Co-funded by the Erasmus+ Programme of the European Union

PASSFR.EU

A Digital Learning Platform for Generation Z: Passport to IFRS®

A Digital Learning Platform for Generation Z: Passport to IFRS®

IFRS® Standard 5 Non-Current Assets Held for Sale And Discontinued Operations

Funded by the Erasmus+ Program of the European Union. However, European Commission and Turkish National Agency cannot be held responsible for any use which may be made of the information contained therein.

CASE STUDY - IFRS 5 NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

Introduction

Entities sometimes decide to discontinue (part of) their operations and to sell some of their non-current assets. This decision influences how and the extent to which entities generate future cash flows. This decision must be appropriately reflected in the financial statements of the entity. Particularly, it is important to understand how the non-current assets held for sale are measured and presented in the financial statements.

Aim of this case study is to discuss and evaluate the consequences on the financial statements of a decision to hold for sale some non-current assets. You are an accountant with Choco Biscuit Ltd., and you are required to assess these consequences for some of the assets of the entity.

The Case Information

Choco Biscuit Ltd. is a small, family-owned entity, producing gourmet cookies. The sales of the entity steadily increased over the last few years, but the demand for gourmet cookies began to decrease at the beginning of the year 20X3, given the deterioration of the general economic context. Management thus considers downsizing the activity and selling some of its non-current assets. This is the case for the production lines PLX07 and PLX09 employed to produce the gourmet cookies with white and black chocolate ganache fillings. Producing these cookies requires significant internal resources, and clients consider their price as being too high.

The following information is available about the two production lines:

	PLX07	PLX09
Date of acquisition	1 Jan. 20X0	1 July 20X1
Cost of acquisition (CU)	120,000	180,000
Useful life	10 years	10 years
Depreciation	Straight line	Straight line
Fair value on March 1 20X3 (CU)	83,000	142,000
Fair value on July 1 20X3 (CU)	82,500	141,500
Fair value on December 31 20X3 (CU)	82,000	142,000
Estimated cost to sell	3,000	2,000

The management decides on March 1 20X3 to sell the two production lines, and an active programme to locate a buyer is initiated. Production line PLX07 will continue to be used until a buyer is found, but it is available for immediate sale. Production line PLX09 will be used to finalise an existing big order received. This is estimated to take place at the end of June 20X3. The two production lines are not sold until the end of 20X3. While management is still committed to selling the two lines, it is also interested in understanding the consequences on the financial statements if the selling plans are abandoned.

Discussion Questions

1) What are the consequences on the financial statements of the plan to sell the two production lines, compared to their continuous use?
2) What will be the consequences on the financial statements if the plan to sell the two production lines is abandoned?

SOLUTION OF CASE STUDY - IFRS 5 NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

1) The two production lines are treated as property, plant and equipment (IAS 16) as long as they are in continuous use. Therefore, they are measured at cost minus any accumulated depreciation and impairment. They are reclassified as non-current assets held for sale when the conditions for such a classification are met (management has committed to sell the assets, an active search for a buyer has begun, the asset available for sale etc.). At the date when these criteria are met, the assets are measured at the lower of their carrying amount and fair value less costs to sell.

If the assets are classified as held for sale, the consequences for the two production lines are the following:

	PLX07	PLX09
Date of acquisition	Jan. 1 20X0	July 1 20X1
Cost of acquisition (CU)	120,000	180,000
Useful life	10 years	10 years
Depreciation	Straight line	Straight line
Annual depreciation (CU)	120,000/10 = 12,000	180,000/10 = 18,000
Date when criteria to reclassify assets as held for sale are met (when the asset is available for immediate sale)	March 1 20X3	July 1 20X3
Period of continuous use	Jan. 1 20X0 – March 1 20X3	July 1 20X1 – July 1 20X3
Accumulated depreciation (CU)	12,000 * 3 + 12,000 * 2/12 = 38,000	18,000 * 2 = 36,000
Carrying amount at the reclassification date (CU)	120,000 – 38,000 = 82,000	180,000 – 36,000 = 144,000
Fair value less costs to sell at the classification date (CU)	83,000 – 3,000 = 80,000	141,500 – 2,000 = 139,500
Impairment loss recognised upon reclassification (CU)	2,000	4,500
Fair value less costs to sell at the end of 20X3 (CU)	82,000 – 3,000 = 79,000	142,000 – 2,000 = 140,000
Adjustment of the impairment loss at the end of 20X3 (CU)	Additional loss of 1,000 is recognised	Reversal of the impairment loss for 500

The impact on the financial statements of 20X3 is the following:

		PLX07 (in CU)	PLX09 (in CU)
If the asset is classified as held for sale	Statement of financial position	79,000	140,000
	Statement of profit or loss	expense of 5,000 (depreciation of 2,000 and impairment losses of 3,000)	expense of 13,000 (depreciation of 9,000 and impairment of 4,000)
If the asset is used as property, plant and equipment	Statement of financial position	72,000 (82,000 – 10,000 for another 10 months of depreciation)	135,000 (144,000 – 9,000 for another 6 months of depreciation)
	Statement of profit or loss	12,000 (a full year of depreciation)	18,000 (a full year of depreciation)

2) If at the end of the year the management decides to terminate the selling plan and to continue to use the assets, these are reclassified as property, plant and equipment. At the date of reclassification, they should be measured at the lower of carrying amount before the 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 the recoverable amount. The carrying amount is lower than the fair value less costs to sell, therefore this would be the value of the assets (irrespective of the estimated value in use).