

30 January 2008

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

Dear Madam/Sir

Exposure Draft of proposed amendments to IFRS 5 *Discontinued Operations*

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on the Exposure Draft of proposed amendments to IFRS 5 *Discontinued Operations* (the ED). This letter is submitted in EFRAG's capacity of contributing to 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 interpretations/amendments on the issues.

The ED proposes to introduce a new, converged definition of 'discontinued operations'. It also proposes to require additional disclosures related to components of an entity that have been or will be disposed of; and the intention is that those disclosures will be common to both IFRS and US GAAP. Although we in principle support the objective of trying to achieve greater convergence in this area, we disagree with some key elements of the approach proposed. In particular:

- EFRAG does not agree with the proposal in the ED that the definition of discontinued operations should focus on 'operating segments'. We think the definition should focus on some sort of major discontinuance notion, but do not think that will always be achieved by focusing on operating segments.
- EFRAG does not support the proposal that information about all components of the reporting entity that have been either disposed of or are classified as held for sale should be disclosed, regardless whether those components are a discontinued operation as defined. We think the scope of the disclosure should be limited to only those discontinuances presented separately in the income statement.

Our detailed comments are set out in the appendix to this letter.

We hope that you find our comments helpful. If you wish to discuss them further, please do not hesitate to contact Frederiek Vermeulen or me.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

Appendix

EFrag's detailed comments on the ED *Discontinued Operations*

Question 1 – Definition of discontinued operations

IFRS 5 defines a discontinued operation as a component of an entity that either has been disposed of or is classified as held for sale and

- (a) represents a separate major line of business or geographical area of operations,*
- (b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations, or*
- (c) is a subsidiary acquired exclusively with a view to resale.*

This exposure draft proposes changing the definition so that a discontinued operation is a component of an entity that

- (a) is an operating segment (as that term is defined in IFRS 8 Segment Reporting) and either has been disposed of or is classified as held for sale or*
- (b) is a business (as that term is defined in IFRS 3 Business Combinations (as revised in 2008)) that meets the criteria to be classified as held for sale on acquisition.*

The exposure draft proposes that an entity should determine whether the component of an entity meets the definition of an operating segment regardless of whether it is required to apply IFRS 8.

Question 1(a)—Do you agree with the proposed definition? Why or why not? If not, what definition would you propose, and why?

What does EFRAG believe is the best approach?

- 1 As a general comment, EFRAG is broadly supportive of the efforts of the IASB and FASB to achieve greater convergence between IFRS and US GAAP because we believe it will benefit global accounting; although we do not support convergence regardless of cost. We have to date supported the Boards' efforts to achieve greater convergence in the area of accounting for discontinued operations, and we think an important part of that process is to have a converged definition of a discontinued operation.
- 2 However, EFRAG disagrees with the proposal in the ED that the definition of a discontinued operation should focus on operating segments as defined in IFRS 8. We think the focus should be the size of the discontinuance rather than its nature, so we think a discontinued operation should be defined in terms of major discontinuances rather than operating segments.
- 3 It is our understanding that users wish to make assessments about sustainable future cash flows and to do that they wish to try to isolate the effect of major discontinuances. We recognise that there is a debate to be had as to what exactly is meant by 'a major discontinuance', but we do not think that defining a discontinued operation in terms of

an 'operating segment' as defined in IFRS 8 will necessarily result in major discontinuances being presented separately—because 'a major discontinuance' will only sometimes be the same thing as 'discontinuing an IFRS 8 operating segment'. It follows that in our view the proposal in the ED will not necessarily provide users with the information they need.

- 4 For example consider the position of a company that has various product lines and operates in various countries. Such a company probably manages its activities in a multi-dimensional way (by looking at activities both by product line and by country) but has chosen to comply with IFRS 8 by providing segment information by product line.
 - (a) Assume the entity decides to close down its operations in a particular country, and those activities are substantial. As that country is not a reported segment, under the proposals in the ED the discontinuance would not be treated as a discontinued operation. Yet it would be a major discontinuance and it is our understanding that users would want information about such a discontinuance to be presented separately on the face of the income statement.
 - (b) Assume now that the entity decides to close down its operations in a particular country and those activities are substantial and involve discontinuing the whole of one product line and part of another. Under the proposals in the ED the part of the discontinuance relating to the discontinuance of the product line would be treated as a discontinued operation and presented separately, but the rest of the discontinuance would not. Yet it is our understanding that users want information presented separately on the face of the income statement about the whole of the discontinuance.

Operating segments v components

- 5 Although we believe the best approach would be not to base the definition of discontinued operations on the notion of operating segment, we thought it might be helpful to say that, if we had to choose between defining discontinued operations by reference to operating segments or by reference to the components notion that underlies the proposed new disclosure requirement set out in paragraph 41A, we would strongly favour the operating segment notion. There are two reasons for this:
 - (a) We think the components notion will result in the separate presentation of some discontinuances that are too small. Small discontinuances are a fact of business life and users understand that; their focus is on the bigger discontinuances. Presenting smaller discontinuances separately and providing note disclosures about those smaller discontinuances could result in so many small discontinuances being presented separately and so much data being disclosed that the useful information is obscured.
 - (b) We think that focusing on operating segments has some advantages. In particular, it means that if a part of the business is considered important enough to be dealt with separately in the segment reporting, it will be dealt with separately should it be discontinued; and that a part of the business that is not considered important enough to be dealt with separately in the segment reporting will not be dealt with separately should it be discontinued.

In the remainder of this letter we have put aside our concerns about basing the definition of discontinued operations on operating segments in order to be as constructive as possible about the proposals made.

Some detailed comments on the operating segment proposal

6 On a more detailed level, we suggest that the way in which subparagraph (b) of the definition of a discontinued operation is worded should be looked at again, because we stumbled over it. An amendment along the following lines might help:

(b) is a *business* that on acquisition met ~~meets~~ the criteria to be classified as held for sale ~~on acquisition~~.

7 In addition, we think that the IASB should clarify whether the references to 'operating segments' are references to operating segments prior to aggregation or after aggregation. We think it would be consistent with the proposed amendment to IAS 36 being made as part of the Improvements to IFRSs (2008) (Impairment of Assets – unit of accounting for goodwill impairment) were the reference to be to operating segments before aggregation. We also think that is what the ED implies by referring in paragraph 32 to paragraphs 5-10 of IFRS 8, but we think it would be helpful if explicit guidance was provided.

Question 1(b)—If an entity is not required to apply IFRS 8, is it feasible for the entity to determine whether the component of an entity meets the definition of an operating segment? Why or why not? If not, what definition would you propose for an entity that is not required to apply IFRS 8, and why?

8 EFRAG sees no difficulty in entities that are not required to apply IFRS 8 being required to apply an operating segment notion when applying IFRS 5. The operating segment notion refers to the reporting entity's internal reporting system—not to whether or not it is listed—and it would have an internal reporting system regardless of whether the entity is applying IFRS 8.

Question 2 – Amounts presented for discontinued operations

Under IFRS 8, amounts disclosed for operating segments are the amounts reported to the chief operating decision maker. Nevertheless, although the proposed definition of a discontinued operation refers to operating segments, this exposure draft proposes that the amounts presented for discontinued operations should be based on the amounts presented in the statement of comprehensive income, even if segment information disclosed to comply with IFRS 8 includes different amounts that are reported to the chief operating decision maker.

Question 2—Do you agree that the amounts presented for discontinued operations should be based on the amounts presented in the statement of comprehensive income? Why or why not? If not, what amounts should be presented and why?

9 EFRAG agrees that, in order to present objective and consistent data, amounts should be determined in accordance with those IFRSs used to determine the amounts presented in the statement of comprehensive income.

Question 3 – Disclosures for all components of an entity that have been disposed of or are classified as held for sale

The exposure draft proposes disclosures for all components of an entity that have been disposed of or are classified as held for sale, except for businesses that meet the criteria to be classified as held for sale on acquisition.

Question 3(a)—Do you agree with the proposed disclosure requirements? Why, or why not? If not, what changes would you propose, and why?

The scope of proposed new paragraph 41A

- 10 We do not support the approach proposed in paragraph 41A, which is that information about components of the reporting entity that have been either disposed of or are classified as held for sale should be provided in the notes of the financial statements, regardless of whether those components are a discontinued operation as defined.
- 11 Our main concern is that we think this ‘component’ notion will result in some very small discontinuances being disclosed. As we have already said, users understand that small discontinuances are a fact of business life and are primarily interested in much bigger discontinuances. As a result, focusing the disclosures on components could result in a mass of data that would obscure the key messages.
- 12 We also think the information necessary to comply with a disclosure based on components would not always be available (particularly for the corresponding periods).
- 13 In addition, we are very uncomfortable with the rationale for this disclosure requirement, as set out in paragraph BC8. That rationale is in effect that the IASB and FASB could not agree on how to define a discontinued operation, with FASB favouring a definition that would treat smaller components of the entity as discontinued operations than the definition the IASB favoured; so a compromise was reached in which the IASB got its way on the definition of a discontinued operation, but disclosures would be required that would ensure that the information that FASB thought should be disclosed on the face of the primary financial statements would at least be disclosed in the notes. We understand that, if convergence is to be achieved, compromise will sometimes be necessary. However, it seems to us that it is important that, regardless of whether a compromise is involved, the overall result should be an improvement in financial reporting and, for the reasons set out in the preceding paragraph, we do not believe that has been achieved in this case.
- 14 In our view, the principal objective of this disclosure should be to support the income statement presentation by providing more information about the discontinuances presented separately in that statement. A disclosure that focuses on components does not do that. If the separate presentation is based on an operating segments notion and the disclosure on a components notion, the effect will be that the disclosures about discontinuances will neither support nor be reconcilable to the discontinuances dealt with by separate presentation. That is not helpful for users.
- 15 For the above reasons, we think the scope of proposed new paragraph 41A should be amended so that the disclosures described are required only in respect of discontinuances that are presented separately in the income statement.

Subsuming existing paragraphs 33(c) and (d) into proposed new paragraph 41A

- 16 We note that the disclosure requirements that are in paragraphs 33(c) and (d) of the existing standard have been “subsumed” into paragraphs 41A(c) and (b). This change is not simply about moving a requirement around within the standard, because paragraph 33 applies only to discontinued operations whilst paragraph 41A applies to all discontinued components.
- 17 In our response to question 3(a) we argued that proposed new paragraph 41A’s scope should be narrowed so that the disclosures described are required only in respect of discontinuances that are presented separately in the income statement (ie discontinued operations).
- (a) If that was done, the disclosures required by existing paragraph 33 and by proposed new paragraph 41A will both be provided only for discontinuances that are presented separately in the income statement. As such, we do not think that anything would be achieved by subsuming paragraphs 33(c) and (d) into paragraph 41A. It would also not cause any harm.
- (b) On the other hand, if the IASB does not narrow the scope of proposed new paragraph 41A in the way we have suggested, we do not think it is appropriate to subsume paragraphs 33(c) and (d) into paragraph 41A. In our view the disclosures required by existing paragraph 33 should be provided only for discontinuances that are presented separately in the income statement.

Question 3(b)—Do you agree with the disclosure exemptions for businesses that meet the criteria to be classified as held for sale on acquisition? Why or why not? If not, what changes would you propose, and why?

- 18 EFRAG agrees with the proposal in paragraph 41B of the ED to exempt businesses classified on acquisition as held for resale from the disclosures described in paragraph 41A of the ED. The objective of IFRS 5 is to provide users with information about components that have been part of the reporting entity’s continuing operations but either no longer are or are expected not to be shortly. Businesses classified on acquisition as held for resale were never part of the entity’s continuing operations.
- 19 Having said that, we think it would be better if the exemption was set out in a separate paragraph rather than at the end of paragraph 41B.

Question 4 – Effective date and transition

Entities would be required to apply the proposed changes prospectively, from a date to be determined by the IASB after exposure, with one exception: the amounts in the statement of comprehensive income (or in the separate income statement) should be reclassified on the basis of the revised definition of discontinued operations for all periods presented. Earlier application would be permitted.

Question 4—Are the transitional provisions appropriate? Why or why not? If not, what would you propose, and why?

- 20 In general, EFRAG’s strong preference is that all new or amended accounting requirements should be applied retrospectively, because such application significantly

enhances the comparability—and therefore the usefulness—of the information provided. Therefore, if it is difficult to apply a standard retrospectively if a particular effective date is used, our preference would be to defer the effective date (ie allow a longer lead-time) so that retrospective application would be possible—rather than require (or permit) prospective application. For that reason, we generally support prospective application of new or amended requirements only if retrospective application is impracticable.

- 21 However, we do not believe that whether the new definition of discontinued operations is applied retrospectively or prospectively will have any significant effect on the usefulness of the information provided. That is because discontinued operations that have been presented as such in a prior period still reflect activities which have been in the course of being disposed of, or have been effectively disposed of or abandoned; and to make assessments about the future users are primarily interested in the activities that are continuing.
- 22 Bearing that in mind, we think that whether the new definition is applied retrospectively or prospectively is largely a matter of practicability. As we think that in some cases it might not be possible to apply the definition retrospectively—because the information will not have been gathered at the time—we think it is preferable to apply the new definition prospectively.
- 23 We agree that prospective application of the revised disclosures is appropriate.
- 24 We think incidentally that, in view of the ED's transition arrangements, an amendment will need to be made to IFRS 1.
- 25 Finally, we note that several amendments to IFRS 5 have been approved or proposed recently (see IFRIC 17 *Distribution of Non-Cash Assets to Owners* and the ED *Improvements to IFRSs 2008*) and think it would be helpful if the IASB could align the effective dates of all three amendments to ensure that preparers are not faced with three versions of one standard within a relative short timeframe.

Other comments

A need for a more detailed review of IFRS 5, probably as part of the FSP project

- 26 Judging from the recent *Financial Statement Presentation* Discussion Paper, the IASB does not intend to use the currently active phase of the Financial Statement Presentation (FSP) project to take another look at the principle underlying IFRS 5, which is that discontinued operations should be presented separately and in a condensed form in the primary financial statements rather than, say, in a memorandum column or simply in the notes. We think it is a pity that this principle is not being reconsidered because there appear to be enough concerns about the standard to warrant its reconsideration. We would therefore encourage the IASB to take another, longer, look at it as soon as possible as part of the FSP project.

Abandoned operations

- 27 We note that under existing IFRS discontinued operations are accounted for differently depending on whether they are to be discontinued because of a sale or because they are to be abandoned. In IFRS 5.BC36 the IASB argues that “a distinction can be

drawn between an asset that is to be sold and an asset that is to be abandoned, because the former will be recovered principally through sale and the latter through its 'continuing use'".

- 28 We are not convinced by this argument that abandonment and sale are sufficiently different economically to justify a difference in accounting. For example, consider the example of an entity that decides to sell a disposal group that meets the definition of a discontinued operation. After negotiations with potential buyers the entity decides to stop trying to sell the disposal group and instead simply to abandon it. In such a scenario the entity would retrospectively report the discontinued operations separately when the decision is taken to try to sell, then reclassify the operations into continuing operations when the decision is taken to abandon them instead, then reclassify them again as discontinued operations once the wind-down of the operations is completed.
- 29 We think this to-ing and fro-ing will be really confusing for users. We also think it is unnecessary because in both cases (selling or abandoning) the entity clearly decides not to continue the operation in the presentation changes with the decision whether it will be sold or abandoned. We would therefore encourage the IASB to take another look at this issue as soon as possible; perhaps as part of the FSP project.