Organismo Italiano di Contabilità – OIC (The Italian standard setter)
Italy, 00187 Roma, Via Poli 29
Tel. 0039/06/6976681 fax 0039/06/69766830
e-mail: presidenza@fondazioneoic.it

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

October 1, 2003

Re : Organismo Italiano di Contabilità (OIC): Comments on "ED 4 Disposal of Non-current Assets and Presentation of Discontinued Operations".

Dear David ,

I am pleased to inform you that the Executive Committee of the OIC ("Comitato Esecutivo") has issued its comments on the "ED 4 Disposal of Non-current Assets and Presentation of Discontinued Operations", enclosed herewith.

Generally speaking, rather than attempting to put forward an optimal and autonomous proposal of an accounting principle concerning the Disposal of Non-current Assets and Presentation of Discontinued Operations, the document appears to be overly influenced by the aim of achieving convergence with the sFAS.

In particular, we agree with the criticisms raised in EFRAG's introductory letter that anticipate and summarise the main aspects emerging from the responses to the IASB's questions.

Furthermore, it is felt that the principle may lead to complexities in its application that are disproportionate compared with any real improvement in the information contained in the financial statements; an improvement that could be achieved by:

- adequate "disclosure" of the pertinent information concerning the planned disposal/sale operations;
- applying the measurement criteria "lower of carrying amount and fair value less costs to sell"

Organismo Italiano di Contabilità – OIC (The Italian standard setter)
Italy, 00187 Roma, Via Poli 29
Tel. 0039/06/6976681 fax 0039/06/69766830
e-mail: presidenza@fondazioneoic.it

Furthermore, our responses to the questions are based on an acceptance of the general approach followed by the IASB.

Please find herewith attached EFRAG's draft reply to the IASB document together with the comments of the OIC.

Yours sincerely,

Prof. Angelo Provasoli
(OIC – Chairman)

cc: Kevin Stevenson

Attachments

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?

Draft Response

We agree with the IASB proposal to classify separately non-current assets held for sale, as defined by paragraphs 4 and 5 and Appendix B of the exposure draft, because it improves the information available to users of financial statements in assessing the timing and amount of future cash flows.

However, paragraph 5 of ED 4 states that sale transactions include exchanges of non-current assets for other non-current assets.

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 in our Improvements comment letter our concern that the accounting for exchange of non-monetary assets should be dealt with comprehensively in a separate standard. As a result, 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. Recent IASB decisions have tightened the recognition conditions referred to above.

We believe that Appendix B contains key requirements that should be part 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 which makes us wonder whether a user can be expected to have all these rules in mind when assessing the meaning of the held for sale category. We therefore invite the Board to use more principles based language. 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", as it is done in 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.

OIC comments

We agree with the view stated by EFRAG that a separate classification of "non-current assets held for sale" could increase the information on companies' future cash flows.

We agree with the view stated by EFRAG concerning the treatment of exchanges.

We further agree with EFRAG suggestion to use more "principles based" language, and with the comment that it would be more appropriate to insert the requirements for inclusion in the "held for sale category" in the main text rather than in Appendix B.

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?

Draft 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 divesture 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. We do not support this conclusion because, as expressed in our Improvements comment letter, we believe that the improved IAS 16 *Property, Plant and Equipment* should not require an annual reassessment of residual value where there are no indications of impairment.

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. Paragraph 14 (and BC 28-29) further explain that the allocation of an impairment loss of a disposal group should be to the non-current assets that are within the scope of the draft IFRS. We do not support this allocation requirement which differs from draft IAS 36.

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 such a requirement internally inconsistent and therefore recommend the Board to amend the draft IAS 36 requirements for *held for sale* assets.

<u>OIC comments</u>

We agree with the view stated by EFRAG.

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?

<u>Draft Response</u>

We refer to our response to question 2 above.

We find the wording of paragraph 2 somewhat confusing in that it specifically scopes out goodwill but in the last sentence scopes in disposal groups, apparently including goodwill. Assuming this is what is intended it would be helpful to clarify the point by explaining the last sentence with an explanation of the different treatments.

<u>OIC comments</u>

We agree with the view stated by EFRAG, especially regarding the need to further clarify the treatment of goodwill.

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?

Draft Response

Subject to our comments raised in our answers to question 1 and 2 above, we support the Board's proposed consequential amendment to draft IFRS X *Business Combinations* because it ensures that non-current assets that meet the criteria to be classified as held for sale will be measured on a consistent basis, independently from how they were acquired.

OIC comments

We support the proposal in ED4, and supported by EFRAG, to measure all assets classified as "held for sale" on a consistent basis.

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?

Draft Response

While we agree with the requirements of B6 and B7 we do not support the view taken in B8. According to the B8 (*Subsequent gains* requirements) any subsequent increase in fair value shall be recognised to its full extent and treated as a revaluation increase in accordance with the standard under which the assets were revalued before their classification as held for sale. We believe that these requirements are 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. Therefore, we recommend the Board to amend paragraph B8 accordingly.

Further, we recommend the Board to include in its Illustrative Examples an example that illustrates the requirements of B6-B8 regarding impairment losses and subsequent increases in fair value less costs to sell of assets that were previously revalued.

<u>OIC comments</u>

We agree with the view expressed by EFRAG as, also in our opinion, the change in the classification of an asset changes its measurement requirements.

Furthermore, as suggested by EFRAG, we agree with the idea of including an illustrative example of the requirements of paragraphs B6-B8.

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?

<u>Draft Response</u>

We agree with the Board's proposal.

<u>OIC comments</u>

We do not agree with EFRAG's view on this question. In view of the fact that the basis for a consolidation must be a "non-temporary control", we believe that the exemption should remain.

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?

<u>Draft Response</u>

We agree with the IASB proposal to present separately 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 because it improves the information available to users of financial statements in assessing the timing and amount of future cash flows.

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.

<u>OIC comments</u>

We agree with EFRAG's view on this issue, as it seems more meaningful to provide information on the nature of the assets and liabilities before the sale, which, while respecting the conditions of ED4, does not appear certain. Even where adequately explained in the notes to the accounts, the offsetting of assets and liabilities in the balance sheet may result in insufficient information being available to the users.

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?

<u>Views for consideration by EFRAG commentators</u>

(Note for EFRAG commentators: while EFRAG is seeking comments on all the points raised in this letter, as well as any other concern commentators might have, we explicitly ask the EFRAG commentators to provide us with their views regarding the points raised under this question)

In our preliminary discussions this question raised diverging views as the whether the proposed standard improves the current requirements under IAS 35. We therefore found it useful to reflect the views below and specifically ask for comments thereon:

? ***Relatively small units will need to be classified as discontinued***

The concern is raised that the threshold for a discontinued operation is too low leading to (i) cumbersome requirements for preparers and (ii) many activities being excluded for the "regular" reporting (continuing operations).

In assessing this question a good understanding of the classification criteria for a discontinued operation (see (a) and (b) in the above question) is crucial. In this respect, we noted that the illustrative examples 8 to 11 are helpful.

On the other hand, it is argued that when relatively small units are classified as discontinued this will give a clearer understanding of the profitability of continuing operations.

? ***The introduction of a stricter classification trigger***

While under IAS 35 an operation is classified as discontinuing at the earlier of (i) the entity entering into a binding sale agreement and (ii) the board of directors approving and announcing a formal disposal plan the proposed classification triggers under ED 4 are considered tighter. Under the draft IFRS an operation should be classified as discontinued when it is disposed of or classified as held for sale. The concern is raised that the earlier reporting of intended discontinuation under IAS 35 provides better information for users.

With regard to the importance of convergence, we believe that convergence should secure the best standards even though they may diverge from existing IAS or FAS.

<u>OIC comments</u>

? ***Relatively small units will need to be classified as discontinued***

The threshold for “discontinued operations” does indeed seem to be very low, with the inevitable risk that a large number of operations will be included and that preparers of financial statements will be faced with a considerable task. Even the users themselves may draw little benefit from continuous changes in information. The comparability and homogeneity of data is definitely necessary, but a certain “stability” in them seems to be equally necessary. A change from the way data have been presented in the past would require users to make an effort in order to understand the changes; therefore, it should be limited to matters of definite importance.
Therefore, reference to IAS 35 appears preferable.

? ***The introduction of a stricter classification trigger***

Concerning Discontinued Operations that have an impact on balance sheet assets, it is felt that, for the purposes of applying the criteria for the presentation/classification of discontinued operations, the criteria proposed under IAS 35 guarantee better information for users.
Concerning the importance of “convergence”, we agree with the view expressed by EFRAG.

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?

<u>Draft Response</u>

We believe that the presentation of a single amount, profit after 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.

<u>OIC comments</u>

We agree with the view expressed by EFRAG.

<u>Other comments</u>

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 and the time needed for the European endorsement process we are concerned that a final standard could only be endorsed in the fourth quarter of 2004 which would cause 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*.

<u>OIC comments</u>

We agree with the view expressed by EFRAG.

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 gaming opportunity, 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.

<u>OIC comments</u>

We agree with the view expressed by EFRAG.

Other OIC comments

Date of classification

The meaning of “date of classification” does not seem to be defined precisely. Presumably, it should correspond to the date when the requirements as currently stated in Appendix B are met, but it might also mean the financial statements date (year end or interim) in which the reclassification is made. Therefore, it would seem appropriate to also specify this term exactly in Appendix A Defined terms.

Valuation of liabilities

Paragraph 3 of ED4 refers to paragraphs 11 and 14 concerning accounting for individual asset and liability items that are not covered by the application of the principle but which are included in a disposal group. However, paragraphs 11 and 14 make no mention of how to account for liabilities. One might infer by analogy that liabilities should be valued in accordance with the individual reference IFRS. However, it would seem appropriate to provide an explicit indication that such is the case by inserting a note in paragraph 11.