

Chapter 3.1: Starting Point—Financial Accounts

Learning Objective

After completing this chapter, you will be able to identify the correct financial accounts to use as the starting point for GloBE Income calculations and navigate the hierarchy of accounting standard options.

1. The Starting Point: Financial Accounting Net Income or Loss

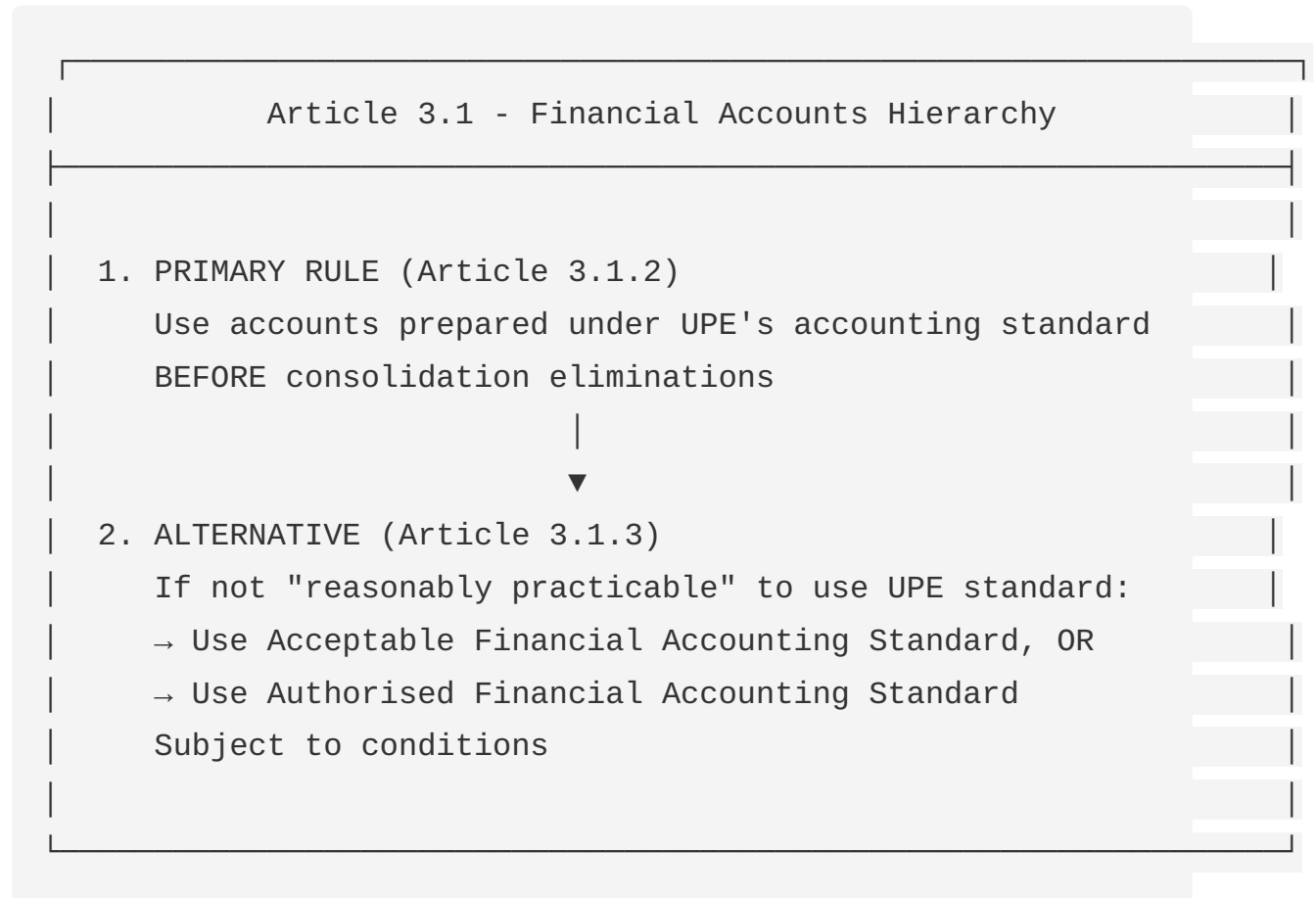
GloBE Income or Loss begins with **Financial Accounting Net Income or Loss** (*Article 3.1.1*). This is the "below the line" net income or loss of the Constituent Entity—the figure after tax expense in the financial accounts.

Critical distinction: GloBE calculations use entity-level accounts, NOT the consolidated group accounts.

Common Misconception	Correct Approach
Use consolidated P&L for GloBE Income	Use each CE's individual P&L before consolidation eliminations
Group adjustments don't matter	Each CE's accounts must be evaluated separately
Errors that net to zero at group level are fine	Entity-level errors affect that jurisdiction's ETR

2. Article 3.1 Hierarchy

The GloBE Rules establish a hierarchy for determining which financial accounts to use:



3. Step 1: Identify the UPE's Accounting Standard

3.1 Process

1. Obtain the UPE's consolidated financial statements
2. Identify the accounting framework used (typically stated in Note 1 or accounting policies section)
3. This becomes the "default" standard for all CE calculations

3.2 Common UPE Accounting Standards

Standard	Typical Users
IFRS	EU-listed companies, UK companies, Australian companies, many Asian groups
US GAAP	US-listed companies, US-headquartered MNEs
Japanese GAAP	Japanese groups not using IFRS
Swiss GAAP FER	Swiss companies (explicitly an Acceptable Standard)

3.3 Stratos Example

Stratos Group plc prepares consolidated financial statements under **IFRS** (as required for UK-listed companies). Therefore, IFRS is the primary accounting standard for all Stratos CE GloBE calculations.

4. Step 2: Determine Each CE's Financial Accounts

4.1 The Primary Rule (Article 3.1.2)

For each Constituent Entity, use the **net income or loss determined in preparing the Consolidated Financial Statements** of the UPE, **before any consolidation adjustments eliminating intra-group transactions**.

What this means in practice:

Item	Treatment
Intra-group sales	Include in CE's GloBE Income (not eliminated)
Intra-group dividends	

Item	Treatment
	Include initially (eliminated via Article 3.2 adjustments)
Intra-group interest	Include in CE's GloBE Income (not eliminated)
Management charges	Include in CE's GloBE Income
Purchase Price Allocation (PPA) adjustments	Generally include as reflected in consolidation

4.2 Worked Example: Intra-Group Sale

Scenario: SG Germany GmbH sells software licences to SG France SAS for €5 million. In Stratos's consolidated accounts, this revenue is eliminated.

Approach	GloBE Treatment
Wrong: Use consolidated accounts	Sale eliminated; German GloBE Income understated
Correct: Use pre-elimination accounts	€5M included in German GloBE Income; €5M cost in French GloBE Income

Result: Each entity's GloBE Income reflects the arm's-length intra-group transaction.

5. Step 3: Apply the Alternative Standard Exception (If Needed)

5.1 When Does Article 3.1.3 Apply?

The alternative standard exception applies when it is "**not reasonably practicable**" to determine a CE's Financial Accounting Net Income using the UPE's standard.

Common situations:

Situation	Example
Recently acquired entity	TechStart Ltd still maintains accounts under local Irish GAAP pending integration
Local statutory requirement	Japanese subsidiary required to file accounts under Japanese GAAP
System limitations	Legacy accounting system cannot produce IFRS-compliant reports
Materiality	Small entity where conversion cost exceeds benefit

5.2 Conditions for Using Alternative Standard

If invoking Article 3.1.3, **three conditions must be met**:

Condition	Requirement
1. Maintained accounts	CE's financial accounts are maintained based on that alternative standard
2. Reliable information	The information in those accounts is reliable
3. Conform permanent differences	Permanent differences exceeding €1 million are adjusted to conform to UPE's standard

5.3 The €1 Million Threshold

Key rule: If using an alternative accounting standard, any permanent difference exceeding €1 million must be adjusted to align with the UPE's accounting standard.

What is a permanent difference? A permanent difference arises when the alternative standard treats an item differently from the UPE's standard in a way that will **never reverse**. This differs from a timing difference, which reverses over time.

Type	Example	Treatment
Permanent difference >€1M	Different revenue recognition principle resulting in €2M variance	Must adjust to UPE standard
Permanent difference ≤€1M	Minor difference in expense classification	No adjustment required
Timing difference	Different depreciation rates (IFRS vs local GAAP)	No adjustment required (reverses over asset life)

5.4 Worked Example: Alternative Standard Application

Scenario: Stratos acquires TechStart Ltd (Ireland) on 1 July 2025. TechStart maintains accounts under Irish GAAP, which differs from IFRS.

Step 1: Assess practicability - TechStart's systems are not yet integrated with Stratos's IFRS reporting - Conversion to IFRS would require significant manual adjustment - Conclusion: Not reasonably practicable to use IFRS for FY 2025

Step 2: Verify conditions

Condition	Assessment
Maintained accounts	Yes—TechStart prepares Irish GAAP accounts for statutory filing
Reliable information	Yes—accounts are audited
Permanent differences >€1M	One identified (see below)

Step 3: Identify and adjust permanent differences

Item	Irish GAAP	IFRS	Difference	Adjustment?
R&D costs	Capitalised and amortised	Expensed as incurred	€1.8M permanent	Yes—adjust
Lease accounting	Operating lease	IFRS 16 right-of-use	Timing difference	No
Revenue recognition	Similar to IFRS 15	IFRS 15	€0.3M	No (below €1M)

Result: TechStart's Irish GAAP accounts are used, with a €1.8M adjustment for R&D treatment.

6. Acceptable vs Authorised Financial Accounting Standards

The GloBE Rules distinguish between two categories of alternative standards:

6.1 Acceptable Financial Accounting Standard (*Article 10.1*)

These are **specifically recognised** standards that can be used without additional adjustment for competitive distortions:

Standard	Status
IFRS (as issued by IASB)	Acceptable
US GAAP	Acceptable
Swiss GAAP FER	Acceptable (explicitly listed)
Australian AASB standards	Acceptable (IFRS-based)
UK-adopted IFRS	Acceptable

6.2 Authorised Financial Accounting Standard (*Article 10.1*)

These are **generally accepted accounting principles** in a jurisdiction that are authorised by an accounting standard setter or government. They are acceptable BUT may require adjustment for **Material Competitive Distortions**.

Standard	Status	Notes
Japanese GAAP	Authorised	Check for material distortions
Chinese Accounting Standards	Authorised	Check for material distortions
Indian GAAP (Ind AS)	Authorised	Largely IFRS-converged
Swiss Code of Obligations	Authorised	May have distortions vs IFRS
Irish GAAP (FRS 102)	Authorised	Largely UK GAAP aligned

6.3 Material Competitive Distortion Test

When using an Authorised (but not Acceptable) standard, check whether application creates a **Material Competitive Distortion**:

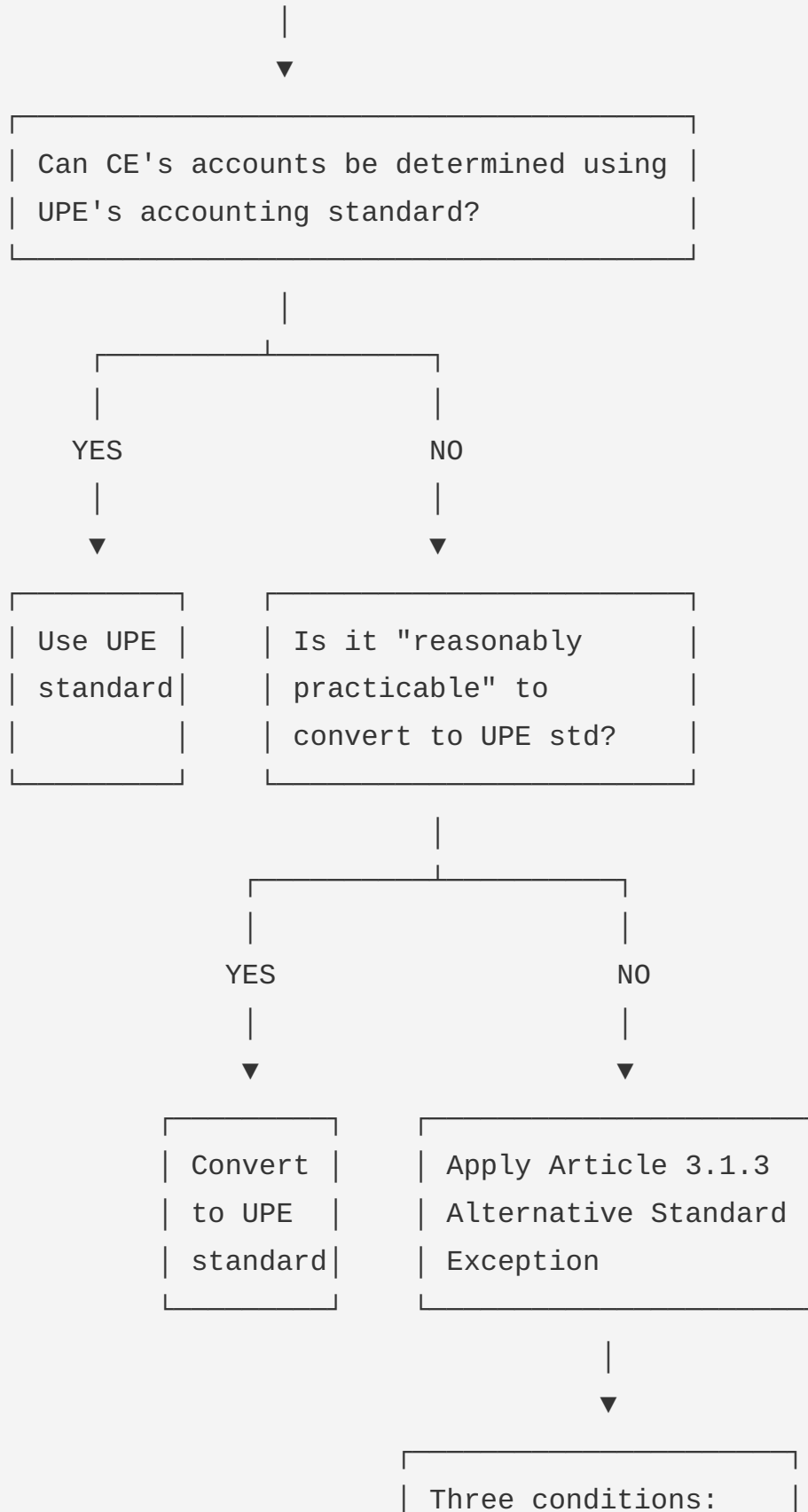
Definition: A variation exceeding **€75 million** in a fiscal year between the authorised standard treatment and what IFRS would produce.

Test	Threshold	Consequence
Material Competitive Distortion	>€75M aggregate variance	Must adjust to eliminate distortion
No Material Competitive Distortion	≤€75M aggregate variance	No adjustment required

Note: The €75M threshold applies at the MNE Group level, not per entity.

7. Decision Tree: Which Financial Accounts to Use

START: Identify CE's GloBE Income starting point



1. Maintained accts
2. Reliable info
3. Adjust >€1M perm
differences



Is standard
"Acceptable" or
"Authorised"?

ACCEPTABLE

AUTHORISED



No MCD
check
needed

Check for
Material
Competitive
Distortion
(>€75M)

≤€75M

>€75M



Use as
is

Adjust to
eliminate MCD

8. Consolidation Adjustments: What Stays, What Goes

8.1 Adjustments Made During Consolidation

When preparing consolidated accounts, the parent makes various adjustments. For GloBE purposes, you need to understand which adjustments apply:

Consolidation Adjustment	GloBE Treatment	Reason
Eliminate intra-group sales	Do NOT eliminate	GloBE uses pre-elimination accounts
Eliminate intra-group dividends	Do NOT eliminate (adjust later per Art. 3.2.1)	Handled separately
Eliminate intra-group profits in inventory	Do NOT eliminate	Entity-level profit is recognised
Goodwill amortisation/impairment	Include	Part of entity's P&L
Purchase Price Allocation (PPA)	Include	Reflected in acquiree's accounts
Currency translation adjustments	Include (if in P&L)	Part of financial accounting income
Minority interest share	Do NOT deduct	Handled in Top-Up Tax allocation

8.2 Worked Example: Pre-Elimination vs Post-Elimination

Stratos Group Consolidation — German Subsidiary

Item	SG Germany Individual Accounts	Consolidated Accounts	GloBE Starting Point
External revenue	€35,000,000	€35,000,000	€35,000,000
Intra-group revenue (to France)	€5,000,000	Eliminated	€5,000,000
Total revenue	€40,000,000	€35,000,000	€40,000,000
External costs	(€22,000,000)	(€22,000,000)	(€22,000,000)
Intra-group costs (from UK)	(€3,000,000)	Eliminated	(€3,000,000)
Other expenses	(€8,000,000)	(€8,000,000)	(€8,000,000)
Tax expense	(€2,100,000)	(€2,100,000)	(€2,100,000)
Net Income	€4,900,000	€2,900,000	€4,900,000

Key insight: The German entity's GloBE starting point is **€4,900,000** (individual accounts), not €2,900,000 (consolidated contribution).

9. Minority Interest Treatment

A common question: How do minority interests affect the GloBE Income starting point?

Answer: There is **no reduction** in Financial Accounting Net Income or Loss for minority interests at the starting point stage. Minority interests are addressed later, during Top-Up Tax allocation (see *Chapter 2.4*).

9.1 Worked Example: Minority Interest

Scenario: SG Ireland Ltd has 60% Stratos ownership and 40% external investor ownership. Net income is €5,200,000.

Approach	Value
GloBE Income starting point	€5,200,000 (full amount)
Minority share of income	Not deducted
Adjustment in allocation	40% attributed to external investor at Top-Up Tax stage

10. Materiality in GloBE Calculations

10.1 Inherited Materiality Threshold

The GloBE Rules do not specify a separate materiality threshold for calculating GloBE Income. Instead, **the same materiality threshold used for consolidated financial statements applies.**

Practical implication: If an item was immaterial for consolidated accounts purposes, it remains immaterial for GloBE purposes.

10.2 When Materiality Matters

Situation	Consideration
Small adjustments	If below materiality, no need to calculate precisely
Alternative standard differences	€1M threshold for permanent differences is separate from general materiality
Entity-level errors	

Situation	Consideration
	May be immaterial at group level but material at entity/ jurisdiction level

Warning: An error that nets to zero at group level can still affect GloBE calculations if it misstates income between jurisdictions.

11. Stratos Practical Application

11.1 Stratos Group Accounting Framework Summary

Entity	Jurisdiction	Statutory Accounts	GloBE Accounts	Notes
Stratos Group plc	UK	IFRS	IFRS	UPE
SG Holdings Ltd	UK	UK GAAP (FRS 101)	IFRS	Converted for consolidation
SG Germany GmbH	Germany	German HGB	IFRS	Converted for consolidation
SG France SAS	France	French GAAP	IFRS	Converted for consolidation
SG Netherlands BV	Netherlands	Dutch GAAP	IFRS	Converted for consolidation
SG Ireland Ltd	Ireland	Irish GAAP (FRS 102)	IFRS	Converted for consolidation
SG Singapore Pte Ltd	Singapore	SFRS	IFRS	SFRS is IFRS-identical

Entity	Jurisdiction	Statutory Accounts	GloBE Accounts	Notes
TechStart Ltd	Ireland	Irish GAAP	Irish GAAP*	*Art. 3.1.3 exception applied

11.2 TechStart Exception Documentation

For TechStart Ltd, Stratos must document why the Article 3.1.3 exception applies:

Documentation Checklist:

Item	Evidence
Not reasonably practicable	Integration timeline extends beyond FY 2025; manual conversion would require €150K consultancy cost
Maintained accounts	Audited Irish GAAP accounts filed with CRO
Reliable information	Unqualified audit opinion
Permanent differences >€1M	R&D capitalisation: €1.8M adjusted to IFRS treatment

12. Common Pitfalls

12.1 Pitfall 1: Using Consolidated P&L Directly

Wrong: Taking the consolidated P&L and allocating to jurisdictions based on revenue splits.

Correct: Using each CE's individual financial accounts before consolidation eliminations.

12.2 Pitfall 2: Eliminating Intra-Group Transactions

Wrong: Removing intra-group sales when calculating GloBE Income because "they're eliminated at group level."

Correct: Including all intra-group transactions at arm's-length values in each CE's GloBE Income.

12.3 Pitfall 3: Deducting Minority Interest

Wrong: Reducing a CE's GloBE Income by the minority share (e.g., 40% for external investor).

Correct: Using full GloBE Income; minority adjustment occurs during Top-Up Tax allocation.

12.4 Pitfall 4: Ignoring Alternative Standard Conditions

Wrong: Using local GAAP accounts "because that's what we have" without checking the three conditions.

Correct: Verifying maintained accounts, reliability, and adjusting permanent differences >€1M.

12.5 Pitfall 5: Missing Material Competitive Distortions

Wrong: Using an Authorised standard without checking for the €75M distortion threshold.

Correct: Comparing key principles to IFRS and quantifying any aggregate variance.