IFRS 5 Non-current assets held for sale and Discontinued operations - a closer look

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IFRS 5
Non-current Assets
Held for Sale and
Discontinued Operations
- A Closer Look

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The International Financial Reporting Standard 5 (IFRS 5) was issued as one of the outputs of a short-term project being undertaken by the International Accounting Standards Board (IASB) and the United States Financial Accounting Standards Board (FASB). In September 2002, the project was added to the IASB agenda. On 24 July 2003, the IASB issued the Exposure Draft ED 4 *Disposal of Non-current Assets and Presentation of Discontinued Operations*. Then on 31 March 2004 the IASB published IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

IFRS 5 arises from the IASB's consideration of the FASB's Statement of Financial Accounting Standards No. 144 (SFAS 144) *Accounting for the Impairment or Disposal of Long-Lived Assets* with the objective of reducing differences between IFRS and US Generally Accepted Accounting Principles (GAAP) that are capable of resolution in a relatively short time. IFRS 5 achieves substantial convergence with the requirements of SFAS 144 with respect to the timing of the classification of operations as discontinued operations and the presentation of such operations. With respect to long-lived assets that are not being disposed of, the impairment recognition and measurement standards in SFAS 144 are significantly different from those in IAS 36 *Impairment of Assets*. However those differences have not been addressed in the short-term convergence project.

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Objective

The objective of IFRS 5 is to specify the accounting requirements for non-current assets that are held for sale, and the presentation and disclosure of discontinued operations. IFRS 5 supersedes IAS 35 *Discontinuing Operations*.

In particular, the objectives of IFRS 5 are to specify that:
(a) assets that meet the criteria to be classified as held for sale to be measured at the lower of carrying amount and fair value less costs to sell, and depreciation on such assets to cease; and
(b) assets that meet the criteria to be classified as held for sale, and the assets and liabilities included within a disposal group classified as held for sale to be presented separately as a single amount either on the face of the income statement or in the notes, and the results of discontinued operations to be presented separately in the income statement.

Scope

IFRS 5:

(a) establishes a classification for non-current assets 'held for sale' using the defined terms set out in Appendix A to the IFRS 5 and the same criteria as those contained in SFAS 144.

(b) introduces the concept of a ‘disposal group’, being a group of assets, which an entity intends to be disposed of, by sale or otherwise, together as a group in a single transaction, and some liabilities directly associated with those assets that will be transferred in the transaction.

(c) classifies an operation as discontinued at the date the operation meets the criteria to be classified as held for sale or when the entity has disposed of the operation

d) requires assets or disposal groups that are classified as held for sale to be measured at the lower of carrying amount and the fair value less costs of sale;

d) specifies that assets classified as held for sale, or included within disposal groups classified as held for sale, should not be depreciated;

e) specifies that assets classified as held for sale, and the assets and liabilities included within disposal groups classified as held for sale, should be presented separately on the face of the balance sheet;

g) requires the results of discontinued operations to be presented separately on the face of the income statement; and

h) prohibits the retrospective classification of an operation as discontinued, when the classification criteria are not met until after the balance sheet date.

The measurement provisions of IFRS 5 apply to all non-current assets and disposal groups, except for:

∗ deferred tax assets (IAS 12 *Income Taxes*);

∗ assets arising from employee benefits (IAS 19 *Employee Benefits*);

∗ financial assets within the scope of IAS 39 *Financial Instruments: Recognition and Measurement*;

∗ non-current assets that are accounted for in accordance with the fair value model in IAS 40 *Investment Property*;

∗ non-current assets that are measured at fair value less estimated point-of-sale costs in accordance with IAS 41 *Agriculture*; and

∗ contractual rights under insurance contracts as defined in IFRS 4 *Insurance Contracts*.

Assets held for sale

An entity classifies a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered mainly through a sale transaction rather than through continuing usage. That is, the asset (or disposal group) is available for immediate sale in its present condition and its sale is highly probable. Sale should be expected within one year. The classification also applies to disposal groups, which are a group of assets and possibly some liabilities which an entity intends to dispose of in a single transaction.

For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active programme to locate a buyer and complete the plan must have been initiated. Further, the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification, except as permitted by paragraph 9, and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

A component of an entity comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. In other words, a component of an entity will have been a cash-generating unit or a group of cash-generating units while being held for use.

An entity shall not classify as held for sale a non-current asset (or disposal group) that is to be abandoned. This is because its carrying amount will be recovered principally through continuing use.

Held for sale classification

The conditions for a non-current asset or disposal group to be classified as held for sale are as follows:

- the management must be committed to a plan to selling the assets
- an active programme to locate a buyer must be initiated

- the assets must be available for immediate sale in their present condition and its sale must be highly probable
- the asset must be currently marketed actively at a sale price that is reasonable in relation to its current fair value
- the sale should be completed, or expected to be so, within a year from the date of the classification as held for sale (subject to limited exceptions), and
- the actions required to complete the planned sale will have been made, and it is unlikely that the plan will be significantly changed or withdrawn.

The assets need to be disposed of through sale. Therefore, operations that are expected to be wound down or abandoned would not meet the definition (but may be classified as discontinued once abandoned). It is possible that the sale may not be completed within one year, but the delay effectively must be caused by events beyond the entity's control and the entity must still be committed to selling the asset.

A non-current asset (or disposal group) should be re-measured in accordance with the applicable IFRS immediately before it is reclassified as held for sale. Gains and losses on re-measurement are recognised in accordance with the relevant standard.

Non-current assets or disposal groups that are classified as held for sale should not be depreciated.

Subsidiaries Held for Disposal

IFRS 5 applies to accounting for an investment in a subsidiary for which control is intended to be temporary because the subsidiary was acquired and is held exclusively with a view to its subsequent disposal in the near future. For such a subsidiary, if it is highly probable that the sale will be completed within 12 months then the parent should account for its investment in the subsidiary under IFRS 5 as an asset held for sale, rather than consolidate it under IAS 27 *Consolidated and Separate Financial Statements*.

However, IAS 27 still requires that if a subsidiary that had previously been consolidated is now being held for sale, the parent must continue to consolidate such a subsidiary until it is actually disposed of. It is not excluded from consolidation and reported as an asset held for sale under IFRS 5.

Measurement of non-current assets which are held for sale

The following principles apply:

At the time of classification as held for sale. Immediately before the initial classification of a non-current asset (disposal group) as held for sale, the carrying amount of the asset will be measured in accordance with applicable IFRSs. Resulting adjustments are also recognised in accordance with applicable IFRSs.

After classification as held for sale. When a non-current asset (or disposal group) are classified as held for sale, they are measured at the lower of the carrying amount and fair value less cost to sell. If the sale is expected to occur in over a year's time, the entity should measure the cost to sell at its present value, and any increase due to the unwinding of the discount is charged to profit or loss.

Impairment. Impairment must be considered both at the time of classification as held for sale and subsequently:

> **At the time of classification as held for sale.** Immediately prior to classifying an asset (or disposal group) as held for sale, measure and recognise impairment in accordance with the applicable IFRSs (generally IAS 16 *Property, Plant and Equipment*, IAS 36, IAS 38 *Intangible Assets*, and IAS 39). Any impairment loss on write-down of the asset (or disposal group) to fair value less costs to sell is recognised in profit or loss unless the asset had been measured at revalued amount under IAS 16 or IAS 38, in which case the impairment is treated as a revaluation decrease. Any gain on subsequent increase in fair value less costs to sell is also recognised in profit or loss, but not in excess of the cumulative impairment loss already recognised on the asset either in accordance with IFRS 5 or IAS 36.
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> **After classification as held for sale.** Calculate any impairment loss based on the difference between the adjusted carrying amounts of the asset/disposal group and fair value less costs to sell. Any impairment loss that arises by using the measurement principles in IFRS 5 must be recognised in profit or loss, even for assets previously carried at revalued amounts.

Assets carried at fair value prior to initial classification. For such assets, the requirement to deduct costs to sell from fair value will result in an immediate charge to profit or loss.

Subsequent increases in fair value. A gain for any subsequent increase in fair value less costs to sell of an asset can be recognised in the profit or loss to the extent that it is not in excess of the cumulative impairment loss that has been recognised in accordance with IFRS 5 or previously in accordance with IAS 36.

Disclosure – non-current assets held for sale

The key disclosure requirements include:

Non-current assets classified as held for sale and the assets of a disposal group classified as held for sale must be disclosed separately from other assets in the balance sheet.

The liabilities of a disposal group classified as held for sale must also be disclosed separately from other liabilities in the balance sheet.

Analysis of the major classes of assets and liabilities that is classified as held for sale must be disclosed on the face of the balance sheet or in the notes.

Gain or loss arising on reclassification or subsequent measurement of a non-current asset classified as held for sale.

There are also several other additional discloses required, including a description of the non-current assets of a disposal group classified as held for sale and the reason for reclassification, a description of the facts and circumstances surrounding the sale, and the expected manner and timing of that disposal.

Definition of a Discontinued Operation

The definition of a discontinued operation is very much the same as the definition of a discontinuing operation in IAS 35. IFRS 5 states that a discontinued operation is considered as a component of an entity that either has been disposed of or is classified as held for sale, and
* represents a separate major line of business or geographical area of operations,
* is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations, or
* is a subsidiary acquired exclusively with a view to resale.

It may be a subsidiary, or a major line of business or geographical area. It will have been a cash-generating unit (or group of cash-generating units) as defined in IAS 36.

An operation should be classified as discontinued at the earlier of the date that the operation has been disposed of and the date that it meets the criteria to be classified as held for sale.

Disclosures - Discontinued Operation

In addition to the income statement and cash flow statement presentations noted above, the following disclosures are required:

* Adjustments made in the current period to amounts disclosed as a discontinued operation in prior periods must be separately disclosed.

* If an entity ceases to classify a component as held for sale, the results of that component previously presented in discontinued operations must be reclassified and included in income from continuing operations for all periods presented.

The additional disclosure requirements of discontinued operations include:
* analysis of the post-tax profit or loss into revenue, expenses, pre-tax profit or loss, and the related income tax expense;
* the gain or loss recognised on re-measurement to fair value less costs to sell or on disposal, and the related income tax expense;
* net cash flows attributable to operating, investing and financing activities;

∗ assets held for sale separately from all other assets; and
∗ liabilities of a disposal group held for sale separately from all other liabilities.

Presentation - Discontinued Operation

Income statement presentation. The total of the post-tax profit or loss of the discontinued operation, and the post-tax gain or loss recognised on the measurement to fair value less cost to sell or fair value adjustments on the disposal of the assets (or disposal group) should be presented as a single amount on the face of the income statement. Detailed disclosure of revenue, expenses, pre-tax profit or loss, and the related income tax expense is required either in the notes or on the face of the income statement. If this information is presented on the face of the income statement, then the information should be separately disclosed from that of continuing operations. Such detailed disclosures must cover both the current and all prior periods presented in the financial statements.

Cash flow statement presentation. As regards the presentation in the cash flow statement, the net cash flows attributable to the operating, investing and financing activities of the discontinued operation should be separately shown on the face of the cash flow statement or disclosed in the notes.

No retroactive classification. Retroactive classification as a discontinued operation where the discontinued criteria are met after the balance sheet date is prohibited by IFRS 5.

Key Changes from IAS 35

While IFRS 5 supersedes IAS 35, the actual amendments are limited to:
* The introduction of the term "a component of an entity", which is defined as a cash generating unit or a group of cash generating units;
* A change in the timing of the classification of an operation as discontinued. IAS 35 classified an operation as discontinuing at the earlier of (i) the entity entering into a binding sales agreement and (ii) the board of directors approving and announcing a formal disposal plan. Under the new standard, an operation shall be classified as discontinued at the date the operation meets the criteria to be classified as held for sale or when the entity has actually disposed of the operation;
* A requirement to show the results of discontinued operations separately on the face of the income statement, which is optional under IAS 35;
* A prohibition of retroactive classification of an operation as discontinued when the criteria for that classification are not met until after the balance sheet date but before the financial statements are authorised for issuance.

Effective Date and Transition

IFRS 5 is applicable prospectively for annual periods beginning on or after 1 January 2005, with earlier application encouraged provided the valuations and other information needed to apply the standard were obtained at the time that the IFRS 5 criteria were originally met. In terms of IFRS 1, a first time adopter shall apply IFRS 5 retrospectively unless transition date is prior to 1 January 2005 in which case the transitional provisions apply.

Comparison with UK GAAP

Under both FRS 3 *Reporting Financial Performance* and IFRS 5, the activities that are ending must be significant to be classed as discontinued operations. FRS 3 requires that they must have a material effect on the nature and focus of the reporting entity's operations and a material reduction in its operating facilities, whereas IFRS 5 states that the activities must represent a separate, major line of business or geographical area of operations.

The classification criteria for a discontinued operation under IFRS 5 precludes recognising an operation as discontinued where those criteria were not met at the balance sheet date. The criteria, which are the same as those for recognising any other asset as held for sale, include:

1 a) the asset or disposal group is available for immediate sale;

2 b) an active plan, supported by management, should be in place, and active steps being taken to find a buyer and conclude the sale;

3 c) the asset (or disposal group) should be marketed for sale at a price that is reasonable relative to its fair value, and the sale is expected to be concluded within one year at that price, although a period of more than one year does not preclude carrying the asset as available for sale provided that the events that cause the extension are outside the entity's control; and

4 d) if changes in circumstances mean that the classification criteria are no longer met, the entity should immediately cease to classify the asset (or disposal group) as available for sale.

Under FRS 3 operations could be recognised as discontinued if the sale or termination had been completed after the balance sheet date, but no later than three months of the balance sheet date or the date on which the financial statements were approved, whichever was the earlier. This need not be the case under IFRS 5, where the sale needs to be completed normally within one year of the asset or disposal group becoming available for resale.

FRS 3 requires full information to be given about discontinued operations (for example, turnover, costs of sales and net operating expenses) in the profit and loss account. IFRS 5 requires only the profit from discontinued operations to be shown on the face of the income statement (after profit from continuing operations), with appropriate analysis given in the notes.

There are no specific requirements in UK GAAP (FRS 15 *Tangible fixed assets*, for example) to disclose separately on the balance sheet assets held for sale, although some argue that they should be disclosed as a separate category within fixed assets. Others consider that assets no longer held for use should be reclassified as current assets or as current asset investments. If the former, the asset will be carried at the lower of cost or net realisable and if the latter, can be carried at valuation.

IFRS 5 requires the assets and liabilities to be disclosed separately: as additional lines after sub-totals of other current assets and current liabilities. Additionally, if any amounts relating to the assets have been taken direct to equity, then a separate line needs to be shown in the equity section of the balance sheet disclosing that amount.

Other key points

Entities often acquire non-current assets exclusively with a view to disposal. Such a non-current asset will be classified as held for sale at the date of the acquisition only if it is anticipated that it will be sold within the one-year period, and it is highly probable that the held for sale criteria will be met within a short period (normally three months) of the acquisition date. If the criteria for classifying a non-current asset as held for sale occur after the balance sheet date, then the non-current asset should not be shown as held for sale but disclosure of the fact should be made.

If an entity is winding up operations or 'abandoning' assets, then these assets do not meet the definition of held for sale. However, a disposal group that is to be abandoned may meet the definition of a discontinued activity. Abandonment means that the non-current asset has been used to the end of its economic life or the disposal group will be closed rather than sold. If the asset is temporarily not being used, it is not deemed to be abandoned.

Change of plans

If criteria for an asset to be classified as held for sale are no longer met, then the asset or disposal group ceases to be held for sale. In this case, it should be valued at the lower of the carrying amount before the asset or disposal group was classified as held for sale (as adjusted for any subsequent depreciation, amortisation or re-valuation), and its recoverable amount at the date of the decision not to sell. Any adjustment to the value should be shown in income from continuing operations for the period.

Conclusion

This IASB/FASB convergence initiative leads to high quality accounting solutions in accounting for assets held for sale, the timing of the recognition of discontinued operations and the presentation of those operations.

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