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International Accounting Standards Board



**INFORMATION FOR OBSERVERS**

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| **IFRIC meeting:** | **2 November 2006, London** |
| **Project:** | **Review of published tentative agenda decisions** |
| **Subject:** | **IAS 32 *Financial Instruments: Presentation* - Puts and forwards held by minority interests and IFRS 3 *Business Combinations* - Are puts or forwards received by minority interests in a business combination contingent consideration? (Agenda Paper 7(iii))** |

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## Tentative agenda decision published in July-2006 IFRIC Update

### IAS 32 *Financial Instruments: Presentation* - Puts and forwards held by minority interests

The IFRIC considered a request for clarification of the accounting when a parent entity has entered into a forward to acquire the shares held by the [non-controlling] minority interest in a subsidiary or the holder of the [non-controlling] minority interest can put its shares to the parent entity.

Paragraph 23 of IAS 32 states that a parent must recognise a financial liability when it has an obligation to pay cash in the future to purchase the minority's shares, even if the payment of that cash is conditional on the option being exercised by the holder. After initial recognition any liability to which

IFRS 3 is not being applied will be accounted for in accordance with IAS 39. The parent will reclassify the liability to equity if a put expires unexercised.

The IFRIC agreed that there is likely to be divergence in practice in how the related equity is reclassified. However, the IFRIC did not believe that it could reach a consensus view on this matter on a timely basis. Accordingly, [the IFRIC decided] not to add this item to its agenda.

**IFRS 3 *Business Combinations* - Are puts or forwards received by minority interests in a business combination contingent consideration?**

The IFRIC considered a request for an interpretation of whether a put or forward entered into by a parent entity, as part of a business combination, to acquire the shares held by the [non-controlling] minority interest was contingent or deferred consideration.

The accounting for these arrangements, including the circumstances considered by the IFRIC, is being considered by the Board as part of the current redeliberations on the proposed revised IFRS 3 *Business Combinations*. The IFRIC therefore believed that it could not develop guidance more quickly than is likely to be developed in the business combinations project and [decided] not to take a project on this issue onto its agenda.

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Sir David Tweedie
Chairman of the
International Accounting Standards Board
30 Cannon Street
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September 18, 2006

**IFRIC Update July 2006**

Dear Sir David,

E.ON is writing in response to the latest agenda decisions of the IFRIC as published in the IFRIC Update dated July 2006.

We are especially referring to the following issues:

- IAS 32 *Financial Instruments: Presentation* - Puts and forwards held by minority interests
- IFRS 3 *Business Combinations* - Are puts or forwards received by minority interests in a business combination contingent consideration?

The IFRIC decided not to take the items to the agenda based on the fact that the IFRIC did not believe that it could reach a consensus view on this matter on a timely basis and that part of the issue is subject to the current project on the revised IFRS 3 *Business Combination*.

We would like to take the opportunity to comment on these agenda decisions as we were already analysing the issue for the E.ON Group as well.

We were glad to see that the IFRIC started considering these issues. In our view, the questions surrounding puts and forwards held by minority interests generate many complex accounting issues with a need for interpretation regardless of whether these instruments were entered into in the context of a business combination or not.

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Our concern is that significant divergence in practice, as also acknowledged by the IFRIC, could arise due to a lack of clear interpretative guidance. Due to this potential divergence and the material amounts involved, comparability, understandability and usefulness of the financial information could be diminished. In our view, a resolution by the IFRIC is necessary as the IASB decided not to require application of any new standards before 2009. Otherwise, companies will be subject to uncertainty for a significant period of time. We also think that a solution implemented in the revised IFRS 3 would only solve part of the issues.

Therefore, we would like to ask you to reconsider that the IFRIC addresses the issue. A copy of this paper was also provided to Robert P. Garnett, in his function as the non-voting chairman of the IFRIC.

If you wish to discuss any of the issues raised or further explore our concerns and experiences, please do not hesitate to contact us.

Yours sincerely,

Michael Wilhelm
Senior Vice President Accounting
Chief Accounting Officer
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25 September 2006

Robert Garnett, Chairman
International Financial Reporting Interpretations Committee
30 Cannon Street
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Email: ifric@iasb.org

Dear Bob,

**Proposed rejection wording: *IAS 32 Financial Instruments: Presentation* – Puts and forwards held by minority interests and *IFRS 3 Business Combinations* - Are puts or forwards received by minority interests in a business combination contingent consideration?**

Deloitte Touche Tohmatsu is pleased to respond to the IFRIC's publication in the July 2006 *IFRIC Update* of the tentative decision not to take both of the above issues onto the IFRIC agenda with a view to developing a full interpretation.

We agree that where an entity has a forward purchase or written put over a subsidiary's shares which will or may result in the physical delivery of those shares to the parent, that a gross obligation should be recognised in the group financial statements in accordance with IAS 32. If the same arrangement was over the parent's equity a gross obligation would equally be recognised and therefore it is appropriate that an arrangement over a subsidiary's shares results in the same liability treatment. We believe IAS 32 is clear in this respect when these arrangements are entered into independently of a business combination.

The IAS 32 rejection notice wording refers to puts and forwards held by minority interests although it is not clear whether the rejection notice solely addresses the scenario where these arrangements are entered into as part of a business combination or not. We are concerned that the wording "after initial recognition any liability to which IFRS 3 is not being applied will be accounted for in accordance with IAS 39" could imply that, where such an arrangement is entered into outside of a business combination, an entity may have a choice to recognise the forward or put liability in accordance with IFRS 3. We presume the IFRIC does not intend the rejection notice to be interpreted in this way. To avoid any ambiguity the rejection notice should make clear that it relates only to those arrangements that are entered into in the absence of a business combination. Such an approach would make clear that the two fact patterns - (i) forward purchases and written puts over a subsidiary's shares entered into as part of a business combination and (ii) standalone forward purchases and written puts over a subsidiary's shares - are subject to two separate rejection notices.

Where the forward purchase or written put is not entered into as part of a business combination we believe the IFRIC could have gone further and explained that the debit in equity is a potential transaction with minority interest holders, as opposed to an actual derecognition of minority interest. Derecognising the minority interest on entering into the arrangement would not be appropriate where the minority shareholders retain their investment in the subsidiary and continue to be able to exercise their rights as shareholders. Without an explicit statement to this effect, we believe there will be diversity in practice in the presentation of the debit in equity.

Where a forward purchase or written put over a minority interest's shares in a subsidiary is entered into as part of a business combination we would start with the presumption that the treatment should be the same as for a standalone forward purchase or written put. However, we do believe that it might be necessary to rebut this presumption where, in substance, the parent has purchased a 100% stake in the subsidiary. The ability of the minority interest holders to exercise their rights and the practical ability and advantage for the minority interest to sell their interest to a third party would among other factors need to be considered in determining whether the parent has acquired all or part of the entity. These factors will have more relevance in a forward purchase arrangement that is exclusively physically settled where the minority interest is obligated to sell their interest to the parent at a predetermined date. We recognise that further deliberation is needed in this area and therefore support the IFRIC's proposed approach that this issue would be best dealt with as part of the Board's deliberations on the revised IFRS 3. It is important that the IASB staff on the business combinations project and on the financial instruments project work together so there is no ambiguity as to how the two standards interact. The use of derivatives over outstanding stakes in a business combination is a common acquisition strategy for the buyer and exit strategy for the seller, particularly with the acquisition of owner-managed businesses where the founders retain an interest post acquisition. We therefore urge the Board to accelerate its work in this area as part of the wider improvements to IFRS 3.

If you have any questions concerning our comments, please contact Ken Wild in London at +44 (0) 207 007 0907.

Sincerely,

**Ken Wild**
**Global IFRS Leader**

cc: Allan Cook, IFRIC

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29 September 2006

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Dear Sir

**Tentative Agenda Decisions:**

**IAS 32 *Financial Instruments: Presentation* - Puts and forwards held by minority interests**

**IFRS 3 *Business Combinations* - Are puts or forwards received by minority interests in a business combination contingent consideration**

We disagree with the tentative agenda decisions in respect of the above two issues set out in the July 2006 IFRIC Update. Put options on minority interests are frequently negotiated in connection with business combinations and are commonly used as a mechanism for aligning the interests of controlling and non-controlling interests. The issue of how to account for such put options under IFRS has been the subject of much discussion among preparers and auditors for the past three years and there is considerable divergence in practice. Moreover, the impact on financial statements of applying one accounting treatment rather than another is often more material than most cases that are referred to IFRIC.

This issue of accounting for put options held by minority interests was first raised with the IFRIC/IASB more than two years ago and the two aspects that are the subject of the tentative agenda decisions were first considered by IFRIC in December 2005. We believe that to postpone consideration of these important issues now, having allowed so much time to pass without addressing them, would be an abdication of responsibility by IFRIC and the IASB. In our view, the highest priority of the IASB in these early days of IFRS implementation worldwide should be to support preparers and users in applying IFRS today by fixing anomalies in the current standards, clarifying the intentions behind aspects of the standards and, where more than one accounting treatment is regarded as equally appropriate, determining the acceptable alternatives.

It seems to us that IFRIC has been unduly selective in identifying the aspects of accounting for put options held by minorities. It has focused almost entirely on the 'credit' side of the accounting – and not even all aspects of this - whereas there is at least as much uncertainty concerning the appropriate accounting for the 'debit' side. For example, in the case of a put option given to the non-controlling shareholder in connection with a business combination, should all of the goodwill of the acquired business (ie including the share attributable to the minority interest) be recognised at acquisition date?

IFRIC has also not considered the impact, if any, of minority put options on income statement presentation or on earnings per share.

We see no point in trying to tackle only certain aspects of accounting for put options held by minority interests and believe that the only sensible way forward is to address the topic as a whole. As the difficulty of determining how to account for such puts can in many ways be traced to the different recognition and measurement models underlying IAS 27/IFRS 3 and IAS 39, we acknowledge that it may well not be possible to conclude that only one accounting treatment is appropriate. (In this regard, we do not think it is appropriate for IFRIC to ask those commenting on a rejection notice that does not discuss the issue to express views on which of two standards should apply.) However, if no further consideration is to be given to one of the two issues rejected by IFRIC and the other issue is to be deferred on the grounds that the Board will consider it as part of its Business Combinations project, no progress whatever will be made for some considerable time. In our view it would be very valuable if IFRIC were to identify any practices in relation to accounting for put options held by minority interests that they consider to be unacceptable or less preferable than others. We therefore believe that IFRIC should continue to address this issue.

Yours faithfully

Ernst & Young