

# Disposal of Long-Lived Assets and Discontinued Operations — Background Information and Basis for Conclusions

## Section 3475

### Foreword

The pre-changeover standards in Part V of the CPA Canada Handbook – Accounting, which included this Basis for Conclusions document, have been removed from the Handbook. This Basis for Conclusions was developed to accompany the pre-changeover standard and, since that standard was fully converged with Part II of the Handbook, it remains relevant.

The Accounting Standards Board believes Background Information and Basis for Conclusions material will assist:

- readers of the CPA Canada Handbook – Accounting in understanding and applying the Recommendations in the revised Section;
- users of financial statements in understanding the information provided by reporting enterprises; and
- everyone interested in financial reporting in obtaining a better appreciation of the work that has gone into the development of the new standard.

The contents of this document do not form part of the CPA Canada Handbook – Accounting. The Accounting Standards Board does not intend to include in Background Information and Basis for Conclusions documents any guidance that is necessary for applying a Recommendation.

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### INTRODUCTION

1. This document summarizes considerations that were deemed significant by the Accounting Standards Board (AcSB) members in reaching the conclusions in DISPOSAL OF LONG-LIVED ASSETS AND DISCONTINUED OPERATIONS, Section 3475. It sets out the reasons the AcSB undertook the project to develop the standard, the process of research and deliberation, the key decisions made and the principal reasons for accepting certain approaches and rejecting others. Individual AcSB members gave greater weight to some factors than to others.
2. Nothing in this document is to be taken as overriding the Recommendations in Section 3475; however, the discussion may assist Handbook users in understanding the Recommendations and the AcSB's intent with respect to its interpretation and application. This Section is intended to harmonize with the asset disposal and discontinued operations provisions of the Financial Accounting Standards Board (FASB) Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." The FASB has provided a detailed analysis of its deliberations and conclusions, 1 which might also be of value to Handbook users.

### BACKGROUND

3. This Section replaces the disposal provisions of PROPERTY, PLANT AND EQUIPMENT, Section 3061, as well as DISCONTINUED OPERATIONS, Section 3475.
4. In 2001 the AcSB decided to develop a new accounting standard on the impairment of long-lived assets. After considering alternative approaches, it was decided to harmonize with FAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." In addition to impairment, FAS 144 addresses accounting for the disposal of long-lived assets by sale or otherwise, as well as discontinued operations. The guidance on accounting for long-lived assets to be disposed of was more complete in FAS 144 than in existing Canadian GAAP, and the discontinued operations provisions created a GAAP difference where US and Canadian GAAP were previously consistent. The AcSB therefore decided to include the disposal of long-lived assets and discontinued operations within the scope of the project and to consider whether Canadian GAAP on these topics should be harmonized with FAS 144, consistent with its objective of facilitating access by Canadian enterprises to US and global capital markets by eliminating, or minimizing, GAAP differences within North America and internationally, as appropriate.
5. The AcSB issued an Exposure Draft, "Impairment or Disposal of Long-Lived Assets," in February 2002. This was based on FAS 144, amended to conform to Canadian standards and terminology, with the intent that this would result in harmonized accounting with the US on this topic.
6. The responses to the Exposure Draft did not result in the AcSB making any fundamental changes to the proposals, although several clarifications and other improvements were made (without conflicting with the objective of harmonizing with FAS 144). During the exposure period, FASB issued additional guidance on the disposal provisions of FAS 144. (This related to the disposal of an equity method investment and to the transitional provisions.) The AcSB reviewed these and decided to incorporate the guidance into this standard. The AcSB also decided to publish the final Recommendations as two Sections: IMPAIRMENT OF LONG-LIVED ASSETS, Section 3063, and DISPOSAL OF LONG-LIVED ASSETS AND DISCONTINUED OPERATIONS, Section 3475.

#### **LONG-LIVED ASSETS TO BE DISPOSED OF OTHER THAN BY SALE**

7. The AcSB determined that the provisions in FAS 144 are generally consistent with PROPERTY, PLANT AND EQUIPMENT, Section 3061, but provide more guidance. A consequential amendment was made to NON-MONETARY TRANSACTIONS, Section 3830. This relates to the disposal of an asset as part of a non-monetary transaction that does not represent the culmination of the earnings process and is recorded at carrying amount. The AcSB concurred with the FASB view that these transactions are significant economic events that should result in an impairment loss if the carrying amount of the asset exceeds its fair value at the disposal date.
8. **LONG-LIVED ASSETS TO BE DISPOSED OF BY SALE**
9. The AcSB determined that the recognition provisions in FAS 144 provided useful additional guidance on when a disposal by sale should be recognized.
10. The measurement provisions of existing Canadian GAAP related to long-lived assets held for disposal were generally consistent with FAS 144, but there were some specific differences. DISCONTINUED OPERATIONS, Section 3475, required that estimated operating losses for disposals that met the definition of discontinued operations should be provided for at the measurement date. Emerging Issues Committee Abstract EIC-63, "Income Statement Presentation of Results of a Portion of a Business Segment Held for Disposal," requires that for disposals not meeting the definition of a discontinued operation, the future operating losses are not recognized in advance, but as incurred. The AcSB concurred with the FASB view that all disposals by sale should be accounted for in the same way, whether they meet the definition of a discontinued operation or not. Since estimated future losses do not meet the definition of a liability, they should not be accrued in advance. The AcSB noted, however, that where the assets to be disposed of are valued at fair value less cost to sell (being less than carrying amount), the fair value may include the market's valuation of unavoidable anticipated future losses.
11. A long-lived asset to be disposed of by sale is measured at the lower of its carrying amount or its fair value less cost to sell at each reporting date. This is a process of valuation and the periodic charge to earnings is a result of the change in this amount during the period. Depreciation is not charged. Depreciating the asset would reduce its carrying amount below (or further below) fair value less cost to sell and result in a gain (or larger gain) at the time of disposal.
12. SUBSIDIARIES, paragraph 1590.12, states that "An enterprise acquired with the clearly demonstrated intention that it be disposed of in the foreseeable future is a temporary investment." This results in the assets and liabilities of such an enterprise being reported as a single number in the parent's balance sheet, rather than by their separate components. Consistent with FAS 144, the AcSB determined that all assets to be disposed of should be accounted for and reported in the same manner. Section 1590 was amended to delete paragraph 1590.12.
13. IMPAIRED LOANS, Section 3025, includes specific accounting requirements for foreclosed assets. These are not the same as the accounting for assets held for sale under Section 3475. The AcSB could see no conceptual justification for having different accounting procedures for assets based on how they were acquired, and viewed the existence of different accounting methods for similar assets held for sale as incompatible with the objectives of consistency and transparency. The AcSB consequently decided to amend Section 3025 to make the accounting for foreclosed assets consistent with Section 3475. This had not been identified in the Exposure Draft "Impairment or Disposal of Long-Lived Assets" so, because of the potential significance of the change, a separate Exposure Draft on this was issued in September 2002.

## **DISCONTINUED OPERATIONS**

13. FINANCIAL STATEMENT CONCEPTS, paragraph 1000.15, states: "The objective of financial statements is to communicate information that is useful to investors, members, contributors, creditors and other users ("users") in making resource allocation decisions and/or assessing management stewardship." Discontinued operations are presented separately from the results of other activities in the income statement to help users of financial statements understand the historical financial performance of those portions of the business that the enterprise will continue to control in the future. This will become one of the inputs to the user's estimate of the future so that effective resource allocation decisions can be made. Separately presenting discontinued operations makes the financial statements more useful for resource allocation decisions.
14. DISCONTINUED OPERATIONS, Section 3475, defined which disposals could be classified as a discontinued operation. The definition (including requirements that the disposal be a line of business and that it be significant) had the effect of excluding many disposals.
15. Prior to FAS 144, US GAAP had a similar definition of discontinued operations to that in DISCONTINUED OPERATIONS, Section 3475. In their deliberations on FAS 144, the FASB observed that disposals that do not meet the definition of discontinued operations also might have a significant effect on the enterprise's ongoing operations and that broadening the reporting of discontinued operations would improve the information provided to users.
16. The AcSB agreed that information on discontinued operations was useful to users of financial statements, and that more complete information would increase the usefulness. However, some AcSB members were concerned with possible implications for the perceived quality of reported earnings.
17. One concern was that when a component of an enterprise meets the definition of a discontinued operation, its operating results for both current and prior periods are reported in discontinued operations and not in revenues and expenses with the results of other operations. Classification as a discontinued operation results in restatement of revenues and expenses (although not of total earnings) for prior periods. Increasing the number of disposals that meet the definition of a discontinued operation will increase the number of times that revenues and expenses have to be restated, potentially causing confusion among users as to what the revenues and expenses really were. AcSB members noted that revenues and earnings attributable to discontinued operations would be disclosed. This would assist users in comparing financial statements restated for discontinued operations.
18. A further concern was that this would provide company management with an increased ability to report adverse earnings impacts on earnings "below the line" and to downplay them in communications with shareholders, analysts and other users. The increased use of pro forma earnings in recent years contributed to this concern.
19. In discussing these concerns, some AcSB members felt that discontinued operations should not be separated out in the income statement, but the information could be disclosed in the notes to the financial statements. This would provide the users with the information they need, without any adverse impacts on the income statement. Others felt that note disclosure is not as effective as presentation in the financial statements themselves. It was also noted that the 1999 G4+1 position paper, "Reporting Financial Performance: Proposals for Change," proposed that disposal gains and losses on fixed assets be reported separately from the results of operating activities. This is also consistent with the recommendations of the AICPA Special Committee on Financial Reporting in its report "Improving Business Reporting — A Customer Focus." Both of these supported including more items than are in the current definition of discontinued operations.
20. In FAS 144, the subject of discontinued operations is a presentation issue. There are no measurement aspects and net earnings are not affected by the definition. It might, therefore, be argued to be less important to harmonize on this issue than on other aspects of impairment or disposal of long-lived assets. The current Canadian definition could be retained. The IASB has a project on its agenda on reporting financial performance and the definition and presentation of discontinued operations will be addressed in that project.
21. Current international thinking is to broaden the category of discontinued operations and present these separately from earnings from operating activities in the income statement. AcSB members could not identify any unique Canadian circumstances to justify a US GAAP difference and were concerned at the confusion that would be caused for Canadian enterprises subject to US GAAP if different definitions were in place. In their Canadian and US financial statements, these enterprises would report different earnings before discontinued operations as well as different earnings from discontinued operations for each year impacted by the difference in definitions. The AcSB therefore agreed to adopt the more inclusive definition of discontinued operations from FAS 144. It also noted that the rationale for reporting discontinued operations separately applied equally to disposals that included, or did not include, long-lived assets.
22. Some respondents to the ED were concerned that enterprises would be required to classify certain disposals as discontinued operations even though the required data (including prior-year comparative data) would be difficult to obtain. The AcSB agreed this was not the intent. In many cases the data would be available, although it may not have been disclosed separately in published financial statements, and in such cases a disposal should be reported as a discontinued operation (if it meets the requirements in the Section for classification as a discontinued operation). In other cases the enterprise should consider the benefit to users of the financial statements and the costs involved in obtaining the data in accordance with Section 1000.

## **PRESENTATION AND DISCLOSURE**

23. The AcSB decided to incorporate Emerging Issues Committee Abstract EIC-41, "Presentation of Assets and Liabilities Held for Disposal," into the new Handbook Section since it related to the subject matter and would be more convenient for users of the Handbook.
24. The AcSB determined that the disclosure requirements of FAS 144 were largely similar to those under existing Canadian GAAP and that the benefits of the disclosures would be greater than the costs.

#### **TRANSITIONAL PROVISIONS**

25. The revised Handbook Section was approved in October 2002. A January 1, 2003 effective date could cause practical difficulties for a number of preparers, who would only have seen the final Handbook Recommendations shortly before that date. (The AcSB noted that details of its decisions are posted on its web site following each AcSB meeting, providing constituents with a way to keep current as the AcSB reviews Exposure Draft responses and finalizes a Handbook Section.) The provisions for accounting for assets to be disposed of were therefore set to apply to assets with disposal activities initiated by the commitment to a plan on or after May 1, 2003.
26. Certain Canadian enterprises are also required to prepare financial statements under US GAAP. The AcSB is sympathetic to these enterprises' desire to minimize GAAP differences and the additional work of keeping separate accounting records for Canadian and US GAAP. Early adoption is encouraged. This permits an enterprise to report its full year 2002 results on a consistent basis for the disposal of long-lived assets.
27. The consequential amendments to SUBSIDIARIES, Section 1590, IMPAIRED LOANS, Section 3025, and to NON-MONETARY TRANSACTIONS, Section 3830, apply to assets with disposal activities initiated by the commitment to a plan on or after May 1, 2003, with early adoption encouraged.

#### **DIFFERENTIAL REPORTING**

28. The Exposure Draft was reviewed by the Differential Reporting Advisory Committee. They requested certain clarifications be added to the Section but did not recommend a differential reporting option.
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## **Footnotes**

1. FAS 144, Appendix B, Background Information and Basis for Conclusions (August 2001).

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