

DISCONTINUING OPERATIONS

AS
24

Objective	<p>AS 24 is applicable to all discontinuing operations.</p> <p>The objective of AS 24 is to establish principles for reporting information about discontinuing operations, thereby enhancing the ability of users of financial statements to make projections of an enterprise's cash flows, earnings-generating capacity, and financial position by segregating information about discontinuing operations from information about continuing operations.</p>
Discontinuing Operation	<p>A discontinuing operation is a component of an enterprise: (PARA 3)</p> <p>a) That the enterprise, pursuant to a single plan, is:</p> <ul style="list-style-type: none"> ➤ <i>Disposing of substantially in its entirety</i>, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders or ➤ <i>Disposing of piecemeal</i>, such as by selling off the component's assets and settling its liabilities individually or ➤ Terminating through <i>abandonment</i> and <p>b) That represents a separate major line of business or geographical area of operations.</p> <p>c) That can be distinguished operationally and for financial reporting purposes.</p> <p>A component can be distinguished operationally and for financial reporting purposes - criterion (c) of the definition of a discontinuing operation - if all the following conditions are met:</p> <ol style="list-style-type: none"> a. The operating assets & liabilities of the component can be directly attributed to it. b. Its revenue can be directly attributed to it. c. At least majority of its operating expenses can be directly attributed to it. <p>Discontinuing operations are infrequent events, but this does not mean that all infrequent events are discontinuing operations. The fact that a disposal of a component of an enterprise is classified as a discontinuing operation under AS 24 does not, in itself, bring into question the enterprise's ability to continue as a going concern.</p> <p><i>Examples of activities</i> that do not necessarily satisfy criterion(a)of definition, but that might do so in combination with other circumstances, include:</p> <ul style="list-style-type: none"> ❖ Gradual or evolutionary phasing out of a product line or class of service. ❖ Discontinuing, even if relatively abruptly, several products within an ongoing line of business. ❖ Shifting of some production or marketing activities for a particular line of business from one location to another and ❖ Closing of a facility to achieve productivity improvements or other cost savings. <p>An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.</p>

<p>Initial Disclosure event</p>	<p>Occurrence of one of the following, <i>whichever occurs earlier</i>:</p> <p>a) The enterprise has entered into a binding sale agreement for substantially all of assets attributable to the discontinuing operation or</p> <p>b) The enterprise's board of directors or similar governing body has both</p> <p>(i) approved a detailed, formal plan for the discontinuance and</p> <p>(ii) made an announcement of the plan.</p> <p>A detailed, formal plan for the discontinuance normally includes:</p> <ul style="list-style-type: none"> ➤ identification of the major assets to be disposed of; ➤ the expected method of disposal; ➤ the period expected to be required for completion of the disposal; ➤ the principal locations affected; ➤ the location, function, and approximate number of employees who will be compensated for terminating their services; and ➤ the estimated proceeds or salvage to be realised by disposal. <p>An enterprise's board of directors or similar governing body is considered to have made the announcement of a detailed, formal plan for discontinuance, if it has announced the main features of the plan to those affected by it, such as, lenders, stock exchanges, trade payables, trade unions, etc. in a sufficiently specific manner so as to make the enterprise demonstrably committed to the discontinuance.</p>
<p>Recognition and Measurement</p>	<p>For recognising and measuring the effect of discontinuing operations, this AS does not provide any guidelines, but for the purpose the relevant Accounting Standards should be referred.</p>
<p>Presentation & Disclosure (Initial Disclosure)</p>	<p>An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event occurs:</p> <ul style="list-style-type: none"> ❖ A description of the discontinuing operation(s) ❖ The business or geographical segment(s) in which it is reported as per AS 17 ❖ The date and nature of the initial disclosure event. ❖ The date or period in which the discontinuance is expected to be completed if known or determinable ❖ The carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled ❖ The amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period ❖ The amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto ❖ The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period
<p>Presentation of the above disclosures</p>	<p>All the disclosures above should be presented in the notes to the financial statements except for amounts pertaining to pre-tax profit/loss of the discontinuing operation and the income tax expense thereon (second last above) which should be shown on the face of the statement of profit and loss.</p>

Other disclosures	<p>When an enterprise disposes of assets or settles liabilities attributable to a discontinuing operation or enters into binding agreements for the sale of such assets or the settlement of such liabilities, it should include, in its financial statements, the following information when the events occur:</p> <ol style="list-style-type: none"> a. For any gain or loss that is recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation, <ol style="list-style-type: none"> (i) the amount of the pre-tax gain or loss and (ii) income tax expense relating to the gain or loss and b. The net selling price or range of prices (which is after deducting expected disposal costs) of those net assets for which the enterprise has entered into one or more binding sale agreements, the expected timing of receipt of those cash flows and the carrying amount of those net assets on the balance sheet date.
Updating the disclosures	<p>In addition to these disclosures, an enterprise should include, in its financial statements, for periods subsequent to the one in which the initial disclosure event occurs, a description of any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled and the events causing those changes.</p> <p>The disclosures should continue in financial statements for periods up to and including the period in which the discontinuance is completed.</p> <p>Discontinuance is completed when the plan is substantially completed or abandoned, though full payments from the buyer(s) may not yet have been received.</p> <p>Any disclosures required by AS 24 should be presented separately for each discontinuing operation.</p>
Restatement of Prior Periods	<p>Comparative information for prior periods that is presented in financial statements prepared after the initial disclosure event should be restated to segregate assets, liabilities, revenue, expenses, and cash flows of continuing and discontinuing operations in a manner similar to that mentioned above.</p>
Disclosure in interim financial reports <i>(RTP Nov 2022)</i>	<p>Disclosures in an interim financial report in respect of a discontinuing operation should be made in accordance with AS 25, 'Interim Financial Reporting', including:</p> <ol style="list-style-type: none"> a. Any significant activities or events since the end of the most recent annual reporting period relating to a discontinuing operation and b. Any significant changes in the amount or timing of cash flows relating to the assets to be disposed or liabilities to be settled.

Example 1:

Co XY runs a famous chain of restaurants. It decides to sell its stake in one of the restaurant. This restaurant contributes around 5% of total revenue to the entire business. XY does not intend to sell any other restaurant as part of its strategy.

In the above case, the sale of one restaurant out of the chain does not constitute disposal of business under a single plan, or a portion that represents a major line of business or geographical area of operations. Thus, it cannot be regarded as a discontinuing operation.

Example 2:

Group MN operates in various industries including Hotels, Airlines and Software through its subsidiaries. It has decided to sell its Airline business to be able to concentrate on other verticals. As a result, it has started to sell its aircrafts and paying off the associated liabilities. During the year, it has sold off 5 aircrafts out of the fleet of 50 aircrafts so far as part of the sale. The Airline business constitutes 25% of total group revenue.

In the above case, Airline business may be considered as discontinuing operation. This is due to the fact that the assets are sold off as part of a single plan, and that the business represents a separate major line of business, and can be distinguished both operationally and for financial reporting purposes.

Example 3:

GH, a large car manufacturing company, decides to discontinue its manufacturing operations relating to the diesel cars production. It plans to restructure the business by revamping its existing operations, and starting new manufacturing process for manufacture and sale of electric vehicles.

In the above example, it needs to be evaluated whether the restructuring is a result of continuing operations, or termination of existing operations, and accordingly it can be concluded whether it is a case of discontinuing operations or not.

Example 4:

Entity RT operates in a single state and is trading in 3 products – X, Y and Z. Details with respect to the performance of each of the products are as under:

Particulars	X	Y	Z	Total
Sales	1,00,000	14,00,000	20,00,000	35,00,000
Cost of Goods Sold	(80,000)	(10,80,000)	(14,40,000)	(26,00,000)
Gross Margin	20,000	3,20,000	5,60,000	9,00,000
Operational Expenses	(15,000)	(1,70,000)	(3,60,000)	(5,45,000)
Profit before tax	5,000	1,50,000	2,00,000	3,55,000

RT has decided to sell the business relating to Product Y to another entity. Since Product Y constitutes a major product, it may be considered as a discontinuing operations.

ASSIGNMENT QUESTIONS

Question 1 *(RTP May 2018) / (RTP May 2023)*

A consumer goods producer has changed the product line as follows:

	Dish Washing Bar (per month)	Clothes Washing Bar (per month)
January, 2021 – September, 2021	2,00,000	2,00,000
October, 2021 – December, 2021	1,00,000	3,00,000
January, 2022- March, 2022	0	4,00,000

The company has enforced a gradual enforcement of change in product-line on the basis of an overall plan. The Board of Directors of the company has passed a resolution in March, 2022 to this effect. The company follows calendar year as its accounting year. You are required to advise whether it should be treated as a discontinuing operation or not as per AS 24?

Solution

As per AS 24, a discontinuing operation is a component of an enterprise:

- a. That the enterprise, pursuant to a single plan, is:
 - (i) Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders or
 - (ii) Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or
 - (iii) Terminating through abandonment and
- b. That represents a separate major line of business or geographical area of operations.
- c. That can be distinguished operationally and for financial reporting purposes.

As per provisions of the standard, business enterprises frequently close facilities, abandon products or even product lines, and change the size of their work force in response to market forces. While those kinds of terminations generally are not, in themselves, discontinuing operations, they can occur in connection with a discontinuing operation. Examples of activities that do not necessarily satisfy criterion of discontinuing operation are gradual or evolutionary phasing out of a product line or class of service, discontinuing, even if relatively abruptly, several products within an ongoing line of business.

In the given case, the company has enforced a gradual enforcement of change in product line and does not represent a separate major line of business and hence is not a discontinued operation. If it were a discontinuing operation, the initial disclosure event is the occurrence of one of the following, whichever occurs earlier:

- (i) the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or
- (ii) the enterprises board of directors or similar governing body has both approved a detailed, formal plan for discontinuance and made an announcement of the plan.

Question 2 *(Inter July 2021) (5 Marks) / (RTP May 2021) (Similar) / (ICAI Study Material)*

Rohini Limited is in the business of manufacture of passenger cars and commercial vehicles. The Company is working on a strategic plan to close the production of passenger cars and to produce only commercial vehicles over the coming 5 years. However, no specific plans have been drawn up for sale of neither the division nor its assets. As part of its prospective plan it will reduce the production of passenger cars by 20% annually. It also plans to establish another new factory for the manufacture of commercial vehicles and transfer surplus employees in a phased manner. You are required to comment:

- a) If mere gradual phasing out in itself can be considered as a 'discontinuing operation' within the meaning of AS-24.
- b) If the Company passes a resolution to sell some of the assets in the passenger car division and also to transfer few other assets of the passenger car division to the new factory, does this trigger the application of AS-24?
- c) Would your answer to the above be different if the Company resolves to sell the assets of the passenger car division in a phased but time bound manner?

Solution

- a) As per AS 24, a discontinuing operation is a component of an enterprise:
- a. That the enterprise, pursuant to a single plan, is:
 - (iv) Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders or
 - (v) Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or
 - (vi) Terminating through abandonment and
 - b. That represents a separate major line of business or geographical area of operations.
 - c. That can be distinguished operationally and for financial reporting purposes.
- Mere gradual phasing is not considered as discontinuing operation as defined under AS 24, 'Discontinuing Operation'. Examples of activities that do not necessarily satisfy criterion of the definition, but that might do so in combination with other circumstances, include:
- 1) Gradual or evolutionary phasing out of a product line or class of service.
 - 2) Shifting of some production or marketing activities for a particular line of business from one location to another and
 - 3) Closing of a facility to achieve productivity improvements or other cost savings.
- In this case, it cannot be considered as Discontinuing Operation as per AS-24 as the companies' strategic plan has no final approval from the board through a resolution and there is no specific time bound activities like shifting of assets and employees. Moreover, the new segment i.e. commercial vehicle production line in a new factory has not started.

b) No, the resolution is silent about stoppage of the Car segment in definite time period. Though, sale of some assets and some transfer proposal were passed through a resolution to the new factory, but the closure road map and new segment starting roadmap are missing. Hence, AS 24 will not be applicable and it cannot be considered as Discontinuing operations.

- c) Yes, phased and time bound program resolved in the board clearly indicates the closure of the passenger car segment in a definite time frame and will constitute a clear roadmap. Hence, this action will attract compliance of AS 24 and it will be considered as Discontinuing Operations as per AS-24.

Question 3 *(RTP Nov 2018) / (RTP May 2020) / (RTP May 2022)*

Give four examples of activities that do not necessarily satisfy criterion (a) of paragraph 3 of AS 24, but that might do so in combination with other circumstances.

Solution

Para 3 of AS 24 "Discontinuing Operations" explains the criteria for determination of discontinuing operations. According to Paragraph 9 of AS 24, examples of activities that do not necessarily satisfy criterion (a) of paragraph 3, but that might do so in combination with other circumstances, include:

- a) Gradual or evolutionary phasing out of a product line or class of service;
- b) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
- c) Shifting of some production or marketing activities for a particular line of business from one location to another; and
- d) Closing of a facility to achieve productivity improvements or other cost savings.

An example in relation to consolidated financial statements is selling a subsidiary whose activities are similar to those of the parent or other subsidiaries.

Question 4 (Inter Nov 2018)/(Inter Nov 2023) (5 Marks)/(RTP May 2020)/(Nov 2020)/(May 2022)

What are the disclosure and presentation requirements of AS 24 for discontinuing operations?

Solution

An enterprise should include the following information relating to a discontinuing operation in its financial statements beginning with the financial statements for the period in which the initial disclosure event (as defined in paragraph 15) occurs:

- a) a description of the discontinuing operation(s);
- b) the business or geographical segment(s) in which it is reported as per AS 17, Segment Reporting;
- c) the date and nature of the initial disclosure event;
- d) the date or period in which the discontinuance is expected to be completed if known or determinable;
- e) the carrying amounts, as of the balance sheet date, of the total assets to be disposed of and the total liabilities to be settled;
- f) the amounts of revenue and expenses in respect of the ordinary activities attributable to the discontinuing operation during the current financial reporting period;
- g) the amount of pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense related thereto; and
- h) the amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

Question 5 (RTP Nov 2021)

What are discontinuing operations as per AS 24? Should an enterprise include prescribed information relating to a discontinuing operation in its financial statements?

Solution

As per AS 24, a discontinuing operation is a component of an enterprise:

- a. That the enterprise, pursuant to a single plan, is:
 - (i) Disposing of substantially in its entirety, such as by selling the component in a single transaction or by demerger or spin-off of ownership of the component to the enterprise's shareholders or
 - (ii) Disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually or
 - (iii) Terminating through abandonment and
- b. That represents a separate major line of business or geographical area of operations.
- c. That can be distinguished operationally and for financial reporting purposes.

An enterprise should include prescribed information relating to a discontinuing operation in its financial statements, as per requirements of AS 24, beginning with the financial statements for the period in which the initial disclosure event occurs.