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Guide to preparing carve- out financial statements



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1 Introduction

1.1 Carve-out financial statements (updated April 2026)

Companies often consider divestitures to raise capital or maximize shareholder value. A divestiture may take the form of a sale of all or a portion of a business, a spin-off of all or a portion of a business to existing shareholders, or an initial public offering (IPO). Regardless of the form of the transaction, entities may need financial statements reflecting the operations to be divested to comply with regulatory requirements, to enable the seller and the buyer to evaluate the potential transaction or to obtain financing.

The term “carve-out financial statements” is used in practice to describe the financial statements of a business, such as a division or components of a business (or groups of businesses), that are derived from the existing consolidated financial statements of a parent entity. The composition of the financial statements prepared for a carve-out reporting entity¹ depends on the facts and circumstances of the transaction. For example, the carve-out entity may be a discrete business that represents a portion of a legal entity or a group of businesses held by multiple legal entities controlled by the same parent. In contrast, when the reporting entity is a legal entity, full financial statements of the legal entity would be prepared rather than carve-out financial statements.

The principal purpose of carve-out financial statements is to present the historical operations of the carve-out entity and reflect all of the costs of doing business. The carve-out entity financial statements should provide users with relevant information on how the carve-out entity operated under its parent in the periods presented.

This publication provides considerations for the preparation of carve-out financial statements that represent the historical periods prior to the divestiture transaction in accordance with US GAAP and relevant Securities and Exchange Commission (SEC) guidance. It is not meant to provide comprehensive guidance for the parent entity’s accounting and reporting of the divestiture, which would follow existing US GAAP and SEC guidance where applicable. Refer to our Financial reporting developments (FRD) publications for additional information on these topics. They are available on our [AccountingLink](#) website.

We note that neither US GAAP nor the SEC staff provide comprehensive guidance on preparing carve-out financial statements. In its Financial Reporting Manual (FRM),² the staff in the SEC’s Division of Corporation Finance addresses certain aspects of reporting in carve-out financial statements that are required under Rule 3-05 of Regulation S-X, *Financial statements of businesses acquired or to be acquired*, for significant business acquisitions.

Section 2935.16 of the FRM says the allocation of certain expenses that are not specifically identifiable to the acquired or to-be-acquired business (e.g., indirect expenses not directly involved in the revenue-producing activity) should comply with the guidance in SEC Staff Accounting Bulletin (SAB) Topic 1.B.1, *Costs reflected in historical financial statements* (codified in ASC 220-10-S99-3). SAB Topic 1.B.1 requires the costs of a subsidiary that a parent incurred on its behalf to be reflected in the historical financial statements (see section 3.1.3 of this publication). Similarly, assets and/or liabilities (e.g., debt) that are not specifically identifiable to the acquired or to-be-acquired business still may be included in the required

¹ For the purposes of this publication, the terms “carve-out reporting entity” and “carve-out entity” refer to the operations or businesses for which carve-out financial statements are prepared and not a legal entity.

² The FRM’s front cover notes that it is designed to provide internal guidance only to Division of Corporation Finance staff and is non-authoritative. However, because the information in the FRM has been useful to registrants and their auditors, the SEC staff has posted it on the SEC’s website at the following link: [sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml](https://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml).

financial statements of the acquired business, when supported by a reasonable basis (see section 3.1.1 of this publication). Although this guidance is only applicable to SEC registrants, private companies often look to the guidance in the FRM and SAB Topic 1.B.1, given the limited guidance in US GAAP.

For topics on which there is no authoritative guidance, we provide considerations to help entities prepare carve-out financial statements.

1.2 When carve-out financial statements may be required

When deciding whether carve-out financial statements are needed, a company should consider the facts and circumstances of the planned transaction, including the information needs of stakeholders, as well as any SEC reporting requirements.

When a registrant has to include carve-out financial statements in an SEC filing, the applicable SEC rules will determine the form and content of the SEC filing, including the historical periods to be presented and whether the financial statements need to be audited.

Carve-out financial statements may be required to satisfy SEC reporting requirements in the event of a significant business acquisition (see section 1.2.1), a spin-off or split-off of all or a portion of a business to existing shareholders (see section 1.2.2), or an IPO (see section 1.2.3).

1.2.1 Financial statements necessary to comply with Rule 3-05 and Article 11 of Regulation S-X (updated April 2026)

Rule 3-05 of Regulation S-X and Rule 8-04 for smaller reporting companies, which are both entitled *Financial statements of businesses acquired or to be acquired*, require SEC registrants to provide separate financial statements of significant³ acquired businesses⁴ or businesses to be acquired in reports on Form 8-K and proxy statements under the Securities Exchange Act of 1934 (Exchange Act or 1934 Act) and in registration statements (including post-effective amendments) under both the Exchange Act (e.g., Form 10) and the Securities Act of 1933 (Securities Act or 1933 Act) (e.g., Forms S-1 and S-3).⁵

See our Technical Line, [*Applying the SEC's requirements for significant acquired businesses*](#), for guidance on how to evaluate the significance of acquired or to-be-acquired businesses and when and for what periods audited financial statements are required under the rules.

Rule 3-05 applies to the acquisition of selected parts of an entity that meet the definition of a business in Rule 11-01(d) of Regulation S-X (see section 1.2.1.1). The form of the financial statements may vary depending on the nature of the transaction.

The SEC staff has indicated⁶ it would generally expect carve-out financial statements to be provided for an acquired business that does not constitute substantially all of the assets and liabilities (e.g., division, product line) of an entity.

That contrasts with the SEC staff's view that it would not object to a registrant filing an entity's full financial statements if the registrant has acquired substantially all of that entity's key operating assets. In these situations, any adjustments relating to specific assets and liabilities not acquired or assumed by the registrant would be reflected in the Article 11 pro forma financial information.⁷

³ An acquired business is significant if the results of any of the three significance tests in Rule 1-02(w) of Regulation S-X (i.e., asset, investment or income) exceeds 20%.

⁴ As defined in Rule 11-01(d) of Regulation S-X.

⁵ Except registration statements filed under Rule 462(b).

⁶ Section 2935.6 of the FRM.

⁷ Section 2935.5 of the FRM.

Article 11 of Regulation S-X describes the requirements to provide pro forma financial information (see section 4.8). Pro forma financial information that complies with these requirements must accompany Rule 3-05 financial statements of acquired businesses.

1.2.1.1

Definition of a business under Article 11 of Regulation S-X (updated April 2026)

When assessing the need to provide financial statements for an acquired or to-be-acquired business under Rule 3-05, an entity evaluates the definition of a business in Rule 11-01(d) of Regulation S-X. The SEC staff said that this analysis focuses primarily on whether the nature of the revenue-producing activity previously associated with the acquired assets will remain generally the same after the acquisition. As a result, management will need to exercise judgment in this area.

There is a presumption that a separate entity, subsidiary, division or an interest in a producing oil and gas property is a business.⁸ The SEC staff also views the acquisition of an interest in a business that will be accounted for under the equity method (including when the fair value option has been elected) as the acquisition of a business for SEC reporting purposes.⁹ A lesser component of an entity, such as a product line, may also be considered a business for SEC reporting purposes.

When evaluating whether such a component is a business, registrants should consider both of the criteria in Rule 11-01(d). The SEC staff has stated that new carrying values of assets, or changes in the financing, management, operating procedures or other aspects of the business are not unusual following a business acquisition, and they typically do not eliminate the relevance of historical financial statements. The SEC staff encourages registrants that have succeeded to a revenue-producing activity by merger or acquisition, with at least one of the other factors listed in Rule 11-01(d)(2) remaining with the acquired component after the acquisition, to obtain concurrence from the staff in advance of a filing if they intend to omit financial statements related to the assets and activity.¹⁰

Excerpt from SEC rules and regulations

Regulation S-X, Article 11 Pro forma financial information

Rule 11-01, Presentation requirements

- (d) For purposes of this rule, the term business should be evaluated in light of the facts and circumstances involved and whether there is sufficient continuity of the acquired entity's operations prior to and after the transactions so that disclosure of prior financial information is material to an understanding of future operations. A presumption exists that a separate entity, a subsidiary, or a division is a business. However, a lesser component of an entity may also constitute a business. Among the facts and circumstances which should be considered in evaluating whether an acquisition of a lesser component of an entity constitutes a business are the following:
- (1) Whether the nature of the revenue-producing activity of the component will remain generally the same as before the transaction; or
 - (2) Whether any of the following attributes remain with the component after the transaction:
 - (i) Physical facilities,
 - (ii) Employee base,
 - (iii) Market distribution system,

⁸ Sections 2910.2 and 2910.5 of the FRM.

⁹ Section 2905.3 of the FRM.

¹⁰ Note to Section 2910.2 of the FRM.

- (iv) Sales force,
- (v) Customer base,
- (vi) Operating rights,
- (vii) Production techniques, or
- (viii) Trade names.

The definition of a business under Article 11 differs from the US GAAP definition in Accounting Standards Codification (ASC) 805.¹¹ Therefore, it is possible for an acquisition to be considered a business for SEC reporting purposes but not for accounting purposes. Further, acquired assets and liabilities that do not meet the SEC's definition of a business are not subject to the reporting requirements of Rule 3-05 or Article 11 of Regulation S-X, even if they meet the US GAAP definition of a business under ASC 805. See section 2.1.3 of our FRD, *Business combinations*, for guidance on what constitutes a business as that term is defined in ASC 805.

1.2.1.2

Abbreviated financial statements in lieu of carve-out financial statements (updated April 2026)

Under Rule 3-05(e) of Regulation S-X, registrants can provide abbreviated financial statements (i.e., an abbreviated statement of comprehensive income and a statement of assets acquired and liabilities assumed) for an acquisition of net assets that constitutes a business when all of the following conditions are met:

- ▶ The total assets and total revenue (both after intercompany eliminations) of the acquired or to-be-acquired business constitute no more than 20% of the total assets and total revenue of the seller¹² as of and for the most recently completed fiscal year.
- ▶ The acquired or to-be-acquired business was not a separate entity, subsidiary, operating segment (as defined by US GAAP or IFRS[®] Accounting Standards)¹³ or division during the periods for which Rule 3-05 financial statements would be required.
- ▶ Separate financial statements for the business have never previously been prepared, the seller has not maintained the distinct and separate accounts necessary to present full financial statements of the business, and it is impracticable to prepare such financial statements.

The statement of assets acquired and liabilities assumed is presented on the basis of the seller's historical US GAAP carrying value.¹⁴

Registrants that do not meet the criteria above but believe abbreviated financial statements would provide sufficient disclosure for investors should consider contacting the SEC staff and requesting permission to provide abbreviated financial statements prior to filing such financial statements necessary to comply with Rule 3-05 (see section 1.2.4).

¹¹ ASC 805, *Business Combinations*.

¹² Section 2935.7 of the FRM says it may be appropriate to consider the total assets and revenues of the seller on a consolidated basis rather than the specific subsidiary of the seller that owns the business being acquired.

¹³ Section 2935.7 of the FRM says the registrant should consider whether the business would have qualified as an operating segment under US GAAP or IFRS Accounting Standards, as applicable, even if the business was not required to assess its operating segments under those frameworks.

¹⁴ Section 2935.8 of the FRM.

Under Rule 3-05(e), the abbreviated statement of comprehensive income must include all expenses incurred by or on behalf of the acquired or to-be-acquired business during the pre-acquisition financial statement periods to be presented, including all costs of sales or services, selling, distribution, general and administrative, marketing, depreciation, amortization, and research and development expenses. Corporate overhead allocations, interest expense for debt that will not be assumed by the registrant and income tax expense can normally be excluded. The title of the statement must be appropriately modified to indicate that it omits certain expenses (e.g., statement of revenues and direct expenses).¹⁵

A registrant also needs to comply with the related disclosure requirements. Rule 3-05(e) requires that the notes to the abbreviated financial statements identify the omitted expenses, explain the reason for the omission and disclose the impracticability of preparing financial statements that include the omitted expenses. A registrant also needs to include a description of how the statements are not indicative of the future financial condition or operating results of the acquired or to-be-acquired business because of the omission of various expenses. In addition, a statement of cash flows is not required when abbreviated financial statements are presented. However, registrants are required to provide in the notes to the abbreviated financial statements information about the operating, investing and financing cash flows of the acquired or to-be-acquired business to the extent it is available.

Additional considerations for oil and gas properties

Rule 3-05(f)(2) and Section 2935.11 of the FRM allow a registrant to only present statements of revenues and expenses that exclude expenses not comparable to the proposed future operations (e.g., depreciation, depletion and amortization, corporate overhead, income taxes, and interest for debt not assumed by the registrant) of an acquired business engaged in oil- and gas-producing activities if (1) the acquisition generates substantially all of its revenues from oil- and gas-producing activities (as defined in Rule 4-10 of Regulation S-X) and (2) the qualifying conditions in Rule 3-05(e) described above are met. Registrants meeting the Rule 3-05(f) criteria may omit the statement of assets acquired and liabilities assumed.¹⁶

The SEC staff will consider requests to waive the requirement for presenting the prior year of the abbreviated financial statements and instead allow presentation of only the latest fiscal year and interim period, if the registrant can demonstrate that the prior year's information would not be meaningful because the property had no material quantity of production.

This publication does not address the preparation of abbreviated financial statements used to comply with Rule 3-05. For more information on abbreviated financial statements, see section 2935 in the FRM.

1.2.2

Financial statements in a spin-off transaction

Carve-out financial statements will generally be required in a spin-off transaction as the spin-off transaction will likely involve a reorganization of the businesses being spun off immediately prior to the transaction rather than the distribution of a business through an existing legal subsidiary. A spin-off is defined in ASC 505-60¹⁷ as a transfer of assets that constitute a business (as that term is defined in ASC 805) by an entity (the spinor) into a new legal entity (the spinnee). The transfer is followed by a distribution of the shares of the spinnee to the spinor's shareholders, without the surrender by the shareholders of any shares of the spinor.

The spinnee will need to prepare financial statements if it is required to file a registration statement with the SEC on Form 10 or Form S-1. In some cases, the spinor may be required to provide financial statements of the spinnee in a proxy statement seeking shareholder approval for the spin-off transaction.

¹⁵ Section 2935.9 of the FRM.

¹⁶ Section 2935.11 of the FRM.

¹⁷ ASC 505-60, *Equity – Spinoffs and Reverse Spinoffs*.

If the businesses that will comprise the legal and accounting spinnee reside in various legal entities of the ultimate parent, the historical financial statements of the businesses reorganized into the spinnee will generally constitute the predecessor to the newly formed entity and carve-out financial statements would be required in a registration statement.

1.2.3 **Other circumstances, including an IPO (updated April 2026)**

A parent entity's plans may involve other strategic alternatives in which historical carve-out financial statements may be necessary. For example, an entity may wish to raise capital by selling an existing division or segment to the public in an IPO with securities registered on Form S-1. If the historical operations of the division or segment reside in various legal entities of the ultimate parent, historical carve-out financial statements of the division or segment may constitute the predecessor to the entity raising capital in the public offering and would be required in the Form S-1.

As another example, an existing SEC registrant may pursue the acquisition of a division or segment of another entity. When the transaction involves a merger that requires the registrant to exchange its securities for the securities or assets of another entity, the securities to be issued are generally registered under the Securities Act on Form S-4. In such cases, historical carve-out financial statements of the target division or segment may be required to be included in the Form S-4.

1.2.4 **Rule 3-13 waiver requests (updated April 2026)**

Registrants may submit a request to the Office of Chief Accountant of the SEC's Division of Corporation Finance (CF-OCA) for relief from the requirement to file Rule 3-05 financial statements or to substitute them with appropriate statements of comparable character if application of the rules and guidelines produces an anomalous result. The CF-OCA staff may exercise its delegated authority under Rule 3-13 of Regulation S-X to waive some or all of the required acquiree financial statements or permit other financial statements to be substituted, as long as the staff deems it to be consistent with investor protection.¹⁸

As a reminder, a company's failure to obtain a waiver or comply with the SEC reporting requirements could prevent a registration statement from being declared effective.

¹⁸ Note to Topic 2 of the FRM.

2 Overview of considerations for preparing carve-out financial statements

2.1 Identifying the carve-out entity

The first step in preparing carve-out financial statements is identifying the business or businesses that will comprise the carve-out reporting entity. Proper identification of the carve-out entity is critical as that will inform decisions made in preparing the financial statements, including the identification of assets and liabilities and the allocation of costs.

Identifying the carve-out entity may be relatively straightforward if a company divests an operating segment (or reportable segment) or a reporting unit. However, if the divestiture comprises a portion or portions of any of these structures, identifying the carve-out entity may be more challenging. For example, a company may divest only certain brands or operations in certain sectors or geographical areas. Identifying the carve-out entity also may be challenging if financial statements are to be prepared prior to the finalization of a purchase and sale agreement or spin-off transaction that would specify the assets and liabilities or legal entities to be included in the carve-out entity.

The objective of carve-out financial statements is to show the historical performance of the business. Accordingly, the carve-out financial statements should include all relevant activities that were part of the business in the periods presented.

Consideration should be given to the nature and legal structure of the transaction, the purpose of the carve-out financial statements and how the businesses that will form the basis of the transaction were managed by the parent entity.

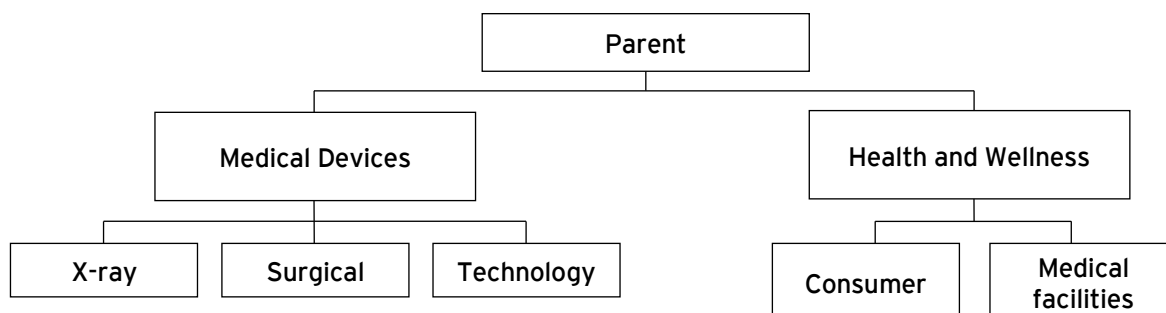
The legal structure

When identifying the carve-out entity, management should consider the legal structure of the transaction and the effects on the carve-out financial statements of including or excluding certain legal entities from the carve-out entity. For example, a parent may sell a business that is a legal entity, that is comprised of portions of multiple legal entities or that is a combination of the two. In a spin-off, the parent may reorganize its businesses into a new legal entity. When the divestiture includes a reorganization, it is important to understand the legal structure of the transaction and identify the legal entities and businesses that will be included in the new entity when the transaction is completed. This is commonly referred to as the “legal entity approach.”

Following a legal entity approach, if the transaction involves a reorganization of the parent’s existing legal entities and one or more of these entities will be included in the transaction (e.g., transferred to a newly formed entity in connection with a spin-off), we believe management should evaluate whether all of the historical operations of the legal entities included in the transaction should be included in the carve-out entity. If all of the historical operations of the legal entities are included in the carve-out financial statements, any assets and operations of a legal entity to be disposed of that will be retained by the parent contemporaneously with the transaction would be reflected as an adjustment to the pro forma financial information that may be presented with the carve-out financial statements.

Illustration 2-1 Identification of the carve-out entity in a spin-off using a legal entity approach

Parent is a manufacturer and distributor with two operating segments, Medical Devices and Health and Wellness.



Parent has decided to spin off its Medical Devices operating segment, which consists of multiple legal entities. However, Parent will retain the Technology business it recently established to develop software for use in medical devices. The Technology business is not significant to the overall operating segment. Parent will transfer the existing legal entities that comprise the Medical Devices operating segment into a newly formed entity (SpinCo) in connection with the spin-off transaction. However, contemporaneously with the transaction, SpinCo will distribute the Technology business to Parent.

Identification of the carve-out entity

Under a legal entity approach, all of the businesses of the Medical Devices operating segment would be included in the historical carve-out financial statements. SpinCo would remove the operations and net assets related to the Technology business as an adjustment in its pro forma financial information filed with the SEC in connection with the transaction.

In some circumstances, management may wish to exclude businesses or activities that the parent entity will retain as part of the transaction from the carve-out financial statements. For example, while several legal entities may become part of a newly formed entity in a spin-off, the parent may retain some of the legal entities' businesses through a distribution to the parent. When following a legal entity approach, we believe companies may consider SAB Topic 5.Z.7, *Accounting for the spin-off of a subsidiary*, (codified in ASC 505-60-S99-1) to determine whether certain assets and historical results of operations can be excluded from the carve-out financial statements. Such an evaluation would consider whether the operations to be excluded (1) are dissimilar compared to the remaining carve-out entity, (2) have been managed and financed historically as if they were autonomous, (3) have no more than incidental common facilities and costs, (4) will be operated and financed autonomously after the transaction, and (5) will not have material financial commitments, guarantees or contingent liabilities to each other after the transaction.

Excerpt from SEC staff interpretations**Codification of Staff Accounting Bulletins****Topic 5.Z.7, Accounting for the spin-off of a subsidiary**

Facts: A Company disposes of a business through the distribution of a subsidiary's stock to the Company's shareholders on a pro rata basis in a transaction that is referred to as a spin-off.

Question: May the Company elect to characterize the spin-off transaction as resulting in a change in the reporting entity and restate its historical financial statements as if the Company never had an investment in the subsidiary, in the manner specified by FASB ASC Topic 250, Accounting Changes and Error Corrections?

Interpretive Response: Not ordinarily. If the Company was required to file periodic reports under the Exchange Act within one year prior to the spin-off, the staff believes the Company should reflect the disposition in conformity with FASB ASC Topic 360. This presentation most fairly and completely depicts for investors the effects of the previous and current organization of the Company. However, in limited circumstances involving the initial registration of a company under the Exchange Act or Securities Act, the staff has not objected to financial statements that retroactively reflect the reorganization of the business as a change in the reporting entity if the spin-off transaction occurs prior to effectiveness of the registration statement. This presentation may be acceptable in an initial registration if the Company and the subsidiary are in dissimilar businesses, have been managed and financed historically as if they were autonomous, have no more than incidental common facilities and costs, will be operated and financed autonomously after the spin-off, and will not have material financial commitments, guarantees, or contingent liabilities to each other after the spin-off. This exception to the prohibition against retroactive omission of the subsidiary is intended for companies that have not distributed widely financial statements that include the spun-off subsidiary. Also, dissimilarity contemplates substantially greater differences in the nature of the businesses than those that would ordinarily distinguish reportable segments as defined by FASB ASC paragraph 280-10-50-10 (Segment Reporting Topic).

Considering how the underlying businesses are managed

In some circumstances, defining the carve-out entity based solely on the legal structure of the transaction may not provide the most meaningful presentation of financial information to users. For example, if the transaction results in a reorganization of entities under common control immediately prior to the disposal date (e.g., date of spin-off), the legal entities that become a part of the newly formed entity may include other businesses that will be retained by the parent through a distribution back to the parent at the time of the spin-off.

Inclusion of the businesses that will form the basis for the transaction may provide the most meaningful and relevant information for the users of the financial statements. Therefore, entities also may need to consider how the businesses were managed to help financial statement users understand the evolution of those businesses over time. This is commonly referred to as the “management approach.”

For example, if a parent plans to dispose of an operating segment (or substantially all of an operating segment), it would generally be appropriate to identify the operating segment in its entirety as the carve-out entity following a management approach. If certain activities of the operating segment (e.g., a product line) were discontinued during the historical periods, those activities would generally be included in the carve-out financial statements. Management also would consider whether any component of the carve-out entity should be presented as a discontinued operation in the historical periods. Refer to section 4.6 for further discussion.

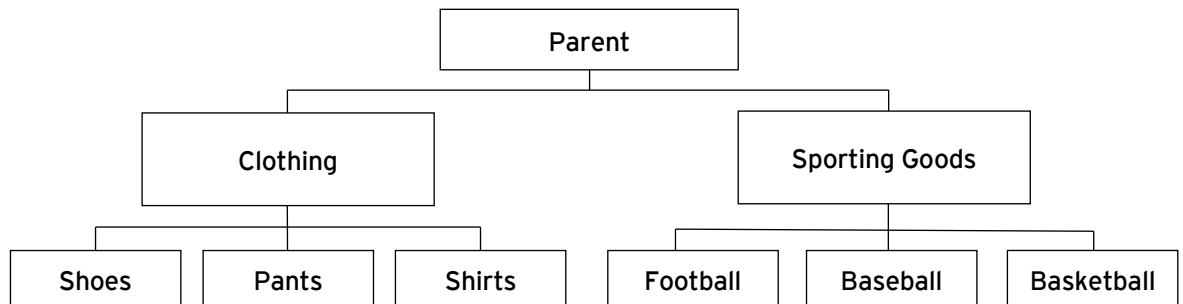
If the carve-out financial statements under the “legal entity approach” or “management approach” reflect any net assets or activities that will be retained by the parent entity, such amounts would be reflected as an adjustment in the pro forma financial information giving effect to the transaction (see section 4.8).

In summary, it may be appropriate to identify the carve-out entity using a management approach even in a transaction involving the transfer of legal entities. Such an evaluation should consider the users of the carve-out financial statements and whether such presentation provides meaningful information for their purposes and is consistent with the terms of the transaction. Depending on the complexities of the transaction, entities may wish to discuss their determination of the carve-out entity with CF-OCA in advance of filing the carve-out financial statements.

Illustration 2-2 Identification of the carve-out entity using a management approach

Parent is a manufacturer and retailer with two operating segments, Clothing and Sporting Goods.

- ▶ The Clothing operating segment includes clothing products for each product line within the Sporting Goods operating segment.
- ▶ The Sporting Goods operating segment includes the football, baseball and basketball product lines. Each of the Sporting Goods operating segment's product lines include an ancillary souvenirs business that is not significant to the entire segment.
- ▶ The Sporting Goods segment discontinued its unprofitable golf product line in the prior year.



Parent has decided to sell substantially all of its Sporting Goods segment, retaining only the ancillary souvenirs business. Based on its test of significance under Rule 1-02(w), the acquirer of the Sporting Goods business concluded it must provide two years of audited carve-out financial statements to comply with Rule 3-05.

Identification of the carve-out entity

As the businesses were historically managed under the Sporting Goods operating segment, and substantially all of the operating segment is sold, it would generally be appropriate to include the entire operating segment in the historical carve-out financial statements. The acquirer would reflect an adjustment in its pro forma financial information to remove operations and net assets related to the ancillary souvenirs business retained by Parent. To the extent the ancillary souvenirs business represented a significant component of the Sporting Goods segment, exclusion of the ancillary souvenirs business from the carve-out entity may be more meaningful to users (i.e., only present the operations of the portions of the product lines disposed of).

Activities associated with the golf product line through the date it was discontinued by Parent generally would be included in the historical carve-out financial statements because those activities also would reflect operations of the entire Sporting Goods segment.

If a parent plans to dispose of less than substantially all of an operating segment, focusing just on the discrete businesses that form the basis for the transaction may represent the most meaningful presentation for financial statement users.

Illustration 2-3 Identification of the carve-out entity in the sale of discrete components

Assume the same facts as in Illustration 2-2 except that Parent plans to sell only its football equipment (from the Sporting Goods operating segment) and football clothing (from the Clothing operating segment) product lines. The combined components are considered a business under Article 11, and based on its test of significance under Rule 1-02(w), the acquirer concluded it must provide one year of audited carve-out financial statements to comply with Rule 3-05.

Identification of the carve-out entity

The football equipment and football clothing lines have historically been managed by Parent in separate operating segments, but they do not represent substantially all of either of those operating segments. Therefore, the carve-out entity would only reflect the discrete net assets and operations of the football equipment and football clothing product lines.

2.2**Basis of presentation**

The carve-out financial statements should disclose the basis of presentation. That is, they should include transparent disclosures that describe the composition of the carve-out entity, how the financial statements were prepared, whether they are combined or consolidated, and under which financial reporting framework the financial statements were prepared. It is important to accurately describe the basis of presentation of the financial statements so users can evaluate the information provided. Combined or consolidated (or both) financial statements may be appropriate depending on the legal structure of the entities and businesses included in the carve-out entity and which presentation is more meaningful under the circumstances. See section 14 or section 20 of our FRD, *Consolidation*, for information on preparing consolidated or combined financial statements, respectively.

Key considerations used in preparing carve-out financial statements are discussed further in section 3.1. The following is an example of an entity's basis of presentation footnote in connection with a spin-off.

Illustration 2-4 Example basis of presentation footnote

The Company has historically operated as part of Parent and not as a standalone company. The accompanying combined carve-out financial statements represent the historical operations of Parent's manufacturing and distribution business and have been derived from Parent's historical accounting records. The carve-out financial statements are prepared in accordance with US GAAP. All revenues and costs as well as assets and liabilities directly associated with the business activity of the Company are included in the financial statements. The financial statements also include allocations of certain general, administrative, sales and marketing expenses and cost of sales from Parent. However, amounts recognized by the Company are not necessarily representative of the amounts that would have been reflected in the financial statements had the Company operated independently of Parent. Related party allocations are discussed further in Note XX.

As part of Parent, the Company is dependent upon Parent for all of its working capital and financing requirements as Parent uses a centralized approach to cash management and financing of its operations. Financial transactions relating to the Company are accounted for through the Net parent investment account. Accordingly, none of Parent's cash, cash equivalents or debt at the corporate level have been assigned to the Company in the financial statements. Net parent investment represents Parent's interest in the recorded net assets of the Company. All significant transactions between the Company and Parent have been included in the accompanying combined financial statements. Transactions with Parent are reflected in the accompanying Combined Statements of Changes in Equity as "Net transfers to parent" and in the accompanying Combined Balance Sheets within "Net parent investment."

All significant intercompany accounts and transactions between the businesses comprising the Company have been eliminated in the accompanying combined financial statements.

2.3 Basis of accounting in assets and liabilities

In determining the appropriate basis of accounting in the assets and liabilities of the businesses to be sold or spun off, it is important to consider the nature of the transaction and the purpose of the carve-out financial statements.

A complicating factor is that a parent and subsidiary may have different carrying amounts for the subsidiary's net assets (e.g., if pushdown accounting wasn't applied in the subsidiary's financial statements). US GAAP¹⁹ gives all acquired entities that meet the definition of a business the option to apply pushdown accounting (i.e., reflect the acquirer's basis of accounting for the acquired entity's assets and liabilities) when an acquirer obtains control of them. Refer to Appendix B of our FRD, *Business combinations*, for further information on pushdown accounting.

Because pushdown accounting is optional, we believe that a carve-out entity created from operations of a subsidiary that chose not to apply pushdown accounting in its separate financial statements would be able to choose either the subsidiary's basis or the parent's basis. However, we believe a consistent approach should be followed across the carve-out entity. For example, if the carve-out entity includes components from multiple subsidiaries under the same parent entity in which pushdown accounting had been applied to some but not all subsidiaries, we believe that the basis of the ultimate parent should be applied consistently for all components included in the carve-out financial statements.

When the parent's basis of accounting in the net assets of a subsidiary differs from that of the subsidiary that is being carved out, an entity also should consider the form of the transaction to determine which basis of accounting to use. For example, if the carve-out transaction involves a reorganization of businesses or net assets under common control, we believe that the basis used in the carve-out financial statements should be the same as the ultimate parent's basis. This is because the guidance in ASC 805-50-30-5 requires that transfers of assets or the exchange of shares between entities under common control be recognized at the historical cost of the parent. Refer to Appendix C of our FRD, *Business combinations*, for more information on accounting for transactions involving entities under common control. Considerations for specific assets and liabilities are discussed in section 3.

Excerpt from Accounting Standards Codification

Business Combinations – Related Issues

Initial Measurement

805-50-30-5

When accounting for a transfer of assets or exchange of shares between entities under common control, the entity that receives the net assets or the **equity interests** shall initially measure the recognized assets and liabilities transferred at their carrying amounts in the accounts of the transferring entity at the date of transfer. If the carrying amounts of the assets and liabilities transferred differ from the historical cost of the parent of the entities under common control, for example, because **pushdown accounting** had not been applied, then the financial statements of the receiving entity shall reflect the transferred assets and liabilities at the historical cost of the parent of the entities under common control.

¹⁹ ASC 805-50-25-4.

2.4 Accounting principles

We believe the carve-out entity would generally follow the accounting principles of the entity from which it is being carved out to reflect the accounting for the carve-out operations under the parent entity. However, given the possibility that determinations about materiality might change (as described in section 2.5), management of the carve-out entity may need to revisit accounting principles for items that were considered immaterial in the former parent's consolidated financial statements. In accordance with ASC 250-10-45-1,²⁰ the initial adoption of an accounting principle to recognize events or transactions that previously were immaterial is not a change in accounting principle. However, any change from the parent's current accounting principle would have to be justified as preferable, and the financial statements would be retrospectively revised, unless it is impractical to do so, in accordance with ASC 250.

US GAAP does not require a parent and its subsidiaries to follow the same accounting principles. Therefore, components of a carve-out entity may apply different alternatives to account for a transaction, and their practices would generally not be adjusted to conform in the combined or consolidated carve-out financial statements. For example, if a component of the carve-out entity applies the first-in, first-out (FIFO) method for inventory accounting but another component of the carve-out entity applies the last-in, first-out (LIFO) method, a change in accounting to conform the inventory policies is not required.

The carve-out entity also may need to reassess the historical application of accounting policies and standards (e.g., accounting for intercompany transactions, impairment tests). This is discussed in section 3 for certain accounts and transactions.

Refer to our FRD, *Accounting changes and error corrections*, for additional guidance on changes in accounting principles.

2.4.1 Adoption of new accounting standards

A carve-out entity is subject to the adoption of new accounting standards, which they generally will adopt at the same time as the parent entity. When determining when a carve-out entity is required to adopt a new accounting standard, management should consider the purpose of the financial statements (e.g., whether the financial statements will be included in an SEC filing or used for internal reporting purposes). If the carve-out entity's financial statements will be filed with the SEC, management should also determine what type of issuer the carve-out entity will be. For example, if the carve-out entity qualifies as an emerging growth company or a smaller reporting company, it would be eligible to follow the transition provisions applicable to non-public business entities.

Refer to our FRD, *Accounting changes and error corrections*, for additional guidance on the adoption of new accounting standards.

2.5 Materiality

When preparing carve-out financial statements, materiality is considered in the context of the carve-out entity. This is likely to result in different materiality thresholds from those used in preparing the parent's consolidated financial statements. Materiality also could change if the carve-out financial statements are prepared for different users than the parent's financial statements.

The carve-out entity also should reconsider the level of precision that was used to apply accounting policies, such as capitalization thresholds.

²⁰ ASC 250, *Accounting Changes and Error Corrections*.

2.6 Internal control over financial reporting

Management of the parent entity may need to design specific processes and controls to prepare carve-out financial statements. While the parent's existing controls may be used in some instances, the internal controls for the carve-out financial statements need to be designed to prevent or detect material misstatements or omissions with respect to those financial statements. This may require changes to the parent's existing controls or the addition of new controls.

Refer to our FRD, *Accounting changes and error corrections*, for additional guidance.

2.7 Evaluate available information

As a starting point, management may evaluate what it reports internally and externally about the carve-out operations. For example, if the carve-out entity represents a single operating segment or reporting unit of the former parent, identifying the assets and liabilities of the carve-out entity and allocating costs would likely require less effort than if the carve-out entity consisted of portions of different operating segments or reporting units. Management also may consider existing accounting ledgers of entities in the carve-out group and review historical cost allocations or parent charges. However, these cost allocations may require adjustments to reflect all the costs of doing business.

The more information that is available at an appropriate level of disaggregation consistent with the composition of the carve-out entity, the less challenging it will be to prepare the carve-out financial statements.

2.8 Use of hindsight

Generally, hindsight should not be used to prepare carve-out financial statements. The carve-out entity should use information that was available at the time that the parent entity was preparing its historical financial statements. For example, a carve-out entity's valuation allowance evaluation should be based on the carve-out entity's taxable income projections available at the historical assessment date and should not consider hindsight. Refer to section 3.13.2 for information about calculating deferred taxes for carve-out financial statements.

If errors in previously issued financial statements are identified at the parent entity that would impact the carve-out entity, the carve-out entity should consider the appropriate accounting when preparing its financial statements.

3 Key accounting and financial reporting considerations

3.1 Key considerations for preparing carve-out financial statements

Below are key considerations that may be applied when preparing carve-out financial statements to present the carve-out entity as it operated in the periods presented under its former parent entity.

Carve-out entity financial statements generally include balance sheet and income statement allocations. The balance sheet of a carve-out entity should generally include assets currently or formerly owned by the carve-out entity and liabilities that are or were the legal responsibility of the carve-out entity, while the income statement of a carve-out entity should generally reflect the carve-out entity's costs of doing business. As a result, it is possible for a carve-out entity's income statement to include an allocation for costs related to using an asset that isn't reflected on the carve-out entity's balance sheet because the asset is owned by the parent entity.

3.1.1 Assets and liabilities

The determination of which assets and liabilities are recognized by the carve-out entity will be influenced by how the carve-out entity is defined as discussed in section 2.1. When legal entities exist within the carve-out entity, the determination of which assets and liabilities are recognized by the carve-out entity will generally be more straightforward. The determination may be more complex and require more judgment if the carve-out entity lacks a well-defined legal structure.

Consideration may be given to which entity legally owned the assets or was legally required to settle the liability in the historical periods. We believe the carve-out entity should recognize assets and liabilities it has legal title to by virtue of its composition (i.e., when an entity within the carve-out entity has legal ownership). Consideration also may be given to the legal form of the transaction that is giving rise to the need for carve-out financial statements, including which assets and liabilities will be included in the newly formed entity or otherwise transferred to a buyer. For example, assets and liabilities relating to the operations of the carve-out entity that are transferred in the transaction would generally be recognized by the carve-out entity.

The carve-out entity also may evaluate the extent to which other assets and liabilities were used in or created by its historical operations. We believe that when an asset or liability (or component of an asset or liability) was exclusively used in or created by the carve-out entity's historical operations, the asset or liability is directly attributable to the carve-out entity and should be recognized in its financial statements. For example, a component of the parent entity's accounts receivable may be directly attributable to the carve-out business and would be recognized in the carve-out financial statements. See further discussion in section 3.3.

Evaluating assets and liabilities that are recognized by the parent entity as a single unit of accounting (e.g., building) but shared among the parent and its consolidated businesses (including the carve-out business) requires judgment. Due to the nature of the item as a single unit of accounting, we believe it would be inappropriate to allocate a portion of such an asset or liability (e.g., a portion of a building). The carve-out entity will, therefore, need to determine whether to recognize the entire shared asset or liability or not recognize it at all.

When the carve-out entity does not recognize a shared asset or liability, it may still need to recognize an expense in its financial statements to reflect the costs attributable to the carve-out business as it operated under the parent entity. The carve-out entity should develop a reasonable and supportable methodology to recognize an expense associated with its use of such assets or incurrence of such liabilities. Such an expense would generally result in the recognition of an intercompany amount due to or from the parent entity. This intercompany amount also may be recognized in the statement of changes in equity as part of a net investment of the parent. See section 3.1.3 for further discussion of allocating costs attributable to the carve-out business and section 3.14 for additional information regarding intercompany transactions.

3.1.2 Revenue and cost of sales

Revenue and cost of sales associated with the carve-out business should be reflected for each of the historical periods presented. Whether the carve-out entity is an operating segment or a product line, the parent often has readily available information about revenue and cost of sales that is directly attributable to the carve-out entity. The carve-out entity also may need to consider whether intercompany transactions with its parent entity should be reflected as revenue or cost of sales in the carve-out financial statements. See section 3.14 for additional information regarding intercompany transactions.

3.1.3 Other expenses

Another aspect of preparing carve-out financial statements is reflecting all the costs of doing business as discussed in SAB Topic 1.B.1 (codified in ASC 220-10-S99-3) below.

Excerpt from SEC staff interpretations

Codification of Staff Accounting Bulletins

Topic 1.B.1, Costs reflected in historical financial statements

Question 1: Should the subsidiary's historical income statements reflect all of the expenses that the parent incurred on its behalf?

Interpretive Response: In general, the staff believes that the historical income statements of a registrant should reflect all of its costs of doing business. Therefore, in specific situations, the staff has required the subsidiary to revise its financial statements to include certain expenses incurred by the parent on its behalf. Examples of such expenses may include, but are not necessarily limited to, the following (income taxes and interest are discussed separately below):

1. Officer and employee salaries,
2. Rent or depreciation,
3. Advertising,
4. Accounting and legal services, and
5. Other selling, general and administrative expenses.

When the subsidiary's financial statements have been previously reported on by independent accountants and have been used other than for internal purposes, the staff has accepted a presentation that shows income before tax as previously reported, followed by adjustments for expenses not previously allocated, income taxes, and adjusted net income.

Question 2: How should the amount of expenses incurred on the subsidiary's behalf by its parent be determined, and what disclosure is required in the financial statements?

Interpretive Response: The staff expects any expenses clearly applicable to the subsidiary to be reflected in its income statements. However, the staff understands that in some situations a reasonable method of allocating common expenses to the subsidiary (e.g., incremental or proportional cost allocation) must be chosen because specific identification of expenses is not practicable. In these situations, the staff has required an explanation of the allocation method used in the notes to the financial statements along with management's assertion that the method used is reasonable.

In addition, since agreements with related parties are by definition not at arms length and may be changed at any time, the staff has required footnote disclosure, when practicable, of management's estimate of what the expenses (other than income taxes and interest discussed separately below) would have been on a stand alone basis, that is, the cost that would have been incurred if the subsidiary had operated as an unaffiliated entity. The disclosure has been presented for each year for which an income statement was required when such basis produced materially different results.

While the SAB Topic specifically addresses the SEC staff's views in the context of registration statements pursuant to the 1933 Act, the SEC staff also expects registrants to follow it in 1934 Act reports (e.g., Form 8-K). Therefore, when the financial statements of an acquired business that was part of another entity are presented in Form 8-K in accordance with Rule 3-05, the principles of the SAB Topic should also be applied to those financial statements.

SAB Topic 1.B.1 requires that the separate financial statements (e.g., carve-out financial statements) reflect all costs of doing business. This includes costs incurred by the parent that are directly attributable to the carve-out entity's operations as well as the entity's allocable share of other corporate costs. The SAB Topic lists the following as examples of allocable expenses:

- ▶ Officer and employee salaries
- ▶ Rent or depreciation
- ▶ Advertising
- ▶ Accounting and legal services
- ▶ Other selling, general and administrative expenses

Reflecting all costs of doing business may require an entity to reflect costs that were not previously allocated or charged by the former parent. In determining these costs, it is helpful to consider them in three broad categories to assess how clearly they relate to the carve-out entity, as the following chart shows:

| Cost type | Approach | Example |
|--|---|---|
| Directly attributable to carve-out entity | Allocate 100% to carve-out entity | <i>Environmental reserve expense related to a carve-out entity site that was historically recorded on the corporate general ledger</i> |
| Shared (partly related to carve-out entity, partly related to another business) | Use a reasonable allocation method (e.g., proportional allocation) in all periods | <i>Corporate expense associated with the C-suite and human resources function for the consolidated parent historically recorded on corporate general ledger</i> |
| Not related to carve-out entity | Do not allocate to carve-out entity financial statements | <i>Expense associated with obsolete inventory unrelated to the carve-out entity</i> |

The SEC staff expects costs that are clearly applicable to the carve-out entity (e.g., due to the ownership of an asset or obligation to settle a liability of the carve-out entity) to be reflected in its income statement. Shared costs that were covered by the former parent or were shared by other subsidiaries should be allocated based on a rational and consistent methodology in all periods presented. The methodology used to allocate a particular shared cost should provide the best reflection of the activity and cost in the historical periods. For example, a methodology might include the use of sales, headcount or square footage depending on the nature of the cost. Further, existing shared cost pools of the parent entity should be evaluated to determine whether any costs are specific to the carve-out entity or other operations not included in the carve-out entity and, therefore, would be excluded from the shared cost pool.

The SEC staff expects any expenses clearly applicable to the carve-out entity to be reflected in the entity's income statements. However, the staff understands that in some situations a reasonable method of allocating common expenses to the entity (e.g., a proportional cost allocation) is appropriate because identifying specific expenses is not practicable. Under SAB Topic 1.B.1, the SEC staff requires registrants to provide an explanation in the notes to the financial statements of the allocation methods used and an assertion by management that the method is reasonable. The SEC staff often requests that management disclose that the carve-out financial statements reflect all the costs of doing business, including expenses incurred by the former parent on the carve-out entity's behalf.

The SAB Topic also requires management to disclose an estimate of what the expenses (other than income taxes and interest) would have been on a standalone basis (i.e., if the carve-out entity had operated as an unaffiliated entity), unless it is impracticable to do so. If it is impracticable to do so, the SEC staff often asks that management explicitly disclose this in the carve-out financial statements.

Below is an example disclosure for a spin-off transaction that describes how an entity disclosed its cost allocations.

Illustration 3-1 Example disclosure on cost allocations in a spin-off

The historical costs and expenses reflected in our financial statements include an allocation for certain corporate and shared service functions historically provided by our former Parent, including, but not limited to, executive oversight, accounting, treasury, tax, legal, human resources, occupancy, procurement, information technology, and other shared services. These expenses have been allocated to us on the basis of direct usage when identifiable, with the remainder allocated on a pro rata basis of consolidated sales, headcount, tangible assets or other measures considered to be a reasonable reflection of the historical utilization levels of these services.

Management believes the assumptions underlying our consolidated financial statements, including the assumptions regarding the allocation of general corporate expenses from our former Parent, are reasonable. Nevertheless, our consolidated financial statements may not include all of the actual expenses that would have been incurred had we operated as a standalone company during the periods presented and may not reflect our consolidated results of operations, financial position and cash flows had we operated as a standalone company during the periods presented. Actual costs that would have been incurred if we had operated as a standalone company would depend on multiple factors, including organizational structure and strategic decisions made in various areas, including information technology and infrastructure. We also may incur additional costs associated with being a standalone, publicly listed company that were not included in the expense allocations and, therefore, would result in additional costs that are not reflected in our historical results of operations, financial position and cash flows.

3.2 Cash and cash equivalents

Cash, cash equivalents and amounts generally described as restricted cash or cash equivalents legally held by the carve-out entity (when legal entities exist within the carve-out entity) should be included in the carve-out financial statements. However, consolidated entities often have centralized cash management arrangements in which excess cash is swept into a cash pool with cash from other entities. These types of sweep accounts generally are parent entity bank accounts that are used to fund the cash requirements of the other entities in the arrangement.

Questions may arise about whether the deposits of the carve-out entity in the central cash account should be classified as cash and cash equivalents. We believe the conclusion of whether funds held in a cash pool are classified as cash or cash equivalents on the carve-out entity's standalone financial statements is based on the legal structure of the arrangement (i.e., who controls such funds).

If the carve-out entity does not control the funds held in the cash pool, it would recognize them as a note due from a parent, rather than as cash. Additionally, a note due from a parent entity, even if payable on demand or within three months of notice of repayment (regardless of whether the note presents an insignificant risk of changes in value due to changes in interest rates), generally would not be considered a cash equivalent. Rather, such notes are considered loans, and the carve-out entity generally would classify them as receivables from the parent. See section 3.14 for further discussion of accounting for intercompany transactions.

In circumstances in which the carve-out entity did not historically have cash balances, the carve-out entity should still include the effects of cash activities on its statement of cash flows. Refer to section 4.2 for considerations in preparing the statement of cash flows.

3.3 Other current assets and liabilities

The considerations in section 3.1.1 may be applied to determine which assets and liabilities should be reflected in the carve-out financial statements. The complexity of this determination may vary depending on the nature of the assets and liabilities, the extent of centralized processing or the extent of detailed information associated with accounting records supporting the account balances.

Additionally, the carve-out entity may need to develop a reasonable and supportable methodology to recognize an expense associated with its use of assets or incurrence of liabilities of the parent entity.

3.3.1 Centralized processing

Questions often arise on how centrally processed account balances (e.g., receivables, payables) should be reflected in the carve-out financial statements due to a lack of entity-specific information for each transaction in the general ledger. We believe that transaction-specific information should be evaluated to determine which components of the account balance relate to the carve-out entity. An entity may need to review ledger details on this activity.

Illustration 3-2 Example of accounts receivable

ABC is a multinational manufacturing company with numerous subsidiaries and product lines. It has a shared service center to process billing (including maintenance of the accounts receivable subledger) company-wide. ABC completes a transaction to sell certain businesses that make up certain product lines, and the agreement stipulates that carve-out financial statements are required. The balances comprising the accounts receivable ledger are not segregated at a product line level and need to be analyzed to identify which receivables relate to the carve-out entity.

ABC analyzes transactional information to identify which receivable balances relate to the carve-out entity. ABC examines the customer name/number, contract number or product number in its customer invoices to identify the receivables that directly relate to the carve-out entity (based on the customers and related products attributable to the carve-out entity).

Further analysis may be necessary if customers buy several types of products and only some of them are directly attributable to the carve-out entity. In addition, ABC may need to analyze the unapplied cash, rebates or discounts that are attributable to the carve-out entity.

Illustration 3-3 Example of liabilities

ABC is a multinational manufacturing company with numerous subsidiaries and product lines. It has a centralized procurement department to facilitate material purchases and a shared service center to process routine transactions company-wide (including accounts payable). ABC completes a transaction to sell certain businesses that make up certain product lines, and the agreement stipulates that carve-out financial statements are required. The balances comprising the accounts payable ledger are not segregated at a product line level and need to be analyzed to identify which payables relate to the carve-out entity.

ABC analyzes transactional information to identify which payables relate to the carve-out entity. ABC examines the "ship to" address included on the vendor invoices to identify payables that relate to the carve-out entity (based on the addresses of businesses included in the carve-out entity). For payables where the ship to address is not specified on the vendor invoice, ABC examines the type and/or stock keeping unit (SKU) of materials purchased.

3.4

Allowances for receivables and loans (updated April 2026)

A carve-out entity that records accounts or loans receivable in its financial statements should consider whether a credit loss allowance should be separately recognized under ASC 326. As credit loss must be evaluated based on the loans and receivables included in the carve-out financial statements, the unit of accounting for the carve-out entity may differ from the parent entity. This would be the case if one or more, but not all, of the loans or receivables in the parent's unit of accounting are attributable to the carve-out entity.

Under ASC 326, an entity is required to determine an estimate of expected credit losses measured over the contractual life of the receivable or loan and record an allowance that, when deducted from the amortized cost²¹ basis of the asset, reflects the net amount expected to be collected. In addition to information about past events and current conditions, the current expected credit loss (CECL) allowance should reflect the risk of loss, even when that risk is remote, and it should consider reasonable and supportable forecasts of future economic conditions unless the entity applies the practical expedient in ASC 326-20-35-10C. We believe that such conditions should be evaluated based on the specific facts and circumstances that existed on the balance sheet date of the carve-out financial statements (i.e., hindsight is not considered).

Entities that elect to apply the practical expedient in ASC 326-20-30-10C may assume that the current conditions as of the balance sheet date remain unchanged for the remaining life of the asset in the development of a reasonable and supportable forecast when estimating expected credit losses for certain current accounts receivable.

²¹ For short-term receivables, the amortized cost will generally be the same as the carrying value (i.e., unpaid principal balance) of the financial asset. See our FRD, *Credit impairment under ASC 326*, for further information on the components of a financial asset's amortized cost basis.

See our FRD, [Credit impairment under ASC 326](#), for further guidance on applying the credit impairment standard.

3.5 Inventory

The carve-out entity may need to develop an attribution method to identify inventory and related inventory reserves that should be recognized in the carve-out financial statements. While finished goods inventory may be more easily attributed to the carve-out entity financial statements, it may be challenging to attribute raw materials or work-in-process inventory to the carve-out entity.

For example, if the company has raw material inventory that may be used by the carve-out entity to produce goods but is also a product used by the parent entity to produce goods, the company should develop an attribution method to identify the portion of raw material inventory that should be recorded in the carve-out entity's financial statements. Additional challenges may arise if the carve-out entity uses the LIFO method to account for inventory.

3.6 Long-lived assets

The considerations in section 3.1.1 may be applied to determine which long-lived assets should be reflected in the carve-out financial statements.

3.6.1 Long-lived assets used by the carve-out entity and the parent entity

Long-lived assets are frequently used by multiple entities or multiple components of entities. Questions often arise regarding how the cost or carrying amount of shared long-lived assets should be reflected in the carve-out entity financial statements. We do not believe it is appropriate to allocate a portion of a long-lived asset's carrying amount to the carve-out entity. That is, it is not appropriate to separate a portion of a long-lived asset that was recognized as a single unit of accounting. We believe judgment will be required to determine whether the carve-out entity should recognize the entire asset. In making its decision, management may consider which entity has legal title to the long-lived asset, whether the long-lived asset relates to the operations of the carve-out entity and will be transferred as part of the transaction and the extent of its use in the historical operations of the carve-out entity.

A carve-out entity that reflects the carrying amount of a long-lived asset on its balance sheet also recognizes the asset's depreciation expense. When the parent entity uses a portion of a long-lived asset recognized by the carve-out entity, the amount of parent entity expense (e.g., corporate expenses, shared service costs) allocated to the carve-out entity may be reduced to reflect the parent company's usage of the asset. A carve-out entity that does not reflect the carrying amount of a long-lived asset on its balance sheet (i.e., it is recognized by the parent) should recognize an operating expense to reflect its usage of the long-lived asset in accordance with SAB Topic 1.B.1.

Illustration 3-4 Example of shared long-lived assets

The parent and carve-out entity share a building used for management activities (e.g., sales offices, business development). The parent has legal title and will retain ownership of the building after the completion of the transaction. The building comprises 75 offices; 70 are used by the parent entity and five are used by the carve-out entity. The square footage of each office is the same.

The building would not be recognized in the carve-out financial statements since the parent entity owns it and will retain it after the transaction, and the building is not extensively used in the carve-out entity operations. However, the carve-out entity should recognize an operating expense in its income statement to reflect its use of the building in accordance with SAB Topic 1.B.1.

3.6.2 Impairment considerations

A carve-out entity may identify different asset groups for impairment testing under ASC 360²² than the parent historically did. If impairment indicators are present (for current or historical reporting periods), the carve-out entity should identify its asset groups using the assets recognized in the carve-out financial statements and group them at the lowest level for which identifiable cash flows are largely independent of cash flows from other assets and liabilities in accordance with ASC 360-10-35-23. Impairment indicators should be evaluated at the points in time in the historical periods at which the indicators existed, and subsequent facts and circumstances (e.g., improved performance) should not be used to determine whether an impairment indicator existed. Similarly, the cash flows used to test recoverability and/or measure an impairment loss should be based on information available at that historical impairment assessment date.

Consideration also should be given to whether the transaction giving rise to the carve-out financial statements results in an impairment indicator as defined in ASC 360, as of the most recent balance sheet date, for assets recognized by the carve-out entity. For example, an impairment indicator may exist if the transaction sales price is below the carrying value of the net assets in the carve-out financial statements. If an impairment indicator is present, the parent entity and carve-out entity may reach different conclusions about the classification of an asset group or the measurement of an impairment. The parent entity may conclude that the asset group should be classified as held for sale in its consolidated financial statements; however, the carve-out entity would classify the asset group as held and used unless the assets meet the definition of held for sale based on the facts and circumstances of the carve-out entity. The parent entity also may conclude that the asset group is impaired at the carve-out transaction date; however, the carve-out entity would need to separately evaluate and measure impairment based on the classification of the asset group, which would generally be on a held-and-used basis.

3.7 Goodwill

Management should consider whether any goodwill recognized by the parent entity is attributable to the carve-out entity and should be reflected in the carve-out financial statements. As part of this assessment, management should consider the basis of accounting in the assets and liabilities that will be reflected in the carve-out financial statements (i.e., whether the assets and liabilities will be reflected at the ultimate parent's basis). See section 2.3 for additional considerations for evaluating the basis of accounting for assets and liabilities.

To reflect goodwill in the carve-out financial statements using the parent's basis, we generally believe a "historical goodwill concept" would be applied. That is, the amount of goodwill recognized at an acquisition date related to an earlier acquisition of a business (i.e., acquisition-specific goodwill) that is included in the carve-out entity would be presented in the carve-out financial statements.

The amount of goodwill recorded in the carve-out financial statements may differ from the amount assigned by the parent as part of its accounting for the disposition. See section 3.14 of our FRD, *Intangibles – Goodwill and other*, for parent entity considerations for disposing of all or a portion of a reporting unit.

Because goodwill attributed to the carve-out entity using the parent's basis is acquisition-specific, it may include synergistic goodwill that the parent entity previously assigned to other reporting units that were expected to benefit from the synergies of the business combination.

²² ASC 360, *Property, Plant, and Equipment*.

Illustration 3-5 Acquisition-specific goodwill

On 1 January 20X8, Company A acquires Business B for consideration transferred of \$200 million. The fair value of the identifiable net assets acquired is \$160 million and goodwill is \$40 million. Business B will be placed in reporting unit RU3. RU3 also includes the net assets (\$100 million) and goodwill (\$20 million) of Business C, which was acquired by Company A on 1 January 20X6. As part of the Business B acquisition, Company A's two other reporting units (RU1 and RU2) are expected to benefit from the synergies of the combination. As such, Company A assigns goodwill of \$30 million to RU3, \$6 million to RU1 and \$4 million to RU2. Assume that prior to the acquisition, RU1 and RU2 had no goodwill recorded. In addition, none of the acquired assets and assumed liabilities were assigned to RU1 or RU2.

| (In millions) | RU 1 | RU 2 | RU 3 | Total |
|---------------------------------|----------|----------|-------------------------|-----------|
| Net assets (excluding goodwill) | \$ 60 | \$ 50 | \$ 260 ⁽¹⁾ | \$ 370 |
| Goodwill | <u>6</u> | <u>4</u> | <u>50⁽²⁾</u> | <u>60</u> |
| Total net assets | \$ 66 | \$ 54 | \$ 310 | \$ 430 |

On 1 January 20X1, Company A decides to spin off Business B. As of 1 January 20X1, the fair value of RU3 was \$350 million (\$245 million related to Business B and \$105 million related to Business C).

Analysis*Accounting by parent (Company A)*

In determining the amount of goodwill to derecognize, Company A should use the relative fair value approach. As such, Company A should derecognize goodwill of \$35 million [$(\$245 \text{ million} / \$350 \text{ million}) \times \50 million] associated with the spin-off of Business B. Note that none of the goodwill assigned to RU1 and RU2 is considered in determining the amount of goodwill to derecognize. The remaining goodwill balance in RU3 should be tested for impairment in accordance with ASC 350-20-40-7.

Accounting by spinnee (comprising Business B as the carve-out entity)

The standalone financial statements of the spinnee would include goodwill of \$40 million. Because Business B accounts for the goodwill using the historical goodwill concept, the \$40 million acquisition-specific goodwill related to Company A's acquisition of Business B on 1 January 20X8 would be presented in the standalone financial statements of Business B.

¹ Business B's net assets (excluding goodwill) of \$160 million plus Business C's net assets (excluding goodwill) of \$100 million.

² Business B's goodwill of \$30 million (\$40 million less \$10 million assigned to RU1 and RU2) plus Business C's goodwill of \$20 million.

Additional complexities may arise if the carve-out entity comprises businesses that were acquired at various points in time and/or were acquired by the parent as part of a larger acquisition. If the carve-out entity represents only a portion of a previously acquired business, we believe that management should develop a reasonable and supportable methodology for determining the acquisition-specific goodwill attributable to the carve-out entity. For example, an approach may include attribution based on the portion of the fair value of the acquired business included in the carve-out entity compared to the fair value of the acquired business as a whole on the date of that acquisition.

Illustration 3-6 Allocation of historic goodwill based on fair value

On 1 January 20X4, Company A acquires Business B and records \$40 million of goodwill. Business B includes Divisions 1, 2 and 3.

On 1 January 20X9, Company A decides to spin off Division 1 and prepares carve-out financial statements. Company A compares the fair value of Division 1 and Business B on their acquisition date (i.e., 1 January 20X4) and concludes that Division 1 represented 40% of the fair value of Business B at that time. The Division 1 carve-out entity is allocated \$16 million of acquisition-specific goodwill (40% x \$40 million).

3.7.1**Allocating goodwill when pushdown accounting was not applied**

Situations may arise when the business to be disposed of is carved out from an entity in which pushdown accounting was not applied in the historical financial statements. As discussed in section 2.3, we do not believe that the carve-out entity always would be required to use the ultimate parent's basis (i.e., apply pushdown accounting). The carve-out entity may use the basis reflected in the subsidiary from which it is being carved out. In this case, goodwill recognized in the carve-out financial statements may vary depending on whether the basis in the assets and liabilities reflects the basis of the ultimate parent or the subsidiary from which it is being carved out. However, we believe a consistent approach should be followed across the carve-out entity. Further, the basis used to allocate goodwill also must be the same as the basis used in the recognition and measurement of other assets and liabilities. Consider the following example:

Illustration 3-7 Pushdown accounting was not applied

On 1 January 20X3, Subsidiary S acquires Business B and recognizes \$10 million of goodwill with respect to its acquisition of Business B. Business B is merged into the business of Subsidiary S. Subsidiary S has no other goodwill balances. On 1 January 20X6, Parent P acquires Subsidiary S in a business combination and recognizes \$30 million of goodwill with respect to its acquisition of Subsidiary S. Subsidiary S does not elect to apply pushdown accounting in its separate standalone financial statements.

On 1 January 20X9, Subsidiary S decides to sell Business B and prepares carve-out financial statements in anticipation of the sale.

Analysis

Alternative A – Subsidiary S prepares the carve-out financial statements using the basis as reflected by Subsidiary S. The goodwill recognized by Subsidiary S when it acquired Business B was \$10 million. Accordingly, the carve-out financial statements for Business B would reflect goodwill of \$10 million.

Alternative B – Subsidiary S prepares the carve-out financial statements using the ultimate parent's basis. In doing so, it compares the fair value of Business B and Subsidiary S on the date it was acquired by Parent P (1 January 20X6) and concludes that Business B represented 50% of the fair value of Subsidiary S at that time. Accordingly, the carve-out financial statements of Business B would reflect goodwill of \$15 million (50% x \$30 million).

As discussed in section 2.3, we believe that an entity should consider the nature and form of the transaction to determine the basis of accounting when the ultimate parent has a basis that differs from that of the subsidiary from which the business is being carved out. For example, in Illustration 3-7 above, if the transaction giving rise to the need for carve-out financial statements will result in the transfer of Business B into a newly formed entity (e.g., common control transaction) in preparation for a spin-off transaction, we believe that the goodwill reflected in the carve-out financial statements would follow Alternative B in accordance with ASC 805-50-30-5.

3.7.2 Impairment considerations

Once the amount of goodwill attributable to the carve-out entity has been determined, management must assess goodwill for impairment based on the reporting units of the carve-out entity. Consistent with the guidance in ASC 350-20-35-41, the methodology used to determine the amount of goodwill to assign to a reporting unit must be reasonable and supportable and applied in a consistent manner, considering the reporting units as of the acquisition date on which goodwill was initially recorded and any subsequent changes in the carve-out entity's reporting structure. See section 3.11 of our FRD, *Intangibles – Goodwill and other*, for further information on assigning goodwill to reporting units.

The carve-out entity's tests for goodwill impairment may yield an impairment charge that was previously not recognized by the parent. For example, assume a reporting unit at the parent entity (RU1) is separated into two reporting units (RUA and RUB) for the carve-out entity. At the parent-entity level, the fair value of RU1 has historically exceeded its carrying amount and no impairment has been recognized. However, RUB has recently experienced significant losses while RUA has been historically profitable. When goodwill is tested at the RUA and RUB levels, the carve-out entity may conclude that the RUB goodwill is impaired even though no impairment was previously recognized by the parent entity. When making this assessment, management should consider the information that was available at the date the impairment tests would have been performed by the parent.

3.7.2.1 Identification of operating segments and reporting units

To identify a carve-out entity's reporting units, management must first identify the operating segments based on the internal reporting structure of the carve-out entity. Refer to section 2.1 for further discussion on identifying the carve-out entity.

Operating segments are components of the carve-out entity that (1) engage in business activities from which they may earn revenues or incur expenses, (2) have their operating results regularly reviewed by the carve-out entity's chief operating decision-maker (CODM) to allocate resources and assess performance and (3) have discrete financial information. The CODM of the carve-out entity is the individual or individuals within the carve-out entity who evaluate the operating results to assess performance and allocate resources. See section 2 of our FRD, *Segment reporting*, for more information on identifying the CODM and operating segments.

A reporting unit is an operating segment or one level below the operating segment (referred to as a component). A component of an operating segment is a reporting unit of the carve-out entity if the component constitutes a business or a nonprofit activity for which discrete financial information is available and segment management of the carve-out entity regularly reviews the operating results of that component. Two or more components of an operating segment must be aggregated and deemed a single reporting unit if the components have similar economic characteristics. See section 3.8 of our FRD, *Intangibles – Goodwill and other*, for further information on the identification of reporting units.

In determining the CODM, operating segments and reporting units, management must carefully consider the facts and circumstances of the carve-out entity. This evaluation may result in a CODM, operating segments and reporting units that differ from those of the parent entity.

Illustration 3-8 Identification of reporting units

ABC Company has identified its CEO as its CODM and has two operating segments, the clothing and accessories divisions. The VP of Clothing is the segment manager of the clothing division and regularly reviews the discrete financial information for the two components of the clothing operating segment, casual wear and active wear. ABC Company determined that casual wear and active wear have similar economic characteristics and, therefore, represent a single reporting unit.

ABC Company decides to spin off the clothing division and prepares carve-out financial statements. The VP of Clothing is determined to be the CODM of the carve-out entity and two operating segments are identified, casual wear and active wear. The carve-out entity concludes that its operating segments are also its two reporting units, casual wear and active wear. The carve-out entity is unable to aggregate casual wear and active wear as they represent separate operating segments.

Anticipated changes should not be considered in the analysis. For example, if it is expected that the carve-out entity will reorganize its structure after it is spun off from the parent entity, the expected change is not reflected in the determination of its operating segments and reporting units for purposes of the goodwill impairment test. Such changes would not be considered until the restructuring occurs and are accounted for on a prospective basis in accordance with ASC 350-20-35-45.

3.7.3 Goodwill disclosure considerations

If a carve-out entity's financial statements include goodwill, the entity must meet the disclosure requirements in ASC 350-20-50-1 and ASC 350-20-50-1A. See section 4.2.1 of our FRD, *Intangibles – Goodwill and other*, for information on goodwill disclosure requirements and sections 3.7 and 3.7.1 above for guidance on allocating goodwill to the carve-out entity.

3.8 Intangible assets

When identifying intangible assets attributable to the carve-out entity, management should consider the basis of accounting in the assets and liabilities that will be reflected in the carve-out financial statements (i.e., whether the assets and liabilities will be reflected at the ultimate parent's basis). See section 2.3 for additional considerations when evaluating the basis of accounting for assets and liabilities. The considerations in section 3.1.1 may be applied to determine which intangible assets should be reflected in the carve-out financial statements.

It may be difficult to identify a carve-out entity's intangible assets if the assets are shared between the carve-out entity and the parent. For example, assume that the carve-out entity and parent entity use an indefinite-lived brand name equally. If ownership of the brand name is expected to be included in the disposal or spin-off, we believe that the brand intangible asset should be included in the carve-out financial statements. However, if the business to be disposed of will not own the brand name but will license it from the parent entity, we believe the brand intangible asset should not be reflected in the financial statements of the carve-out entity. In either scenario, the carve-out entity would not reflect an operating expense related to the indefinite-lived intangible asset if the carve-out entity has not historically been charged for use of the brand.

If the carve-out entity reflects the carrying amount of a finite-lived intangible asset on its balance sheet, the corresponding amortization expense also would be recognized. However, even if the carve-out entity does not reflect the carrying amount of the finite-lived intangible asset, it should use a reasonable allocation method and recognize an operating expense to reflect its usage of the finite-lived intangible asset.

3.8.1 Impairment considerations

When the carve-out entity has indefinite-lived intangible assets, impairment must be evaluated based on the assets assigned to the carve-out entity. First, management must determine the unit of accounting for purposes of impairment testing for the assets assigned to the carve-out entity in accordance with ASC 350-30-35-21 through 35-28. If indefinite-lived intangibles are operated as a single asset within the carve-out entity and, as such, are essentially inseparable from one another, they must be combined into a single unit of accounting for impairment testing.

The unit of accounting for the carve-out entity may differ from that of the parent entity. This would be the case if one or more, but not all, of the indefinite-lived intangible assets in the parent's unit of accounting are attributable to the carve-out entity. If the carve-out entity's unit of accounting differs from that of the parent entity, management should assess the indefinite-lived intangible assets for impairment. When making this assessment, management should consider the information that was available when the assets were tested for impairment by the parent.

For additional parent entity considerations for disposal transactions that will result in the derecognition of an indefinite-lived intangible asset that was previously combined with other indefinite-lived intangible assets of the parent entity for impairment purposes, see section 2.3.3.1 of our FRD, *Intangibles – Goodwill and other*.

Finite-lived intangible assets are reviewed for impairment in accordance with the guidance on impairment of long-lived assets in subsections of ASC 360-10. See section 3.6.2 for impairment considerations for long-lived assets.

3.9 Compensation matters (updated April 2026)

The carve-out financial statements should reflect the compensation (e.g., salaries, deferred compensation, bonuses) of the employees who provided services to the carve-out entity. That compensation should be proportionate to the services provided. That is, if all of an employee's time is dedicated to the operations of a carve-out entity, all of the employee's compensation should be reflected in the carve-out financial statements. If an employee's time is partially spent providing services to the carve-out entity, we would expect the employee's compensation to be reflected proportionately in the carve-out financial statements.

When management of the parent is responsible for supervising the carve-out entity's operations, instead of directly attributing a portion of management's compensation, the carve-out financial statements might include an overhead charge from the parent entity to the carve-out entity that considers the cost of the services that management provides. See section 3.1.3 for further discussion on reflecting expenses in carve-out financial statements.

While this concept applies to all compensation expense, certain types of compensation require additional considerations as discussed below.

3.9.1 Share-based payment awards

Carve-out financial statements should include the compensation cost attributable to share-based payment awards issued to grantees in exchange for goods or services provided to the carve-out entity. Consistent with the discussion above, this amount could reflect the compensation cost recognized under ASC 718²³ for goods and services used or consumed in the carve-out operations or part of a separate allocated overhead charge (e.g., for parent employees who oversee the carve-out operations).

²³ ASC 718, *Compensation – Stock Compensation*.

3.9.1.1 Modifications

Modifications of share-based payment awards (e.g., acceleration of vesting) that occur in connection with the carve-out transaction should be accounted for in accordance with ASC 718. See section 8 of our FRD, *Share-based payment*, for guidance on the accounting for the modification of a share-based payment award. If a modification is made prior to the date of the carve-out transaction, it could result in additional compensation cost being recognized in the carve-out financial statements.

3.9.1.2 Disclosures

The carve-out financial statements should consider the share-based payment disclosures required by ASC 718. When a carve-out entity has its own share-based payment plan, the disclosures should be based on that plan. When grantees provide goods or services to the carve-out operations and participate in a parent's share-based payment plan, we believe the carve-out entity should consider providing relevant disclosures required by ASC 718 in the carve-out financial statements. For example, entities should consider disclosing the nature and terms of the arrangement, the amount of compensation cost recognized, the amount and period over which future compensation cost is expected to be recognized, and the method for estimating the fair value of share-based payment awards. For grantees who provide goods or services indirectly to the carve-out entity (e.g., parent entity C-suite employees), compensation cost may be included consistent with the overall disclosure of shared costs as discussed in section 3.1.3.

3.9.2 Defined benefit plans

When a carve-out entity has its own defined benefit plan (i.e., a legal entity within the carve-out entity sponsors the plan), the related financial statement amounts should be included in the carve-out financial statements following the single employer accounting model in ASC 715.²⁴

When employees of the carve-out entity participate in a defined benefit plan sponsored by the parent entity, we believe the carve-out entity should follow the guidance in ASC 715-30-55-62 through 55-64, which addresses the accounting in the standalone financial statements of a subsidiary that participates in a defined benefit plan for which the plan assets are not segregated and restricted for each subsidiary. Under this guidance, the carve-out entity accounts for its participation in the parent's plan as a participation in a multiemployer pension plan and recognizes as an expense for each period the amount it is required to contribute to the parent's plan for each participant. The carve-out entity also should recognize a liability for any contributions due and unpaid to the parent's plan either separately or as part of amounts due to the parent.

If the parent's plan does not require the participating subsidiaries or portions thereof that comprise the carve-out entity to make any contributions to the plan, we believe that the carve-out entity should consider the guidance in section 3.1.3.

Due to the nature of plan sponsorship (that is, the plan is legally sponsored by the parent in the historical periods), we generally believe that the obligations and the assets of the plan should be included in the parent's financial statements. We do not believe that it is appropriate to reflect the carve-out entity's share (i.e., an allocation) of the benefit obligation, plan assets or related accumulated other comprehensive income (AOCI) amounts in the carve-out financial statements.

²⁴ ASC 715, *Compensation – Retirement Benefits*.

However, in certain cases, employees of the carve-out entity are the only participants in a parent's plan, and the plan sponsorship will transfer in the carve-out transaction. In these cases, it may be appropriate to consider the carve-out entity the plan sponsor for accounting purposes for all periods presented in the carve-out financial statements.

As part of the carve-out transaction, a plan may be divided into two or more separate defined benefit plans (i.e., a plan split-up). Plan split-ups are subject to complex regulations regarding the allocation of accrued benefits and plan assets and may require advance approval by one or more regulatory bodies such as the Internal Revenue Service or the Pension Benefit Guaranty Corporation. ASC 715-30-55-90 through 55-92 provides further guidance on how to account for plan split-ups. The accounting for the plan split-up would occur at the time the split-up becomes effective. That is, it would not affect the carve-out financial statements prior to the split-up.

3.9.2.1

Disclosures

When a carve-out entity has its own defined benefit plan (i.e., a legal entity within the carve-out entity sponsors the plan), the disclosures required by ASC 715-20-50 should be provided for that plan. However, when employees of the carve-out entity participate in the defined benefit plan of the parent, we believe that the carve-out financial statements should include disclosure of net periodic benefit cost recognized and a description of the nature and effect of any significant changes during the period affecting comparability, such as a change in the rate of employer contributions, a business combination or a divestiture. These disclosures are similar to the disclosures required for defined contribution plans in ASC 715-70-50-1.

3.10

Contingencies

Contingencies may relate to a variety of circumstances, such as pending or threatened litigation, environmental obligations or guarantees. It is common practice for entities to recognize liabilities and expenses for contingencies on the parent entity general ledger rather than the general ledger of the specific entity to which they relate. Therefore, the preparers of carve-out entity financial statements should analyze the facts and circumstances of each contingency to determine whether to recognize the liability and related expense in the carve-out financial statements.

A liability should be recognized for an obligation that meets the recognition conditions in ASC 450²⁵ (i.e., the loss is probable and is reasonably estimable) in the carve-out financial statements when the carve-out entity is the primary obligor (i.e., it is legally responsible for settling the liability). If the carve-out entity is the primary obligor and the exposure is directly attributable to the carve-out entity's historical operations, we believe the carve-out entity would recognize an expense in the carve-out financial statements in the period the related liability is recognized. When the carve-out entity is not the primary obligor but the exposure is directly attributable to the carve-out entity's historical operations, the carve-out entity should evaluate the facts and circumstances to determine whether to recognize a liability and/or expense in the carve-out financial statements.

Management also should evaluate whether contingencies related to the carve-out entity that are not probable or estimable require disclosure in the carve-out financial statements.

²⁵ ASC 450, *Contingencies*.

Illustration 3-9 Example of contingency directly attributable to the carve-out entity's operations

The parent entity records contingent liabilities associated with litigation on its general ledger. The carve-out entity operates in the life sciences industry and develops medical devices that are marketed and sold to hospitals. Frequently, medical devices sold by the carve-out entity and its competitors have patents associated with them. The parent entity legally owns the medical device patents and has a contingent liability recorded at corporate headquarters for a patent infringement case related to a medical device being sold by the carve-out entity. The parent entity is the primary obligor in the patent infringement case. No other subsidiaries of the parent entity were involved in the development, marketing or sales of the device.

We believe the carve-out entity would recognize a liability and expense associated with the patent infringement litigation because the contingency is directly attributable to the carve-out entity's historical operations in the period that the obligation becomes probable and reasonably estimable.

3.10.1 Indemnity agreements with the parent entity

The parent entity may indemnify the carve-out entity for specific contingencies as part of the transaction that creates the need for carve-out financial statements. If the exposure is directly attributable to the carve-out entity's historical operations, we believe the carve-out entity would generally recognize a liability and expense in the carve-out financial statements, regardless of whether it is indemnified by the parent entity. We believe the carve-out entity should separately recognize a receivable for the indemnity provided by the parent entity (i.e., gross presentation) for periods in which the indemnity is in place. See section 19.4.7.2 of our FRD, *Income taxes*, for more information on certain accounting and reporting considerations for tax indemnity agreements.

3.11 Debt

If the carve-out entity is the legal obligor of a debt instrument, a liability should be reflected in the carve-out financial statements as discussed in section 3.1.1. This would include joint and several debt arrangements that are recognized under ASC 405-40.²⁶ If the carve-out entity was not previously a legal obligor, but an obligation will be transferred to the carve-out entity in connection with the transaction (e.g., the carve-out entity will assume the parent's debt) and relates to the carve-out entity's operations, we generally believe a liability should be recognized in the carve-out financial statements for all periods that the debt was outstanding. If an obligation will not be transferred to the carve-out entity in connection with the transaction, but the proceeds from the obligation were used to fund the historical operations of the carve-out entity, refer to section 3.11.1 for additional guidance. Any discount, interest or other costs (e.g., legal fees, printing costs, underwriters' fees) associated with the carve-out entity debt also should be reflected in the historical financial statements of the carve-out entity.

3.11.1 Intercompany debt

When intercompany debt is subject to an agreement, the terms of that agreement should inform the classification of balances due to the parent entity in the carve-out financial statements. See section 3.14 for guidance on intercompany amounts that are not subject to an agreement (e.g., intercompany receivables, intercompany payables).

²⁶ ASC 405-40, *Liabilities – Obligations Resulting from Joint and Several Liability Arrangements*.

An interest charge may not have been recorded on intercompany debt due from the carve-out entity in the historical period. In evaluating whether interest expense should be recorded for amounts classified as intercompany debt, the following SEC guidance should be considered.

Excerpt from SEC staff interpretations

Codification of Staff Accounting Bulletins

Topic 1.B.1, Costs reflected in historical financial statements

Question 4: Should the historical income statements reflect a charge for interest on intercompany debt if no such charge had been previously provided?

Interpretive Response: The staff generally believes that financial statements are more useful to investors if they reflect all costs of doing business, including interest costs. Because of the inherent difficulty in distinguishing the elements of a subsidiary's capital structure, the staff has not insisted that the historical income statements include an interest charge on intercompany debt if such a charge was not provided in the past, except when debt specifically related to the operations of the subsidiary and previously carried on the parent's books will henceforth be recorded in the subsidiary's books. In any case, financing arrangements with the parent must be discussed in a note to the financial statements. In this connection, the staff has taken the position that, where an interest charge on intercompany debt has not been provided, appropriate disclosure would include an analysis of the intercompany accounts as well as the average balance due to or from related parties for each period for which an income statement is required. The analysis of the intercompany accounts has taken the form of a listing of transactions (e.g., the allocation of costs to the subsidiary, intercompany purchases, and cash transfers between entities) for each period for which an income statement was required, reconciled to the intercompany accounts reflected in the balance sheets.

Due to the difficulty of distinguishing the elements of the carve-out entity's capital structure, the SEC staff will not insist that an interest charge for intercompany debt be included in the income statement if such a charge was not previously provided. However, an interest charge is required if (1) the parent is servicing debt specifically related to the carve-out entity's operations and (2) the debt that was previously carried on the parent's books will henceforth be recorded in the carve-out entity's books. The appropriate amount of the interest charge in each period may be determined based on a reasonable and supportable allocation method. For example, the interest charge may be based on the portion of the debt used to support the operations of the carve-out entity. In any case, the SEC staff requires footnote disclosure of all financing arrangements with the parent.

3.12

Derivatives and hedging

If the parent entity has derivative instruments, management should evaluate whether any of the instruments should be included in the carve-out financial statements. If a derivative instrument was designated as a hedging instrument of a hedged item (e.g., inventory, interest rate payments on debt) that is included in the carve-out financial statements, the hedging instrument also should be included in the carve-out financial statements. Any changes in fair value of the hedging instrument previously recognized in the parent entity's AOCI for cash flow hedges would also be included. Likewise, the carve-out financial statements should include the applicable portion of the basis adjustment made to a hedged item in a fair value hedge.

Refer to our FRD, *Derivatives and hedging*, for further information on accounting for derivative instruments and hedging activities generally.

3.12.1 Normal purchases and normal sales ASC 815 scope exception

The parent entity may have derivative contracts for the purchase or sale of nonfinancial items (e.g., commodities, inventories). Such contracts need not be accounted for as derivative instruments if they constitute normal purchases or normal sales (NPNS) as defined in ASC 815.²⁷ That exception requires certain criteria to be met, as described in section 2.5.2 of our FRD, *Derivatives and hedging*. If an NPNS contract is reflected in the carve-out financial statements, we believe the carve-out entity would not reassess the conclusions reached by the parent entity about applying the NPNS exception in the historical periods presented.

3.13 Income taxes

One of the more complex aspects of the preparation of carve-out financial statements is determining how income taxes are recognized. This is primarily due to the disparity that often exists between the legal structure the parent entity has historically used to file its tax returns and the structure of the carve-out entity. Carve-out entities frequently comprise components of legal entities (e.g., a specific product line) or a combination of legal entities and components of legal entities. It is critical that management understand the organizational and legal structure of the carve-out entity, including how it corresponds to the historical legal structure of the parent entity.

Due to the similarities between separate and carve-out financial statements, for purposes of recognizing income taxes in carve-out financial statements, an entity may analogize to the income tax accounting considerations for separate financial statements. Income tax considerations for separate financial statements are discussed in section 17 of our FRD, *Income taxes*. Further, section 18.11 of our FRD, *Income taxes*, provides income tax disclosure considerations to which a carve-out entity may analogize.

Certain foreign jurisdictions tax corporate income at different rates depending on whether (and, in some cases, when) that income is distributed to shareholders. For considerations on how to account for these situations to which a carve-out entity may analogize, refer to section 5.3.1.2 of our FRD, *Income taxes*.

3.13.1 Separate return method (updated April 2026)

The carve-out entity must apply a method consistent with the principles outlined in ASC 740²⁸ to determine the tax provision to recognize in its financial statements. The separate return method is the preferred and most commonly used method.

Excerpt from Accounting Standards Codification

Income taxes – Overall

Initial Measurement

740-10-30-27

The consolidated amount of current and deferred tax expense for a group that files a consolidated tax return shall be allocated among the members of the group when those members issue separate financial statements. This Subtopic does not require a single allocation method. The method adopted, however, shall be systematic, rational, and consistent with the broad principles established by this Subtopic. A method that allocates current and deferred taxes to members of the group by applying this Topic to each member as if it were a separate taxpayer meets those criteria. In that situation, the sum of the amounts allocated to individual members of the group may not equal the consolidated amount. That may also be the result when there are intra-entity transactions between members of the group. The criteria are satisfied, nevertheless, after giving effect to the type of adjustments (including eliminations) normally present in preparing consolidated financial statements.

²⁷ ASC 815, *Derivatives and Hedging*.

²⁸ ASC 740, *Income Taxes*.

740-10-30-27A

An entity is not required to allocate the consolidated amount of current and deferred tax expense to legal entities that are not subject to tax. However, an entity may elect to allocate the consolidated amount of current and deferred tax expense to legal entities that are both not subject to tax and disregarded by the taxing authority (for example, disregarded entities such as single-member limited liability companies). The election is not required for all members of a group that files a consolidated tax return; that is, the election may be made for individual members of the group that files a consolidated tax return. An entity shall not make the election to allocate the consolidated amount of current and deferred tax expense for legal entities that are partnerships or are other pass-through entities that are not wholly owned.

740-10-30-28

Examples of methods that are not consistent with the broad principles established by this Subtopic include the following:

- a. A method that allocates only current taxes payable to a member of the group that has taxable temporary differences
- b. A method that allocates deferred taxes to a member of the group using a method fundamentally different from the asset and liability method described in this Subtopic (for example, the deferred method that was used before 1989)
- c. A method that allocates no current or deferred tax expense to a member of the group that has taxable income because the consolidated group has no current or deferred tax expense.

ASC 740-10-30-27 requires that the amount of current and deferred tax expense for a group that files a consolidated income tax return be allocated among the members of that group when those members issue separate financial statements, but it doesn't establish a mandatory allocation method. That is, a current and deferred tax expense allocation would be required in the separate financial statements of an entity that is a member of a consolidated income tax return group or when an entity is required to provide separate subsidiary financial statements for regulatory filings. The allocation method adopted must be systematic, rational and consistent with the broad principles of ASC 740. Under the separate return method, for example, current and deferred taxes are allocated as if each group member were a separate taxpayer. Consistent with ASC 740-10-30-27, the sum of the amounts allocated to members of the income tax return group under this method may not equal the consolidated amount.

ASC 740-10-30-27A clarifies that an entity is not required to allocate the consolidated amount of current and deferred tax expense to the separate financial statements of legal entities that are not subject to income tax. However, the guidance allows an entity to make an election to allocate the consolidated amount of current and deferred tax expense to the separate financial statements of wholly owned legal entities that are both not subject to tax and disregarded by the taxing authority (e.g., a single member limited liability company). Entities should consider this guidance when preparing carve-out financial statements that only include legal entities that are not subject to tax.

For carve-out financial statements included in filings with the SEC, entities should also consider the guidance in SAB Topic 1.B.1 (codified in ASC 220-10-S99-3) as discussed below. See section 17.1.1 of our FRD, *Income taxes*, for further guidance on this election.

Excerpt from SEC staff interpretations

Codification of Staff Accounting Bulletins

Topic 1.B.1, Costs reflected in historical financial statements

Question 3: What are the staff's views with respect to the accounting for and disclosure of the subsidiary's income tax expense?

Interpretive Response: Recently, a number of parent companies have sold interests in subsidiaries, but have retained sufficient ownership interests to permit continued inclusion of the subsidiaries in their consolidated tax returns. The staff believes that it is material to investors to know what the effect on income would have been if the registrant had not been eligible to be included in a consolidated income tax return with its parent. Some of these subsidiaries have calculated their tax provision on the separate return basis, which the staff believes is the preferable method. Others, however, have used different allocation methods. When the historical income statements in the filing do not reflect the tax provision on the separate return basis, the staff has required a pro forma income statement for the most recent year and interim period reflecting a tax provision calculated on the separate return basis.¹

¹ FASB ASC paragraph 740-10-30-27 (Income Taxes Topic) states: "The consolidated amount of current and deferred tax expense for a group that files a consolidated tax return shall be allocated among the members of the group when those members issue separate financial statements. ... The method adopted ... shall be systematic, rational, and consistent with the broad principles established by this Subtopic. A method that allocates current and deferred taxes to members of the group by applying this Topic to each member as if it were a separate taxpayer meets those criteria."

In SAB Topic 1.B.1, the SEC staff indicated that a computation based on a separate return (i.e., as if the registrant had not been included in a consolidated income tax return group with its parent) is the preferred method for determining income taxes in the separate financial statements of registrants that file consolidated tax returns. The SEC staff believes it is material to investors to know what the effect on income would have been if the registrant had not been eligible to be included in a consolidated income tax return group with its parent. As transactions reported in the carve-out financial statements have income tax implications to the taxable entity of which the reporting entity is a part, the SEC staff believes the carve-out financial statements should reflect income tax expense and deferred tax assets and liabilities attributable to the reporting entity.²⁹ If income taxes have not been computed on a separate return basis in the entity's historical financial statements, the SEC staff requires a pro forma income statement for the most recent year and interim period reflecting a tax provision calculated on a separate return basis.

A carve-out entity whose financial statements will not be included in an SEC filing may use other methods to determine its tax provision as long as the method used complies with ASC 740-10-30-27. However, because the SEC staff requires pro forma disclosures to reflect the results of operations on a separate return basis and entities often face challenges in complying with ASC 740, although not required, the separate return method is the predominant method used to compute income taxes for a carve-out entity whose financial statements will not be included in an SEC filing.

See section 17.3 of our FRD, *Income taxes*, for further information regarding the tax provisions of non-legal entities (e.g., divisions) in carve-out financial statements.

²⁹ Comments made by SEC staff at the 12 June 2001 AICPA SEC Regulations Committee meeting.

3.13.2 Deferred taxes

Deferred tax assets and liabilities that are attributable to the carve-out entity should be determined using a bottom-up approach.

The carve-out entity should recognize a valuation allowance and corresponding charge to income tax expense if it is not more likely than not that it will realize all or a portion of a deferred tax asset. This evaluation should be based on the entity's taxable income projections available at the historical assessment date (i.e., not considering hindsight) and could result in the carve-out entity reaching a different conclusion than the parent entity on a historical basis. See section 6 of our FRD, *Income taxes*, for further information on determining a valuation allowance. In addition, a carve-out entity may use the guidance in section 11.15 of our FRD, *Income taxes*, which provides information on allocating current and deferred tax expense to the separate financial statements of a subsidiary.

3.13.3 Uncertain tax positions

The carve-out entity recognizes and measures its uncertain tax positions for which it is the primary obligor in accordance with ASC 740. In determining whether the carve-out entity is the primary obligor, management should carefully consider the specific facts and circumstances, including whether the separate operations of the carve-out entity gave rise to the position and how the taxing authority in the applicable jurisdiction would identify the primary obligor. For instance, if the carve-out entity was previously included in the consolidated return of the parent and the taxing authority considers all entities in a consolidated return primarily obligated for the tax positions taken, both the carve-out entity and the parent would be primary obligors for the uncertain tax positions taken related to the carve-out entity's operations in tax returns prior to the carve-out transaction. Significant judgment will be required. See section 19 of our FRD, *Income taxes*, for further information on accounting for uncertain tax positions.

The carve-out entity could be the primary obligor for uncertain tax positions of the parent that are unrelated to the carve-out entity's operations. Those obligations would not be accounted for in the carve-out financial statements under ASC 740. Instead, this exposure generally would be accounted for under ASC 450. Also, in some cases, the parent entity may indemnify the carve-out entity for uncertain tax positions. See section 3.10.1 for further discussion on indemnity agreements.

3.14 Intercompany transactions

The nature and extent of intercompany transactions and balances will vary based on the nature of the parent entity's historical structure and operations. Identifying historical intercompany transactions and balances could require significant effort because they were eliminated from the historical parent entity financial statements or the parent entity did not allocate expenses (e.g., corporate expenses) to the carve-out entity. For example, intercompany transactions and balances could include revenues, receivables, expenses, payables, loans, debt, interest and dividends. See section 3.11.1 for guidance on intercompany debt (including interest).

Intercompany transactions and balances that occur and exist between components of the carve-out entity should continue to be eliminated. For transactions between the carve-out entity and its parent entity, the carve-out entity should evaluate the relevant guidance in existing US GAAP to account for such transactions. However, because these transactions are between related parties and cannot be presumed to be carried out on an arm's-length basis, additional disclosures often are required. See section 4.9 for guidance on related party transactions.

3.14.1 Presentation of amounts due to and from the parent entity

Questions often arise about how amounts due to and from the parent entity are presented in the carve-out entity's financial statements. If the carve-out entity determines that an intercompany amount should be reflected in its financial statements, the entity should consider the facts and circumstances of that intercompany arrangement when determining the appropriate presentation.

In the carve-out entity's balance sheet, carve-out entities generally reflect intercompany balances as an intercompany receivable (asset) or payable (liability). We believe the parent entity's past practices of settling intercompany funding provided by the parent, as well as how intercompany amounts will be settled pursuant to the transaction's terms, may inform the classification of balances due to the parent entity in the carve-out financial statements. For example, intercompany amounts that have historically been settled using cash would generally be presented as an intercompany asset or liability due to or from the parent, whereas amounts that are forgiven are often treated as contributions or distributions of capital.

Entities should consider which presentation would provide financial statement users with the most meaningful information. Regardless of which presentation is deemed most appropriate for a particular intercompany balance, the carve-out entity financial statements should disclose the policy used to record these transactions. An example disclosure is provided below.

Illustration 3-10 Intercompany transactions disclosure

Intercompany transactions between the Company and Parent have been included in these combined financial statements and are forgiven at the time the transaction is recorded. The total net effect of the settlement of these intercompany transactions is reflected in the combined statements of cash flows as a financing activity and in the combined balance sheets as parent company investment. The components of the net transfers to and from Parent as of 31 December 20X0, 20X9 and 20X8 are as follows:

| | <i>(In thousands)</i> | | |
|--|-----------------------|-----------------|-----------------|
| | <u>20X0</u> | <u>20X9</u> | <u>20X8</u> |
| Cash pooling and general financing activities | \$ (400) | \$ (700) | \$ (800) |
| Sales to Parent | (120) | (150) | (100) |
| Purchases from Parent | 40 | 70 | 50 |
| Corporate allocations | 250 | 270 | 300 |
| Income tax expense | <u>80</u> | <u>100</u> | <u>120</u> |
| Net decrease in Parent company investment | \$ (150) | \$ (410) | \$ (430) |

3.15 Foreign currency matters

If a carve-out entity, as a reporting entity with a single reporting currency, consolidates a foreign entity,³⁰ the carve-out entity will need to apply the guidance in ASC 830³¹ to determine any cumulative translation adjustment balance in the statement of changes in equity. Once the carve-out reporting entity is identified as discussed in section 2.1, the functional currency of each entity included in the financial statements of the carve-out reporting entity should be determined consistent with the historical conclusions reached by the parent entity. An entity's functional currency is the currency of the primary economic environment in which it operates. See section 2.1 of our FRD, *Foreign currency matters*, for further information.

³⁰ ASC 830 defines a foreign entity as an operation (e.g., subsidiary, division, branch, joint venture) whose financial statements are both (1) prepared in a currency other than the reporting currency of the reporting entity and (2) combined or consolidated with or accounted for on the equity basis in the financial statements of the reporting entity.

³¹ ASC 830, *Foreign Currency Matters*.

After the functional currency of each entity is identified, the account balances of each entity not denominated in that entity's functional currency should be remeasured into that entity's functional currency by applying the requirements of accounting for foreign currency transactions in ASC 830. See section 3 of our FRD, *Foreign currency matters*, for further guidance.

After the account balances of each entity included in the carve-out reporting entity are stated in their functional currencies, the account balances of each foreign entity are translated into the reporting currency of the carve-out reporting entity using the current rate method. Resulting translation adjustments are recorded in a separate component of stockholders' equity. See section 4 of our FRD, *Foreign currency matters*, for further guidance.

3.16 Exit or disposal costs (restructuring)

The parent entity may incur costs in connection with historical restructuring actions or restructuring actions related to a carve-out transaction. Entities should use the considerations in sections 3.1.1 and 3.1.3, which are based on SAB Topic 1.B.1, to determine the liabilities and expenses that should be recognized in the carve-out financial statements. The carve-out entity should recognize a liability and related expense from restructuring actions associated with its historical operations.

Refer to our FRD, *Exit or disposal cost obligations*, for information about the accounting for exit or disposal costs.

3.17 Leases

The carve-out entity may be a party to a lease. A lessee recognizes a right-of-use (ROU) asset and corresponding lease liability on the balance sheet for many lease arrangements.³²

The carve-out entity should apply judgment when determining whether an ROU asset and lease liability should be reflected in its carve-out financial statements. If an underlying asset is controlled solely by the carve-out entity, the carve-out entity is the obligor of the lease agreement; or the lease will be assumed by the carve-out entity, the ROU asset and lease liability should be reflected in the carve-out financial statements.

See our FRD, *Lease accounting – Accounting Standards Codification 842, Leases*, for additional information on the accounting for leases under ASC 842.

Regardless of whether the carve-out entity recognizes an ROU asset or lease liability on its balance sheet, if lease expense (operating lease) or lease interest and amortization (finance lease) is directly attributable to the carve-out entity, that expense should be reflected in the carve-out entity's financial statements. Refer to section 3.1.3 for income statement allocation considerations.

³² Lessees can make an accounting policy election (by class of underlying asset to which the right of use relates) to not recognize ROU assets and lease liabilities for leases that meet ASC 842's definition of a short-term lease (i.e., the short-term lease election). Additionally, an entity with leases that only have variable lease payments that do not depend on an index or a rate will not record a corresponding ROU asset and lease liability.

3.18 Investments

Excerpt from Accounting Standards Codification

Financial Instruments – Overall

Recognition

825-10-25-6

An acquirer, parent, or primary beneficiary decides whether to apply the fair value option to eligible items of an acquiree, subsidiary, or consolidated VIE, but that decision applies only in the consolidated financial statements. Fair value option choices made by an acquired entity, subsidiary, or VIE continue to apply in separate financial statements of those entities if they issue separate financial statements.

A carve-out entity may have items for which it is eligible to apply the fair value option in the scope of ASC 825. In accordance with ASC 825-10-25-6, even if the parent entity did not elect the fair value option, the carve-out entity may elect to apply it for those eligible items. If the carve-out entity's election differs from the parent entity, the carve-out entity should use its election for purposes of the carve-out financial statements.

Refer to our FRD, *Issuer's accounting for debt and equity financings*, for more information about applying the fair value option to a debt instrument and our FRD, *Equity method investments and joint ventures*, for more information about applying the fair value option to an equity method investment.

3.19 Contract liabilities (added April 2026)

A contract liability exists when a customer pays consideration before an entity transfers a good or service to a customer. If either the carve-out entity or its parent receives consideration and the carve-out entity has an obligation to transfer goods or services to the customer, the carve-out entity recognizes a contract liability.

4 Other accounting and financial reporting considerations

4.1 Statement of changes in equity (updated April 2026)

The types of accounts and activity reflected in the statement of changes in equity will vary depending on the structure of the carve-out entity. As the carve-out entity often comprises a portion of a legal entity or a combination of legal entities (or portions thereof), the statement of changes in equity will often be limited to changes in the parent's net investment but also may include changes in other components of the carve-out entity's equity (e.g., AOCI). The carve-out entity should reconcile the activity within the statement of changes in equity to the other financial statements (e.g., income statement, statement of cash flows) to verify that the activity reflected is complete. In contrast, when the reporting entity is a legal entity and full financial statements of the legal entity are prepared rather than carve-out financial statements, the statement of changes in equity would reflect the full equity structure of that legal entity.

4.2 Statement of cash flows

Generally, the carve-out balance sheet and income statement are prepared prior to the statement of cash flows and used as the basis for developing the statement of cash flows. This approach helps provide consistency in the judgments and amounts reflected throughout the carve-out financial statements. It generally would be more difficult for the carve-out entity to start with the parent entity statement of cash flows as the basis for preparing the carve-out statement of cash flows.

While cash, cash equivalents and amounts generally described as restricted cash or restricted cash equivalents may not be reflected in the balance sheet of the carve-out entity as discussed in section 3.2, the statement of cash flows should reflect the relevant information about the cash receipts and cash payments of the carve-out entity during the periods presented in accordance with ASC 230.³³ Therefore, intercompany transactions that were eliminated in the parent entity's financial statements often comprise a substantial amount of activity in the carve-out statement of cash flows. Management should evaluate the nature of these transactions to determine the appropriate classification within the statement of cash flows (i.e., whether the activity is an operating, investing or financing activity in accordance with ASC 230).

If the carve-out entity has intercompany accounts receivable and accounts payable with the parent entity that are settled using cash, those amounts would generally be reflected as operating cash flows. In addition, cash flows related to the principal portion of intercompany debt between the carve-out entity and the parent entity would generally be reflected as an investing activity if a note receivable is due from the parent entity, or as a financing activity if a note payable is due to a parent entity.

The statement of cash flows guidance in ASC 230 is principles-based and often requires judgments about classifying certain cash receipts and cash payments. We encourage entities to fully and adequately disclose their judgments with respect to the statement of cash flows. Transparent financial reporting and complete disclosure will enhance users' ability to understand a carve-out entity's statement of cash flows.

³³ ASC 230, *Statement of Cash Flows*.

4.2.1 Centralized cash management arrangements

As discussed in section 3.2, consolidated entities often have centralized cash management arrangements in which excess cash is swept into a cash pool with cash from other entities. When a carve-out entity participates in such an arrangement and determines that the funds in the arrangement are not cash or cash equivalents, the amounts are reflected as changes in amounts due to or from the parent entity in its statement of cash flows.

Changes in a carve-out entity's receivable relating to a centralized cash management program are presented as investing activities, and changes in a carve-out entity's liability relating to a centralized cash management program are presented as financing activities.³⁴ Payments to and receipts from the cash pool would be presented on a gross or net basis, in accordance with ASC 230-10-45-7 through 45-9.

4.3 Earnings per share

Because carve-out financial statements are not legal entity financial statements, they rarely include earnings per share (EPS) information. However, if the carve-out transaction results in the formation of a new public entity (e.g., a division of an entity is reorganized into a newly formed entity), then any financial statements issued subsequent to the transaction must include EPS information in the comparative historical periods previously covered by the carve-out financial statements.

See section 6.7 of our FRD, *Earnings per share*, for additional considerations.

4.4 Segment reporting

Segment reporting disclosure requirements apply only to public entities, as described in ASC 280-10-15-2 through 15-3,³⁵ which includes entities that make filings with a regulatory agency in preparation for the sale of securities in a public market (e.g., an IPO). Management should consider the nature of the transaction to determine whether segment disclosures are required in the financial statements of the carve-out entity. For example, segment disclosures are required for newly formed public entities (e.g., spin-off) but are not required when preparing carve-out financial statements to comply with Rule 3-05. However, even when segment disclosures are not required, a carve-out entity is still required to determine its operating segments in order to identify its reporting units for the purpose of goodwill impairment testing as discussed in section 3.7.2.1.

If segment disclosures are provided pursuant to ASC 280, management must first identify the carve-out entity's operating segments. See section 3.7.2.1 for considerations for determining the CODM and operating segments. Once operating segments are identified, management can (but is not required) to aggregate operating segments if they meet the aggregation criteria in ASC 280-10-50-11. When applying the aggregation criteria and determining whether operating segments are similar, management should consider only the operations of the carve-out entity and not those of the parent entity. See section 3.1 of our FRD, *Segment reporting*, for additional considerations on application of the aggregation criteria. Management can then determine the reportable segments for the carve-out entity by applying the quantitative thresholds in ASC 280-10-50-12 through 50-19.

³⁴ Alternative presentations may be acceptable depending on the facts and circumstances.

³⁵ ASC 280, *Segment Reporting*.

4.5 Subsequent events

ASC 855³⁶ requires management to evaluate subsequent events to determine whether it needs to recognize or disclose them. While subsequent events affecting the carve-out entity may be a subset of the events the parent entity previously identified, the parent entity's conclusions regarding these events should be reevaluated using the carve-out entity's materiality threshold.

Management is required to evaluate all subsequent events that occur up until the date the carve-out financial statements are either issued or are available to be issued, which may occur after the parent entity issues its financial statements. We understand that there is diversity in practice among carve-out entities about whether to recognize certain subsequent events. In practice, some carve-out entities recognize events identified after the issuance of the parent entity's financial statements that affect the most recent period presented in the carve-out financial statements based on the guidance in ASC 855-10-25-1 and ASC 855-10-25-3. We understand that other carve-out entities analogize to the reissuance guidance in ASC 855-10-25-4 and only disclose such events since carve-out financial statements are often derived from previously issued financial statements of a parent entity, unless such event is required to be recognized by GAAP or other regulatory requirements.

4.5.1 Initial registration statement considerations

In an IPO, a registrant does not become an SEC filer until its registration statement is effective, because that is the point when it becomes required to file or furnish financial statements with the SEC. The effect of this is that an IPO candidate (a company that is going through the initial registration statement process, but its registration statement has not yet been declared effective) that has reached the cut-off date for recognizing subsequent events in its financial statements based upon the "available to be issued date" as a non-SEC filer will not have to "re-open" its subsequent events recognition if its financial statements are subsequently filed or are included in pre-effective IPO registration statement amendments with the SEC.

However, we believe that IPO candidates going through an initial registration with the SEC (which are not SEC filers) should disclose material Type II subsequent events necessary to keep the financial statements from being misleading in the notes to their latest annual or interim financial statements included in the registration statement through each registration statement submission, filing or pre-effective amendment filing date.

4.6 Discontinued operations

The carve-out entity would need to make its own assessment about the presentation of discontinued operations in accordance with ASC 205-20.³⁷ If the parent entity retains certain net assets or activities of the carve-out entity as discussed in section 2.1, for example, management should evaluate whether any of these components should be presented as discontinued operations in the historical periods of the carve-out financial statements.

The parent entity also will need to determine the appropriate reporting and presentation requirements related to the disposition. If the parent is required to present discontinued operations in its financial statements, it is possible that these discontinued operations will differ from the carve-out entity's reported operations in its separate financial statements. For example, the reporting of discontinued operations in the parent entity's financial statements would not include an allocation of corporate overhead and/or indirect fixed costs, while the carve-out entity's financial statements may include an allocation of those costs. Refer to section 3.1.3 for guidance on allocating parent entity expenses to the carve-out entity.

³⁶ ASC 855, *Subsequent Events*.

³⁷ ASC 205-20, *Presentation of Financial Statements – Discontinued Operations*.

In certain situations, the carve-out entity may have disposed of certain components (or classified certain disposal groups as held for sale) prior to the most recent balance sheet date, and those operations are within a historical period that must be presented in the carve-out financial statements. The carve-out entity should evaluate whether the disposal qualifies for presentation as a discontinued operation. If it doesn't, the carve-out entity should consider the disclosure requirements in ASC 360-10 for the disposal of individually significant components that have either been disposed of or are classified as held for sale.

See below for an illustration:

Illustration 4-1 Discontinued operations in the historical periods of a carve-out entity

Company A is in the process of preparing carve-out financial statements of Segment B in connection with a contemplated initial public offering (IPO). Historically, Segment B consisted of Divisions 1, 2 and 3.

Based on SEC reporting requirements for the IPO process, Segment B, which does not meet the definition of an emerging growth company or a smaller reporting company, is required to prepare carve-out financial statements as of 31 December 20X5 and 20X4 and for each of the three years ended 31 December 20X5.

Division 3 was disposed of on 30 June 20X5 and did not meet the held-for-sale criteria prior to disposal. In preparing the carve-out financial statements for Segment B, management is evaluating whether it should present the financial results of Division 3 as discontinued operations in the historical carve-out financial statements.

Analysis

For Division 3 to qualify as a discontinued operation for Segment B at the historical balance sheet dates, all of the following criteria must be met:

- ▶ The disposal group is a component of an entity (or group of components)
- ▶ It meets the held-for-sale criteria (ASC 360-10-45-9), is disposed of by sale, or is disposed of other than by sale (e.g., abandonment, spin-off)
- ▶ It represents a strategic shift that has (or will have) a major effect on the operations and financial results

For illustrative purposes, we are assuming Division 3 is a component of Segment B, and its disposal in 20X5 represents a strategic shift that has (or will have) a major effect on the operations and financial results of Segment B.

Given the criteria to qualify for presenting the disposal as a discontinued operation are met as of 30 June 20X5, Segment B should present Division 3 within discontinued operations in its statement of operations for the period ended 31 December 20X5 and all prior comparative periods that include the disposal group (i.e., 20X3 and 20X4). In accordance with ASC 205-20-45-10, Segment B should also present the assets and liabilities of Division 3 in the statement of financial position separately from those of the continuing operations for all prior comparative periods that include the disposal group (i.e., 20X4).

Additionally, in certain situations, a parent entity may not have presented a component that is held for sale or disposed of as a discontinued operation in its historical financial statements (e.g., it did not meet the strategic shift criteria); however, the carve-out entity should separately evaluate whether such component qualifies for presentation as a discontinued operation in the carve-out historical financial statements.

See our FRD, ***Discontinued operations***, for more information on reporting discontinued operations.

4.7 Other entity financial statement requirements for the carve-out entity

The carve-out financial statements may reflect the operations of certain businesses acquired by the parent entity during the historical periods presented for the carve-out entity. If the carve-out entity is presented as the predecessor (e.g., in connection with a registration statement), management would need to evaluate the significance of the business acquisition in the context of the carve-out financial statements to determine whether separate financial statements for the acquired business are required under Rule 3-05. The acquisition may not have been considered significant under the subsidiary tests in Rule 1-02(w) of Regulation S-X for the larger parent entity, but it might be significant for the carve-out entity (i.e., the predecessor). Therefore, the significance tests would need to be separately performed for the carve-out entity using the amounts for the carve-out entity in the denominator of the significance tests.

Similarly, the carve-out entity would need to reassess the significance of any equity method investment included in the carve-out entity under Rule 3-09 of Regulation S-X, *Separate financial statements of subsidiaries not consolidated and 50 percent or less owned persons*, and Rule 4-08(g) of Regulation S-X, *Summarized financial information of subsidiaries not consolidated and 50 percent or less owned persons*, to determine whether separate financial statements or summarized financial information of the investee may be required.

4.8 Pro forma financial information (updated April 2026)

SEC registrants (including a carve-out entity that becomes one) may be required to present pro forma financial information under Article 11 of Regulation S-X.

Pro forma financial information presents historical balance sheet and income statement information adjusted as if a transaction had occurred at an earlier time. Pro forma financial information is intended to provide investors with information about the effect of a transaction by showing how a transaction or a group of transactions might have affected historical financial statements to illustrate the scope of the change in the registrant's financial position and results of operations.

This information is required when events occur or conditions exist for which disclosure would be material to investors. Companies must present Article 11 pro forma financial information when certain transactions occur, including:

- ▶ Significant acquisitions or probable acquisitions of businesses, including equity method investments, those that meet the definition of a real estate operation under Rule 3-14 of Regulation S-X³⁸ and a combination of entities under common control
- ▶ Dispositions or probable dispositions of significant businesses, including real estate operations³⁸
- ▶ Roll-up transactions
- ▶ Spin-offs
- ▶ Any other transaction that has occurred or is probable for which disclosure of pro formas would be material to investors

If a carve-out entity determines that pro forma financial information would be meaningful, management must consider the two types of pro forma adjustments required on its face: transaction accounting adjustments and autonomous entity adjustments.

³⁸ Refer to our Technical Line, [*How to apply the amended S-X Rule 3-14 to real estate acquisitions*](#), for additional information.

A registrant makes transaction accounting adjustments to show how a transaction would have affected the historical financial information of the registrant. Autonomous entity adjustments are used to show what a new registrant (e.g., the carve-out entity) that was part of another entity would have looked like as a standalone entity (e.g., in a spin-off transaction). A registrant can also elect to present in the explanatory notes to the pro forma financial information management's adjustments that provide supplemental forward-looking information.

Our SEC Financial Reporting Series publication, *Pro forma financial information – A guide for applying Article 11 of Regulation S-X*, summarizes the requirements for pro forma financial information and illustrates how registrants may apply the guidance to different transactions and pro forma adjustments.

4.9 Related party considerations

The carve-out entity may be a party to transactions that were historically eliminated in consolidation by the parent entity. These transactions will generally be reflected in the carve-out entity's financial statements and will likely meet the definition of related party transactions. As a result, the carve-out entity should disclose information about these related party transactions in accordance with ASC 850.³⁹

When carve-out financial statements are filed with the SEC, they must comply with the additional reporting requirements in Regulation S-X Rule 4-08(k), which requires registrants to:

- ▶ Present related party transactions separately on the face of the balance sheet, statement of comprehensive income and statement of cash flows
- ▶ Disclose any intercompany profits or losses resulting from transactions with related parties and the related effects

Refer to section 3.1.3 for income statement allocation considerations when expenses arise from related party transactions and section 3.11.1 for considerations related to a carve-out entity's financing arrangement with the parent entity.

4.9.1 CECL considerations (updated September 2025)

ASC 326-20 does not apply to related party loans and receivables between entities under common control. However, the loans and receivables that a carve-out entity and its former parent entity continue to hold with each other will be subject to ASC 326 when the entities are no longer under common control. Refer to our FRD, *Credit impairment under ASC 326*, for information about the application of ASC 326.

³⁹ ASC 850, *Related Party Disclosures*.

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