香 港 會 計 師 公 會
HONG KONG SOCIETY OF ACCOUNTANTS
(Incorporated by the Professional Accountants Ordinance, Cap. 50)

By air-mail and e-mail <CommentLetters@iasb.org.uk>

Our. Ref.: C/FASC 24 October 2003

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

Dear Sir/Madam,

Exposure Draft
ED 4 Disposal of Non-current Assets
and Presentation of Discontinued Operations

The Hong Kong Society of Accountants (HKSA) welcomes the opportunity to provide you with our comments on the Exposure Draft ED 4 Disposal of Non-current Assets and Presentation of Discontinued Operations.

We set out in the attachment our response to the questions raised in your Invitation to Comment.

The HKSA has a policy of converging its Statements of Standard Accounting Practice with the International Accounting Standards Board's Standards. The standard setting due process applied in Hong Kong (details of which are available on the HKSA's website) acts to support this policy. The HKSA's Financial Accounting Standards Committee (FASC) issued an Invitation to Comment on the exposure draft with a comment period concurrent with that set by the IASB. Accordingly, the accompanying comments may reflect the views not only of members of the FASC but also of constituents in Hong Kong who provided comments to the HKSA.

If you have any questions on our comments, please contact our Deputy Director - Accounting, Mr. Simon Riley, in the first instance.

Yours faithfully

WINNIE C.W. CHEUNG
SENIOR DIRECTOR
PROFESSIONAL & TECHNICAL DEVELOPMENT
HONG KONG SOCIETY OF ACCOUNTANTS

WCC/SR/al

香港金鐘道八十九號力寶中心二座四樓
4th Floor, Tower Two, Lippo Centre, 89 Queensway, Hong Kong
Tel: 2287 7228 Fax: 2865 6603 / 2865 6776
http://www.hksa.org.hk E-mail: hksa@hksa.org.hk

Hong Kong Society of Accountants' comments on the IASB's Exposure Draft 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. Assets so classified may be required to be presented separately 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?

We agree with the principle of presenting separately on the balance sheet those non-current assets held for productive purposes from assets held for disposal.

The wording of paragraph 7 leaves us in doubt as to how one "shall not account for a non-current that has been temporarily taken out of use as if it had been abandoned". If such an event is excluded from the scope of ED 4 then that should be made more explicit in the wording of paragraph 7 and it should be expressed in a positive manner.

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. Is this measurement basis appropriate for non-current assets classified as held for sale?

ED 4 essentially creates a new category of non-current non-financial asset, specifically an asset "held for sale", which most likely had been previously accounted for under IAS 16 or IAS 40 (or possibly also under IAS 38) but which is expected to generate no future economic benefit *from continued use*. The Board's premise for creating a new category of asset appears to be that an asset held for sale is held for a purpose clearly distinct from that applying to assets accounted for under IAS 16 and IAS 40 and that the measurement of assets earmarked for disposal is currently not addressed sufficiently in the respective existing standards. As an alternative to the Board's point of view, we would suggest that the existing requirements in IAS 16 and IAS 40, together with the application of IAS 36, could apply just as effectively for measuring assets held for disposal.

We would recommend that the Board include directly within IAS 16 and IAS 40 requirements for the measurement of assets held for disposal (assuming the current requirements are somehow considered deficient) rather than within a separate standard.

If the Board believes that it is necessary to create a new category of non-current non-financial asset held for sale, and if it is considered by the Board that this new category of asset is akin to an item of inventory accounted for under IAS 2, we would agree that the measurement basis proposed in ED 4 paragraph 8 is consistent with that applying under IAS 2. We would also concur that assets held for disposal should generally not be depreciated. But we would note that the measurement basis proposed in ED 4 is inconsistent with that applying to 'available-for-sale' financial assets (arguably the financial asset equivalent of the type of asset to which ED 4 proposes accounting measurement) that, under IAS 39 are carried at fair value. We would welcome the Board's clearer statement – in the Basis of Conclusions on the new IFRS – as to why the measurement basis underlying the requirement in ED 4 paragraph 8 is the appropriate basis.

We disagree with the "rare circumstances" reference in paragraph 10. Whether circumstances are expected to be "rare" or not, should have absolutely no impact on how they ought to be accounted for. We would strongly advocate the Board, as a matter of drafting principle, never to use the phrase "rare circumstances". The fact that something is expected to occur infrequently should never be used as a test for whether a certain type of accounting should be applied. A "rare" test should also not be used to justify accounting treatment, such as in the case of paragraph 10. We also express our concern about the proposition in paragraph 10 to discount and would recommend this proposal be deferred until a more thorough consideration on the issues associated with discounting have been completed.

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. Is this appropriate?

We concur with the proposed 'portfolio' approach to grouping assets and liabilities that are to be disposed of together in a single transaction as a disposal group.

We would concur with the proposal to measure a disposal group on a 'portfolio' basis. Elsewhere in this comment letter, however, we have raised concerns as to the measurement basis proposed in ED 4 and our suggestions as to an appropriate measurement approach for 'assets held for sale or disposal' would also apply to a disposal group.

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. It therefore proposes a consequential amendment to [draft] IFRS X *Business Combinations* 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?

We concur with the proposition in question 4.

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. Is this appropriate?

Following from our comments on question 2 above, if the Board believes that it is necessary to create a new category of asset ('tangible non-financial non-current assets held for sale'), in order to address the question of the treatment of revaluation reserves existing at the time of transfer, and subsequent measurement, we consider the appropriate first point of reference should be to IAS 40 paragraphs 51 to 59, which deal with transfers between categories of assets, specifically those paragraphs that deal with transfers from other categories to investment property. We consider that, upon transfer, the same measurement principles as currently specified under IAS 40 paragraphs 55 and 56 should apply for items of property, plant and equipment transferred to the "held for disposal" category.

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. Is the removal of this exemption appropriate?

In response to our invitation to comment on ED 4, we received two comment letters, which contained similar expressions of disagreement with the proposition in question 6. One of these comment letters stated the following:

> "Our understanding of the rationale for the above from IAS 27 is to reflect the fact that this would be superseded by paragraphs 9 and B3 of the ED. These require that the newly acquired asset be classified as held for sale at fair value less costs to sell. However, we do not agree with the proposal if the rationale is to require full consolidation of such subsidiaries. Consolidation reflects a holding company's control over the subsidiaries' long-term development and economic resources. For a subsidiary acquired purely for resale, it is quite unlikely that the group company will devote much effort to align the strategy and policy of the subsidiary. We thus do not see adequate justification for converging with (SFAS 144) on this."

In our covering letter, we note that our comments may reflect the views not only of members of the FASC but also of constituents in Hong Kong who provided comments to the HKSA. We have included the above comment because we believe it is representative of our constituency's views and we would wish the IASB to take into account – especially for the published basis of conclusions – the fact that there do appear to be divergent views within the constituency.

The proposition contained in question 6 may be appropriate in principle. If a subsidiary is to be disposed of in its entirety the (temporary) investor should still be able to account for the assets and liabilities acquired albeit on an intended temporary basis. The accounting requirements that would apply to any asset or liability the entity intends to hold exclusively for disposal should not be any different regardless of whether or not those assets are held in a subsidiary. But we believe the proposition in question 6 is challenged on a 'cost:benefit' basis. The cost of generating such financial information would potentially far outweigh the benefit to users. There are also consolidation-related questions, not addressed within ED 4, as to whether the results of the subsidiary during the time it is temporarily owned (but not necessarily *controlled*) by the investor needs to be included within the group income statement.

We believe that any proposed amendment to IAS 27 should be outside the scope of ED 4. The Board does have another project underway on issues associated with consolidation accounting and we believe that any proposal within ED 4 to amend IAS 27 is premature and potential prejudicial to a full debate on the meaning of "control" which we would expect to occur as part of the consolidation project.

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. Is this presentation appropriate?

We concur with the proposition in question 7.

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.

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?

Our overall preference would be to leave IAS 35 substantially unamended until, or as part of, the completion of the performance reporting project and that, as discussed in our reply to question 5 above, the measurement of assets held for sale be dealt within the respective existing standards.

We do not agree with the proposition in question 8. We are a strong supporter of the global convergence of financial reporting standards but, unfortunately, comments were not invited from us when the US FASB developed SFAS 144. Had we the opportunity to comment on the exposure draft preceding SFAS 144, we would have advocated the inclusion within SFAS 144 provisions consistent with the IAS 35 approach to the definition of a 'discontinuing operation' which only covers separate major lines of business or geographical area of operations that may have significant impact to the entity. The proposal in ED 4 would entail substantial effort and reporting costs, but with minimal benefits to users when only relatively small units would be classified as discontinued.

If an entity regularly buys and sells operations that would otherwise be classified as discontinued operations, we believe that would fall under the exclusion provided by way of the definition to “current asset”, specifically criterion (a) and (b) of that definition.

We would also recommend that alignments need to be made for paragraphs 6 and 23. Paragraph 6 states that non-current asset to be abandoned should not be classified as held for sale but presented as discontinued operations, while in paragraph 23, the definition of discontinued operation only covers asset that either has been disposed of or is classified as held for sale, without including planned abandonment.

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. 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?

One out of the four comment letters we received from our local constituency indicated support for showing a single profit after tax amount on the face of the income statement with breakdowns shown in the notes to the financial statements on the basis that it provides a clearer presentation.

We concur with the Board’s approach to minimise the presentation and disclosure impact resulting from ED 4 and to retain substantially the same disclosures as presently applying under IAS 35.

Apart from issues dealing with the recognition of an event as constituting a “discontinuing operation”, the present IAS 35 is primarily a disclosure and presentation standard. The IASB is currently embarking on what we consider is a vitally important project on financial performance reporting and we presume that the outcome of this project will have significant impact on the way that discontinued or discontinuing operations will be presented in the financial statements.

We note that ED 4 proposes to remove the option presently applying under IAS 35 paragraph 40. Pending finalisation of the financial performance reporting project, we would recommend retention of the option applying under IAS 35 paragraph 40.