



Staff Paper

Project	Consolidation
Topic	Disclosures for subsidiaries

Introduction

1. The staff presented to the boards at their March joint meeting a general disclosure principle and supplemental disclosure requirements for subsidiaries. At that meeting, the boards instructed the staff to conduct further research as to how a general disclosure principle could be expressed and how the proposed supplemental disclosures relate to that principle.
2. This agenda paper:
 - (a) provides background on how analysts use the information provided in the financial statements;
 - (b) presents a revised general disclosure principle; and
 - (c) recommends a list of specific disclosures for subsidiaries to supplement the general disclosure principle.

The appendix to this paper contains a summary of the boards' tentative decisions at their March meeting and of the staff recommendations in this paper.

What information do analysts need to analyse consolidated financial statements?

3. Based on the staff's discussions with analysts, they appear to use different techniques to analyse financial statements depending on their objectives. In addition, based on their different objectives they require different information to

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perform their analysis. Equity analysts typically seek to value the interest that the ordinary shareholders of the parent hold in the group. They usually use a valuation multiple based on a price to earnings (P/E)-ratio, an enterprise value (EV) to EBITDA-ratio or variations of those metrics. However some equity analysts may also use a discounted cash flow model. Credit analysts assessing the credit quality of the parent typically use the cash flows available to the parent in their assessment. In order to perform these valuations the analyst needs to identify the cash flows or earnings attributable to the ordinary shareholders of the parent.

4. The consolidated financial statements present the financial position, the comprehensive income and cash flows of the group as if it was a single entity. The consolidated financial statements 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 parent entity. For example, if the parent does not hold all shares in the subsidiary, it has to consider the protective rights of other shareholders of that subsidiary (non-controlling interests). Similarly, the existence of creditors of subsidiaries limit a parent's ability to access cash generated by a subsidiary's assets and, in the absence of guarantee arrangements, a parent would typically not be legally responsible for a corporate subsidiary's debts.
5. Therefore, to identify the cash flows and income attributable to the parent, the analyst must understand the composition of the group, the non-controlling interests' share in the profits or losses, cash flows and net assets of group entities, how protective rights affect the parent's ability to access and use the assets and resources of its subsidiary and the leverage in subsidiaries. An understanding beyond just the amount of consolidated profit attributed to non-controlling interests on an aggregate basis is required to meet these information needs.
6. Most valuation models are based on forward-looking earnings or cash flow information. As a consequence, the analyst must also understand potential

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changes in the composition of the group as changes would effect the future cash flows and net income attributable to ordinary shareholders of the parent.

7. For the same reason, the analyst must have a thorough understanding of the group's risk exposure, both with respect to its subsidiaries and with respect to the group's involvement with unconsolidated entities.

Disclosure principle

8. We believe that the following disclosure principles address the informational needs of users of financial statements as outlined above:

A reporting entity shall disclose information that helps users of financial statements to understand:

- (a) the composition (and changes in the composition) of the group;
- (b) the effect of any significant or unusual legal, contractual or regulatory restrictions on the reporting entity's ability to access and use assets and liabilities of consolidated entities;
- (c) the nature of, and changes in, the risks associated with the reporting entity's involvement with other entities and how those risks could affect future cash flows.

9. The staff believe that those general disclosure principles should be supplemented by specific disclosure requirements. In addition, the staff recommend that the final disclosure requirements clarify that those specific disclosure requirements are minimum disclosures only and that, depending on individual facts and circumstances, additional disclosures might be needed to meet the general disclosure principles.
10. At the joint March meeting, the boards tentatively decided that to comply with the general disclosure principle, a reporting entity should be required to disclose:
 - (a) all significant judgements and assumptions in determining whether it controls another entity and any changes in its control assessments that require significant judgement and the reasons for those changes.

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The staff believe that this disclosure is consistent with the objective that a reporting entity should disclose information that helps users to understand the composition and changes in the composition of the group. When drafting the final disclosure requirements the staff will investigate how this relationship could be expressed more clearly.¹

- (b) the nature of restrictions on assets and liabilities as a result of where they are held in the group.

In the staff's view, this disclosure is consistent with the principle that a reporting entity should disclose information that helps users understand the effect of any significant or unusual legal, contractual or regulatory restrictions on the reporting entity's ability to access and use assets and liabilities of consolidated entities.

11. Some staff also believe that in order to meet the disclosure objective in paragraph 10(a) of this paper, there should be a specific disclosure requirement focusing on situations where an interest holder has a significant investment in an entity but concludes that it doesn't have the power to direct the activities of the other entity. In this case the reporting entity shall disclose the surrounding facts and circumstances that underlie the basis for its conclusion and the rationale or strategy for holding a significant investment in an entity without obtaining control of the entity (including any strategies employed to mitigate the risks from that investment).
12. This agenda paper discusses, whether a reporting entity should also be required to disclose:
 - (a) summarised financial information for subsidiaries;
 - (b) the interests that the non-controlling interests have in the group; and

¹ Subtopic 810-10, as amended by Statement No. 167 contains a disclosure objective, which focuses on how the reporting entity's involvement with subsidiaries that are considered structured entities affects the reporting entity's consolidated financial position, financial performance and cash flows. The staff believe that this disclosure objective is effectively covered by the general disclosure principles stated in paragraph 8 (a) and (c). When drafting the final disclosure requirements the staff will also investigate how this implication could be clarified.

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- (c) its risk exposure from its involvement with subsidiaries.

Summarised financial information for subsidiaries***Proposals in ED 9 and ED 10***

13. Paragraph C7 of 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. Most respondents to ED 9 welcomed the proposal. ED 10 *Consolidated Financial Statements* did not propose any related disclosure requirements. Although Subtopic 810-10 does not contain any comparable disclosure requirements, the SEC's Regulation S-K Item 601 includes a similar requirement to be provided as an exhibit to a company's Form 10-K.

Respondents' comments to ED 9 and ED 10

14. 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. However, some respondents disagreed with the proposal because, in their view, the informational objective underpinning such a disclosure is already met by the segment disclosure requirements in IFRS 8 *Operating Segments* and ASC Topic 280 *Segment Reporting*.
15. Respondents emphasised also that many jurisdictions already require a similar disclosure outside of the financial statements. As a consequence, those respondents believed that the proposal would duplicate information that is already available to users. Other respondents expressed concerns that it might be difficult to introduce the proposed disclosure for large groups with hundreds or even thousands of subsidiaries.

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16. Even though ED 10 did not address this issue, some respondents asked the IASB to 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 require disclosure of a table of summary information by legal structure, 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. This information would enable users to better predict cash flows by identifying the assets and liabilities that are being held by subsidiaries, evaluating risk exposures of particular group entities (e.g. by identifying which entities hold debt) and assessing which entities generate cash flows. Users of financial statements have consistently requested such information.

Staff analysis

17. Some staff agree with respondents to ED 10 and believe that the following disclosures for individually material subsidiaries are consistent with the disclosure principle that a reporting entity should disclose information that would help users to understand the composition of the group:
- (a) **the name** because naming individually material subsidiaries 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 a subsidiary.
 - (c) **the proportion of ownership interest and, if different, proportion of voting rights held** because this information enables users to make adjustments to group earnings/cash flows to determine the amount attributable to the shareholders of the parent.

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- (d) **summarised financial information about the subsidiary**, such as the subsidiary's assets, liabilities, revenues, profit or loss, dividends paid to non-controlling interests and cash flows (before intercompany eliminations). Again, this information would help users to make adjustments to group earnings/cash flows to determine the amount attributable to the shareholders of the parent.
18. Those staff note that the segment information required in IFRS 8 and Topic 280 of the ASC does not provide users with the desired information because segment information ignores the legal boundaries within the group in a similar manner to consolidated financial statements. It treats items as being freely available within a segment without regard to the entity's legal structure. In their view, the proposed disclosures and the segment reporting requirements pursue different informational objectives. The segment reporting standards require a reporting entity to disclose information that enables users to evaluate the nature and financial effects of the business activities in which it engages and the economic environment in which it operates. In contrast, the proposed disclosure aims to provide users of financial statements with information about the composition of the group and the effect of legal structures within the group on the reporting entity's ability to access and use assets and resources of subsidiaries. Therefore, those staff believe that the disclosures complement each other and are not duplicative.
19. Those staff also do not believe that the proposed disclosures would impose excessive costs on preparers of financial statements because the information to be disclosed must be available to the reporting entity when preparing consolidated financial statements. In addition, they emphasise that the proposed disclosures would be limited to individually material subsidiaries only, rather than all subsidiaries of the reporting entity.
20. Other staff do not believe that the disclosures proposed in paragraph 17 of this paper should be required 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 the segment information enables users to

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evaluate the nature and financial effects of a particular business activity. In addition, the determination of an entity's reporting segments is based on the information provided to the chief operating decision maker of the reporting entity, and accordingly the level of disaggregation of the segments should provide the appropriate level of information. . Those staff would suggest that, if the boards believe that the information currently provided in the segment reporting standards are inadequate, this should be dealt with in a separate project addressing segment reporting.

21. Additionally, those staff believe that the legal structure is often irrelevant. For example, a reporting entity with manufacturing operations may establish a number of legal entities in different states or countries to perform product distribution in order to minimize their tax expense. Alternatively, a reporting entity may have a central finance entity that manages finances for the consolidated group and all of the intercompany loans held by the finance entity are eliminated on consolidation. These staff believe that including information about these entities' separate financial statements is not relevant to users and would complicate the financial statements.

The interest that the non-controlling interests have in the group's activities***Proposals in ED 10***

22. Paragraph B35 of ED 10 proposed that a reporting entity disclose information about the interest that the non-controlling interest holders (NCIs) have in the performance, cash-flows and net assets of the group. This information would include, for example: (a) the non-controlling interests' share of profit or loss and comprehensive income; (b) its proportionate interest in dividends paid by subsidiaries; and (c) the business activity or segment to which the non-controlling interests relate.

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Respondents' comments to ED 10

23. A few respondents commented on the proposal. Those respondents had some concerns with respect to the proposal. In particular, they requested that the IASB clarify whether a reporting entity should disclose the interest that the NCIs have in the performance, cash flows and net assets of the group before or after intercompany eliminations.
24. In addition, IFRS 8 and Topic 280 do not require the allocation of non-controlling interests to segments. Therefore, some respondents argued that the allocation of NCIs to business activities or segments could not be done easily and would require additional application guidance. Therefore, they asked the IASB to remove the disclosure requirement in paragraph B35(c) of ED 10.

Staff analysis

25. According to the requirements in IAS 1 *Presentation of Financial Statements* a reporting entity presents non-controlling interests as follows:
- (a) **Statement of financial position:** As a minimum, the reporting entity presents the non-controlling interests, presented within equity;
 - (b) **Statement of comprehensive income:** The reporting entity discloses:
 - (i) profit or loss attributable to non-controlling interests and owners of the parent;
 - (ii) total comprehensive income for the period attributable to non-controlling interests and owners of the parent.
 - (c) **Statement of changes in equity:** The reporting entity discloses for each component of equity, including non-controlling interest, a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing:
 - (i) profit or loss;
 - (ii) each item of other comprehensive income; and
 - (iii) transactions with owners in their capacity as owners, showing separately contributions by and distributions to

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owners and changes in ownership interests in subsidiaries that do not result in a loss of control.

- (d) **Statement of cash flows:** IAS 7 Statement of Cash Flows does not contain particular presentation or disclosure requirements for non-controlling interests.
26. Topics 210-230 and Subtopic 810-10 of the ASC contain similar presentation and disclosure requirements for NCIs.
27. Some staff believe that the disclosure and presentation requirements for NCIs were recently reviewed and updated with the issuance of the Statement 160 amendments to Subtopic 810-10 and the amendments to IAS 27 in phase II of the joint project on business combinations. Accordingly, they do not believe there is a need to revise the recently amended requirements and include additional disclosure requirements relating to NCIs. Other staff believe that although some of the disclosure requirements proposed in ED 10 are already required, in their view, the proposals in ED 10 go further. For example, the proposals in ED 10 would require a reporting entity disclose information as to where the non-controlling interests are located in the group. Depending on whether the boards agree that the disclosures proposed in paragraph 17 of this agenda paper should be required, these disclosure requirements may not be necessary as the reporting entity would be required to disclose its proportion of ownership interests in individually material subsidiaries. However, to supplement the disclosures related to NCIs, these staff recommend that the boards affirm the proposal in ED 10 that a reporting entity should disclose the non-controlling interests' proportionate interest in dividends paid for each individually material subsidiary.
28. ED 10 proposed that a reporting entity should disclose the business activity or segment to which the non-controlling interests relate. However, the staff agree with respondents that it would be difficult to allocate non-controlling interests to particular segments. Therefore, neither IFRS 8 nor Topic 280 requires such an allocation. As a consequence, the staff recommend that the boards do not finalise this disclosure proposal.

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Risk disclosures for subsidiaries***Requirements in the Statement 167 amendments to Topic 810-10 for VIEs***

29. The Statement 167 amendments to Subtopic 810-10 contain disclosures about the nature of, and risks associated with, a reporting entity's involvement with consolidated structured entities. Paragraph 810-10-50-5A(d) requires an enterprise that is the primary beneficiary of a variable interest entity to disclose qualitative and quantitative information about the enterprise's involvement (giving consideration to both explicit and implicit variable interests) with the variable interest entity, including, but not limited to, the nature, purpose, size, and activities of the variable interest entity, and how the entity is financed.
30. In addition, paragraph 810-10-50-3(d) requires the primary beneficiary of a variable interest entity to disclose the terms of the arrangement, giving consideration to both explicit arrangements and implicit variable interests that could require the enterprise to provide financial support (for example, liquidity arrangements and obligations to purchase assets) to the variable interest entity, including events or circumstances that could expose the enterprise to a loss.

Respondents' comments to ED 10

31. ED 10 did not propose risk disclosures for subsidiaries. However, one respondent to ED 10 had asked the IASB to consider whether it should develop a disclosure for a reporting entity's risk exposure from its subsidiaries.

Staff analysis

32. We agree with this respondent that it would assist users in their risk assessment if a reporting entity provided disclosures about the nature of, and risks associated with, a reporting entity's subsidiaries, similar to the disclosures in paragraph 810-10-50 of the ASC.
33. At the joint March meeting, the boards tentatively decided that a reporting entity should disclose its implicit obligations to support its subsidiaries. We recommend that, similar to the disclosure in paragraph 810-10-50-3(d) of the

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ASC, a reporting entity should be required to disclose whether it has an explicit obligation to support any of its subsidiaries.

We acknowledge that it would help users in their understanding of the risk exposure of the reporting entity if the reporting entity provided the disclosure discussed in paragraph 17 for all individually material subsidiaries.

However, we propose to restrict those disclosures to consolidated structured entities. This is because the staff believe that it would be difficult to make the recommendation operational for all entities as this would require detailed information about all commitments (including loans) between a parent and any of its subsidiaries.

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Questions for the boards

- (1) Do the boards agree with the modified disclosure principle, according to which a reporting entity should disclose:
- (a) the composition (and changes in the composition) of the group;
 - (b) the effect of any significant or unusual legal, contractual or regulatory restrictions on the reporting entity's ability to access and use assets and resources of consolidated entities to generate future cash flows;
 - (c) the nature of, and changes in the risks associated with the reporting entity's involvement with other entities and how those risks affect future cash flows?
- (2) Do the boards believe that to help users of financial statements to understand the composition of the group the reporting entity should disclose:
- (a) in situations where an interest holder has a significant investment in an entity but concludes that it does not have the power to direct the activities of the other entity: (i) the surrounding facts and circumstances that underly the basis for its conclusion and (ii) the rationale or strategy for holding a significant investment in an entity without obtaining control of the entity (including any strategies employed to mitigate the risks from that investment.
 - (b) a list of individually material subsidiaries containing (i) the name, (ii) the country of incorporation or residence, (iii) the proportion of ownership interest and, if different, proportion of voting interest held and (iv) summarised financial information? Do the boards believe that a reporting entity should also disclose the non-controlling interests' proportionate interest in dividends paid for each individually material subsidiary?
- (3) Do the boards agree that to help users of financial statements to understand the nature of, and changes in, the risks associated with the reporting entity's involvement with structured entities and how those risks affect future net cash inflows the reporting entity should disclose the terms of any explicit arrangements that could require a reporting entity to provide financial support to a consolidated structured entity?

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Appendix – Summary of the disclosure requirements for subsidiaries

34. This agenda paper recommends that the boards adopt the following general disclosure principle:

A reporting entity shall disclose information that helps users of financial statements to understand:

- (a) the composition (and changes in the composition) of the group;
- (b) the effect of any significant or unusual legal, contractual or regulatory restrictions on the reporting entity's ability to access and use assets and liabilities of consolidated entities to generate future cash flows;
- (c) the nature of, and changes in, the risks associated with the reporting entity's involvement with other entities and how those risks affect future cash flows.

35. In March, the boards tentatively decided that to comply with the general disclosure principle a reporting entity should disclose:

- (a) all significant judgements and assumptions in determining whether it controls another entity and any changes in its control assessments that require significant judgement and the reasons for those changes;

Some staff recommend to supplement this general disclosure requirement with a more specific disclosure requirement, according to which a reporting entity should always disclose situations where it holds a significant investment in an entity but concludes that it does not have the power to direct the activities of the other entity.

- (b) the nature of restrictions on assets and liabilities as a result of where they are held in the group.

36. In this agenda paper, we recommend that a reporting entity should disclose the terms of any explicit arrangements that a could require a reporting entity to provide support to a consolidated structured entity.

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37. Some staff recommend that a reporting entity should also 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, including the non-controlling interests' interest in dividends paid, of individually material subsidiaries.
38. In March, the boards tentatively decided that a reporting entity could provide the disclosures on an aggregated basis, unless separate disclosure would provide more decision-useful information. The final disclosure requirements will contain application guidance on how the information could be aggregated.
39. We will also clarify in drafting that the specific disclosure requirements described above are minimum disclosures only and that, depending on individual facts and circumstances, additional disclosures might be needed to meet the general disclosure principle.