



# HM TREASURY

## Financial Reporting Advisory Board Paper

### ***IFRS 5: Non-current assets held for sale and discontinued operations***

<b>Issue:</b>	Applying IFRS <i>Non-current assets held for sale and discontinued operations</i> in the context of resource and other accounts covered by the Government Financial Reporting Manual.
<b>Impact on guidance:</b>	The proposed text in Annex A relates to the shadow FReM.
<b>IAS/IFRS adaptation?</b>	No
<b>IPSAS compliant?</b>	N/A
<b>Interpretation for the public sector context?</b>	Yes: the value in use of a non-cash-generating asset is the present value of the asset's remaining service potential.
<b>Impact on budgetary regime?</b>	No
<b>Alignment with National Accounts</b>	No
<b>Impact on Estimates?</b>	No
<b>Recommendation:</b>	That the Board agree that IFRS 5 applies in full, as interpreted for the public sector context.
<b>Timing:</b>	Not yet known: depends on future decision on date for moving to EU-adopted IFRS.

## **DETAIL**

### ***Background***

1. IFRS 5 *Non-current assets held for sale and discontinued operations* was issued as one of the outputs of a short-term project being undertaken by the IASB and the US Financial Accounting

Standards Board (FASB), aimed at reducing the differences between IFRS and US Statements of Financial Accounting Standards (SFAS). IFRS 5 achieves significant convergence with the requirements of SFAS 144 *Accounting for the impairment or disposal of long-lived assets* in accounting for assets held for sale, the timing of the recognition of discontinued operations and the presentation of those operations.

*The main features of IFRS 5*

2. The introduction to IFRS 5 lists its main features as:

- a) adopting the classification of assets held for sale, using the defined terms set out in Appendix A to the IFRS;
- b) introducing the concept of a disposal group, which is a group of assets that will be disposed of (by sale or otherwise as a group in a single transaction) together with the associated liabilities;
- c) requiring 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) specifying that assets classified as held for sale, or included within disposal groups classified as held for sale, should not be depreciated;
- e) specifying 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;
- f) classifying 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;
- g) requiring the results of discontinued operations to be presented separately on the face of the income statement; and
- h) prohibiting the retrospective classification of an operation as discontinued, when the classification criteria are not met until after the balance sheet date.

3. IFRS 5 does **not** apply to the following assets, which are covered by other standards:

- a) deferred tax assets (IAS 12 *Income taxes*);
- b) assets arising from employee benefits (IAS 19 *Employee benefits*);
- c) financial assets within the scope of IAS 39 *Financial instruments: recognition and measurement*;
- d) non-current assets held at fair value under IAS 40 *Investment properties*;
- e) non-current assets measured at fair value under IAS 41 *Agriculture*; and
- f) contractual rights under insurance contracts as defined in IFRS 4 *Insurance contracts*.

### *Comparison with requirements under UK GAAP*

4. Under both FRS 3 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.

5. 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:

- a) the asset or disposal group is available for immediate sale;
- b) an active plan, supported by management, should be in place, and active steps being taken to find a buyer and conclude the sale;
- 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
- 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.

6. Under UK GAAP (FRS 3 *Reporting Financial Performance*) 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.

7. 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.

8. 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.

9. 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.

### *Impact of IFRS 5 on public sector accounts*

10. Entities covered by the requirements of the FReM might from time to time hold assets classified as held for sale or might have discontinued operations. The activities must cease completely: that is, responsibilities transferred from one part of the public sector to another (such as machinery of government changes) are not discontinued operations.

11. IFRS 5 (paragraph 15) 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 (or net selling price). Under the current FReM, these assets would be carried at expected net selling price. (Assets held for use are carried at value in use, which will be either a valuation based on expected future cash flows or expected service potential.)

12. In theory, therefore, there is a possibility that the move to IFRS 5 requirements could result in a change to the current accounting treatment in the following scenario. Entity A has an asset whose value in use is £1 million. It decides to sell the asset, and classifies it as an asset held for sale at the balance sheet date, with sale being completed a week afterwards. The expected fair value less costs of sale (or net selling price) is £1.1 million. Under the current FReM, the asset would be revalued to £1.1 million with nil profit on disposal – the revaluation would be taken to the revaluation reserve and that reserve adjusted against the general fund on completion of the sale. Under IFRS 5, the asset would be carried at £1 million, and a profit of £0.1 million would be taken on disposal.

13. The Treasury believes that, in practice, assets will be written down to fair value less costs of sale, and that the recognition of profits in the way described in paragraph 12 will be rare. The Treasury proposes, therefore, that IFRS 5 should apply in full, but with the defined terms in Appendix A interpreted in the public sector context. The interpretations have been benchmarked against the *Glossary of defined terms: IPSAS 1 to IPSAS 21* issued by the International Public Sector Accounting Standards Board in January 2005.

### ***Impact on disclosures in resource and other accounts***

14. The presentation and disclosure requirements of IFRS 5 will be taken into account in developing the format of resource and other accounts in the light of the move to EU-adopted IFRS and other initiatives.

### ***IAS/IFRS compliance***

15. The proposals are compliant with IFRS 5.

### ***IPSAS compliance***

16. IPSASB has not yet issued an IPSAS on assets held for sale and discontinued operations and the proposals in Annex A to this paper, other than the interpretations for the public sector context (see paragraph 13) have not, therefore, been benchmarked against international public sector interpretations.

### ***Proposed text for the shadow Government Financial Reporting Manual***

17. See Annex A for the proposed amendments to the shadow FReM.

### ***Impact on the budgetary regime***

18. The proposals are, in practice, unlikely to give rise to changes to the underlying events that give rise to entities holding assets for sale or discontinuing operations, and so the implementation of IFRS 5 will have no impact on the budgetary regime.

### ***Alignment with National Accounts***

19. National Accounts do not recognise profit or loss on disposal. The value of the asset is taken as the realised amount and the transfer of the asset is recorded at that amount.

### ***Impact on Estimates***

20. The proposals are unlikely, in practice, to give rise to changes in current accounting practice and so will have no impact on Estimates.

### ***Summary and recommendation***

21. IFRS 5 deals with accounting for assets held for sale, the timing of the recognition of discontinued operations and the presentation of those operations. In practice, the implementation of IFRS 5 should have little or no effect on the way in which entities covered by the requirements of the FReM account for these transactions under UK GAAP.

22. The Board is invited to approve the proposed text for the shadow FReM at Annex A.

**HM Treasury**

**29 June 2006**

## **PROPOSED TEXT FOR THE SHADOW GOVERNMENT FINANCIAL REPORTING MANUAL**

### **IFRS 5 Non-current assets held for sale and discontinued operations**

#### ***Applicability***

IFRS 5 applies in full, as interpreted.

#### ***Objectives of IFRS 5***

The objectives of IFRS 5 are to specify that

- a) assets held for sale should be measured at the lower of carrying amount and fair value less costs to sell, and for depreciation on those assets to cease; and
- b) assets held for sale should be presented separately, either on the face of the balance sheet or in the notes, and the results of discontinued operations should be presented separately in the income statement.

#### ***Interpretations of IFRS 5 for the public sector context***

The following interpretations of IFRS 5 defined terms apply:

- a) in order to qualify as 'discontinued operations', the activities must cease completely: that is, responsibilities transferred from one part of the public sector to another (such as machinery of government changes) are not discontinued operations
- b) the 'value in use' of a non-cash-generating asset is the present value of the asset's remaining service potential, which can be assumed to be at least equal to the cost of replacing that service potential.