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MFRS Hot Topics

Non-controlling interests and other comprehensive income

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Welcome to MFRS Hot Topics - a publication from SJ Grant Thornton. This publication discusses the treatment for items for other comprehensive income that relate to subsidiaries in a few circumstances.

Introduction

This Hot Topic provides guidance on accounting for items of other comprehensive income (OCI) that relate to subsidiaries in the following circumstances:

- there is a non-controlling interest in the subsidiary
- the parent's ownership interest increases or decreases (without loss of control)
- the parent loses control of the subsidiary.

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Guidance

Background

Items recognised in other comprehensive income (OCI)
The main items that MFRS requires to be recognised in OCI are:

- revaluations of property, plant and equipment and intangible assets (MFRS 116.39-40, MFRS 138.85-86)
- remeasurements of defined benefit liabilities (assets) (MFRS 119.57(d))
- exchange differences on translating foreign operations (MFRS 121.39(c) and 44)
- fair value movements on available-for-sale financial assets except impairment losses and foreign exchange gains and losses (MFRS 139.55(b))
- in cash flow (and net investment) hedge accounting, the effective portion of the gain or loss on the hedging instrument (normally a derivative) (MFRS 139.95(a) and 102(a))
- current and deferred tax relating to the above items (MFRS 112.61A(a))
- the investor's share of OCI of equity accounted associates and jointly controlled entities (MFRS 128.10).

Reclassification adjustments
MFRS requires some amounts recognised in OCI to be reclassified to profit or loss in specified circumstances. MFRS 101.7 and 93 refer to these as 'reclassification adjustments'. MFRS requires reclassification adjustments:

- on disposal of a foreign operation (MFRS 121.48)
- on derecognition or impairment of available-for-sale financial assets (MFRS 139.55(b) and 67)
- in cash flow hedge accounting, when the hedged transaction affects profit or loss and in various other circumstances (MFRS 139.97-102)
- to recognise the investor's share of reclassification adjustments of equity accounted investees (MFRS 128.22(c), MFRS 128.23, MFRS 128.25 and MFRS 131.45B)
- on loss of control of a subsidiary, as if the related assets or liabilities had been disposed of directly - see guidance below (MFRS 10.B99).

Reclassification adjustments are not permitted for revaluations of property, plant and equipment and intangible assets or for remeasurements of defined benefit plan liabilities (assets) (although transfers between components of equity are permitted on derecognition of these items) (MFRS 119.BC99).

OCI when there are non-controlling interests

Items credited or charged to OCI

If items charged or credited to OCI relate to a subsidiary in which there is a non-controlling interest, the current period and cumulative balance is allocated between the parent's ownership interest and the non-controlling interest.

In practice this involves:

- recording 100% of the OCI in the single Statement of Comprehensive Income or separate Statement of Other Comprehensive Income
- disclosing the attribution of total comprehensive income between the non-controlling interest and owners of the parent (MFRS 101.81(b))
- including the non-controlling interest's share of accumulated OCI in the non-controlling interest's component of equity.

The third requirement has the effect that the components of equity (sometimes referred to as 'reserves') that relate to specific types of OCI do not show 100% of the cumulative OCI in the Statement of Financial Position or in the Statement of Changes in Equity (see example below).

Example 1 - attribution of 'revaluation surplus'
Entity P owns 90% of Entity S with the remaining 10% held by non-controlling interests. Entity P applies the MFRS 116 revaluation model in its consolidated financial statements. The revaluation surplus is included as a separate component of equity (or reserve). At 31 December 20X0 Entity S's property is revalued, and a revaluation surplus of CU100 arises in the annual period. The cumulative revaluation surplus on S's property at this reporting date is CU500.

This has the following effects on Entity P's consolidated financial statements (ignoring any tax effects)
- it give rise to current period OCI of CU100
- in the allocation of total comprehensive income, CU90 is attributed to the parent's owners and CU10 to the non-controlling interests
- in the Statement of Financial Position and Statement of Changes in Equity, the revaluation reserve is stated as CU450. The remaining revaluation surplus of CU50 is included in the non-controlling interest part of equity. (Total equity attributable to non-controlling interests is not typically analysed between its components in published financial statements, hence this amount of CU50 may not be visible).

The illustrative presentation included in MFRS 101's Implementation Guidance provides a more extensive example along with illustrative primary statements.

Reclassification adjustments

Reclassification adjustments arising on disposal or impairment of available-for-sale financial assets, and adjustments arising from cash flow hedge accounting, relate to 100% of the applicable amount previously recognised in OCI. The OCI reclassified into profit or loss for the period therefore includes both the amounts attributed to the parent's owners and the amounts attributed to the non-controlling interests. Consequently, the total reclassification adjustment presented in the Statement of Comprehensive Income is not the amount included in the applicable component of equity (as this is the amount attributable to the parent's owners). The amount of OCI reclassified to profit or loss that was attributed to the non-controlling interests is reallocated to those interests.

Example 2 - reclassification adjustment
Entity P owns 90% of Entity S with the remaining 10% held by non-controlling interests. At 31 June 20X1 Entity S holds an available-for-sale financial asset at its fair value of CU400. Original cost was CU300 and the cumulative gain of CU100 has been reported in OCI. Of this CU100 gain, CU90 is included in an AFS reserve within the parent's owners' equity and CU10 has been allocated to the non-controlling interest component of equity. On the same day, Entity S sells the asset for its carrying amount of CU400.

The accounting entries recorded are:

	Dr	Cr
Cash	400	
AFS investment		400
Gain on disposal (P&L)*		100
AFS reserve (equity)	90	
Non-controlling interests (equity)	10*	

The gain on disposal of CU100 is itself allocated between the parent's owners and the non-controlling interest as per Example 1. The effect on equity is: the CU90 that was in the AFS reserve becomes part of retained earnings; non-controlling interests stays the same (as the 10% share of OCI of CU10 is removed and the 10% share of the P&L gain is reallocated, the net effect on non-controlling interest is nil).

Reclassification adjustments arising on loss of control are addressed later.

OCI and changes in ownership interests

If the parent's ownership interest in a subsidiary is increased or decreased (without loss of control):

- controlling and non-controlling interests are adjusted to reflect the new relative interests (MFRS 10.23, MFRS 10.BC96). *In our view*, the components of equity relating to cumulative OCI (e.g. revaluation, currency translation and AFS reserves) should be reallocated between the amounts attributable to the parent's owners and the non-controlling interest component
- any difference between the consideration paid or received and the amount by which non-controlling interests are adjusted is recognised in equity (not in OCI), and attributed to owners of the parent (MFRS 10.B96).

As noted above, we believe that 'reallocation' is required in respect of all components of equity that relate to cumulative OCI. MFRS 121.48C is explicit that this reallocation is required on a decrease in ownership interest (partial disposal) of a subsidiary that includes a foreign operation. MFRS does not provide explicit guidance on reallocation of other components of equity. *In our view* reallocation is the most appropriate treatment in relation to revaluation reserves, AFS reserves etc (both on an increase and a decrease in ownership). This is because reallocation results in each component of equity attributable to the controlling interest displaying the proportion of the applicable gain or loss to which the parent's owners would be entitled on realisation. We also believe this approach is consistent with MFRS 10.23 and MFRS 10.BC96.

Example 3 - change in ownership interest

Entity P owns 100% of Entity S (a foreign operation) which was acquired in a previous business combination. The consideration transferred at the acquisition date was CU3,000. At 31 March 20X1 Entity S's net assets (as reported in Entity P's consolidated financial statements) are CU5,000. The consolidated financial statements also include the following components of equity relating to S: retained earnings of CU1,000; revaluation surplus of CU1,200 and foreign currency translation reserve of CU(200). On 31 March 20X1 Entity P sells 20% of its shares in S to an unrelated third party investor for cash of CU1,100. Transaction costs are insignificant. The accounting entries recorded in the consolidated financial statements are:

	Dr	CR
Cash	1,100	
Non-controlling interests (equity) *(note 1)*		1,000
Revaluation surplus (equity)	240	
Currency translation reserve *(equity)*		40
Retained earnings (equity) *(note 2)*		300

Notes

1. The change in non-controlling interests is 20% of Entity S's net assets ie CU1,000. This represents: reallocation of the revaluation surplus and currency translation reserve CU200 [20%*(1,200 - 200)]; and recognition of the proportionate share of the non-controlling interests' share of other equity of CU800 [20%*(5,000 - 1,200 + 200)].
2. The increase in retained earnings of CU300 can be rationalised as the notional 'gain' on the part disposal of CU100 [1,100 - (20%*CU5,000)] plus the 'realisation' of 20% of the revaluation surplus and currency translation reserve.

In this example Entity P owns 100% of Entity S prior to the transaction in question (i.e. there is no non-controlling interest). If there are pre-existing non-controlling interests that were measured at fair value (as permitted by MFRS 3.19), the total of non-controlling interests will not normally equal the proportionate interest in the subsidiary's recognised net assets. There may also be other factors affecting the recognised amount of non-controlling interests e.g. the existence of different classes of equity.

OCI and loss of control of subsidiary

The requirements on loss of control of subsidiaries are set out in MFRS 10.25-26 and MFRS 10B97-99. The parent entity recognises a gain or loss on when it loses control. This gain or loss is attributed to the parent's owners. It is determined as the difference after the parent:

- derecognises the assets and liabilities of the subsidiary (including goodwill) (MFRS 10.B98(a)(i))
- derecognises the non-controlling interest including any attributable components of OCI (MFRS 10.B98(a)(ii))
- recognises:
  - the fair value of the consideration received (if any) (MFRS 10.B98(b)(i))
  - if applicable, the distribution of shares in the subsidiary to owners (in their capacity as owners) (MFRS 10.B98(b)(ii))
  - the fair value of any investment retained in the former subsidiary (MFRS 10.B98(b)(iii))
- accounts for any amounts recorded in OCI in the same way as they would be treated if the related assets and liabilities had been disposed of directly (MFRS 10.B99)

In applying this final requirement, it should be noted that MFRS 121.48B sets out more specific requirements on how to deal with the currency translation reserve. It states that:

> 'On disposal of a subsidiary that includes a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation that have been attributed to the non-controlling interests shall be derecognised, but shall not be reclassified to profit or loss.'

In other words, only the parent's share of the currency translation reserve is reclassified to profit or loss. For other items of comprehensive income for which reclassification adjustments are required by MFRS (available-for-sale assets and cash flow hedging reserves), in our view the entire gain or loss should be reclassified. This approach is consistent with the accounting when the related assets or liabilities are disposed of directly and is therefore consistent with MFRS 10.B99. This approach affects the allocation of the total gain or loss among its components, but does not affect the net amount of gain or loss.

Example 4 - loss of control

Entity P owns 75% of Entity S (which includes a foreign operation). At 30 September 20X1 the amounts included in Entity P's consolidated financial statements relating to Entity S are as follows:

	Note	CU
Available for sale (AFS) asset	*1*	1,200
Revalued property	*2*	2,000
Other assets and liabilities		800
Net assets		4,000
Equity attributable to the parent		
Accumulated OCI:		
- AFS reserve	*3*	150
- Currency translation reserve	*3*	75
- Revaluation surplus	*3*	300
Other reserves	*4*	2,475
Non-controlling interests	*5*	1,000
Total equity		4,000

Notes

1. Comprising cost 1,000 and recognised fair value increase 200
2. Including revaluation surplus 400
3. Net of amounts attributed to non-controlling interests
4. P's share of equity on acquisition 1,500 plus post acquisition retained earnings 975
5. NCI's share of: Entity S's equity at acquisition 500; post acquisition retained earnings 325; accumulated OCI 175

On 30 September 20X1 Entity P disposes of its entire interest in Entity S for cash consideration of CU3,600. The accounting entries recorded in the consolidated financial statements are:

	Dr	**Cr**
Cash	3,600	
Net assets of S		4,000
Gain on disposal of AFS asset (P&L) *(note 1)*		200
AFS reserve	150	
Currency gain (P&L) *(note 2)*		75
Currency translation reserve (equity)	75	
Revaluation surplus *(note 3)*	300	
Retained earnings (equity)		300
Non-controlling interests	1,000	
Gain on disposal of S (P&L) *(note 4)*		550

Notes:

1. The entire fair value increase relating to the AFS assets is reclassified to profit or loss, including the amount attributable to non-controlling interests. This is because the entire amount would have been reclassified if the AFS assets had been disposed of directly (MFRS 10.B99).
2. By contrast, with the currency translation reserve only the amount attributable to the parent's owners is reclassified in accordance with MFRS 121.48B.
3. It is common practice for entities that apply MFRS 116's revaluation model to reclassify the revaluation surplus to retained earnings on disposal (as a reserve transfer within equity not into profit or loss). A reclassification within equity is permitted but not required (MFRS 116.41). If an entity adopts this accounting policy on a direct disposal of revalued property, the same reclassification is made on loss of control of a subsidiary in order to comply with MFRS 10.B99.
4. The gain on disposal is the balancing item as determined in accordance with MFRS 10.B98. Intuitively, the gain might be expected to be CU600 (proceeds of 3,600 less 75% of 4,000). However, the effect of recognising the entire fair value increase relating to the AFS assets is to restrict the gain on disposal of S by CU50 (the amount of the AFS gain attributable to the non-controlling interests). The transaction gives rise to an overall gain of CU825 (550+200+75). This gain can be rationalised as: the 'expected' gain of CU600 plus the parent's share of the cumulative OCI items that are reclassified to profit or loss (the AFS and currency translation reserves).

OCI and equity accounting

This Hot Topic provides guidance on accounting for OCI that relates to a subsidiary in which there is a non-controlling interest. It is not intended to provide detailed guidance on OCI that arises in the financial statements of equity accounted investments (ie most associates and joint ventures). In summary, however, it should be noted that:

- the investor recognises its share of OCI of the associate or joint venture within its own OCI (MFRS 128.10)
- reclassification adjustments are made on loss of significant influence in a similar manner to loss of control of a subsidiary (ie if direct disposal of the related assets or liabilities would result in a reclassification adjustment) (MFRS 128.22-23)

if the investor reduces its interest in the associate or joint venture without a loss of significant influence and it continues to apply the equity method, the entity shall reclassify to profit or loss the proportion of the gain or loss that had previously been recognised in other comprehensive income relating to that reduction in ownership interest if that gain or loss would be required to be reclassified to profit or loss on the disposal of the related assets or liabilities.

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