Exposure Draft

Guidance Note on Combined Financial Statements

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Issued by

Accounting Standards Board

The Institute of Chartered Accountants of India

Exposure Draft

Guidance Note on Combined Financial Statements

(Consolidated financial statements of an entity are prepared for a group as defined in Ind AS 110, Consolidated Financial Statements. There may be some occasions where preparation of consolidated financial statements would not be appropriate because of absence of control, e.g., in group loan arrangements, take-overs, demergers, spin-offs and initial public offerings, etc. In such cases, specific financial information is required for part or parts of entities which may or may not be part of a group. Combined financial statements may be prepared for these specific purposes. As of now, there was no guidance on preparation of combined financial statements in India. The guidance on combined financial statements is necessary in order to curb diverse prevailing practices.

In this direction, following is the Exposure Draft of the Guidance Note on Combined Financial Statements, issued by the Accounting Standards Board of the ICAI, for comments. The Board invites comments on any aspect of this Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.)

Comments can be submitted using one of the following methods so as to receive not later than September 5, 2016:

1. *Electronically:* *click on* ***http://www.icai.org/comments/asb/*** *to submit comments online*

2. *Email:* *Comments can be sent at commentsasb@icai.in*

3. *Postal:* *Secretary, Accounting Standards Board,*
The Institute of Chartered Accountants of India,
ICAI Bhawan, Post Box No. 7100,
Indraprastha Marg, New Delhi – 110 002

Further clarifications on any aspect of this Exposure Draft may be sought by e-mail to asb@icai.in

Guidance Note on Combined Financial Statements

Introduction

1. Generally, consolidated financial statements of an entity are required to be presented under the relevant legal or regulatory requirements. In India, these requirements are met by presenting consolidated financial statements prepared under the applicable Accounting Standards. However, there may be some occasions such as group loan arrangements, take-overs, demergers, spin-offs and initial public offerings, etc. where specific financial information is required for part or parts of entities which may or may not be part of a group. In the absence of control, preparation of consolidated financial statements would not be appropriate. In such cases, to present relevant financial information of part or parts of the entities, combined financial statements may be prepared.

2. The combined financial statements can include financial information pertaining to different entities, divisions, branches and/or an aggregation of similar assets, associated liabilities and operations in a specified geographic region or line of business pertaining to different entities. Combined financial statements can be prepared by aggregating financial statements of segments, separate entities or components of groups which may have separate management and accounting records.

3. Preparing combined financial statements can require significant judgement, driven by the purpose for which the statements are being prepared.

Objective

4. This Guidance Note provides the meaning of combined financial statements, indicative situations in which these may be required to be prepared and procedure for preparation of the financial statements, carve-out financial statements and required disclosures.

Definitions

5. The following terms are used in this Guidance Note with the meanings specified:

   Financial Statements: For the purpose of this Guidance Note, financial statements providing historical financial information of the combining or carve-out businesses for specific purpose comprising:

   (A.) (i) Statement of Profit and Loss
   (ii) Balance Sheet
   (iii) Statement of Cash Flows
   (iv) Notes to the Accounts
   in accordance with the applicable Accounting Standards (AS) notified under the Companies (Accounting Standards) Rules, 2006 as amended from time to time.

(B.) (i) Statement of Profit and Loss (including Other Comprehensive Income)
(ii) Balance Sheet
(iii) Statement of Cash Flows
(iv) Statements of Changes in Equity
(v) Notes to the Accounts

in accordance with the applicable Indian Accounting Standards (Ind AS) notified under the Companies (Indian Accounting Standards) Rules, 2015 as amended from time to time.

(C.) Non-corporate entities preparing financial statements in accordance with the Accounting Standards issued by Institute of Chartered Accountants of India similar to those stated at (A.) and (B.) above.

Combining businesses: For the purpose of this Guidance Note and notwithstanding the definition of 'business' under Ind AS 103, *Business Combinations*, the term combining businesses refers to two or more entities and/or divisions/segments/businesses of the same or different entities which are being aggregated for the purpose of preparation of combined financial statements.

Combined Financial Statements: Combined financial statements are the financial statements that present the combined historical financial information of combining businesses that do not comprise a group for which consolidated financial statements can be prepared. The term 'combined financial statements' has also been used in this Guidance Note for financial statements of a carve-out business.

Carve-out business: Carve-out business refers to the carved out assets and liabilities and income and expenses. Carved out business could be a division/segment/business/assets with associated liabilities of an entity.

Remaining Group: Entities or part of entities other than the carve-out business for which combined financial statements are prepared.

Common Control: Combining businesses are said to be under common control when all the combining entities are ultimately controlled by the same party or parties and that control is not transitory.

6. The terms used in this Guidance Note and not defined in this Guidance Note have same meaning as specified in the relevant Accounting Standards.

Circumstances in which Combined Financial Statements may be prepared

7. Combined financial statements for two or more combining businesses may be required to be prepared, for example, in the following cases:

a) under circumstances of transactions such as acquisition or disposition negotiations/agreement; for instance, a group of entities which do not form a group from a legal point of view, but are the subject matter of an acquisition or disposal;

b) filings in accordance with statutory or regulatory requirements, e.g., initial public offerings by Real Estate Investment Trusts and Infrastructure Investment Trusts etc.;

c) there may be circumstances in which combined financial statements of commonly controlled entities are likely to be more meaningful than their separate financial statements. For example, combined financial statements would be useful if one or more individuals control several entities that are related/unrelated in their operations.

d) there may be circumstances where some companies under the same group, for the purpose of borrowings from banks or other financial institutions, are required to prepare combined financial statements, e.g., group loan arrangements.

e) demerger of a segment from a business

Scope

8. This Guidance Note applies to every entity which prepares combined financial statements.

9. This Guidance Note also applies in the preparation of condensed combined financial statements prepared in accordance with the requirements of the applicable Accounting Standards.

10. The recommendations contained in this Guidance Note are applicable, *mutatis mutandis,* for the purpose of preparation of financial statements of a carve-out business.

11. This Guidance Note should not be construed to be applicable to the general purpose financial statements as the combined financial statements are prepared for specific purposes and, therefore, are 'special purpose financial statements'.

Procedure for preparation of combined financial statements for combining two or more entities

12. The guidance given in paragraphs 13 and 14 is applicable for preparation of combined financial statements for combined businesses of two or more entities in their entirety.

13. The procedure for preparing combined financial statements of the combining entities is the same as that for consolidated financial statements as per the applicable Accounting Standards. Accordingly, when combined financial statements are prepared, intra-group transactions and profits or losses should be eliminated, and non-controlling interests, foreign operations, different fiscal periods, or income taxes should be treated in the same

manner as in consolidated financial statements prepared under the applicable Accounting Standards.

14. In case the combining entities or any one of the combining entities are under common control, the carrying amounts pertaining to a subsidiary, as reflected in the consolidated financial statements of the parent, should be used for the purpose of preparing combined financial statements.

Example: X intends to dispose of its segment A, together with B (directly owned Subsidiary which was acquired by X five years ago). Management prepares combined financial statements for A and B. Combined financial statements should be prepared using the amounts in X's consolidated financial statements pertaining to subsidiary B.

Procedure for preparing Combined Financial Statements for other combining businesses

15. The guidance given in paragraphs 16 to 32 is applicable for preparation of combined financial statements for combining businesses other than combining two or more entities in their entirety. For example, a toll road project of company A is sought to be combined with a toll road project of Company B by an Infrastructure Investment Trust (carve-out assets/business); each of the companies have remaining projects which would continue to operate independently. In such cases, for preparing combined financial statements, difficulties in allocation may arise, for example, where a group of employees provides services for a particular asset as well as for the rest of the project, e.g., payroll, accounting, centralised purchasing, marketing, rent, advertising, legal, insurance, management expenses, etc.

16. Where transactions or balances are not accounted for in a manner which clearly attributes them to the carve out assets and liabilities and income and expenses pertaining to the concerned projects (collectively termed as 'carve-out business'), it will be desirable to develop methods for allocating the relevant amounts to the carve-out business with a view to providing the fairest approximation to the amounts actually attributable to the carve-out business. An appropriate method can be adopted and applied on a rational and consistent basis for allocation purposes. Where there is no rational or consistent basis for doing so, any other appropriate basis may be followed for allocation; however, a disclosure of the fact and basis adopted for allocation shall be made.

Example: Allocation of brand cost amongst various segments when only one segment is being combined while other segments also use the brand. However, brand cost may be allocated on equal basis if no rational basis is available.

Basis for allocating transaction amounts and balances

17. The appropriate basis for allocating common income and expenditure to a carve-out business will vary according to the circumstances. For instance, centrally accounted-for salaries and other related costs including retirement benefits may be allocated on the basis of headcount; however, relative levels of staff turnover or other factors also need

consideration. Similarly, the costs of a head office accounts department may be allocated based on the relevant sizes of the carve-out business and remaining group. However, if other factors suggest that size is not a good indicator, for example, a disproportionate number of the accounting team is engaged in work for one part of the business and not the other refinements to the approach might be considered appropriate.

18. Assets may be allocated on the basis of control, usage, legal ownership or any other basis on a rational and consistent basis.

19. The basis of allocation of a group third party debt assumed by the carve-out business may be by reference to the terms of the separation agreement. In other cases, the debt may be treated as part of the carve-out business where the debt can be related to that business.

20. Finance lease liabilities may be allocated in line with the allocation of the related assets.

21. The allocation of the incomes and expenses generally move with the related assets and liabilities.

    Example: The allocation of interest income and expenses would follow the way in which the related instruments have been apportioned.

22. The purpose of the allocation is to attribute an appropriate element to the carve-out business. The purpose of any of the allocations is not to create hypothetical income and expenses or assets and liabilities as if the combining businesses had always been a standalone entity. Thus, the position shown may not be that which might have existed if the carve-out business had been a stand-alone business.

Relationship with the remaining group

23. In addition to transactions with 'third parties', the results of the business will also include transactions with the remaining group.

    Example: Sales which were previously regarded as 'intra- group' will need to be re-examined to determine whether they relate to entities within the carve-out business or outside it.

24. It is necessary to identify the extent of the relationships between the carve-out business and the remaining group. Balances with the remaining group may comprise elements of trading balances and short term or long term funding balances, which may or may not have been interest bearing. Balances of a trading nature will normally be presented as an element of debtors or creditors. Balances which are considered to be funding in nature (having regard, *inter alia,* to the use of the funds, the period for which they remain outstanding and the level of other funds) will normally be classified according to their general nature. Where the balance is interest bearing and has other characteristics of debt, it will be presented as debt financing. Where the balance does not have the characteristics of debt, it will be classified as capital and be presented in the manner of equity, typically aggregated with the owners'contribution (capital) and reserves of the carve-out business.

Example: Carve-out business was charged royalty on a periodic basis for the use of a product pertaining to one of the combining businesses. From the perspective of combined financial statements, this fee stands payable to the owners since it is owed to the owners. It will be presented in the manner of debt financing in the combined financial statements since royalty is charged on a periodic basis which is similar to the interest payments in a loan and bears the characteristics of debt. However, in case no royalty is charged for the use of the product, then it will be treated as owner's contribution.

25. Balances with the remaining group may also contain elements of third party debtors or creditors which have been accounted for on behalf of the carve-out business by the remaining group.

    Examples: VAT, payroll taxes, certain customers or suppliers common to the carve-out business and the remaining group, and external funding balances.

    Such elements of the balances with the remaining group should be allocated appropriately.

Impairment

26. The carved out business would need to determine its cash generating units for impairment testing. Carve-out business should make separate assessment of whether any event has occurred with regard to its stand alone operations that would trigger the need to perform an impairment test for each period covered by the combined financial statements. Impairment should not be apportioned to the carve-out business. Rather, it should be based on the actual assets allocated to the carve-out business and the carve-out business's stand alone results.

Exceptional items

27. Exceptional items should be allocated to the carve-out business and accounted for in accordance with the applicable Accounting Standards.

Taxation

28. The allocation of tax expenses in preparing combined financial statements depends on whether the combining businesses have filed separate tax returns or have their tax affairs dealt with as part of a larger tax entity. Generally, tax expenses should be allocated to the carve-out business as if the carve-out business is a separate taxable entity.

29. The approach would involve the aggregation of the tax expenses actually incurred by the companies within the carve-out business (reflecting the benefits, reliefs and charges), after considering the tax effects of any adjustments. Where the information relating to the tax expenses actually incurred is not available, the tax expenses should be recomputed on the basis of the results of the carve-out business. Thus, if separate tax returns do not exist, a basis for allocating overall tax expenses must be determined on rational and consistent basis.

Capital

30. In preparing combined financial statements of carved out businesses, it may not be possible to arrive at the amount of share capital pertaining to combining businesses. In such cases, the difference between the assets and liabilities of the combining businesses, being net investment, may be presented as capital.

Cash flow statements

31. A cash flow statement is prepared for the carve out business based on the carve out information.

32. Where the overall group operates a central cash account, cash flows relating to centrally settled costs are allocated to the carve out business to the extent that the related balances are allocated to the carve out business.

Disclosures

33. Disclosure is required in the notes to the combined financial statements of the fact that the information presented may not be representative of the position which may prevail after the transaction. Similarly, the fact that position shown may not be that which might have existed if the carve-out business had been a stand-alone business should also be disclosed.

34. Comparatives are not necessarily required to be given for the combined financial statements.

35. The following shall be disclosed in the combined financial statements:

    a) the purpose of preparation of combined financial statements;

    b) a list of combining businesses;

    c) statement of compliance with the applicable Accounting Standards;

    d) the principal accounting policies followed in preparing the combined financial statements;

    e) the basis for allocation, critical assumptions, judgments, and estimates involved in the preparation of combined financial statements;

    f) other disclosures as per the requirements of applicable Accounting Standards to the extent relevant;

    g) where the accounting policies are not uniform, disclosure of that fact along with the accounting framework followed;

h) extent of balances (not having the characteristics of debt) treated as part of equity (refer paragraph 24); and

i) the basis of pricing inter-group transfers and any change therein should be disclosed in the combined financial statements.

36. The above disclosures are not exhaustive and specific disclosures that will assist users' understanding of combined financial statements should also be made.