## Group reorganization Part I

(Relevant to Paper I: PBE Financial Accounting)

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Since the 2008 financial turmoil, the term "group reorganization" has appeared nearly every day in newspapers and restructuring documents.

Group reorganizations often involve the disposal of assets, subsidiaries, debt restructuring, and a change of management.

To help readers follow the many changes in this area, this topic is divided into three small articles.

This first article covers the reasons for disposal of assets, classification of "held for sale", measurement of non-current assets (or disposal groups) classified as held for sale. The next article will deal with recognition of impairment losses and reversals**,** changes to a plan of sale, presentation and disclosure. The third article will give numerical examples to explain the concepts clearly.

### Reasons for disposal of assets and / or subsidiaries

There are different reasons for these kinds of disposals. The following reasons are found in announcements made by listed companies in Hong Kong:

- focus on the group's core activity of manufacturing and supplying [nutritional] supplements for the global market
- enable the group to devote its resources to developing the core business
- enhancing the overall utilization of the group's resources
- enable the group to realize its investments at a fair price
- the company would be unable to realize cash for its underlying investment

Hong Kong Financial Reporting Standard 5 "Non-current Assets Held for Sale and Discontinued Operations specifies the accounting treatment for assets held for sale, and the presentation and disclosure of discontinued operations. The following concepts and accounting practices are crucial and need to be studied carefully before applying the Standard:

### Classification of "held for sale"

1. An entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be **recovered principally through a sale transaction** rather than through continuous use.

2. For this purpose, **the asset (or disposal group)** must be **available for immediate sale** in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and **its sale must be *highly probable***.

3. What does highly probable mean?
   - appropriate level of management must be **committed to a plan to sell** the asset (or disposal group), and
   - an **active programme** to locate a buyer and complete the plan must have been initiated
   - the asset (or disposal group) must be **actively marketed for sale** at a **price** that is **reasonable** in relation **to its current fair value**, and
   - the sale should be **expected to qualify for recognition as a completed sale *within* one year *from the date of classification***, except:
     - an extension of the period required to complete a sale does not preclude an asset (or disposal group) from being classified as held for sale if the delay is **caused by events or circumstances beyond the entity's control** and there is **sufficient evidence that the entity remains committed to its plan to sell** the asset (or disposal group), and actions required to complete the plan should indicate that it is **unlikely that significant changes to the plan will be made** *or* that **the plan will be withdrawn**.

4. Examples of such events and circumstances may include the following:

(a) **at the date** an entity **commits itself to a plan to sell** a non-current asset (or disposal group) it **reasonably expects** that others (not a buyer) will impose **conditions on the transfer** of the asset (or disposal group) that **will extend the period** required to complete the sale, and:

(i) actions necessary to respond to those conditions cannot be initiated until after a *firm purchase commitment* is obtained, and
(ii) a firm purchase commitment is **highly probable** within one year.

(b) an entity obtains a firm purchase commitment and, as a result, **a buyer** or others **unexpectedly impose conditions on the transfer** of a non-current asset (or disposal group) previously classified as held for sale that **will extend the period required to complete the sale**, and:

(i) **timely actions** necessary to respond to the conditions have been **taken**, and
(ii) a **favourable resolution** of the delaying factors is **expected**.

(c) during the initial one-year period, **circumstances arise** that were **previously considered unlikely** and, as a result, a non-current asset (or disposal group) previously classified as held for sale is not sold by the end of that period;

(i) during the **initial one-year period** the entity **took action necessary** to respond to the change in circumstances,
(ii) the **non-current asset** (or disposal group) is being **actively marketed** at a price that is reasonable, given the change in circumstances, and
(iii) the criteria in paragraphs 2 and 3 above are met as well.

5. A disposal group, being a **group of assets** to be disposed of, by sale or otherwise, together as a group in a single transaction, and **liabilities directly associated** with those assets that **will be transferred in the transaction.**

6. Special point to note: When an entity acquires a non-current asset (or disposal group) **exclusively with a view to its subsequent disposal**, it shall classify the non-current asset (or disposal group) as held for sale at the acquisition date only if the one-year requirement in paragraph 3 is met (except as permitted by paragraph 4) and it is highly probable that any other criteria in paragraphs 2 and 3 that are not met at that date will be met within a short period following the acquisition (usually within three months).

7. If the criteria in paragraphs 2 and 3 are met after the reporting period, an entity shall not classify a non-current asset (or disposal group) as held for sale in those financial statements when issued. However, when those criteria are met after the reporting period but before the authorization of the financial statements for issue, the entity shall disclose the information specified in paragraphs 31(a), (b) and (d) in the notes in Part II.

**Measurement of non-current assets (or disposal groups) classified as held for sale**

8. HKFRS 5 specifies that assets or disposal groups that are classified as held for sale are carried at the ***lower of*** **carrying amount** and **fair value (**the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction***) less*** **costs to sell**.

9. It also specifies that an asset classified as held for sale, or included within a disposal group that is classified as held for sale, is **not depreciated**.

10. When **the sale is expected to occur beyond one year,** the entity shall **measure the costs to sell at their present value**. Any **increase in the present value of the costs to sell** that arises from the passage of time shall be presented in profit or loss as a **financing cost**.

11. The classification and presentation requirements of HKFRS 5 apply to all recognized *non-current assets (assets classified according to a liquidity presentation, non-current assets are assets that include amounts expected to be recovered more than twelve months after the reporting period)* and to all *disposal groups* of an entity. The measurement requirements of HKFRS 5 apply to all recognized non-current assets and disposal groups, except for those assets listed below which shall continue to be measured in accordance with the following:

    (a) deferred tax assets (HKAS 12 "Income Taxes")

    (b) assets arising from employee benefits (HKAS 19 "Employee Benefits")

(c) financial assets within the scope of HKAS 39 “Financial Instruments: Recognition and Measurement”

(d) non-current assets that are accounted for in accordance with the fair value model in HKAS 40 “Investment Property”

(e) non-current assets that are measured at fair value less estimated point-of-sale costs to sell in accordance with HKAS 41 “Agriculture”

(f) contractual rights underinsurance contracts as defined in HKFRS 4 “Insurance Contracts”

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*That's the end of Part I. The discussion of group reorganizations will continue in the April 2011 issue of T/Dialogue.*