture significant business units and not minor operations, e.g. individual retails outlets or factories. This should avoid minor changes in the entity being disclosed as discontinued operations in each reporting period as well as the continuous restatement of prior year results.

On a drafting point, the definition of a cash-generating unit should be aligned with the revised version of IAS 36, following completion of the Business Combinations project.

We believe that it is appropriate that an operation cannot be treated as a discontinued operation if there is 'continuing involvement' with the operation after it has been disposed of. We note that this seems to suggest that if an operation were sold into a joint venture or an associate it would not be classified as a discontinued operation.

However, guidance on what constitutes 'continuing involvement' is not provided in the proposed standard. We believe that the term should be applied in a general sense (for example as used in IAS 18) rather than in any specific connotation (as per IAS 39). It would be helpful if this was made more explicit.

Finally, we note that in the US the Emerging Issues Task Force has an active project that may result in the issue of additional guidance on the identification of discontinued operations. This suggests that the practical application of the current US standard, FAS 144, on which ED 4 is based, may not be wholly clear. The Board should monitor the outcome of this project and, if additional guidance is issued, consider whether and how it should be reflected in ED 4.

IASB Question 9

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 prefer the approach in the exposure draft. The prominent disclosure of the proposed items on the face of the income statement will assist users of financial statements.

Appendix 2 – Other comments and drafting matters

- Paragraph 11

The 'fair value less costs to sell' of a disposal group is an independently derived amount and should not be affected by the required (re)measurement in accordance with other applicable IFRSs. We assume that the sentence should read, '… with other applicable IFRSs before **any gain or loss between** the fair value less costs to sell of the disposal group **and the carrying amount of that disposal group** is measured.'

- Paragraph 12: Allocation of costs to sell to income statement

The Basis for conclusions is clear that costs to sell are reported in the income statement. The standard is less clear, though we can reach the same conclusions reading paragraphs 12 and B6-8, in the case of an asset carried on the basis of cost or on the basis of a fair value derived from market values.

We are more concerned in the case of an asset carried on the basis of depreciated replacement cost (DRC) in accordance with IAS 16. In practice a DRC valuation always is accompanied by an impairment test (value-in-use) because a DRC valuation could overstate the value (IAS 36 paragraph 4).

In certain industries or markets, there is often a big difference between the DRC valuation and value in use. We believe that the Board should investigate the implications in more detail, but because of the significant implications for the income statement, we do not believe that this issue can wait until the Board reconsiders revaluation generally.

- Appendix A: Definition of 'highly probable'

It is clear from the Basis for Conclusions that the new terminology 'highly probable' should mean the same as 'likely to occur' in US GAAP. The co-existence of two separate sets of terminology that are intended to be equivalent is unhelpful. We suggest that the Board seeks to agree terminology with FASB and uses it consistently.

Where the Board wishes something different, or even where it intends greater judgement to be applied than is inherent in the US terminology, the use of a different term then would be a clear indication.

- Appendix A: Definition of 'firm purchase commitment'

The definition includes the term "**un**related party". Does this correspond with the opposite of the meaning of "related party" in IAS 24 *Related Party Disclosures*? Whilst it would be helpful for standards to be consistent, it is unclear why a binding agreement with any entity is not sufficient. Clearly where the entity was related **and** included in the (consolidated) accounts of the reporting entity, consolidation principles concerning the elimination of intra-group transactions would preclude any reclassification.

- Paragraph 28

It appears that all non-current assets (and the assets and, separately, the liabilities of disposal groups) held for sale are presented together on the face of the balance sheet. If this is the case, the assets of a discontinued operation will be combined with other held for sale assets.

Given the separate disclosure of income statement and cash flow items relating to discontinued operations we consider that a similar distinction to identify separately the assets and liabilities of a discontinued operation should be made. It may be sufficient for such an analysis to be provided only in the notes to the financial statements.

- Paragraph B5

Paragraph B5 states that, 'Paragraph 12 requires … before classification as held for sale'. Whilst we agree with the intention, this is not what paragraph 12 states, particularly when read in conjunction with the principle in paragraph 8.

- Paragraph C9

In terms of the scope exclusion to be added to IAS 36, it is correct that ED 4 will contain specific requirements for the recognition and measurement of such assets, though in places, ED 4 refers back to IAS 36, either implicitly in its use of terminology 'impairment loss' (e.g. paragraph 12) or explicitly (e.g. paragraph 18) which is confusing.

The Board may be relying on the application of IAS 36 before reclassification as held for sale. However, paragraph 8 is not clear about the sequence for applying the order of reclassification and re-measurement. We suggest that the drafting of this section is improved.

In addition, it is not clear whether the disclosure requirements of IAS 36 continue to be relevant.

- Paragraph C11

Similarly, it would be useful to explain in the Basis for Conclusions why IAS 40 *Investment property* – in particular the disclosure requirements of that standard – should cease to apply where an investment property is held for sale. We are not clear on the rationale for this.

We also assume that the Board is not proposing to delete from all other standards those paragraphs that deal with the disposal of such assets (e.g. IAS 40, paragraphs 60-64) on the basis that, at the point of sale, they are no longer 'held for sale' but 'sold' and they therefore, once again, fall under the original standard (including those requirements that deal with disposals). It would be helpful if this were clarified as, arguably, all non-current assets will meet the criteria for held for sale at least momentarily before disposal.