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International Accounting Standards Board First Floor 30 Cannon Street London EC4M 6XH United Kingdom 23 January 2008



Financial Accounting Standards Board 401 Merritt 7 Norwalk, Connecticut 06856 United States LETTER OF COMMENT NO.

Comments on:

Invitation to Comment - Exposure Draft of Proposed Amendments to IFRS 5 Discontinued Operations

Proposed FASB Staff Position No. FAS 144-d, "Amending the Criteria for Reporting a Discontinued Operation"

Dear Sir/Madam:

The global organisation of Ernst & Young is pleased to respond to the International Accounting Standards Board's (IASB) Exposure Draft (ED) and the Financial Accounting Standards Board's (FASB) Proposed FASB Staff Position (Proposed FSP) on the proposed amendments to their respective standards on reporting discontinued operations.

We generally support the direction of the ED and the Proposed FSP, as they are intended to achieve greater consistency and comparability in financial reporting, as well as international convergence. However, we believe the Boards should consider whether it is appropriate to continue to present discontinued operations separately on the face of the statement of comprehensive income (IFRS) or income statement (U.S. GAAP). (For convenience, we will refer to both collectively as the statement of comprehensive income in this letter.) We also recognize that the Boards' Discussion Paper – *Preliminary Views on Financial Statement Presentation* – retains the discontinued operations classification in the statement of comprehensive income.

Retention of discontinued operations presentation

As the business environment continues to evolve, changes in a company's business are relatively frequent. The rate of change in a global company's business is accelerating to such a rapid pace that one could argue that change is the norm rather than the exception. In today's business environment, entities find themselves continually evaluating the need to make changes to respond to market developments. Disposals of components, and even operating segments, are a normal part of business processes and thus may not warrant separate presentation on the face of the statement of comprehensive income. However,



regardless of the frequency of disposals that would qualify as discontinued operations, we question whether reporting discontinued operations on the face of the statement of comprehensive income provides users with meaningful information. An alternative to discontinued operations presentation in the statement of comprehensive income would include the disclosures proposed by the ED and the Proposed FSP for disposals of operating segments accompanied by a robust management discussion whereby the company could provide information about what it believes would be most useful for readers.

Continuing operations and cash flows

With respect to the proposed definition of discontinued operations in the ED and Proposed FSP, we recommend that the Boards reconsider their decisions to omit consideration of significant continuing operations and cash flows with the disposed component from the criteria for discontinued operations classification. The IASB considered and rejected considerations of continuing operations and cash flows and continuing involvement in the definition of discontinued operations in International Financial Reporting Standard 5 (IFRS 5), Non-current Assets Held for Sale and Discontinued Operations, as discussed in IFRS 5, paragraph BC70. The consideration of significant continuing operations and cash flows with the disposed component is discussed in FASB Statement No. 144 (Statement 144), Accounting for the Impairment or Disposal of Long-Lived Assets, paragraph 42(a), as further interpreted by EITF Issue 03-13, "Applying the Conditions in Paragraph 42 of FASB Statement No. 144 in Determining Whether to Report Discontinued Operations" (Issue 03-13). The FASB has proposed deleting paragraph 42 from Statement 144 and nullifying Issue 03-13 in the Proposed FSP. Based on the proposed amendments to Statement 144 and the current version of IFRS 5, we are concerned that the resulting discontinued operations presentation may not "provide users with information that is relevant in assessing the ongoing ability of the entity to generate cash flows" (IFRS 5, BC62). Consider the following examples:

1. Commercial real estate (adapted from EITF 03-13, Appendix B, Example 3)
An entity owns various commercial real estate properties and has two operating segments – shopping malls and office space. The entity commits to a plan to sell its shopping malls. The properties are classified as held for sale at that date. The ongoing entity will enter into a long-term management agreement with the buyer under which the ongoing entity will continue to manage the day-to-day operations of the shopping malls in exchange for a management fee at market rates.

The ongoing entity estimates that continuing cash inflows as a result of a continuation of activities (providing management services) will result in the ongoing entity recognizing CU 250 thousand of revenue. The ongoing entity estimates that the disposed operating segment would have generated CU 5 million of rental revenue absent the disposal transaction. The ongoing entity estimates that after the disposal transaction, continuing cash outflows as a result of a continuation of activities (providing management services) between the ongoing entity and the disposed component will result in the ongoing entity recognizing CU 200 thousand of cash outflows. The ongoing entity estimates that the disposed operating segment would have generated CU 1 million of cash outflows associated with owning and managing the building absent the disposal transaction.



2. Restaurant franchisor (adapted from EITF 03-13, Appendix B, Example 10)
An entity that is a franchisor in the quick-service restaurant business also operates company-owned restaurants. The entity's operating segments are franchise operations and four regions of company-owned restaurants (5 operating segments in total).

Based on its evaluation of the performance of the company-owned restaurants in certain markets, the entity commits to a plan to sell its company-owned restaurants in one region (that is, one operating segment) to an existing franchisee. The restaurants are classified as held for sale at that date. The ongoing entity will enter into a franchise agreement that will provide it with the right to sell product to the restaurants in addition to receiving franchise fees determined, in part, based on the future revenues of the restaurants. The entity estimates that the continuing cash inflows from the sale of product will approximate 20 percent of the cash inflows, while the franchise fee will approximate 5 percent of the cash inflows that would have been generated by the disposed component absent the disposal transaction.

3. Continuing entity is sole supplier to disposed segment

Entity A disposes of Subsidiary B on 1 January 2009. Prior to classifying Subsidiary B as a discontinued operation, Entity A had revenues from external customers of CU 100, CU 113, and CU 127, in 2006, 2007, and 2008, respectively. Revenues from external customers attributable to Subsidiary B in those years were CU 25, CU 38, and CU 52. Entity A was the primary supplier of a raw material to Subsidiary B, and Entity A entered into a supply arrangement with Subsidiary B to continue that relationship after the disposal. Entity A's intercompany revenues from the supply arrangement were CU 13, CU 19, and CU 26, in 2006, 2007, and 2008, respectively. Prior to classifying Subsidiary B as discontinued operations, these intercompany transactions eliminated in consolidation. In 2009, the supply arrangement generated revenues of CU 34 for Entity A. As a result, Entity A presented revenues from external customers in 2006, 2007, 2008, and 2009, of CU 75, CU 75, CU 75, and CU 109.

Based on the definition of discontinued operations in the ED and Proposed FSP, we believe that many constituents would conclude that these disposals should be classified as discontinued operations. We question whether the disposals in the examples above should be classified as discontinued operations, because significant portions of the operations and cash flows of the disposed operating segment remain in the continuing entity. As illustrated in Example 3, the periods after a disposal transaction would include significant increases in revenues and cash flows in continuing operations due to the continuing relationships with the disposed operating segment (and the exclusion of the disposed operating segment's prior operating results from continuing operations), if the disposed operations are considered discontinued operations. We question whether that presentation provides users with information that is relevant in assessing trends in the entity's revenues and cash flows.

While we recommend that Boards reconsider their decisions to omit consideration of significant continuing operations and cash flows with the disposed component from the criteria for discontinued operations classification, we do not recommend that the Boards include consideration of significant continuing involvement (as currently discussed in Statement 144, paragraph 42(b)) in the definition of discontinued operations. Subject to considerations of the significance of continuing operations and cash flows, we believe that,



for example, the operating results of an entity that goes from being consolidated to being an equity-method investee should be in discontinued operations.

While we understand that the Boards recognize the implementation issues with the notions of continuing operations and cash flows (as discussed in the Basis for Conclusions of IFRS 5 and the Basis for Conclusions of the Proposed FSP), we believe that this matter deserves further consideration by the Boards. At a minimum, we recommend that the Boards require disclosure regarding the expected continuing future cash flows and involvement the entity expects from the disposed component. We recommend that the Boards consider the current disclosure requirements in EITF 03-13, paragraph 17, when doing so.

Presentation of operations between the continuing entity and the disposed operating segment in the statement of comprehensive income

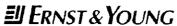
If the Boards do not consider continuing operations and cash flows an impediment to discontinued operations classification, we believe that the Boards should provide guidance regarding the presentation of transactions between the continuing entity and the disposed operating segment in the statement of comprehensive income. For example, consider the situation illustrated in our Example 3 above in which Entity A sells raw materials to Subsidiary B for an intercompany profit, and Subsidiary B then sells the product to an unrelated third-party. The intercompany profit would not be recognized until the sale to the third-party. Upon a disposition of the subsidiary that is presented as a discontinued operation, it is not clear whether, if sales to the unrelated party have been completed, the intercompany profit should be included in continuing or discontinued operations for periods prior to disposal. Similarly, if the sales to the unrelated party have not yet happened in the periods presented prior to disposal, the intercompany profit is eliminated and is not shown at all, even though this information may be more useful to the reader to understand what consequences the continuing involvement would have on profit or loss from continuing operations. Allocating intercompany profits and losses to continuing and discontinuing operations with continuing operations or cash flows raises a number of practical issues and may under certain circumstances lead to significant over- or understatement of profit or loss from continuing and discontinuing operations. The effect of these situations may be particularly significant when the continuing operations and cash flows with the disposed component are significant, as illustrated by Entity A's 45% increase in revenue in 2009 solely from the supply arrangement with its former Subsidiary B.

* * * * *

As with all converged standards, we strongly encourage the Boards to use the same wording when expressing the same concept. Accordingly, we recommend that the Boards review the resulting standards to ensure that there are not unnecessary differences in the drafting of the standards. We believe that this will reduce the likelihood of unintended implementation differences in the future. In those cases where it is not possible to use the same words but the Boards intend for the same accounting, it would help if the basis for conclusions expressly stated that they did not expect the accounting to be different, and the reasons for different words.

On the basis that the Boards decide to pursue amendments to the definition of discontinued operations, our responses to the specific questions posed in the ED and Proposed FSP and





additional comments on the more specific details of the exposure drafts are set out in the appendices to this letter.

We would be pleased to discuss our comments further with the Boards or their staffs at your convenience. Please contact either Leo van der Tas (Netherlands – Rotterdam, +31 10 4068114) or Carlo Pippolo (US – New York, +1 212 773 1790).

Very truly yours,

Ernst + Young

Attachments:

Appendix A - Responses to specific questions in the IASB Exposure Draft

Appendix B - Responses to specific questions in the proposed FASB Staff Position



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?

Yes, we agree. Amounts presented for discontinued operations should be based on IFRS. We agree with the IASB's rationale that the link to operating segments is only being used to classify discontinued activities not to measure them (BC 10). Presenting discontinued operations based on amounts internally reported to the chief operating decision maker, which may differ from IFRS, would result in an inappropriate mixture of bases of accounting presented in the statement of comprehensive income and in the IFRS 5 disclosures in the notes.

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

No, we do not agree with the proposed disclosure requirements. We question the usefulness of these additional disclosures as they relate to components that are not significant enough to meet the definition of discontinued operations and therefore may be rather small individually. It appears contradictory that, on the one side, the IASB intends to reduce the number of discontinued operations, but on the other side, proposes additional disclosures in the notes for discontinued activities that are not significant enough to be presented as a discontinued operation on the face of the statement of comprehensive income.

In addition, we have the following recommendations:

- The ED requires disclosure of the major income and expense items, including impairments, interest, depreciation and amortization. We believe the Board should clarify what constitutes "major." If the Boards choose not to do so, then we presume that an entity would have discretion in defining major.
- We recommend that the IASB clarify how the "major income and expense items" referred to in proposed paragraph 41A relates to the minimum items required to be included in the statement of comprehensive income in accordance with IAS 1, Presentation of Financial Statements, paragraph 82.
- We recommend that the Board clarify whether the disclosures required by proposed paragraphs 33(b) and 41A are permitted on an aggregate basis for all disposed components, or whether it is required for all individual components. Further, if aggregation is permitted, the Boards should clarify whether an entity could aggregate components classified in discontinued and continuing operations in the same disclosure.
- Proposed paragraph 33(b) (i) require disclosures of "the pre-tax profit or loss of discontinued operations, together with major income and expense items constituting that profit or loss, including impairments, interest, depreciation and amortization." The same disclosure is required by proposed paragraph 41A(a) for all disposed components, regardless of whether it is presented as a discontinued operation or within continuing operations. We believe that these two paragraphs are redundant and that the disclosure requirement need only be referenced once.



APPENDIX A

Responses to the specific questions raised in the IASB's Exposure Draft

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

Subject to the comments in the introduction to this letter, we agree with the proposed definition and believe that the link to an entity's reporting under IFRS 8, Operating Segments, will increase the consistency in the level of information disclosed within the financial statements – more specifically, reducing the need to make yet another assessment about the significance of a component of the business to the whole business.

We also agree that the presentation of activities acquired exclusively with a view to resale as part of a business combination (now consistently referred to as "held for sale on acquisition") as a discontinued operation should not be limited by legal form.

Please also refer to the introduction to this letter for our views on whether the definition of discontinued operations should also consider the entity's continuing involvement with the disposed component.

We note that the August 2008 Exposure Draft of Proposed Improvements to IFRSs includes a proposed amendment to IAS 36 to clarify that the reference to an operating segment in that standard refers to an operating segment before aggregation. We believe that the Board has the same intent with its use of operating segment in the ED, so we recommend a similar clarification in proposed paragraph 32(a). We also refer to our proposed recommendation in our comment letter dated 10 November 2008 on Proposed Improvements to International Financial Reporting Standards, Questions 1, IAS 36 Impairment of Assets, to revise paragraph 12 of IFRS 8.

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?

We believe that it is feasible for an entity that is not required to apply IFRS 8 to determine whether the component of an entity meets the definition of an operating segment. All entities will have some sort of internal management reporting that will allow them to apply the guidance in IFRS 8 when they have disposed of a component. We do not believe that applying IFRS 8 for these entities will be particularly onerous.

We recommend that the Board clarify whether the principle articulated in the proposed paragraph 32A also applies to other references to IFRS 8, such as in IAS 36.80(b), where it is not clear whether an entity must apply IFRS 8 for the purpose of allocating goodwill to CGUs even if scoped out of IFRS 8.



 We also refer to the cover letter for our comments on additional disclosures about expected continuing cash flows as we refer to in our cover letter.

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?

Yes, we agree. Businesses that meet the criteria to be classified as held for sale on acquisition were never part of continuing operations. As a result, the disclosures would not be relevant for users of the financial statements.

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

We agree with the proposed transition rules. They represent a reasonably balanced approach to transition because the proposed additional disclosures would not need to be given for prior periods, e.g., in relation to discontinued operations already disposed of.



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APPENDIX B

Responses to the specific questions raised in the proposed FASB Staff Position

1. The proposed FSP would amend the definition of a discontinued operation so that a discontinued operation is a component of an entity that is (a) an operating segment (as that term is defined in FASB Statement No. 131, Disclosures about Segments of an Enterprise and Related Information) and either has been disposed of or is classified as held for sale or (b) a business (as that term is defined in FASB Statement No. 141 [revised 2007], Business Combinations) or a nonprofit activity that meets the criteria to be classified as held for sale on acquisition. Do you agree with the proposed definition of a discontinued operation? Why or why not? If not, what definition would you propose and why?

Subject to the comments in the introduction to this letter, we agree with the proposed definition. We believe that the current definition in Statement 144 results in reporting too many disposals as discontinued operations, which significantly reduces the usefulness of the financial statements. The link to an entity's internal management approach and related reporting under Statement 131 will reduce the lack of consistency involved in determining what is or is not a component.

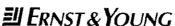
We also agree that the presentation of activities acquired exclusively for resale as part of a business combination (now consistently referred to as "held for sale on acquisition") as a discontinued operation should not be limited by legal form.

Please also refer to the introduction to this letter for our views on whether the definition of discontinued operations should also consider the entity's continuing operations and cash flows with the disposed component as currently discussed in Statement 144, paragraph 42(a), and Issue 03-13.

2. Based on the proposed definition of a discontinued operation, an operating segment is the general level of aggregation for determining whether a component of an entity would be reported in the discontinued operation section of the income statement (or statement of activities for not-for-profit entities). The definition would no longer include certain subsidiaries and asset groups that do not meet the definition of an operating segment. Is it feasible for an entity that is not required to apply Statement 131 (that is, a nonpublic business entity and a not-for-profit 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 Statement 131 and why?

We believe that it is feasible for an entity that is not required to apply Statement 131 to determine whether the component of an entity meets the definition of an operating segment. All entities will have some internal management reporting that will allow them to apply the guidance in Statement 131 when they dispose of a component. We do not believe that applying Statement 131 for these entities will be particularly onerous. Further, other US GAAP pronouncements require all business entities to apply Statement 131; for example, FASB Statement No. 142, Goodwill and Other Intangible Assets.





We note that the IASB's August 2008 Exposure Draft of Proposed Improvements to IFRSs includes a proposed amendment to IAS 36 to clarify that the reference to an operating segment in that standard refers to an operating segment before aggregation. We believe that the Board has the same intent with its use of operating segment in the Proposed FSP, so we recommend a similar clarification in proposed paragraph 41(a).

3. Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes would you propose and why?

No, we do not agree with the proposed disclosure requirements. We question the usefulness of these additional disclosures as they relate to components that are not significant enough to meet the definition of discontinued operations and therefore may be rather small individually. It appears contradictory that, on the one side, the FASB intends to reduce the number of discontinued operations, but on the other side, proposes additional disclosures in the notes for discontinued activities that are not significant enough to be presented as a discontinued operation on the face of the statement of comprehensive income.

In addition, we have the following recommendations:

- The Proposed FSP requires disclosure of the major income and expense items, including impairments, interest, depreciation and amortization. We believe the Board should clarify what constitutes "major." If the Boards choose not to do so, then we presume that an entity would have discretion in defining major.
- We recommend that the Boards clarify whether the disclosures required by proposed paragraphs 47 and 47A are permitted on an aggregate basis for all disposed components, or whether it is required for all individual components. Further, if aggregation is permitted, the Boards should clarify whether an entity could aggregate components classified in discontinued and continuing operations in the same disclosure.
- 4. Under the disclosure requirements, income tax expense or benefit does not have to be calculated and disclosed for components of an entity that are reported within continuing operations and that have been disposed of or are classified as held for sale. Do you agree or do you believe it would be beneficial to require income tax expense or benefit to be calculated and disclosed for discontinued components of an entity within continuing operations? If so, how would you calculate and disclose the income tax expense or benefit?

We agree with the proposed disclosure requirements. We concur with the Board that this income tax calculation would increase complexity and would amend the intraperiod tax allocation model in FASB Statement No. 109, Accounting for Income Taxes.

We recommend that the Board specifically address whether subsequent adjustments to an income tax uncertainty within the scope of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No.109, would be an example of an adjustment to previously reported discontinued operations that should be classified in discontinued operations as discussed in paragraph 44 of Statement 144.



5. Do you agree with the disclosure exemptions for a business or a nonprofit activity that meets the criteria to be classified as held for sale on acquisition? Why or why not? If not, what changes would you propose and why?

Yes, we agree. Businesses that meet the criteria to be classified as held for sale on acquisition were never part of continuing operations. As a result the disclosures would not be relevant information for users of the financial statements.

6. Are the effective date and transition provisions sufficient for compiling the information needed? Why or why not? If not, what would you propose and why?

Yes, we believe that the effective date and transition provisions are sufficient for compiling the information needed. While we would prefer that the ED and the Proposed FSP have the same transition provisions, we recognize that entities that apply US GAAP should have the information necessary to make all of the transition disclosures.

We believe that the transition provisions in Statement 144 should be updated to include the FASB's staff announcement codified as EITF Topic No. D-104, "Clarification of Transition Guidance in Paragraph 51 of FASB Statement No. 144."

Other comments

Scope of Statement 144 - investments in equity securities accounted for under the equity method

Current Statement 144 excludes investments in equity securities from its scope, which is reasonable when considering only the impairment guidance in Statement 144. However, it is possible that an equity method investment could be a component of an entity or even an operating segment. We recommend that the FASB clarify the scope of the discontinued operations guidance in Statement 144 with respect to equity method investments. We note that equity method investments under IAS 28, *Investments in Associates*, are not excluded from the scope of IFRS 5, so this would be an opportunity to address convergence, as well.

<u>Definition of a component of an entity</u>

The Proposed FSP removes the following portion of the definition of a component of an entity in Statement 144, paragraph 41:

A component of an entity may be a reportable segment or an operating segment (as those terms are defined in paragraph 10 of Statement 131), a reporting unit (as that term is defined in Statement 142), a subsidiary or an asset group (as that term is defined in paragraph 4).

We believe that this portion of the definition is still relevant and should be retained, as the amended standard will require disclosures for all disposed components, even those that do not qualify as discontinued operations.