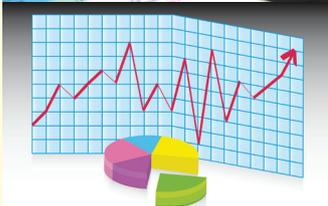




Federation of European Accountants  
Fédération des Experts comptables Européens



## Corporate Reporting



### Combined and Carve-Out Financial Statements

#### ANALYSIS OF COMMON PRACTICES

February 2013

*FEE Capital Markets Working Party*

*Standing for trust and integrity*





Federation of European Accountants  
Fédération des Experts comptables Européens

## **Combined and Carve-out Financial Statements**

### **ANALYSIS OF COMMON PRACTICES**

**A document primarily based on the responses received to the FEE Discussion Paper Combined Financial Statements and additional research undertaken by FEE**

**February 2013**

*FEE Capital Markets Working Party*



**NOTE:**

**This document is neither a standard setting document nor authoritative guidance. It has been prepared with due care considering different practices applied by a variety of professionals in a number of European Union jurisdictions and beyond. It is issued to share common practices among preparers and other practitioners.**

**About FEE**

FEE (Fédération des Experts-comptables Européens - Federation of European Accountants) represents 45 professional institutes of accountants and auditors from 33 European countries, including all 27 EU Member States.

In representing the profession, FEE recognises the public interest. FEE has a combined membership of more than 700.000 professional accountants working in different capacities in public practice, small and larger firms, business, public sector and education, who all contribute to a more efficient, transparent, and sustainable European economy.



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## 1. INTRODUCTION

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### Background

#### Purpose of the Analysis of Common Practices

- 1.1. FEE has identified a need for a paper summarising commonly accepted practices related to the preparation of combined and carve-out financial statements that are perceived to be consistent with the principles of International Financial Reporting Standards (“IFRS”).
- 1.2. Harmonisation of the practices of preparing combined financial statements would be a contribution to a better functioning of capital markets. Accordingly, it is considered that this Analysis of Common Practices will help to share best practices and will be of use to preparers and users, as well as other practitioners.
- 1.3. This Analysis of Common Practices (“Paper”):
  - Builds primarily on the FEE Discussion Paper Combined Financial Statements<sup>1</sup> of April 2011 and the responses received to its related Request for Comments which were very helpful for FEE to develop its further thinking on combined and carve-out financial statements;
  - Addresses additional relevant issues raised by the respondents that were not covered by the original Discussion Paper; and
  - Includes additional input that the FEE Capital Markets Working Party considers necessary and that makes the document more comprehensive and more useful to the reader.
- 1.4. Generally, this Paper summarises the prevalent issues and challenges encountered when preparing combined and carve-out financial statements in compliance with IFRS - as well as the most common practices used to address them.

#### Need for public discussion due to diverse practices

- 1.5. Capital markets in Europe and around the globe require meaningful, reliable, relevant and comparable financial information about issuers of securities.
- 1.6. When securities are offered to the public or admitted to trading, the EU Directive and Regulation for prospectuses and/or specific guidance issued by securities regulators in the EU require such financial information be provided for (at least) the last two or three financial years, depending on the nature of the respective securities or type of issuer.
- 1.7. Usually such financial information is provided by presenting consolidated financial statements prepared in accordance with IFRS as endorsed in the EU.

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<sup>1</sup> See [http://www.fee.be/images/publications/capital\\_markets/Combined\\_Financial\\_Statements\\_-\\_A\\_Discussion\\_Paper\\_1104\\_Colour8420113684.pdf](http://www.fee.be/images/publications/capital_markets/Combined_Financial_Statements_-_A_Discussion_Paper_1104_Colour8420113684.pdf)



- 1.8. In case of a divestment of a division or a business line or similar kind of transactions, however, such consolidated financial statements do not show the historical financial information of the respective economic activities that are the subject of the capital markets transaction. Therefore, in some cases the information may be provided by presenting combined financial statements showing the financial position, financial performance and cash flows of the economic activities.

### Scope of the Paper

- 1.9. **Combined financial statements** is a generic term used to describe financial statements that present the historical financial information of a number of entities or parts of entities that do not comprise a group for which consolidated financial statements can be prepared. A proposed comprehensive definition of combined financial statements, derived from the FEE consultation process, is set out in paragraph 3.10 below.
- 1.10. This Analysis of Common Practices covers both combined financial statements and carve-out ones. Please note that throughout the Paper the generic term “combined financial statements” is used.

### Regulatory requirements regarding preparation of combined financial statements

- 1.11. In Europe there is the EU Prospectus Directive<sup>2</sup> in effect which defines the regulatory requirements related to the preparation of combined financial statements (for more details see below). Similar regulatory requirements apply in other capital markets outside the EU. FEE believes that this Paper could prove useful for preparers and investors from both Europe and other capital markets.
- 1.12. The EU Prospectus Directive does not have an explicit requirement for the preparation of combined financial statements. However, the implementation of the Prospectus Directive in the EU, combined with the adoption of IFRSs for listed companies in the EU, has increased the focus on the presentation of historical financial information in prospectuses. This focus was enhanced by the amendment<sup>3</sup> to the Prospectus Directive that effectively, requires issuers of securities with a complex financial history, where the entire business undertaking by the issuer is not covered by historical financial information relating to the issuer, to include specific additional items of financial information relating to an entity other than the issuer. In many cases this requirement can be fulfilled by the inclusion of combined financial statements showing the historical information of an area of economic activities with a common element (hereafter referred to as “an Area of Economic Activities”).

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<sup>2</sup> Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements.

<sup>3</sup> Commission Regulation (EC) No 211/2007 of 27 February 2007 amending Regulation (EC) No 809/2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards financial information in prospectuses where the issuer has a complex financial history or has made a significant financial commitment.

## IFRS pronouncements

- 1.13. At present, the IFRSs do not contain a specific standard governing the preparation of combined and carve-out financial statements. Also, none of the existing IFRSs provides principles for their preparation. Therefore, diverse practices in preparing such financial information have developed. They include but are not limited to:
- Determination of the Area of Economic Activities (entities or parts of entities) to be combined;
  - Applicable accounting policies;
  - Treatment of specific accounting issues, e.g. allocation of different types of costs, income, taxes, etc.;
  - Disclosures.

## Structure of the Paper

- 1.14. The Paper describes the key areas relevant for the preparation and understanding of combined financial statements under IFRS in sections as set out below:
- **Section 1** provides the background to the Paper. It summarises the reasons why there is a need for this document and suggests the potential way forward.
  - **Section 2** describes the international technical background to the preparation of combined financial statements as of the date when the Paper is issued.
  - **Section 3** analyses the types of historical financial information. It seeks to clearly differentiate combined financial statements from consolidated financial statements and pro forma financial information.
  - **Section 4** deals with the principal approaches underlying the preparation of combined financial statements such as common control, common management and common business.
  - **Section 5** discusses the definition of the Area of Economic Activities presented in combined financial statements in the context of existing international accounting standards and guidance.
  - **Section 6** deals with the key building blocks (major critical accounting issues) relevant to the preparation of combined financial statements, such as applicable accounting policies, treatment of specific accounting issues (allocation principles, subsequent events, transactions between different Areas of Economic Activities, segment information) and disclosures.
  - **Section 7** summarises the areas related to combined financial statements that may need special attention in the medium and longer term.
  - **Section 8** invites the readers to provide additional input or comments to enable FEE to update this Paper on an ongoing basis.



## **Audit and reporting of combined financial statements**

- 1.15. The original Discussion Paper did not address the aspect of auditing or auditor's reporting on combined financial statements. Consequently, the Analysis of Common Practices is not specifically considering any audit related issues.

## **Ongoing update of the Paper and the way forward**

### **Ongoing update of the Paper**

- 1.16. As practice is constantly evolving, FEE will monitor developments in the area of combined financial statements. This document may need updating.
- 1.17. FEE welcomes comments from stakeholders on this matter. Should you provide us with feedback, please contact the FEE Secretariat ([Secretariat@fee.be](mailto:Secretariat@fee.be), please see also the FEE website [www.fee.be](http://www.fee.be)).

### **The way forward**

- 1.18. This Paper may be of help to stakeholders with an interest in the subject matter, in particular preparers, users, practitioners, regulators, researchers and professional bodies.
- 1.19. It could also be useful in encouraging the International Accounting Standards Board (IASB) to consider a project on combined financial statements in its future agenda.
- 1.20. Additionally, the Paper could be informative for securities regulators such as the European Securities and Markets Authority (ESMA) and other national supervisors charged with enforcing financial reporting within the European Union; and it could also contribute to encouraging public debate.
- 1.21. Possible matters for further consideration are addressed in greater detail in Section 7 of this Paper.

## 2. TECHNICAL BACKGROUND

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- 2.1. The preparation of financial statements to provide the historical financial performance of economic activities that do not constitute a group legally required to publish consolidated financial statements but an area of economic activities with a common element has been practiced for many years, often in connection with securities' offerings or under securities' laws or regulations.
- 2.2. Such financial information is designated as "combined financial statements" to differentiate it from "consolidated financial statements" as prepared under generally accepted accounting frameworks in different places across the globe and as referred to under IFRS in the International Accounting Standard 27 Consolidated and Separated Financial Statements (IAS 27) and IFRS 10 Consolidated Financial Statements<sup>4</sup>.
- 2.3. Whilst in some markets the term "combined financial information" is used, the term "combined financial statements" has been used throughout this Paper.
- 2.4. Currently IFRS do not include a specific IFRS standard dedicated to or covering the preparation of combined financial statements; there is equally no interpretation or interpretation guidance. However, Paragraph 12, IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, stipulates: "[...] management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practice [...]".

### IFRS regarding combined financial statements

- 2.5. As stated above, as of today there is no specific standard dealing with the preparation of combined financial statements under IFRS<sup>5</sup>.
- 2.6. The IFRS framework does not set the criteria that must be met for combined financial statements to be appropriate. However, there is a development within the IFRS as reflected in the Exposure Draft issued in 2010 by the International Accounting Standards Board on the Conceptual Framework for Financial Reporting – The Reporting Entity (the "ED")<sup>6</sup>.
- 2.7. Having regard to the feedback received to the 2011 Agenda Consultation, the IASB intends to give priority to work on the Conceptual Framework project – mainly focusing on elements of financial statements, measurement, presentation, disclosure and reporting entity<sup>7</sup>. Based on the IASB's workplan (December 2012), the IASB plans to issue a Discussion Paper (chapters addressing elements of financial statements, measurement, reporting entity, and presentation and disclosure) in the second quarter of 2013.

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<sup>4</sup> Commission Regulation (EU) No 1254/2012 of 11 December 2012 requires IFRS 10 to be applied, at the latest, as from the commencement date of a company's first financial year starting on or after 1 January 2014 (i.e. early adoption is permitted).

<sup>5</sup> The IFRS for SMEs (issued in 2009, currently under revision) only defines combined financial statements, but does not set any specific criteria in terms of IFRS compliance other than compliance with IFRS for SMEs. The definition in section 9.28 is as follows: "Combined financial statements are a single set of financial statements of two or more entities controlled by a single investor." Section 9.29 includes the following requirement: "If the investor prepares combined financial statements and describes them as conforming to the IFRS for SMEs, those statements shall comply with all of the requirements of this IFRS. [...]"

<sup>6</sup> Please see the ED via the following link: <http://www.ifrs.org/Current-Projects/IASB-Projects/Conceptual-Framework/EDMar10/Documents/EDConceptualFrameworkMar10.pdf>

<sup>7</sup> Source: Agenda Paper: Report of the IASB Chair to the IFRS Foundation Trustees, Brussels, 12 October 2012.



2.8. The ED contains the following statements relevant to the discussion of combined financial statements:

RE2: "A reporting entity is a circumscribed area of economic activities whose financial information has the potential to be useful to existing and potential equity investors, lenders and other creditors who cannot directly obtain the information they need in making decisions about providing resources to the entity and in assessing whether management and the governing board of that entity have made efficient and effective use of the resources provided."

RE3: "A reporting entity has three features:

- (a) economic activities of an entity are being conducted, have been conducted or will be conducted;
- (b) those economic activities can be objectively distinguished from those of other entities and from the economic environment in which the entity exists; and
- (c) financial information about the economic activities of that entity has the potential to be useful in making decisions about providing resources to the entity and in assessing whether the management and the governing board have made efficient and effective use of the resources provided.

These features are necessary but not always sufficient to identify a reporting entity."

RE6: "A portion of an entity could qualify as a reporting entity if the economic activities of that portion can be distinguished objectively from the rest of the entity and financial information about that portion of the entity has the potential to be useful in making decisions about providing resources to that portion of the entity. For example, a potential equity investor could be considering a purchase of a branch or division of an entity."

RE7: "An entity controls another entity when it has the power to direct the activities of that other entity to generate benefits for (or limit losses to) itself."

RE12: "Combined financial statements include information about two or more commonly controlled entities. Combined financial statements do not include information about the controlling entity and are often prepared when the controlling entity does not prepare financial reports. Combined financial statements might provide useful information about the commonly controlled entities as a group."

BC25: "As noted in paragraph RE 7, the Board concluded that if an entity that controls one or more entities prepares financial reports, it should present consolidated financial statements. However, not all controlling entities prepare financial reports. For example, the controlling entity could be an individual or a group of individuals, such as a family. If so, combined financial statements might provide useful information about the commonly controlled entities as a group."

## **UK GAAP**

2.9. The annexure to UK SIR 2000 Investment Reporting Standards Applicable to Public Reporting Engagements on Historical Information (Revised) provides some guidance concerning the presentation of combined financial information that may be helpful in developing a proper definition of economic activities:

Para 26: "Where the entities have been under common management and control but do not form a legal group, the historical financial statements will normally be presented on a combined or aggregated basis. [...]"

Para 27: Where a business has formed part of a larger group ("overall group") during the three year period, but has not been accounted for separately, it may be desirable to present a separate track record (a "carve out") for that business ("carve out business"), derived from the records of the overall group. [...]"

Para 28: When considering whether it is appropriate to present carve out financial statements, the following factors will be relevant:

- (a) the extent to which the carve out business has been separately managed and financially controlled within the overall group; and
- (b) the extent to which it is practicable to identify the historical financial information attributable to the carve out business."

## Italian GAAP

2.10. The Italian Accounting Standard Principi Contabili 17 Il Bilancio Consolidato<sup>8</sup> addresses partly combined financial statements (Bilanci Aggregati). It states the following:

"While consolidated financial statements are characterised by the fact that a company controls, directly or indirectly, the consolidated companies, combined financial statements reflect the financial position of a group of companies/economic activities not tied together by a legal relationship of control. In cases where there is control due to legal ownership it is not allowed to prepare combined financial statement as an alternative to the consolidated financial statements.

Combined financial statements may be submitted as a supplement to financial statements of individual related entities (related entity is defined as follows - an entity that, directly or indirectly, controls or is controlled or is under common control with respect to the entity preparing the financial statement) in the following cases:

- although there is no relationship in terms of legal ownership, the volume and nature of transactions that occur among them cause the combined financial statements to be more significant than the separate financial statements of the entities;
- companies are owned by a single economic entity, for example: are owned by one person or by a legal entity and operate in the same industry;
- are managed by the same governing bodies;
- are subject to a transaction such as acquisition or disposition negotiations/agreement; for instance a group of companies which do not form a group from a legal point of view, but are the subject matter of an acquisition or disposal.

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<sup>8</sup> Principi Contabili 17 del Consiglio Nazionale dei Dottori Commercialisti e del Consiglio Nazionale dei Ragionieri modificati dall'OIC in relazione alla riforma del diritto societario Il Bilancio Consolidato, 16 settembre 2005, Sostituisce il principio n. 17 del marzo 1996.



Combined financial statements are prepared using the same principles as the ones used for the preparation of consolidated financial statements. Therefore such process entails elimination of all transactions between the combined companies/activities, including internal profits, and in particular those related to inventories and fixed assets. However, the combined net equity will result as the aggregation of the net equities of the combined entities net of the effects of the transactions which have been eliminated.”<sup>9</sup>

## US GAAP

2.11. US specific guidance considered relevant includes the following:

- United States Accounting Standards Codification Topic 810-10-45 and Topic 810-10-55-1B;
- US Securities and Exchange Commission (SEC) Division of Corporation Finance: Financial Reporting Manual, updated 4 October 2012;
- SEC Regulation S-X Article 3A – Consolidated and Combined Financial Statements;
- SEC Regulation S-X Article 11 – Pro-Forma Financial Information;
- SEC Staff Accounting Bulletin Topic 1B “Allocation of Expenses and Related Disclosure in Financial Statements of Subsidiaries, Divisions, or Lesser Business Components of Another Entity”; and
- speech by Leslie Overton, SEC Staff on the subject matter during the AICPA SEC Conference in 2006.

2.12. United States Accounting Standards Codification Topic 810-10-55-1B on Combined Statements stipulates:

“To justify the preparation of consolidated statements, the controlling financial interest shall rest directly or indirectly in one of the entities included in the consolidation. There are circumstances, however, in which combined financial statements (as distinguished from consolidated financial statements) of commonly controlled entities are likely to be more meaningful than their separate statements. For example, combined financial statements would be useful if one individual owns a controlling financial interest in several entities that are related in their operations. Combined statements might also be used to present the financial position and the results of entities under common management.”

2.13. The Topic 810-10-45-10 states the following:

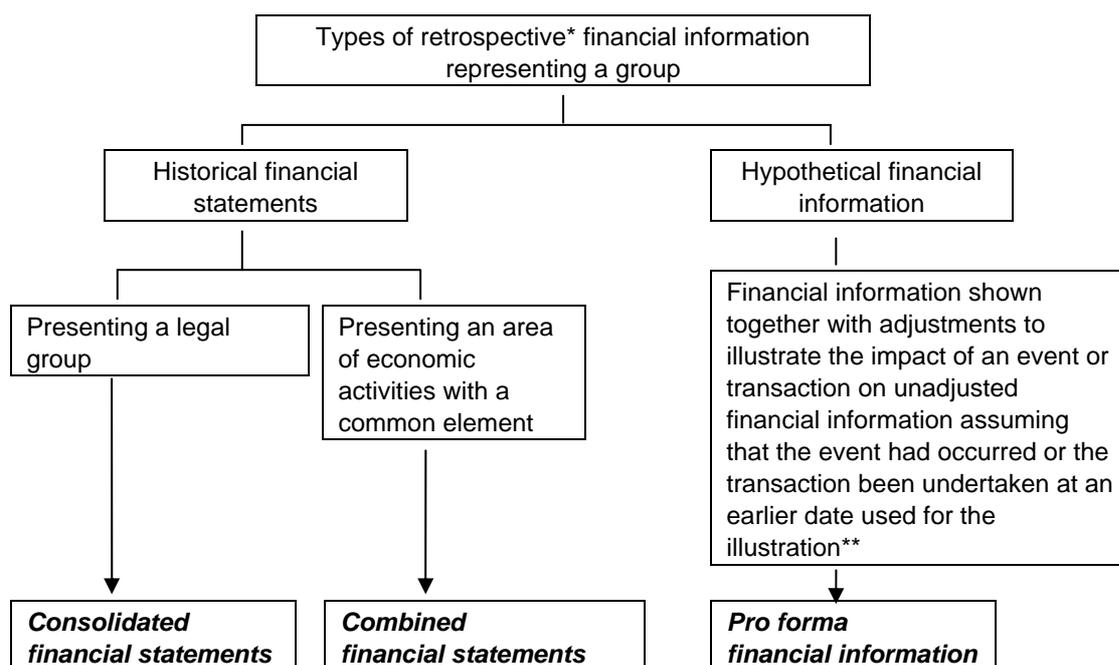
“If combined financial statements are prepared for a group of related entities, such as a group of commonly controlled entities, intra-entity transactions and profits or losses shall be eliminated, and non-controlling interests, foreign operations, different fiscal periods, or income taxes, shall be treated in the same manner as in consolidated financial statements.”

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<sup>9</sup> Please note that this translation is for information only and was kindly provided by a member of the Consiglio Nazionale dei Dottori Commercialisti e Degli Esperti Contabili (CNDCEC) and should not be considered as an official translation.

### 3. TYPES OF RETROSPECTIVE FINANCIAL INFORMATION

- 3.1. Due to the fact that combined financial statements do not relate to a group as a whole legally required to present consolidated financial statements, but rather to presenting an area of economic activities with a common element as depicted below, there are uncertainties about the characterisation of combined financial statements within the different types of financial information covering the past. Those uncertainties also lead to different terms being used for such financial information which is sometimes called "pro forma" in order to differentiate it from consolidated financial statements.
- 3.2. In order to avoid misunderstandings due to the different terms used, the following illustration shows the principal character of combined financial statements as historical financial information and how it differs from pro forma financial information which is hypothetical financial information for the past in the context of the EU Prospectus Directive and the International Standard on Assurance Engagements ISAE 3420 Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus.
- 3.3. Financial information to present figures for the past falls typically under one of the following types:



\* The term "retrospective" in this context refers to financial information presented at a certain point in time (i.e. the reporting date or any point in time thereafter) which reflect actual transactions which have occurred in the past (historical financial information) or actual transactions that took place at a specific point in time and are reflected as if they would have occurred at an earlier point in time as compared to the actual point in time of occurrence (hypothetical financial information). Conversely, prospective financial information would relate to future transactions which have not yet occurred (i.e. forecasts or projections).

\*\* The above definition of pro forma financial information has been derived from ISAE 3420 Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus.

### **Definition of consolidated financial statements**

- 3.4. According to IAS 27 (paragraph 4) consolidated financial statements are the financial statements of a group presented as those of a single economic entity. IFRS 10 (Appendix A, Defined terms) defines consolidated financial statements as “the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity”.

### **Definition of pro forma financial information**

- 3.5. Pro forma financial information is hypothetical financial information created to present an illustration of how a transaction or series of transactions (e.g. business combination or disposition) might have affected an entity, had this specific transaction or series of transactions been undertaken at the commencement of the period being presented, or at the balance sheet date presented in the last (consolidated) financial statements of the reporting entity.
- 3.6. Although neither the EU Directive nor the EU Regulation on prospectuses include a definition of pro forma financial information, the EU Regulation describes the requirement for the preparation of pro forma financial information in a prospectus (Annex I 20.2. of the EU Regulation) as follows:

"In the case of a significant gross change, a description of how the transaction might have affected the assets and liabilities and earnings of the issuer, had the transaction been undertaken at the commencement of the period being reported on or at the date reported. This requirement will normally be satisfied by the inclusion of pro forma financial information. This pro forma financial information is to be presented as set out in Annex II and must include the information indicated therein."

Further details are set out in Annex II 'Pro forma financial information building block'. In Annex II 1 lit. (c), the EU Regulation clearly determines that pro forma financial information in the meaning of the EU law solely

"addresses a hypothetical situation and, therefore, does not represent the company's actual financial position or results".

- 3.7. Such information is supplementary to historical financial statements and always has a connection to historical financial information. It is not published in isolation.

### **Possible definition of combined financial statements**

- 3.8. As shown in the illustration above, both consolidated and combined financial statements are historical financial information. The only significant difference between them is that consolidated financial statements require the consolidation of the parent company and all of its subsidiaries, i.e. the presentation of a whole group in the meaning of IAS 27/IFRS 10, whereas combined financial statements present the historical financial information of an Area of Economic Activities. The premise underlying the preparation of combined financial statements is that there is a binding element for the constituent elements forming an Area of Economic Activities throughout the period concerned. This premise is discussed in more detail in Section 4.



- 3.9. In contrast to pro forma financial information, combined financial statements do not include hypothetical assumptions and, therefore, can be characterised as historical financial information.
- 3.10. Resulting from that characterisation, **combined financial statements may be defined as** financial statements presenting the historical financial information of an Area of Economic Activities for which consolidated financial statements are not prepared in order to present the financial position of the combined economic activities and their financial performance and cash flows.

## 4. PRINCIPAL APPROACHES UNDERLYING THE PREPARATION OF COMBINED FINANCIAL STATEMENTS

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- 4.1. The principal characteristic of combined financial statements is that they present the historical financial information of an Area of Economic Activities for which it is not possible to present consolidated financial statements because a full parent-subsiary relationship (as defined by IAS 27/IFRS 10) does not exist amongst all component entities being combined.
- 4.2. Combined financial statements are prepared where a reporting purpose exists, for example on a business separation, which requires presentation of historical financial statements on the basis that the business had reported independently in the past.
- 4.3. A fundamental condition for preparing combined financial statements is that there must be an element which could be said to have "bound" the constituent elements together throughout the period for which the financial information is to be prepared. Whilst it is possible to combine the financial information of any given entities, the absence of a "binding" element means that the resulting statements should be considered to be pro forma which, in the context of a prospectus prepared in accordance with the EU Prospectus Directive, would be presented in accordance with the rules governing such information.
- 4.4. In many cases it is not just entities that are included when preparing combined financial statements, but also portions of entities. This can be the case when the parts of entities are sufficiently identifiable and, from a financial reporting perspective, separable from the entity which they are part of.
- 4.5. Market practice provides the following three main categories of what constitutes a binding element (each mutually exclusive at the relevant reporting dates and for all the reporting periods to be presented, while noting that in practice a combination of any of these three main categories could occur):
  - There has been **common control** by an entity, or a person;
  - There has been **common management**;
  - There has been a **common business**.
- 4.6. The basis on which combined financial statements are prepared can depend on the particular circumstances of any given situation. Set out below are examples illustrating the approaches applied under the three categories listed above where a binding element exists.



## COMMON CONTROL APPROACH

- 4.7. Under the common control approach entities or parts of entities may be combined if they were under common control as defined by the respective reporting framework (for example IAS 27) during the entire period covered by the combined financial statements. This approach reflects the current control principle under IFRS and allows for the preparation of financial statements for economic activities, which were for the respective reporting period part of a larger group or commonly controlled by the same individual(s).
- 4.8. Under this approach, common control is the main binding element. The reference to an Area of Economic Activities is also important – please refer to Section 5 of this Paper.
- 4.9. If single entities or parts of such entities forming part of the respective economic activity are acquired or disposed during the reporting period, the results of such entities, or parts of entities, are included for the period for which they were under the common control of the ultimate parent, but not for any earlier or later period.

### **Appropriateness of common control approach for the preparation of combined financial statements**

- 4.10. The common control approach is considered the most appropriate when preparing combined financial statements and is widely used in practice. It can be used only for the period when the common control existed.
- 4.11. Further clarification of common control would be useful even when the meaning of control is in line with the IFRS concept. Generally, the profession is supporting the establishment of underlying principles rather than of overly prescriptive rules<sup>10</sup>.

### **Scenario analysis**

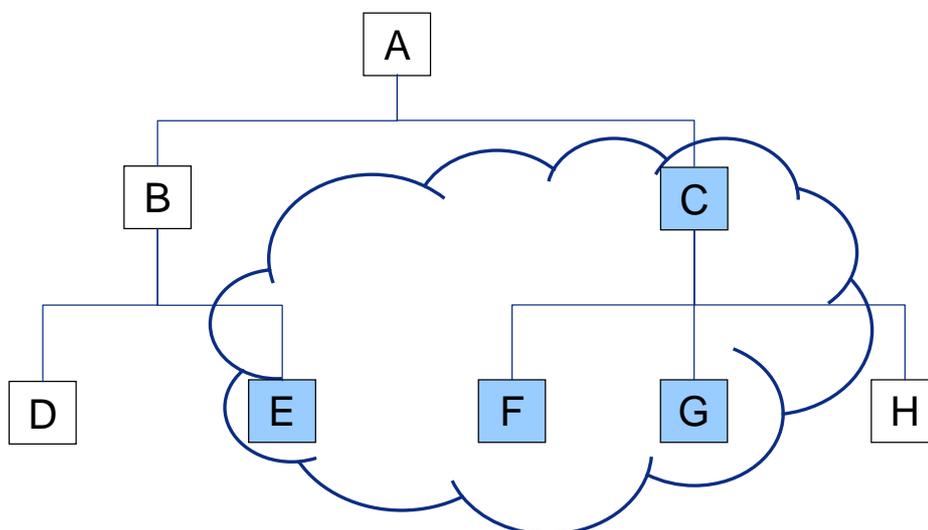
- 4.12. The following diagrams illustrate two typical scenarios in which combined financial statements may be prepared in order to show the historical information of an Area of Economic Activities that forms part of a larger group.

#### Scenario a):

- 4.13. An economic activity is carved out from a group into a separate entity in order to present the historical financial information for such economic activity (combined financial statements) independently of the financial information (consolidated financial statements) of the whole group.

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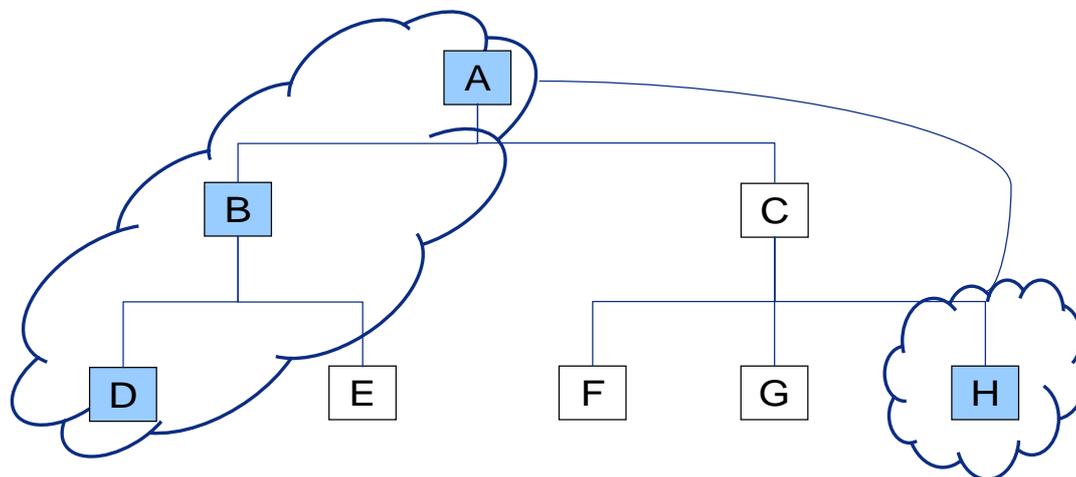
<sup>10</sup> When developing guidance one should bear in mind potential complications in case of common family ownership and the IASB ED Conceptual Framework for Financial Reporting and in particular Reporting Entity.



- 4.14. Such an approach is considered consistent with the one described under IFRS as it provides useful, comparable information to the users of financial information, on both the economic activities that were demerged (and which have become a separate listed entity) as well as on the consolidated group as a whole.

Scenario b):

- 4.15. A group is demerging a significant part of its economic activities and wishes to present the historical financial information for its remaining economic activities (combined financial statements) to investors independently of the financial information (consolidated financial statements) of the whole group. The main reasons as to why such information might be requested include the ability of reporting independently from the whole group and hence to enable to distinguish more clearly the financial information and the comparatives, but also there may be an economic purpose.

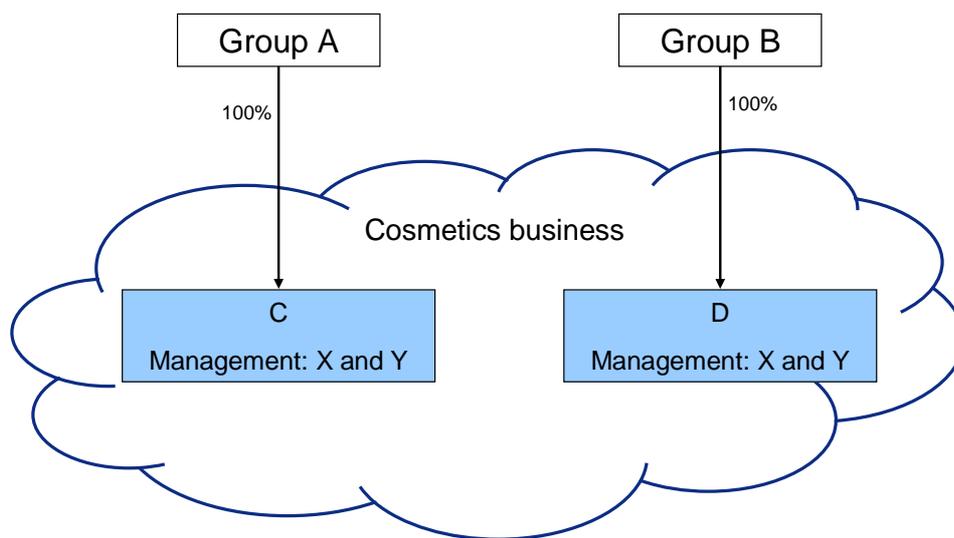


- 4.16. Combined financial statements focus on the information necessary to understand the financial position of the remaining economic activities throughout the financial periods presented as well as providing information regarding the relations between the remaining economic activities and the carved out entity on the basis of IAS 24.3. Related Party Disclosures. Combined financial statements for the remaining group may be prepared in order to address the needs of both groups of shareholders in case of demerger or partial listing of an existing group<sup>11</sup>.

### COMMON MANAGEMENT APPROACH

- 4.17. Under the common management approach entities or parts of entities may be combined if all combined entities or parts of entities were under a common management.
- 4.18. This approach is applied in cases where entities are not necessarily jointly owned, but commonly managed by the same management. It allows the preparation of combined financial statements regardless of any changes in the ownership structures and enables preparers to show the historical information on an economic activity for every period during which this economic activity is commonly managed.
- 4.19. The following diagram illustrates a typical scenario in which combined financial statements may be prepared to show the historical information on an economic activity that was commonly managed but not commonly controlled.

<sup>11</sup> Under IFRS 5 Non-current Assets Held for Sale and Discontinued Operations consolidated financial statements take account of discontinued operations to give all necessary information to understand the financial information regarding the remaining business through disclosure of assets, and liabilities, as being held for sale, albeit only at the latest reporting date, and of the impact on operations.



### Appropriateness of common management approach for the preparation of combined financial statements

4.20. It is generally believed that the common management approach on its own is not sufficient to describe the resulting combined financial statements as IFRS compliant. In most cases common control would also be present, i.e. common control might be evidenced by common management. However, under certain circumstances the common management approach may be appropriate. Such circumstances are described below.

### Circumstances necessary to assume common management

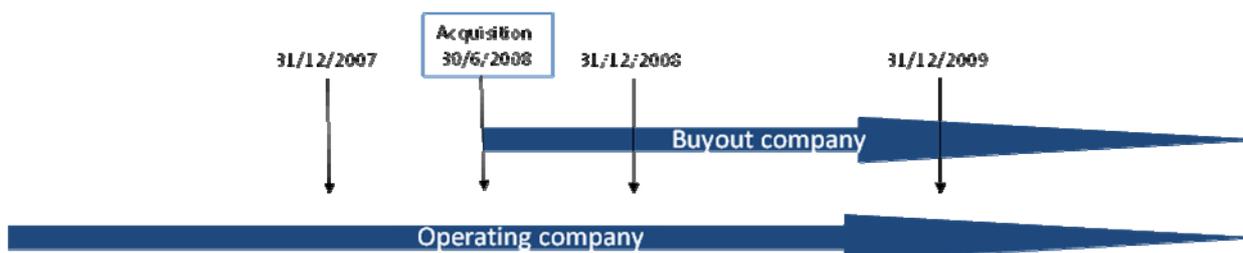
4.21. Possible circumstances when it would be appropriate to apply common management approach include:

- Managing operations of all economic entities as one entity (any decisions impacting one of them impacts others);
- Common management (Board of Directors or management) with possibly members of scarce industry competence;
- Common interest on the level of shareholders in the case of two separate groups (e.g.: economic interest, family members<sup>12</sup>).

<sup>12</sup> Please refer to the paragraphs BC25 as well as RE12 of the IASB ED Conceptual Framework for Financial Reporting – The Reporting Entity not all controlling entities prepare financial reports. For example, the controlling entity could be an individual or a group of individuals, such as a family. If so, combined financial statements might provide useful information about the commonly controlled entities as a group.

## COMMON BUSINESS APPROACH

- 4.22. Not infrequently a business may undergo a corporate restructuring as a result of changes in, or transactions between, its shareholders. Such transactions often fall to be treated as business combinations under IFRS 3 which requires the application of acquisition accounting. However, the underlying business will have continued its economic activities during the reporting period.
- 4.23. This would be the case where for example a business has been subject to a leveraged acquisition or buy-out by a financial buyer during the reporting period, as illustrated in the diagram below.



- 4.24. In cases such as this, market practice in some jurisdictions is to present historical records for three years in a single set of financial statements. In the United States for example, the financial information prior to the acquisition or buy-out is presented next to the financial information subsequent to the acquisition or buy-out – the so-called "black line" approach because a line is often drawn down the page to distinguish the "predecessor" period from that of the "successor". In the UK, the predecessor and successor periods would be aggregated together or combined. In both jurisdictions the step-up through the fair value exercise arising on the acquisition date would be retained. In some GAAPs the same effect would be delivered in the operating company's financial record (so-called "push-down" accounting). Common business approach is applied in practice under the circumstances described above.
- 4.25. The common business approach has not been widely seen in practice in Europe, but clearly sometimes there is demand from investors across Europe for such information. In practice this approach is applied in jurisdictions, where market practice is to present historical records for three years in a single set of financial statements – e.g. the UK.
- 4.26. However, it is generally argued that the business approach is not sufficient as a sole determinant in deciding to produce combined financial statements and is usually not considered as an appropriate basis for the preparation of combined financial statements that are said to be in accordance with IFRS<sup>13</sup>.

<sup>13</sup> Some jurisdictions may consider financial statements prepared in line with that approach as pro forma financial information if the entities are not under common control.

## 5. IDENTIFYING THE AREA OF ECONOMIC ACTIVITIES

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- 5.1. In order to present combined financial statements it is essential to properly define the Area of Economic Activities that might be combined. To develop a proper definition of the Area of Economic Activities it seems useful to take account of the IASB Exposure Draft issued in 2010 on the Conceptual Framework for Financial Reporting - The Reporting Entity and existing IFRSs dealing with related issues.

### **IASB Exposure Draft Conceptual Framework for Financial Reporting: The Reporting Entity**

- 5.2. The ED provides useful statements for the discussion on the definition of the Area of Economic Activities (please refer to paragraph 2.9. above).

### **IFRS pronouncements**

- 5.3. Under current IFRSs, there are a number of definitions which might serve as a starting point for developing a definition of the Area of Economic Activities in the context of combined financial statements (i.e. IFRS 3 Business Combinations, IFRS 5 Non-current Assets Held for Sale and Discontinued Operations and IFRS 8 Operating Segments).

#### IFRS 3 Business Combinations

- 5.4. Appendix A defines a "business" in the context of determining what has been acquired and whether business combination accounting needs to be applied as:

"An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants."

The basis for conclusions section in IFRS 3 provides commentary on why this definition was used and reconciles that with previous positions held under IFRS and US GAAP.

#### IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

- 5.5. A "component of an entity" is defined in the context of determining whether to disclose a discontinued operation:

"Operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity."

#### IFRS 8 Operating Segments

- 5.6. An "operating segment" is defined as:

"a component of an entity:

- (a) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity),
- (b) whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and
- (c) for which discrete financial information is available."

## Other GAAP (UK SIR 2000)

5.7. At present, in Europe there is limited guidance with respect to the preparation of combined financial statements. The annexure to UK SIR 2000 Investment reporting standards applicable to public reporting engagements on historical information (Revised) provides some guidance concerning the presentation of combined financial information that might be helpful in developing a proper definition of the Area of Economic Activities:

Para 26: "Where the entities have been under common management and control, but do not form a legal group, the historical financial statements will normally be presented on a combined or aggregated basis. [...]"

Para 27: Where a business has formed part of a larger group ("overall group") during the three year period, but has not been accounted for separately, it may be desirable to present a separate track record (a "carve out") for that business ("carve out business"), derived from the records of the overall group. [...]"

Para 28: When considering whether it is appropriate to present carve out financial statements, the following factors will be relevant:

- (a) the extent to which the carve out business has been separately managed and financially controlled within the overall group; and
- (b) the extent to which it is practicable to identify the historical financial information attributable to the carve out business."

## Conclusion

5.8. The following key elements might serve as a basis for the definition of the Area of Economic Activities in the context of combined financial statements and are derived from the aforementioned definitions:

- (1) The economic activities encompass a set of assets and liabilities that can be clearly distinguished from those that are linked to other economic activities;
- (2) The economic activities of such integrated set of assets and liabilities were conducted, or could have been separately conducted, for the purpose of providing a return in the form of dividends, lower costs or other economic benefits.

5.9. The definition in the ED includes the requirement that "economic activities of an entity **are being** conducted, **have been conducted** or **will be** conducted" which may suggest that the definition of a reporting entity can be met merely by intending to conduct economic activities at some point in the future. In the context of combined financial statements the "will be conducted" should be seen as relating to the situation where the economic activities have not, at the relevant reporting date, been separated from the whole group.

## Possible definition of the area of economic activities with a common element in the context of combined financial statements

5.10. Taking into account these key elements, **"the area of economic activities with a common element" could be defined as** an integrated set of assets and liabilities which were or could have been separately conducted for the purpose of providing a return in the form of dividends, lower costs or other economic benefits.



- 5.11. It is necessary to properly define the Area of Economic Activities. It is important to note that the proposed definition of the Area of Economic Activities in the context of the combined financial statements should refer primarily to the past in contrast to the definition of a reporting entity as defined by the IASB, which has partly a more future oriented dimension.

## 6. KEY BUILDING BLOCKS (MAJOR CRITICAL ACCOUNTING ISSUES)

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### 6.1. Full compliance with all requirements under IFRS

- 6.1.1. A key principle for preparing combined financial statements under IFRS is that all requirements under the applicable accounting standard (IAS/IFRS) or interpretation of the IFRS as issued by the IFRS Interpretation Committee (IFRIC) must be applied. This principle includes the requirement that combined financial statements must comprise all elements of financial statements, e.g. including statement of financial position, statement of comprehensive income, statement of changes in equity, statement of cash flows, as well as notes. However, since IFRS does not provide special requirements for combined financial statements, there could be a wide range of interpretation in applying the respective accounting requirements.
- 6.1.2. Based upon that key principle of applying all requirements under IFRS, the principles of consolidation accounting are applied when preparing combined financial statements. As a result, the entities and parts of entities within the perimeter of the Area of Economic Activities being reported on are included within the combined financial statements after eliminating intercompany balances and transactions. The entities or parts of entities are treated as acquired or disposed of at dates at which they enter or leave the perimeter of the Area of Economic Activities whose combined financial statements are being prepared.

### 6.2. Accounting policies

- 6.2.1. In preparing combined financial statements attention should be given to the accounting policies which are appropriate to the purpose for which the combined financial statements are being created.
- 6.2.2. The accounting information previously recorded in respect of the Area of Economic Activities will be the basis in the preparation of the combined financial statements. It may then be necessary, subject to the particular circumstances, to overlay adjustments to reflect the [entire] presentation of the combined financial statements in accordance with the chosen and uniform accounting policies.
- 6.2.3. Some of the existing accounting policy choices and where they could be best applied are described below:
- (a) **Using the accounting policies applied in preparing the consolidated financial statements of the group to which the respective Area of Economic Activities belong;** this is frequently the case, where a seller is preparing information on parts of a group legally required to prepare consolidated financial statements that is to be sold whereby this information serves for presentation to its existing investors or potential acquirers.<sup>14</sup>
  - (b) **Using the accounting policies that are consistent with those to be applied in the next financial statements of the reporting entity to which the respective Area of Economic Activities will belong;** this is often the case where an Area of Economic Activities is being demerged from an existing group into a new separate legal listed entity and the combined financial statements are intended to show the historical

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<sup>14</sup> This is consistent with the guidance outlined in IFRS 1.D16(a) (i.e., a subsidiary becoming a first-time adopter of IFRS later than its parent can elect the carrying amounts that would be included in the parent's consolidated financial statements...).

information on the Area of Economic Activities forming part of that new entity using accounting policies which differ from those of the former group.<sup>15</sup>

- (c) Using the accounting policies of another entity where that other entity is acquiring the Area of Economic Activities;** this is for example the case in jurisdictions (such as the UK) that require an acquiring listed company to present historical financial statements of the acquired business in accordance with its own accounting policies as opposed to those of the selling entity.<sup>16</sup>

### 6.3. Principles of allocation

- 6.3.1. As a principle, combined financial statements may only include income and expenses, assets and liabilities that are clearly identifiable.
- 6.3.2. In the vast majority of cases such income and expenses, assets and liabilities should be easily identifiable as belonging to the Area of Economic Activities for which combined financial statements are to be prepared. However, there are a number of circumstances where it may be necessary to allocate amounts as being attributable to the Area of Economic Activities concerned where such amounts have historically not been allocated in such way.
- 6.3.3. This can occur, for example, where a group of employees provides services for the Area of Economic Activities as well as for the rest of the larger group. A further example can be a situation whereby all properties are held by a single entity and these properties are used by the Area of Economic Activities as well as by the rest of the larger group.
- 6.3.4. Combined financial statements represent historical financial information. Accordingly, the purpose of allocations should be to attribute all the income and expenses, assets and liabilities that were actually recognised in the combined entities or part of entities for which the combined financial statements are prepared.
- 6.3.5. There should be a reasonable basis for determining the allocation of expenses, for example by reference to relevant non-financial measures such as headcount, utilisation, square footage or time. In other words, allocations should not be arbitrary.
- 6.3.6. The purpose of any of the allocations is not to create hypothetical income and expenses or assets and liabilities as if the entities or parts of entities combined had always been a stand-alone entity.

### Importance of additional disclosures and clear articulation in the basis of preparation

- 6.3.7. Whilst there may be a number of reasonable alternative ways in which the amounts could be allocated when preparing combined financial statements, the essence is that the basis on which the information has been prepared should be clearly set out in the basis for preparation note to combined financial statements.

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<sup>15</sup> In these instances the newly created reporting entity would be considered a first-time adopter of IFRS in accordance with IFRS 1.3 and could elect accounting policies and optional exemptions independent from the group that has prepared consolidated IFRS financial statements before to which the respective economic activities of the subject reporting entity have pertained.

<sup>16</sup> In these instances the acquiree (i.e., the respective economic activities of the subject reporting entity) would be as well considered a first-time adopter of IFRS in accordance with IFRS 1.3 and could elect accounting policies and optional exemptions consistent with those of the acquirer.



6.3.8. Additional disclosures are considered key to the investors'/users' understanding and their information needs. In particular, one should not underestimate the importance of related party disclosures. The users of financial statements not only need to understand how the allocations have been made, but also that the amounts recorded for certain intra-group transactions might not correspond to those which the newly combined entity might record in the future with the same legal counterparties (due to the change in the structure of the group and different pricing policies).

### **Practical examples**

6.3.9. Areas where the exercise of judgments may be needed the most are where the amounts ought to be allocated but were properly dealt with as group items historically. Examples include corporate tax expenses, finance costs and pension costs which are discussed further below.

#### Corporate tax

6.3.10. The allocation of tax charges in preparing combined financial statements depends on whether the entities carrying out the economic activities for which the combined financial statements are to be prepared have filed separate tax returns or whether their tax affairs have been dealt with as part of a larger tax entity.

6.3.11. Under the first scenario, the tax charges, assets and liabilities would be accounted for in accordance with the tax returns.

6.3.12. If separate tax returns do not exist, a basis for the allocation of the overall tax charges needs to be determined. Some of the options that could be applied include:

- Treating the economic activities comprising the combined financial statements as if they were an independent group for tax purposes. This creates accounting entries that need to be reversed through reserves as the amounts arising do not reflect tax liabilities that will ever be paid.
- Treating the business as a separate tax payer within the group from which it is being separated.
- Allocating tax balances on a proportionate basis by applying the overall group tax rate to the income earned by the business comprising the combined financial statements.

#### Finance costs

6.3.13. In addressing the question of what finance costs are relevant to the Area of Economic Activities for which the combined financial statements are to be prepared, preparers need to consider the overall financing of the larger group and the financing of the combined group.

6.3.14. Generally, the allocation of finance costs can:

- Reflect the allocation historically used by the group concerned – if the group was provided with a loan from a holding company, account for liability and related interest when preparing an Area of Economic Activities' combined financial statements;

- Reflect the substance of the group's overall financing, i.e. if the overall group has financed its operations with debt, then a portion of the debt with accrued interest and a related finance expense would be accounted for when preparing an Area of Economic Activities' combined financial statements.

### Pension costs

6.3.15. Complexity can also arise when considering how to allocate the cost of a defined benefit pension plan. If a contractual agreement or adequate allocation policy (e.g. based on the obligation attributable to the plan participation) exists that allocates the cost then this should be followed. However, in some cases there is no contractual basis or policy for allocation. In such cases, particularly in the situation of an Area of Economic Activities being carved out of a larger group, a solution could be to revert to a contributions basis of accounting, i.e. to allocate the costs equal to the contribution of the participants in the pension plan to the Area of Economic Activities.

### **Need for additional guidance regarding allocations**

6.3.16. FEE generally acknowledges that there is a significant diversity in practice given there is no specific guidance from standard setters on whether or not and how to impute charges for group transactions. Such guidance should be restricted however to principles only and its main focus should be to restrict allocation and estimation methods in an attempt to remain as close as possible to the principles of IFRSs. Additionally, the term "clearly identifiable" income, expenses, assets and liabilities needs to be further clarified and defined.

6.3.17. Potential guidance is of importance as allocation might need to be applied – apart from the three areas discussed above - to other financial statements items, such as share based payments, third party financing, derivative financial instruments, overhead costs, etc.

## **6.4. Dealing with subsequent events**

6.4.1. One of the key questions arising when preparing combined financial statements is determining the extent to which subsequent events arising should be adjusted for. This is of particular relevance when combined financial statements are authorised for issue at a later date than the consolidated financial statements of the parent group from which they have been derived.

6.4.2. A range of possibilities exist:

### **(a) Make no adjustment for any subsequent events since the parent group's last consolidated financial statements were drawn up**

This approach is based on the assumption that the combined financial statements should reflect exactly the position that was presented in the consolidated financial statements of the group from which the Area of Economic Activities for which the combined financial statements are being prepared has been carved out.

**(b) Adjust for events occurring since the parent group's most recent consolidated financial statements were drawn up**

Under this approach only the last period to be presented is "kept open" with earlier periods being "frozen". It is based on the principles of IFRS 1 and taking advantage of the relevant exemptions in that standard. IFRS 1 is held to be available as the reporting entity has never prepared financial statements before. The date of the parent group's first time adoption of IFRS would not be taken account of.

**(c) Treat each period presented as being "open"**

This would require each of the periods presented to be re-opened and adjustments to be made for events occurring through to the date the combined financial statements are drawn up.

- 6.4.3. Option b) to adjust for subsequent events occurring since the parent group's most recent consolidated financial statements were drawn up is usually considered as consistent with IFRS 1. It is argued that it is better to present the performance of the business as it was run by the management in the past – in other words to keep the comparative periods closed. The approach is also consistent with IAS 10 Events after the Reporting Period as well as IFRS 1 First time adoption of IFRS which specifies that comparative periods are not restated for new information unless there was an error or a change in accounting policy when adopting IFRS.
- 6.4.4. In practice, we understand that in major capital markets around the world there is wide acceptance of option a) to make no adjustment for any subsequent events since the parent group's last consolidated financial statements were drawn up. The conceptual ground of this approach is the notion of a transfer of pre-existing (unincorporated) Area of Economic Activities from one or multiple legal entities into a newly established reporting entity (i.e. the carve-out entity) while there is simultaneously no substance for reconsidering subsequent events.
- 6.4.5. Option c) is considered appropriate as it means to treat each period as open and adjust for subsequent events so that to make the figures in the combined financial statements correspond by reflecting all events and transactions with the benefit of hindsight.

## **6.5. Accounting for transactions between different Areas of Economic Activities**

- 6.5.1. Transactions within a group can relate to trading activities where one group entity provides goods or services to another for use in the other's trading activities or they can represent charges across the group for the provision of group-wide services. Whilst such transactions may be on an arm's length basis, it may not always be possible to determine the arm's length basis when determining intra-group transfer pricing.
- 6.5.2. When drawing up a group's consolidated financial statements, the basis on which intra-group transactions are made is irrelevant as such transactions are eliminated on consolidation. When a part of a group is "carved-out" the basis on which transactions across the boundary between that part carved out and the remainder of the group are recorded needs to be dealt with.

### **Transactions between the Area of Economic Activities and the rest of the larger group**

- 6.5.3. At initial recognition both the acquirer and the transferor should choose an accounting policy in respect of their separate financial statements that will be applied consistently to all similar common control transactions, including combined financial statements. According to the literature issued by the international accounting practices it could be either:

- (a) **Fair value accounting** (reflecting the difference as a contribution to or deduction from capital); or
- (b) **Historical value accounting** (leaving cross-group transactions at the price at which they were historically dealt with).

6.5.4. The revenues should be measured with actual transfer prices as long as they reflect arm's length prices. If the prices deviate significantly from arm's length, it seems to be appropriate to measure the revenues with fair value<sup>17</sup>.

6.5.5. Whatever the approach adopted, full disclosure of the approach taken and the respective transactions should be made as if they were related party transactions notwithstanding that there may not be any direct ownership relationship.

### **Interest free loans from holding company and other related parties**

6.5.6. Please note that this sub-section does not deal with equity when IAS 32 Financial Instruments: Presentation applies.

6.5.7. From the conceptual point of view under consideration of the IASB Conceptual Framework for Financial Reporting perspective and according to the literature, it is appropriate that the fair value accounting should be applied when accounting for interest-free loans between related parties. However, we need to recognise that one could follow other approaches, depending on the circumstances.

6.5.8. In particular one should always consider the nature of the loan. In some circumstances the difference between the consideration paid or received and the fair value of the financial instrument may represent a distribution or a capital contribution.

6.5.9. If the loan is interest-free, i.e. not on market terms, there will be a difference between the cash advanced to the borrower, i.e. not on market terms, there will be a difference between the cash advanced to the borrower and the initial recognition amount of the loan at fair value. The fair value adjustment is, in substance, a distribution from the subsidiary to its parent because it does not meet the definition of an expense<sup>18</sup>. Therefore, the adjustment to recognise the loan at its fair value should be recognised directly in equity as a deemed distribution.

6.5.10. The deemed distribution should be recognised in equity irrespective of whether the subsidiary has distributable profits. The legal framework in the lender's jurisdiction will govern whether the transfer of funds from a subsidiary with no legally distributable profits to its parent by way of a deemed distribution would render management of the subsidiary in breach of either their fiduciary duties and/or the corporate governance rules in that jurisdiction. Therefore, the level of distributable profits may be a factor affecting the lender's decision to provide an interest-free loan to its parent. However, this will not affect the accounting entries if a loan is made.

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<sup>17</sup> It is assumed that if the transactions between the carved out entity and the rest of the larger group are not valued at arm's lengths, it is because of the specific relationship between them. The definitions of income and expense exclude capital transactions with equity participants. Accordingly, such transactions, as for example capital contributions from shareholders, are recognised directly in equity, in the same way as distributions made to the shareholders (See IFRS Framework 4.25).

<sup>18</sup> As defined in the paragraph 70 of the Framework for the Preparation and Presentation of Financial Statements.



## 6.6 Segment information

### Reporting structure has existed throughout the reporting period

- 6.6.1. When there is a mandatory filing, or the entity is in the process of filing, (IFRS 8 paragraph 2 (b) (ii) and the reporting structure on the level of the economic activities has existed throughout the whole reporting period, IFRS 8 Operating Segments will be applied on a “sub-segment” level adding information on segments in combined financial statements seems to be mandatory.
- 6.6.2. Providing additional information on segments is perceived as always useful for investors, not just when there is a mandatory filing or planned filing.

### Reporting structure has not existed throughout the reporting period

- 6.6.3. When the Area of Economic Activities to be carved out have not had a reporting structure reflecting the segments at the end of the reporting period (in case of a filing or in the process of a filing) the structure which was present at a later date may be used for the purposes of the segment reporting. The reported figures for the period, when the period-end structure was not in place, need to be adjusted accordingly to make them comparable.

### Restatement of comparative figures for previous reporting periods

- 6.6.4. As far as the previously reported segment information is concerned, one should apply the requirements of IFRS 8 – in particular the paragraphs 29 and 30 which state among others: “If an entity changes the structure of its internal organisation in a manner that causes the composition of its reportable segments to change, the corresponding information for earlier periods, including interim periods, shall be restated unless the information is not available and the cost to develop it would be excessive. The determination of whether the information is not available and the cost to develop it would be excessive shall be made for each individual item of disclosure.”

## 6.7. Earnings per share

- 6.7.1 IAS 33 Earnings Per Share assumes that there is a listed company with a share capital which is the basis for the calculation of the earnings per share ratio. As this is not necessarily the case in a combined or carve out situation there is no requirement to present such information. However, an earnings per share ratio can be determined on the basis of the targeted structure for the purposes of an IPO. In such circumstances the number of shares of the IPO vehicle is to be used. Relevant disclosures are required.

## 6.8. Specific disclosure requirements

- 6.8.1. Fundamental to understanding combined financial statements is a clear description of the basis on which they have been prepared. Such basis should address **at least** the following:
- The purpose for which the combined financial statements are prepared.
  - The entities or parts of entities that comprise the Area of Economic Activities for which combined financial statements have been prepared.



- The accounting policies applied, including the reason for applying those accounting policies.
- The basis for allocation of income, expenses, assets and liabilities; particularly where such basis is different from that historically shown in the specific accounting records of the entities or parts of entities included in the combined financial statements (as discussed in paragraphs 6.3.7 and 6.3.8 above).
- The principle for considering subsequent events.
- The method of accounting for transactions between combined economic activities and the group they were part of.
- IAS 24 Related Party Disclosures regarding the relationship between the Area of Economic Activities and the larger group.

6.8.2. The above list is not exhaustive and specific disclosures that will assist users' understanding of combined financial statements will depend on particular circumstances.



## 7. MATTERS FOR FURTHER CONSIDERATION

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7.1. The issues surrounding the preparation of combined financial statements that would merit further debate and action are summarised below:

### **Areas to be addressed in the medium term:**

- Finalisation of the Conceptual Framework for Financial Reporting and in particular the chapter on the Reporting Entity.

### **Areas to be addressed in the longer term:**

- Consideration of a separate IFRS or guidance dedicated to combined financial statements;
- Consideration of international guidance on the provision of audit or other form of assurance on combined financial statements.



## 8. INVITATION TO CONTRIBUTE

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### Ongoing update of the Paper

- 8.1 As mentioned in Section 1 Introduction, as practice is constantly evolving, FEE will monitor developments in the area of combined financial statements. This document may need updating.
- 8.2 FEE welcomes comments from stakeholders on any part of this document. Should you provide us with feedback, please contact the FEE Secretariat ([Secretariat@fee.be](mailto:Secretariat@fee.be), please see also the FEE website [www.fee.be](http://www.fee.be)).

## APPENDIX: REFERENCES

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The following list provides references to external documents that might be of use. This list is not exhaustive.

### European Union

- Commission Regulation (EC) No 211/2007 of 27 February 2007 amending Regulation (EC) No 809/2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards financial information in prospectuses where the issuer has a complex financial history or has made a significant financial commitment  
<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:061:0024:0027:EN:PDF>
- Directive 2010/73/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market  
<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:327:0001:0012:EN:PDF>
- Annex II of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (page 60)  
<http://eur-lex.europa.eu/LexUriServ/site/en/consleg/2004/L/02004L0039-20060428-en.pdf>

### France

- The French accounting standard related to combined financial statements: Règlement N°99-02 du 29 avril 1999 relatif aux Comptes Consolidés des Sociétés Commerciales et Entreprises Publiques (page 53, in French)  
[http://www.anc.gouv.fr/sections/normes\\_privées/reglements/reglements\\_1999/reg1999\\_02\\_modifi\\_e/downloadFile/file/reg1999\\_02\\_modifie.pdf?nocache=1319638434.32](http://www.anc.gouv.fr/sections/normes_privées/reglements/reglements_1999/reg1999_02_modifi_e/downloadFile/file/reg1999_02_modifie.pdf?nocache=1319638434.32)

### Germany\*

- Schindler/Böttcher/Roß: Erstellung von Pro-Form-Abschlüssen – Systematisierung, Bestandsaufnahme und Vergleich mit US-amerikanischen Regelungen Die Wirtschaftsprüfung, Heft 1/2001 (page 22, in German)
- Schindler/Böttcher/Roß: Empfehlungen zur Erstellung von Pro-Forma-Abschlüssen, Die Wirtschaftsprüfung, Heft 3/2001 (page 139, in German)
- Teufel: Prüfung kapitalmarktorientierter Berichtsinstrumente in Förschle/Peemöller Wirtschaftsprüfung und Interne Revision Heidelberg 2004 (page 622, in German)
- Förschle/Almeling: Gruppenabschluss und Pro-Forma-Finanzinformationen in Budde/Förschle/Winkeljohann Sonderbilanzen 2008 (page 325, in German)

### Pro-forma financial information

IDW RH 1.004: Preparation of Pro Forma Financial Information - Erstellung von Pro-Forma-Finanzinformationen (available in both German and English)

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\* These documents are not in the public domain but can be made available by FEE upon request.



### **Hungary\***

- Information regarding Hungary in relation to Combined Financial Statements under IFRS (available in Hungarian)

### **Italy**

- Commissione Nazionale per le Società e la Borsa (CONSOB) - Comunicazione n. EM/1052803 5 July 2001
- Italian Accounting Standard issued by Organismo Italiano Di Contabilità (del Consiglio Nazionale dei Dottori Commercialisti e del Consiglio Nazionale dei Ragionieri modificati dall'OIC in relazione alla riforma del diritto societario) *Principi Contabili 17 Il Bilancio Consolidato* which addresses partly combined financial statements (Bilanci Aggregati) as of 16 September 2005, Sostituisce il principio n. 17 del marzo 1996 (available in Italian)

### **United Kingdom**

- Standard for Investment Reporting SIR 2000: Investment Reporting Standards applicable to public reporting engagements on historical financial information (Revised), March 2011 - Annexure: Accounting conventions commonly used in the preparation of historical financial information in investment circulars (page 27)  
<http://www.frc.org.uk/getattachment/a1a3b5ca-b85e-4d3a-81fc-6c2cf5858b2e/SIR-2000-Revised-Investment-Reporting-Standards-Applicable-to-Public-Reporting-Engagements-on-Historical-Financial-Information.aspx>

### **United States**

- U.S. Accounting Standards Codification Topic 810-10-45 and Topic 810-10-55;
- US SEC Codification of Staff Accounting Bulletins, Topic 1: Financial Statements  
<http://www.sec.gov/interps/account/sabcodet1.htm>
- SEC Regulation S-X Article 3A – Consolidated and Combined Financial Statements;
- SEC Regulation S-X Article 11 – Pro-Forma Financial Information;
- SEC Staff Accounting Bulletin (SAB) Topic 1B Allocation of Expenses and Related Disclosure in Financial Statements of Subsidiaries, Divisions, or Lesser Business Components of Another Entity;
- US Securities and Exchange Commission (SEC) Division of Corporation Finance: Financial Reporting Manual, updated 30 June 2011;
- Department of Professional Practice SEC Financial Statement Requirements for Business Combinations, Third Edition, 2010;
- Speech by Leslie A. Overton, SEC Staff in 2006 on Accounting and Reporting Issues for an IPO in Connection with a Merger of Entities under Common Control  
<http://www.sec.gov/news/speech/2006/spch121206lao.htm>

### Pro-forma financial information

- US SEC Regulation S-X, § 210.11 Pro Forma Financial Information, 9 July 1982

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\* These documents are not in the public domain but can be made available by FEE upon request.



### Other

- Insights into IFRS – an overview September 2011, 8th Edition, KPMG IFRG Limited
- Manual of Accounting, IFRS 2012, Global Accounting Consulting Services, PricewaterhouseCoopers LLP
- International GAAP 2012, Generally Accepted Accounting Practice under International Financial Reporting Standards, Ernst & Young LLP
- iGAAP 2012 – a guide to IFRS reporting, Deloitte Touche Tohmatsu Limited
- IASB Exposure Draft Conceptual Framework for Financial Reporting: The Reporting Entity, March 2010
- Agenda Paper: Report of the IASB Chair to the IFRS Foundation Trustees, Brussels, 12 October 2012.
- IAASB the International Standard on Assurance Engagements ISAE 3420 Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus, December 2011

<http://www.ifac.org/sites/default/files/publications/files/B011%202012%20IASB%20Handbook%20ISAE%203420-final.pdf>

- Commission Regulation (EU) No 1254/2012 of 11 December 2012 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Financial Reporting Standard 10, International Financial Reporting Standard 11, International Financial Reporting Standard 12, International Accounting Standard 27 (2011), and International Accounting Standard 28 (2011)

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:360:0001:0077:EN:PDF>

- FEE Discussion Paper Combined Financial Statements, April 2011



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