Reporting Discontinued Operations

By John D. Rossi III, CPA

A new standard that amends the body of knowledge on discontinued operations was released April 10, 2014. This standard can be found in Accounting Standards Update (ASU) 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. The intent of the changes is to better reflect a company’s discontinued operations. The result should be a reduced number of qualifying disposals, as well as a reduction in complexity. Applicable to business or nonprofit activities, the new standard enhances convergence with international financial reporting standards (IFRS) because part of the new definition is based on parts of IFRS 5.

The definition of an operating component is the same as it was under FAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets, but the new standard represents a significant shift in its effect on operations and financial results. Under legacy GAAP, the definition of discontinued operations included the results of operations of a component that has been disposed of or is classified as held for sale if both of the following conditions are met:

- The component’s operations and cash flows have been or will be eliminated from the company’s ongoing operations.
- The company won’t have any significant continuing involvement in the component’s operations.

The changes arose from concerns that too many disposals, including small groups of assets, met the definition of a discontinued operation. The new definition is a shift in thinking, focusing on operations that have a major (“major,” by the way, is not defined in the new standard) effect on operations and financial results, including line of business or geographic area. Equity method investments are now included in the definition of discontinued operations, provided they represent a major part of operations. As a step toward principles-based accounting, there are no bright lines; analysis will require more professional judgment.

Under the new definition, only disposals representing a major strategic shift in the operating and financial results of operations should be reported as discontinued operations. Examples would include a disposal of a major geographic area, a major line of business, or a major equity method investment.

In addition, there should be no write-down to fair value unless there is impairment. Impairments at time of disposal should be part of continuing operations. Only impairments for assets subsequently impaired are classified as discontinued operations. Also, discontinued operations should not be carried at their net realizable value, and expected operating losses should not be recognized before they occur.

The new standard permits continuing involvement with a discontinued operation if cash flows remain between the discontinued operation and the entity after disposal. The entity would be required to disclose information about the nature, timing, and amount of continuing cash flows and involvement. The thought is that outsourcing should not prevent something from being a discontinued operation.

Disclosures, which are extensive, include periods with discontinued operations or when assets are classified as held for sale. Disclosures should include information about disposal, expected manner and timing, balance sheet line item, and carrying amounts of major assets and liabilities within the disposal group, including gain or loss recognized and revenue and pretax profit or loss.

In addition, major classes of line items constituting pretax profit and loss of discontinued operations are either total operating and investing cash flows or depreciation, amortization, capital expenditures, and significant operating and investing items. A reconciliation of major assets and liabilities should be classified as held-for-sale and disclosed in the notes to total assets and liabilities of the disposal group classified as held for sale and presented separately on the balance sheet, including all prior periods presented.

Disclose any subsequent continuing involvement, including amount of cash inflows and outflows from and to discontinued operations. If sold or classified as held for sale, disclose pretax profit or loss attributable to the parent of an entity.

The new standard is required to be adopted by public business and not-for-profit entities in annual periods and interim periods beginning on or after Dec. 15, 2014. It is effective for nonpublic companies in annual periods and interim periods beginning on or after Dec. 15, 2015.

Companies that have previously been required to include discontinued operations and have planned disposals should carefully consider the circumstances and effects this new standard will have on disposal transactions and their accounting and reporting functions and financial statements going forward.

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