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Financial Accounting Standards Board
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26 August 2013

**Proposed Accounting Standards Update, *Reporting Discontinued Operations*
(File Reference No. 2103-230)**

Dear Ms. Cospers:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Reporting Discontinued Operations* (the Proposed Update), issued by the Financial Accounting Standards Board (FASB or Board). While we generally support the Proposed Update's objective to improve the usefulness of financial statements by highlighting significant strategic shifts in an entity's business operations and are supportive of the Board's decision to raise the threshold to qualify as a discontinued operation, we believe that such information may be better articulated in pro forma disclosure rather than on the face of the financial statements (hereinafter the income statement). Our view is consistent with our 23 January 2009 letter to the FASB and the International Accounting Standards Board (IASB) (collectively, the Boards) in response to Proposed FASB Staff Position No. FAS 144-d, "Amending the Criteria for Reporting a Discontinued Operation," and the Exposure Draft of Proposed Amendments to IFRS 5 Discontinued Operations, respectively. In addition, while we are supportive of raising the threshold for qualifying as a discontinued operation, we are not supportive of removing the qualifying criteria related to continuing operations and cash flows.

Retention of discontinued operations presentation

In today's business environment, changes in a company's operations have become the norm rather than the exception. 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 income statement. However, regardless of the frequency of disposals that would qualify as discontinued operations, we question whether reporting discontinued operations on the face of the income statement provides users with meaningful information. Disclosures of pro forma results, similar to those described in ASC 805-10-S50 for material acquisitions, would likely provide financial statement users with appropriate information. Public companies would further describe disposals and their expected impact on their businesses and financial results in a robust management discussion and analysis, outside of the financial statements.

Continuing operations and cash flows

We do not agree with the Board's decision to exclude from the definition of a discontinued operation the existing consideration of significant continuing operations and cash flows with the disposed component. We believe that presenting an operation as discontinued if a reporting entity has significant continuing operations and cash flows with the discontinued operation would not address concerns about the complexity of the existing standard and its inconsistent application. In addition, we question the usefulness of presenting operations as discontinued when significant operations and cash flows related to the disposal will be part of the continuing entity's operations.

If the Board decides to eliminate this criterion we believe further guidance will be necessary to evaluate whether a disposal with continuing involvement is really a qualifying disposal. That is, at what point are continuing operations and cash flows so significant that the disposal would not qualify as a disposal of a "separate major line of business" or a "separate major geographic area of operations" because the continuing involvement effectively would mean the operations are being retained?

Consider the following examples of disposals that we believe highlight these concerns:

1. Commercial real estate (adapted from ASC 205-20-55-60 through 55-62)

An entity owns various commercial real estate properties and has two major lines of business - shopping malls and office space. The entity commits to a plan to sell its shopping malls and classifies the properties 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 an annual management fee at market rates of \$250,000, resulting in operating income of \$50,000 per year. The ongoing entity estimates that the shopping malls would have generated \$5 million of rental revenue and \$1 million of operating income if they hadn't been sold.

2. Restaurant franchisor (adapted from ASC 205-20-55-35 through 55-38)

An entity that is a franchisor in the quick-service restaurant business also operates company-owned restaurants. The entity's business comprises franchise operations and four regions of company-owned restaurants (i.e., a total of five major lines of business and geographical areas of operation). 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 (i.e., one major geographical area of operations) 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 products 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 products and the franchise fees will approximate 20% and 5% respectively of the cash inflows that would have been generated by the disposed component if it had not been sold.

3. Continuing entity is sole supplier to disposed segment

Entity A disposes of Subsidiary B on 1 January 2013. Prior to classifying Subsidiary B as a discontinued operation, Entity A had consolidated revenues from external customers of \$100, \$113 and \$127 in 2010, 2011 and 2012, respectively. Revenues from external customers attributable to Subsidiary B included in the consolidated revenues in those years were \$25, \$38 and \$52. Entity A was the primary supplier of a raw material to Subsidiary B and 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 \$13, \$19 and \$26 in 2010, 2011 and 2012, respectively. Prior to classifying Subsidiary B as a discontinued operation, these intercompany transactions were eliminated in consolidation. In 2013, the supply arrangement generated revenues of \$34 for Entity A and other revenues were \$75. As a result (and assuming no other changes), Entity A presented revenues from external customers in 2010, 2011, 2012, and 2013 of \$75, \$75, \$75 and \$109 respectively.

In each of these examples an entity has disposed of operations that constitute a "separate major line of business" or "separate major geographic area," but it will have continuing operations related to that business. We question whether it is appropriate in any of these situations to conclude that a "separate major line of business" or "separate major geographic area" has been disposed of when, in fact, a portion of the operations have been retained, albeit in an evolved form.

Based on the definition of discontinued operations in the Proposed Update and the Board's comments about why it removed the continuing involvement criterion, we believe that many constituents would conclude that each of these disposals should be classified as discontinued operations. We question the appropriateness of that conclusion because in each example significant portions of the operations and cash flows associated with the disposed operating segment will continue after the disposal. It is not clear whether a significant strategic shift in the entities' business operations has occurred or whether the existing strategy is simply being executed under a different operating structure. It also raises the question, at what level do continuing cash flows indicate that a qualifying disposal has not occurred? That is, at what point are continuing cash flows so significant that there really has not been a disposal? We recognize that these are the same issues the Board recognized in ASC 205-20-45-1 and question whether the difficulty and diversity in applying these requirements should result in a change in the principle designed originally to reflect as discontinued only those operations that were, in fact, no longer continuing.

Furthermore, the examples (particularly Examples 2 and 3) demonstrate that the presentation as a discontinued operation could produce a counterintuitive result. That is, revenues and cash flows from continuing operations could increase significantly after a disposal transaction due to the continuing relationship with the former subsidiary and the exclusion of its prior operating results from continuing operations. We question whether that presentation would provide users with information that is relevant in assessing trends in the entity's revenues and cash flows.

Presentation of operations between the continuing entity and the discontinued operation in the income statement

If the Board does not consider significant continuing operations and cash flows as impediments to classification as discontinued operations, the Board should consider additional presentation guidance. We believe that financial statement users would be better served if entities consistently presented the income statement effect of transactions between the continuing entity and the disposed operation.

Consider the situation in our Example 3 in which Entity A sells raw materials to Subsidiary B for an intercompany profit, and Subsidiary B sells the product to an unrelated third party. The intercompany profit would be eliminated and profit would not be recognized until the sale to the third party. We assume that all third-party sales and all costs will be reflected as discontinued in the periods presented before disposal. However, once the disposal transaction occurs, the sales to the disposed entity and related costs will be included in the continuing entity's operating result. We question how this presentation provides users with information that is useful to understanding the continuing business.

While we recommend that the Board reconsider its decision to omit consideration of significant continuing operations and cash flows with the disposed component from the criteria for discontinued operations classification, we agree with the Board's decision to omit consideration of significant continuing involvement (as currently discussed in ASC 205-20-45-1b) from the definition.

As with all standards, we strongly encourage the Board to use the same words as IFRS to express the same concepts. If it is not possible to use the same words (for example, the use of "component" rather than "cash generating unit" in the definition of a discontinued operation) but the intended meaning is the same, we believe the basis for conclusions should explicitly state that the Board does not expect differences in accounting due solely to terminology differences. Likewise, when there are significant differences between the disclosure requirements, we believe that the Board should clearly state the reasons for the differences in the basis for conclusions.

Our responses to the specific questions posed in the Proposed Update and additional comments are set out in the appendix to this letter.

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We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,



Responses to the specific questions raised in the Proposed Accounting Standards Update

Question 1:

Do you agree with the proposed definition of discontinued operations? Is it understandable and operable?

Response:

Except for the objections we raise in our cover letter regarding the usefulness of presenting discontinued operations in the income statement and concerns over the elimination of the consideration of significant continuing operations and cash flows from the evaluation of discontinued operations, we agree with the proposed definition. We believe that the current definition in ASC 250-20 results in too many disposals being reported as discontinued operations, which significantly reduces the usefulness of the financial statements. We also agree that the presentation of activities acquired exclusively for resale as part of a business combination (referred to as "held for sale on acquisition") as discontinued operations should not be limited by legal form.

We nevertheless believe that additional guidance is necessary to make the proposal operable. Under the proposal, we believe that preparers' determinations of what constitutes a "major line of business or major geographical area" could differ significantly. The implementation guidance proposed in paragraphs 205-20-55-86 through 55-88 and in paragraphs 205-20-55-90 through 55-92 of the Proposed Update reflects a major line of business and major geographic area of operation at the threshold of 20% of the product lines and retail stores, respectively. It is not clear whether the Board intended to create a quantitative threshold of 20%, and we are concerned that preparers might interpret the guidance, as proposed, to mean that 20% is "major" (which may not be consistent with how the Board views the term "major" in other projects such as its joint leasing project with the IASB). If the Board chooses not to provide either a definition or more specific guidance, we assume that the determination would be left to the preparer's discretion and that the Board would expect differences in practice and would consider the differences to be appropriate. In that case, we recommend that the concept of a "significant strategic shift in operations" should also be included in the definition.

Question 2:

Do you agree that the continuing involvement criterion in the existing definition should be eliminated? Why or why not?

Response:

As noted in our cover letter, we do not agree with the Board's decision to eliminate consideration of significant continuing operations and cash flows with the disposed component from the criteria for discontinued operations classification. However, we agree that significant continuing involvement (as currently reflected in ASC 205-20-45-1b) should not be a factor in the definition of discontinued operations.

While the Board has noted the elimination of operations and cash flows criteria may address some preparers "... difficulty in applying the guidance in Issue 03-13 to the individual fact pattern", a difficulty we do not see in our practice since the issuance of EITF 03-13, it will instead be replaced by a subjective evaluation of what is and is not a qualifying disposal (i.e., how continuing operations and cash flows are considered in evaluating whether a qualifying disposal has occurred). In addition, we believe that simply raising the threshold for what qualifies as a discontinued operation (i.e., a separate major line of business or major geographic area) will go a long way in reducing the preparer concern the Board noted.

Question 3:

Do you agree with the scope of the amendments in this proposed Update? Do you agree that the disposals of equity method investments and oil and gas properties that are accounted for using the full-cost method of accounting should be eligible for discontinued operations presentation if they meet the criteria to be reported in discontinued operations?

Response:

We agree that the complete disposal of an equity method investment should be eligible for discontinued operations presentation subject to meeting the criterion as a major line of business or major geographic area and also subject to our previous comments with respect to significant continuing operations and cash flows. We are less clear about a partial disposal of an equity method investment that results in accounting for the investment at cost and eliminating the recognition of equity income following the disposal. If the Board intends for only the complete disposal of an equity method investment to be eligible for presentation as a discontinued operation, that point should be clear in the scope change included in any final standard issued.

We are also unclear whether the Board intended a partial disposal of an equity method investment, such that the remaining investment no longer qualifies for equity method accounting, to qualify as a disposal eligible to be treated as a discontinued operation. That is, assume Entity X owns 25% of the stock of Company A and accounts for its investment on the equity method. Entity X disposes of a portion of its investment such that it then owns 18% of the stock and determines it no longer qualifies to apply the equity method of accounting. Was the Board intent that the equity method investment could qualify as a discontinued operation with the cost method investment considered part of continuing operations following the disposal?

We would not object to including oil and gas properties accounted for using the full cost method in the scope of discontinued operations if both of the following conditions are met:

1. The disposal meets the criterion of a disposal of a major line of business or major geographic area

and

2. A complete cost center is disposed of. Permitting the disposal of a partial cost center to be presented as a discontinued operation would require the Board to provide guidance on determining the criteria for separating the cost center, ultimately requiring the Board to address the full cost method of accounting for oil and gas properties.

Question 4:

U.S. GAAP and the amendments in this proposed Update do not specify whether an entity should reclassify the assets and liabilities of a discontinued operation classified as held for sale in the statement of financial position for periods before reclassification. Should an entity be required to reclassify the assets and liabilities of a discontinued operation classified as held for sale in the statement of financial position for periods before reclassification? Why or why not?

Response:

Yes, we believe that if separate presentation in the income statement is useful to financial statement users' understanding of the business, the comparability of the balance sheet should also be preserved through reclassification for periods prior to initial presentation. Furthermore, we suggest that the Board consider and include a discussion that addresses why net income from discontinued operations should be separately presented and comprehensive income from discontinued operations should not.

Question 5:

Do you agree with the disclosures required for disposals of individually material components of an entity? If not, which disclosure or disclosures would you eliminate or add and why?

Response:

No, we do not agree with the proposed disclosure requirements and believe that these incremental requirements would contribute to ongoing disclosure overload. Consistent with our support of the revised definition of a discontinued operation (i.e., raising the threshold for qualifying as a discontinued operation), we also question the usefulness of these additional disclosures as they relate to components that are not significant enough to meet the definition of a discontinued operation. If the FASB believes that reducing the number of discontinued operations would improve financial reporting, it seems inconsistent to propose additional disclosures for discontinued activities that do not meet the revised definition or that did not meet the prior definition. Furthermore, if the Board believes that disclosures are necessary for all material disposals, it should consider whether the standard would be more appropriate as a disclosure standard than as a presentation standard.

In addition, the Proposed Update would require disclosure of the major line items constituting the pretax profit (loss) and major classes of assets and liabilities of the individually material component of an entity included as part of a disposal group. As noted in our response to Question 1 above with respect to the use of the term "major" in the definition of a discontinued operation, we believe that the Board should clarify what constitutes "major" beyond the examples included in the Proposed Update. If the Board chooses not to do so, we presume that an entity would have discretion in determining what is major and that diversity in practice would arise.

Question 6:

Do you agree that businesses held for sale on acquisition should be excluded from certain disclosure requirements? Why or why not?

Response:

Yes. Businesses that meet the criteria to be classified as held for sale on acquisition are likely never considered part of the future continuing operations from a financial statement users' perspective. As a result, the disclosures would not be relevant information for users of the financial statements.

Question 7:

Do you agree with the prospective application transition method? Why or why not?

Response:

While prospective application might reduce the amount of effort required to implement the amendments, it could result in financial statements that are difficult to understand until all periods are presented on the same basis. In situations where discontinued operations are presented under both existing standards and the Proposed Update, comparing financial statements between periods would be challenging. For example, if a real estate investment trust disposed of buildings in periods before and after the effective date of the Proposed Update and reflected discontinued operations in prior periods but not subsequent periods, the comparability and usefulness of the financial statements would be impaired. In addition, it is not clear whether the additional proposed disclosure requirements would apply to only the disposal transactions after the adoption of the Proposed Update and, if so, how the reconciliations proposed in paragraphs 205-20-50-1B should be presented.

Question 8:

How much time do you think will be needed to prepare for and implement the amendments in this proposed Update?

Response:

Given the significant expansion of disclosure requirements as well as the effects of removing the elimination of continuing operations and cash flows criteria, we believe companies will need significant time to both analyze the standard and prepare for implementation.

Question 9:

Do the modified disclosures for nonpublic entities provide the right level of disclosure? If not, how should the proposed Update be modified for nonpublic entities?

Response:

See our response to Question 5.