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

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

SCOPE AND KEY DEFINITIONS

IFRS Standard 5 Non-current Assets Held for Sale and Discontinued Operations should be used by the entities to account for non-current assets, disposal groups and components of the entity that are held for sale or disposal, and to disclose any discontinued operations.

IFRS 5 does not apply to assets that are covered by IAS Standard 12 Income Taxes, IAS Standard 19 Employee Benefits, IFRS Standard 9 Financial Instruments, IAS Standard 40 Investment property, IAS Standard 41 Agriculture, or IFRS Standard 4 Insurance Contracts.

To understand this standard correctly, we must know some basic definitions (IFRS5.Appendix A):

- component of an entity - operations and cash flows that can be clearly distinguished from the rest of the entity; a component of the entity may be a major line of business or geographical area, or a subsidiary acquired exclusively with a view to resale;
- discontinued operation - 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, is part of a single co-ordinated plan to dispose of a separate major line of business, or is a subsidiary acquired exclusively with a view to resale.
- disposal group - a group of assets and liabilities directly associated with those assets that the entity intends to dispose of in a single transaction; the disposal group may be a group of cash-generating units, a single cash-generating unit, or part of a cash-generating unit.

RECOGNITION AND MEASUREMENT

An entity will 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 (IFRS5.6).

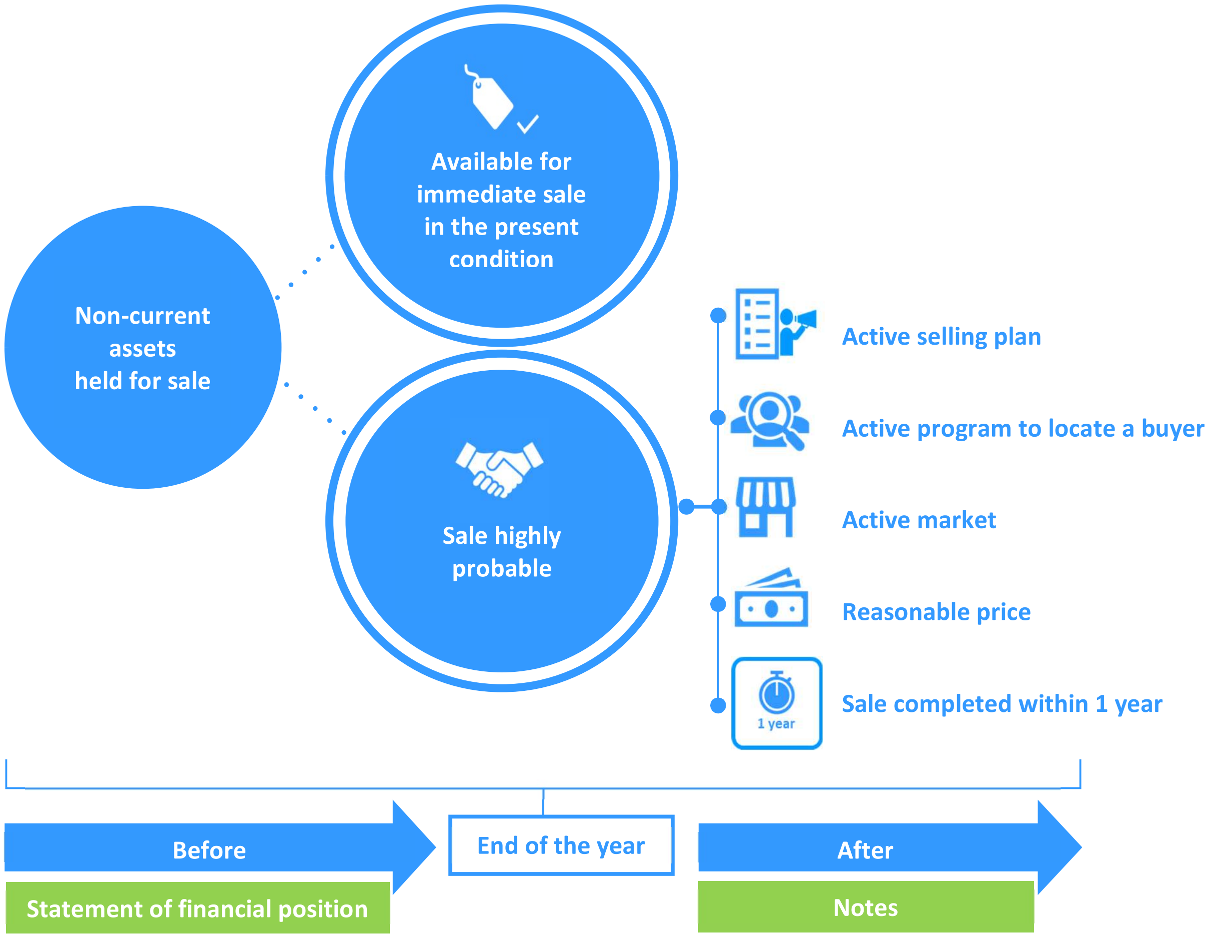
Two main conditions should be met to classify an item as held for sale:

1. the asset (or disposal group) should be available for immediate sale in its present condition;
2. the sale must be highly probable.

The asset should be traded on an active market and a reasonable price should be established (see Figure 1). Exchanges of non-current assets for other non-current assets are also permitted. Steps should be taken by management to identify a possible buyer and the selling plan should be completed within one year from the date of classification.

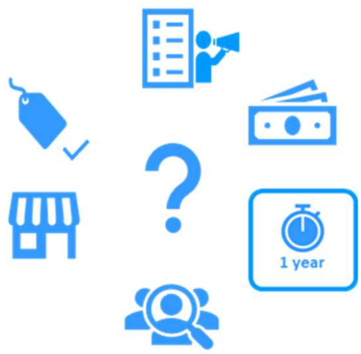
Under certain circumstances, the period to complete the sale can be extended as the delay can be determined by factors that are beyond the entity’s control. Such external factors can be related to the market or certain regulatory conditions. If the entity remains committed to its initial plan, no changes in classification are needed.

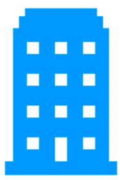
Figure 1. Criteria for classification as held for sale



If the criteria are met after the reporting period, the entity is not allowed to classify a non-current asset or disposal group as held for sale in its financial statements. However, it can disclose its commitment to dispose of it in the notes to the financial statements.

For example, let us suppose that an entity operating in the automotive industry is committed to sell two of its buildings and has initiated actions to locate a buyer by advertising the disposal in a local newspaper.





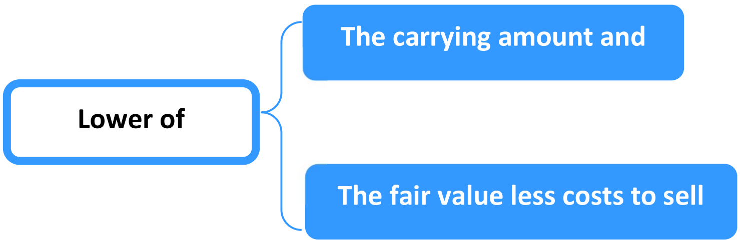
The first building is used by the administrative department and it will be vacated and transferred to a potential buyer after the settlement of

The second building is used by the production department and it will only be vacated after the end of the production cycle in progress.

Are these assets classified as held for sale? The answer is yes only for the building that is used by the administrative department. Notice that the time to vacate the building is usual and customary for similar transactions but it is abnormal for the one that is used by the production department.

A non-current asset (or disposal group) that is held for sale will be measured at the lower of its carrying amount and fair value less costs to sell (IFRS5.15) (see Figure 2).

Figure 2. Measurement of non-current assets (or disposal group) held for sale



The carrying amount should be determined before the initial classification as held for sale, by using the applicable IFRS Standards for non-current assets (or liabilities that are included in a disposal group). When the fair value less costs to sell is lower than the carrying amount, an impairment loss should be recognised (IFRS5.20).

For example, let us suppose that an entity plans to sell a vehicle for which it applies the cost model under IAS 16 Property, Plant and Equipment. At the date of the reclassification as held for sale, the carrying amount of the vehicle is CU100,000, its fair value is CU95,000 and the costs to sell are CU5,000. In this case an impairment loss should be recorded for CU10,000, as the fair value less costs to sell is CU90,000, relative to the carrying amount of CU100,000. Now let's assume that the entity applies the revaluation model. The carrying amount will be the fair value and this should be compared to the fair value less costs to sell. Hence, the impairment loss will be the estimated costs to sell, that is CU5,000.

When the sale is expected to occur beyond one year, the present value of the costs to sell should be computed (IFRS5.17). An increase in the present value of the costs to sell should be reflected in the statement of profit or loss as a financing cost.

An impairment loss recorded for a disposal group should be first allocated to goodwill, until write-off. The remaining loss should be distributed, on a pro rata basis, to the other assets in the group.

Depreciation or amortisation will cease following reclassification as held for sale. However, interest and other expenses attributable to the liabilities of a disposal group classified as held for sale will continue to be recorded.

Notice that a subsequent increase in the fair value can be recorded only to the extent that it does not exceed the impairment loss. A gain or loss not previously recognised by the date of the sale must be recognised at the date of derecognition.

Let's suppose that Alpha purchases some equipment on 1.1.N for CU900, incurring additional transportation and installation costs of CU300. Management intends to use the asset evenly for 10 years, after which the equipment would be sold for CU200. However, management initiates a selling plan and an active program to locate a buyer on 1.10.N+2. On that date, the asset's fair value is CU855, and the costs to sell are estimated to be CU20. However, the asset is not sold until 31.12.N+2, when its fair value less costs to sell is CU820. On 31.12.N+3, the asset was still not sold; its fair value is CU875, and the costs to sell are CU25. What are the applicable accounting policies and the implications on the financial statements at the end of N, N+1, N+2 and N+3?

Solution

As at 1.1.N, the asset is recognized as equipment under IAS 16. It will be depreciated by using the straight-line method (reflective of the even consumption of its benefits) over 10 years. This depreciation pattern continues for N+1.

As at 1.10.N+2, the asset is reclassified as a non-current asset held for sale, under IFRS5. At the same date, the asset's depreciation ceases, and it is measured at the lower of its carrying amount and the fair value less costs to sell. Any possible impairment loss resulting from this measurement is recognized in the respective financial statements.

As at 31.12.N+2 and 31.12.N+3, the asset is still classified as a non-current asset held for sale, under IFRS5, and continues to be measured at the lower of its carrying amount and the fair value less costs to sell, with any possible impairment loss or reversal resulting from this measurement being recognized in the respective financial statements.

What are the implications of all these policies on the Alpha's financial statements prepared for the four years?

Before 1.10.N+2, the asset is depreciated according to the depreciation schedule established by management. Therefore, the annual depreciation is CU100 (the asset's cost is CU900 + CU300 = CU1,200; its residual value is CU200; the resulting depreciable amount is CU1,000; straight-line method on 10 years). This depreciation runs for 2 full years and 9 months, until 1 October N+2. Therefore, depreciation accumulates in the amount of CU275 by that date. This means that the asset's carrying amount as of 1.10.N+2 is CU1,200-CU275=CU925.

As of 1.10.N+2, the entity compares this carrying amount of CU925, to the asset's fair value less costs to sell. That is, with CU835 (CU855-CU20). The difference of CU90 (925-835) is an impairment loss, since the asset's fair value less costs to sell is smaller than its carrying amount. The asset becomes classified as a non-current asset held for sale.

As of 31.12.N+2, the asset is further impaired by CU15. Its carrying amount remains CU925, but the fair value less costs to sell becomes CU820. The total impairment loss recognized as of this date is therefore CU105.

Finally, as of 31.12.N+3, the asset regains some value, as its fair value less costs to sell becomes CU850 (875-25). Therefore, the entity reverses part of the previously recognized impairment loss. This reversal is for CU30, as the asset is measured at the new fair value less costs to sell of CU850.

NON-CURRENT ASSETS (OR DISPOSAL GROUPS) HELD FOR DISTRIBUTION TO OWNERS

The entity can also decide to distribute a non-current asset (or disposal group) to its owners. The above conditions for classification and measurement should also be met, but instead of having a selling plan, the entity should now be committed to a distribution one.

NON-CURRENT ASSETS THAT ARE TO BE ABANDONED

Non-current assets (or disposal groups) that are to be abandoned cannot be classified as held for sale, as their carrying amount will not be recovered through a sale transaction. In other words, the assets will be used to the end of their economic life or closed rather than sold. However, if a component of the entity will be abandoned, the entity should separately disclose the associated results and cash flows.

CHANGES TO A PLAN TO SELL

An entity can decide to reclassify a non-current asset (or disposal group) from being held for sale to being held for distribution to owners (or the other way around). This decision will be considered as a continuation of the initial plan of disposal.

When the criteria for classification as held for sale (or distribution) are no longer met, the non-current asset (disposal group/components of a disposal group) should be measured at the lower of (IFRS5.27):

- the carrying amount before the classification as held for sale, adjusted for any depreciation, amortisation or revaluations that would have been recognised, had the asset not been classified as held for sale, and
- the recoverable amount.

Any required adjustments to the carrying amount will be included in profit or loss from continuing operations.

When a component of the disposal group is removed, the remaining ones will be considered as a group if the criteria for classification as held for sale are still met. Otherwise, the components will be measured individually at the lower of their carrying amounts and fair values less costs to sell at that date (IFRS5.29).

DISCLOSURE

The following information will be separately disclosed on the face of the statement of financial position:

- Non-current assets that are held for sale;
- Assets and liabilities included in a disposal group (the amounts should not be offset);
- Any cumulative income or expense recognised in other comprehensive income.

The statement of comprehensive income should include two distinct sections, for continuing and discontinuing operations, as follows:

- any gain or loss on the remeasurement of a non-current asset (or disposal group) classified as held for sale shall be included in profit or loss from continuing operations, unless the asset was valued before the classification using the revaluation model, in which case the adjustment should be treated as a revaluation increase or decrease in other comprehensive income;
- the revenues, expenses, income tax and result from discontinued operations and the gain or loss recognised on the measurement to fair value less costs to sell of the items constituting the discontinued operation.

The statement of cash flows should separately disclose the net cash flows attributable to the operating, investing, and financing activities of discontinued operations.

The notes to the financial statements should include a description of:

- the non-current asset or the items that are part of the disposal group;
- the facts and circumstances of the sale;
- the expected manner and timing of the sale;
- the gains and losses recorded as a result of a change in the fair value;
- the facts and circumstances of a decision to change the selling plan.

Example

On 1 January 2015, Holden Co. purchased equipment for CU1,000,000. The entity estimated that the asset would be used evenly for a period of ten years, and a residual value of CU20,000. In December 2020, the managers initiated a selling plan. To this end, the entity appointed an agent for CU5,000 to promote the sale and provide assistance in negotiating with potential purchasers. The agent estimated a selling price of CU450,000, based on the current market trends. However, no offer was made by the end of December 2021. The agent advises a CU150,000 decrease in the selling price, as the market conditions deteriorated. Hence, the managers decided to change their plan as they estimated that the asset can generate additional benefits through its use in the production process, in the amount of CU320,000.

Solution

Following the acquisition, Holden Co has recognized a non-current asset for CU1,000,000. The entity estimates that the asset will be used for ten years. As the asset will be consumed evenly over that period, the straight-line method of depreciation should be used. The residual value is the estimated amount that the entity estimates to receive by selling the asset at the end of its useful life. As this value reflects benefits that will be received through a sale transaction and not through consumption, CU20,000 should be subtracted from the cost to compute the asset's depreciation. Consequently, depreciation will be computed as:

$$\textit{Depreciation} = \frac{\textit{cost - residual value}}{\textit{useful life}}$$

$$\textit{Depreciation} = \frac{\text{CU1,000,000 - CU20,000}}{10} = \text{CU98,000}$$

At the end of 2020, the managers decided to sell the asset.

⇨ *Criteria assessment*

The asset is available for sale in its present condition

The managers commited to a selling plan

There is an active program to locate a buyer through a selling agent

There is an active market for the asset

The price is reasonable as it was estimated by the agent

Management are willing to complete the sale within 1 year

The carrying amount at that date should reflect the consumption of the asset for 6 years, as follows:

Carrying amount = cost - accumulated depreciation

Accumulated depreciation from 2015 to 2020: CU98,000 x 6 years = CU588,000

Therefore, the asset's carrying amount is CU412,000.

Notice that the market value of the asset at that date, based on the agent's evaluation, is CU450,000. The costs to sell include the agent's fee of CU5,000. As a result, the fair value of the asset is higher than its carrying amount.

⇨ *Measurement and classification as held for sale*

Carrying amount = CU1,000,000 - 588,000 = CU412,000

Fair value - costs to sell = CU450,000 - 5,000 = CU445,000

lower of

the value of the asset should not be overstated

Property plant and equipment

Non-current assets

Non-current assets held for sale

Current assets

As the criteria are met by the end of 2020, the entity will derecognize the equipment from property, plant and equipment, and it will classify it as held for sale under current assets. The asset will be valued at the lower between the carrying amount and fair value less costs to sell, that is at CU412,000. Depreciation will cease following re-classification.

However, at the end of 2021 the asset is not sold, and we must check if the criteria are still met.

⇨ ***Criteria assessment***

X *The managers are not commited to continue their selling plan*

Since the criteria are not met anymore, the entity should cease classification as held for sale and measure the asset at the lower of its carrying amount before classification as held for sale, adjusted for any depreciation that would have been recognised had the asset not been classified as held for sale, and its recoverable amount. The recoverable amount reflects the higher between the value in use and the fair value less costs to sell, since a rational manager would normally choose the option that will maximise the entity's benefits. In our context, the managers chose to use the equipment rather than to sell it, as the amount that the entity would get from a potential sale is lower than the benefits that the entity can get by using it.

⇨ ***Cessation and reclassification***

Carrying amount = CU412,000 - 98,000 = CU314,000

Fair value - costs to sell = CU300,000 - 5,000 = CU295,000

Value in use = 320,000

Recoverable amount: higher of

a rational manager would choose the option that maximises the entity's benefits

lower of

the value of the asset should not be overstated

Furthermore, as the recoverable amount is higher than its carrying amount, no impairment should be recorded.