Financial Accounting
Advisory Services

Accounting for restructuring
Bringing clarity to the accounting for restructuring activities

As businesses increase their global reach, their operations and corporate structures are becoming more complex. Many businesses find it hard to decide what corporate structure is best for them, and then to undertake the necessary reorganization in order to create it. When choosing the structure, a business needs to take into account commercial, legal, tax, regulatory and accounting considerations. Third-party transactions add an additional layer of risk and complexity.

Careful planning of the steps necessary to achieve the desired structure is critical to any successful reorganization. Identifying and understanding the impacts of any necessary transactions requires experience that may not be found within the organization. Businesses must consider and understand the interaction between tax, accounting, regulatory and legal requirements to avoid unexpected tax charges, unlawful dividends or profit and loss volatility.

Companies face difficult decisions and complex accounting concerns when considering reorganization. Whether the objective is to improve operational or tax efficiency, or to facilitate a clean disposal of a business unit, restructuring can have wider business implications. It can raise accounting, tax and legal issues.

Restructuring is a non-routine process, so businesses may lack the internal expertise to understand the accounting complications that could arise. Therefore, it is essential to obtain specialized accounting advice.
What issues can arise when accounting for the restructuring?

Local accounting requirements can increase the complexity of transferring the operations, assets and liabilities between group entities. EY can help to apply accounting requirements in the following areas:

► The values at which to transfer and record the transferred assets and liabilities
► Accounting for legal mergers of entities
► Accounting for share transactions
► The mechanics of merger accounting
► The necessary disclosures that need to be made within the financial statements
► The impact of restructuring on subsequent impairment analysis, and the impact of complex intercompany arrangements
► Accounting for employee benefit obligations, such as pensions and share award programs related to the transferred entities
► Requirements for provisioning (both before and after the restructuring)
► Validating the going concern presumption of the organization, which is the basis of preparation of financial statements
► The presentation of discontinued operations
► Analyzing the effects of entities’ functional currency (there may be significant foreign currency and hedging implications)

What issues can arise when reorganizing?

When preparing to restructure, businesses must resolve complex accounting issues as they arise. Here are some questions to consider:

► What accounting and legal requirements exist for the transfer of operations, assets and liabilities between group entities?
► What is the most advantageous way to structure transactions?
► Is refinancing taking place simultaneously? How will this affect the restructuring process?
► Are the full accounting consequences and their impact understood? Will the transaction give rise to dividend blocks or covenant breaches?

How to get a clearer view of distributable reserves

Companies in the UK, and in many other countries, need distributable reserves to pay dividends. Cash, by itself, is not sufficient. However, not all businesses have a clear view of the distributable reserves position of all entities within a group. “Dividend blocks” can arise and restrict the ability to pay dividends to shareholders.

EY has developed the Distributable Reserves Model to help organizations identify distributable reserve constraints that may currently exist or arise in the future. This allows them to avoid surprises and removes the need to “firefight” these problems as they arise.

The model can act as a database management tool, allowing all relevant distributable reserves data to be stored in one place.

Using the model:

► Increases visibility and confidence about ability to pay dividends
► Reduces risk of unexpected dividend blocks or unlawful dividends
► Enables sensitivity analysis
► Automatically creates the group structure
► Easy access to relevant information
The model creates the group structure, clearly showing distributable reserves and deficits. It automatically generates separate charts for current state, future state and dividend blocks, with bright green signifying large reserves and bright red denoting significant deficits.

Supporting simultaneous refinancing

Often, refinancing is conducted at the same time as a restructuring, or as an essential feature of it.

EY can help with complications that can arise when:

- Determining whether the refinancing represents either an extinguishment of the existing debt or simply the modification of debt (each has different accounting implications)
- Determining the current versus non-current classification of debts, particularly if there have been breaches of covenants
- Accounting for intragroup guarantees
- Accounting for foreign exchange and hedging

How EY can help your restructuring

- **Group simplification and optimization**
  - Optimize the new group structure to reduce costs, including the administrative costs to prepare, audit and file the financial statements of the group companies
  - Minimize risk through designing and validating a structuring step plan
  - Ensure that the technical accounting challenges that relate to any step plan are considered and understood

- **Acquisition or disposal transactions**
  - Review and assess the accounting impact on either sell-side or buy-side in respect of restructuring transactions (this includes transferring businesses and cleaning up entities before or after the transaction)

- **Distributable reserves**
  - Use the EY Distributable Reserves Model to identify existing distributable reserve constraints and those that may arise in the future
  - Propose structural solutions to resolve dividend blocks and create distributable reserves
  - Undertake analysis of reserves to identify what is distributable and what is not
Why EY?

Our cross-border, multidisciplinary teams (encompassing accounting, tax and legal) are very experienced. They have:

- Advised on the accounting for large, successful IPOs, including assessing the desirable listing structure and identifying, and advising on maximizing distributable reserves
- Provided advice to large corporate groups, private equity investors and investment banks on the accounting for complex structuring transactions
- Undertaken extensive work on developing accounting options and proposed structures for group reorganizations, with a view to ensuring that distribution targets can be met after the transaction has completed
- Coordinated restructuring advice involving multiple jurisdictions, ensuring that the impact on all group entities is appropriately considered

Contacts:

Richard Crisp
rcrisp@uk.ey.com
+ 44 20 7951 2320

Graham Roberts
groberts1@uk.ey.com
+ 44 20 780 69174