IFRS Today

Our series on the most topical issues in IFRS® Standards and financial reporting

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PODCAST TRANSCRIPT

M&A – Selling a business

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Hello – I'm **Peter Carlson** and today I'm joined by **Julia LaPointe** – we work together in KPMG's International Standards Group.

Julia

Hi Peter. We've been talking recently about M&A transactions since we're seeing a lot of activity as we come out of the COVID-19 crisis. In the first podcast in this series, Andrea Schriber and I covered what you need to think about when you acquire a business. Now, we'll be talking about the flip side of that transaction – what does the seller need to consider?

Peter

Unlike acquiring a business, there isn't just one IFRS standard that covers selling a business. Instead, there are several standards that you'll need to consider along the way, from when you first start thinking about selling a business right up until the cash is in the bank. It's important to understand the entire picture up-front so you don't miss required disclosures or get surprised by the accounting impacts at the end.

Julia

Today we'll cover three key steps in the process.

1. First, having thought about selling a business, when does it need to be presented separately in the financial statements as held-for-sale or as a discontinued operation?
2. Next, as the actual transaction comes together, how is it structured? Are you selling a subsidiary or a group of assets and liabilities?
3. And lastly, at what point do you lose control of a subsidiary? How do you calculate the gain or loss on that transaction?

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Peter

So, for that first key step, when does a planned disposal need to be presented separately in the financial statements as held-for-sale or a discontinued operation?

As you start thinking about selling, you've also got to start thinking about IFRS 5. IFRS 5 is the standard on non-current assets held for sale and discontinued operations. It sets down specific classification, presentation and measurement requirements when a group of assets and liabilities, referred to in the standard as a 'disposal group', becomes 'held-for-sale'.

Julia

A disposal group is classified as held-for-sale when its carrying amount will be recovered principally through a sale transaction. Under IFRS 5, this can only happen when a sale is *highly probable*. For example, there needs to be a commitment to a plan to sell by management, active marketing at a reasonable price and an expectation that the sale will take place within a year.

Peter

This can be an important judgement and needs to be closely monitored leading up to the transaction. It's important because once a disposal group is classified as held-for-sale, specific measurement rules apply to make sure the carrying amount of the disposal group isn't higher than its fair value less costs to sell.

Julia

Another major consequence is that the assets and liabilities of a disposal group need to be presented separately on the balance sheet and additional disclosures will be required. Depending on how significant the sale is – for example, if it's a major line of business or a whole geographic area – you may also need to present it as a discontinued operation. This means that the results of the discontinued operation are presented separately from your continuing operations on the P&L, so it has a really major impact on the face of your financial statements.

Peter

Following from that, these presentation and disclosure requirements in IFRS 5 are clearly put in place to ensure that the financial statements communicate the expected sale. If you don't follow them in the right period, your financials could be missing required information and that's clearly a situation you do *not* want to be in.

Julia

Now that the financial statements reflect the expected sale, the next step is to consider and understand the details of the planned transaction and how it's structured. While our discussion today is about selling a business, the accounting rules for the seller aren't actually driven by whether what you've sold would meet the accounting definition of a business. You might remember we discussed that definition in our last podcast.

Peter

Instead, a key driver of the accounting here – that is, when you derecognise and how you calculate that gain or loss – is whether those assets are in a separate legal entity. If they are and you're selling a subsidiary, you have to apply IFRS 10, which is the standard on consolidated financial statements.

If you're just selling a group of assets and liabilities – and not a subsidiary – this isn't covered by IFRS 10, and you follow the usual standards for those assets and liabilities.

Julia

And although it's not a 'sale' per se, you might also need to consider yet another standard if you lose control of a subsidiary by distributing shares in it to your existing shareholders. This is often referred to as a demerger or a spin-off and may be in the scope of IFRIC 17, which is the standard on distributions of non-cash assets to owners.

Peter

The most common type of transaction we see is when a company sells shares in a subsidiary and, as I mentioned, this is accounted for under IFRS 10. So for our last topic, let's focus on the requirements of IFRS 10. **At what point do you lose control of a subsidiary? And once you have, how do you calculate the gain or loss?**

Julia

Well, Peter – IFRS 10 is all about control. You stop consolidating a subsidiary when you lose control of it. This often happens when a company sells all of its interest and completely exits a business, but sometimes you might lose control while still keeping some level of investment. That can happen for a number of reasons. Maybe the purchaser wants you to retain some interest in the business.

Peter

Regardless of whether you give up 100 per cent of that subsidiary or you do keep an interest, it's always important to determine when control is lost because this is when the big financial statement impact happens. At a high level, when you lose control three things happen:

– you derecognise the assets and liabilities of that subsidiary;

– you recognise the fair value of all the consideration that you've received; and

– you recognise any retained investment at fair value.

The result is a gain or loss in the P&L for the difference between the fair value of what you've received and retained, and the carrying amount of what you've given up.

Julia

Now, that may seem like a pretty straightforward calculation, but there are a few areas where we often see clients getting tripped up.

If control is lost in two or more transactions, these may need to be treated as one transaction for accounting purposes – if they're considered to be 'linked'. Now, this assessment can require careful consideration. For example, you might need to look at whether the transactions only make sense economically when considered together.

The consideration you receive could also start to get complicated if it's more than just a fixed amount of cash. For example, if it's contingent on future events – like the performance of the business you've sold – measuring the fair value of that consideration could require making some really difficult estimates.

Peter

So, Julia, we should also remember to recognise those cases where people dispose of a subsidiary that they don't own 100% of, because there are challenges there. To calculate the gain or loss in these cases, IFRS 10 requires that you derecognise the assets and the liabilities, and derecognise any amounts of non-controlling interests. This includes the share of equity reserves such as other comprehensive income (OCI) that might have been attributed to non-controlling interests (NCI).

Julia

So, to summarise what we've covered today, if you're thinking about selling a business, you'll need to:

- consider IFRS 5 early in the process;
- really understand the structure of the transaction; and
- carefully follow the requirements of IFRS 10 when you sell a subsidiary.

We've talked about three areas that may seem simple, but too often it's not.

Peter

Too true. Today we covered selling a business, but we're also seeing an increase in other ways of bringing in new investors and funding – e.g. the creation of a joint venture. So, keep an eye out for the next podcast in our series, which will dive into those transactions.

Julia

And if you want to learn more, just type 'KPMG IFRS' into your browser. You'll find our COVID-19 financial reporting resource centre and lots of other good stuff. Thanks for listening!

Peter

Yes, thanks for listening. And we hope your transaction goes smoothly!

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