



ASC Insights Series: Guide to Accounting Standards

Accounting Standards Codification 205-20,
Presentation of Financial Statements —
Discontinued Operations

August 2024

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Foreword

Welcome to the “**Uniquus’ ASC Insights Series: Guide to Accounting Standards**”, where we combine our collective wisdom to understand various Accounting Standard Codifications (ASCs) comprehensively and in a crisp manner. This series is an invaluable tool for accounting professionals, offering detailed explanations, illustrative examples, and our expert point of view. Designed to support your professional journey, this guide help you navigate complex accounting scenarios and deepen your knowledge.

This is the fifth publication in our “Uniquus’ ASC Insights Series: Guide to Accounting Standards”, focusing on “**ASC 205-20, Presentation of Financial Statements — Discontinued Operations**”. In this installment, we delve into the specifics of ASC 205-20, exploring its implications, key considerations, and practical applications. Through clear illustrations and expert commentary, we aim to make the standard accessible and actionable for practitioners.

ASC 205-20 provides guidance on the presentation and disclosure of discontinued operations, including criteria for determining when the presentation of discontinued operations is appropriate.

We hope you enjoy reading this document and find this series valuable!

Thank you.

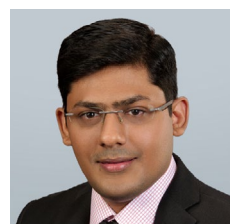
Yours faithfully

For Uniquus Consultech Inc.



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Purpose

The Financial Accounting Standards Board's (FASB's), **ASC 205-20, Presentation of financial statements -Discontinued operations ('ASC 205-20')** provides comprehensive guidance on the reporting and presentation of discontinued operations in financial statements. ASC 205-20 is a critical tool for financial professionals, preparers, auditors, and users of financial statements, offering detailed guidelines on the identification, measurement, and disclosure of discontinued operations.

This publication provides an overview of the requirements, implementation matters, and key considerations related to ASC 205-20. The technical views and accounting positions on the framework keep enhancing depending on carrying out further technical evaluations and their outcomes.

The need for a discussion on the topic of discontinued operations arises from changes in businesses consequent to the COVID-19 pandemic, changes due to focus on environmental considerations, complex accounting and reporting structures and revamping of businesses to requirements of changing times.

As the business environment continues to evolve, so does the need for robust financial reporting standards. Separate reporting of discontinued operations enables financial statements users to understand and evaluate the effects of a disposal transaction on the ongoing operations of an entity and ultimately contributing to a more informed decision-making process for investors, creditors, and other stakeholders.

We sincerely hope you find the enclosed publication informative. We will be happy to participate in any discussions required to clarify our views, which are enclosed in the attached publication. We look forward to hearing from you.



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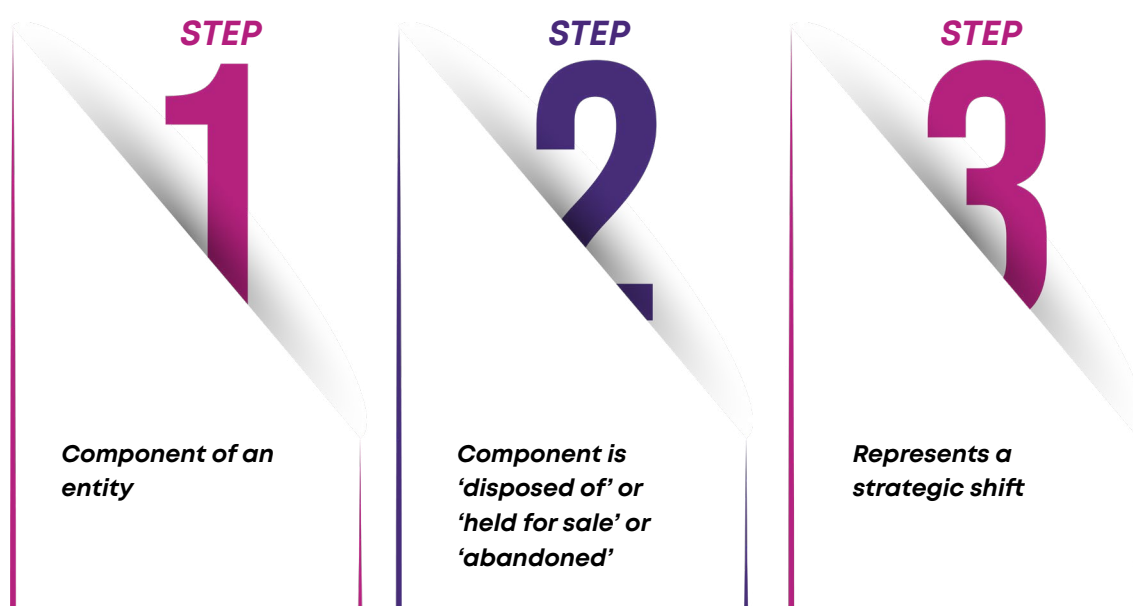
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Background

ASC 205, *Presentation of Financial Statements*, prescribes authoritative guidance for the presentation of financial statements for all the entities reporting under US GAAP accounting framework. Subtopic ASC 205-20 provides guidance on the presentation and disclosure of discontinued operations, including criteria for determining when the presentation of discontinued operations is appropriate.

It provides a 3-step process for determining when and how to report and disclose discontinued operations.



Report discontinued operations if
the above are met

Relevant disclosures



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Summary of Topic

01 Scope

A discontinued operation includes either:

- **Disposal Transaction:**
A component of an entity or group of components that is classified as held-for-sale or have been disposed of by sale or disposed of other than by sale or and represents a strategic shift that has or will have a major effect on an entity's operations and financial results.
- **Newly acquired business:**
A newly acquired business or nonprofit activity that, on acquisition, met the held-for-sale criteria.



02 Criteria for reporting discontinued operations

Subtopic ASC 205-20 requires all reporting entities to **separately present** discontinued operations from continued operations in financial statements, as a single amount in the statement that reports profit or loss. An analysis of this single amount is presented either in the statement that reports profit or loss or in the notes to financial statements. Further, in the Statement of Financial Position for discontinued operations classified as held for sale and for all prior periods presented, the assets and liabilities of the discontinued operation shall be presented separately.

To report any operations under this sub-topic, it is required to meet the definition of Discontinued Operations. Subtopic ASC 205-20 provides guidance on **the determination of discontinued operations as summarized below:**

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A. Qualification Criteria for reporting a “Disposal transaction” as a discontinued transaction

Criteria 1: The Disposal group is a “Component” of an entity

Guidance

- The primary condition for a division or part of an entity to be identified as Component is that the Operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes from the rest of the entity.

A component of an entity may be a reportable segment or an operating segment, a reporting unit, a subsidiary, or an asset group.

Implementation matters

Key considerations in identifying a component is the availability of financial information to conclude that the operations and cash flows of the part of the entity are clearly distinguishable. Financial information would be considered obtainable even if effort, including analysis, and allocation of expenses, would be required to produce such information.

Considering the fact that the definition of a component of an entity does not include any bright lines, judgment is required in determining whether a disposal group constitutes a component of an entity.

Criteria 2: Held-for-sale criteria

Guidance

A component shall be classified as Held for sale if the following criteria are met.



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A. Guidance

Commitment to a plan to sell by Management, having the **authority** to approve the action, is a precondition for assessing held for sale criteria. It is recommendatory to have a documented plan.

Implementation matters

Key considerations :

- Existence of a commitment to a plan to sell rather than a plan to commit, which may be demonstrated in the form of well-documented plan.
- Identification of appropriate level of authority approving the plan, such as the Board's approval, shareholder's approval, CEO approval, etc.

Note: For an entity in bankruptcy proceedings, management or the board may not have the requisite authority to commit to such a plan after filing for bankruptcy. In such case bankruptcy court or the creditors, may be considered as appropriate authority.

B. Guidance

Existence of the **intent and ability** to transfer the entity to a buyer in its present condition.

Implementation matters

In the event of delay in transferring the entity to be sold, reasons for delay should be evaluated to assess if the entity being intended to be transferred meets the definition of available for immediate sale. The criterion does not restrict an entity to be sold from being classified as held for sale while it is being used, provided it is available for immediate sale.

C. Guidance

An **active program** to locate a buyer and other actions required to complete the plan to sell have been initiated.

Implementation matters

Hiring a selling agent to market or deploying internal staff to market the entity to be sold may demonstrate that the entity is engaged in an active program to locate a buyer.

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D Guidance

The possibility of occurrence of the sale of the entity should be such that the sale is **Probable** (“likely to occur”) and is expected to qualify for recognition as a completed sale within one year.

Implementation matters

Assessment of Probability criteria is subjective and requires judgment, as it will require the entity to ascertain the likelihood of the sale. Assessment of probability–

- May require an entity to acquire knowledge of the market in which the entity is being sold, consider its past sales experience and/or consider sales by others of entities with similar characteristics and terms.
- May also require probability assessment of the reasonableness of the sales price in relation to its fair value.

Critical assessment may also be required under circumstances whereby there is a delay in completion of sale beyond the period of one year caused by events or circumstances beyond an entity’s control, provided there is sufficient evidence that the entity remains committed to a qualifying plan to sell the entity.

E Guidance

As per FASB, the **reasonableness of the price** at which an entity to be sold is being marketed is indicative of whether the entity currently the intent and ability has to sell the entity to be sold.

Implementation matters

Assessment of reasonableness of sales price vis a vis to its fair value is a critical indicator to evaluate whether the entity is immediately available for sale.

F Guidance

The possibility that it is unlikely that **significant changes** to the plan will be made or that the plan will be withdrawn should not exist.

Implementation matters

This requires conducting look back analysis to assess, whether entity has a history of making significant changes to the plan of sale or has a history of withdrawing sales of similar entities to be sold. This also helps to conclude that entities have a sufficiently robust plan of sale at the commitment date.

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Criteria 3: Strategic Shift

Guidance

- A component (or group of components) that is disposed of or is classified as held for sale must represent a **strategic shift** having a major effect on an entity's operations and financial results.
- Examples of strategic shift include a disposal of a major geographical area, a major line of business, a major equity method investment, or other major parts of an entity.

Once a reporting entity determines that a disposal constitutes a strategic shift, it must determine whether it has had (or will have) a major effect on the reporting entity's operations and financial results for the disposal to be considered a discontinued operation.

Implementation matters

Assessing whether a disposal is a strategic shift requires evaluating all facts and circumstances, including financial metrics relevant to the entity's financial statement users.

One of the key indicators to qualify as a strategic shift is exiting a major line of business is substantively different than the entity's remaining lines of business and/or a major geographic area.

This is an area of judgment which may require understanding the extent and prominence of an entity's historical communications with investors regarding the importance of such disposal group to the entity's operations and strategy to conclude if there exists a strategy shift.



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B. Newly acquired business or nonprofit activity that on acquisition met the held-for-sale criteria

Guidance

- Businesses or nonprofit activities acquired in connection with a business combination that meet the criteria to be accounted for as held for sale at the date of acquisition are reported as discontinued operations.
- The objective of this requirement is to include those businesses that will never be considered part of a reporting entity's continuing operations in discontinued operations.
- They do not have to satisfy the strategic shift test.

Implementation matters

To consider a newly acquired activity held for sale at the acquisition date, entities are expected to have begun formulating a plan to sell the business or nonprofit activity as of the acquisition date and that they would deem it probable that the held-for-sale criteria will be met within three months.



Key Issues/Considerations

A. Evaluating a group of components in a single plan of disposal for a strategic shift

In the first quarter of 2023, ABC Company's board of directors approved the sale of one of their major business lines, which consists of Unit 1 (not a separate reportable segment) and manufacturing unit of Unit 2 (Unit 2 is a reportable segment and a trading unit). ABC announced the disposal plan as a single plan but will sell Unit 1 and Unit 2 in two separate transactions to different buyers. While neither Unit 1 nor Unit 2 would meet the criteria for discontinued operations individually, together, they contribute more than 20% of the overall group revenue, which, in effect, has impact on ABC Company's operations and financial results. Based on the held-for-sale criteria, Unit 1 was classified as held-for-sale beginning March 31, 2023, while Unit 2 was classified as held-for-sale beginning June 30, 2023.

When should Unit 1 and Unit 2 be presented as discontinued operations, and, in case of only Unit 1 being sold off, will your response change (consider the relationship between both Units will continue after the disposal not resulting in any change in operation for Unit 2).

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Analysis:

As per the principles of ASC 205-20, a component (or a group of components) of a reporting entity that is disposed or meets the criteria to be classified as held for sale should be reported in discontinued operations if the disposal represents a **strategic shift** that has (or will have) a **major effect** on a reporting entity's operations and financial results.

The assessment of what qualifies as a strategic shift is based on qualitative and quantitative factors specific to the reporting entity. The fact that neither Unit 1 nor Unit 2 contribute more than 20% of the overall group revenue, the disposal of any individual component (Unit 1 or Unit 2) would not qualify as a strategic shift, but the disposal of Unit 1 and Unit 2 collectively would meet the criteria to be a strategic shift having major effect. This indicates that a single plan of disposal of both the units will meet the criteria of strategic shift having a major effect.

As Unit 1 and Unit 2 were part of a single plan of disposal and both met the held-for-sale criteria within a short period of time, we believe ABC Company should present Unit 1 and Unit 2 as discontinued operations as of June 30, 2023, as this is the date on which both components comprising the disposal plan were considered held for sale and therefore, met the criteria to be classified as discontinued operations.

In the scenario where only Unit 1 is being divested, and it does not qualify to be a separate reportable segment, and given that the supply arrangement would continue post-disposal, this would not represent a strategic shift that has (or will have) a major effect on an entity's operations and the financial results. Nonetheless, we believe it is crucial to evaluate all relevant facts and circumstances specific to the situation, considering interdependence and arrangement between the units.



Assessment of whether disposal of a component represents a strategic shift is critical and requires judgment. Key considerations evaluating the same include:

- the strategic shift may occur in multiple transactions that are part of the same plan occurring over a reasonable period of time;
- the conclusion drawn for the assessment of strategic shift at the individual subsidiary level may differ from that at the consolidated Group level;
- continuing involvement should also be considered while assessing strategic shift.

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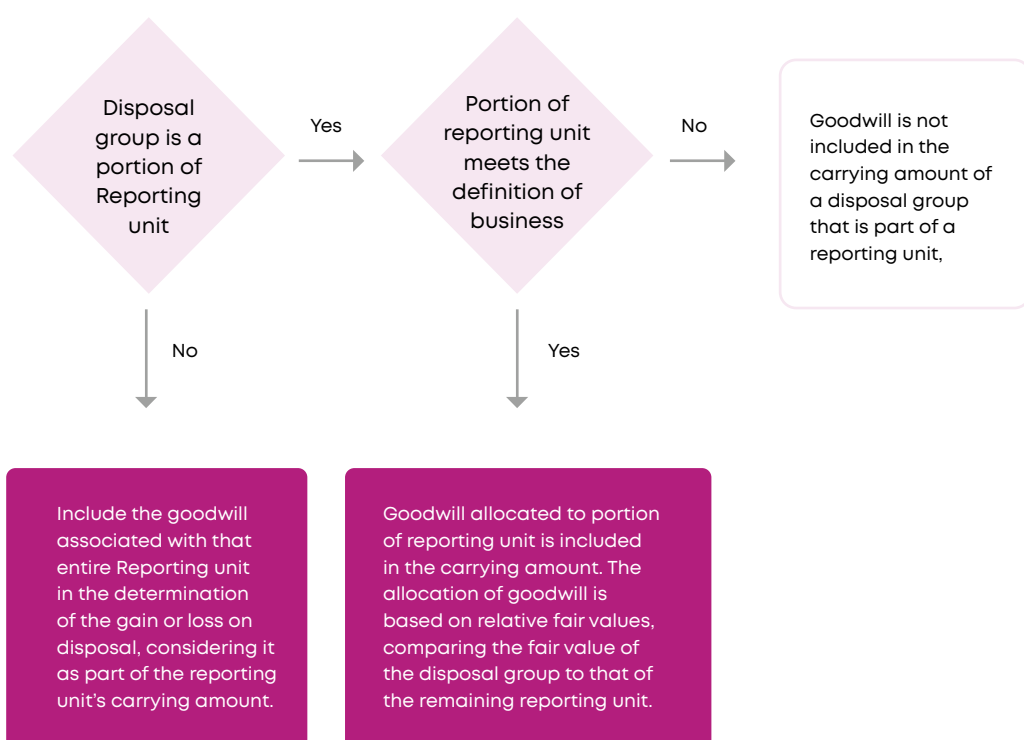
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B. Allocation of goodwill to a disposal group

As per principles of ASC 205-20, a gain or loss recognized on the disposal (or loss recognized on classification as held for sale) of a discontinued operation shall be calculated in accordance with the guidance in other Subtopics. However, a question sometimes arises on how to assign the goodwill to the disposal group.

Analysis:

The following summarises key considerations for the allocation of goodwill to the disposal group:



For example, if a business is being sold for \$100 million and the fair value of the reporting unit excluding the business being sold is \$300 million, then 25% ($\$100 / (\$100 + \$300)$) of the goodwill residing in the reporting unit is included in the carrying amount of the business to be sold.



The key conditions for allocation of goodwill to reporting unit being disposed off (which is a part of Group of components), is whether component being subject to disposal meets the definition of business as per the principles of ASC 805, Business Combination. This may require separate assessment in terms of existence of Inputs and Process which may result in Output, to correctly compute the Gain or loss arising on disposal transaction classified as discontinued operation.

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03 Disclosure requirements

An entity may elect to provide certain information either on the face of the financial statements or in the notes. The disclosure requirements in Subtopic 205-20 for discontinued operations vary depending on the type of operation being disposed of:



Income statement

The current and prior period results of operations of the component, which meets the criteria of discontinued operations, are presented separately. Further, expenses that are expected to continue in the ongoing entity after the disposal date should be reported within continuing operations and generally, should not be allocated to discontinued operations.

A gain or loss recognized on the disposal or loss recognised on classification of held for sale should also be included in discontinued operations line in the income statement. The gain or loss should be presented separately on the face of the income statement or disclosed in the notes to the financial statements.

Adjustments to previously reported amounts in discontinued operations in a prior period (such as, resolution of contingencies that arise pursuant to the terms of the disposal transaction) should be classified separately in the current period discontinued operations along with a disclosure of the nature and amount of such adjustments.

Earnings per share

Entities that report discontinued operations are required to present basic and diluted per-share amounts for that line item either on the face of the statement of operations or in the notes to the financial statements in accordance with the requirements of ASC 260-10-45-3.

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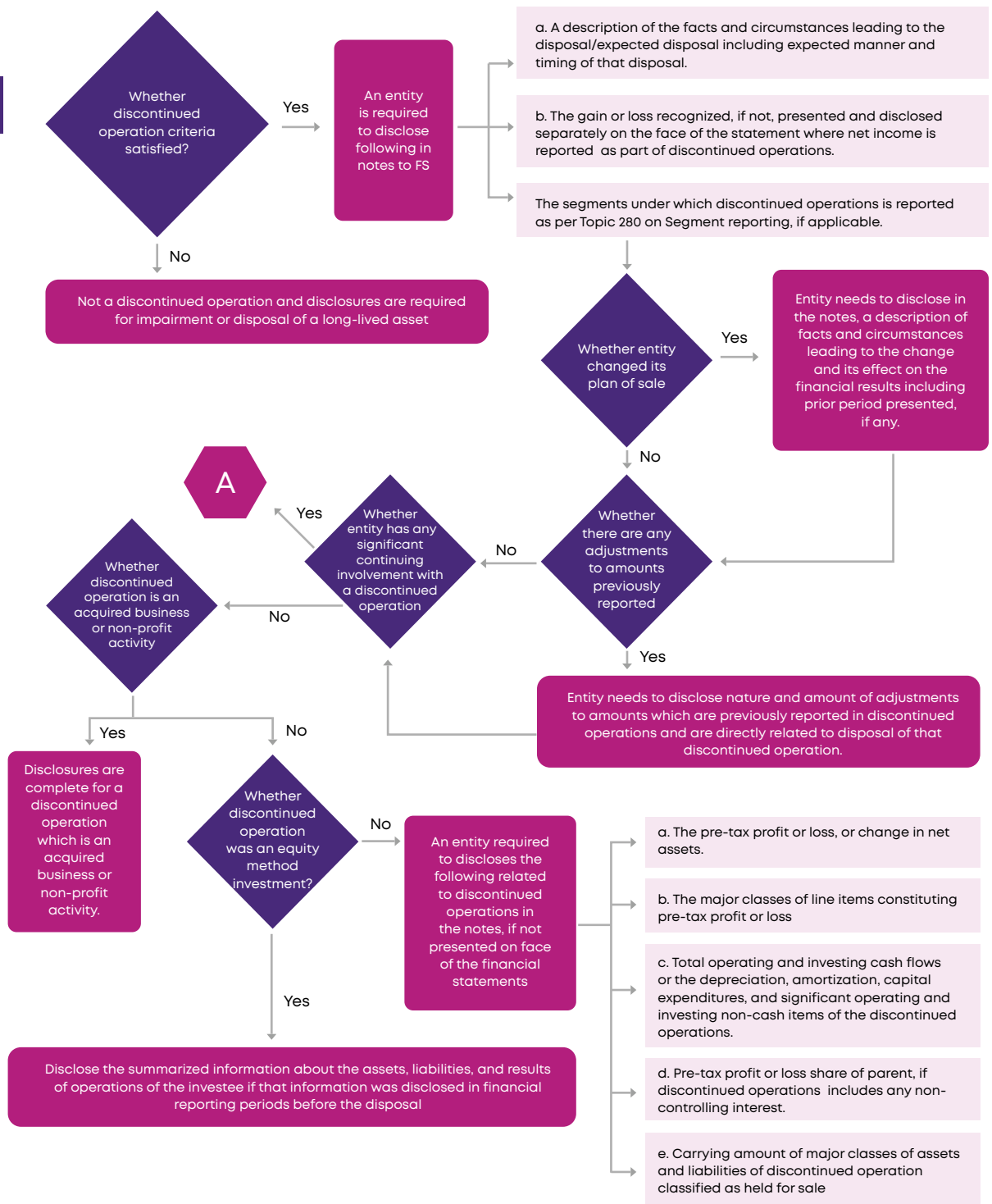
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Statement of financial position

In the period that a discontinued operation meets the criteria to be classified as held for sale, and for all prior periods presented, the assets and liabilities of the discontinued operation should be presented separately in the asset and liabilities sections, respectively, in the statement of financial position.

The following flowchart outlines the essential disclosure requirements mandated by Subtopic 205-20:



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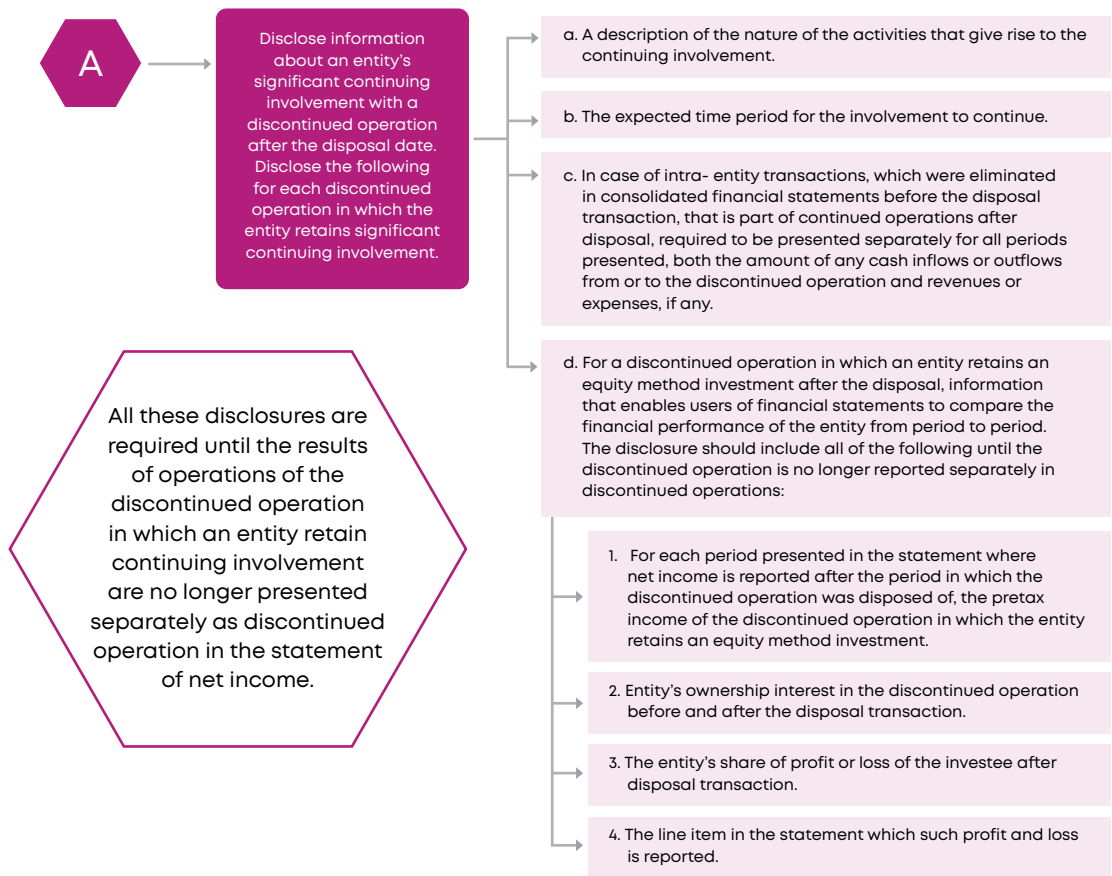
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Disclosures required for continuing operations under other topics are not required for discontinued operations since the reporting requirements outside Subtopic 205-20 generally provide financial statement users with the information needed to evaluate and assess **an entity's ongoing operations**. However, certain disclosures under Topic 275, like those pertaining to risks and uncertainties existing in using estimates, may be required for discontinued operations.



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Key Issues/Considerations

A. Reporting and presentation requirement of discontinued operations for prior periods

A Quick Service Restaurant (QSR) operates 500 outlets throughout the US. The entity divides its stores into five major geographic regions — the Northwest, Southwest, Midwest, Northeast and Southeast — that each have 100 outlets. Each geographic region comprises a major part of the entity's operations and financial results. Each outlet is a component of the entity.

In October 20X4, the entity commits to a plan to sell the 100 outlets in its Southwest region. These 100 outlets account for approximately 25% of the company's assets. The disposal is expected to occur in 20X5.

The planned disposal of the 100 outlets meets the criteria to be classified as an asset held for sale on 31 December 20X4 and recorded a \$300 loss on the classification held for sale as of 31 December 20X4. Also, because the disposal of 100 outlets represents a strategic shift (e.g., disposal of a major geographical area) that will affect the entity's operations and financial results, the disposal qualifies for presentation as a discontinued operation. The financial information of the entity is below mentioned (all amounts in \$)-

Consolidated Statement of Income

	Year ended 31 December		
	20X4	20X3	20X2
Income from continuing operations before tax	32,000	30,000	27,000
Income taxes	(8,000)	(7,500)	6,750
Loss from operations of discontinued outlets	(3,700)	(3,500)	(3,100)
Loss on classification as held for sale	(300)	-	-
Income tax benefit	1,000	875	775

Consolidated Statements of Financial Position

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	31 December	
	20X4	20X3
Assets held for sale		
Current assets	145	38
Long term assets	-	100
Liabilities held for sale		
Current liabilities held for sale	98	25
Long-term liabilities held for sale	-	70

How should entity make the presentation of discontinued operation?

Analysis:

Key considerations for the presentation of discontinued operations:

- When comparative income statements are presented, current and prior periods should report the results of operations of the component in discontinued operations.
- In the period that a discontinued operation meets the criteria to be classified as held for sale, and for all prior periods presented, the assets and liabilities of the discontinued operation should be presented separately in the asset and liabilities sections, respectively, in the statement of financial position.
- Expenses expected to continue in the ongoing entity after the disposal date should be reported within continuing operations and generally should not be allocated to discontinued operations.
- The income tax benefit can be shown as a separate line item, or discontinued operations could be displayed net of tax, with the tax benefit stated parenthetically.
- A gain or loss recognized on the disposal (or loss recognized on classification as held for sale) shall be presented separately on the face of the statement where net income is reported or disclosed in the notes to financial statements.
- Assets and liabilities to be sold should be classified as current or long-term, depending on the anticipated disposal date. Generally, classification as a current asset or liability is appropriate if it is probable that the sale will occur and proceeds will be collected within one year. However, for prior periods, the current and long-term classification of those assets and liabilities should not change because they did not meet the held-for-sale criteria in the prior period.

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Consolidated Statement of Income

	Year ended 31 December		
	20X4	20X3	20X2
Income from continuing operations before tax	\$ 32,000	\$ 30,000	\$ 27,000
Income taxes	(8,000)	(7,500)	6,750
Income from continuing operations	24,000	22,500	20,250
Discontinued operations			
Loss from operations of discontinued Outlets	(3,700)	(3,500)	(3,100)
Loss on classification as held for sale	(300)		
Income tax benefit	1,000	875	775
Loss on discontinued operations	(3,000)	(2,625)	2,325
Net income	21,000	19,875	17,925

Consolidated Statements of Financial Position

	31 December	
	20X4	20X3
Current assets held for sale	\$ 145	\$ 38
Long-term assets held for sale	-	110
Current liabilities held for sale	98	25
Long-term liabilities held for sale	-	70



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B. Presentation of Intercompany transactions that occur before disposal.

XYZ Inc. has two subsidiaries: Subsidiary X and Subsidiary Y. For the year ended 31 December 20X3, Subsidiary X manufactured products for \$1500 and sold them to Subsidiary Y for \$2000. Subsidiary Y then sold all of these products to third-party customers for \$3,500.

XYZ Inc. would normally eliminate the intercompany revenue, cost of sales, and gross profit of Subsidiary X and Subsidiary Y in its consolidated income statement as follows:

			Intercompany eliminations		Consolidated XYZ Inc.
	Subsidiary X	Subsidiary Y	Debit	Credit	
Revenue	\$ 2,000	\$ 3,500	\$ 2,000		\$ 3,500
Cost of sales	(1,500)	(2,000)		\$ 2,000	1,500
Gross Profit	500	1,500			2,000

However, on 1 November 20X3, the Board of Directors of XYZ Inc. approved a plan to sell Subsidiary Y and concluded that its operations should be presented as discontinued operations in its consolidated financial statements for the year ended 31 December 20X3. Under the plan, Subsidiary Y will be sold in early 20X4.

After the sale of Subsidiary Y, both Subsidiary X and the former Subsidiary Y will continue to operate their businesses similarly. That is, Subsidiary X will continue manufacturing products and selling them to former Subsidiary Y. Former Subsidiary Y will continue purchasing products from Subsidiary X and selling them to third-party customers.

How does XYZ Inc. present the intercompany purchases and sales that occur before disposal in the financial statements for the year ended 31 December 20X3?



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Analysis:

As per the facts of the given case, Subsidiary Y should be presented as discontinued operations in its Consolidated Financial Statements (CFS) for the year ended 31 December 20X3, therefore in respect of intercompany sales made by Subsidiary X to Subsidiary Y, XYZ Inc. shall present in continuing operations the intercompany revenue arising from sales made by Subsidiary X to Subsidiary Y that will remain in the consolidated group which otherwise would have been eliminated as an Intercompany adjustments in the CFS. The discontinued operations line item would include the effect of the intercompany revenue or costs of sales attributed to Subsidiary Y, so there is no impact on consolidated net income.

XYZ Inc. can present the pre-disposal intercompany transactions that resulted in sales to third-party customers before the disposal in its consolidated income statement for the year ended 31 December 20X3 as follows:

Consolidated income statement of XYZ Inc. for the year ended 31 December 20X3 is as follows:

Revenue	\$ 2,000
Cost of Sales	(1,500)
Gross Profit	500
Income from continuing operations	500
Income from discontinued operations*	1,500
Net Income	2,000

* *Income from discontinued operations* = \$3,500 - \$2,000 = \$1,500.



This presentation would make the reporting of the continuing operations consistent with the consolidated entity's reporting after the disposal. Since the consolidated group will continue to transact with the component after its disposal, it will continue to record the revenue and costs associated with sales or purchases it makes to the former consolidated component.

However, in our view this presentation is only appropriate for intercompany transactions that resulted in sales to third parties during the period. Intercompany sales and purchases that did not result in sales to third parties would continue to be eliminated in consolidation. That's because the effect of increasing both revenue and the cost of sales for transactions between components cannot result in revenue greater than what the consolidated entity would have reported if it eliminated the intercompany transactions.

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Both **ASC 205-20, Presentation of Financial Statements – Discontinued Operations** under **USGAAP** and **IFRS 5, Non-current Assets Held for Sale and Discontinued Operations** under IFRS, provide guidance on reporting of discontinued operations. This enables the financial statements users to understand and evaluate the effects of a disposal transaction on an entity's ongoing operations.

The following table summarizes the key differences:

	US GAAP – Subtopic ASC 205-20	IFRS Accounting Standard – IFRS 5
Definition	A discontinued operation is defined as either of the following: • A component of an entity that: (a) has been disposed of, meets the criteria to be classified as held for sale, or has been abandoned or spun off and (b) represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. • A business or nonprofit activity that, on acquisition, meets the criteria to be classified as held for sale.	A discontinued operation is a component of an entity that either has been disposed of or is classified as held for sale or for distribution to owners, and that meets any of the following criteria: • It represents a separate major line of business or geographical area of operations. • It is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations. • It is a subsidiary acquired exclusively with a plan to resell.
Reclassification of assets and liabilities for prior periods	When a discontinued operation meets the criteria to be classified as held for sale, and for all prior periods presented, the assets and liabilities of the discontinued operation should be presented separately in the asset and liabilities sections, respectively, in the statement of financial position.	The comparative statement of financial position is not reclassified or re-presented when a non-current asset or disposal group is classified as held-for-sale for prior periods to reflect the classification in the statement of financial position for the latest period presented.

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	US GAAP – Subtopic ASC 205-20	IFRS Accounting Standard – IFRS 5
Unit of account	The unit of account is a component, which may be a reportable segment or operating segment, a reporting unit, a subsidiary, or an asset group, depending on the facts and circumstances.	The unit of account is a component which comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. A component shall be a cash-generating unit or a group of cash-generating units when it is held for use.
Precluded assets	Oil and gas properties accounted for using the full-cost method is specifically excluded from designation as discontinued operations under ASC 205-20.	None of the assets are excluded from IFRS 5 from designation as discontinued operations.
Cash flow information	An entity must present (either in the financial statements or the notes) net cash flows attributable to the operating, investing, and financing activities of discontinued operations.	An entity must disclose either of the following if it is not already presented on the face of the cash flow statement: • The total operating and investing cash flows of the discontinued operation. • The depreciation, amortization, capital expenditures, and significant operating and investing noncash items of the discontinued operation.
Allocation of interest to discontinued operations	• Interest on debt, that is - • to be assumed by a buyer and • required to be repaid due to the disposal transaction. is required to be allocated to discontinued operations. • The allocation to discontinued operations of other consolidated interest expense that is not directly attributable to or related to other operations of the entity is permitted, but not required.	There is no guidance on interest allocation to discontinued operations.

A TEAM THAT YOU CAN TRUST TO DELIVER



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