Draft Illustrative Examples

ED 4 DISPOSAL OF NON-CURRENT ASSETS AND PRESENTATION OF DISCONTINUED OPERATIONS

Comments to be received by 24 October 2003

These draft Illustrative Examples accompany the proposed International Financial Reporting Standard (IFRS) set out in ED 4 *Disposal of Non-current Assets and Presentation of Discontinued Operations* (see separate booklet). Comments on the draft IFRS and its accompanying documents should be submitted in writing so as to be received by **24 October 2003**.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence. If commentators respond by fax or email, it would be helpful if they could also send a hard copy of their response by post. Comments should preferably be sent by email to: **CommentLetters@iasb.org.uk** or addressed to:

Anne McGeachin
Project Manager
International Accounting Standards Board
30 Cannon Street, London EC4M 6XH, United Kingdom

Fax: +44 (0)20 7246 6411

ISBN for this part: 1-904230-26-1

ISBN for complete publication (three parts): 1-904230-23-7

Additional copies of this publication may be obtained from:
IASCF Publications Department,
1st Floor, 30 Cannon Street, London EC4M 6XH, United Kingdom.
Tel: +44 (0)20 7332 2730 Fax: +44 (0)20 7332 2749
Email: publications@iasb.org.uk Web: www.iasb.org.uk

Contents

ED 4 Disposal of Non-current Assets and Presentation of Discontinued Operations

[Draft] Illustrative examples

INTERNATIONAL FINANCIAL REPORTING STANDARD IFRS X Disposal of Non-current Assets and Presentation of Discontinued Operations

[Draft] Illustrative examples

These [draft] examples accompany, but are not part of, the [draft] IFRS

Availability for immediate sale (Appendix B, paragraph B1(b))

To qualify for classification as held for sale, a non-current asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) (paragraph B1(b)). A non-current asset (or disposal group) is available for immediate sale if an entity currently has the intent and ability to transfer the asset (or disposal group) to a buyer in its present condition. Examples 1-3 illustrate situations in which the criterion in paragraph B1(b) would or would not be met.

Example 1

An entity is committed to a plan to sell its headquarters building and has initiated actions to locate a buyer.

(a) The entity intends to transfer the building to a buyer after it vacates the building. The time necessary to vacate the building is usual and customary for sales of such assets. The criterion in paragraph B1(b) would be met at the plan commitment date.

(b) The entity will continue to use the building until construction of a new headquarters building is completed. The entity does not intend to transfer the existing building to a buyer until after construction of the new building is completed (and it vacates the existing building). The delay in the timing of the transfer of the existing building imposed by the entity (seller) demonstrates that the building is not available for immediate sale. The criterion in paragraph B1(b) would not be met until construction of the new building is completed, even if a firm purchase commitment for the future transfer of the existing building is obtained earlier.

Example 2

An entity is committed to a plan to sell a manufacturing facility and has initiated actions to locate a buyer. At the plan commitment date, there is a backlog of uncompleted customer orders.

(a) The entity intends to sell the manufacturing facility with its operations. Any uncompleted customer orders at the sale date will transfer to the buyer. The transfer of uncompleted customer orders at the sale date will not affect the timing of the transfer of the facility. The criterion in paragraph B1(b) would be met at the plan commitment date.

(b) The entity intends to sell the manufacturing facility, but without its operations. The entity does not intend to transfer the facility to a buyer until after it ceases all operations of the facility and eliminates the backlog of uncompleted customer orders. The delay in the timing of the transfer of the facility imposed by the entity (seller) demonstrates that the facility is not available for immediate sale. The criterion in paragraph B1(b) would not be met until the operations of the facility cease, even if a firm purchase commitment for the future transfer of the facility were obtained earlier.

Example 3

An entity acquires through foreclosure a property comprising land and buildings that it intends to sell.

(a) The entity does not intend to transfer the property to a buyer until after it completes renovations to increase its sales value. The delay in the timing of the transfer of the property imposed by the entity (seller) demonstrates that the property is not available for immediate sale. The criterion in paragraph B1(b) would not be met until the renovations are completed.

(b) After the renovations are completed and the property is classified as held for sale but before a firm purchase commitment is obtained, the entity becomes aware of environmental damage requiring remediation. The entity still intends to sell the property. However, the entity does not have the ability to transfer the property to a buyer until after the remediation is completed. The delay in the timing of the transfer of the property imposed by others before a firm purchase commitment is obtained demonstrates that the property is not available for immediate sale. The criterion in paragraph B1(b) would not continue to be met. The property would be reclassified as held and used in accordance with paragraph 17.

Completion of sale expected within one year (paragraph B1(d))

Example 4

To qualify for classification as held for sale, the sale of a non-current asset (or disposal group) must be highly probable, and transfer of the asset (or disposal group) must be expected to qualify for recognition as a completed sale within one year (paragraph B1(d)). That criterion would not be met if, for example:

(a) an entity that is a commercial leasing and finance company is holding for sale or lease equipment that has recently ceased to be leased and the ultimate form of a future transaction (sale or lease) has not yet been determined.

(b) an entity is committed to a plan to 'sell' a property that is in use, and the transfer of the property will be accounted for as a sale and finance leaseback.

Exceptions to the criterion in paragraph B1(d)

An exception to the one-year requirement in paragraph B1(d) applies in limited situations in which the period required to complete the sale of a non-current asset (or disposal group) will be (or has been) extended by events or circumstances beyond an entity's control and specified conditions are met (paragraph B2). Examples 5-7 illustrate those situations.

Example 5

An entity in the power generating industry is committed to a plan to sell a disposal group that represents a significant portion of its regulated operations. The sale requires regulatory approval, which could extend the period required to complete the sale beyond one year. Actions necessary to obtain that approval cannot be initiated until after a buyer is known and a firm purchase commitment is obtained. However, a firm purchase commitment is highly probable within one year. In that situation, the conditions in paragraph B2(a) for an exception to the one-year requirement in paragraph B1(d) would be met.

Example 6

An entity is committed to a plan to sell a manufacturing facility in its present condition and classifies the facility as held for sale at that date. After a firm purchase commitment is obtained, the buyer's inspection of the property identifies environmental damage not previously known to exist. The entity is required by the buyer to make good the damage, which will extend the period required to complete the sale beyond one year. However, the entity has initiated actions to make good the damage, and satisfactory rectification of the damage is highly probable. In that situation, the conditions in paragraph B2(b) for an exception to the one-year requirement in paragraph B1(d) would be met.

Example 7

An entity is committed to a plan to sell a non-current asset and classifies the asset as held for sale at that date.

(a) During the initial one-year period, the market conditions that existed at the date the asset was classified initially as held for sale deteriorate and, as a result, the asset is not sold by the end of that period. During that period, the entity actively solicited but did not receive any reasonable offers to purchase the asset and, in response, reduced the price. The asset continues to be actively marketed at a price that is reasonable given the change in market conditions, and the criteria in paragraph B1 are therefore met. In that situation, the conditions in paragraph B2(c) for an exception to the one-year requirement in paragraph B1(d) would be met. At the end of the initial one-year period, the asset would continue to be classified as held for sale.

(b) During the following one-year period, market conditions deteriorate further, and the asset is not sold by the end of that period. The entity believes that the market conditions will improve and has not further reduced the price of the asset. The asset continues to be held for sale, but at a price in excess of its current fair value. In that situation, the absence of a price reduction demonstrates that the asset is not available for immediate sale as required by the criterion in paragraph B1(b). In addition, the criterion in paragraph B1(e) requires that an asset be marketed at a price that is reasonable in relation to its current fair value. Therefore, the conditions in paragraph B2(c) for an exception to the one-year requirement in paragraph B1(d) would not be met. The asset would be reclassified as held and used in accordance with paragraph 17.

Presenting discontinued operations

The results of operations of a component of an entity that either has been disposed of or is classified as held for sale are required to be reported in discontinued operations if (a) the operations and cash flows of the component have been (or will be) eliminated from the ongoing operations of the entity as a result of the disposal transaction and (b) the entity will not have any significant continuing involvement in the operations of the component after the disposal transaction (paragraph 23). Examples 8-11 illustrate disposal activities that do or do not qualify for presenting as discontinued operations.

Example 8

An entity that manufactures and sells consumer products has several product groups, each with different product lines and brands. For that entity, a product group is the lowest level at which the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, each product group is a component of the entity.

The entity has experienced losses associated with certain brands in its beauty care products group.

(a) The entity decides to exit the beauty care business and is committed to a plan to sell the product group with its operations. The product group is classified as held for sale at that date. The operations and cash flows of the product group will be eliminated from the ongoing operations of the entity as a result of the sale transaction, and the entity will not have any continuing involvement in the operations of the product group after it is sold. In that situation, the conditions in paragraph 23 for presenting in discontinued operations the operations of the product group while it is classified as held for sale would be met.

(b) The entity decides to remain in the beauty care business but will discontinue the brands with which the losses are associated. Because the brands are part of a larger cash-generating product group and, in the aggregate, do not represent a group that is a component of the entity, the conditions in paragraph 23 for presenting in discontinued operations the losses associated with the brands that are discontinued would not be met.

Example 9

An entity that is a franchiser in the quick-service restaurant business also operates company-owned restaurants. For that entity, an individual company-owned restaurant is the lowest level at which the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, each company-owned restaurant is a component of the entity.

(a) The entity has experienced losses on its company-owned restaurants in one region. The entity decides to exit the quick-service restaurant business in that region and commits itself to a plan to sell the restaurants in that region. The restaurants are classified as held for sale at that date. The operations and cash flows of the restaurants in that region will be eliminated from the ongoing operations of the entity as a result of the sale transaction, and the entity will not have any continuing involvement in the operations of the restaurants after they are sold. In that situation, the conditions in paragraph 23 for presenting in discontinued operations the operations of the restaurants while they are classified as held for sale would be met.

(b) Based on its evaluation of the ownership mix of its restaurants in particular markets, the entity commits itself to a plan to sell its company-owned restaurants in one region to an existing franchisee. The restaurants are classified as held for sale at that date. Although each company-owned restaurant is a component of the entity, through the franchise agreement the entity will (1) receive franchise fees determined, in part, based on the future revenues of the restaurants and (2) have significant continuing involvement in the operations of the restaurants after they are sold. In that situation, the conditions in paragraph 23 for presenting in discontinued operations the operations of the restaurants would not be met.

Example 10

An entity that manufactures sporting goods has a bicycle division that designs, manufactures, markets and distributes bicycles. For that entity, the bicycle division is the lowest level at which the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, the bicycle division is a component of the entity.

The entity has experienced losses in its bicycle division resulting from an increase in manufacturing costs (principally labour costs).

(a) The entity decides to exit the bicycle business and commits itself to a plan to sell the division with its operations. The bicycle division is classified as held for sale at that date. The operations and cash flows of the division will be eliminated from the ongoing operations of the entity as a result of the sale transaction, and the entity will not have any continuing involvement in the operations of the division after it is sold. In that situation, the conditions in paragraph 23 for presenting in discontinued operations the operations of the division while it is classified as held for sale would be met.

(b) The entity decides to remain in the bicycle business but will outsource the manufacturing operations and commits itself to a plan to sell the related manufacturing facility. The facility is classified as held for sale at that date. Because the manufacturing facility is part of a larger cash-generating group (the bicycle division), and is not a component of the entity, the conditions in paragraph 23 for presenting in discontinued operations the operations (losses) of the manufacturing facility would not be met. (Those conditions also would not be met if the manufacturing facility were a component of the entity because the decision to outsource the manufacturing operations of the division will not eliminate the operations and cash flows of the division from the ongoing operations of the entity.)

Example 11

An entity owns and operates retail stores that sell household goods. For that entity, each store is the lowest level at which the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, each store is a component of the entity.

To expand its retail store operations in one region, the entity decides to close two of its retail stores and open a new superstore in that region. The new superstore will sell the household goods previously sold through the two retail stores as well as other related products not previously sold. Although each retail store is a component of the entity, the operations and cash flows from the sale of household goods previously sold through the two retail stores in that region will not be eliminated from the ongoing operations of the entity. In that situation, the conditions in paragraph 23 for presenting in discontinued operations the operations of the stores would not be met.

Determining whether an asset has been abandoned

Paragraphs 6 and 7 of the [draft] IFRS specify requirements for assets to be abandoned. Example 12 illustrates when an asset has not been abandoned.

Example 12

An entity ceases to use a manufacturing plant because demand for its product has declined. However, the plant is maintained in workable condition and it is expected that it will be brought back into use if demand picks up. The plant is not abandoned.

Presenting a discontinued operation that has been abandoned

Paragraph 6 of the [draft] IFRS prohibits assets that will be abandoned from being classified as held for sale. However, if the assets to be abandoned are a component of the entity, they are reported in discontinued operations at the date at which they are abandoned. Example 13 illustrates this.

Example 13

In October 2005 an entity decides to abandon one of its cotton mills. The cotton mill is a cash-generating unit that meets the definition of a component of the entity. All work stops at the cotton mill during the year ended 31 December 2006. In the financial statements for the year ended 31 December 2005, results and cash flows of the cotton mill are treated as continuing operations. In the financial statements for the year ended 31 December 2006, the entity makes the disclosures for the cotton mill required by paragraph 24 of the [draft] IFRS, including a restatement of any comparative figures.