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2013-230  
Comment Letter No. 12  
330 North Wabash, Suite 3200  
Chicago, IL 60611

August 27, 2013

Via email to [director@fasb.org](mailto:director@fasb.org)

Susan M. Cospers  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

RE: Proposed Accounting Standards Update, *Reporting Discontinued Operations* (File Reference No. 2013-230)

Dear Ms. Cospers:

We are pleased to provide comments on the discontinued operations exposure draft ("the ED"). We support the Board's objective to reduce the number of disposals that qualify as discontinued operations in order to reserve that presentation for disposals that represent larger strategic shifts.

However, we believe treating businesses that are held for sale upon acquisition as discontinued operations to be inconsistent with the basic objective. We understand some parties supported that idea in response to the proposed FSP on this topic in 2008.<sup>1</sup> During the same timeframe, Statement 141(R) amended the definition of a business, although it was not effective until 2009. Since then, many constituents have come to question whether the current definition of a business is too broad. For example, real estate entities acquire portfolios which may include individual properties that are considered businesses and also meet the held for sale criteria. Since these properties were never an integrated part of the entity's operations, their immediate sale doesn't signal a strategic shift. Consequently, we do not support that aspect of the ED.

We also recommend calibrating a number of the proposed disclosures to achieve a more cost-effective outcome that is consistent for public and private entities. We elaborate on these points and others in the appendix, which includes our responses to the questions posed in the ED.

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Lee Graul, National Director of Accounting at (312) 616-4667 or Adam Brown, Partner in the National Accounting Department at (214) 665-0673.

Very truly yours,

BDO USA, LLP

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<sup>1</sup> As described in paragraph BC 14.

## Appendix - Questions for Respondents

**Question 1: Do you agree with the proposed definition of discontinued operations? Is it understandable and operable?**

The revised definition of a discontinued operation includes businesses that meet the held for sale criteria upon acquisition. We are aware of transactions for which we believe discontinued operations treatment would be inappropriate even if the business meets the held for sale criteria at the acquisition date. Specifically, it is not uncommon for an entity to acquire a portfolio of properties which includes certain properties that the entity immediately plans to sell (i.e. in order to acquire the more desirable properties in a portfolio, the entity was also required to purchase the less desirable properties). These less desirable properties will meet the held for sale criteria on acquisition and therefore, would be reflected as a discontinued operation under the ED because they will frequently constitute businesses under ASC 805. The presentation of discontinued operations for these properties does not appear consistent with the Board's overall objective to capture strategic shifts in an entity's major lines of business or major geographical areas.<sup>2</sup>

Aside from that point, we agree with the proposed definition of discontinued operations. Since an entity's interpretation of the word "major" will be critical to its assessment for reporting discontinued operations, the Board might consider providing additional examples in the implementation guidance to further illustrate the characteristics of a major line of business or geographical area.

**Question 2: Do you agree that the continuing involvement criterion in the existing definition should be eliminated? Why or why not?**

We agree with eliminating the continuing involvement criterion. We share the Board's conclusion that it is better addressed through disclosure than as a precondition for presenting discontinued operations.

**Question 3: Do you agree with the scope of the amendments in this proposed Update? Do you agree that 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?**

In addition to our concerns about businesses that meet the held for sale criteria upon acquisition, we offer the following observations about equity method investments and oil and gas entities that are accounted for under the full-cost method of accounting.

### Equity method investments

We note that equity method investments can be broadly categorized in two groups—strategic and financial. Most strategic investments allow the investor to exert significant influence over the investee and typically convey an ownership interest of 20% or higher. We agree with discontinued

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<sup>2</sup> Paragraph BC29.

operations treatment for disposals of strategic equity method investments when they represent a separate major line of business or geographic area.

However, equity method investments contemplated under ASC 323-30-S99-1, *Accounting for Limited Partnership Investments* generally do not convey significant influence or represent the same size of investment from the investee perspective. An investor's influence over these limited partnerships is characterized as more than "virtually no[ne]" and may represent as little as 3-5% of the investee's capital. BC17 acknowledges that not all equity method investments would qualify as discontinued operations. This would presumably include all "financial" investments under 323-30-S99-1. In addition, we do not believe they should be considered material components of an entity since the related disclosures are premised on a strategic relationship between the investor and investee, rather than a passive financial role. As such, we recommend that the final amendments exclude equity method investments within the scope of 323-30-S99-1 from the revised definition of a discontinued operation.

Separately, in order to meet the held for sale criteria, a disposal of an equity method investment must qualify for recognition as a completed sale within one year under paragraph 360-10-45-9.c. This will introduce an analysis under the transfers and servicing guidance for the first time in connection with a discontinued operations assessment. We note the one-year limit was established in the context of environmental concerns and also to address the possibility of a long-lived asset inappropriately not being depreciated while it is held for sale.<sup>3</sup> Since the transfers and servicing guidance uses a control-based model that contemplates factors such as legal isolation<sup>4</sup> and effective control that are different than those considered during the development of Statement 144, the Board may wish to consider whether there are any unintended consequences associated with the one-year limit for disposals of equity method investments under Topic 860.

*Oil and gas entities that are accounted for using the full-cost method of accounting*

We agree that oil and gas properties accounted for using the full-cost method of accounting should be eligible for discontinued operations presentation, but only if the entire full-cost pool (i.e. all of the properties within a particular country<sup>5</sup>) meets the criteria to be reported in discontinued operations. Under the full-cost method of accounting, the full-cost pool is the unit of account. Accordingly, we do not believe there is a conceptual basis for presenting a discontinued operation if the unit of account is greater than that which is being disposed.<sup>6</sup> We believe it would also be impracticable to identify "material components" of a full cost pool. Therefore, the Board should clarify in the final amendments that the disposal of something less than the full-cost pool does not qualify as a discontinued operation or a material component because they would not represent a strategic shift in the entity.

However, if the Board ultimately concludes that the disposal of something less than the full-cost pool may qualify as a discontinued operation or material component, we believe the disclosures would need to be revised to align with the gain/loss recognition guidance for disposals of properties under the full-cost method. Under Regulation S-X Rule 4-10(c)(6)(i), a gain or loss is only recognized for the sale of something less than the full cost pool if that transaction

<sup>3</sup> See paragraph B73 in Statement 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*.

<sup>4</sup> We note legal isolation encompasses the notion of continuing involvement, which the Board has otherwise decided is not relevant to the definition of discontinued operations under the ED.

<sup>5</sup> Under Regulation S-X Rule 4-10(c)(1), cost centers are established on a country-by-country basis.

<sup>6</sup> This view is consistent with that expressed by AcSEC in Chapter 5 (para 5.49) of the AICPA's guide on *Audits of Entities with Oil and Gas Producing Activities*.

significantly alters the depreciation, depletion, and amortization (DD&A) rate. Therefore, if the disposal of something less than the full cost pool qualifies as a discontinued operation, but does not significantly alter the DD&A rate, a gain/loss would not be recognized on disposal, which commonly occurs for other discontinued operations. In addition, it may be unclear what portion of the pretax profit associated with the entire full cost pool should be attributed to the material component under 360-10-50-4.a. Similar complexities arise for the proposed disclosures in items b. - d. of paragraph 50-4.

**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?**

We do not believe that the amendments need to address the retrospective reclassification of the assets and liabilities of a discontinued operation. In our experience, this is not an area of practice that requires incremental standard setting, as companies have generally been able to reach reasonable conclusions on this point based on their individual facts and circumstances.

**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?**

We note that the required disclosures are based on the identification of individually "material" components. The concept and measurement of materiality is open to broad interpretation by auditors and preparers, and has not historically been a threshold that the Board has defined for accounting purposes. As such, using it on an undefined basis could create diversity in practice.

Additionally, if the intent of the amendments is to reduce the number of disposals that qualify as discontinued operations by limiting them to major strategic shifts in an entity's business, it may be difficult to differentiate that concept from "material" disposals. The language in BC19 refers to material components as those that are not "significant enough" to be discontinued operations. BC20 also uses the term "significant component" as a synonym for "material component." Such language implies a size-based test without actually providing clarity on this point.

To alleviate these concerns, we recommend retaining the disclosures proposed in paragraph 360-10-50-3 and 50-5 for disposals that do not qualify as discontinued operations, including those related to strategic equity method investments. We do not believe the additional disclosures in 50-4 provide a sufficient incremental benefit over the cost they would impose, and recommend deleting them. As such, paragraphs 50-3 and 50-5 would apply to both public and private entities for all disposals that do not qualify as discontinued operations, regardless of size. They would rely on the basic premise that preparers need not apply them to immaterial items. We believe this approach is preferable to introducing the concept of a material component in vaguely-defined terms.

However, if the Board retains paragraph 50-4 for public entities in the final amendments, we recommend clarifying the requirement in the second sentence of sub-paragraph 50-4(c)(2),

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including as it relates to companies that apply the full-cost method of accounting (if applicable in the final amendments as discussed in our response to Question 3). It is unclear what types of assets and liabilities:

- i) would be part of a disposal group (i.e., the entity is disposing of them),
- ii) yet not be part of a material component,
- iii) that nevertheless should be included in disclosures about a material component.

The cross-reference to the example in ASC 205-20-55-93 reflects these amounts as a single item without any further context explaining the basis for including them in the table.

**Question 6: Do you agree that businesses held for sale on acquisition should be excluded from certain disclosure requirements? Why or why not?**

Yes, we agree. However, see our cover letter and response to Question 1 in which we recommend excluding all businesses held for sale at the acquisition date from the definition of a discontinued operation.

**Question 7: Do you agree with the prospective application transition method? Why or why not?**

We agree with prospective application. We do not believe that the benefits of retrospective application will exceed the related costs (considering that adoption of the ED may result in fewer disposals being presented as discontinued operations).

**Question 8: How much time do you think will be needed to prepare for and implement the amendments in this proposed Update?**

We do not envision a significant amount of time will be needed for most entities to prepare for and implement the amendments. However, as we noted in our response to Question 3, oil and gas entities with properties accounted for under the full cost method of accounting may need additional time if the Board intends to require the disclosures for disposals of anything less than the full cost pool.

**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?**

We believe the disclosures applicable to nonpublic entities provide the right level of disclosure for all entities (public and private) as discussed in our response to question 5.

With respect to the disclosures about an entity's continuing involvement with a discontinued operation, we find the objective set forth in ASC 205-20-50-4(d) problematic. Investors routinely negotiate "waterfall" arrangements that convey different returns to each class of investor during different phases of the entity's life cycle, and in liquidation. It would be impractical to determine whether the rights obtained under a waterfall negotiated at the time of disposition

would have been present in prior periods under different conditions. Therefore, we recommend deleting the following language:

This paragraph requires disclosures about an entity's continuing involvement with a discontinued operation after the disposal date. The disclosures are required until the results of operations of the discontinued operation in which an entity retains continuing involvement are no longer presented separately in the statement where net income is reported. An entity shall disclose the following in the notes to financial statements for each discontinued operation in which an entity retains significant continuing involvement after the disposal date:

[sub paragraphs a. - c. omitted]

- d. For a discontinued operation in which an entity retains an equity method investment after the disposal, ~~information that enables users of financial statements to compare the financial performance of the entity from period to period assuming that the entity held the same equity method investment in all periods presented in the statement where net income is reported. The disclosure shall include~~ all of the following until the discontinued operation is no longer reported in the statement where net income is reported:

We agree with providing the four items specified in (d)(1) through (d)(4). They are factual in nature, as opposed to the language we recommend striking that requires a high degree of speculation.