Project **Amendments to IFRS3 and IAS27**

Topic **Measurement of NCI**

Introduction

1. In phase II of the business combinations project, the Board amended the definition of minority interest (MI) in IAS 27 and changed its name from minority interest to non-controlling interest. The amendment has widened the scope of instruments to be included in NCI.

2. IFRS 3 allows an entity to measure NCI either at its acquisition-date fair value or at the NCI's proportionate share of the acquiree's identifiable net assets. Some constituents ask the IFRIC to clarify the requirement with respect to the following issue:

   Should an entity apply the measurement choice in IFRS 3 to all components of NCI?

Background

3. IFRS 3 (as issued in 2004) and IAS 27 (as issued in 2003) defined MI as "that portion of the profit or loss and net assets of a subsidiary attributable to equity interests that are not owned, directly or indirectly through subsidiaries, by the parent".

4. IFRS 3 and IAS 27 (as issued in 2008) amend the definition of NCI to "the equity in a subsidiary not attributable, directly or indirectly to a parent". Some respondents think that the amended definition of NCI has widened the scope of instruments that it covers to include, for example, the equity components of

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IFRIC.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IFRIC or the IASB. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

Decisions made by the IFRIC are reported in IFRIC *Update*.

Interpretations are published only after the IFRIC and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in IASB *Update*.

convertible bonds, warrants, options over own shares and options under share-based payment plans (not held by the parent).

5. IFRS 3.19 provides an entity with the choice of measuring NCI at its acquisition-date fair value or at the NCI's proportionate share of the acquiree's identifiable net assets. Some constituents believe that if an entity measures NCI as a proportionate share of the acquiree's identifiable assets it should measure all components of equity other than those equivalent to minority interests as defined under IFRS 3 (as issued in 2004) at nil on acquisition. They argue that because those equity components are not present ownership instruments that entitle the holder to a pro rata share of the entity's net assets in the event of the liquidation of the acquiree, they do not share any of its identifiable net assets on the business combination. Some staff find it difficult to understand this interpretation because IFRS 3.19 does not impose conditions on elements of NCI—it simply specifies how NCI must be measured.

6. Other constituents believe that the fair value of those NCI components should be included in the measurement of NCI regardless what method an acquirer uses.

Staff Analysis

7. Some staff believe that when the Board issued IFRS 3 (as issued in 2008) it intended the measurement choice to apply only to those components of NCI that are equivalent to MI as defined in IAS 27 (as issued in 2003). However, the matter was discussed at Board meetings, because constituents had identified this concern. Staff, at the time, noted that it was a problem that preparers faced in applying IFRS 3 (2004), because they, and the Board, did not assess the change in the definition of NCI as broadening the elements intended to be caught. They saw it as a simplification of the language.

8. The staff believes that NCI components other than MI should be measured at fair value or the measurement basis required by IFRS. For example, a stock option under share-based payment awards should be measured in accordance with the method in IFRS 2 *Share-based Payment* and the equity component of a

convertible bond should be measured in accordance with IAS 32 *Financial Instruments: Presentation* .

Question	
1.	Does the IFRIC agree that the choice of measuring NCI at its proportionate share of the acquiree's identifiable net assets should not be extended to other components of equity?

9. The next section gives a staff recommendation for an amendment to remedy what these staff see to be a problem. Other staff think that an amendment is not required, for the reasons set out in the alternative view section.

Staff Recommendation

10. The staff has analysed the issue against the IFRIC's agenda criteria:

    (a) Can the issue be resolved efficiently within the confines of existing IFRSs?
    We do not believe IFRSs provide sufficient guidance to resolve the issue. The measurement of equity components other than MI at nil is an unintended consequence of the amendment of the NCI definition and the measurement choice of NCI.

    (b) Do the issues indicate significantly divergent interpretations (either emerging or already existing in practice)?
    Although the standard is only effective on 1 July 2009, we understand there are emerging divergent interpretations.

    (c) Would financial reporting be improved through elimination of the diverse reporting methods?
    Yes, because of the emerging divergent interpretations. In addition, we consider that the measurement basis of NCI is a pervasive and important issue for business combination accounting.

11. If the IFRIC agrees that the choice of measuring NCI only applies to NCI components equivalent to MI, some staff believe that there are two alternatives to approach this issue:

(a) the IFRIC could add a project to its agenda to clarify how other components of the NCI should be measured in a business combination; or

(b) the staff could present this issue to the Board for their consideration for potential inclusion in the exposure draft of proposed Improvements to IFRSs

12. Those staff recommend alternative (b). Those staff are concerned that the current wording of IFRS 3 might not support different measurements for different components of NCI. Therefore, an amendment to the standard might be needed to limit the choice of measuring NCI at its proportionate share of the acquiree's identifiable net assets to MI.

13. If the IFRIC agrees with the staff recommendation to adopt alternative (b), the staff believes that there are two alternatives to amend the standard:

    (b)(i) To limit the NCI measurement choice to those NCI components that are equivalent to MI as defined in IFRS 3 (as issued in 2004), and require the other components to be measured at fair value or other measurement basis as required by IFRS; or

    (b)(ii)To first measure the equity components of NCI to which other IFRSs are applicable, and then to measure the remaining balance either at fair value or NCI's proportionate share of the acquiree's identifiable net assets.

14. The staff recommends alternative (b)(i). This option limits the application of the measurement choice to specific NCI components. It also clarifies the measurement basis for other NCI components at either fair value or other measurement basis if prescribed by IFRS.

15. The difficulty of applying alternative (b)(i) is to properly define the NCI component the measurement choice applies to. The staff does not support using the definition of MI in IFRS 3 (as issued in 2004). This would mean including a definition of an old term in the revised standard that it was intended to replace.

16. The staff proposes to use the term "present ownership instruments that entitle the holder to a pro rata share of the entity's net assets in the event of the liquidation". The term "present ownership interest" is used in paragraph 19 of IAS 27 (as issued in 2008) for the equity components (both controlling and non-controlling) that entitle the holder to an allocation of a proportion of profit or loss and changes in equity. In addition, the Board has set out in IAS 32.16A(a) that one of the criteria for determining whether a puttable instrument is equity is that the instrument shall entitle "the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation".

17. The staff does not support alternative (b)(ii). If there is no other standard specifically applicable to measure a particular NCI component, that component would be recognised at nil if the entity chose to measure NCI at the NCI's proportionate share of the acquiree's identifiable net assets.

18. We have included draft wording of the proposed amendments for both alternative (b)(i) and (b)(ii) in Appendix A.

Question to the IFRIC	
2.	Does the IFRIC agree with the staff recommendation to refer the issue to the Board for inclusion in the exposure draft of proposed Improvements to IFRSs? If not, why?
3.	If the IFRIC agrees with the staff recommendation in question 2 above, which alternative amendments does the IFRIC support?
3.	Does the IFRIC have any comments on the proposed wording of the drafting?

Alternative view

19. Some staff think an amendment is not required. IFRS 3 (2008) defines non-controlling interest. It is a collective term. IFRS 3.19 sets out the measurement requirements for that aggregate (fair value or the proportionate interest in the acquiree's identifiable net assets). Nothing in IFRS 3 prevents a preparer from measuring components of NCI at other amounts. This is how we think practice developed when applying IFRS 3 (2004). That is to say, preparers have been

measuring some MI components at fair value or other measurement bases. If preparers take this approach in applying IFRS 3 (2008) the outcome should be the same as would be achieved by the amendments suggested.

20. These staff are particularly concerned with the suggestion following alternative (b)(i), because it introduces a new implied definition of NCI. These staff are less concerned with the alternative relating to (b)(ii), but they do not think such an amendment is necessary because IFRS 3 (2008) already allows such an approach.

[Appendix A has been omitted from this Observer Note]