

# SSAP 33 Discontinuing Operations

New Statement of Standard Accounting Practice (SSAP) 33, *Discontinuing Operations*, requires additional financial statement disclosure when a significant component of an entity's business is to be abandoned or disposed of by sale either in a single transaction or piecemeal, demerged or spun-off.

SSAP 33 applies to financial statements covering periods beginning on or after 1 January 2002.

The SSAP's reason for being is to improve the predictive value of the income statement.<sup>1</sup> Financial statement users are provided with a basis for assessing an enterprise's future performance because the financial effect of discontinuing operations is presented separately from that of the other, continuing, operations.

## Development of the Statement

The requirement to include disclosure on discontinuing operations was introduced initially in an earlier version of SSAP 2, *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*, in the 1990s.

Although it used the term "discontinued operation", which on the face of it applied only when a discontinuance had been completed, SSAP 2 applied also in respect of operations that were either discontinued after the balance sheet date (and before the date the financial statements were issued) or which were known at that time to be in a process of discontinuance. Apart from this, however, SSAP 2 contained only limited guidance on determining what constituted a discontinued operation.

Under SSAP 2, once an operation was considered to be "discontinued", the following disclosures – most likely in the notes, though the Statement was not specific in this respect – were required:

- (a) The nature of the discontinued operation;
- (b) The industry and geographical segments in which it is reported (if applicable);
- (c) The effective date of discontinuance for accounting purposes;
- (d) The manner of discontinuance (sale or abandonment);
- (e) The gain or loss on discontinuance and the accounting policy used to measure that gain or loss; and
- (f) The revenue and profit or loss from the ordinary activities of the operation for the period, together with the corresponding amounts for each prior period presented.<sup>2</sup>

The HKSA published exposure draft "ED/Discontinuing Operations" in April 2001, which proposed to replace the SSAP 2 provisions on discontinued operations with a more comprehensive set of requirements. The draft was based essentially verbatim on the text contained in the equivalent

International Accounting Standard, IAS 35.<sup>3</sup> SSAP 33 was approved by the Society, essentially unchanged from the ED, to replace the former provisions in SSAP 2.<sup>4</sup>

The new Statement is concerned with the following major issues:

- What distinguishes an operation as being discontinuing?
- When does a discontinuing operation become recognised as such?
- What are the financial reporting consequences of a discontinuing operation?

The Statement is specifically a disclosure and presentation statement. It acknowledges that there will be certain recognition and measurement issues connected with a discontinuing operation (concerning, for example, provisioning, contingencies and asset impairment) and, in these respects, requires application of the principles contained in other relevant SSAP (for example, SSAP 28, *Provisions, Contingent Liabilities and Contingent Assets*, and SSAP 31, *Impairment of Assets*).<sup>5</sup> Accordingly, the effective date from which an operation is accounted for as discontinuing affects only the disclosures regarding the discontinuing operation. It does not affect the timing of recognition of restructuring provision or impairment loss under SSAPs 28 or 31.

## The Definition of a Discontinuing Operation

Under SSAP 33, a discontinuing operation is a relatively large *component* of an enterprise that is being disposed of (either substantially in its entirety or piecemeal), or terminated, and which satisfies all of the following conditions:

- (a) It can be distinguished operationally and for financial reporting purposes;
- (b) It represents a separate major line of business or geographical area of operations; and
- (c) The disposal or termination is pursuant to a single plan.<sup>6</sup>

The Statement does not elaborate on what may be considered to be a "single plan" or on any characteristics necessarily exhibited in a single plan (for example, whether there needs to be planned completion dates). Paragraph 3 of SSAP 33 does, however, make reference to "an overall plan", which presumably envisages the existence of a series of plans so long as they are able to, collectively, constitute a single coherent plan.

### **The Meaning of "Distinguished Operationally and for Financial Reporting Purposes"**

A component satisfies the "distinguishable operationally and for financial reporting purposes" criterion when:

- (a) Its operating assets and liabilities can be directly attributed to it;
- (b) Its income (gross revenue) can be directly attributed to it; *and*
- (c) At least a majority of its operating expenses can be directly attributed to it.

The Statement necessarily sets a threshold for a discontinuing operation to be recognised as such. The mere closure of facilities, abandonment of products or product lines or changes in size of a company’s work force or fixed assets in themselves do not necessarily constitute a discontinuing operation. The above criterion seeks to remove some of the subjectivity that generally surrounds determining how operations undertaken by a company are separated from each other, which are often far less than clear cut. As a result the threshold set in SSAP 33 might be somewhat high – especially when the Statement requires all the criterion to be met for there to be a discontinuing operation – but at least there is a degree of objectivity introduced in the above criterion.

In a practical sense, it may often be found that the ability to satisfy one of the two criteria (that is, being “distinguished operationally and for financial reporting purposes” or constituting “a separate major line of business or geographical area of operations”) will in many cases enable satisfaction of the other, notwithstanding the Statement’s clear distinction between the two tests.

***The Meaning of a “Separate Major Line of Business or Geographical Area of Operations”***

There are grey areas as to what constitutes a *component* that represents a separate major line of business or geographical area of operations. The Statement says that a reportable segment as defined in SSAP 26, *Segment Reporting*, would normally satisfy this criterion and this guideline would apply even when the reporting entity is not required to comply with SSAP 26. However, the Statement also suggests that a part of a segment as defined in SSAP 26 may also satisfy the criterion or, for example in an enterprise that operates in a single business or geographical segment and therefore does not report segment information, a major product or service line may also satisfy the criterion.<sup>7</sup>

The word “major” introduces the concept of materiality to the criterion. If all the other criteria are met and yet, for example, separate disclosure of the component being disposed of or terminated would not have a material impact on the financial statements, the component would probably not constitute a discontinuing operation for financial reporting purposes.

There is the potential for a considerable amount of judgement required in determining when the component being discontinued is not a segment if it meets the definition. In a practical sense, it would be difficult to imagine the situation

of a sale or termination meeting only one of the two conditions described above and yet not the other.

***Going Concern***

SSAP 33 states for the avoidance of doubt that because a component of an enterprise is classified as a discontinuing operation under the SSAP does not, in itself, bring into question the enterprise’s ability to continue as a going concern.<sup>8</sup>

***Application of the Discontinuing Operations Definition in Practice***

Two situations may sometimes occur, which may give rise to concerns whether a restructuring or partial disposal of a business constitutes a discontinuing operation.

In the first situation, a company plans to restructure a reportable business segment of its business into a separate but wholly owned company.

Examining the definition of “discontinuing operation”, from the group’s perspective, it is clear that the restructuring does not involve a disposal or sale because the group is not transacting with any external party when it incorporates a new, wholly-owned, legal entity into which the business segment is transferred. Further, the operations and associated assets and liabilities are not being demerged or spun-off to the enterprise’s shareholders (again, because in a restructuring of this nature, the company is essentially transacting with itself) and the operations are not being terminated nor are the assets associated with those operations being abandoned.

In the second situation, a company plans to dispose of part of its business (for example, the sale of a 70% interest in a previously wholly-owned subsidiary). There is a school of thought that argues that a subsidiary becoming an associated undertaking is, ipso facto, a discontinuance. However, in the view of the author, there would be no real grounds for this argument and it is quite clear that for a sale to be classified as a discontinuing operation it must still satisfy all the necessary conditions contained in paragraph 2 of SSAP 33, one of which is the “disposing of substantially ... (either) in its entirety ... or piecemeal ... pursuant to a single plan”.

***When an Operation is Considered to Be Discontinuing***

Under SSAP 33, an operation is considered to be discontinuing once the “initial disclosure event” occurs, that is, at the earlier of either:<sup>9</sup>

- (a) Entry into one (or more) binding sale agreement(s) for substantially all the assets attributable to the operation; or
- (b) The governing body (board of directors) has both approved a detailed formal plan for the discontinuance and made a public announcement of that plan.

Criterion (a) will typically apply only in the case when the operation is to be disposed of substantially in its entirety. For piecemeal disposals and terminations, criterion (b) will typically constitute the initial disclosure event.

## Financial Reporting Consequences

From the time the initial disclosure event occurs (which is not only during the period itself but also if prior to the approval of the financial statements for issue), and in subsequent reporting periods up to and including that in which the planned discontinuance is substantially completed, the financial statements should disclose the following in respect of each discontinuing operation:<sup>10</sup>

- (a) A description of the discontinuing operation;
- (b) The business or geographical segment(s) to which the discontinuing operation relates;
- (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 and the total liabilities to be disposed of;
- (f) The amounts of turnover, other revenue, expenses, and pre-tax profit or loss from ordinary activities attributable to the discontinuing operation during the current financial reporting period, and the income tax expense relating thereto; and
- (g) The amounts of net cash flows attributable to the operating, investing, and financing activities of the discontinuing operation during the current financial reporting period.

The Statement also specifies the following disclosure requirements:

- For any gain or loss that is recognised on the disposal of assets or settlement of liabilities attributable to the discontinuing operation, (i) the amount of the pre-tax gain or loss and (ii) income tax expense relating to the gain or loss;<sup>11</sup>
- The net selling price or range of prices (after deducting the 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;<sup>12</sup>
- In periods subsequent to when the initial disclosure event occurs, including interim periods, a description of any significant changes in the amount or timing of cash flows relating to the assets and liabilities to be disposed of or settled and the events causing those changes;<sup>13</sup> and
- The fact and effect of any abandonment or withdrawal from a plan that was previously reported as a discontinuing operation.<sup>14</sup>

The disclosure required by SSAP 33 is presented separately for each discontinuing operation.<sup>15</sup> The only disclosure required on the face of the financial statements is the amount of the pre-tax gain or loss recognised on the

disposal of assets or settlement of liabilities attributable to the discontinuing operation.<sup>16</sup> The Statement encourages, but does not require, above items (f) and (g) to be presented on the face of the income statement and cash flow statement, respectively. If those items are presented on the face of the financial statements, especially in the case of multiple discontinuing operations, they could be presented in aggregate with cross-reference made to an analysis of each separate discontinuing operation in the notes.

A discontinuing operation should not be presented as an extraordinary item.<sup>17</sup> A restructuring, transaction, or event that does not meet the definition of a discontinuing operation in SSAP 33 should not be called a discontinuing operation.<sup>18</sup>

SSAP 33 requires the restatement of comparative information (for each prior period presented) for an operation initially reported as discontinuing.<sup>19</sup> The practicability of restating comparative information could itself be considered a test of whether the operation meets the definition of a discontinuing operation. **HKA**

- 1 See the *Framework for the Preparation and Presentation of Financial Statements*, HKSA, June 1997, para. 24 to 26 for further commentary on predictive quality.
- 2 SSAP 2, *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*, HKSA, May 1999, para. 19.
- 3 IAS 35, *Discontinuing Operations*, IASC, June 1998.
- 4 SSAP 33, *Discontinuing Operations*, HKSA, October 2001.
- 5 SSAP 33, para. 17 et seq.
- 6 SSAP 33, para. 2.
- 7 SSAP 33, para. 9.
- 8 SSAP 33, para. 15.
- 9 SSAP 33, para. 16.
- 10 SSAP 33, para. 27, 29, 35 & 38. Illustrative financial statement disclosure is provided in Appendix 1 to the SSAP.
- 11 SSAP 33, para. 31(a).
- 12 SSAP 33, para. 31(b).
- 13 SSAP 33, para. 33 & 47.
- 14 SSAP 33, para. 36.
- 15 SSAP 33, para. 38.
- 16 SSAP 33, para. 39.
- 17 SSAP 33, para. 41.
- 18 SSAP 33, para. 43.
- 19 SSAP 33, para. 45.

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