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Misleading Signals from Operating Cash Flow in the Presence of Noncontrolling Interests

Executive Summary

A noncontrolling interest, also known as a minority interest, exists when a subsidiary is not wholly owned by the parent company. While a careful designation of income and equity attributable to noncontrolling interests is made on the income statement and balance sheet respectively, under GAAP a similar attribution is not made on the statement of cash flows. As such, investors, analysts and other users of financial statements may be unaware that operating cash flow includes amounts attributable to both controlling and noncontrolling interests, potentially leading to over-estimates of cash available for dividends to controlling interests.

In this study, for a sample of firms with significant noncontrollng interests, we examine the amount and placement of distributions to noncontrolling interests on the statement of cash flows. We find that while distribution amounts are significant, averaging 79.2% of income attributable to noncontrolling interests, there is no reporting consistency for the distributions being made. In some instances, distributions are not even disclosed on the statement of cash flows. Recommendations for change to the reporting of distributions to noncontrolling interests on the statement of cash flows are made to make their placement more consistent with the manner in which noncontrolling interest in income is presently reported on the income statement.

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The Georgia Tech Financial Analysis Lab conducts unbiased research on issues of financial reporting and analysis. Unbiased information is vital to effective investment decision-making. Accordingly, we think that independent research organizations, such as our own, have an important role to play in providing information to market participants.

Because our Lab is housed within a university, all of our research reports have an educational quality, as they are designed to impart knowledge and understanding to those who read them. Our focus is on issues that we believe will be of interest to a large segment of stock market participants. Depending on the issue, we may focus our attention on individual companies, groups of companies, or on large segments of the market at large.

A recurring theme in our work is the identification of reporting practices that give investors a misleading signal, whether positive or negative, of corporate earning power. We define earning power as the ability to generate a sustainable stream of earnings that is backed by cash flow. Accordingly, our research may look into reporting practices that affect either earnings or cash flow, or both. At times, our research may look at stock prices generally, though from a fundamental and not technical point of view.

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Misleading Signals from Operating Cash Flow in the Presence of Noncontrolling Interests

Introduction

A noncontrolling interest (formally minority interest) exists when a subsidiary is not wholly owned by the parent company. Noncontrolling interest in income represents the portion of consolidated net income that is attributable to noncontrolling shareholders. Under current generally accepted accounting principles (GAAP), Accounting Standards Codification Topic 805, *Business Combinations*, companies must disclose on the income statement the portion of consolidated net income that is attributable to the parent or controlling interest and the portion that is attributable to noncontrolling interests.[1] Earnings per share are calculated based on the portion of consolidated net income that is attributable to the controlling interest. Noncontrolling interest in equity is the portion of consolidated shareholders' equity that is attributable to noncontrolling shareholders. In the shareholders' equity section of the balance sheet, equity attributable to noncontrolling interests is separately reported.

While a careful designation of income and equity attributable to noncontrolling interests is made on the income statement and balance sheet respectively, under GAAP a similar attribution is not required for the statement of cash flows. Rather, in the operating section, the statement of cash flows only reports consolidated cash provided by operating activities. There is no indication of the extent to which any noncontrolling interest may have claim to that cash flow. Rather, distributions to noncontrolling interests are typically labeled as such in the financing section. But even this presentation approach is not uniform. In fact, in some instances, no disclosure of distributions made to noncontrolling interests is provided on the statement of cash flows. As such, investors, analysts and other users of financial statements may be unaware that operating cash flow includes amounts attributable to both controlling and noncontrolling interests.

If distributions to noncontrolling shareholders are minimal, for all practical purposes, total operating cash flow is the relevant measure of cash flow available to controlling shareholders. Further, distributions are made to noncontrolling interests only with the approval of controlling shareholders. Thus, they constitute a junior claim for which there is no requirement for payment. However, when distributions to noncontrolling interests are significant and recurring, consolidated operating cash flow is no longer a valid measure of cash flow available to controlling shareholders.

The purpose of this research report is to investigate the extent to which distributions are being made to noncontrolling interests and to document how those distributions are being reported on the statement of cash flows. Distributions made by a sample of 24 companies with market capitalizations greater than $1 billion and noncontrolling interest in income of fifteen percent or more of consolidated net income are examined for information on significance of the distributions and their reporting placement in the statement of cash flows. For this sample of firms, using cumulative data over the 2009 – 2011 timeframe, median noncontrolling interest in income was 28.2% of consolidated net income. Distributions were significant. The companies distributed a median 79.2% of noncontrolling interest in income to the noncontrolling

[1] Financial Accounting Standards Board, Accounting Standards Codification Topic 805, Business Combinations (Norwalk, CT: FASB), 2012.

shareholders. While twenty of the 24 companies included in the sample reported distributions to noncontrolling interests separately in the financing section of the statement of cash flows, the reporting of distributions was not consistent across the sample. In fact, in two cases, such distributions were not disclosed on the statement of cash flows. A third company subtracted noncontrolling interest in income from consolidated net income in determining cash provided by operating activities. A fourth company did not make a distribution to its noncontrolling interests.

As a result of this study, some modest changes to the reporting of distributions made to noncontrolling interests are recommended. In particular, it would be helpful to analysts, investors and other users of financial statements if distributions to noncontrolling interests were subtracted from consolidated cash provided by operating activities so that operating cash flow that is available for controlling interests were highlighted. Such an approach would be consistent with the attribution of income to controlling and noncontrolling interests provided on the statement of income. In the absence of a change in the reporting of operating cash flow, more consistent reporting of distributions to noncontrolling interests is recommended. Such distributions should be separately reported in the financing section of the statement of cash flows and clearly labeled as distributions to noncontrolling interests.

In the next section, the financial statements of Verizon Communications, Inc., a company with a significant noncontrolling interest, are provided as an example of how noncontrolling interests are presently reported. That section is followed with a discussion of the data and methodology used. The results section follows. The study is concluded with a discussion of how operating cash flow in the presence of noncontrolling interests can be misleading to readers of financial statements. Recommendations are made for changes to current reporting practices.

Verizon Communications, Inc. and Verizon Wireless

As an illustration of how noncontrolling interests are presently reported, consider the case of Verizon Communications, Inc. Verizon Communications operates Verizon Wireless in a joint venture with Vodafone Group, Plc. Verizon Communications holds a 55% controlling interest in the joint venture, and Vodafone, as the noncontrolling interest, holds the remaining 45%.[2] In Exhibit 1 we provide excerpts from the company's statement of income, detailing the allocation of consolidated net income to controlling and noncontrolling interests.

[2] There are other ownership groups that hold noncontrolling interests in Verizon Communications' wireless partnerships in addition to Vodafone's noncontrolling interest in Verizon Wireless. However, the noncontrolling interests in the wireless partnerships are very small relative to the Verizon Wireless claim and are not referred to separately here.

Exhibit 1. Allocation of Verizon Communications, Inc. Consolidated Net Income to Controlling and Noncontrolling Interests (dollars in millions)

	2011	2010	2009
Net Income	$ 10,198	$ 10,217	$ 11,601
Net income attributable to noncontrolling interest	$ 7,794	$ 7,668	$ 6,707
Net income attributable to Verizon	2,404	2,549	4,894
Net Income	$ 10,198	$ 10,217	$ 11,601

Source: Verizon Communications, Inc. Form 10-K Annual Report to the Securities and Exchange Commission, December 31, 2011.

As seen in Exhibit 1, consolidated net income for Verizon Communications, which includes the results of Verizon Wireless, was $10,198 million, $10,217 million, and $11,601 million in 2011, 2010 and 2009, respectively. However, when examining the breakdown of net income between controlling and noncontrolling interests, it is noteworthy that income attributable to the noncontrolling interest is very high as a percentage of consolidated net income. In fact, at 76.4% in 2011, 75.1% in 2010, and 57.8% in 2009, the noncontrolling interest's share of consolidated net income is higher than their 45% share of the subsidiary Verizon Wireless. This unexpected result occurs because Verizon Wireless is significantly more profitable than the wireline business of the parent company, Verizon Communications, which would report losses in the absence of its share of the Verizon Wireless business.

In Exhibit 2 we provide excerpts from the company's statement of changes in equity. In particular, we provide activity in the noncontrolling interest's share of equity for the years 2011, 2010 and 2009.

Exhibit 2. Consolidated Statements of Changes in Equity, Noncontrolling Interest, Verizon Communications, Inc. (dollars in millions)

	2011	2010	2009
Noncontrolling Interest			
Balance at beginning of year	$48,343	$42,761	$37,199
Net income attributable to noncontrolling interest	7,794	7,668	6,707
Other comprehensive income (loss)	1	(35)	103
Total comprehensive income	7,795	7,633	6,810
Distributions and other	(6,200)	(2,051)	(1,248)
Balance at end of year	49,938	48,343	42,761

Source: Verizon Communications, Inc. Form 10-K Annual Report to the Securities and Exchange Commission, December 31, 2011.

In examining excerpts from the statement of changes in equity provided in Exhibit 2, we can see that Verizon Communications made significant distributions to Vodafone, the noncontrolling interest. Distributions of $6,200 million, $2,051 million and $1,248 million were made in 2011, 2010 and 2009, respectively. These distributions comprised 79.6%, 26.8% and 18.6%, respectively, of net income attributable to the noncontrolling interest. Clearly, with such significant distributions, income attributable to the noncontrolling interest is not simply a calculated amount but rather a real claim on the company's consolidated operating cash flow.

When examining the statement of cash flows, however, cash provided by operating activities does not include an allocation of cash flow to the controlling and noncontrolling interests. Rather, in accordance with generally accepted accounting principles, cash provided by operating activities (operating cash flow) is reported at its full consolidated amount. To the reader, it would appear that total operating cash flow were available for distribution to the Verizon Communications (controlling) shareholders, when, in fact, the noncontrolling interests have a legitimate claim on at least a portion of that cash flow. Exhibit 3 provides the operating section of the company's statement of cash flows.

Exhibit 3. Consolidated Statements of Cash Flows. Operating Section, Verizon Communications, Inc. (dollars in millions)

	2011	**2010**	**2009**
Cash Flows from Operating Activities			
Net Income	**$ 10,198**	$ 10,217	$ 11,601
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization expense	**16,496**	16,405	16,534
Employee retirement benefits	**7,426**	3,988	2,964
Deferred income taxes	**(223)**	3,233	2,093
Provision for uncollectible accounts	**1,026**	1,246	1,306
Equity in earnings of unconsolidated businesses, net of dividends received	**36**	2	389
Changes in current assets and liabilities, net of effects from acquisition/disposition of businesses			
Accounts receivable	**(966)**	(859)	(1,393)
Inventories	**208**	299	235
Other assets	**86**	(313)	(102)
Accounts payable and accrued liabilities	**(1,607)**	1,075	(1,251)
Other, net	**(2,900)**	(1,930)	(986)
Net cash provided by operating activities	**29,780**	33,363	31,390

Source: Verizon Communications, Inc. Form 10-K Annual Report to the Securities and Exchange Commission, December 31, 2011.

In examining Exhibit 3 it can be seen that the reconciliation of net income to cash provided by operating activities begins with consolidated net income, not net income reduced for the noncontrolling interest's share of net income. Further, there are no adjustments to remove an allocation for the noncontrolling interest. As such, the reported cash provided by operating activities is operating cash flow that is available for both the controlling interest and noncontrolling interest. A shareholder holding shares of Verizon Communications, the consolidated entity, might view this consolidated cash provided by operating activities as cash flow that is fully available for distribution to the Verizon shareholders. However, that is not necessarily the case.

Certainly, an argument can be made that the controlling shareholders are under no legal obligation to make distributions to noncontrolling interests. Yet, distributions are being made. In fact, at times, those distributions can be substantial, as we saw in this example.

Readers of financial statements may be of the view that distributions made to noncontrolling interests are explicitly identified in the financing section of the statement of cash flows along with dividends paid to controlling interests. Unfortunately, that is often not the case. Consider, for example, the case of Verizon Communications, where no breakdown of dividends paid to controlling and noncontrolling interests is provided on the statement of cash flows. Rather, only dividends paid to controlling interests are being explicitly reported in the financing section of the statement of cash flows. The financing section of the Verizon Communications cash flow statement is provided in Exhibit 4.

Exhibit 4. Consolidated Statements of Cash Flows. Financing Section, Verizon Communications, Inc. and Subsidiaries (dollars in millions)

	2011	**2010**	**2009**
Cash Flows from Financing Activities			
Proceeds from long-term borrowings	**11,060**	–	12,040
Repayments of long-term borrowings and capital lease obligations	**(11,805)**	(8,136)	(19,260)
Increase (decrease) in short-term obligations, excluding current maturities	**1,928**	(1,097)	(1,652)
Dividends paid	**(5,555)**	(5,412)	(5,271)
Proceeds from sale of common stock	**241**	–	–
Proceeds from access line spin-off	**–**	3,083	–
Other, net	**(1,705)**	(2,088)	(1,864)
Net cash used in financing activities	**(5,836)**	(13,650)	(16,007)

Source: Verizon Communications, Inc. Form 10-K Annual Report to the Securities and Exchange Commission, December 31, 2011.

Distributions to the noncontrolling interest are not broken out on the cash flow statement. To a reader of this statement, it would appear that distributions to the noncontrolling interest are included in the dividends paid amount. But they are not. One must refer to the statement of changes in equity, provided in Exhibit 2, to identify the amount of any distributions made to the noncontrolling interest.

It is interesting to note that in its Management's Discussion and Analysis, Verizon Communications notes the importance of cash provided by operating activities of Verizon Wireless. For example, as noted by the company, "Our primary source of funds continues to be cash generated from operations, primarily of Verizon Wireless."[3] Yet, in reporting under generally accepted accounting principles, while net income is allocated between the controlling and noncontrolling interests, no such allocation is made for cash provided by operating activities.

In the paragraphs that follow we examine the financial statements of other entities with significant noncontrolling interests. We seek to determine whether significant distributions are being made to the noncontrolling interests and how those distributions are being reported.

Data and Methodology

The data used in this study were collected from annual financial statement filings reported to the Securities and Exchange Commission (SEC). Sample firms are nonfinancial companies, filing under U.S. GAAP, with market capitalizations exceeding $1 billion. Our objective is to identify firms with significant noncontrolling interests. Accordingly, we include companies in the sample when cumulative 2009 – 2011 noncontrolling interest in income is 15% or more of cumulative consolidated net income for the same time period. This sample selection process resulted in a pool of 24 companies.

Data were collected for year ends 2009-2011. From the income statement we collected net income, net income attributable to noncontrolling interests, and net income attributable to controlling interests. We collected noncontrolling interest in shareholders' equity and total shareholders' equity from the balance sheet. From the statement of cash flows we collected cash provided by operating activities and, when available, distributions to noncontrolling interests. When distributions to noncontrolling interests were not reported on the statement of cash flows, we collected the amounts of those distributions from the statement of changes in shareholders' equity. When collecting data on distributions made to noncontrolling interests, we made note of the manner and placement of disclosure of the distribution amount in the statement of cash flows. For example, a distribution might be reported in the financing section either in separate notation or combined with dividends to controlling shareholders. Alternatively, a distribution may not be separately disclosed on the statement of cash flows, or, possibly, even reported somewhere other than the financing section.

When calculating the percentage of noncontrolling interest in income to consolidated net income, or distributions to noncontrolling interest as a percentage of noncontrolling interest in income or as a percentage of cash provided by operating activities, cumulative income and cash flow data were used. These cumulative amounts were calculated over the period 2009 – 2011. We collected and used cumulative data so that results would not be unduly impacted by the effects of outliers in any one year. Further, we felt that distributions accumulated over three years would be more representative of longer term management goals for distributions rather than the amount of a payout in any one particular year.

Results

The results of our survey of reporting practices and distribution amounts for noncontrolling interests are presented in a series of tables. In Table 1 we present cumulative noncontrolling

[3] Verizon Communications, Inc. Form 10-K Annual Report to the Securities and Exchange Commission, December 31, 2011, Management's Discussion and Analysis of Financial Condition and Results of Operations.

interest in income as a percentage of net income for the period 2009 – 2011. In Table 2 we look at noncontrolling interests in equity as a percentage of total equity as of 2011. Table 3 presents distributions to noncontrolling interests as a percentage of noncontrolling interest in income and cash provided by operating activities.

Noncontrolling Interest in Income

In examining Table 1, it can be seen that the sample firms report significant noncontrolling interests in income. While our objective was to include companies where cumulative noncontrolling interest in income was at least 15% of consolidated net income, the table indicates that some companies have subsidiaries with noncontrolling interests that are generating very substantial portions of consolidated net income. In the sample, median noncontrolling interest in income as a percentage of consolidated net income is 28.2%. However, in some cases, for example, when the parent company is losing money, that percentage ranges up to, or beyond 100%. Consider, for example, Alcoa, Inc., Hertz Global Holdings, Inc., Liberty Global, Inc., and Sunoco, Inc., where noncontrolling interest in income is at least 100% of consolidated net income.

Table 1. Cumulative Noncontrolling Interest in Income as a Percentage of Net Income for the Period 2009-2011 (dollars in millions)

	Cumulative 2009-2011		
Company Name	**Non-Controlling Interest in Income**	**Net Income**	**% NCI in Net Income**
AES CORP	$3,619	$4,344	83.3%
ALCOA INC	393	107	367.3%
BRINKS CO	71	403	17.6%
BRISTOL-MYERS SQUIBB CO	4,212	21,653	19.5%
CF INDUSTRIES HOLDINGS, INC.	396	2,650	15.0%
CROWN HOLDINGS INC	358	1,298	27.6%
FREEPORT MCMORAN COPPER & GOLD INC	3,180	14,825	21.5%
HCA HOLDINGS, INC.	1,064	5,790	18.4%
HEICO CORP	55	228	24.1%
HERTZ GLOBAL HOLDINGS INC	52	50	104.0%
LAS VEGAS SANDS CORP	491	2,296	21.4%
LIBERTY GLOBAL INC.	704	(93)	100.00%
NEWMONT MINING CORP /DE/	2,241	6,181	36.3%
NUCOR CORP	211	830	25.4%
ONEOK INC /NEW/	792	1,792	44.2%
SCRIPPS NETWORKS INTERACTIVE, INC.	367	1,489	24.6%
SIX FLAGS ENTERTAINMENT CORP	71	98	72.4%
SOHU.COM INC	144	603	23.9%
SUNOCO INC	498	(1,281)	100.0%
TELEPHONE & DATA SYSTEMS INC /DE/	154	691	22.3%
TENNECO INC	69	192	35.9%
VERIZON COMMUNICATIONS INC	22,169	32,016	69.2%
WATSCO INC	87	301	28.9%
WYNN RESORTS LTD	387	1,181	32.8%
Median Noncontrolling Interest in Net Income			**28.2%**
This table reports cumulative (2009-2011) noncontrolling interest in income (NCI) and net income (NI) for the respective companies and the percent of NCI to NI.			
Legend			
Noncontrolling Interest in Net Income -- as reported on the Income Statement			
Net Income -- as reported on the Income Statement (includes both controlling and noncontrolling interests)			
%NCI in Net Income -- noncontrolling interest in net income as a percentage of net income			
Footnotes			
(1) If cumulative net income is negative, then % NCI in Income is set to 100%			
(2) If cumulative noncontrolling interest in net income is negative, then % NCI in Income is set to zero			
(3) For Six Flags Entertainment, results are for the post-bankruptcy period in 2010 and 2011.			

Noncontrolling Interest in Equity

In Table 2 we calculate the percentage of noncontrolling Interest in Equity relative to consolidated equity using data as of year-end 2011. What we find is that for our sample, the median percentage of noncontrolling interest in equity as a percentage of total equity is 16.3% - a significant claim. However, the percentages can range to much higher levels. For example, in the case of Tenneco, Inc., all of the company's consolidated equity is represented by noncontrolling interests. That is, the company has no shareholders' equity beyond that of noncontrolling interests. In other cases, such as Crown Holdings, Inc. and HCA Holdings, Inc., consolidated equity is negative, offsetting the positive equity of the noncontrolling interest. Finally, in one instance, Bristol-Myers Squibb Co., noncontrolling interest in equity is negative though consolidated equity is a positive amount.

Table 2. Noncontrolling Interest in Equity as a Percentage of Total Equity as of Year-End 2011 (dollars in millions)

	As of Year-End 2011		
Company Name	**Noncontrolling Interest in Equity**	**Total Equity**	**% NCI in Equity**
AES CORP	$3,783	$9,729	38.9%
ALCOA INC	3,351	17,195	19.5%
BRINKS CO	74	482	15.4%
BRISTOL-MYERS SQUIBB CO	(89)	15,867	0.00%
CF INDUSTRIES HOLDINGS, INC.	386	4,547	8.5%
CROWN HOLDINGS INC	234	(239)	100.0%
FREEPORT MCMORAN COPPER & GOLD INC	2,911	18,553	15.7%
HCA HOLDINGS INC.	1,244	(7,014)	100.00%
HEICO CORP	91	620	14.7%
HERTZ GLOBAL HOLDINGS INC	0	2,235	0.0%
LAS VEGAS SANDS CORP	1,588	9,439	16.8%
LIBERTY GLOBAL, INC.	126	2,931	4.3%
NEWMONT MINING CORP /DE/	2,875	15,771	18.2%
NUCOR CORP	231	7,707	3.0%
ONEOK INC /NEW/	1,561	3,800	41.1%
SCRIPPS NETWORKS INTERACTIVE, INC.	255	1,934	13.2%
SIX FLAGS ENTERTAINMENT CORP	4	767	0.5%
SOHU.COM INC	211	1,219	17.3%
SUNOCO INC	907	1,800	50.4%
TELEPHONE & DATA SYSTEMS INC /DE/	640	4,603	13.9%
TENNECO INC	43	43	100.0%
VERIZON COMMUNICATIONS INC	49,938	85,908	58.1%
WATSCO INC	199	1002	19.9%
WYNN RESORTS LTD	134	2,223	6.0%
Median Noncontrolling Interest in Equity			**16.3%**

Legend

Noncontrolling Interest in Equity -- as reported on the balance sheet

Total Equity -- as reported on the balance sheet (includes controlling and noncontrolling interests)

%NCI in Equity -- noncontrolling interest in equity as a percentage of total equity

Footnotes

(1) If total shareholders' equity is negative, then % NCI in equity is set to 100%

(2) If noncontrolling interest in equity is negative, then % NCI in equity is set to zero

Distributions to Noncontrolling Interests

In Table 3 we examine distributions made to noncontrolling interests as a percentage of noncontrolling interest in income and as a percentage of cash provided by operating activities. In collecting data on distributions made to noncontrolling interests, we also collected information on how the distributions were being reported in the statement of cash flows.

The results in Table 3 indicate that significant distributions are being made to noncontrolling interests. For our sample, median cumulative distributions comprised 79.2% of noncontrolling interest in income. In four cases, Alcoa, Inc., Hertz Global Holdings, Inc., Nucor Corp. and Six Flags Entertainment Corp., cumulative distributions exceeded noncontrolling interest in income. Only one company in the sample, Sohu.com, did not make a distribution to its noncontrolling interest over the survey period.

In examining how companies report distributions to noncontrolling interests in the statement of cash flows we found that most firms report them in the financing section separately from dividends to controlling interests. Typically, the cash disbursements are labeled as distributions or as dividends to noncontrolling interests. A total of twenty of the 24 companies in the sample employed this approach. One company, Sohu.com, did not make any distributions to its noncontrolling interests. Another, Wynn Resorts, Ltd., combined distributions to noncontrolling interests with dividends to controlling interests and reported them as a single dividend amount. A reader would need to examine the statement of changes in equity to determine the amount of any distribution to noncontrolling interests. Verizon Communications, Inc. did not disclose its distributions to noncontrolling interests in the statement of cash flows. This is an interesting and curious reporting approach given the significance of the distributions being made to the firm's noncontrolling interest. In fact, in 2011, at $6.2 billion, distributions to noncontrolling interests actually exceeded dividends to controlling interests.[4] It is unclear where in the statement of cash flows these distributions were included. Presumably, they were included with "other, net" in the financing section of the statement.

[4] The company labels distributions to noncontrolling interests as "distributions and other." We were unable to determine the amount of "other."

Table 3. Cumulative Distributions to Noncontrolling Interests as a Percentage of Noncontrolling Interest in Income and Operating Cash Flow (dollars in millions)

	Cumulative 2009-2011				
Company Name (Reporting Practice for Distributions to Noncontrolling Interests in Statement of Cash Flows – see footnotes)	**NCI in Income**	**Distributions Made to NCI**	**Operating Cash Flow (OCF)**	**Distributions % of NCI**	**Distributions % of OCF**
AES CORP (1)	3,619	3,179	8,560	87.8%	37.1%
ALCOA INC (1)	393	653	5,819	166.2%	11.2%
BRINKS CO (1)	71	48	678	67.6%	7.1%
BRISTOL MYERS SQUIBB CO (2)	4,212	4,193	13,396	99.5%	31.3%
CF INDUSTRIES HOLDINGS, INC. (1)	396	375	3,955	94.7%	9.5%
CROWN HOLDINGS INC (1)	358	303	1,725	84.6%	17.6%
FREEPORT MCMORAN COP & GOLD (1)	3,180	1,742	17,290	54.8%	10.1%
HCA HOLDINGS, INC. (1)	1,064	1,050	9,765	98.7%	10.8%
HEICO CORP (1)	55	35	303	63.6%	11.6%
HERTZ GLOBAL HOLDINGS INC (1)	52	56	6,135	107.7%	0.9%
LAS VEGAS SANDS CORP (1)	491	10	5,171	2.0%	0.2%
LIBERTY GLOBAL, INC. (1)	704	664	8,458	94.3%	7.9%
NEWMONT MINING CORP /DE/ (1)	2,241	973	9,698	43.4%	10.0%
NUCOR CORP (1)	211	307	3,079	145.5%	10.0%
ONEOK INC /NEW/ (1)	792	761	3,647	96.1%	20.9%
SCRIPPS NETWORKS INTERACTIVE (1)	367	271	1,739	73.8%	15.6%
SIX FLAGS ENTERTAINMENT CORP (1)	71	72	596	101.4%	12.1%
SOHU. COM INC (3)	144	0	890	0.00%	0.00%
SUNOCO INC (1)	498	339	2,379	68.1%	14.2%
TELEPHONE & DATA SYSTEMS INC (1)	154	53	3,429	34.4%	1.5%
TENNECO INC (1)	69	44	730	63.8%	6.0%
VERIZON COMMUNICATIONS INC (4)	22,169	9,499	94,533	42.8%	10.0%
WATSCO INC (1)	87	45	303	51.7%	14.9%
WYNN RESORTS LTD (5)	387	362	3,167	93.5%	11.4%
Medians				**79.2%**	**10.4%**

Legend

Noncontrolling Interest (NCI) in Income – as reported on the income statement

Distributions to Non-Controlling Interests (NCI) – as reported on the statement of cash flows or statement of changes in equity.

Operating Cash Flow (OCF) – as reported on the statement of cash flows.

Distributions % of NCI – distributions to noncontrolling interests as a percentage of NCI in income.

Distributions % of OCF – distributions to noncontrolling interests as a percentage of operating cash flow.

For Six Flags Entertainment, results are for the post-bankruptcy period in 2010 and 2011.

Footnotes

(1) Distributions to noncontrolling interests were reported separately in the financing section of the statement of cash flows.

(2) Income attributable to noncontrolling interests was subtracted from net income in determining operating cash flow. Distributions are net of income taxes as reported in the statement of changes in equity.

(3) No distributions were made to noncontrolling interests.

(4) Distributions are not reported in the statement of cash flows but disclosed in the statement of changes in equity.

(5) Distributions to noncontrolling interests were combined with dividends to controlling shareholders and labeled as dividends in the financing section of statement of cash flows.

Bristol-Myers Squibb Co. employs a unique reporting approach for distributions to its noncontrolling interests. The company deducts noncontrolling interest in income from net income in deriving cash provided by operating activities. In effect, the company is reporting cash provided by operating activities net of any claims to income held by the noncontrolling interest. This is a particularly interesting and insightful approach as it more directly alerts controlling shareholders that a portion of cash provided by operating activities may not be available to them for distribution in the form of dividends. Excerpts from the Bristol-Myers Squibb statement of cash flows are provided in Exhibit 5.

Exhibit 5. Consolidated Statements of Cash Flows. Operating Section, Bristol-Myers Squibb Co. (dollars in millions)

BRISTOL-MYERS SQUIBB COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS
Dollars in Millions

	Year Ended December 31,		
	2011	**2010**	**2009**
Cash Flows From Operating Activities:			
Net earnings	$ 5,260	$ 4,513	$11,862
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Net earnings attributable to noncontrolling interest	(1,551)	(1,411)	(1,250)
Depreciation	448	473	469
Amortization	353	271	238
Deferred income tax expense	415	422	163
Stock-based compensation expense	161	193	183
Impairment charges	28	228	—
Gain related to divestitures of discontinued operations	—	—	(7,275)
Other adjustments	(147)	(32)	(367)
Changes in operating assets and liabilities:			
Receivables	(220)	(270)	227
Inventories	(193)	156	82
Accounts payable	593	315	472
Deferred income	(115)	117	135
U.S. and foreign income taxes payable	(134)	(236)	58
Other	(58)	(248)	(932)
Net Cash Provided by Operating Activities	4,840	4,491	4,065

Source: Bristol-Myers Squibb Form 10-K Annual Report to the Securities and Exchange Commission, December 31, 2011.

Table 3 also presents cumulative distributions to noncontrolling interests as a percentage of cumulative cash provided by operations. The median distribution was 10.4% of operating cash flow, indicating that a significant amount of consolidated cash flow generated from operations was distributed to noncontrolling interests. Distributions to noncontrolling interests ranged from 0% of operating cash flow for Sohu.com to as high as 37.1% in the case of AES Corp.

Operating Cash Flow in the Presence of Noncontrolling Interests.
Under U.S. GAAP a clear attribution of net income to controlling and noncontrolling interests is made on the income statement. Further, earnings per share is calculated using only the controlling interests' share of net income under the premise that the noncontrolling interests' portion of net income belongs to that separate shareholder group. A similar attribution, however, is not made for operating cash flow. Rather, operating cash flow is reported as a single consolidated amount that includes any operating cash flow that may be attributable to noncontrolling interests. Consider the structure of an indirect-method statement of cash flows. The reconciliation of net income to cash provided by operating activities begins with consolidated net income, including non-controlling interests, and reconciles to cash provided by operating activities. No deductions are made for earnings or operating cash flow attributable to noncontrolling interests. As such, total consolidated cash provided by operating activities appears to be available for distribution to the controlling shareholders, when in fact, noncontrolling interests have a legitimate claim on at least some portion of that cash flow.

Certainly, any distribution of operating cash flow to noncontrolling interests is subject to approval by the parent company, and effectively, the controlling shareholders. As such, the argument could be made that legitimate claims notwithstanding, noncontrolling interests are not sharing in the operating cash flow generated by the subsidiaries in which they own shares. However, among the 24 companies reviewed here, the median distribution to noncontrolling interests was 79.2% of noncontrolling interest in income. Further, across the sample of 24 firms, distributions to noncontrolling interests consumed 10.4% of median consolidated operating cash flow. Thus, noncontrolling interests are enjoying significant distributions of the earnings of the subsidiaries in which they hold shares. Accordingly, total cash provided by operating activities should not be viewed as fully available for distribution to the controlling interests.

In evaluating financial performance, many analysts focus on free cash flow. Free cash flow is a discretionary stream of cash that is available to shareholders for such purposes as acquisitions, debt retirement, dividends and stock buybacks. Because it is discretionary, spending free cash flow does not impact the company's ability to generate more. While there are slight variations in the calculation of free cash flow, typically, it is calculated by subtracting from operating cash flow capital expenditures and any distributions to claims superior to the controlling shareholders. For example, along with capital expenditures, preferred dividends would be subtracted from operating cash flow in calculating free cash flow. Some analysts would also subtract dividends to the common or controlling shareholders in calculating free cash flow. However, if one were interested in determining the amount of free cash flow that is available for the payment of dividends to the common or controlling shareholders, that free cash flow would be calculated before common dividends.

Distributions to noncontrolling interests should also be subtracted from operating cash flow when calculating free cash flow. While the claims of noncontrolling interests are not superior to those of the controlling shareholders, distributions to them are, nonetheless, cash that is not available for the controlling shareholders. Yet, as we have seen in the statements reviewed for this research, statements of cash flow do not necessarily highlight distributions made to noncontrolling interests. For example, in the case of Wynn Resorts, distributions to noncontrolling interests were combined with dividends to the controlling shareholders and reported as a single, dividend amount. Verizon Communications did not identify distributions to noncontrolling interests on the statement of cash flows. In cases such as that of Wynn Resorts or Verizon Communications, analysts must refer to the statement of changes in equity to determine the amount of distributions made to noncontrolling interests.

Bristol-Myers Squibb offers a unique approach for the display of noncontrolling interests in the statement of cash flows. Recall that the company reports operating cash flow that is measured after income attributable to noncontrolling interests has been removed. While compelling, we think that such an approach actually understates operating cash flow by removing an income measure that is not necessarily a measure of cash flow. Granted, Bristol-Myers did distribute to noncontrolling interests 99.5% of income attributable to them. So income is, in effect, a valid measure of actual cash distributed to noncontrolling interests in this example. But many of the companies in the sample did not make such sizable distributions. Similarly, such sizable distributions are typically not made by companies in general.

Given the importance to financial performance of operating cash flow and its prominence in the calculation of free cash flow, readers of financial statements would be better served if the cash flow statement more actively highlighted operating cash flow that is available for controlling shareholders in a manner similar to that used for net income on the income statement. For example, immediately after the line item, cash provided by operating activities, the statement of cash flows could provide separate lines that report distributions to noncontrolling interests and cash provided by operating activities available for controlling interests. With such an approach, the statement of cash flows would first highlight cash provided by operating activities that is available for all shareholder claimants, including controlling and noncontrolling interests. This consolidated measure of operating cash flow is the cash flow counterpart of consolidated net income reported on the income statement. Then, by identifying and subtracting distributions made to noncontrolling interests, the statement of cash flows would highlight operating cash flow that is available for the controlling interests. Such a division of operating cash flow into distributions made to noncontrolling interests and the remainder that is available for controlling interests would be more consistent with the attribution of income presently made on the income statement. With one exception, the remainder of the statement of cash flows, the investing and financing sections, would be presented without change. The one exception would be the exclusion of distributions to noncontrolling interests in the financing section of the statement.

Exhibit 6 presents a pro-forma operating section of the statement of cash flows for Verizon Communications, Inc. This pro-forma statement reports net cash provided by operating activities on a consolidated basis and subtracts any distributions made to the noncontrolling interests. The statement then presents a remainder representing operating cash flow that is available to the controlling shareholders.

Exhibit 6. Recommended Pro-Forma Statement of Cash Flows, Operating Section, Verizon Communications, Inc. (dollars in millions)

	2011	2010	2009
Cash Flows from Operating Activities			
Net Income	**$ 10,198**	$ 10,217	$ 11,601
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization expense	**16,496**	16,405	16,534
Employee retirement benefits	**7,426**	3,988	2,964
Deferred income taxes	**(223)**	3,233	2,093
Provision for uncollectible accounts	**1,026**	1,246	1,306
Equity in earnings of unconsolidated businesses, net of dividends received	**36**	2	389
Changes in current assets and liabilities, net of effects from acquisition/disposition of businesses			
Accounts receivable	**(966)**	(859)	(1,393)
Inventories	**208**	299	235
Other assets	**86**	(313)	(102)
Accounts payable and accrued liabilities	**(1,607)**	1,075	(1,251)
Other, net	**(2,900)**	(1,930)	(986)
Net cash provided by operating activities	**29,780**	33,363	31,390
Distributions to noncontrolling interests	**(6,200)**	(2,051)	(1,248)
Net cash provided by operating activities attributable to Verizon	**23,580**	31,312	30,142

Source: Verizon Communications, Inc. Form 10-K Annual Report to the Securities and Exchange Commission, December 31, 2011. The lines, Distributions to noncontrolling interests and Net cash provided by operating activities attributable to Verizon, were added to the operating section of the Verizon Communications statement of cash flows as a recommended reporting format and were not reported by Verizon Communications in that manner. In Verizon's statement of cash flows, the company reported distributions to noncontrolling interests and other for $6,200. A description of other could not be found.

In the absence of a change in the presentation of the statement of cash flows to reflect a direct reduction in cash provided by operating activities to account for distributions made to noncontrolling interests, readers of financial statements would be well served if the statement of cash flows consistently reported distributions made to noncontrolling interests. For example, it would be helpful to financial statement readers if statements of cash flow consistently reported distributions made to noncontrolling interests as a separate line item in the financing section. Given the importance of these distributions to assessments of financial performance, they should not be combined with other categories on the statement of cash flows such as dividends to controlling interests or such non-descript line items as "other, net."

Conclusion

In this study we examine the financial statements of public companies with significant noncontrolling interests. Companies included in the study have a market capitalization of greater than $1 billion and reported income attributable to noncontrolling interests accumulated over the 2009 – 2011 timeframe of at least 15% of cumulative consolidated net income. A total of 24 U.S. companies met these criteria. Across the sample, median income attributable to noncontrolling interests was 28.2% of consolidated net income. These same companies distributed a median of 79.2% of noncontrolling interests in income to the noncontrolling interests.

While twenty of the 24 companies included in the survey reported distributions to noncontrolling interests separately in the financing section of the statement of cash flows, the reporting of distributions was not consistent across the sample. In fact, in two cases, such distributions were not disclosed on the statement of cash flows. Financial statement readers interested in distribution amounts would have to examine the statement of changes in equity to find them. In one case, income attributable to noncontrolling interests was subtracted from net income in measuring operating cash flow. One firm did not make a distribution to its noncontrolling interests.

As a result of this survey, some modest changes to the reporting of distributions made to noncontrolling interests are recommended. In particular, immediately after the line item, cash provided by operating activities, the statement of cash flows could provide separate lines that report distributions to noncontrolling interests and cash provided by operating activities available for controlling interests. Such an approach would be consistent with the attribution of income to controlling and noncontrolling interests provided on the statement of income.

In the absence of a change in the reporting of operating cash flow, more consistent reporting of distributions to noncontrolling interests is recommended. Such distributions should be separately reported in the financing section of the statement of cash flows.

Readers of financial statements would be well served if the FASB, in particular, the Emerging Issues Task Force, gave consideration to these recommendations. Further, analysts and investors should be advised that operating cash flow is calculated before any distributions to noncontrolling interests. Such distributions, which may not be disclosed on the statement of cash flows, but rather, only on the statement of changes in equity, should be subtracted when measuring operating cash flow available for controlling interests or when calculating free cash flow. Finally, corporate managers should be apprised that for analysts and investors to accurately assess corporate cash flow performance, distributions should be clearly disclosed on the statement of cash flows.