



Life Sciences

Accounting and Financial Reporting Update —
Interpretive Guidance on Carve-Outs

March 2018

Carve-Outs

Carve-out financial statements are commonly prepared for divestments of businesses in transactions involving life sciences entities. A carve-out occurs when a parent company segregates a portion of its operations and prepares a distinct set of financial information in preparation for a sale, spin-off, or divestiture of the “carve-out entity.” The carve-out entity may consist of all or part of an individual subsidiary, multiple subsidiaries, an individual segment, multiple segments, or a specific group of products. In some cases, one or more portions of a previously consolidated parent company’s subsidiaries may create the newly defined carve-out operations.

“Carve-out financial statements” is a general term used to describe financial statements derived from the financial statements of a larger parent company. The form of those financial statements may vary, however, depending on the situation. For example, if the acquisition is small, a strategic buyer of a carve-out entity may be satisfied with an unaudited balance sheet and income statement for the most recent fiscal year. Another public buyer, however, may require a full set of SEC-compliant audited financial statements, including footnotes, for the three most recent fiscal years. Further, a third buyer might ask that the periods be audited but be completely unconcerned with SEC reporting considerations. The existence of a foreign buyer could present different requirements and challenges in addition to those noted above, such as working closely with the foreign buyer on IFRS conversion of certain financial statement line items.

Accordingly, assessing the potential audience is critical to understanding the basis of presentation, the periods of financial information required, and the level of effort and organizational focus that may be necessary to meet the needs of the potential transaction. Such an assessment can be particularly difficult when the carve-out financial statements are being prepared before any potential buyers are identified or when the potential buyer pool is numerous or diverse.

Management Considerations

Preparation of the carve-out financial statements can be challenging and often requires management to use judgment and carefully plan ahead. Below are some considerations that management should take into account when preparing carve-out financial statements.

Assembling the Right Team

Involving the appropriate personnel is an integral step in planning for carve-out transactions. Management should evaluate which employees could help provide the information needed to prepare accurate and complete financial statements. Such employees may include those outside accounting (e.g., in operations or human resources). In addition, management may need to engage external specialists (e.g., tax or valuation specialists) to help it develop estimates and allocate certain account balances to the carve-out financial statements.

Materiality and Evaluating Misstatements

Because the materiality thresholds related to the carve-out financial statements would most likely be lower than those of the larger parent entity, management may need to assess accounts and balances of the carve-out entity more closely than it had as part of an audit of the parent. In such cases, management may therefore identify required adjustments related to the carve-out entity that were previously considered to be immaterial to the parent's financial statements.

While consultation with auditors is prudent on this topic, in preparing carve-out financial statements for nonpublic entities (i.e., financial statements that are not to be included in an SEC filing), management should evaluate misstatements on the basis of a policy election between the "rollover" and "iron curtain" approaches. Management of a public entity is required to evaluate the materiality of misstatements by using the calculated misstatement that is greater under these two approaches.

Internal Controls

Management should design and implement processes and controls for preparing the carve-out financial statements (e.g., management may need to design, implement, and execute controls related to the appropriate determination and recording of income statement and balance sheet allocations to the carve-out financial statements). Although an entity may often be able to leverage existing financial statement preparation controls, management should evaluate whether it needs to modify such controls to accommodate process changes related to preparing the carve-out financial statements.

Supporting Documentation

Management should consider the type of documentation necessary to support the assumptions made and results achieved in preparing carve-out financial statements. In some cases, the supporting documentation may already exist (e.g., compensation expense is usually calculated and allocated on an employee-by-employee basis). However, management may need to develop and maintain new documentation for the allocations made for the carve-out financial statements (e.g., a rational and systematic method for allocating selling, general, and administrative expenses).

A best practice is for management to use existing accounting systems as much as possible when preparing carve-out financial statements. The use of existing accounting systems may be limited, however, depending on the level of detail at which the account balances are maintained as well as the structure of the carve-out entity (e.g., whether the carve-out represents a segment of the parent or only part of a segment). If the carve-out entity represents a segment or component for which discrete financial information is readily available, management may be able to readily extract information from its existing accounting records. However, if the carve-out entity includes portions of different segments, further involvement of IT specialists may be required.

Working With Auditors

If, as part of the preparation of carve-out financial statements, external auditors need to issue an audit opinion, management should assist its auditors by helping them understand the process undertaken by management for collecting and maintaining all supporting documentation used in the preparation of the carve-out financial statements. For balances in which judgment or complex estimates are required, management should ensure that its documentation contains enough detail for auditors to reach conclusions about the reasonableness of the amounts allocated to, and balances presented in, the carve-out financial statements.

Regulatory Considerations

In addition to defining the business and financial information required and determining the specific approach to the preparation of the financial information, management should consider any regulatory restrictions that may exist related to the divestiture of a business or the transfer of contracts to the buyer. For example, it is common in the life sciences industry for operations in a specific country to have a delayed closing whereby one or more elements of the business do not fully transfer to a buyer at the time of the divestiture. The delays are frequently linked to jurisdictional requirements for the buyer to obtain the marketing authorizations needed to distribute pharmaceutical products or to negotiate changes to government contracts when nontransferable tender agreements exist.

When transitional services agreements are put in place, management should also consider the financial reporting treatment of any activities performed by the seller on behalf of the buyer and how profits earned during the period that are transferred to the buyer should be reported.

“Remainco” Considerations

Carve-out financial statements typically include an allocation of corporate costs to the business to be divested, such as those related to executive management, IT, tax, insurance, accounting, legal and treasury services, and certain employee benefits. Upon the disposal, the individuals performing these activities may not transfer to the divested business. As a result, the remaining business would retain these “stranded costs.”

The parent company is required under ASC 205-20 to evaluate whether the effect of a disposal resulting from a carve-out transaction is to be presented as a discontinued operation. Depending on the form of the carve-out transaction, this evaluation may occur when (1) the carve-out entity meets the criteria in ASC 205-20-45-1E to be classified as held for sale, (2) the carve-out entity is disposed of by sale, or (3) the carve-out entity is disposed of other than by sale in accordance with ASC 360-10-45-15 (e.g., by abandonment or in a distribution to owners in a spin-off). If the disposal meets the conditions for reporting as a discontinued operation by the parent company, it would be unlikely that amounts presented as discontinued operations for the disposal in the parent-company financial statements would equal the operations reflected in the carve-out entity's financial statements (e.g., because of differences between how expenses may have been allocated in the carve-out financial statements and how expenses associated with the discontinued operation are determined).

Management's determination that a portion of the carve-out entity's operations should be presented in discontinued operations will also affect the carve-out entity's statement of cash flows. See [Section 3.3](#) as well as the interpretive guidance of Deloitte's [A Roadmap to the Preparation of the Statement of Cash Flows](#) for further discussion.

For more information and interpretive guidance on preparing carve-out financial statements, see Deloitte's [A Roadmap to Accounting and Financial Reporting for Carve-Out Transactions](#).

Appendix A — Glossary of Standards and Other Literature

The standards and other literature below were cited or linked to in this publication.

AICPA Literature

Accounting and Valuation Guide *Assets Acquired to Be Used in Research and Development Activities*

AICPA Issues Paper, *Identification and Discussion of Certain Financial Accounting and Reporting Issues Concerning LIFO Inventories*

AICPA *Technical Questions and Answers*, Q&A paragraph 2260.03, "Other Assets; Legal Expenses Incurred to Defend Patent Infringement Suit"

FASB Accounting Standards Updates (ASUs)

ASU 2018-03, *Technical Corrections and Improvements to Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*

ASU 2018-02, *Income Statement — Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income*

ASU 2018-01, *Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842*

ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*

ASU 2017-11, *Earnings per Share (Topic 260); Distinguishing Liabilities From Equity (Topic 480); Derivatives and Hedging (Topic 815): (Part I) Accounting for Certain Financial Instruments With Down Round Features, (Part II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests With a Scope Exception*

ASU 2017-09, *Compensation — Stock Compensation (Topic 718): Scope of Modification Accounting*

ASU 2017-07, *Compensation — Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*

ASU 2017-05, *Other Income — Gains and Losses From the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets*

ASU 2017-04, *Intangibles — Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*

ASU 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*

ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue From Contracts With Customers*

ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash* — a consensus of the FASB Emerging Issues Task Force

ASU 2016-17, *Consolidation (Topic 810): Interests Held Through Related Parties That Are Under Common Control*

ASU 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*

ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments* — a consensus of the Emerging Issues Task Force

ASU 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*

ASU 2016-12, *Revenue From Contracts With Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*

ASU 2016-11, *Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting*

ASU 2016-10, *Revenue From Contracts With Customers (Topic 606): Identifying Performance Obligations and Licensing*

ASU 2016-09, *Compensation — Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*

ASU 2016-08, *Revenue From Contracts With Customers (Topic 606): Principal Versus Agent Considerations (Reporting Revenue Gross Versus Net)*

ASU 2016-02, *Leases (Topic 842)*

ASU 2016-01, *Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*

ASU 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*

ASU 2015-14, *Revenue From Contracts With Customers (Topic 606): Deferral of the Effective Date*

ASU 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*

ASU 2015-01, *Income Statement — Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*

ASU 2014-16, *Derivatives and Hedging (Topic 815): Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity* — a consensus of the FASB Emerging Issues Task Force

ASU 2014-15, *Presentation of Financial Statements — Going Concern (Subtopic 205-40): Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern*

ASU 2014-10, *Development Stage Entities (Topic 915): Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entities Guidance in Topic 810*, Consolidation

ASU 2014-09, *Revenue From Contracts With Customers (Topic 606)*

ASU 2014-02, *Intangibles — Goodwill and Other (Topic 350): Accounting for Goodwill* — a consensus of the Private Company Council

ASU 2011-06, *Other Expenses (Topic 720): Fees Paid to the Federal Government by Health Insurers* — a consensus of the FASB Emerging Issues Task Force

ASU 2010-27, *Other Expenses (Topic 720): Fees Paid to the Federal Government by Pharmaceutical Manufacturers* — a consensus of the FASB Emerging Issues Task Force

ASU 2010-20, *Receivables (Topic 310): Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses*

ASU 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements* — a consensus of the FASB Emerging Issues Task Force

FASB Accounting Standards Codification (ASC) Topics

ASC 205, *Presentation of Financial Statements*

ASC 210, *Balance Sheet*

ASC 220, *Income Statement — Reporting Comprehensive Income*

ASC 230, *Statement of Cash Flows*

ASC 235, *Notes to Financial Statements*

ASC 250, *Accounting Changes and Error Corrections*

ASC 260, *Earnings per Share*

ASC 280, *Segment Reporting*

ASC 320, *Investments — Debt and Equity Securities*

ASC 321, *Investments — Equity Securities*

ASC 323, *Investments — Equity Method and Joint Ventures*

ASC 325, *Investments — Other*

ASC 326, *Financial Instruments — Credit Losses*

ASC 330, *Inventory*

ASC 350, *Intangibles — Goodwill and Other*

ASC 360, *Property, Plant, and Equipment*

ASC 410, *Asset Retirement and Environmental Obligations*

ASC 420, *Exit or Disposal Cost Obligations*

ASC 450, *Contingencies*

ASC 470, *Debt*

ASC 480, *Distinguishing Liabilities From Equity*

ASC 505, *Equity*

ASC 605, *Revenue Recognition*

ASC 606, *Revenue From Contracts With Customers*

ASC 610, *Other Income*

ASC 715, *Compensation — Retirement Benefits*

ASC 718, *Compensation — Stock Compensation*

ASC 720, *Other Expenses*

ASC 730, *Research and Development*

ASC 740, *Income Taxes*

ASC 805, *Business Combinations*

ASC 808, *Collaborative Arrangements*

ASC 810, *Consolidation*

ASC 815, *Derivatives and Hedging*

ASC 820, *Fair Value Measurement*

ASC 825, *Financial Instruments*

ASC 830, *Foreign Currency Matters*

ASC 840, *Leases*

ASC 842, *Leases*

ASC 845, *Nonmonetary Transactions*

ASC 915, *Development Stage Entities*

ASC 958, *Not-for-Profit Entities*

ASC 985, *Software*

Proposed FASB Accounting Standards Updates (Proposed ASUs)

Proposed ASU 2018-200, *Leases (Topic 842): Targeted Improvements*

Proposed ASU 2017-310, *Technical Corrections and Improvements to Recently Issued Standards: I. Accounting Standards Update No. 2016-01, Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities and II. Accounting Standards Update No. 2016-02, Leases (Topic 842)*

FASB Proposed Accounting Standards Update 2017-280, *Consolidation (Topic 812): Reorganization*

FASB Proposed Accounting Standards Update 2017-240, *Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities*

Proposed ASU 2017-220, *Compensation — Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*

Proposed ASU 2017-210, *Inventory (Topic 330): Disclosure Framework — Changes to the Disclosure Requirements for Inventory*

Proposed ASU 2017-200, *Debt (Topic 470): Simplifying the Classification of Debt in a Classified Balance Sheet (Current Versus Noncurrent)*

Proposed ASU 2016-270, *Income Taxes (Topic 740) Disclosure Framework: Changes to the Disclosure Requirements for Income Taxes*

Proposed ASU 2015-340, *Government Assistance (Topic 832): Disclosures by Business Entities About Government Assistance*

Proposed ASU 2015-310, *Notes to Financial Statements (Topic 235): Assessing Whether Disclosures Are Material*

Other FASB Proposal

Proposed Concepts Statement 2014-200, *Conceptual Framework for Financial Reporting: Chapter 8: Notes to Financial Statements*

FASB Statements (Pre-Codification Literature)

Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*

Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements* — an amendment of ARB No. 51

Statement No. 141(R), *Business Combinations*

FASB Interpretations (Pre-Codification Literature)

FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* — an interpretation of FASB Statement No. 109

FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*

FASB Concepts Statements

No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*

No. 6, *Elements of Financial Statements*

EITF Issues (Pre-Codification Literature)

Issue 09-4, "Seller Accounting for Contingent Consideration"

Issue 08-1, "Revenue Arrangements With Multiple Deliverables"

Issue 04-5, "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights"

Issue 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)"

Issue 01-8, "Determining Whether an Arrangement Contains a Lease"

Issue 00-21, "Revenue Arrangements With Multiple Deliverables"

PCAOB Auditing Standard

Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*

SEC C&DI Topic

Non-GAAP Financial Measures

SEC Interpretive Release

33-10403, *Updates to Commission Guidance Regarding Accounting for Sales of Vaccines and Bioterror Countermeasures to the Federal Government for Placement Into the Pediatric Vaccine Stockpile or the Strategic National Stockpile*

SEC Regulation G

"Conditions for Use of Non-GAAP Financial Measures"

SEC Regulation S-K

Item 10(e), "General; Use of Non-GAAP Financial Measures in Commission Filings"

Item 103, "Business; Legal Proceedings."

SEC Regulation S-X

Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired"

Rule 3-09, "Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons"

Rule 3-14, "Special Instructions for Real Estate Operations to Be Acquired"

Rule 4-08(g), "General Notes to Financial Statements; Summarized Financial Information of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons"

Rule 4-08(h), "General Notes to Financial Statements; Income Tax Expense"

SEC Staff Accounting Bulletins (SABs)

SAB Topic 1.M, "Financial Statements; Materiality"

SAB Topic 5.Y, "Miscellaneous Accounting; Accounting and Disclosures Relating to Loss Contingencies"

SAB Topic 11.A, "Miscellaneous Disclosure; Operating-Differential Subsidiaries"

SAB Topic 13, "Revenue Recognition"

SAB Topic 13.A.4, "Revenue Recognition; Selected Revenue Recognition Issues; Fixed or Determinable Sales Price"

SAB Topic 13.B, "Revenue Recognition; Disclosures"

SAB 116, "Staff Accounting Bulletin No. 116"

SAB 118, codified as SEC Staff Accounting Bulletin Topic 5.EE, "Miscellaneous Accounting; Income Tax Accounting Implications of the Tax Cuts and Jobs Act"

Internal Revenue Code (IRC)

IRC Section 78, "Gross Up for Deemed Paid Foreign Tax Credit"

IRC Section 163(j), "Interest; Limitation on Business Interest"

IRC Section 199, "Income Attributable to Domestic Production Activities"

IRC Section 383, "Special Limitations on Certain Excess Credits, Etc."

IRC Section 787, "Termination of Private Foundation Status"

IRC Section 965, "Treatment of Deferred Foreign Income Upon Transition to Participation Exemption System of Taxation"

IRC Section 4191, "Medical Devices"

International Standards

IFRS 16, *Leases*

IFRS 15, *Revenue From Contracts With Customers*

IFRS 11, *Joint Arrangements*

IFRS 3, *Business Combinations*

IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*

Appendix B — Abbreviations

Abbreviation	Description	Abbreviation	Description
AFS	available for sale	E&P	earnings and profits
AICPA	American Institute of Certified Public Accountants	EPS	earnings per share
AMT	alternative minimum tax	EU	European Union
AOCI	accumulated other comprehensive income	FAQ	frequently asked question
API	active pharmaceutical ingredient	FASB	Financial Accounting Standards Board
APIC	additional paid-in capital	FDA	Food and Drug Administration
ASC	FASB Accounting Standards Codification	FDII	foreign derived intangible income
ASU	FASB Accounting Standards Update	FIFO	first in, first out
BCF	beneficial conversion feature	FIN	FASB Interpretation Number (superseded)
BEAT	base erosion anti-abuse tax	FOB	free on board
BEMTA	base erosion minimum tax amount	GAAP	generally accepted accounting principles
BPD	branded prescription drug	GILTI	global intangible low-taxed income
BOLI	bank-owned life insurance	GPO	group purchasing organization
CAM	critical audit matter	IAS	International Accounting Standard
C&DI	SEC Compliance and Disclosure Interpretation	IASB	International Accounting Standards Board
CECL	current expected credit loss	IFRS	International Financial Reporting Standard
CFC	controlled foreign corporation	IIR	investigator-initiated research
CODM	chief operating decision maker	IP	intellectual property
COLI	corporate-owned life insurance	IPO	initial public offering
CRO	contract research organization	IPR&D	in-process research and development
CTA	cumulative translation adjustment	IRC	Internal Revenue Code
DCPs	disclosure controls and procedures	IRS	Internal Revenue Service
DTA	deferred tax asset	IT	information technology
DTL	deferred tax liability	LIFO	last in, first out
EBITDA	earnings before interest, taxes, depreciation, and amortization	LLC	limited liability company
EITF	FASB Emerging Issues Task Force		

Abbreviation	Description
LP	limited partnership
M&A	merger and acquisition
MD&A	Management's Discussion and Analysis
MDET	medical device excise tax
MSL	medical science liaison
NFP	not-for-profit entity
NOL	net operating loss
OCI	other comprehensive income
OEM	original equipment manufacturer
OECD	Organisation for Economic Co-operation and Development
PBE	public business entity
PCAOB	Public Company Accounting Oversight Board
PCC	Private Company Council
PCD asset	purchased financial asset with credit deterioration
PRV	priority review voucher

Abbreviation	Description
PTRS	probability of technical and regulatory success
Q&A	question and answer
R&D	research and development
R&E	research and experimentation
REMS	risk evaluation and mitigation strategy
ROU	right-of-use
SAB	SEC Staff Accounting Bulletin
SEC	Securities and Exchange Commission
SFC	specified foreign corporation
SIFMA	Securities Industry and Financial Markets Association
T.D.	Treasury Decision
TRG	transition resource group
UTB	unrecognized tax benefit
VIE	variable interest entity
WAC	wholesaler acquisition cost

Contacts

If you have any questions about this publication, please contact the following Deloitte industry specialists:

Chris Cooper

U.S. Audit Leader — Life Sciences and Health Care
Deloitte & Touche LLP
+1 973 602 6623
ccooper@deloitte.com

Jeff Ellis

Life Sciences Industry Professional Practice Director
Deloitte & Touche LLP
+1 412 338 7204
jeellis@deloitte.com

Dennis Howell

Senior Consultation Partner, Accounting Services and
Life Sciences Deputy Industry Professional Practice
Director
Deloitte & Touche LLP
+1 203 761 3478
dhowell@deloitte.com

This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor.

Deloitte shall not be responsible for any loss sustained by any person who relies on this publication.

As used in this document, “Deloitte” means Deloitte & Touche LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description our legal structure. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2018 Deloitte Development LLC. All rights reserved.