

October 27, 2003

Sir David Tweedie  
Chairman IASB  
30 Cannon Street  
London EC4M 6XH  
UK

Dear David,

Re: ED 4 *Disposal of Non-current Assets and Presentation of Discontinued Operations*

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the Exposure Draft *Disposal of Non-current Assets and Presentation of Discontinued Operations*. This letter is submitted in EFRAG's capacity of contributing to the IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive IFRS on the issues.

While EFRAG is supportive of the IASB/FASB convergence agreement, we regard it as important that convergence should secure the best standards even though they may diverge from existing IFRSs or SFAS. In this respect, we support the Board's decision not to pursue full convergence with the current FASB Statement 144 *Accounting for the Impairment or Disposal of Long-Lived Assets*. As explained in detail in our response, we agree that it would be an improvement of current standards to require a separate classification in the balance sheet of non-current assets (or a disposal group) held for sale. We have however important reservations with a number of elements of ED 4, which can be summarised as follows:

- We do not support the proposed measurement requirement for non-current assets classified as held for sale. We believe that depreciation should cease only when an asset is retired from active use. Our concern is that the proposed standard would lead to inappropriate accounting especially when an entity decides to dispose of a division. Even though the assets of such a held for sale division are being used until divestiture this would not be reflected as such in the income statement.
- We found the ED 4 measurement proposals confusing and sometimes inconsistent, as explained in detail in our answer to question 2. Furthermore, we believe that the current IFRSs adequately address measurement issues arising when non-current assets are held for sale.
- We believe that the replacement of IAS 35 *Discontinuing Operations* by the proposed new standard will not lead to better financial reporting, as explained in detail in our response to question 8.

Therefore, we recommend the Board not to adopt any ED 4 measurement requirements and to incorporate any *held for sale* specific presentation and disclosure requirements in the existing standards ((draft) IAS 16 *Property, Plant and Equipment*, IAS 35 *Discontinuing Operations*, (draft) IAS 36 *Intangible Assets* and (draft) IAS 38 *Impairment of Assets*) instead of adopting a separate standard. Such an integrated approach would contribute to the understandability of IFRS in general.

We believe that the project of convergence with SFAS 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* needs further research on the cost and benefit implications before the Board decides on amendments of the definition of discontinuing operations. Such research should be based on experience in practice of applying the relevant IASB and FASB standards and should address the differences in timing as well as the level for classification as held for sale - discontinuing operation.

More generally we are concerned about the IASB timetable and in particular the little time left to complete the stable platform (i.e. standards that will be mandatory as from January 1, 2005 [hereinafter referred to as the "2005 standards"]). In attempting to complete both the 2005 standards and the short term convergence programme by 2005 the IASB runs the risk of producing sub-optimal solutions for both or not meeting the published time-table for the stable platform.

Appendix 1 sets out our answers to the questions raised in the draft standard.

If you would like further clarification of the points raised in this letter Paul Rutteman or myself would be happy to discuss these further with you.

Yours sincerely

Johan van Helleman  
EFRAG, Chairman

**Q1. 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?*

**Response**

We agree that it would be an improvement of current standards to require a separate classification in the balance sheet of non-current assets (or a disposal group) held for sale. Since such assets (liabilities) meet the definition of a current asset (liability), a separate presentation will harmonise current practices and improve the information available to users of financial statements in assessing the timing and amount of future cash flows.

However, paragraph 5 of ED 4 states that sale transactions include exchanges of non-current assets for other non-current assets. When a non-current asset is exchanged for another asset with the same value, we believe it inappropriate to present such an asset as part of the assets held for sale as no sale or similar discontinuation of activities is intended. Indeed, the overall objective of the held for sale classification is to provide users of financial statements with additional information about future cash flows.

In our comment letter, dated September 12, 2002, on the Exposure Draft of Proposed Improvements to International Accounting Standards ("Improvements comment letter") we expressed our disagreement with the Board's proposal that in principle all exchanges of items of property, plant and equipment should be measured at fair value. Instead, we support a distinction between exchanges which are in effect sales of dissimilar items and swaps of similar assets that have a similar use in the same line of business (and have a similar fair value). As explained in (old) paragraph 22 of IAS 16 *Property, Plant and Equipment* the earnings process in the latter case is incomplete so no gain or loss should be recognised on the exchange transactions. We further expressed concern in our Improvements comment letter that the accounting for exchange of non-monetary assets should be dealt with comprehensively in a separate standard.

In summary, we believe that paragraph 5 of ED 4 should state that sale transactions do not include exchanges of non-current assets for similar non-current assets.

We believe that Appendix B contains key requirements that should be part of the body of the standard instead of being separated in an Appendix. The current Appendix approach makes the draft standard less easy to read.

Further, the Appendix B requirements are very prescriptive in nature containing detailed rules for classification as *held for sale*. We therefore suggest the Board incorporates in the body of the standard more principles based held for sale criteria such as "the sale must be highly probable" and

the asset/liability must be “available for immediate sale”. The remainder of B1, B2 and B3 could then be included as Implementation Guidance.

With regard to the current wording, we suggest the Board amends paragraph B2 c (ii) by including the words “in relation to its current fair value” immediately after “a reference to a price that is reasonable”, consistent with B1 (e). Finally, we believe that the requirements under B3 should include B1 (a) (in addition to B1 (d)) i.e. that management, having the authority to approve the action, commits itself to a plan to sell.

Further, we recommend the Board includes in its Illustrative Examples an example that clarifies how assets/liabilities held for sale should be presented in its IAS 1 Appendix *Illustrative Financial Statement Structure*. For instance, should non-current assets classified as held for sale/discontinued be presented separately from assets and liabilities in a disposal group? We would favour an aggregation of all assets/liabilities held for sale being classified as current.

## Q2. **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?*

### **Response**

In its response to the Exposure Draft on Improvements to various standards EFRAG stated that it believes that depreciation should cease only when an asset is retired from active use (equivalent to the “abandoned” concept of ED 4) and held for sale. The asset should then be measured at fair value less costs to sell although an impairment test should be carried out when the decision is made that the asset is held for sale. We agree with the alternative view expressed by two Board members (AV 2 (b) and 9) that it is conceptually wrong to cease depreciation/amortisation while assets are still in active use. In particular, we believe that the current proposal leads to inappropriate accounting when an entity decides to dispose of a division and meets the *held for sale* criteria: even though the assets of such a held for sale division are being used until divestiture this would not be reflected as such in the income statement.

The Board concluded in BC 23 that the measurement requirements of the proposed standard would often not involve a significant change from the requirements of existing or proposed IFRS. Based on this conclusion we recommend the Board not to adopt any ED 4 measurement requirements and to incorporate any held for sale specific presentation and disclosure requirements in the existing standards ((draft) IAS 16 *Property, Plant and Equipment*, IAS 35 *Discontinuing Operations*, (draft) IAS 36 *Intangible Assets* and (draft) IAS 38 *Impairment of Assets*) instead of adopting a separate standard. Such an integrated approach would contribute to the understandability of IFRS in general.

Paragraph 11 explains that the carrying amounts of any assets that are not covered by the draft IFRS, including goodwill, but are included in a disposal group classified as held for sale, shall be measured in accordance with other applicable IFRS before the fair value less costs to sell of the disposal group is measured. The reference to other applicable IFRS implies that no actual convergence can be achieved for assets held for sale. Indeed, there are significant differences between the IASB and FASB impairment testing models which can be summarised as follows:

- The use of discounting: SFAS 144 uses undiscounted cash flows while the IAS 36 value in use calculation involves discounting of the expected future cash flows to be generated by the asset to their net present value;
- Goodwill and intangible assets that are not amortised: the impairment review prescribed by SFAS 142 *Goodwill and Other Intangible Assets* requires goodwill to be assigned to a reporting unit of the business on acquisition instead of a cash generating unit as it is required under draft IAS 36. If the carrying amount of a reporting unit, including goodwill, exceeds its fair value (amount at which it could be sold to a willing party) then the goodwill should be tested to measure the amount of impairment loss, if any. Under the SFAS 142 impairment test the implied fair value of the goodwill needs to be compared with the carrying amount of that goodwill. Without explicitly saying so, the proposed amendments to IAS 36 and 38, following the ED 3 *Business Combinations* publication in December 2002, contain proposals to converge with the SFAS 142 impairment testing requirements. However, at the July 2003 Board meeting the IASB tentatively concluded that the complexity and costs of applying the SFAS 142 based “two-step” approach as proposed in its exposure draft would outweigh the benefits of that approach. The Board therefore tentatively agreed to retain the current IAS 36 impairment test;
- Reversal of impairment charges: draft IAS 36 permits an impairment charge to be reversed in certain circumstances while US GAAP prohibits the reversal of an impairment loss.

Paragraph 14 (and BC 28-29) further explains that the impairment loss of a disposal group should be allocated to the non-current assets that are within the scope of the draft IFRS. We do not support this allocation requirement because it differs from (draft) IAS 36 and thereby introduces an inconsistency for the measurement of goodwill when held for sale as part of a disposal group.

Our understanding of ED 4 is that goodwill should be tested for impairment in accordance with draft IAS 36 which means that the concept of “value in use” must still be applied for an asset that is *held for sale*. We find the application of value in use for assets to be sold inconsistent and therefore recommend the Board to amend the draft IAS 36 requirements for *held for sale* assets in case the Board would pursue the ED 4 measurement proposals.

**Q3. 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?*

**Response**

We believe that the introduction of the newly defined concepts of “disposal group” and “component of an entity” are confusing in relation to the existing defined concept of “cash generating unit”. Further, we fail to see the rationale for introducing the “single transaction” requirement of a disposal group. Existing IFRSs already split up a reporting entity into different levels (e.g. a cash generating unit (IAS 36), a segment (IAS 14 *Segment Reporting*)) and we are not convinced of the need for a new standard introducing new sublevels of a reporting entity. Therefore, we recommend the Board not to adopt any ED 4 measurement requirements and to incorporate any *held for sale* specific presentation and disclosure requirements (e.g. assets/liabilities held for sale) in the existing standards ((draft) IAS 16 *Property, Plant and Equipment*, IAS 35 *Discontinuing Operations*, (draft) IAS 36 *Intangible Assets* and (draft) IAS 38 *Impairment of Assets*). Such an integrated approach would contribute to the understandability of IFRS in general.

With regard to the measurement requirements, it is our understanding that the proposed standard does not consider situations that would require an adjustment to the carrying amount of a liability in the disposal group (instead of an asset). For instance, it can be envisaged that the disposal of a provision affects the time horizon over which the outflow of resources embodying economic benefits will take place. Therefore, we recommend the Board to amend the measurement requirements in (draft) IAS 36 for a disposal group accordingly.

**Q4. 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?*

**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.

**Q5. 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?*

**Response**

The requirements of B7-B8 are similar to the (draft) IAS 36 requirements (paragraph 53 and 118), which confirms our proposal to build on the (draft) IAS 36 instead of proposing a new standard (see also our responses to question 2 and 3). The B6 requirement that "any impairment loss that arises on reclassification of the asset (or of a disposal group containing the asset) shall be recognised in the income statement" appears to be in conflict with the requirements in B7-B8. In addition, we believe that the B8 requirement "to recognise any subsequent increase in fair value as a revaluation increase in accordance with the standard under which the assets were revalued before their classification as held for sale" is inconsistent with the principal measurement requirement, as expressed in paragraph 8, that a non-current asset (or disposal group) classified as held for sale shall be measured at the lower of its carrying amount and fair value less costs to sell.

**Q6. 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?*

**Response**

We consider the proposed removal of the (draft) IAS 27 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries* exemption from consolidation for subsidiaries acquired and held exclusively with a view to resale inappropriate. We believe it is of little benefit for users of consolidated financial statements to include assets and liabilities in the financial position of the acquiring entity, which were never part of the entity and are intended to be sold. We can envisage cases in which entities are forced to sell acquired businesses (e.g. Competition regulations), preventing the entity from taking control of the underlying assets and liabilities. Therefore, we believe it would be more appropriate to present such subsidiaries at their fair value in the consolidated balance sheet and we recommend the Board to retain the limited exemption in (draft) IAS 27.

**Q7. 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?*

**Response**

We agree with the IASB proposal to present in the balance sheet non-current assets classified as held for sale and assets and liabilities in a disposal group classified as held for sale separately because it improves the information available to users of financial statements in assessing the timing and amount of future cash flows. We refer to our response to question 1 in this respect.

We support the Board's view that assets and liabilities of a disposal group classified as held for sale should not be offset as prescribed by the IFRS Framework.

**Q8. 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?*

## **Response**

EFRAG believes that the replacement of IAS 35 *Discontinuing Operations* by the proposed new standard will not improve the quality of financial information provided to users.

The proposed threshold for a *discontinued operation* implies that a cash generating unit can qualify as a discontinued operation. We have strong reservations whether such an approach would result in more useful information for the users and fear that the cost of producing it will outweigh the benefits. The discontinuance of a cash generating unit will often not indicate a strategic decision to change the size or focus of the operations but be driven by rationalisation of the continuing operations. We are therefore concerned that the reporting of discontinuing cash generating units as discontinued operations would lead to a loss of relevance and readability of the financial statements.

Further, we are concerned that the significant decrease in threshold for a discontinued operation will result in a continuous restatement of previously published financial information. Such continuous restatements might impair the credibility of financial reporting.

The carving out of discontinuing operations is designed to enhance the predictive value of the income statement. Therefore, we believe that the current IAS 35 criteria (that a discontinuing operation should represent a separate major line of business or geographical area of operations) are superior to the current proposals in achieving the objective of predictive information.

To conclude, we believe that the project of convergence with SFAS 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* needs further research on the cost and benefit implications before the Board decides on amendments of the definition of discontinuing operations. With regard to the importance of convergence, we believe that convergence should secure the best standards even though they may diverge from existing IFRS or SFAS.

**Q9. 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?*

**Response**

We believe that the presentation of a single amount, profit **before** tax, 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 regard to the disclosure requirements for discontinuing operations, we invite the Board to consider consequential amendments to the IAS 14 *Segment Reporting* requirements.

**Other comments****1. First-time Adoption**

As a result of the IFRS 1 requirements, European 2005 first-time adopters will have to apply the proposed standard for periods beginning on or after January 1, 2004 (instead of January 1, 2005 as proposed by the draft standard). Based on the current IASB time-table we are concerned that 2005 first-time adopter will be confronted with undue time restraints for a 2004 application. We therefore recommend the Board to consider a consequential amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards* such that 2005 first-time adopters are not required but encouraged to apply the proposed standard for the comparative period(s).

**2. Change in a plan of sale – presentation of required adjustments**

Paragraph 24 (b) requires the gain or loss, recognised on the re-measurement to fair value less cost to sell or disposal of the assets or disposal group(s) comprising the discontinued operation, to be presented either in the notes or on the face of the financial statements. When a change in a plan of sale occurs, paragraph 19 requires that the entity shall include in income from continuing operations in the period in which the criteria in Appendix B are not met, any required adjustment to the carrying amount of a non-current asset that ceases to be classified as held for sale. To avoid any misleading representation, we believe that any adjustment following changes to a plan of sale should be presented in the same way as the impact of the re-measurement was initially presented.