IFRS 5 - QUESTION

Rockby, a public limited company, has committed itself before its year-end of 31 March 2004 to a plan of action to sell a subsidiary, Bye. The sale is expected to be completed on 1 July 2004 and the financial statements of the group were signed on 15 May 2004. The subsidiary, Bye, a public limited company, had net assets at the year end of $5 million and the book value of related goodwill is $1 million. Bye has made a loss of $500,000 from 1 April 2004 to 15 May 2004 and is expected to make a further loss up to the date of sale of $600,000. Rockby was at 15 May 2004 negotiating the consideration for the sale of Bye but no contract Rockby expected to receive $4.5 million for the company after selling costs. The value-in-use of Bye at 15 May 2004 was estimated at $3.9 million.

Further the non-current assets of Rockby include the following items of plant and head office land and

(i) Tangible non-current assets held for use in operating leases: at 31 March 2004 the company has at carrying value $10 million of plant which has recently been leased out on operating leases. These leases have now expired. The company is undecided as to whether to sell the plant or lease it to customers under finance leases. The fair value less selling costs of the plant is $9 million and the value-in-use is estimated at $12

Plant with a carrying value of $5 million at 31 March 2004 has ceased to be used because of a downturn in the economy. The company had decided at 31 March 2004 to maintain the plant in workable condition in case of a change in economic conditions. Rockby subsequently sold the plant by auction on 14 May 2004 for

(ii) The Board of Rockby approved the relocation of the head office site on 1 March 2003. The head office land and buildings were renovated and upgraded in the year to 31 March 2003 with a view to selling the site. During the improvements, subsidence was found in the foundations of the main building. The work to correct the subsidence and the renovations were completed on 1 June 2003. As at 31 March 2003 the renovations had cost $2·3 million and the cost of correcting the subsidence was $1 million. The carrying value of the head office land and buildings was $5 million at 31 March 2003 before accounting for the renovation. Rockby moved its head office to the new site in June 2003 and at the same time, the old head However, the market for commercial property had deteriorated significantly and as at 31 March 2004, a buyer for the property had not been found. At that time the company did not wish to reduce the price and hoped that market conditions would improve. On 20 April 2004, a bid of $8·3 million was received for the property and eventually it was sold (net of costs) for $7·5 million on 1 June 2004. The carrying value of the head office land and buildings was $7 million at 31 March 2004. Non-current assets are shown in the

Required:

(a) Discuss the way in which the sale of the subsidiary, Bye, would be dealt with in the group financial statements of Rockby at 31 March 2004 under IFRS 5.

(b) Discuss whether the following non-current assets would be classed as 'held for sale' if IFRS 5 had been

(i) the items of plant in the group financial statements at 31 March 2004;

(ii) the head office land and buildings in the group financial statements at 31 March 2003 and 31 March

IFRS 5 - SOLUTION

Part (a)

Under IFRS 5, a non-current asset or disposal group (in this case Bye – as it is a cash generating unit) should be classified as 'held for sale' if its carrying amounts will be recovered principally through a sale transaction rather than through continuing use. The criteria which have to be met are:
(i) a commitment to a plan
(ii) the asset is available for immediate sale
(iii) actively trying to find a buyer
(iv) sale is highly probable
(v) asset is being actively marketed
(vi) unlikely to be significant changes to the plan

These criteria seem to have been met in this case. Before classification of the item as 'held for sale' an impairment review will need to be undertaken irrespective of any indication or otherwise of impairment. Any loss will be charged to the income statements. IFRS 5 requires items 'held for sale' to be reported at the lower of carrying value and 'fair value less costs to sell'. The latter phrase essentially means net selling price. IFRS 5 requires extensive disclosure on the face of the income statements and in the notes regarding the subsidiary. In the SFP, it should be presented separately from other assets and liabilities. There are additional disclosures to be made concerning the facts and circumstances leading to the disposal and the segment in which the subsidiary is presented under IFRS 8 Operating Segments.

Part (b) (i)

To qualify as a 'held for sale' asset, the sale must be 'highly probable' and generally must be completed within one year. In the case of the operating lease assets, they will not qualify as 'held for sale' assets at 31 March 2004 as the company has not made a decision as to whether they should be sold or leased. They should, therefore, be shown as non-current assets and depreciated. 'Held for sale' assets are not depreciated. The carrying value of the assets will be $10 million. 'Held for sale' assets are valued at the lower of carrying value and fair value less selling costs under IFRS 5. The assets are not impaired because the value-in-use is above the carrying value.

The plant would not be classed as a 'held for sale' asset at 31 March 2004 even though the plant was sold at auction prior to the date that the financial statements were signed. The 'held for sale' criteria were not met at the balance sheet date and IFRS 5 prohibits the classification of noncurrent assets as 'held for sale' if the criteria are met after the balance sheet date and before the financial statements are signed. The company should disclose relevant information in the financial statements for the year ended 31 March 2004

Part (b) (ii)

Under IFRS 5, a non-current asset qualifies as 'held for sale' if it is available for immediate sale in its present condition subject to the usual selling terms. The company should have the intent and the ability to sell the asset in its present condition. At 31 March 2003, although the company ultimately wishes to sell the property, it would be unlikely to achieve this until the subsidence was dealt with. Additionally the company's view was that the property should be sold when the renovations were completed which would have been at 1 June 2003. Also as at 31 March 2003, the company had not attempted to find a buyer for the property. Hence the property could not be classed as 'held for sale' at that date.

As at 31 March 2004, the property had not been sold although it had been on the market for over nine months. The market conditions had deteriorated significantly and yet the company did not wish to reduce the price. It seems as though the price asked for the property is in excess of its fair value especially as a bid of $8·3 million was received shortly after the year end (20 April 2004). The property has been vacated and, therefore, is available for sale but the price does not seem reasonable in relation to its current fair value ($10 million price as opposed to $8·3 million bid and ultimate sale of $7·5 million). Therefore, it would appear that at 31 March 2004, the intent to sell the asset might be questionable. The property fails the test set out in IFRS 5 as regards the reasonableness of price and, therefore, should not be classed as 'held for sale'.