Project **Annual Improvement**

Topic **Amendments to IFRS3 and IAS27 - Transition requirements for negative non-controlling interests**

Proposed amendments

1. In phase II of the business combinations project, the Board changed the attribution of losses applicable to non-controlling interest (NCI) that exceed the NCI in the subsidiary's equity and required an entity to allocate those losses to the NCI even if this results in the NCI having a deficit balance. Although the amended standard states that retrospective application is not required, some constituents ask the Board to clarify the requirement with respect to the following issue:

   Issue: How should an entity account for losses in excess of the NCI in the subsidiary's equity that were previously absorbed by the owners of the parent (a) at the day of transition and (b) when the subsidiary reports subsequently profits?

Staff recommendation

2. The staff recommends that the Board:

   (a) add this issue to the annual improvements project; and

   (b) add additional guidance to IAS 27 (as issued in 2008) for the transition and subsequent accounting for losses in excess of NCI's equity that were previously absorbed by the owners of the parent.

Background

3. IAS 27 (as issued in 2003) requires attribution of losses in excess of the NCI's equity against the equity of the owners of the parent unless the NCI has a binding obligation to fund those losses. Future earnings would then be allocated

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

to the owners of the parent to the extent that they have previously absorbed losses.

4. The amendment to IAS 27 in 2008 requires allocation of losses to the NCI even if this results in NCI having a deficit balance. To simplify the transition, the Board decided not to require retrospective application of the amendment. As a consequence, an entity does not restate profit or loss attributions for individual reporting periods before the amendment is applied (IFRS 3.45(a)).

5. However, the standard does not explain how the amendment should be applied at the date of transition and does not address the subsequent accounting for the amendment. Therefore, some constituents ask the Board to provide guidance on the following two questions:

Question 1: At the day of transition should an entity reallocate losses attributable to NCI that were previously allocated against the equity of the owners of the parent to NCI?

Question 2: If reallocation is not required, how should the subsidiary allocate future profits? Should it be allocated to the owners of the parent until the previously absorbed losses have been reversed? Or should an entity allocate future profits on the basis of the present ownership interests of the owners of the parent and NCI, ignoring the losses that have been previously absorbed by the owners of the parent?

Staff Analysis

6. The staff believes that there are three alternatives to address those questions:

Alternative 1: Upon transition, the entity does not reallocate previously absorbed losses from equity of the owners of the parent to NCI. In addition, future profits are allocated in proportion to the respective interests of the owners of the parent and NCI; thus ignoring the losses that have been previously absorbed by the owners of the parent.

Alternative 2: Upon transition, the entity does not reallocate previously absorbed losses from equity of the owners of the parent to NCI. However, future profits will be allocated first to the owners of the parent until the previously absorbed losses are reversed. Subsequently profits are attributed to the owners of the parent and NCI.

Alternative 3: Upon transition, the entity reallocates previously absorbed losses from the equity of the owners of the parent to NCI without restating prior years' comparatives. If the Board adopts this alternative, it is not necessary to provide further guidance on the subsequent accounting.

7. Staff are divided into two views.

View 1

8. Some staff believe that when the Board issued IAS 27 (as issued in 2008) it intended Alternative 1 to apply. An extract of the June 2007 agenda paper is attached as Appendix B.

9. Those staff acknowledge that a consequence of adopting Alternative 1 is that upon transition the NCI balance is different from the amount that would be recorded if the amended standard had been applied. However, we note that this is not the only situation where on transition a NCI balance is carried over that departs from the requirement of the revised standard. The Board decided to require prospective application of IAS 27 (as issued in 2008) and does not require the restatement of the NCI balance to comply with the revised standard. To require the recasting of a negative NCI balance on transition would therefore be inconsistent with the transition requirements for other situations.

10. Alternatives 2 and 3 would require an entity to reallocate equity between the owners of the parent and the non-controlling interest. We believe that the arguments against requiring retrospective application of the amended requirement are equally applicable to the reallocation of equity on the transition date or a subsequent date. In July 2007 the Board observed that this might cause the implementation issues as it is unclear how far an entity must go back to reallocate equity and that information might not be available.

11. Therefore, those staff recommend that the Board clarify that:

    (a) upon transition, an entity does not reallocate previously absorbed losses from equity of the owners of the parent to the non-controlling interest; and

    (b) the entity allocates subsequent profits on the basis of the present ownership interests of the owners of the parent and NCI.

12. Alternatively, this matter could be referred to the IFRIC. If the Board agrees that the requirements are already clear the IFRIC could be asked whether theu agree with the Board assessment.

View 2

13. Other staff support Alternative 3. Those staff consider that in the previous deliberation, the Board has only exempted the retrospective application of the amended requirement, but not the reallocation of equity on the transition date.

14. Those staff consider that by adopting alternative 3, the NCI balance will reflect at the transition date all profits and losses that were attributable to NCI. It therefore provides a clean starting point that is consistent with the requirement of the amended standard for the allocation of future profits and there is no need to address questions 2 in Note 5 above.

15. Those staff also consider that entities should have the information to perform the reallocation readily available. Because in order to comply with the requirements in IAS 27 (as issued in 2003) entities had to keep track of loss attributable to NCI that were applied against the equity of the controlling interest. They also believe it will enhance comparability between entities if the NCI of all entities is measured in the same manner.

16. Therefore, those staff recommend that the Board propose amending IAS 27 to state that upon transition, an entity shall reallocate previously absorbed losses from equity of the owners of the parent to the non-controlling interest.

Question to the Board
(1) Does the Board agree to add this issue to the annual improvements project? (2) Does the Board support view 1 or view 2 in this paper?

Appendix A

A1. Draft of the proposed amendment to IAS 27 *Consolidated and Separate Financial Statements* for View 1

IAS 27 Consolidated and Separate Financial Statements

Paragraph 45(a) is amended as follows (new text is underlined):

45(a) … Therefore, an entity shall not restate any profit or loss attribution for reporting periods before the amendment is applied. <u>An entity that has allocated losses in excess of the equity of the non-controlling interest in the subsidiary to the owners of the parent before the amendment is applied shall not adjust equity attributable to non-controlling interest on transition. If the subsidiary reports profits after the application of the amendment, such profits shall be allocated on the basis of present ownership interest of the parent and non-controlling interests.</u>

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of the proposed amendments.

BC1 In phase II of the Board's project on business combinations the Board has amended the attribution of total comprehensive income to owners of the parent and non-controlling interests. The amended standard requires that total comprehensive income is attributed to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance. The Board decided to require prospective application of the amendment because of the implementation difficulties and costs associated with a retrospective application of the amendment.

BC2 Subsequent to the publication of the amended Standard, some constituents asked the Board to clarify the transition requirements when an entity has previously allocated losses in excess of the equity of non-controlling interests to equity of the owners of the parent. Constituents asked how an entity should account for those losses (a) at the day of transition and (b) when the subsidiary reports subsequently profits.

BC3 The Board noted that the adjustment of equity attributable to non-controlling interest on the transition date or a subsequent date would impose implementation difficulties and costs on preparers similar to those that would arise from retrospective application of the amendment. The Board proposes therefore to clarify that on transition an entity does not adjust equity attributable to non-controlling interest for losses that were previously attributed to the owners of the parent. In addition, the Board proposes to clarify that if a subsidiary reports profits after the application of the

amendment, such profits are allocated on the basis of present ownership interest of the parent and non-controlling interests.

BC4 When the Board discussed amending paragraph 45(a) the corresponding US GAAP standard SFAS 160 *Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51* was already effective. Therefore, the Board does not believe that the proposed amendment will affect the alignment of IAS 27 and SFAS 160.

A2. Draft of the proposed amendment to IAS 27 *Consolidated and Separate Financial Statements* for View 2

IAS 27 Consolidated and Separate Financial Statements

Paragraph 45(a) is amended as follows (new text is underlined):

45(a) … Therefore, an entity shall not restate any profit or loss attribution for reporting periods before the amendment is applied. <u>If before the application of this Standard an entity has allocated losses in excess of the equity of non-controlling interest to the controlling interest, the entity shall allocate those losses to the non-controlling interest and adjust the equity of the controlling interest accordingly when it applies the amendments.</u>

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of the proposed amendments.

BC1 In phase II of the Board's project on business combinations the Board has amended the attribution of total comprehensive income to owners of the parent and non-controlling interests. The amended standard requires that total comprehensive income is attributed to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance. The Board decided to require prospective application of the amendment because of the implementation difficulties and costs associated with a retrospective application of the amendment.

BC2 Subsequent to the publication of the amended Standard, some constituents asked the Board to clarify the transition requirements when an entity has previously allocated losses in excess of the equity of non-controlling interests to equity of the owners of the parent. Constituents asked how an entity should account for those losses (a) at the day of transition and (b) when the subsidiary reports subsequently profits.

BC3 The Board noted that it did not intend to extend the exemption for retrospective application of the revised requirement to the reallocation of equity on the transition date. The Board consider that reallocating previously absorbed losses from equity of the owners of the parent to the non-controlling interest enhance comparability of the financial statements. The Board therefore proposes to clarify that on transition an entity shall adjust equity attributable to non-controlling interest for losses that were previously attributed to the owners of the parent.

APPENDIX B

B1. Extract from the Agenda Paper of the IASB's June 2007 Board Meeting

PURPOSE OF THIS MEMORANDUM

1. The purpose of this memo is to ask the Boards to reconsider one of the transition requirements of the NCI standard.

Transition for Losses in Excess of the Non-controlling Interests Equity that Were Attributed to the Parent

2. ARB 51 and IAS 27 currently require that if losses applicable to the minority (non-controlling) interest exceed the minority interest equity balance, such excess and any further losses applicable to the minority interest are charged against the majority interest since there is no obligation of the minority interest to make good such losses. If future earnings do materialize, the majority interest should be credited to the extent of such losses previously absorbed. The NCI standard will amend ARB 51 and IAS 27 to change that requirement. As such, the parent and non-controlling interest are attributed their share of the losses even if the non-controlling interest balance becomes a deficit.

3. The transition section of the Pre-ballot Draft of the NCI standard proposes to require that if the parent controls the subsidiary when the standard is applied, the parent would recast consolidated net income attributable to the parent to deduct any losses that were attributed to the parent because those losses exceeded the non-controlling interest in the equity capital of the subsidiary. Those losses would be reattributed to the non-controlling interest. The Boards believed recasting for excess losses would improve comparability. The staff is now concerned that this decision will cause practice issues that will outweigh the benefits of comparability.

4. The staff recommends that the Boards change this decision. We recommend that the Boards only require that consolidated net income be recast to combine the amounts attributable to the parent and non-controlling interest, but that the amounts attributable to the parent and the non-controlling interest NOT be changed if the

parent was previously attributed excess losses. The staff is concerned that this will lead to practice issues, such as:

a. The NCI transition decisions were premised on the view that the disclosure provisions should be applied retrospectively for comparability, but that transactions and amount recognized in the financial statements should not be changed. Recasting for excess losses is not just a simple recast. It would require preparers to restate their earnings attributable to the owners of the parent and, therefore, will affect EPS in prior periods.

b. It is much simpler for the preparer not to recast prior earnings. If the Boards do not change this decision, they would need to provide additional guidance about how far back earnings should be recast or else questions will arise.

c. The Boards would have to provide guidance on how to record that recast in the period of adoption (that is, would it be a charge to beginning retained earnings).

d. The recast is only applied if the subsidiary is still owned by the parent when the parent adopts the NCI standard. If the subsidiary is not owned by the parent when the NCI standard is adopted, then earnings would not be recast because that would change the amount recognized as a gain or loss when the subsidiary was disposed of. Thus, comparability will not be achieved anyway.