AS-24: DISCONTINUING OPERATIONS

STUDENT NOTES

WHAT IS A DISCONTINUING OPERATION

Discontinuing Operation:- Is a component of the entity which

How to identify this

1. Represents;
- Separate major line of business
  OR
- Geographical area of operations

2. Can be distinguished for;
- Operational purpose ✓
  AND
- Financial reporting purpose ✓

3. Is discontinued as per a SINGLE PLAN by

- Selling SUBSTANTIALLY IN TOTAL Either in
  - Single transaction
  - Demerger
  - spinoff
- Selling off components assets INDIVIDUALLY (piecemeal disposal) And settling its liabilities also individually.
- Termination through ABANDONEMENT. (Stopping with an intention to sell later on.)

WHEN IS A COMPONENT CONSIDERED DISTINGUISHABLE FOR OPERATIONAL & FINANCIAL REPORTING PURPOSES

- When the operations Assets & Liabilities can be directly attributed to it.
- Its revenue can be directly attributed to it. ✓
- A majority of its expenses can be directly attributed to it. ✓

CA Tejas Suchak

LSD

STUDENT NOTES

Hotels

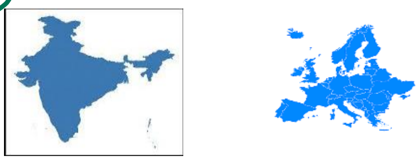
TCS

Tata Sky

Big Basket

Airlines

TATA STEEL → Tata motors



INDIA EUROPE

- Different geographical area of operations &
- Can be distinguished for operational & Financial Reporting Purposes

separate major line of business

Reliance Industries Limited

Oil & Gas | Mass Media | Telecommunication | Retail

Mass Media → 1 component

Mass Media → 2 - discontinued as per single plan

sell → total

indiv. assets sell

abond

- Separate Major Line of Business
- Can be distinguished for operational & Financial Reporting Purposes

IMPORTANT POINT: DISCONTINUING OPERATIONS VS DISCONTINUING PRODUCT LINE

If an entity discontinues a product line, it will not be considered a discontinuing operation and hence no disclosure is required under this standard.
(Eg: TATA discontinuing NANO)

TATA MOTORS

→ "Discontinue"
→ "As per a single plan" } Discontinuing operation → ?

Answer = no

Product line and not an operation

TATA Motors → India → component; Europe → component

Geographical area →

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AS-24: DISCONTINUING OPERATIONS

STUDENT NOTES

INITIAL DISCLOSURE EVENT

Entity should disclose discontinuing operation from earlier of the following:

- *Entered into a binding sale agreement for substantially all of the assets of the discontinuing operation.*

OR

- *Board of Directors/similar governing body has;*

-- Approved a detailed, formal plan for discontinuance. AND
-- Made an announcement of the formal plan for discontinuance.

INFORMATION TO BE DISCLOSED

Think from BoD POV

- *Identification of major assets to be disposed off.*
- *Expected method of disposal*
- *Expected period to complete the disposal*
- *Principal locations affected.*
- *Location, function & approximate number of employees who will be compensated for terminating their services.*
- *Estimated amount to be realised by disposal.*

Student Notes

QUESTION 1 (RTP MAY 18)

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

	Dish washing Bar (Per month)	Clothes washing bar (Per month)
January 2016- September 2016	2,00,000	2,00,000
October 2016-December 2016	1,00,000	3,00,000
January 2017- March 2017	Nil	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 has passed a resolution in March 2016 to this effect. The company follows calendar year as its accounting year.

You required to advise the company whether it should be treated as discontinuing operation or not as per AS 24?

Answer:

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

(i) that the enterprise, pursuant to a single plan, is:

(1) disposing of substantially in its entirety,

(2) disposing of piecemeal, or

(3) terminating through abandonment; and

(ii) that represents a separate major line of business or geographical area of operations; and

(iii) 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

Student Notes

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 (RTP MAY 20)

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

(ii) 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.

***Answer**:*

(i) 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.

(ii) 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:

Student Notes

(i) Gradual or evolutionary phasing out of a product line or class of service;
(ii) Discontinuing, even if relatively abruptly, several products within an ongoing line of business;
(iii) Shifting of some production or marketing activities for a particular line of business from one location to another; and
(iv) 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 3 (RTP NOV 20) HW

What do you understand by Discontinuing Operations? What are the disclosure and presentation requirements of AS 24 for discontinuing operations? Explain in brief.

***Answer**:*

As per AS 24 “Discontinuing Operations”, 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 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:

- 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;

AS-19: LEASES

(EACH QUESTION IS FOR 5 MARKS)

Question 1

ABC Ltd. took a machine on lease from XYZ Ltd., the fair value being Rs. 10,00,000. The economic life of the machine as well as the lease term is 4 years. At the end of each year, ABC Ltd. pays Rs. 3,50,000. The lessee has guaranteed a residual value of Rs. 50,000 on expiry of the lease to the lessor. However, XYZ Ltd. estimates that the residential value of the machinery will be Rs. 35,000 only. The implicit rate of return is 16% and PV factors at 16% for year 1, year 2, year 3 and year 4 are 0.8621, 0.7432, 0.6407 and 0.5523 respectively. You are required to calculate the value of machinery to be considered by ABC Ltd. and the finance charges for each year.

Answer 1

As per AS 19 "Leases", the lessee should recognize the lease as an asset and a liability at the inceptionof a finance lease. Such recognition should be at an amount equal to the fair value of the leased assetat the inception of lease. However, if the fair value of the leased asset exceeds the present value of minimum lease payment from the standpoint of the lessee, the amount recorded as an asset and liability should be the present value of minimum lease payments from the stand point of the lessee.

Value of machinery

In the given case, fair value of the machinery is Rs. 10, 00,000 and the net present value of minimumlease payments is Rs. 10, 07,020 (Refer working Note). As the present value of the machine is more than the fair value of the machine, the machine and the corresponding liability will be recorded at value of Rs. 10,00,000.

O/s int TO - Inst = CO

100

Calculation of finance charges for each year

Year	**Finance charge**	**Payment**	**Reduction in outstanding liability**	**Outstanding liability**
1st year beginning	**(Rs.)** -	**(Rs.)** -	**(Rs.)** -	**(Rs.)** **10,00,000**
End of 1st year	1,60,000	3,50,000	1,90,000	8,10,000
End of 2nd year	1,29,600	3,50,000	2,20,400	5,89,600
End of 3rd year	94,336	3,50,000	2,55,664	3,33,936
End of 4th year	~~53,430~~	3,50,000	2,96,570	~~37,366~~
Working Note:				

333936 + 66064 = 400000 - 350000+50000 = 400000 = 0

Present value of minimum lease payments

Annual lease rental x PV factor

Rs. 3,50,000 x (0.8621 + 0.7432 + 0.6407+ 0.5523= Rs. 9,79 ,405

Present value of guaranteed residual value Rs. 50,000 x (0.5523)=Rs.27,615

Rs. 10,07,020

L50

I : CA = 40 FV = 50 RCA=40
RCA = 40 SP = 50 P = 10 → P&L Cr.

II CA=40 FV=45 RCA=40
RCA = 40 SP = 38 L=2

V CA = 40 FV = 35 L=5 → P&L Dr.
RCA = 35
RCA = 35 SP = 39 (FV=35) P=4 → Defer.

Question 2

CA

A Ltd. sold machinery having WDV of Rs. 40 lakhs to B Ltd. for Rs. 50 lakhs and the same machinerywas leased back by B Ltd. to A Ltd. The lease back is operating lease. Explain the accounting treatment as per AS 19 in the following cases:

(i) Sale price of Rs. 50 lakhs is equal to fair value
(ii) Fair value is Rs. 45 lakhs and sale price is Rs. 38 lakhs.
(iii) Fair value is Rs. 40 lakhs and sale price is Rs. 50 lakhs.
(iv) Fair value is Rs. 46 lakhs and sale price is Rs. 50 lakhs
Fair value is Rs. 35 lakhs and sale price is Rs. 39 lakhs.

III RCA = 40 SP = 50 (FV=40)
P=10 → Defer

IV RCA = 40 SP = 50 (FV=46)
P = 10 → 6 → P&L Cr. ; 4 → Defer.

Answer 2

Following will be the treatment in the given cases:

(i) When sale price of Rs. 24 lakhs is equal to fair value, A Ltd. should immediately recognise the profit of Rs. 4 lakhs (i.e. 24 – 20) in its books.

(ii) When fair value is Rs. 20 lakhs & sale price is Rs. 24 lakhs then profit of Rs. 4 lakhs is to be deferred and amortised over the lease period.

(iii) When fair value is Rs. 22 lakhs & sale price is Rs. 25 lakhs, profit of Rs. 2 lakhs (22 − 20) to be immediately recognised in its books and balance profit of Rs.3 lakhs (25−22) is to be amortised/deferred over lease period.

(iv) When fair value of leased machinery is Rs. 25 lakhs & sale price is Rs. 18 lakhs, then loss of Rs. 2 lakhs (20–18) to be immediately recognised by A Ltd. in its books provided loss is not compensated by future lease payment.

(v) When fair value is Rs. 18 lakhs & sale price is Rs. 19 lakhs, then the loss of Rs. 2 lakhs (20−18) to be immediately recognised by A Ltd. in its books and profit of Rs. 1 lakhs (19−18) should be amortised/deferred over lease period.

Question 3

Test disc.
AS-24 sum
AS-12 sum
New AS-17

You are required to give the necessary journal entry at the inception of lease to record the assettaken on finance lease in books of lessee from the following information:
Lease period = 5 years;
Annual lease rents = Rs. 50,000 at the end of each year.Guaranteed residual value = Rs. 25,000
Fair Value at the inception (beginning) of lease = Rs. 2,00,000
Interest rate implicit on lease is = 12.6% (Discounted rates for year 1 to 5 are .890, .790, .700, .622 and .552 respectively).

Answer 3

Present value of minimum lease payment is computed below:

Year	*MLP Rs.*	*DF (12.6%)*	*PV Rs.*
1	*50,000*	*0.890*	*44,500*
2	*50,000*	*0.790*	*39,500*
3	*50,000*	*0.700*	*35,000*
4	*50,000*	*0.622*	*31,100*
5	*50,000*	*0.552*	*27,600*