Specific Comments on

IASB ED 4 *Disposal of Non-Current Assets and Presentation of Discontinued Operations*

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?

Comment

HoTARAC notes that the proposed separate classification, measurement and disclosure of non-current assets appears to be based on management's intent to hold the assets for sale, and as such it is considered to be subjective and not conceptually sound. As a general principle, and consistent with Australian Accounting Standard AASB 1040 *Statement of Financial Position*, assets should be classified and disclosed according to their nature or function. A requirement to separately disclose assets based on management's intent would create an unnecessary layer of disclosure.

Additionally, a subjective classification of assets based on management's intent would be difficult to apply and may necessitate prescriptive, or rule based, requirements to eliminate and/or reduce divergence in accounting practice. This would conflict with the IASB's objective of setting principles based standards.

The proposed standard refers to Appendix B for the criteria to be applied in classifying an asset that is held for sale. While it is acknowledged that all paragraphs in IFRS, bold and non-bold, have equal authority, the majority of HoTARAC members believe that it would be more appropriate for the main criteria for classification, and hence application of the proposed standard, to form part of the body of the proposed standard rather than be contained in an Appendix.

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?

Comment

The majority of HoTARAC members believe that the proposed measurement basis for non-current assets classified as held for sale is inappropriate. There is no validity in specifying one measurement basis for non-current assets that are classified as held for sale and another measurement basis for assets that do not fall within this subjective classification.

With respect to the proposal to cease depreciation for assets held for sale, the majority of HoTARAC members do not support this proposal. This proposal is contrary to current requirements to depreciate non-current assets on a basis that reflects the assets' pattern of use and on a systematic basis over the assets' useful life, irrespective of whether the assets are earmarked for sale. There may be circumstances where assets are still being used while they are "held for sale". Indeed, circumstances may arise where a disposal group, which forms a significant component of an entity, may possess assets still in active use while being "held for sale" for a prolonged period of time. Where this is the case, the proposed requirement to cease depreciation for assets that are held for sale would be inappropriate and could conceivably lead to a misstatement of operating results.

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?

Comment

The majority of HoTARAC members support the proposed measurement basis for assets classified as held for sale to also apply to a disposal group, if the IASB proceeds with the issue of an accounting standard for the disposal of non-current assets. However, the requirement to allocate any resulting impairment loss to reduce the carrying amount of non-current assets in the disposal group is inconsistent with the proposed revision to IAS 36 *Impairment of Assets*, which proposes the allocation of impairment arising on a cash generating unit to firstly reduce the carrying amount of goodwill and then to reduce the carrying amounts of other assets on a pro-rata basis.

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?

Comment

The majority of HoTARAC members oppose the proposal to measure newly acquired assets, that meet the criteria for assets held for sale, to be measured at fair value less cost to sell on initial recognition, for the same reasons as those specified at Question 2. However, if the proposed measurement basis were incorporated into the standard, the majority of HoTARAC members support the consequential amendment to the IFRS on business combinations.

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?

Comment

The majority of HoTARAC members do not support the proposed accounting treatment for impairment losses arising from write-downs of assets, to fair value less costs to sell and any subsequent changes arising from costs to sell, which is to be recognised in the income statement. The accounting treatment of impairment losses and changes in fair value should be dealt with under the standard that deals with these issues, ie IAS 36. Additionally, there should be no distinction between an impairment loss attributable to a change in fair value or a change in selling costs.

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?

Comment

HoTARAC supports the removal of the exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale. This would ensure that the consolidated financial statements include all controlled entities irrespective of whether they are acquired and held exclusively with a view to resale.

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

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?

Comment

The majority of HoTARAC members do not support the separate presentation of assets and disposal groups classified as held for sale in the Balance Sheet for the reasons stated at Question 2. However, where the proposed classification and measurement basis for assets held for sale will be incorporated into the Standard, the majority of HoTARAC members support separate presentation on the face of the Balance Sheet.

Question 8 – Classification as a discontinued operation

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?

Comment

All HoTARAC members oppose the proposed definition of discontinuing operations in ED 4 on the basis that, potentially more items would be classified as discontinued, and the resulting restatement of comparatives would occur more frequently. That is, given the frequency of public sector operations being discontinued, the proposed revised definition of discontinuing operations, and the resulting restatement of comparatives, could occur annually. Such disclosures would be onerous on the public sector, may defeat the usefulness of the disclosure and would not improve the quality of financial reporting on this issue.

To retain the usefulness of the disclosure for discontinuing operations, we would prefer the addition of a requirement to restrict a discontinuing operation to a separate major line of business, or geographical area of operations, similar to that contained in Australian Accounting Standard AASB 1042 *Discontinuing Operations*.

HoTARAC acknowledges that the above proposal, to restrict the definition of a discontinuing operation, would not converge with SFAS. HoTARAC believes, that while the IASB should, where possible, converge its standards with those of the FASB, this should not be at the expense of the overall quality of financial reporting.

Question 9 – Presentation of a discontinued operation

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?

Comment

The majority of HoTARAC members prefer the alternative approach of presenting a single amount for discontinued operations on the face of the Income Statement, with a breakdown of the above components, to be disclosed in the notes. To do otherwise would clutter the face of the financial statements and detract from the understandability of the Income Statement.

Other issues - Comments

Some HoTARAC members have expressed comments on the following issues:

Consequential amendment to the definition of "recoverable amount" in IAS 36

Some HoTARAC members have noted that ED 4 makes a consequential amendment to the definition of "recoverable amount" in IAS 36. Recoverable amount is redefined to mean the higher of fair value less selling costs and value in use. Fair value less selling costs is a proposed substitute for "net selling price" previously used in IAS 36.

The above amendment to the recoverable amount definition, implies that the concept of "fair value" is separate to the concept of "value in use". This is further discussed below:

IAS 16 and IAS 36 Changes Fair Value Concept from that in AASB 1041

The meaning of fair value in IAS 16 and IAS 36 differs from fair value in Australian Accounting Standard AASB 1041 *Revaluation of Non-Current Assets.* IAS 16 deals with the recognition and measurement of "an item of property, plant and equipment" (paragraphs 7 and 14). The application of IAS 36 is then used to determine whether an asset has been impaired. IAS 16 determines the recoverable amount of an asset as the higher of an asset's or cash-generating operation's net selling price and value in use. This two step process is not problematic when assets are recognised at cost under IAS 16 and written down under IAS 36.

However, this two step process may be problematic where assets are measured at fair value. That is, fair value in IAS 16 and AASB 1041 is defined in terms of the amount willing parties would expect to exchange. Applying this two step process, fair value is determined under IAS 16 and then impairment/recoverable amount is determined separately under IAS 36. In short, an impaired asset would seem to be valued at fair value (under IAS 16) less write down to recoverable amount (under IAS 36). This derived amount however, is recoverable amount, not fair value.

Conversely, AASB 1041 paragraph 5.1.9 requires that "where assets belong to a cash-generating operation, and the sum of the market buying prices of the assets forming that cash-generating operation exceeds the fair value of that operation, the fair values of the assets should be determined after deducting that excess." This means that the fair value of an asset that is part of a cash-generating asset is determined after considering the value-in-use of the cash-generating operation. In short, the write-down to recoverable amount is part of the determination of fair value, not something different, additional or separate from it.

However, under the amended definition of recoverable amount, fair value is mathematically determined as fair value (under IAS 16) less the amount to write this down to recoverable amount, (where recoverable amount is now redefined (in IAS36) to mean the higher of fair value less selling costs and value in use). This derived amount is, in effect, recoverable amount, not fair value.
It is recommended that both IAS 16 and IAS 36 be amended to state the position correctly regarding the meaning of fair value. IAS 16 should state that, where assets are valued at fair value (as defined), this includes the consideration of impairment in IAS 36. Similarly, IAS 36 should state that where assets are valued at fair value, the consideration of impairment in this standard is part of the determination of fair value in IAS 16.
If IAS 16 and IAS 36 do not say this, it fundamentally changes the concept of fair value to mean fair value minus impairment i.e. an oxymoron.

Changes to a plan of sale

ED 4 proposes, that where the asset held for sale criteria are no longer met, the entity must cease to classify the asset as held for sale and the asset must be measured at the lower of its carrying amount before the asset was classified as held for sale (adjusted for any depreciation) and the recoverable amount at the date of the subsequent decision not to sell. Some HoTARAC members believe that this proposal does not appear to take into consideration circumstances where an entity may have previously adopted the revalued amount option under IAS 16. That is, where there is a change of plan for the asset sale, some HoTARAC members believe that an entity should be permitted to value the asset at fair value, subject to an impairment test.