IFRS 5 – Non-current Assets Held for Sale and Discontinued Operations

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This article is designed to clarify and illustrate the requirements of IFRS 5 in so far as they are examinable on the P1 Corporate Reporting paper. It will also be of interest to students of P2 Advanced Corporate Reporting.

Introduction:
There are two distinct parts to this IFRS. Both are related and can occur together, but each can also occur independently of the other.

"Non-current assets held for sale" deals with the situation where an entity decides that a non-current asset (which by definition is held for continuing use in the business) is no longer to be held for continuing use. Rather it is to be sold. As this is an intention rather than an observable fact, strict controls are laid down by IFRS 5 to regulate when an asset is considered to be "held for sale" and also its accounting treatment.

"Discontinued operations" arise when an entity decides to discontinue a part of its business. This part of IFRS 5 is concerned with separate disclosure of the results of operations deemed to be discontinued.

It is possible to have a discontinued operation which has no assets held for sale. Similarly it is possible to have assets held for sale without discontinuing an operation. They can also occur together.

Non-current assets held for sale:
Recognition
The core principle is that a non-current assets is deemed to be held for sale if its carrying value is expected to be recovered through selling it rather than using it. Making this judgment has two important accounting implications:

1. It is carried within current assets in the statement of financial position; and
2. It is not depreciated from the date of reclassification.

In order to make this judgment, the asset must meet two strict conditions:

1. It is available for immediate sale in its present condition at the date classification to "held for sale" is made (this means the asset cannot be in use); and
2. The sale must be highly probable.

The first of these is a fact, whereas the second is an opinion. IFRS 5 offers guidance on when this opinion is likely to be justified. According to IFRS 5, a sale is considered to be highly probable when all the following are met:

1. Management are committed to the plan to sell the asset;
2. An active programme to locate a buyer and complete the plan must have been initiated;
3. The asset must be actively marketed at a reasonable price;
4. It is expected that the sale will qualify for recognition as a completed sale within one year from the date of classification; and
5. It is unlikely that significant changes will be made to the plan, or that the asset will be withdrawn from sale.

Measurement

Once the decision has been made to classify an asset as "held for sale" in accordance with the above conditions, the question of measurement arises. At what value will we carry the asset within current assets? IFRS 5 requires the following procedure:

1. Before transfer to "held for sale", remeasure the asset if the policy of the entity is to do so. For example, if the asset is land, and the policy of the entity is to carry land under the fair value model if IAS 16, then revalue the land as at the date of transfer. And gain or loss is dealt with under IAS 16. If the entity applies the cost model of IAS 16, no revaluation will take place.
2. The transfer to current assets (held for sale) then takes place at the LOWER OF:
   a. The value arrived at in step 1; and
   b. The "fair value less costs to sell".

   Note that the revaluation amount (in step 1, if applied) will usually be fair value. "Fair value less costs to sell" is usually a lower amount. Any difference is taken to the Statement of Profit or Loss and Other Comprehensive Income.
3. The "fair value less costs to sell" is constantly reviewed, and the asset is kept at a value equal to the lower of that value or its original carrying value prior to recognition in current assets.
4. Depreciation is not charged as long as the asset is carried within current assets. This is because it is not being used (by definition). Any reduction in value should be captured by the revised "fair value less costs to sell".

Example 1: Building held for sale

Pinch plc owns a building which it has used for many years as a factory. On 1 January 2012 the building had a carrying value of €15m with an estimated useful economic life of 15 years. Pinch uses the cost model under IAS 16 to account for buildings. On 1 April 2012 Pinch plc commenced operations in a new building, and the old one was placed on the market as it was no longer being used. The estimated proceeds of sale were €13 million, less selling costs of €0.2 million. It was seen as highly probable at that date that the building would sell at that price. By year end, 31 December 2012, the building remained unsold, so Pinch plc reduced the asking price to €11m. The estimate of selling costs remained the same. The directors of Pinch plc believed at that date it was highly probable the sale would occur within 12 months at the lower price.

Required: Explain how the old building should be treated in the books of Pinch plc for year ended 31 December 2012.

Solution

The building qualifies for transfer to "held for sale" on 1 April 2012 as the two conditions were met at that date:

1. It was available for immediate sale in its present condition at the date classification to "held for sale" is made; and
2. The sale was considered highly probable.

The carrying value on 1 April 2012 was €15 million less 3 month's depreciation (15m * 1/15 * 3/12) of €0.25 million. Therefore the carrying value was €14.75 million. Always assume depreciation is calculated on a time-apportioned basis unless otherwise instructed.

The "fair value less costs to sell" on 1 April 2012 was €12.8 million (13m – 0.2m).
Therefore the initial value to be assigned to the non-current asset held for sale is €12.8 million (lower of (1) carrying value at date of transfer and (2) "fair value less costs to sell"). The loss in value of €1.95 million (14.75m – 12.8m) is taken to profit or loss for the year.

No depreciation is charged from 1 April 2012.

At 31 December 2012, the next reporting date, the asset has not been sold. The applicability of the conditions is reviewed, and the fair value less costs to sell is also reviewed. Based on the failure to sell the asset, the price was reduced. The conditions are still met in that:

1. It is still available for immediate sale in its present condition; and
2. The sale is still considered highly probable.

Therefore the classification continues to be “held for sale”, but the asset’s carrying amount is reduced to the revised “fair value less costs to sell” of €10.8 million (11m – 0.2m). The further reduction in value of €2 million (12.8m – 10.8m) is taken to profit or loss for year ended 31 December 2012.

Discontinued Operations:
Definition
A discontinued operation is 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.

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.

To be classified as discontinued, a significant separate part of the entity’s business must have been completely discontinued, OR qualify for classification as “held for sale” under IFRS 5 rules above.

For example, if a retailer had 25 stores in Ireland and 10 in the UK, and decided to close 5 underperforming stores, this would NOT qualify as a discontinued operation, as it has not ceased a separate line of business. If, however, it decided to close the 10 stores in the UK, this would be considered a discontinued operation, as it is exiting a geographical area of operations.

Presentation
The profit or loss for the year on discontinued operations is presented as a separate line in the statement of profit or loss and other comprehensive income after the figure “profit for the year”. The line items from “Revenue” to “profit for the year” should therefore include continuing operations only.

The figure for discontinued operations should include the post tax gain or loss on disposal of the assets of the operation (if sold) or the gain or loss on remeasurement following transfer to “held for sale” (if relevant). If no assets are sold or to be sold this will not be relevant.

The breakdown of the profit or loss from discontinued operations (into revenue, expenses, tax etc.) may be provided in a note to the financial statements or on the face of the performance statement.

Example: Discontinued operation

Hatter plc has decided to dispose of a major division of its business. The related assets qualify to be classified as "held for sale" in the statement of financial position. The following summary draft statement of profit or loss and other comprehensive income has been prepared.

Hatter plc: Statement of Profit or Loss and Other Comprehensive Income for year ended 31 December 2012

	€m
Revenue	800
Cost of sales & expenses	(560)
Profit before tax	240
Tax	(115)
Profit after tax	125

The division being disposed of was a component of Hatter plc, and was a major line of business which is now ceasing permanently and in its entirety. The division contributed revenue of €200m, costs of €275m and a tax refund of €15m in the year ended 31 December 2012 (net loss 60). These amounts are included in the above figures. The assets to be sold have a combined fair value less costs to sell of €39m below their carrying value. This has not yet been recognised.

Required: Redraft the above SPLOCI to comply with IFRS 5.

Solution:

Hatter plc: Statement of Profit or Loss and Other Comprehensive Income for year ended 31 December 2012

	€m
Continuing operations:	
Revenue (800 – 200)	600
Cost of sales & expenses (560 – 275)	(285)
Profit before tax	315
Tax (115 + 15)	(130)
Profit for the period from continuing operations	185
Discontinued operations:	
Loss for the period from discontinued operations (60 + 39)	(99)
Profit for the period	86