INTERNATIONAL FINANCIAL REPORTING STANDARD 5 –NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

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SUMMARY

International Financial Reporting Standard 5 has the working title *Non-current assets held for sale and discontinued operations*. This financial reporting standard also represents a new group of standards along with the previous four, including existing International Accounting Standard, regardless if it concerns existing or revised standards, as a wish for further coordination of accounting regulations on world level. This idea is a concretisation of the wishes of International Accounting Standards Board, that at prior wish to establish specific rules in woods of existing rules imposing financial reporting standards as vital in financial reporting. This standard replaces existing International Accounting Standard 35 - *Discontinuing Operations* and achieves substantial convergence with the requirements of SFAS 144 Accounting for the Impairment or Disposal of Non-current Assets that are synonyms for assets held for sale, followed by specifying the conditions for its classification, and in the final are determined the ways of presentation and publishing of those type of activities. This way it is wished to reduce or at least abate the differences between US GAAP and International Financial Reporting Standards through joined short - term convergence project of American Accounting Standards and IFRS 5.

Keywords: International Financial Reporting Standard, International Accounting Standard, International Accounting Standards Board, US GAAP, non-current assets held for sale, discontinued operations.

1. INTERNATIONAL FINANCIAL REPORTING STANDARD 5

1.1. International Financial Reporting Standard 5 obligators - Non-current assets held for sale and discontinued operations

As all International Financial Reporting Standards, all obligators defined by Income Tax Law must apply this Standard as well as by the obligators whose securities are quoted on stock markets or planned to be included into the official exchange quotation in accordance with existing rules of Securities Market Law in The Republic of Croatia.

Other obligators failed to fulfil conditions, in accordance with existing regulations, may individually choose application of International Financial Reporting Standards in accordance with Article 18 of Accounting Law**,** published in Official Gazette number 146/05. An entity must start applying International Financial Reporting Standard 5 from 1st January 2005, but with earlier application permitted, which should be reported during the financial statements analysis.

Obligators forced to apply financial reporting standards in their business have „International Financial Reporting Standards 2004 on their disposal, including International Standards (IS) and Interpretations effective from 31st March 2004"in edition of Croatian Association of Accountants and Financial Experts CAAFE from 2005.

1.2. Main characteristics of International Financial Reporting Standard 5 - Non-current assets held for sale and discontinued operations

With the purpose of easier understanding of this Financial Reporting Standard and better understanding of IFRS 5, imposed are the need and necessity to present its main characteristics in one place.

The main characteristics of International Financial Reporting Standard 5 are following:

1. This Standard introduces a new term into the usage; non-current assets held for sale and the concept of disposal groups, as a balance sheet category. Assets held for sale perceive every non-current asset held for sale within a disposal group. A disposal group mainly perceives: "a group of assets, which an entity intends to dispose of in a single transaction by sale or other way possibly with directly associated liabilities transferred with that transaction.

The group includes Goodwill gained with a business combination if the cash generating unit to which the goodwill is so allocated" is in compliance with International Financial Standard 36 – *Impairment of Assets* in revised section from 2004. If we read carefully the former definition, we could ask ourselves what is a cash generating unit? In compliance to appendix A, consisting element of International Financial Reporting Standards page 536, it is said that it is the smallest group of assets that includes the asset and that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.

2. International Financial Reporting Standard 5 establishes the ways of measurement, classification and presentation of non-current assets held for sale and disposal through the same groups. It means that such assets held for sale and disposal are carried at the lower value of carrying amount and the fair value less costs to sell. Costs to sell, according to Appendix A of International Financial Reporting Standards, are defined as dependent costs in direct connection to the disposal of assets excluding financial costs and Income tax cost**.** Then, assets held for sale and disposal through groups (categories) are not depreciated, and are disclosed separately on the face of the balance sheet.

3. We have already mentioned several times that this financial reporting standard replaces IAS 35 - *Discontinuation of operation* and in relation to it prescribes following requirements:

a) time of business classification changes and in relation to IAS 35 represents important change; it is defined as terminated from the moment when, for instance, selling contract becomes a compulsory for an entity.
b) it prescribes the effects of discontinued operations to be presented separately in the profit and loss account, as a basic financial statement, and
c) it does not anticipate the possibility of retroactive classification as a discontinued operation, but prohibits it.

Based on such defined main characteristics of this financial reporting standard we can easily determine the objective of IFRS 5.

1.3. Objective and operation area of International Financial Reporting Standard 5 - Non-current assets held for sale and discontinued operations

Up to now, we have witnessed there could be a specific objective conducted for every Standard. An objective set like this represents a synthesis of the content of entire Standard in short form and thereafter it is expanded and analysed through sub-objectives, which represent operation area of each Standard.

The main objective of this Standard is to define conditions and ways of accounting and classification of assets held for sale inside disposal groups and ways of publishing and presentation of the information about discontinuing operations of a business entity.

International Financial Reporting Standard 5 affects entire non-current assets and it is applied to all disposal groups according to point 2 of the Standard. The same standard implies that non-current assets consist of tangible, intangible and financial assets according to IAS 1.58 – *Presentation of Financial Statements*, i.e. all assets are expected to be refinanced after 12 months.

When we are familiar with all important facts regarding International Financial Reporting Standard 5 operation area, we may attempt to define disposal groups (categories).

According to IFRS 5, disposal groups are categories of assets, which an entity intends to dispose of in a single transaction by sale or other way possibly with directly associated liabilities.

Observing disposal categories (groups) we may conclude that they could appear in the following form:

- “cash„ generating units
- single cash generating unit or
- only a part of a cash generating unit “[1]

That way the group (category) may imply any kind or part of an asset i.e. liability with the belonging current assets[2], current liabilities and assets excluded by IFRS 5.5. To Excluded assets to which accepted elements of classification of disposal assets do not apply, following implies:

a) ‘’according to IAS 12 – *Income tax* – deferred tax assets
b) according to IAS 19 – *Employee benefits* – employee’s entitlements to benefits
c) according to IAS 39 - *Financial instruments: Recognition and measurement* – entire assets according to this IAS.
d) according to IAS 40 – *Investment property* - long- term property measured at fair value of this IAS.
e) according to IAS 41 - *Agriculture* - long-term property measured at fair value less estimated point-of-sale costs
f) according to IFRS 4- *Insurance contracts*- contractual rights coming from insurance contract in accordance to IFRS 4 points’’ [3].

It is also important to say that according to this Standard non-current assets that may be written-off and depreciated, cannot classify as held-for-sale asset. This way we have

[1] Hrvatska zajednica računovođa i financijskih djelatnika:Međunarodni standardi financijskog izvješćivanja uključujući Međunarodne računovodstvene standarde i objašnjenja do 31.ožujka 2004.,Zagreb,2005.,str.528

[2] According to Appendix A of IFRS 5, Current assets refer to the type of assets that satisfy any of the following criteria:
a) It is expected to be converted or sold, or consumed in the normal operating cycle of subject,
b) It is hold primarily for trading,
c) Its conversion is expected in 12 months after the date of the balance sheet or
d) Cash or cash equivalent, unless prohibited for trading and for liabilities settlement at least twelve months after the date of the balance sheet.

[3] Hrvatska zajednica računovođa i financijskih djelatnika: Međunarodni standardi financijskog izvješćivanja uključujući Međunarodne računovodstvene standarde i objašnjenja do 31.ožujka 2004.,Zagreb,2005.,str.528.

narrowed the criteria for classification of assets held-for-sale, necessary to define for further research of this Standard that will be discussed in continuation.

1.3.1. Criteria for classification of assets held for sale, according to International Financial Reporting Standard 5- Non-current assets held for sale and discontinued operations

In accordance with the provisions of points 6-12 of International Financial Reporting Standard 5 there are several ways and approaches to determine the criteria for classification of assets held for sale inside disposal groups (categories).

Non-current assets of an entity may be classified as an asset held-for-sale sale if its book value can be recovered through sale instead of continuous consummation that wastes it.

In order to make the described way of classification of assets realistic, it is necessary to satisfy the criteria of classification of assets prescribed by points 7 and 8 of IFRS 5, classified as follows:

a) asset or disposal group must be ready for sale in the existing condition with certain outcome, and that is a probable sale
b) situation that prescribes the asset held for sale is very certain and probable, and must correspond to:

- plan for the sale of an asset or a disposal group (category) and
- management is committed to the program for locating potential buyers inside the entity.

c) sales price of an asset or a disposal group (category) must be known and proportional to their fair value.
d) the mentioned sale of an asset or a disposal group (category) must be conducted within a year, and
e) there is a small or almost no probability of unpredictable situations that would cause deviation from prescribed plan or question the sales management plan.

Availability for immediate sales is considered as availability of an asset that meets the regular standards of such asset sale. There is a general rule for sale or transfer of asset; the longer is prolongation of sale or transfer of asset, the asset is less available for immediate or sudden sale, and no longer meets the criteria of immediate availability, and inversely - ceteris paribus.

The mentioned criterion is only one of the determinants that must be met due to determination of the criterion of classification of assets held-for-sale sale and there is the criterion that sales must be highly probable.

To make the sale in our example probable, the management of an entity must precisely and on the level define a business plan for the treated asset or the disposal group (category) that imply locating of potential buyer/s and conducting the original plan with a small probability of deviation from the planned.

In variable market conditions and due to different unpredictable market situations, the mentioned time limit for sales of an asset or a disposal group (category) may sometimes exceed the planned one-year time limit. According to the Standard, such deviation is allowed only in case of vis major, though even then there must be valid reasons for exceeding the time-limit, while on the other hand there must be enough strength to conduct the coordinated and agreed operation plan for sale completely.

Due to unpredictable situations and market transactions sometimes may happen that the traded asset is prescribed for further sale i.e. resale and a few words should be said about that.

1.3.1.1. Assets traded for further sale - RESALE according to International Financial Reporting Standard 5- Non-current assets held for sale and discontinued operations

According to IFRS 5.3, non-current asset primarily traded to be sold again or resold must not classify as current asset until it becomes classified as held-for-sale. According to point 11 of International Financial Reporting Standard 5 such asset may be reclassified and re-held-for-sale if the time limit is effective from the day of supply, usually inside one quarter**,** is met.

If the preceding conditions are met after the date of the balance sheet, the asset cannot be classified as held-for-sale, whereas in the contrary it the asset has the status of held-for-sale/ resale and the entity must announce the information in notes prescribed by points 41a, 41b, 41c that imply:

- ‘’description of the non-current assets,
- description of the facts and circumstances under which the sale was conducted or that led towards the expected disposal,
- profit or loss from asset evaluation unless separately disclosed in the profit and loss account, and
- if applicable; a part of an entity whose non-current asset or the disposal group (category) is in compliance with IAS 14 – ***Segment reporting’’***[4]

[4] Croatian Association of Accountants and Financial Experts: International Financial Reporting Standards including Interpretation of International Accounting Standards effective from 31st March 2004, Zagreb, 2005, pg.534.

An asset acquired in such way and held for further sale – resale of subsidiaries which thus satisfies the criteria from point 11 may be classified as a disposal group (category) held-for-sale.

1.4. Measuring of non-currents assets held for sale, according to International Financial Reporting Standard 5-*Non-current assets held for sale and discontinued operations*

Up to now we have been constantly mentioning in this Standard that non-current asset is held for sale inside disposal groups (categories). A logical question is imposing; how is the asset measured and how are disposal groups (categories) defined?

Measuring of non-current asset held for sale is conducted upon International Financial Reporting Standard 5, at lower value from:

1. book value or
2. fair value less costs to sale.

Prior to initiating the classification of an asset or disposal groups (categories) held for sale, «book value of assets should be measured in compliance with appropriate International Financial Reporting Standard that is applied[5]. » If an asset is acquired as the result of a business combination, it will be measured at fair value less costs to sale.

After classification of non-current asset to held for sale, the asset is not a subject to depreciation, in accordance with IFRS 5.25 i.e. IFRS 5 which prescribes:

«An entity shall not depreciate (or amortise) a non – current asset while it is classified as held for sale while it is part of a disposal group classified as held for sale.»

Such asset is defined as a newly acquired asset that should be classified in order to be held for sale, and in accordance with IFRS 5.16 it is conducted in the way that at initial recognition an asset is measured at value lower than the cost to supply (book value) or at fair value less cost to sell arising from sale of asset classified as held for sale.

In case of additional measurement of an asset or a disposal group (category) and in accordance with IFRS 5.19 book value of an asset or liabilities that are out of the frame of the measurement principles of IFRS 5 must be carried in compliance with an appropriate International Financial Reporting Standard.[6]

It is a general opinion that value of assets measured at fair value gives much better information than the information gathered by value of assets measured at fair value less cost to sell i.e. by lower than book value.

[5] Ibidem, pg. 530, article 18.

[6] For details refer to chapter Objective and Operation Area of International Financial Reporting Standard 5 – Non-current Asset Held to Sale and Discontinued Operation.

Subsidiaries classified as held-for-sale asset also represent a disposal group (category), and their measurement is conducted in compliance with the requirements of International Financial Reporting Standard 5.

1.5. Recognition of profits and losses incurred by depreciation and writing off, according to International Financial Reporting Standard 5- *Non-current assets held for sale and discontinued operations*

Any incurred loss that arises on non-current asset held for sale at fair value less costs to sell, is recognized in the profit and loss account for all deductions in accordance with Article 20 of International Financial Reporting Standard 5.

In accordance with article 21 of this IFRS and IAS 36 – *Impairment of assets,* in case of additional increase of value of asset, profits are recognized and disclosed in the profit and loss account, but at their fair value less costs to sell i.e. at corrected level of earlier recognized losses from deduction. Profits and losses implying to certain disposal group (category) are recognized at book value of treated non-current asset in compliance with the provisions and articles of IFRS 5, and points 104a, 104b and point 122 of IAS 36- *Impairment of assets.*

Preceding points of IAS 36 say that due to loss impairment, Goodwill is reduced first and the unarranged value of the asset is allocated to the asset with similar characteristics in proportion to its book value. Profits incurred through sale of an asset increase its fair value and are equally allocated to the asset, but not to Goodwill, and that imposes important difference between recognition of incurred profits and losses.

In article 24 of IFRS 5 it is discussed what happens with unrecognized profits and losses until the date of the sale of non-current asset. In such situations their recognition is prescribed at the moment of disposal and the procedure and requirements are described by points 67-72 of IAS 16- *Property, Plant and Equipment*, whereas in case of intangible assets according to IAS 38 the treatment is conducted in accordance with points 112-117.

Analyzing the prescribed requirements in preceding points of IAS 16 and IAS 38 we may conclude that profits and losses at the moment of disposal are attributed to profit or loss at the moment of disposal and represent the difference between accomplished net profit of disposal and book value or fair value in case classified asset held for sale is measured at fair value less costs to sell in accordance to article 15 of International Financial Reporting Standard 5.

1.6. Presentation and announcement of assets according to International financial reporting standard 5- ***Non-current assets held for sale and discontinued operations***

Discontinued operations in The Republic of Croatia are usually a consequence of primary performed bankruptcy, followed by liquidation which represents cancellation of that entity from the registry administrated on the nearby Commercial Court and thus the entity stops existing.

This Standard introduces the term Suspended activity into the usage and represents ″an organizational component that is not disposed or held for sale, but

1. represents a separate significant business operation or geographical area of operation,
2. it is part of the uniquely coordinated plan of disposal of separate significant business operation or geographical area of operation or
3. it is about a subsidiary acquired exclusively for the purpose of sale.″[7]

In accordance to article 31 of IFRS 5, a component of an entity includes operations and cash flows that may be clearly, operationally and for the purpose of financial reporting distinguished from other entities. Therefore, the organizational component inhere will be already mentioned unit/s that generate/ s cash and has a sale character.

It is important to mention here that an entity is obliged to announce the information in case of discontinued and continued operation.

In case of discontinued operation the entity must follow article 33 of IFRS 5 described on pages 532 and 533 and it is obliged to announce following information on the face of the profit and loss account and in the notes of financial statements.

In accordance with the preceding article the entity must announce following information in the profits and loss account:

1. Unique amount, which implies:

a) the sum of the post-tax profit or loss of the discontinued operation and

b) the sum of the post-tax profit or loss recognised on the measurement at market value less costs to sell or based on disposal of asset as act of a discontinued operation.

In accordance with article 33, in the notes of financial statement an entity must disclose following:

2. analysis of unique amount from point 1, in:

a) revenue, expenses, pre-tax profit or loss from discontinued operations,

[7] Hrvatska zajednica računovođa i financijskih djelatnika: Međunarodni standardi financijskog izvješćivanja uključujući Međunarodne računovodstvene standarde i objašnjenja do 31.ožujka 2004.,Zagreb,2005.,str.532.

b) and related income taxes in accordance with point 81 of IAS 12 – *Income taxes,*
c) profit or loss recognized on the measurement to market value less cost to sell or based on disposal of the asset that is the act of discontinued o operation, and
d) related income tax in accordance with point 81 of IAS 12 – *Income taxes,*

3. The net cash flows attributable to the operating, investing and financial activities of discontinued operation.

IFRS 5.34 prescribes for an entity to repeat the presentation of the information from the preceding categories 1-3 entitled to the earlier periods disclosed in financial statements.

The current year adjustments related to earlier presented amounts in article 33 are prescribed by IFRS 5.35.

In case of continued activity an entity must meet IFRS 5.37 in the way that acquired profit or loss appearing as a consequence of additional measurement of asset or group (category) for disposal held for sale, presents as profit/ loss from continued operation.

1.6.2. Presentation and announcement of non-current asset or groups for disposal classified as held for sale of asset according to International Financial Reporting Standard 5 – Non-current assets held or sale and discontinued operations

Non-current asset classified as held-for-sale and asset from disposal groups (categories) are disclosed in the basic financial statement – balance sheet, separately from other types of asset normally presented in the balance sheet.

This standard has also prescribed a presentation of arising liabilities of groups (categories) for disposal separately from other liabilities normally presented on the right or passive side of the balance sheet. In accordance with IFRS 38.5 an obligation has been prescribed to disclose the main types of assets and liabilities classified for sale also separately and in two ways: in the balance sheet itself or in the notes of financial reports.

If during business operations a subsidiary has been acquired, as a group (category) for disposal, there is not an obligation prescribed for announcement of main types of asset and liabilities thus synchronised with IFRS 5.39.

As a need for presentation of information of prior period, this Standard in accordance with IFRS 5.40 does not oblige an entity to a new classification or reclassification, nor repeated disclosure of assets, liabilities and groups (categories) for disposal classified as held for sale in the balance sheet for prior periods.

2. CONCLUSIONS

International Financial Reporting Standard 5 has replaced earlier existing International Accounting Standard 35 – *Discontinuing Operations.* If we remind ourselves of the beginning of elaboration of this Standard we will see that IFRS 5 has a working title *Non-current assets held for sale and discontinued operations*. Simultaneously, the Standard introduces a new balance term and category called Non-current assets held to sale.

Within its activity and transitional provisions this Standard not only is it used on entire non-current asset defined by The Accounting Law, but also on the groups (categories) for disposal that classify and predict asset for sale with certain exceptions. On the other hand, this Standard excludes writing offs and depreciation of non-current asset where we come to conclusion that this type of asset (written off and depreciated) cannot be classified as asset held for sale. Therefore, application of deprecation and accompanied calculations is stopped.

Non-current assets characterized as held for sale is measured at lower value from purchased or book value or at fair value less costs that have sales character. In comparison to IAS 35 – *Discontinued operation*, IFRS 5 prescribes following:

1. changes classification time to discontinued,
2. introduces a new way of presenting results of discontinued operation, separately in the profit and loss account, and
3. prohibits repeated classification of business operation of an entity if conditions are not met by the date of the balance sheet.

Accepting opinions and attitudes of International Accounting Standards Board (IASB) and SFAS, an operation should be considered discontinued when in contrast with the above written and according to a lot of authors these are: disposal or sales.

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