Subsidiaries acquired exclusively with a view to resale — a new approach

The previous version of AC 132, Consolidated Financial Statements and Accounting for Investments in Subsidiaries, contained an exemption from the consolidation of a subsidiary where control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future. Such investments were accounted for in terms of AC 133, Financial Instruments: Recognition and Measurement, in the consolidated financial statements.

With the release of IFRS 5 (AC 142), Non-current Assets Held for Sale and Discontinued Operations, during 2004, this exemption from consolidation has been eliminated; and the revised IAS 27 (AC 132), Consolidated and Separate Financial Statements, now requires all subsidiaries to be consolidated. This article addresses the implication of this change for the accounting in the consolidated financial statements for a subsidiary acquired exclusively with a view to resale.

Classification as ‘held for sale’
An asset or a disposal group is normally classified as ‘held for sale’ if its carrying amount will be recovered principally through a sale transaction and if the following criteria are met (IFRS 5 (AC 142) para 06-08):

- The asset or disposal group is available for immediate sale in its present condition;
- The appropriate level of management is committed to a plan to sell the asset or disposal group;
- An active programme to locate a buyer has been initiated;
- The asset or disposal group is actively marketed for sale at a price that is reasonable in relation to its current fair value;
- The sale is expected to qualify for recognition as a completed sale within one year from the date of classification of the asset or disposal group as held for sale; and
- Actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

IFRS 5 (AC 142), however, determines that when an entity acquires a non-current asset or disposal group exclusively with a view to its subsequent disposal, the non-current asset or disposal group must be classified as ‘held for sale’ on the acquisition date only if:

- The one-year requirement is met; and
- It is highly probable that the other criteria qualifying the asset or disposal group to be classified as ‘held for sale’ will be met within a short period after the acquisition of the asset or the disposal group (usually within three months).

A disposal group is defined as 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 (IFRS 5 (AC 142) Appendix A).

A subsidiary that is acquired exclusively with a view to its subsequent disposal is therefore classified on the acquisition date of the subsidiary as a non-current disposal group 'held for sale' if it is expected that the subsidiary will be disposed of within one year and the other IFRS 5 (AC 142) criteria are complied with within three months of the acquisition date.

Classification as a discontinued operation

A subsidiary that is acquired exclusively with a view to resale and that is a component of an entity that has been disposed of, or is classified as 'held for sale', is included in the definition of a discontinued operation (IFRS 5 (AC 142) para 32(c); IFRS 5 (AC 142) Appendix A). A component of an entity is one whose operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.

This means that a subsidiary that is classified as 'held for sale' on the acquisition thereof will also be a discontinued operation if it qualifies as a component of the entity. Normally, a significant subsidiary should represent a component of the entity.

Implications of being classified as 'held for sale' and as a discontinued operation

Due to the fact that the revised IAS 27 (AC 132) now requires all subsidiaries to be consolidated, a subsidiary that is classified as 'held for sale' on the acquisition thereof must also be consolidated. The implications for the consolidated financial statements resulting from the fact that such a subsidiary is classified as a discontinued operation and meets the definition of a disposal group are the following:

- In the consolidated income statement, the total of the post-tax profit or loss of the subsidiary and the post-tax gain or loss recognised on the subsequent measurement of the disposal group must be included as a single line item under a sub-heading, namely 'discontinued operations'. The income and expenses of the subsidiary are therefore not consolidated on a line-by-line basis with the income and expenses of the holding company.
- The detailed analysis of the single amount presented on the face of the income statement, presented either in the notes to the financial statements or on the face of the income statement, which is normally required by IFRS 5 (AC 142), is not required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as 'held for sale' on the acquisition date (IFRS 5 (AC 142) para 33(b)(iv)).
- The disclosure of the net cash flows attributable to the operating, investing and financing activities of the discontinued operation (which is presented either in the notes or on the face of the financial statements) normally required by IFRS 5 (AC 142), are not required for disposal groups that are newly acquired subsidiaries which meet the criteria to be classified as 'held for sale' on the acquisition date (IFRS 5 (AC 142) para 33(c)).
- In the consolidated balance sheet, the assets and liabilities of a disposal group classified as 'held for sale' must be presented separately from other assets and liabilities in the balance sheet (the assets and liabilities of the same disposal group may not be offset against each other). The assets and liabilities of the subsidiary are therefore not consolidated on a line-by-line basis with the assets and liabilities of the holding company.
- The disclosure of the major classes of assets and liabilities classified as 'held for sale' disclosed either on the face of the balance sheet or in the notes, as normally required by IFRS 5 (AC 142), is not required if the disposal group is a newly acquired subsidiary that meets the criteria to be classified as 'held for sale' on the acquisition date (IFRS 5 (AC 142) para 39).

Accounting on the acquisition date and meeting the criteria for classification as 'held for sale'

IFRS 3 (AC 140), Business combinations, requires an acquirer to recognise the acquiree's identifiable assets, liabilities and contingent liabilities at their fair value on the acquisition date. The excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities represents goodwill.

IFRS 5 (AC 142), however, contains an exemption from the normal principle contained in IFRS 3 (AC 140) to determine the fair value of each of the acquiree's individual identifiable assets, liabilities and contingent liabilities on the acquisition date, namely in the case of a subsidiary acquired exclusively for resale and meeting the criteria for classification as 'held for sale' on the acquisition date (IFRS 5 (AC 142) para BC52-58, Guidance on implementing IFRS 5 (AC 142) - Example 13).

One could argue that there are two reasons for this exemption from individual fair value accounting on the acquisition date:

- Firstly, under the previous AC 132, an acquirer was not required to determine the fair value of the individual assets and liabilities of the acquiree; as the investment in the subsidiary was merely shown as an AC 133 investment in the consolidated financial statements. Requiring an entity to determine individual fair values of assets and liabilities upon acquisition as a result of the requirement to consolidate these subsidiaries could potentially mean that the entity has to obtain much more information than in the past.
- Secondly, individual fair value accounting on the date of acquisition would make the disclosure exemptions in IFRS 5 (AC 142) (as discussed above) useless, as all the information would be available to provide full IFRS 5 (AC 142) disclosure where the fair value of individual assets and liabilities were determined on the acquisition date.

IFRS 5 (AC 142) contains a computational short-cut that can be used to arrive at the amounts to be presented on the face of the balance sheet and the income statement. This short-cut deems the determination of the fair value of individual assets on the date of acquisition unnecessary, in the case where the IFRS 5 (AC 142) exemption from individual fair value accounting on the acquisition date is applicable.

The basic mechanics of the computational short-cut are the following:

- A subsidiary that is acquired exclusively for resale and that meets the criteria to be classified as 'held for sale' on the date of acquisition represents a disposal group in terms of IFRS 5 (AC 142);
- On the date of acquisition, the fair value less costs to sell of the disposal group (subsidiary) needs to be determined;
- On the date of acquisition, the fair value of the identifiable liabilities of the subsidiary needs to be determined;
- The value attributable to the total assets on the date of acquisition is determined.
by adding the fair value of the identifiable liabilities to the fair value less cost to sell of the disposal group;

• On the balance sheet date, the disposal group is remeasured to the lower of its carrying amount (fair value less cost to sell at acquisition date plus/minus additional assets and liabilities obtained since the acquisition date), or fair value less cost to sell on the balance sheet date; the liabilities are remeasured in accordance with applicable IFRSs; and the total assets are measured by adding the fair value of the identifiable liabilities to the fair value less cost to sell of the disposal group;

• Any gain or loss on the remeasurement of the disposal group is recognised in profit or loss; and

• There is no requirement to allocate the gain or loss on remeasurement to individual assets and liabilities, as detailed disclosure is not required by IFRS 5 (AC 142).

Consider the following example:

(Note: For simplicity’s sake, this example ignores taxation.)

On 1 September 20X1 a company (A) acquires a 100% interest (100 000 shares) in another entity (B) for R2.20 per share. A has acquired this interest in B exclusively with a view to its subsequent disposal, and on the acquisition date all the criteria in terms of IFRS 5 are complied with.

On 1 September 20X1 the trial balance of B contains the following items:

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<tr>
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<tbody>
<tr>
<td>Property, plant and equipment</td>
<td>180 000</td>
</tr>
<tr>
<td>Inventory</td>
<td>108 000</td>
</tr>
<tr>
<td>Equity</td>
<td>288 000</td>
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<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Liabilities (fair value)</td>
<td>78 000</td>
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</tbody>
</table>

All liabilities have been designated as 'at fair value through profit or loss' in terms of IAS 39 (AC 133).

On the acquisition date, the costs to sell the 100% interest in B amount to R20 000.

The fair value less cost to sell of the disposal group on the acquisition date is therefore R200 000 (100 000 shares x R2.20 – R20 000). Goodwill amounts to R20 000.

For the three months ending 31 December 20X1 (the year-end), the total profit of the subsidiary before depreciation was R30 000 and was earned in cash. Depreciation of property, plant and equipment amounted to R20 000. The fair value of liabilities remained unchanged on 31 December 20X1. In the consolidated financial statements, the property, plant and equipment should not be depreciated, as, in terms of IAS 16 (AC 123), Property, Plant and Equipment (paragraph 55), depreciation ceases when an asset is included in an IFRS 5 (AC 142) disposal group.

On 31 December 20X1 the shares of B traded at R2.05 per share. On the balance sheet date, the costs to sell the 100% interest in B still amount to R20 000.

On 31 December 20X1 the disposal group should be measured at the lower of its carrying amount, namely R200 000 (fair value less cost to sell at acquisition date) plus R30 000 cash earned since the acquisition, and the fair value less cost to sell on the balance sheet date of R185 000 (100 000 shares x R2.05 per share – R20 000). An impairment loss of R45 000 is therefore recognised in profit or loss.

An amount of R263 000 (185 000 + 78 000) is allocated to the non-current assets held for sale, while the liabilities are shown as R78 000.

The disclosure on the face of the consolidated income statement and balance sheet is as follows:

• A loss from discontinued operations of R15 000 (30 000 – 45 000) is disclosed as a single amount on the face of the income statement;

• Non-current assets held for sale of R283 000 (263 000 + 20 000 goodwill) are disclosed as a single line item, non-current assets classified as 'held for sale', on the face of the balance sheet (refer to Guidance on implementing IFRS 5 (AC 142) - Example 12);

• Liabilities associated with non-current assets held for sale of R78 000 are disclosed as a single line item, liabilities directly associated with non-current assets classified as held for sale, on the face of the balance sheet. >
Concluding thoughts

The disclosure and individual fair value accounting exemptions provided in IFRS 5 (AC 142) for subsidiaries acquired exclusively with a view to resale should save costs and effort in the consolidation of these subsidiaries. Care should, however, be taken to ensure that compliance is achieved with the IFRS 5 (AC 142) criteria for classifying a disposal group as 'held for sale' on the date of acquisition. Failure to comply with these criteria upon the acquisition of a subsidiary acquired exclusively with a view to resale may well result in unfavourable implications for the group.

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