Full consolidation of partly owned subsidiaries requires additional disclosure

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Full consolidation of partly owned subsidiaries requires additional disclosure

1. Significant uncertainty in 'non-controlling interest' line item

2. Many entities report 'non-controlling interest'

3. Standards require a solution, but do not (yet) specify one

4. Solutions that reduce uncertainties

1. Significant uncertainty in line item 'non-controlling interest'

Fully consolidated financial statements primarily reflect controlled entities: the perspective of common, and outside shareholders combined

Investors tend to assess an entity's value, leverage and liquidity from the perspective of the common shareholder

Only 2 line items in the balance sheet and income statement reflect the common shareholders perspective:

- common equity
- net income attributable to common shareholders

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1. Significant uncertainty in 'non-controlling interest' line item

Non-controlling interest in equity represents the net amount of very specific assets and liabilities located in the partly owned subsidiaries that is attributable to outside shareholders.

This net amount implies a wide range of possible gross amounts:

HoldingCo	Full consolidation	Attributable to outside shareholders				
		Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario x
Cash	100	20		8	32	0 - 100
Accounts receivable	100		20	32	8	0 - 100
Total assets	**200**	**20**	**20**	**40**	**40**	**20 - 120**
Accounts payable	50			4	16	0 - 50
Interest bearing debt	50			16	4	0 - 50
Non-controlling interest	**20**	**20**	**20**	**20**	**20**	**20**
Common equity	80					
Group equity	100					
Total liabilities & equity	**200**	**20**	**20**	**40**	**40**	**20 - 120**

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1. Significant uncertainty in 'non-controlling interest' line item

The 'proportionate share' of a line item shows what part of the fully consolidated total is attributable to the common shareholder

		Less	Equals
	Full consolidation	**Non-controlling interest in equity**	**Proportionate share**
Cash	300	1	299
Accounts receivable	200	50	150
Goodwill	400	200	200
Total assets	**900**	**251**	**649**
Accounts payable	300	25	275
Interest paying debt	500	225	275
Total liabilities	**800**	**250**	**550**
Non-controlling interest	1	1	
Common equity	99		**99**
Group equity	**100**		
Total liabilities & equity	**900**	**251**	**649**

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1. Significant uncertainty in 'non-controlling interest' line item

A wide range of possible gross amounts results in
a wide range of favourable and unfavourable scenarios.

Example AkzoNobel:

AkzoNobel, Scenario 'Favourable'	Full consolidation	Subsidiaries, % owned 100%	51%	Proportionate share	
EBITDA	1,964	1,964	-	1,964	(1,964 = 1,964 * 100% + 0 * 51%)
Cash	2,851	2,851	-	2,851	
Debt	3,787	-	3,787	1,931	
Net debt	936	(2,851)	3,787	(920)	

AkzoNobel, Scenario 'Unfavourable'	Full consolidation	Subsidiaries, % owned 100%	51%	Proportionate share	
EBITDA	1,964	-	1,964	1,002	(1,002 = 0 * 100% + 1,964 * 51%)
Cash	2,851	-	2,851	1,454	
Debt	3,787	3,787	-	3,787	
Net debt	936	3,787	(2,851)	2,333	

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1. Significant uncertainty in ‘non-controlling interest’ line item

Significant uncertainty in assessment of valuation, leverage and liquidity

	AkzoNobel Full consolidation		AkzoNobel, Scenario 1 Proportionate share		AkzoNobel, Scenario 2 Proportionate share	
		=		or		or anything in between?
Cash	**2,851**		**2,851**		**1,454**	
Debt	3,787		1,931		3,787	
Net debt	936		(920)		2,333	
Non-controlling interests	525					
Market value equity	12,280		12,280		12,280	
Firm value	13,741		11,360		14,613	
EBITDA	1,964		1,964		1,002	
Common financial ratios						
Net debt / EBITDA	**0.5x**		**<net cash>**		**2.3x**	
Firm value / EBITDA	**7.0x**		**5.8x**		**14.6x**	

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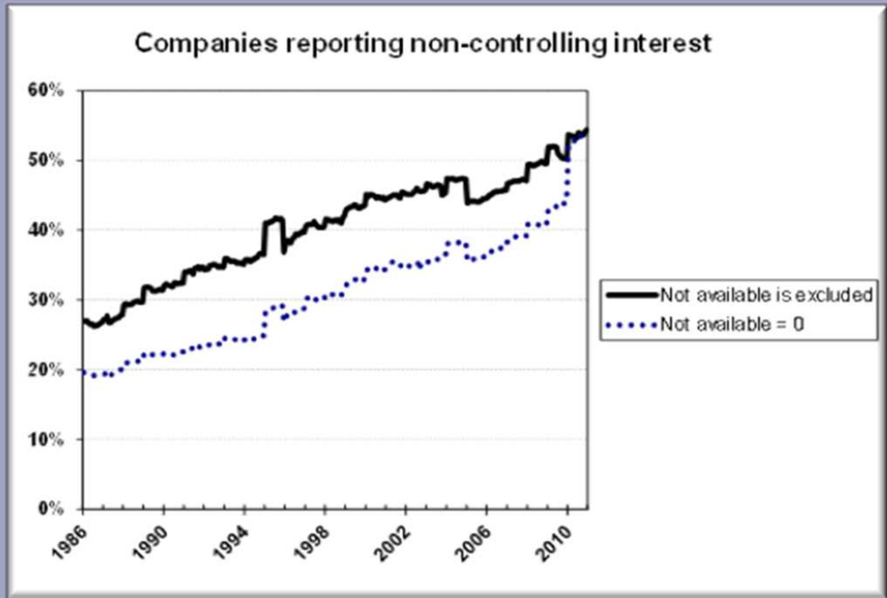
2. Many entities report 'non-controlling interest'

- A majority of a large sample of listed companies worldwide report 'non-controlling interest'

	% of companies with non-controlling interests		
Region	not nil	> 10%	**Sample size**
Europe	61%	17%	2,606
North America	33%	8%	2,708
RoW	69%	23%	2,582
Grand Total	**54%**	**16%**	7,896

- Over the past 35 years the percentage of large US entities that fully consolidate partly owned subsidiaries has doubled



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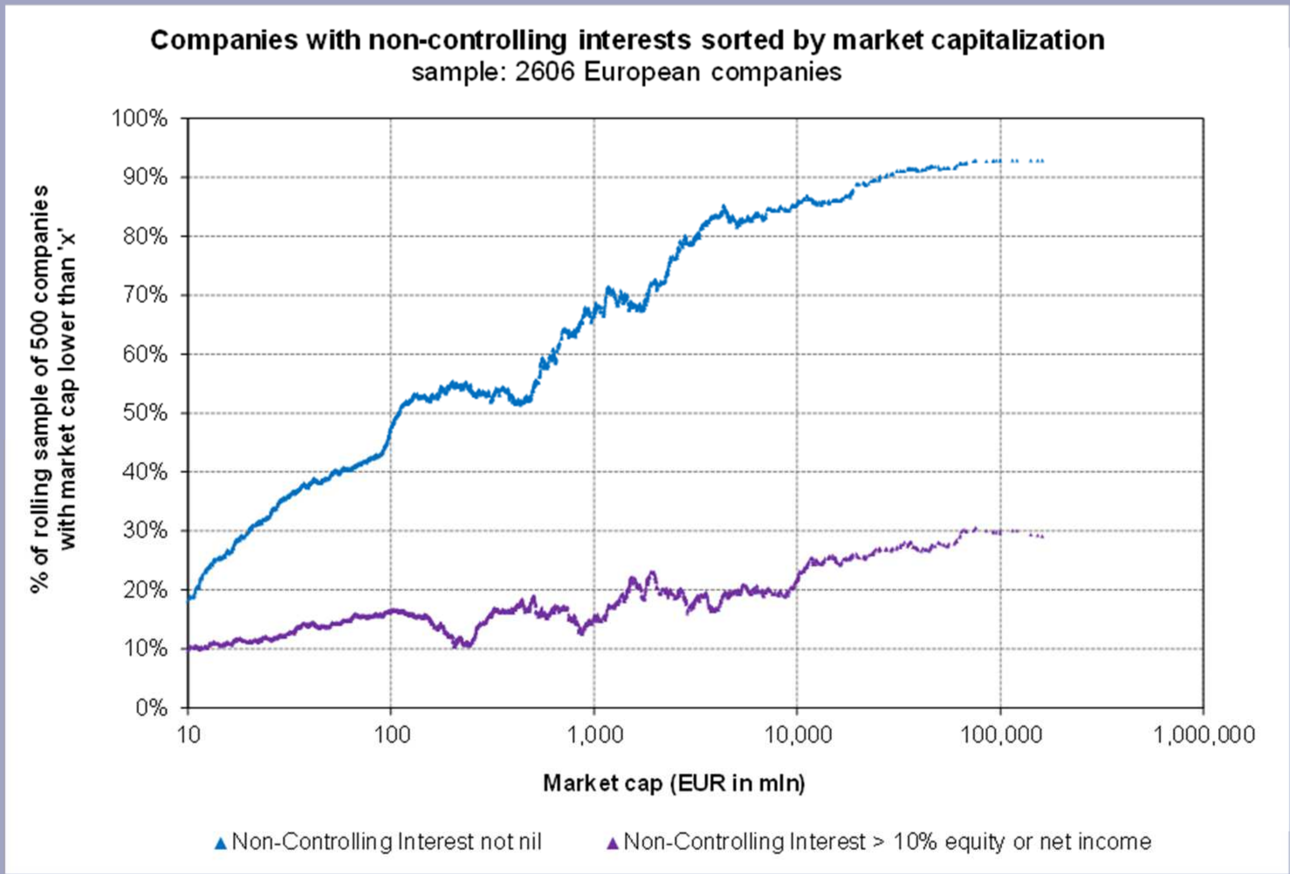
2. Many entities report ‘non-controlling interest’

Larger entities tend to more often control partly owned subsidiaries than smaller entities.



3. Standards require a solution, but do not (yet) specify one

- IFRS 12 objective: disclosure should enable users of the entity's financial statements to evaluate the effects of interests in partly owned subsidiaries on its (i.e. the entity's) financial position, financial performance and cash flows.

- Paragraph 3 of IFRS 12 states: 'If the disclosures required by this IFRS, together with disclosures required by other IFRSs, do not meet the objective in paragraph 1, an entity shall disclose whatever additional information is necessary to meet that objective.'

- IAS 1 – Definitions – 'Material':
  "Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. …"

3. Standards require a solution, but do not (yet) specify one

Disclosures ‘per other entity’ as specified in IFRS 12 do not allow for calculation of proportionate shares at group level:

- ‘Per entity’ includes intragroup transactions
- Too low suggested level of detail for partly owned subsidiaries
- A large number of partly owned subsidiaries is too time intensive for analysts to analyse

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4. Solutions: Why 'proportionate shares'

Financial reporting influences financial analysis

Current financial analysis uses a 2-step approach:

- assume 100% ownership of all subsidiaries
- adjust for non-controlling interest

'Proportionate shares' allows for 1-step approach:

- actual ownership percentages of all subsidiaries are start point

4. Solutions

- Create consensus amongst users, standard setters, preparers and supervisory bodies that insight in ‘proportionate shares’ is relevant for financial analysis

- How could companies provide insight in proportionate shares?
  - Indirectly: disclosing composition of NCI in equity & net income
  - Directly: disclosing proportionate shares
  - ‘Not material’ statement

- How could IASB contribute
  - Annual improvement of IFRS 12
  - Revisions following PIR of IFRS 12: too late
  - Revisions following PIR of IFRS 8

4. Indirect solution: Require composition of NCI

Nutreco N.V. annual report provided some detail on non-controlling interests

- Proportionate share of net income is 99.5% of group income
- Proportionate share of operating profit is 98.2% of operating profit

Non-controlling interest

The non-controlling interest mainly consists of Piensos Nanfor (50%) and Piensos Nanpro (50%) in Spain and Trouw Nutrition Russia (10%). For disclosure on the change of non-controlling interest reference is made to note 6 Acquisitions.

The key items for profit or loss (based on the non-Nutreco share) for the non-controlling interests are shown in the table below:

(EUR x million)	2011	2010
Revenue	101.5	98.9
Gross margin	17.0	16.7
Operating result	3.5	4.2
TOTAL RESULT FOR THE PERIOD	**0.7**	**1.6**

4. Indirect solution: Require composition of NCI Example disclosure

Note x 'non-controlling interest in group equity'

Outside shareholders own stakes in subsidiaries that we fully consolidate.
The non-controlling interest in group equity of 1 represents the share of outside shareholders in group equity.
This amount represents a net amount of assets and liabilities attributable to those outside shareholders.
The amounts attributable to outside shareholders for each line-item of our fully consolidated balance sheet are:

Balance sheet	**Attributable to outside shareholders**
Cash	1
Accounts receivable	50
Goodwill	200
Total assets	**251**
Accounts payable	25
Interest paying debt	225
Total liabilities	**250**
Group equity	**1**
Total liabilities & equity	**251**

Note y 'non-controlling interest in net income'

Outside shareholders own stakes in subsidiaries that we fully consolidate.
The non-controlling interest in group equity of x represents the share of outside shareholders in net income.
This amount represents a net amount attributable to those outside shareholders.
The amounts attributable to outside shareholders for each line-item of our fully consolidated income statement are:

Income statement	**Attributable to outside shareholders**
…	

Note z 'non-controlling interest in cash flow statement'

Outside shareholders own stakes in subsidiaries that we fully consolidate.
Amounts attributable to outside shareholders are included in some, or all, of these line-items.
The amounts attributable to outside shareholders for each line-item of our fully consolidated cash flow statement are:

Cash flow statement	**Attributable to outside shareholders**
…	

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4. Direct solution

Revision of IFRS 8 Operating Segments (following current PIR)

- disclosure what part of the presented performance indicators is attributable to common shareholders (i.e. the proportionate shares)
- even if this is not wholly consistent with the concept of ‘through the eyes of the chief operating decision maker’

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4. Direct solution: Example disclosure

Example: company 'Fresenius SE & Co.KGaA'

Operating segment reporting with room for improvement

	Operating segment					
Fully consolidated (EUR in mln)	**FMC**	**Kabi**	**Helios**	**Vamed**	**Other**	**Total**
Revenue	9,192	3,964	2,665	737	(36)	16,522
EBIT	1,491	803	270	44	(45)	2,563

Estimated segment ownership

Estimated outside shareholders' ownership,	**69.7%**	***6.8%***	***7.4%***	**25.7%**	**0.0%**	**42.8%**
based on 'non-controlling interest / Group income'						
	Operating segment					
Estimated company's proportionate shares (EUR in mln)	**FMC**	**Kabi**	**Helios**	**Vamed**	**Other**	**Total**
Revenue	2,782	*3,693*	*2,468*	547	(36)	*9,454*
EBIT	451	*748*	*250*	33	(45)	*1,437*

Suggested operating segment reporting format

	Operating segment											
(EUR in mln, company's proportionate share as %)	**FMC**		**Kabi**		**Helios**		**Vamed**		**Other**		**Total**	
Revenue	9,192	x%	*3,964*	x%	*2,665*	x%	737	x%	(36)	x%	*16,522*	x%
EBIT	1,491	x%	*803*	x%	*270*	x%	44	x%	(45)	x%	*2,563*	x%

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Discussion topics

1. Does the full consolidation of a partly owned subsidiary significantly increases uncertainty for users?

2. Would ‘proportional shares’ provide valuable insight for users?

3. Should IFRS 12 include a request for insight in proportional shares?*

4. Are proportionate shares relevant for insight in segment reporting?*

* if materially different from fully consolidated amounts