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ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS – EVALUATION OF LIQUIDITY – DETERMINATION OF RATIO – OR NECESSITY OF ADJUSTMENT?

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Abstract

The change in the use of an asset results from economic conditions and requires that a company revalue the asset and adjusts its value by costs of sale or liquidation. The current value of the asset determined in that way influences the financial result of the company and enables the movement of value from non-current assets to current assets. This change has an impact on the evaluation of financial situation and financial ratios.The aim of this article is to describe principles of measurement and presentation of assets held for sale and application of financial analysis in order to assess risks by potential investors. The purpose of this work constitutes part of a wide-ranging discussion on the directions of changes in financial reporting and principles of effective investing.

Keywords: Non-Current Assets Held for Sale, IFRS, Accounting Liquidity, Financial Risk, Investment Decisions, Adjustments and Exclusions

1. Introduction

The Warsaw Stock Exchange requires that all listed companies apply IFRS to prepare their financial statements. According to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, companies present assets as current assets at estimated value.

The change in the use of an asset results from economic conditions and requires that a company revalue the asset and adjusts its value by costs of sale or liquidation (Kiziukiewicz, 2001). A current value of the asset determined in that way influences the financial result of the company and enables the movement of value from non-current assets to current assets (Sierpińska and Wędzki, 2002). This change has an impact on the assessment of financial position and financial ratios (Szyszko and Szczepański, 2003). This article presents the rules of disclosure of information on non-current assets held for sale and discontinued operations based on the example of a Polish stock-listed company which prepares financial statements in accordance with the IFRSs. On the basis of presented information and conducted analysis, financial and accounting areas of risks of investment decisions are indicated as well as the necessity of applying adjustment as an indispensable element to minimize risks while making decisions by stakeholders (Voss, 2012).

The aim of this article is to describe principles of measurement and presentation of assets held for sale and use of financial information to assess risk by potential investors. The purpose of this work constitutes part of a wide-ranging discussion on directions of changes in financial reporting and principles of effective investing (Prewysz-Kwinto and Voss, 2012).

The primary methods used during the preparation of this work included: analysis and review of legal acts and subject literature as well as application of financial analysis to financial decision making.

2. Non-current Assets Held for Sale and Discontinued Operations

Information on future events may influence a company's financial position, liquidity as well as a price of stocks, and thus investors' decisions. Sale of assets may concern one asset or a specified disposal group of assets (Piszczyk, 2011).

The Polish legal regulations – the Polish Accounting Act – do not include rules related to principles of classification and presentation of non-current assets held for sale in financial statements. Only Article 10.3 of the Act reads: *for matters not regulated by the Act, while adopting their principles (policies) of accounting, entities may apply domestic accounting standards issued by the Polish Accounting Standards Committee. If no applicable domestic accounting standard exists, entities may apply IAS/ IFRS* (Polish Accounting Act, 1994). It means that business entities which own non-current assets held for sale or assets not used due to discontinued operations can be recognised in financial statements in accordance with the International Financial Reporting Standard 5 *Non-current Assets Held for Sale and Discontinued Operations*.

The purpose of the standard is to determine an accounting approach to assets held for sale as well as presentation and disclosure of information on discontinued operations. In particular, the standard requires (IFRS, 2013):

- assets that meet the criteria to be classified as held for sale to be measured at the lower of carrying amount and fair value less costs to sell, and depreciation on such assets to cease; and
- assets that meet the criteria to be classified as held for sale to be presented separately in the statement of financial position and the results of discontinued operations to be presented separately in the statement of comprehensive income.

According to IFRS 5 terminology, a 'disposal group' is a group of assets which are intended to be disposed of, by sale or otherwise, together as a group in a single transaction (including liabilities directly associated with those assets that will be transferred in the transaction). The group includes goodwill acquired in a business combination provided that the group is a cash-generating unit to which goodwill has been allocated (IAS 36) or it is an operation within such a cash-generating unit (IFRS, 2013).

3. Classification of Non-current Assets as Held for Sale

According to international standards, an entity shall classify a non-current asset as held for sale if its carrying amount will be recovered principally through a sale transaction. It means that the entity will discontinue using the asset in accordance with its current purpose and that the asset is available for immediate sale in its present condition. It is assumed that the sale is highly probable, i.e. the management of the entity is committed to sell the asset and the asset is actively marketed for sale at a reasonable price. In addition, the sale should be expected to be completed within one year from the date of classification (Kedzior, 2011). If the entity expects to recover the carrying value of non-current assets or disposal group principally through a sale transaction, not through their continuous use for the company's purposes, the assets qualify for a separate group *property, plant and equipment held for sale* which constitutes an item of current assets.

When an entity acquires a non-current asset exclusively with a view to sale it, it may classify the non-current asset as held for sale at the acquisition date. However, the condition must be met that the sale will be completed within one year from the date of classification.

Moreover, it must be probable that if the required criteria specified above are not met at the acquisition date, they will be met within a short period following that date – usually within three months (Panfil, 2008).

If the required criteria are met after the reporting period, an entity does not classify a non-current asset as held for sale. It should be recognised in the financial statements in accordance with the actual circumstances at the reporting date. If the criteria are met after the reporting period but before the authorisation of the financial statement for issue, the entity should disclose the following information in the notes:

1) a description of the non-current asset;
2) a description of facts and circumstances of the sale, or leading to the expected disposal, and the expected manner and timing of that disposal;
3) if applicable, the reportable segment in which the non-current asset is presented – in accordance with IFRS 8 *Operating Segments*.

The period to complete the sale of an asset may exceed one year under certain conditions. According to Article 9 of IFRS 5, an extension of the period required to complete a sale does not preclude an asset from being classified as held for sale. It is the case when the delay is caused by events or circumstances beyond the entity's control. The entity should have sufficient evidence that it remains committed to its plan to sell the asset.

A non-current asset or disposal group recognised as held for sale is measured at the lower of the following:

- carrying amount or
- fair value less costs to sell

A carrying amount of an asset held for sale is measured in accordance with applicable IFRSs. The carrying amount is measured immediately before the classification of the asset as held for sale. When the sale is expected to occur beyond one year, costs to sell are measured at their present value. If there is any increase in the present value of costs resulting from the passage of time, it should be presented in the profit or loss as a financing cost.

If a newly acquired asset meets the criteria to be classified as held for sale, the asset is measured on initial recognition at the lower of its carrying value which would have been recognised had it not been classified as held for sale (e.g., cost or fair value less costs to sell).

On initial or subsequent re-measurement of an asset or disposal group, an impairment loss for write-down of the asset to fair value less costs to sell should be recognised as a difference between the fair value and the carrying amount of the asset.

According to IFRSs, a non-current asset should not be depreciated while it is classified as held for sale.

IFRS 5 requires a specific presentation of non-current assets held for sale. According to Article 38, they are presented separately from other assets in the statement of financial position. They are not moved from non-current assets to current assets, but to a separate category.

Moreover, according to the IFRS, any gain or loss on the re-measurement of a non-current asset classified as held for sale which does not meet the definition of a discontinued operation (discontinued operation is a component of an entity that has been either disposed of or is classified as held for sale, and represents a separate major line of business or geographical area of operations. It is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations or it is a subsidiary acquired exclusively with a view to resale) should be included in the profit or loss from continuing operations.

An entity presents as a single amount in the statement of comprehensive income the total of post-tax profit or loss from discontinued operations for the period and post-tax gain or loss on the disposal of discontinued operations (or on the re-classification of assets and liabilities of discontinued operations as held for sale). Therefore, the statement of comprehensive income is divided into two sections – continuing operations and discontinued operations. The scope of disclosures in the notes includes:

- a description of non-current assets (or disposal group);
- a description of facts and circumstances of the sale, or leading to the expected disposal, and the expected manner and timing of that disposal;

- gain or loss on subsequent increase in fair value less costs to sell of an asset, and if not presented separately in the statement of comprehensive income, the caption in the statement of comprehensive income that includes that gain or loss;
- if applicable, the reportable segment in which the non-current asset is presented – in accordance with IFRS 8 *Operating Segments*.

IFRS 5 requires disclosures in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. Consequently, disclosures required by other IFRSs do not apply to such assets unless those standards specifically require disclosures in respect of non-current assets classified as held for sale or discontinued operations, or disclosures relate to the measurement of assets and liabilities within a disposal group outside the scope of the requirements specified in IFRS 5, and such disclosures are not presented in any other part of the financial statements.

4. Presentation of Assets Held for Sale and Discontinued Operations in the Financial Statements of a Listed Company Kernel Holding S.A.

4.1. Overview of the Company

Kernel Holding S.A. was incorporated under the legislation of Luxembourg on 15 June 2005 and registered with the Luxembourg Register of Companies under number B - 109 173. The company is the holding company for a group of business entities which constitute the group as subsidiaries. The company has been listed on the Warsaw Stock Exchange since 2007. Presently, the primary business activity of the Group includes production and sale of bottled sunflower oil, production and subsequent export of sunflower oil and meal, the wholesale trade of grain (mainly wheat, barley and corn), farming and logistics and shipment services. The Group's primary activity is based in Ukraine and Russia. As of 30 June 2013 the Group employed 17.603 employees (17.743 people as of 30 June 2012). The Group's financial year runs from July 1 to June 30.

4.2. The Company's Financial Data Including Assets Held for Sale

Assets held for sale are recognised in the statement of financial position (Table 1) and in the consolidated statement of profit and loss (Table 2).

Moreover, a note to the consolidated statement on discontinued operations included the following information (Note 5): In May 2013 the Group disposed of the sugar plant Chorkivskyi Sp. z o.o. In addition, following the directors' approval on 27 June 2013 of a plan to sell all other sugar plants of the Group, they were reclassified as held for sale. As the Group does not plan to dispose of the rights to cultivate the land on which sugar beets were grown for further processing by sugar plants, the Group classified as discontinued operations only revenue and all other expenses related to tolling services (ordering party's raw material used) rendered by sugar plants to other entities of the Group.

According to Note 37, the sugar plant Orzhytsky Sp. z o.o. was sold after the reporting period had ended.

Table 1. Statement of financial position – balance sheet
(in USD thousands unless specified otherwise)

Items	30.06.2013	30.06.2012
Assets		
Current assets		
Cash	678,827	82,529
Trade accounts receivables, net	149,600	146,362
Prepayments to suppliers and other current assets, net	118,353	90,335
Corporate Income Tax prepaid	19,323	1,794
Taxes recoverable and prepaid	190,695	233,861
Inventory	270,248	410,182
Biological assets	247,268	153,338
Assets classified as held for sale	23,176	-
Total current assets	**1,097,490**	**1,118,401**
Non-current assets		
Property, plant and equipment, net	767,317	728,371
Intangible assets, net	162,287	91,087
Goodwill	157,431	137,227
Investments in joint-venture	94,026	-
Deferred tax assets	22,850	21,502
Other non-current assets	65,541	19,805
Total non-current assets	**1,269,452**	**997,992**
Total assets	**2,366,942**	**2,116,393**
Liabilities and equity		
Current liabilities		
Trade accounts payable	51,751	25,490
Advances from customers and other current liabilities	202,051	154,699
Short-term borrowings	398,700	167,348
Current portion of long-term borrowings	50,893	98,622
Liabilities directly associated with assets classified as held for sale	1,909	-
Total current liabilities	**705,304**	**446,159**
Non-current liabilities		
Long-term borrowings	256,630	414,238
Obligations under finance lease	19,093	12,622
Deferred tax liabilities	27,721	26,356
Other non-current liabilities	5,839	6,317
Total non-current liabilities	**309,283**	**459,533**
Equity attributable to Kernel holding S.A. equity holders		
Issued capital	2,104	2,104
Share premium reserve	463,879	463,879
Additional paid-in capital	39,944	39,944
Equity-settled employee benefits reserve	3,028	1,211
Revaluation reserve	40,053	15,049
Transition reserve	(160,941)	(167,082)
Retained earnings	946,772	824,578
Total equity attributable to Kernel holding S.A. equity holders	**1,334,839**	**1,179,683**
Non-controlling interest	17,516	31,018
Total equity	**1,352,355**	**1,210,701**
Total liabilities and equity	**2,366,942**	**2,116,393**
Book value	1,334,839	1,179,683
Number of shares	79,683,410	79,140,131
Book value per one share (in USD)	16.75	14.91

Source: Kernel (2013)

Table 2. Consolidated profit and loss (in USD thousands)

Item	30.06.2013	30.06.2012
Revenue	2,796,752	2,071,810
Cost of sale	(2,385,889)	(1,614,436)
Gross profit	**410,863**	**457,374**
Other operating income	106,286	65,899
Operating expenses / Distribution cost	(238,061)	(199,102)
General and administrative expenses	(78,197)	(66,874)
Profit from operating activity	**200,891**	**257,297**
Financial costs, net	(74,878)	(63,084)
Foreign exchange gain, net	2,908	5,037
Other expenses, net	(5,998)	(2,925)
Share of losses of joint ventures	(2,201)	-
Profit before income tax	**120,722**	**196,325**
Income tax (expense)/ benefit	(6,171)	9,300
Profit for the year from continuing operations	**114,551**	**205,625**
Discontinued operations:		
(Loss)/ Profit for the year from discontinued operations	(9,625)	5,157
Profit for the year	**104,926**	**210,782**
Profit/ (Loss) for the year attributable to:		
Equity holders of Kernel Holding S.A.	**111,264**	**206,700**
Non-controlling interest	(6,338)	4,082

Source: Kernel (2013)

The entities of Kernel Group, the activities of which were classified as discontinued operations for the year ended 30 June 2013 are presented in Table 3.

Table 3. Discontinued operations within Kernel S.A. group

Subsidiary	Primary activity	Country of incorpo-ration	Group's effective ownership interest as of:	
			30.06.2013	30.06.2012
Sugar Plant Chortkivskyi Sp. z o.o.	Production plants. Production of sugar	Ukraine	90.1%	73.8%
Tsukrove Sp. z o.o.			100.0%	71.3%
Palmirasugar ALC			89.1%	72.7%
Sugar Plant Orzhytsky Sp. z o.o.			89.6%	73.4%

Source: author's compilation based on Kernel (2013)

Based on a note to the financial statements, Table 4 presents the balance of assets classified as held for sale as of 30 June 2013.

Table 4. The balance of assets classified as held for sale (in USD thousands)

Item	30.06.2013
Cash	71
Trade accounts receivable, net	3291
Taxes recoverable and prepaid, net	277
Inventory	606
Property, plant and equipment, net	17,749
Deferred tax assets	1,143
Other non-current assets	39
Assets of sugar plants classified as held for sale	**23,176**
Trade accounts payable	(19)
Advances from customers and other current liabilities	(1,859)
Other non-current liabilities	(31)
Liabilities of sugar plants associated with assets held for sale	**(1,909)**
Net assets of sugar plants classified as held for sale	**21,267**

Source: author's compilation based on Kernel (2013)

The combined results of the discontinued operations included in the profit for the year are presented in Table 5. The comparative result from the discontinued operations is presented again to reflect operations classified as discontinued in the previous year. In Table 6 cash flows from discontinued operations are presented.

Table 5. Result for the year from discontinued operations (in USD thousands)

Item	30.06.2013	30.06.2012
Revenue	8,167	85,631
Cost of sales	(6,580)	(82,032)
Other operating (expenses)/ income	(380)	94
Distribution of expenses	(870)	(1,266)
General and administrative expenses	(4,455)	(3,254)
Financial income (expenses), net	208	(1,277)
Foreign exchange gain, net	377	232
Gain on disposal of property, plant and equipment	7,428	-
Other income/ (expenses)	208	(561)
Income tax benefit	944	7,590
Profit for the year from discontinued operations	**5,047**	**5,157**
Loss on re-measurement to fair value less costs to sell	(14,672)	-
Net (loss) profit for the year from discontinued operations	**(9,625)**	**5,157**

Source: author's compilation based on Kernel (2013)

Table 6. Cash flows from discontinued operations (in USD thousands)

Item	30.06.2013	30.06.2012
Net cash (outflow)/ inflow from operating activities	(19,615)	26,478
Net cash inflow/ (outflow) from investing activities	19,592	(951)
Net cash outflow from financing activities	-	(25,451)
Net cash flows	**(23)**	**76**

Source: author's compilation based on Kernel (2013)

Kernel S.A. prepares and presents financial information in accordance with the IFRSs. The company presents the items of assets and results of economic decisions in respect of non-current assets classified as held for sale in accordance with IFRS 5.

The presented components of the financial statements show that as at end of June 2013 the value of assets classified as held for sale was USD 23,176,000, and Liabilities directly associated with the assets held for sale amounted to USD 1,909,000. Moreover, in 2013 there was a loss for the year from the discontinued operations in the amount of USD 9,625,000.

Based on the presented information, a potential user may conduct a financial analysis in order to obtain necessary information on the financial position of the company.

5. Conclusion

Financial analysis is a group of methods and tools used to assess a financial position of a company. It investigates financial positions and results as well as specific relations between certain financial categories. The categories are expressed in terms of money and their value is determined at a defined time – reporting date (Dynus *et al.* 2005). All business entities aim at achieving certain benefits for investors. Bearing that in mind, the purpose of assessing financial position is to disclose all relevant factors which influence determination of financial and market positions of an entity (Naruc *et al*. 2008).

In the case of comparative analysis which is based on comparison in three dimensions, i.e. time, space and pattern, attention should be paid to the necessity of adjustments and exemptions.

Data analysis over time based on the example of the described listed company shows that in 2012 the company did not own assets held for sale nor current liabilities associated with the disposal of assets. While assessing the next two consecutive years, applicable adjustments should be made (to items of the statement of financial position, statement of profit and loss and cash flows) in order to obtain comparable data for the next analysed periods. While making a comparative analysis in space, an investor, by comparing the company's data for the analysed period with the data of competition or trade-related data, also has to pay attention to results after adjustments related to information on the sale of non-current assets or discontinued operations.

In the case of the presented company the reporting period may constitute another difficulty. The company presents data for the period from 1 July 2012 until 30 June 2013 while the majority of companies present data for the period from 1 January 2013 until 21 December 2013.

In order to make a comparative analysis using pattern, e.g., whether an entity's ratios have been evaluated as desirable, attention should also be paid to how the reclassification of a non-current asset (non-current assets classified as held for sale or discontinued operations) to a current asset influences the ratios and what the impact of expenses and income from discontinued operations is.

The conditions described above pose new challenges for the user of financial statements, not only in respect of financial analysis but also a good knowledge of financial reporting standards and skills to utilise information presented in notes.

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