



SAS Quadra 05. Bloco J. CFC
Brasília, Distrito Federal – Brazil
www.cpc.org.br

October 24, 2014

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

RE: Outreach Request: IFRS 5 – Non-current assets held for sale and discontinued operations.

Dear Board Members,

The Comitê de Pronunciamentos Contábeis - CPC (Brazilian Accounting Pronouncements Committee)¹ welcomes the opportunity to respond to the Outreach Request – **IFRS 5: Non-current assets held for sale and discontinued operations.**

We are a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidance for Brazilian companies.

Background of the issue

Issue 1A—Scope issue: Loss of control over non-current assets or disposal groups

In defining the criteria to classify non-current assets as held for sale, paragraphs 6–8 of IFRS 5 refer only to ‘sale’ transactions. Meanwhile, paragraph 5A of IFRS 5 states that IFRS 5 requirements are also applicable to a non-current asset (or disposal group) that is classified as held for ‘distribution to owners’ acting in their capacity as owners (held for distribution to owners).

The issue is whether IFRS 5 applies to the non-current assets that belong to a subsidiary of an entity when the entity is expected to lose control of the subsidiary. Particularly, the submitter asked whether the event of ‘loss of control’ in the following three cases meets the requirements of IFRS 5 for classifying those assets as held for sale or as held for distribution to owners.

¹ The Brazilian Accounting Pronouncements Committee (CPC) is a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidances for Brazilian companies. Our members are nominated by the following entities: ABRASCA (Brazilian Listed Companies Association), APIMEC (National Association of Capital Market Investment Professionals and Analysts), BMFBOVESPA (Brazilian Stock Exchange and Mercantile & Future Exchange), CFC (Federal Accounting Council), FIPECAFI (Financial and Accounting Research Institute Foundation) and IBRACON (Brazilian Institute of Independent Auditors).



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Case 1 – Dilution

Entity A has a 67 per cent interest in Entity B. Before the year-end, Entity B issues new shares which are fully subscribed by a new investor (Entity C). Following the increase in share capital, Entity A retains an interest of 44 per cent in Entity B and voting rights. At the same time, Entities A and C sign an agreement providing new governance rules over Entity B, based on which Entity A is no longer represented in the Entity B's Board and its management.

Entity A considers that its decision not to subscribe to the issuance of new shares is equivalent to a decision of disinvestment in Entity B, such that the investment in Entity B will not be recovered principally 'through the continuing use of the asset' as described in paragraph 6 of IFRS 5.

Case 2 – Call option given to a non-controlling shareholder

At 31 December 20X1, Entity A controls Subsidiary S by owning 75 per cent of its shares. Entity B owns the remaining 25 percent of the shares and has a call option on the shares owned by Entity A. The call option is deep in the money and is exercisable starting from 30 September 20X2. On that basis, Entity B expects to take control over Subsidiary S on 30 September 20X2 and Entity A expects to lose control, cease consolidation of Subsidiary S and account for its investment using the equity method.

Case 3—Modification of the shareholders' agreement

Entity A controls Subsidiary S on the basis of an agreement with the other three shareholders. The agreement gives Entity A the right to have nine out of the twelve members of the Board of Directors. In November 20X1, Entity A and the other shareholders decided not to renew the agreement ending in July 20X2. On that basis, Entity A will lose control in July 20X2.

Issue 1B—Scope issue: Disposal groups consisting mainly of financial instruments

Paragraph 4 of IFRS 5 states that the disposal group may include any assets and any liabilities. On the other hand, paragraph 5 of IFRS 5 states that financial assets are scoped out for measurement purposes.

The issue is whether IFRS 5 applies to an entity for which disposal groups mainly, or fully, consist of financial instruments. In particular, the submitter raised this issue in relation to a circumstance where a fair value of the disposal group is less than the carrying amount of it. The submitter notes that applying the requirement in paragraph 5 of IFRS 5 would imply that the (impairment) loss is recognised only when the sale effectively occurs because an impairment loss is allocated only to non-current assets of the disposal group, and this conflicts with the measurement principles set out in IFRS 5 for disposal groups that require measurement at fair value less cost to sell at the date of classification of a 'disposal group'.



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Issue 2—Definition of a major line of business

Paragraph 32 of IFRS 5 refers to the notion of ‘a separate line of business or geographical area of operations’ when providing the criteria for meeting the definition of a ‘discontinued operation’.

The submitter notes that IFRS 5 does not define what should be considered as a ‘separate major line of business’. Consequently, the interpretation of ‘separate major line of business’ varies depending on cases. The submitter asks whether entities in the following three cases appropriately applied paragraph 32 of IFRS 5.

Case 1—disposal groups in the same operating segment

An entity disposed of three subsidiaries from the same operating segment. The entity treated these subsidiaries as being a “major lines of business” according to paragraph 32 of IFRS 5 and classified them as “discontinued operations” in accordance with IFRS 5. It therefore treated the three subsidiaries as one disposal group and disclosed a single line item for the losses made by the subsidiaries over the period.

Case 2—disposal groups in different operating segments

An entity disposed of several subsidiaries, which include: (1) a subsidiary in Country A; (2) a subsidiary in Country B; and (3) several subsidiaries in Country C.

In accordance with IFRS 8 Operating Segments, the entity classifies Countries A and C’s subsidiaries separately as operating segments, while the subsidiary in Country B is included in another operating segment. The entity considered that only Countries A and C’s subsidiaries qualify as ‘major lines of business’ according to paragraph 32 of IFRS 5 and disclosed separately the result from these subsidiaries.

Case 3—consideration of the size of unit

An entity disposed of one subsidiary that had been previously disclosed as a separate operating segment. In considering the requirements of paragraph 32 of IFRS 5, the entity assessed the impact of the disposal on its results and also that the group continues to operate other businesses in that geographical region and the same type of business in other different geographical regions.

The entity also took into account paragraph BC69 of IFRS 5 which makes reference to the fact that in reaching its conclusions on this issue, the IASB concluded that the application of the definition of a discontinued operation in SFAS 144 would give rise to the classification of units that were too small, thus indicating that only operations which were of a significant magnitude were intended to constitute a ‘major’ operation. Consequently, the entity did not disclose the subsidiary as a ‘major’ line of business or geographical area of operations for IFRS 5 purposes.



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Our Comments

Our jurisdiction is concerned that the absence of certain definitions in IFRS 5, together with the lack of implementation guidance gives a lot of flexibility to entities when classifying and measuring non-current assets held for sale and discontinued operations, and this may impair the comparability and understandability of financial statements.

Paragraph 6 of IFRS 5 states that “an entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally **through a sale transaction** rather than through continuing use.” [emphasis added]. Paragraph 5A of IFRS 5 indicates that IFRS 5 also applies to a non-current asset (or disposal group) that is classified as held for distribution to owners acting in their capacity as owners.

However in Case 1 (“Dilution”) is necessary observe other situations or variables before to considers that its decision to not subscribe to the issuance of new shares is equivalent to a decision of disinvestment in entity B, such that the investment in entity B will not be recovered principally through the continuing use of the asset.

With respect to the Case about (“Disposal Groups”) Paragraph 7 of IFRS 5 provides the criteria to be met before an asset or disposal group is classified as held for sale by defining two elements: availability for immediate sale in its present condition subject only to terms that are usual and customary for sales and that the sale must be highly probable. Paragraph 8 of IFRS 5 provides further guidance on the notion of “highly probable” and the requirements to meet this criterion include the following: the management must be committed to a plan to sell, the asset must be actively marketed for sale at a reasonable price, and an active programme to locate a buyer must exist. It also clarifies that subject to certain exceptions, the sale is expected within one year from the date of classification and actions required to complete the sale indicate that the plan will not be significantly changed or withdrawn.

We note that since there are no definitions, guidance or examples that illustrate what can be understood by “actively marketed for sale at a price that is reasonable in relation to its current fair value”, the notions of “highly probable” and “an active programme to locate a buyer” may lead to different interpretations.

Some comments about Case 3 (“Consideration of the size of unit”):

- Paragraph 8A of IFRS 5 states that, “an entity that is committed to a sale plan involving loss of control of a subsidiary shall classify all the assets and liabilities of that subsidiary as held for sale when the criteria set out in paragraphs 6–8 are met, regardless of whether the entity will retain a non-controlling interest in its former subsidiary after the sale.”
- Paragraph 15 of IFRS 5 defines the measurement basis for assets classified as held for sale by stating that, “an entity shall measure a non-current asset (or



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disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.”

However, it is not clear if the measurement basis defined should be applied to all assets and liabilities regardless of whether the entity retains a non-controlling interest and whether the entity shall measure its non-controlling interest taking into account a control premium in transactions when there is a loss of control. It is also not clear if an entity can apply different measurement techniques for the parts disposed and retained.

If you have any questions about our comments, please contact us at operacoes@cpc.org.br.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Idésio da Silva Coelho Júnior'.

Idésio da Silva Coelho Júnior
Chair of International Affairs
Comitê de Pronunciamentos Contábeis (CPC)