Staff Paper

Project	**Consolidation**
Topic	**Disclosures – Non-controlling interests' involvement in the group's activities**

Introduction

1. In June 2010, the Board tentatively decided that the final disclosure standard should include a disclosure objective requiring financial statements to include information that helps users of the financial statements understand non-controlling interests' involvement in the group's activities.

2. IAS 1 *Presentation of Financial Statements* currently includes requirements to provide some information related to non-controlling interests involvement in the group's activities. Specifically, IAS 1 requires a reporting entity to present separately the portion of total equity that is attributable to the non-controlling interests in the statement of financial position and the portion of the profit or loss and total comprehensive income attributable to non-controlling interests in the statement of comprehensive income. However, the proposed disclosure objective that was tentatively agreed to at the June 2010 Board meeting goes further than the presentation requirements in IAS 1. For example, the disclosure objective might require a reporting entity to disclose additional information as to where the non-controlling interests are located in the group and how their location within the group affects their ability to participate in the profits or losses and cash flows of the group.

3. The purpose of this agenda paper is to analyse whether the disclosure objective should be supplemented by specific disclosure requirements that would require a

reporting entity to disclose additional information (including summarised financial information) about subsidiaries that have a non-controlling interest that is material to the reporting entity.

4. This agenda paper:

   (a) discusses whether there is a need for additional information (including summarised financial information) about a reporting entity's subsidiaries with material non-controlling interests; and

   (b) outlines proposed disclosure requirements to address this information need.

Is there a need for a disclosure?

5. Based on our discussions with analysts, it is apparent that they use different techniques to analyse financial statements, including valuation multiples based on a price to earnings (P/E)-ratio, an enterprise value (EV) to EBITDA-ratio, or variations of those metrics and discounted cash flow models. In order to perform those valuations, the analyst needs to identify profits or cash flows that are attributable to the ordinary shareholders of the parent and those that are attributable to non-controlling interests.

6. IAS 1 provides some of the information necessary to perform the valuations by requiring a reporting entity to present:

   (a) *in the statement of financial position*, the non-controlling interest within equity;

   (b) *in the statement of comprehensive income*, profit or loss and total comprehensive income for the period attributable to the non-controlling interest; and

   (c) *in the statement of changes in equity*, a reconciliation between the non-controlling interest at the beginning of the period and the end of the period.

7. Analysts confirmed that the presentation requirements in IAS 1 provide important information related to the profits or losses and cash flows attributable to the ordinary shareholders of the parent. However, they emphasised that they need additional information to generate robust estimates of the future profits/losses and cash flows attributable to the ordinary shareholders of the parent. The consolidated financial statements present the financial position, the comprehensive income and cash flows of the group as a single entity. They ignore the legal boundaries of the parent and its subsidiaries. However, those legal boundaries could affect the parent's access and use of assets and resources of its subsidiaries and, therefore, affect the cash flows that can be distributed to the shareholders of the parent.

8. To identify the profits or losses and cash flows available to the shareholders of the parent, the analyst must understand the non-controlling interests' share in the profits or losses, cash flows and net assets of the subsidiaries and how the non-controlling interests' rights in those subsidiaries affect the parent's ability to access and use the assets and resources of its subsidiaries.

9. As a consequence, analysts have communicated that they consider it to be helpful to have an understanding of the non-controlling interests' involvement in the group's net assets, profits or losses and cash flows that goes beyond the aggregated amounts that are presented in accordance with IAS 1. Rather, to estimate profits or losses and cash flows attributable to the ordinary shareholders of the parent, analysts need detailed information about those subsidiaries that have a non-controlling interest that is material to the reporting entity.

10. IFRS 8 *Operating Segments* requires a reporting entity to disclose information about its reporting segments that enables users of its financial statements to evaluate the nature and financial effects of the business activities in which the reporting entity engages and the economic environments in which it operates. An operating segment can consist either of one legal entity, of a group of entities or of a part of an entity. IFRS 8 requires neither disclosure of the non-controlling interests in an operating segment nor disclosure of dividend payments within the group. Therefore, segment information would generally

not allow analysts to estimate profits or losses and cash flows attributable to the ordinary shareholders of the parent.

11. The staff believes the proposed disclosure objective would help users of financial statements understand the non-controlling interests' involvement in the group's activities. However, analysts argue that this disclosure objective should be supplemented by more specific disclosure requirements. In their view, only specific disclosure requirements can ensure that all information necessary to estimate the profits or losses and cash flows attributable to the ordinary shareholders of the parent is provided on a consistent basis.

What would the disclosure look like?

12. ED 9 *Joint Arrangements* proposed that the reporting entity should disclose a list of significant subsidiaries, including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting powers held. Users had asked the IASB to reintroduce the disclosure after it had previously eliminated a similar disclosure from IAS 27 *Consolidated and Separate Financial Statements* as part of the Improvements project in 2003. ED 10 *Consolidated Financial Statements* did not propose any related disclosure requirements. This disclosure requirement is similar to requirement in the SEC's Regulation S-K Item 601, except that the information is required to be provided as an exhibit to a company's Form 10-K.

13. Most respondents to ED 9 agreed that the IASB should reintroduce a requirement for a reporting entity to disclose a list of its significant subsidiaries. In addition, even though ED 10 did not include a similar requirement, some respondents to ED 10 requested that the IASB require a reporting entity to disclose information about its subsidiaries that would go beyond the proposals in ED 9. Those respondents asked the IASB to consider disclosure requirements that would include a table of summarised information by legal entity, such as, condensed financial statements for all individually material subsidiaries reconciled to the consolidated financial statements. In their view, such a

disclosure would provide insight into the structures within the group that comprise a significant portion of the consolidated group's assets and revenues.

14. The staff has sympathy for respondents' requests that a reporting entity should disclose legal and summarised financial information of subsidiaries. However, we believe that if the board decides to require such a disclosure, the disclosure requirements should be limited to those subsidiaries that have non-controlling interests that are material to the reporting entity.

15. Consistent with that disclosure objective, the staff believes that a reporting entity should be required to provide the following disclosures:

    (a) **the name of the subsidiary** because naming subsidiaries that have non-controlling interests that are individually material to the reporting entity helps users to search for other information that might be useful for their analysis of the subsidiary.

    (b) **the country of incorporation or residence** because this assists users in understanding the political, economic and currency risk associated with those subsidiaries.

    (c) **the method for allocating the profits or losses to the non-controlling interest and, if it is different to the proportion of ownership interests, the proportion of voting rights held by the non-controlling interest** because this information enables users to understand the profits or cash flows attributable to the ordinary shareholders of the parent and the amount attributable to non-controlling interest.

    (d) **summarised financial information for the subsidiary**, such as the subsidiary's assets, liabilities, revenues, profit or loss and dividends paid to non-controlling interests (before intercompany eliminations). Again, this information would help users to understand the profits or losses and cash flows attributable to the ordinary shareholders of the parent and the amount attributable to non-controlling interest.

16. The following example illustrates the application of the disclosure requirement:

ABC Group has 26 subsidiaries. The following subsidiaries have non-controlling interests that are material to ABC Group:

	ABC AG Switzerland		ABC Inc. USA		ABC Consult United Kingdom	
	20X1	*20X0*	*20X1*	*20X0*	*20X1*	*20X0*
Ownership held by ABC Group	*75%*	*75%*	*60%*	*55%*	*65%*	*65%*
Summarised financial information	*CU*	*CU*	*CU*	*CU*	*CU*	*CU*
Total Assets	3,245	3,200	458	450	280	295
Total Liabilities	2,197	2,234	310	303	173	162
Net Assets	1,048	966	148	147	107	133
Revenues	4,020	3,967	600	598	423	456
Profit or loss	620	598	250	241	-50	2
Dividends distributed to NCI	150	140	80	75	0	0
Operating cash flow	1,100	1,074	431	412	-5	-1
Net cash flow	580	567	187	175	-67	-3

17. We do not believe that the proposed disclosures would impose excessive costs on preparers of financial statements because the information to be disclosed would generally be available to the reporting entity when preparing consolidated financial statements.

18. We acknowledge that sometimes subsidiaries will not prepare their individual financial statements for the information to be incorporated in the consolidated financial statements of the group. In addition, there might be situations, in which a subsidiary neither prepares financial statements in accordance with IFRSs nor does the reporting entity prepare a reconciliation of the subsidiary's financial statements to IFRSs, because it prepares the group financial statements directly without recourse to the individual financial statements of its subsidiaries.

19. We agree that, in those cases, the proposed disclosure requirement would impose additional costs on the reporting entity. However, we note that paragraph 37(b) of IAS 28 *Investments in Associates* contains a similar disclosure requirement for the reporting entity's investments in associates. We are not aware that this disclosure has imposed insurmountable challenges on preparers.

20. The proposed disclosure requirements would be limited to subsidiaries that have non-controlling interests that are individually material to the reporting entity,

rather than all subsidiaries of the reporting entity. In addition, the information to be provided could be aggregated in accordance with the general aggregation principle in the disclosure standard. According to that principle, a reporting entity may aggregate disclosures for similar entities if separate disclosure would not provide more useful information to users of financial statements. Therefore, a reporting entity could, for example, aggregate the summarised financial information of two or more subsidiaries according to their activities or geographical location if the non-controlling interests of the entities have similar rights.

21. Some board members have asked the staff to investigate whether the scope of the proposed disclosure requirement should be limited to those situations where a reporting entity is required to disclose the effect of significant or unusual statutory, contractual or regulatory rights of the non-controlling interests that restrict the reporting entity's ability to access and use the assets and liabilities of a subsidiary.

22. We have discussed this request with the user representatives of the IASB and the FASB. Those board members did not believe that the scope of the proposed disclosure requirement should be limited to these situations. In their view, any form of non-controlling interest, regardless of whether it has significant or unusual statutory, contractual or regulatory rights, would affect the profits or losses and cash flows attributable to the ordinary shareholders of the parent and should therefore be disclosed.

Staff recommendation

23. The staff has come to different conclusions as to whether the Board should introduce a disclosure requirement that would require a reporting entity to disclose additional information (including summarised financial information) about subsidiaries that have a non-controlling interest that is material to the reporting entity.

24. Some staff recommend that the Board should require the disclosure because users of financial statements need to estimate the profits or cash flows attributable to the ordinary shareholders of the parent. Disclosure of legal and summarised financial information of the subsidiaries would enable users to generate a more robust estimate of those profits or cash flows by identifying, for example:
    (a) the assets and liabilities that are being held by subsidiaries;
    (b) risk exposures of particular group entities (e.g. by identifying which entities hold debt); and
    (c) those entities that generate significant cash flows.
25. Those staff note that users of financial statements have consistently requested such information.
26. Other staff do not believe that the disclosure requirement should be introduced as part of this project. They believe that the objective of providing such disclosures would be similar to the objectives of providing segment information. They believe that if the Board thinks that segment information does not enable users to evaluate the nature and financial effects of a particular business activity, the Board should examine whether the requirements for segment reporting need to be revised as part of a separate project.

Question for the Board

For subsidiaries with non-controlling interests that are individually material to the reporting entity, does the Board believe that the reporting entity should disclose:

(a) the name;

(b) the country of incorporation or residence;

(c) the proportion of ownership interest and, if different, proportion of voting interest held; and

(d) summarised financial information?