ACCOUNTING POLICIES ON FINANCIAL REPORTING OF NON-CURRENT ASSETS HELD FOR SALE

Abstract: *In this article the author intends to present, through a more analytical approach, and bring up for discussions the concerns regarding the recognition, measurement, derecognition and reporting in the financial statements of fixed assets held with the purpose of sale.*

Key words: *held for sale, high probability, sales plan, disposal group, fair value, book value.*

In business portfolio of domestic entities there can be often found the activities from different fields little tangent to one another. This phenomenon is predefined by the limited local market, otherwise in order to obtain a proposed profit level the entities are obliged to diversify their business.

Obviously, the indicators of these businesses (profitability, turnover, cash flow, etc.) are different, and their portfolio is constantly changing – expanding through initiation or procurement and reducing through waving or sale. As a rule, these processes occur simultaneously.

A constant change of the business portfolio shall modify the main characteristics of the entities: financial statement, operations results, cash flow, income and expenses.

We shall refer in this article to the aspects of calculation of non-current assets removed from use and intended for sale.

IFRS 5 „Non-current assets held for sale and discontinued operations" establishes the requirements regarding the information content on the discontinued operations and non-current assets removed from use that is necessary to present in financial statements.

IFRS 5 „Non-current assets held for sale and discontinued operations" has a small volume of prescriptions. Adoption of IFRS 5 was necessary to clarify the requirements for financial reporting stipulated in IAS 1 „Presentation of Financial Statements". We refer to:

1. In the statement of financial position, long-term assets and liabilities should be presented separately from the current ones. Thus, a dilemma derives: how to present and assess non-current assets in case when the entity is informed about the possible transfer of non-current assets through sale.

2. Financial statement shall be prepared on the going concern basis that considers that the entity will continue its operations in future. However, IAS 1 does not at all apply to peculiarities of reporting for discontinued operations.

To cover these gaps IFRS 5 was developed.

The financial statement users welcome the calculations and presentation of information on non-current assets held for sale and discontinued operations to distinguish between: (i) the results of operations that will be maintained by the entity, assets and liabilities that will remain as patrimonial elements of the entity and will serve the entity in future, and (ii) the results of operations that were and/or are to be alienated, assets and liabilities of the entity to be removed from the patrimony of the entity.

The first impression is that record keeping of non-current assets held for sale and discontinued operations do not present any difficulties: if the entity decides to sell them, then it is possible to make reclassifications. In practice, however, some difficulties can occur on determining the time when the asset reclassification is necessary; however, just the intentions of alienations are not sufficient for reclassification. In addition, still exists an aspect of correct assessment of the asset, but in case when a group of assets is exposed to alienation it is important to assess correctly all obligations and goodwill related to this group.

A non-current asset (or a group of assets) is classified by the entity as held for sale in case when its book value will be mainly recovered through the sales transaction and not through its continuous use. Thus, the non-current asset does not any longer meet the recognition criteria for tangible and intangible non-current assets, because it does not bring any economic benefits to the entity by usage, the fact that makes the entity derecognize immobilizing.

The entity can make disposal plans within a single transaction, either a non-current asset or a group of assets with possible related liabilities. For such situations, IFRS 5 provides a term of ***disposal group***, which means a group of assets to be disposed of by sale or otherwise, together in a single transaction and liabilities directly associated with those assets that are to be transferred within the same transaction.

Thus, the term disposal group held for sale is a very complex concept. In terms of cash-generating unit, such a disposal group can represent a group of cash-generating units, a unique cash generator element or a component a cash-generator element. The group can include any asset or liability, including current assets, current liabilities or assets that are not covered by IFRS 5. The provisions of IFRS 5 are applied to the group as a whole.

In order to classify one current asset (group) as to be disposed, it must meet all of the following criteria:

- ***the asset (group) shall be available for immediate sale in its present condition.*** For example, an asset transferred for rent cannot be classified as an asset held for sale until the expiration of the rent term. If this criterion is met, the next one shall be checked.
- ***sale must have a high probability.*** In According to IFRS 5 high probability shall mean probability that is significantly higher than probably, and probably is considered when there are more chances to happen than not to happen. Similar explanations can be found in IAS 37 „Provisions, Contingent Liabilities and Contingent Assets". To be sure that the sale has a high probability of achieving it, it is necessary to demonstrate that:
- the entity management is strongly convinced of the asset (group) sale, i. e. has a plan to sell the asset. It is obvious that under the current conditions of the relationships between entities and control public authorities, some questions regarding the content and the method of approving the sales plan may appear. From this point of view, we would consider it relevant that the sales plan should include the entities actions regarding the development of the asset sale process, sale value, responsible persons and terms of execution.
- the entity initiated the asset disposal plan and launched an active program of identification of a buyer. The initiation of the non-current assets disposal plan implementation can be confirmed by means of advertisement, dissemination of information to the public, etc.
- the actions necessary for the implementation and completion of the plan should indicate that is not likely the existence of modifications that could influence the development of the plan or result in its interruption. Otherwise, the actions included in the sales plan should have a higher probability of its implementation, without any doubts regarding their development or about the plan in general.
- the asset is actively promoted on the market in respect of its sale at a price reasonably correlated to its current fair value.
- the entity expects the sale to take place within one year, at the latest, from the date of the asset classification as available for sale. This can be confirmed by including the terms of reference about the execution of the sale plan actions.

There are events or circumstances that can extend the period necessary for the sale completion. Any extension of the period necessary for the sale completion does not hinder the classification of an asset (or a group intended for disposal) as held for sale if the delay results from events or circumstances beyond the entity control, and in case of sufficient proves, that the entity remains committed to its plan of the asset sale (or of the group intended for disposal).

Information related to the proof of extending the period of non-current assets classification as held for sale should include: real grounds, juridical and economic reasons that led to the extension of the sale period; measures undertaken to comply with the initial terms of these assets sale by enclosing the justifying documents (examination of inquires and offers from potential buyers, advertisement activities); documentation regarding the rapid sales of the corresponding non-current assets (agreements of intention, proofs of advance payments, etc.); information on the fair value of these non-current assets.

Classification of non-current assets into the category of assets intended for sale or their exclusion from the respective category requires making use of the professional logic. If the entity is willing to dispose (alienate) the asset, it should make all efforts to sell it. That is, the entity should act as quick as possible to sell the non-current asset, not just to declare it. Thus, the classification of the asset as "intended for sale" is based on the measures undertaken by the entity management until the end of the reporting period and its expectations that the sale shall be successfully completed.

Sales transactions of non-current assets also include the exchange between the fixed assets in case when the exchange is of a commercial nature.

Classification of an exchange transaction as a commercial one can be found in IAS "16 *Non-current tangible assets"*. The transaction is of commercial nature if it is assessed that the received cash flows of the fixed asset differ from the cash flows of the disposed fixed asset and the particular value of the entity by means of the assets exchange is modified.

The entity should assign to the category of assets intended for sale also the non-current assets, which it considers to distribute to the owners. Their reclassification shall be done under the same conditions as in the case of sale of the fixed assets: assets should be available for immediate distribution in their current state, and the distribution should have a high probability, confirmed by the fact that the activities undertaken for their distribution had been initiated and estimated to be executed within one year term from the date of their classification. The activities stipulated for the execution of the distribution should indicate that this is unlikely to have significant modifications regarding the distribution or that the distribution is to be interrupted. As a part of assessment whether the distribution has a high probability under the Republic of Moldova conditions, the approval of the transaction by the shareholders could have been taken into consideration.

It is necessary to mention that fixed assets (or groups intended for disposal) which should be abandoned are not included in the category of the assets intended for sale, because these fixed assets (or groups intended for disposal) should be used until the end of their economic life and should rather be decommissioned than sold. Therefore, they do not meet the basic condition of the definition of the asset intended for sale - the book value of the asset will not be retrieved through sale. However, the entity shall present separately the result and the cash flow generated by the group of assets that should be abandoned and scrapped if this group represents a major segment of a distinct activity, or a geographic area of operations, or is a part of a unique coordinated plan of disposal of a major segment of a distinct activity, or of a geographic area of operations, or is a subsidiary acquired exclusively with the intention to be resold, that represents the discontinued operations.

In case when the fixed asset is classified in the category held for sale, the entity should evaluate it at its lowest book value and fair value minus costs generated by sales. The ability to provide a proper assessment is in fact a key to success, because in order to buy or to sell an asset it is imperatively necessary to know its value.

According to IFRS 5, the fair value represents the price that would be received for the sale of an asset or paid to transfer the liability into a regulated transaction between market participants at the date of evaluation. The benchmark in determining the fair value confers IFRS 13 "Fair value". The application of the fair value requires reflecting market values in the financial statements and its changes in the outcomes statements achieved by the entity. This process is already facing numerous practical problems because estimation of the fair value continues to be a subjective process for the local entities, especially because this should be done even in the absence of a market, which implies a lot of professional reasoning and the possibility of being manipulated by the person in charge with the estimation. The ways of estimating the sale costs also present difficulties. The local entities that apply IFRS have the following questions: how and by whom are the sale costs estimated? Where should they be registered – in the asset sale plan or in a distinct calculation? Which are the ways of approval? What is the proof and safety that they are reliable? Which are the tax implications? We support the opinion that, after the approval of the IFRS application in the Republic of Moldova, it is necessary to elaborate national standards of evaluation correlated with the international standards of evaluation.

The distribution costs related to the non-current asset (or group intended for disposal), which is classified as held for its distribution to owners, shall be estimated under the same conditions.

It should be mentioned that the initial evaluation of the fixed asset, as held for sale, when comparing its book value with the fair value minus the sale costs, the book value shall be determined according to the IFRS previously applicable. Thus, if a fixed asset is cataloged as a non-current asset held for sale, its book value at the moment of classification shall be determined according to the stipulations of IAS 16 "Tangible assets".

For example, the entity „Galacom" JSC owns a building that intends to dispose of it. The building is free and the entity undertook actions for identifying a buyer. At the balance sheet date, the entity classifies the building as available for sale. The entry value of the building is 10 million lei, and the accumulated depreciation is 4 million lei. The fair value of the building is 5 million lei. The estimated auction costs amount to 10 thousand lei, cadastral expenses – 7 thousand lei. The book value determined according to the stipulations of IAS 16, constitutes 6 million lei (10 mln lei – 4 mln lei = 6 mln lei). The fair value minus the sale costs constitutes 4,983 mln lei (5 mln –10 thousand lei – 7 thousand lei = 4,983 mln lei). Consequently, the value of the asset intended for sale shall constitute 4,983 mln lei.

Applying the general plan of accounts, the entity shall do the next accounting records:

Elimination of the fixed asset depreciation:

Debt account 124 „Depreciation of fixed assets" – 4 mln lei

Credit account 123 „Fixed assets" – 4 mln lei.

Cataloging the fixed asset in the non-current asset intended for sale:

Debt account 263„Non-current assets held for sale" -4,983 mln lei

Credit account 123 „Fixed assets" – 4,983 mln lei.

Recognition of the difference as a loss from depreciation:

Debt account 721"Expenses related to non-current assets"– 1,017 mln lei.

Credit account 123 „ Fixed assets"– 10 mln lei.

When drawing up the accounting formulas for the non-current assets held for sale an account of I degree from the current assets class – 263 "Non-current assets held for sale" were used. The introduction of a new account into group 26 is dictated by the stipulations of IAS 1, which describes the minimum of information needed to be presented in the statement of financial position. Thus, immediately after the current assets, the entity shall submit the statement of financial position, in a separate line, the total of the non-current assets classified as held for sale and of the assets included in the groups intended for disposal, classified as held for sale (according to IFRS 5 "Non-current assets held for sale and discontinued operations"). The fact to consider these non-current assets intended for sale as current assets presents reluctance.

In the majority of cases, the book value does not coincide with the fair value minus sales costs. According to IFRS 5 any initial reduction of the book value of an asset (or a group intended for sale) up to the fair value minus sales costs, shall be recognized as loss from depreciation. It is relevant to register this loss in account 721 „ Expenses related to non-current assets". We consider it justified to reflect this depreciation as expenses related to non-current assets because these expenses are generated by the exit of the non-current assets from operation.

In addition to the account of expenses related to the non-current assets the surplus obtained from the reevaluation of the non-current asset shall be recognized if the asset previously classified as an asset held for sale, until its inclusion in the corresponding group, had been evaluated at the reevaluated value.

One of the conditions for recognition of the non-current assets held for sale is that the term of sale should not exceed one year. However, if there are grounded circumstances, IFRS 5 admits the extension of the term. In case if the term of sale exceeds one year the entity should evaluate the general sales costs at their updated value. Any increase of the updated value of the general sales costs arising from the passage of time should be presented in the profit or loss section as financing costs. Therefore, in order to register these expenses the local entities will use account 722 "Financing costs" in correspondence with the accounting records of a non-current asset, for example, 123 „Fixed assets", 111 "Intangible assets", etc.

For example, JSC DEPO holds a video surveillance system that is intended for disposal. The sale may take place at any time, and the actions undertaken to find a buyer have been initiated. The book value of the system is 200 000 lei, the accumulated depreciation is 40 000 lei. The fair value of the system is 164 000 lei, the sale shall be done in one year and three months, present expenses connected with sales are estimated at 22 000 lei, the discount rate is 10%.

Since the sale shall be done in one year and three months, the updated value costs connected with sale were calculated and estimated at 24 805 lei ((22 000 *1,1)*1,025). Hence, the difference between the present general sales costs and the updated costs is 2 805 lei (24 805-22 000), which the entity recognizes as financial expenses. Knowing the updated value of the sales costs we shall determine the fair value, which constitutes 139 195 lei (164000 -24805) and is less than its book value (200000-400000). As a result of classifying the fixed asset as an asset held for sale, the last is evaluated at its lowest value – 139 195 lei.

Based on the example we shall draw up the accounting record:

Debt account 263„Non-current assets held for sale" – 139 195 lei (164000-24805)

Debt account 124 „Depreciation of fixed assets" – 40 000 lei

Debt account 721"Expenses related to non-current assets"– 18 000 lei.

Debt account 722"Financing costs"– 2 805 lei.

Credit account 123 „Fixed assets" – 200 000 lei.

According to IFRS 5, in the category of non-current assets held for sale could also be included a new acquired asset, in case if it meets the criteria of determination. For example, during the reporting period the entity purchased a set of appliances for making coffee, but before the moment of their putting into operation the stipulations linked to their functioning have been modified. The entity no longer wants to install them and intends to sell them. In this case, the recognition criteria are verified, i. e. the existence of the sales plan, the development of the sales actions, etc. If conditions are met, the new acquired asset is classified as for sale.

According to IFRS 5, the depreciation of the non-current assets held for sale and assets that are a part of a group of assets held for sale cease to be calculated and are registered from the date of their classification in this category, despite the fact that the asset can be further used. Thus, the entity shall not calculate the depreciation of a non-current asset as long as it is classified as held for sale or as long as it is a part of a group intended for disposal, classified as held for sale.

But it should be reiterated that in the situation, where there is a group intended for disposal classified as held for sale, and the entity registers interests and other expenses, which can be attributed to the debts connected with this group intended for disposal, the last should be further recognized.

Being held as non-current asset for sale, its fair value can be modified. Any further decrease of the fair value minus sales costs are recognized as an impairment loss. This loss should be registered by the local entity in account 714 "Other operating expenses". Any further increase of the fair value minus general sales costs of one asset is recognized as a gain, but without exceeding the cumulative impairment loss that was recognized either according to IFRS 5, or previously in accordance with IAS 36 Assets Depreciation. Respectively the subsequent growth will be registered in account 612 "Other operating income".

IFRS 5 defines as well the provisions regarding the modification of the sales plan, in this case, when the entity is no longer sure about the non-current asset sale or does not take any necessary measures regarding sales. In other words, the criteria for further recognition of the non-current asset held for sale are no longer met. In our opinion, "modification of the sales plan" is not the appropriate one. Abandoning the intention for sale may result in failure to meet the recognition criteria of the non-current asset held for sale. The entity should cease the classification of the asset (or of the group intended for disposal) held for sale. Therefore, it is necessary to reclassify again to the category of non-current assets. In consequence its derecognition occurs, or such a provision ("derecognition of the non-current asset held for sale") would be appropriate in the circumstances. Maintaining of wording "modification of the sales plan" does not fully explain the essence of the situation and may cause uncertainties.

After reclassification the non-current asset is evaluated at the lowest value among:

(a) its book account before classification as an asset held for sale, adjusted for any impairment, depreciation or reevaluation that would have been established if the asset was not classified as an asset held for sale, or would continue to be listed among assets intended for use and (b) its value recoverable at the date of subsequent decision not to be sold.

Recoverable value of the asset is the biggest value among fair values of an asset minus general sales costs and its value in use. Value in use is defined as an updated value of the estimated future cash flow that is expected to be realized from the use of an asset in future and from its disposal at the end of its useful life. Thus, if the entity did not manage to sell the non-current asset and no longer has any evidence that still meets the criteria of determination that the asset held for sale scrolls through reclassification. For this end, the entity first estimates for the given asset the fair value minus sales costs, then the value in use, after that it chooses the biggest one among them, which will serve as recoverable value. The recoverable value is compared with the book value and the smallest one is applied. However, before the comparison it is necessary to determine the book value, taking into account depreciations and impairments as well as the fact that non-current asset would have been in operation.

It is necessary to mention that adjusting the book value to an asset or the periodic value in use to an asset that derives from the evaluation of the present situation of the asset and liabilities and the expected future benefits and obligations associated therewith are qualified, in accordance with IAS 8 "Accounting Policies", as a modification of the book value as a result of new information and new developments. The effect of the book value modification should be recognized prospectively by including it in the profit or loss modification period.

For example, at the end of December 2013 the entity decided to sell an automated teller machine, as a result it was classified and recognized as an asset held for sale. At the moment of classification as an asset held for sale, the input value of the automated teller machine was 132 600 lei, the accumulated depreciation was 26 000 lei, the liquidation value was 2 000 lei, the estimated remaining useful life was 5 years, to calculate depreciation a linear method was used. Fair value minus sales costs at the respective date is 101 400 lei. On November 1, 2014, the intention of the entity management to sell the equipment changed and there was taken a decision not to sell the asset, therefore the asset would be used in the activity of the entity. At the date of reclassification the recoverable value of the equipment was 91 000 lei.

The entity shall establish the following accounting formulas:

At the end of December 2013 the asset shall be transferred under the category of non-current assets held for sale and shall be evaluated at the lowest value among its book value and fair value minus sales costs:

Debt account 124 Depreciation of fixed assets – 26 000 lei

Credit account 123 „Fixed assets" –26 000.

Debt account 263 „Non-current assets held for sale" –101 400 lei

Debt account 721"Expenses related to non-current assets"-5 200

Credit account 123 „Fixed assets" – 106 600.

On November 1, 2014, the asset is reclassified in accordance with fixed assets. For the given asset, the depreciation was not calculated since its determination as an asset held for sale, despite the fact that it continued functioning. Thus, in order to calculate the book value it is necessary to recalculate the accumulated depreciation for the period within which the asset was classified as an asset held for sale. The book value is 84 500 lei (101400-(101400/5ani/12 luni*10)), and the recoverable value is 91 000 lei.

Debt account 123 „Fixed assets" – 91 000 lei

Debt account 714 „Other operating costs" – 10 400 lei

Credit account 263 „Non-current assets held for sale" –101 400 lei

In conclusion the non-current asset held for sale that is to be reclassified and passed in the category of non-current asset, which shall be used in operation, shall always cause an expense because the asset held for sale is evaluated at its fair value minus sales costs, and, at its reclassification other two values are compared: the book value and the recoverable value, and the smallest of which shall serve as basis for evaluation. Expenses arising from the fair value minus the sales costs and the new basis for evaluation (the smallest from the book value and the recoverable value) shall be recognized on the account of other operational expenses.

Conclusions and recommendations:

In the Republic of Moldova IFRS are mandatory for public interest entities, hence, for financial institutions, investment funds, insurance companies, and non-state pension funds and commercial societies whose shares are quoted on the stock exchange. At the same time, in compliance with art. 4 par. (2) of the Law on Accounting, IFRS can be also applied, on a voluntary basis, by the other local entities. In addition, in the case when the stipulations of the SNC and of other normative acts do not cover some ranges of transactions, the entity is encouraged to apply the stipulations of IFRS. As previously mentioned, IFRS 5 "Non-current assets held for sale and discontinued operations" has a reduced volume of prescriptions, but it is important and the adoption of this IFRS was required for the clarification of the requirements in respect of the financial reporting stipulated in IAS 1 "Presentation of Financial Statements".

The entity applying the IFRS classifies a non-current asset as held for sale if its book value is recovered mainly from sales rather than from utilization. Classification of non-current assets into the category of assets intended for sale or their exclusion from the respective category requires making use of the professional logic. If the entity is willing to dispose (alienate) the asset, than it should endeavor for its sale.

At the moment the general plan of bookkeeping accounts does not include an account for the evidence of the non-current assets held for sale. It was suggested to use for the evidence of the corresponding assets an account of I degree from the current assets class – 263 "Non-current assets held for sale". The basic premise for the introduction of this account serves the IAS 1, according to which the entity, immediately after the current assets, shall submit in the statement of the financial position, in a separate line, the total of the non-current assets classified as held for sale and of the assets included in the groups intended for disposal, classified as held for sale (according to IFRS 5 “Non-current assets held for sale and discontinued operations”).

It is also not clear from IFRS 5 to which expenses should be reflected the losses from depreciation, defined as any initial reduction of the book value of an asset (or group intended for sale) before the fair value minus the sales costs. We suggest to register this loss in account 721 „Expenses related to non-current assets”, because these expenses are generated by the exit of the non-current assets from operation. But, any reduction or subsequent growth of the fair value minus sales costs should be registered by the local entities in account 714 “Other operating costs” or account 612 „ Other operating income”.

I hope that the clarifications and approaches presented in this article shall facilitate the perception and shall eliminate some difficult aspects in the practical application of the stipulations of IFRS 5.

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