

Discontinued operations: Identification, presentation and disclosure

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February 2020

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Introduction

Financial statements present a historical view of an entity's financial position, operations and cash flows. Many financial statement users are interested in using the statements as a basis to predict the future. A lender is interested in historical cash flows for purposes of predicting future cash flows and a borrower's ability to repay a loan. A potential investor uses the historical information to evaluate a potential investee's ability to provide a sufficient return on investment. A current shareholder uses the historical information to make decisions about whether to sell or hold its investment.

When an entity disposes of part of its operations, recasting financial information to show the ongoing entity separate from the part disposed of is often more meaningful to users of the financial statements. In some situations, when an entity plans to dispose of part of its operations, a similar recasting of financial information is beneficial. The accounting standard setters have specified different requirements over the years to determine when the operating results of disposals or planned disposals should be separately presented and recast as discontinued operations. For many years, the requirements were very narrow, which resulted in few discontinued operations. Then, the requirements were broadened, which resulted in many more discontinued operations. Many constituents expressed concern that the broader requirements were resulting in too many discontinued operations. In response to this concern, the Financial Accounting Standards Board (FASB) revisited the requirements and amended their guidance such that significantly fewer disposals (or planned disposals) are presented as discontinued operations.

This white paper provides an overview of the discontinued operations guidance in Subtopic 205-20, *Presentation of Financial Statements – Discontinued Operations*, of the FASB's Accounting Standards Codification (ASC), as well as an appendix that provides a tabular presentation of the related disclosure requirements.

Discontinued operations guidance

In general, the discontinued operations guidance applies to both public and private entities, including nonprofit entities. However, the model does not apply to oil and gas properties for which the full-cost method is used for accounting purposes.

The types of disposals or planned disposals that must be evaluated for discontinued operations treatment are those involving: (a) a component or group of components of an entity and (b) a business or nonprofit activity that, on acquisition, is classified as held for sale. If an equity method investment meets the definition of a component of an entity, its disposal or planned disposal must also be evaluated for discontinued operations treatment. The factors involved in determining whether the disposal or planned disposal of a *component or group of components of an entity* represents a discontinued operation are different from the factors involved in determining whether the disposal or planned disposal of an *acquired business or nonprofit activity* that, on acquisition, is classified as held for sale represents a discontinued operation. The factors considered in each regard are discussed in detail and presented in a flowchart in the sections that follow.

Expected future losses of the discontinued operation are not accrued upon its classification as a discontinued operation. These losses are recognized in the future as they are incurred.

Component or a group of components of an entity

A component or a group of components of an entity is treated as a discontinued operation when both of the following are true:

- The component or group of components either: (a) meets the held for sale criteria in ASC 205-20-45-1E, (b) has been disposed of by sale or (c) has been disposed of other than by sale.

- Disposing of the component or group of components represents a strategic shift that has or is expected to have a major effect on the entity's operations and financial results.

Based on the definition of a component of an entity in the Master Glossary of the ASC, a disposal or planned disposal is considered a component of an entity when it has "operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity." Units of account used elsewhere in the ASC that may represent a component of an entity, depending on the facts and circumstances, include a reportable segment, an operating segment, a reporting unit, a subsidiary and an asset group.

Determining whether the disposal or planned disposal of a component or a group of components of an entity represents a strategic shift will require a significant amount of judgment to be exercised. Neither strategic shift nor major effect is defined in ASC 205-20. However, ASC 205-20-55 includes five examples that illustrate application of the strategic shift concept to specific fact patterns, which provides some context around what constitutes a strategic shift that has a major effect on the entity's operations and financial results. For example, in three of the examples in ASC 205-20-55, disposals or planned disposals of the following were considered to represent strategic shifts that would have a major effect on the entity's operations and financial results: (a) a product line representing 15% of the entity's revenues, (b) operations in a geographical area representing 20% of the entity's total assets and (c) stores in malls representing 15% of the entity's total net income. By no means do these examples provide bright lines for what should be considered a major effect on the entity's operations and financial results. Judgment must be exercised in each set of facts and circumstances to determine whether a disposal or planned disposal represents a strategic shift and whether that strategic shift has a major effect on the entity's operations and financial results.

While the strategic shift and major effects concepts do not preclude the existence of ongoing cash flows and significant continuing involvement with a discontinued operation, care should still be exercised in assessing whether the existence of any ongoing cash flows or significant continuing involvement is indicative that a strategic shift has not occurred.

Example

Food Maker (FM) manufactures and sells food products that are grouped into five major geographical areas (A through E). Each major geographical area accounts for 20% of FM's assets and includes several major brands (Brands G through P). Each major brand represents 10% of FM's revenues. Assume that each geographical area and each brand represents a component of FM. Growth in Area A is slower than in the other four major geographical areas of FM's operations. As a result, FM decides to sell its operations in Area A. In addition, sales of Brand H products in Area C are lagging behind those in the other four major geographical areas of FM's operations. As a result, FM decides to discontinue the manufacture and sale of Brand H products in Area C. Sales of Brand H products in Area C represent 10% of total Brand H product sales and 1% of FM's total sales.

The questions that arise in this example are whether selling the operations in Area A and discontinuing the manufacture and sale of Brand H products in Area C represent strategic shifts that will have a major effect on FM's operations and financial results. Based on the limited information provided, FM's sale of its operations in Area A likely represents a strategic shift that will have a major effect on FM's operations and financial results. In contrast, FM discontinuing the manufacture and sale of Brand H products in Area C likely does not represent a strategic shift that will have a major effect on FM's operations and financial results.

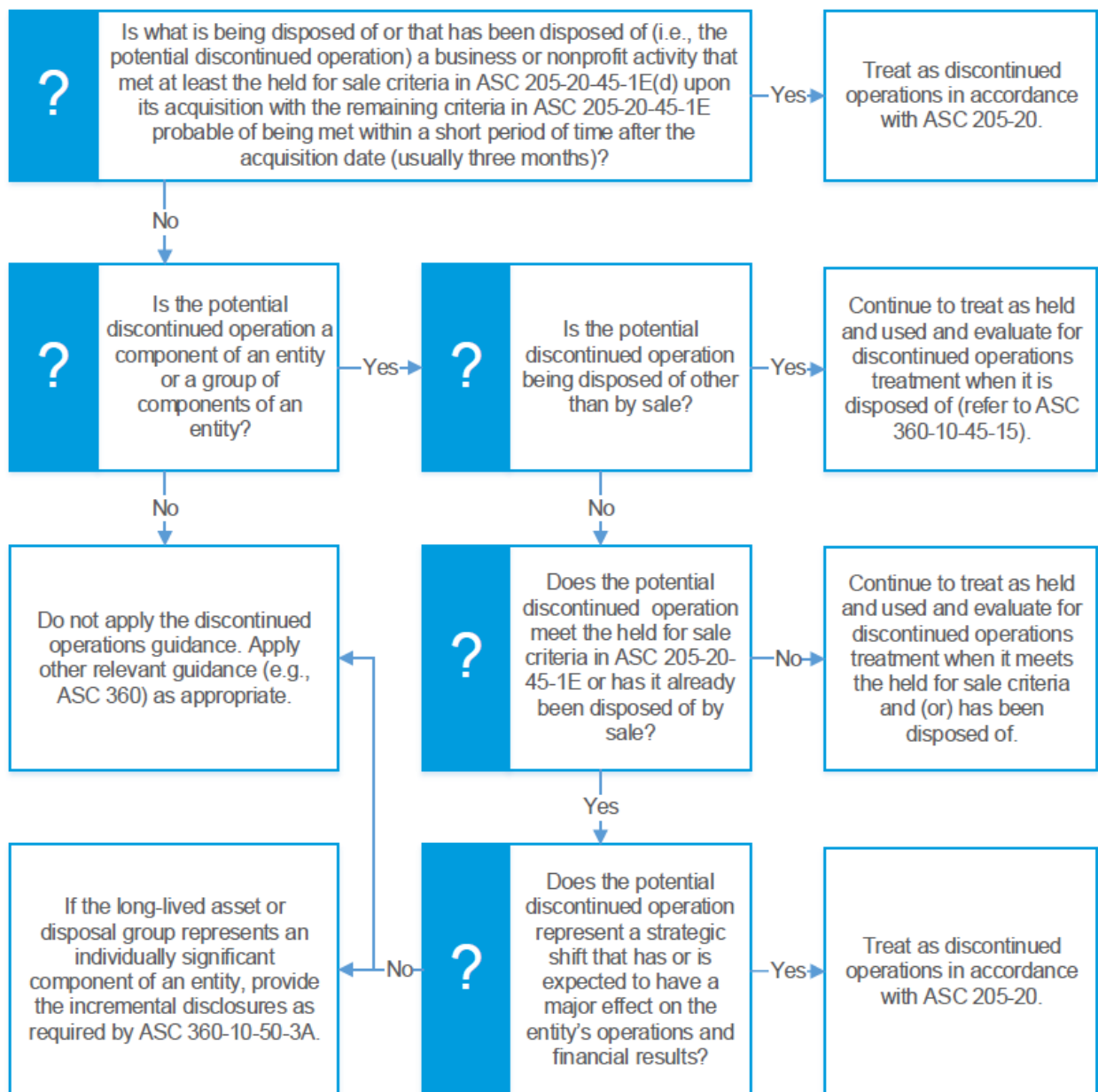
Business or nonprofit activity that, on acquisition, is classified as held for sale

If an entity acquires a business or nonprofit activity and the business or nonprofit activity meets the held for sale criteria in ASC 205-20-45-1E on acquisition, it is considered a discontinued operation. The

disposal or planned disposal of the business or nonprofit activity does not have to represent a strategic shift.

The held for sale criterion in ASC 205-20-45-1E(d) must be met on the acquisition date for an acquired business or nonprofit activity to be considered a discontinued operation provided that any of the remaining criteria not met on the acquisition date are probable of being met within a short period of time (usually three months) following the acquisition date. This clarification is consistent with the preexisting and corresponding guidance in ASC 360-10-45-12.

Flowchart: Identifying discontinued operations



Presentation

Application of the guidance on how to present discontinued operations is first applied upon the earlier of the disposition of the discontinued operation or its meeting the held for sale criteria. Presentation requirements for discontinued operations on the income statement, balance sheet and cash flow statement are discussed in the sections that follow.

Income statement

For purposes of this discussion, the income statement also includes the statement of activities for a nonprofit organization.

For all periods presented on the income statement, the results of discontinued operations, net of tax, should be separately presented from the results of continuing operations. The results of discontinued operations should include any gain or loss recognized when the discontinued operation is classified as held for sale and (or) when it is actually disposed of. Recognition and measurement of the gain or loss is determined using other applicable guidance in the ASC (e.g., the impairment recognition guidance related to assets held for sale in ASC 360-10-35). For presentation purposes, the income tax effects of discontinued operations can either be shown as a separate line item or parenthetically. In addition, if any gain or loss related to the disposal of a discontinued operation or any loss related to when it was classified as held for sale is not separately presented on the income statement itself, it must be disclosed in the footnotes.

Following is an example of how discontinued operations may be presented in the income statement of a calendar-year-end entity when the disposal of a component of the entity is considered a discontinued operation in 20X5:

| | Year ending December 31 (amounts in millions) | |
|---|--|---------|
| | 20X5 | 20X4 |
| Income from continuing operations before income taxes | \$1,100 | \$1,000 |
| Income taxes | (385) | (350) |
| Income from continuing operations | 715 | 650 |
| Income (loss) from discontinued operations (net of income tax benefit of \$14 in 20X5 and income tax expense of \$35 in 20X4) | (26) | 65 |
| Net income | \$689 | \$715 |

A few notes about this example:

- Instead of presenting income taxes parenthetically on the income statement, the entity may show the pretax income (loss) from discontinued operations and the income tax expense (benefit) on separate lines with a subtotal for the net amount of income (loss) from discontinued operations.
- If the entity recognized a gain or loss upon the disposal of the discontinued operation in 20X5, it would need to disclose the amount of that gain or loss in the footnotes because it did not separately present the gain or loss on the face of the income statement (neither parenthetically nor as a separate line).
- Even though the component was not classified as held for sale or disposed of until 20X5, its results of operations for all prior periods presented (20X4) must be reclassified from income from continuing operations to income (loss) from discontinued operations.
- If the entity adjusts an amount presented in discontinued operations in a subsequent period (e.g., it receives contingent proceeds or payments related to the sale of the discontinued operation), such

adjustment should be presented in discontinued operations in that subsequent period. For example, assume that the entity received an additional \$1 million in 20X6 from the buyer related to its sale of the discontinued operation based on the resolution of a contingency. In that situation, the \$1 million of income (net of taxes) would be presented in discontinued operations in 20X6.

Balance sheet

The carrying amounts of the current and noncurrent assets and liabilities of a discontinued operation must be presented separately for each balance sheet date prior to the disposal of the discontinued operation. This is the case even if the discontinued operation did not meet the held for sale criteria prior to its disposal. This is a presentation matter and should not otherwise affect when an entity applies the recognition and measurement guidance in other applicable sections of the ASC (e.g., the recognition and measurement guidance included in ASC 360-10-35-43 related to the impairment testing of assets held for sale). For example, consider a situation in which an entity with a calendar year end disposes of a discontinued operation in 20X5 that did not meet the held for sale criteria prior to its disposal. If the entity presents a 20X4 balance sheet for comparative purposes, the discontinued operation's current and noncurrent assets and liabilities would be presented separately in the 20X4 balance sheet. However, the entity would not retroactively apply the recognition and measurement guidance in ASC 360-10-35-43 to 20X4.

When a discontinued operation is classified as held for sale in the current period, an entity is required to provide, for all periods presented, the discontinued operation's major classes of assets and liabilities either on the balance sheet itself or in the footnotes. For this purpose, a loss recognized in accordance with ASC 360-10-35-43 upon classifying the discontinued operation as held for sale should be allocated to the discontinued operation's major classes of assets and liabilities in the current period. This loss, as well as any gain or loss recognized on the disposal of a discontinued operation in the current period, should not be allocated to the discontinued operation's major classes of assets and liabilities in prior periods. If an entity chooses to present the discontinued operation's major classes of assets and liabilities in the footnotes, it must also provide a reconciliation of those amounts to the discontinued operation's total current and noncurrent assets and liabilities presented on the balance sheet itself. ASC 205-20 does not define major classes of assets and liabilities. However, in an illustrative disclosure, major classes of assets and liabilities presented included cash, trade receivables, inventories, property, plant and equipment, trade payables and short-term borrowings. The facts and circumstances should be analyzed in specific situations and judgment applied when identifying what should be considered a discontinued operation's major classes of assets and liabilities.

Cash flow statement presentation

For a discontinued operation that is a component or group of components of an entity, but that is not an equity method investment, an entity must present one of the following on the face of the cash flow statement or disclose one of the following in its footnotes:

- Operating and investing cash flows for all periods presented
- Depreciation, amortization, capital expenditures and significant operating and investing noncash items for all periods presented

Disclosures

There are numerous disclosure requirements that apply to discontinued operations. The nature and extent of these disclosures depend on several factors, including the following: (a) whether the discontinued operation represents a component or group of components of an entity, or a business or nonprofit activity that, on acquisition, is classified as held for sale, (b) whether the discontinued operation is made up of an equity method investment, (c) whether there has been a change in the plan of sale, (d) whether adjustments to amounts previously recorded as discontinued operations were made and (e)

whether the entity retains significant continuing involvement in the discontinued operation after its disposal. In addition, there are also disclosure requirements applicable to an individually significant component of an entity that has either been disposed of or is classified as held for sale, but that *does not* qualify for discontinued operations treatment. All of these disclosure requirements are included in Appendix A of this white paper.

Appendix A: Disclosure requirements applicable to discontinued operations and disposals of individually significant components that are not discontinued operations

There are numerous disclosure requirements that apply to discontinued operations. The nature and extent of the required disclosures depends on several factors. All of the disclosures required by ASC 205-20-50 are included in the first table in this appendix. In addition to providing the actual disclosure requirements, the table also highlights the circumstances under which each disclosure must be provided. The second table in this appendix includes the disclosure requirements applicable to an individually significant component of an entity that has either been disposed of or is classified as held for sale, but that *does not* qualify for discontinued operations treatment.

Disclosure requirements applicable to discontinued operations

| Disclosure requirements (Note 1) | Applicable to all discontinued operations or only certain discontinued operations (Note 2)? |
|---|---|
| <p>205-20-50-1 The following shall be disclosed in the notes to financial statements that cover the period in which a discontinued operation either has been disposed of or is classified as held for sale under the requirements of paragraph 205-20-45-1E:</p> <ol style="list-style-type: none"> a. A description of both of the following: <ol style="list-style-type: none"> 1. The facts and circumstances leading to the disposal or expected disposal 2. The expected manner and timing of that disposal. b. If not separately presented on the face of the statement where net income is reported (or statement of activities for a not-for-profit entity) as part of discontinued operations (see paragraph 205-20-45-3B), the gain or loss recognized in accordance with paragraph 205-20-45-3C. c. Subparagraph superseded by Accounting Standards Update No. 2014-08 d. If applicable, the segment(s) in which the discontinued operation is reported under Topic 280 on segment reporting. | All |
| <p>205-20-50-3 An entity may change its plan of sale as addressed in paragraph 360-10-35-44 or paragraph 360-10-35-45. In the period in which the decision is made to change the plan for selling the discontinued operation, an entity shall disclose in the notes to financial statements a description of the facts and circumstances leading to the decision to change that plan and the change's effect on the results of operations for the period and any prior periods presented.</p> | All discontinued operations for which there has been a <i>change in the plan of sale</i> |
| <p>205-20-50-3A The nature and amount of adjustments to amounts previously reported in discontinued operations that are directly related to the disposal of a discontinued operation in a prior period shall be disclosed (see paragraph 205-20-45-</p> | All discontinued operations for which there has been an <i>adjustment to a previously reported amount</i> |

| Disclosure requirements (Note 1) | Applicable to all discontinued operations or only certain discontinued operations (Note 2)? |
|---|---|
| 5 for examples of circumstances in which those types of adjustments may arise). | |
| <p>205-20-50-4A An entity shall disclose information about its significant continuing involvement with a discontinued operation after the disposal date. Examples of continuing involvement with a discontinued operation after the disposal date include a supply and distribution agreement, a financial guarantee, an option to repurchase a discontinued operation, and an equity method investment in the discontinued operation. The disclosures are required until the results of operations of the discontinued operation in which an entity retains significant continuing involvement are no longer presented separately as discontinued operations in the statement where net income is reported (or statement of activities for a not-for-profit entity).</p> | All discontinued operations in which the entity retains <i>significant continuing involvement</i> after the disposal date |
| <p>205-20-50-4B An entity shall disclose the following in the notes to financial statements for each discontinued operation in which the entity retains significant continuing involvement after the disposal date:</p> <ol style="list-style-type: none"> a. A description of the nature of the activities that give rise to the continuing involvement. b. The period of time during which the involvement is expected to continue. c. For all periods presented, both of the following: <ol style="list-style-type: none"> 1. The amount of any cash inflows or outflows from or to the discontinued operation after the disposal transaction 2. Revenues or expenses presented, if any, in continuing operations after the disposal transaction that before the disposal transaction were eliminated in consolidated financial statements as intra-entity transactions. d. For a discontinued operation in which an entity retains an equity method investment after the disposal (the investee), information that enables users of financial statements to compare the financial performance of the entity from period to period assuming that the entity held the same equity method investment in all periods presented in the statement where net income is reported (or statement of activities for a not-for-profit entity). The disclosure shall include all of the following until the discontinued operation is no longer reported separately in discontinued operations: | All discontinued operations in which the entity retains <i>significant continuing involvement</i> after the disposal date |

| Disclosure requirements (Note 1) | Applicable to all discontinued operations or only certain discontinued operations (Note 2)? |
|--|---|
| <ol style="list-style-type: none"> 1. For each period presented in the statement where net income is reported (or statement of activities for a not-for-profit entity) after the period in which the discontinued operation was disposed of, the pretax income of the investee in which the entity retains an equity method investment 2. The entity's ownership interest in the discontinued operation before the disposal transaction 3. The entity's ownership interest in the investee after the disposal transaction 4. The entity's share of the income or loss of the investee in the period(s) after the disposal transaction and the line item in the statement where net income is reported (or statement of activities for a not-for-profit entity) that includes the income or loss. | |
| <p>205-20-50-5A Paragraphs 205-20-50-5B through 50-5D provide disclosures required for discontinued operations that meet the criteria in paragraphs 205-20-45-1B through 45-1C except for a discontinued operation that was an equity method investment before the disposal. For disclosures required for discontinued operations that were equity method investments before the disposal, see paragraph 205-20-50-7.</p> | <p>Only discontinued operations that are a component or group of components of an entity or an equity method investment (Note 3)</p> |
| <p>205-20-50-5B An entity shall disclose, to the extent not presented on the face of the financial statements as part of discontinued operations, all of the following in the notes to financial statements:</p> <ol style="list-style-type: none"> a. The pretax profit or loss (or change in net assets for a not-for-profit entity) of the discontinued operation for the periods in which the results of operations of the discontinued operation are presented in the statement where net income is reported (or statement of activities for a not-for-profit entity). b. The major classes of line items constituting the pretax profit or loss (or change in net assets for a not-for-profit entity) of the discontinued operation (for example, revenue, cost of sales, depreciation and amortization, and interest expense) for the periods in which the results of operations of the discontinued operation are presented in the statement where net income is reported (or statement of activities for a not-for-profit entity). c. Either of the following: <ol style="list-style-type: none"> 1. The total operating and investing cash flows of the discontinued operation for the periods in which the results of operations of the discontinued operation are | <p>Only discontinued operations that are a component or group of components of an entity, but that are not an equity method investment (Note 3)</p> |

| Disclosure requirements (Note 1) | Applicable to all discontinued operations or only certain discontinued operations (Note 2)? |
|---|---|
| <p>presented in the statement where net income is reported (or statement of activities for a not-for-profit entity)</p> <p>2. The depreciation, amortization, capital expenditures, and significant operating and investing noncash items of the discontinued operation for the periods in which the results of operations of the discontinued operation are presented in the statement where net income is reported (or statement of activities for a not-for-profit entity).</p> <p>d. If the discontinued operation includes a noncontrolling interest, the pretax profit or loss (or change in net assets for a not-for-profit entity) attributable to the parent for the periods in which the results of operations of the discontinued operation are presented in the statement where net income is reported (or statement of activities for a not-for-profit entity).</p> <p>e. The carrying amount(s) of the major classes of assets and liabilities included as part of a discontinued operation classified as held for sale for the period in which the discontinued operation is classified as held for sale and all prior periods presented in the statement of financial position. Any loss recognized on the discontinued operation classified as held for sale in accordance with paragraphs 205-20-45-3B through 45-3C shall not be allocated to the major classes of assets and liabilities of the discontinued operation.</p> | |
| <p>205-20-50-5C If an entity provides the disclosures required by paragraph 205-20-50-5B(a), (b), and (e) in the notes to financial statements, the entity shall disclose the following:</p> <p>a. For the initial period in which the disposal group is classified as held for sale and for all prior periods presented in the statement of financial position, a reconciliation of both of the following:</p> <ol style="list-style-type: none"> 1. The amounts disclosed in paragraph 205-20-50-5B(e) 2. Total assets and total liabilities of the disposal group classified as held for sale that are presented separately on the face of the statement of financial position. If the disposal group includes assets and liabilities that are not part of the discontinued operation, an entity shall present those assets and liabilities in line items in the reconciliations that are separate from the assets and liabilities of the | <p>Only discontinued operations that are a component or group of components of an entity, but that are not an equity method investment (Note 3)</p> |

| Disclosure requirements (Note 1) | Applicable to all discontinued operations or only certain discontinued operations (Note 2)? |
|---|---|
| <p>discontinued operation (see paragraph 205-20-55-102 for an Example).</p> <p>b. For the periods in which the results of operations of the discontinued operation are reported in the statement where net income is reported (or statement of activities for a not-for-profit entity), a reconciliation of both of the following:</p> <ol style="list-style-type: none"> 1. The amounts disclosed in paragraph 205-20-50-5B(a) and (b) 2. The after-tax profit or loss from discontinued operations presented on the face of the statement where net income is reported (or statement of activities for a not-for-profit entity) (see paragraph 205-20-55-103 for an Example). | |
| <p>205-20-50-5D For purposes of the reconciliation in paragraph 205-20-50-5C(a) or (b), an entity may aggregate the amounts that are not considered major and present them as one line item in the reconciliation.</p> | <p>Only discontinued operations that are a component or group of components of an entity, but that are not an equity method investment (Note 3)</p> |
| <p>205-20-50-7 For an equity method investment that meets the criteria in paragraphs 205-20-45-1B through 45-1C, an entity shall disclose summarized information about the assets, liabilities, and results of operations of the investee if that information was disclosed in financial reporting periods before the disposal in accordance with paragraph 323-10-50-3(c).</p> | <p>Only discontinued operations in which the component of an entity is an equity method investment (Note 3)</p> |

Note 1: The disclosure requirements presented in this column of the table have been taken verbatim (with permission) from the indicated paragraph of the ASC.

Note 2: For purposes of this table, *all* discontinued operations include those that are: (a) a component of an entity or a group of components in an entity (which could be an equity method investment) that meet the criteria to be classified as held for sale or that have already been disposed of and (b) a business or nonprofit activity classified as held for sale when it is acquired.

Note 3: These disclosure requirements are not applicable to a discontinued operation made up of a business or nonprofit activity that meets the held for sale criteria on acquisition.

Disclosure requirements applicable to an individually significant component of an entity that has either been disposed of or is classified as held for sale, but that does not qualify for discontinued operations treatment

| Disclosure requirements (Note 1) | Applicable to public or private entities (Note 2) |
|--|---|
| <p>360-10-50-3A In addition to the disclosures in paragraph 360-10-50-3, if a long-lived asset (disposal group) includes an individually significant component of an entity that either has been disposed of or is classified as held for sale (see paragraph 360-10-45-9) and does not qualify for presentation and disclosure as a discontinued operation (see Subtopic 205-20 on discontinued operations), a public business entity and a</p> | <p>Public only</p> |

| Disclosure requirements (Note 1) | Applicable to public or private entities (Note 2) |
|--|---|
| <p>not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market shall disclose the information in (a). All other entities shall disclose the information in (b).</p> <p>a. For a public business entity and a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market, both of the following:</p> <ol style="list-style-type: none"> 1. The pretax profit or loss (or change in net assets for a not-for-profit entity) of the individually significant component of an entity for the period in which it is disposed of or is classified as held for sale and for all prior periods that are presented in the statement where net income is reported (or statement of activities for a not-for-profit entity) calculated in accordance with paragraphs 205-20-45-6 through 45-9. 2. If the individually significant component of an entity includes a noncontrolling interest, the pretax profit or loss (or change in net assets for a not-for-profit entity) attributable to the parent for the period in which it is disposed of or is classified as held for sale and for all prior periods that are presented in the statement where net income is reported (or statement of activities for a not-for-profit entity). | |
| <p>b. For all other entities, both of the following:</p> <ol style="list-style-type: none"> 1. The pretax profit or loss (or change in net assets for a not-for-profit entity) of the individually significant component of an entity for the period in which it is disposed of or is classified as held for sale calculated in accordance with paragraphs 205-20-45-6 through 45-9 2. If the individually significant component of an entity includes a noncontrolling interest, the pretax profit or loss (or change in net assets for a not-for-profit entity) attributable to the parent for the period in which it is disposed of or is classified as held for sale. | Private only |

Note 1: The disclosure requirements presented in this column of the table have been taken verbatim (with permission) from the indicated paragraph of the ASC.

Note 2: For purposes of this table: (a) public entities include public business entities and nonprofit entities that have issued, or are conduit bond obligors for, securities that are traded, listed or quoted on an exchange or an over-the-counter market and (b) private entities include all other entities within the scope of the related guidance (e.g., private companies, not-for-profit entities that have not issued and are not conduit bond obligors for securities that are traded, listed or quoted on an exchange or an over-the-counter market).

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