Project	**Put options written over non-controlling interests**
Topic	**Subsequent measurement – Dividends**

Purpose of this paper

1. Agenda paper 4B discussed the initial recognition of NCI puts.
2. It identifies that on initial recognition, a financial liability is recognised for the fair value (present value of the redemption amount) of the NCI put, and that this financial liability is reclassified from equity.
3. Subsequently to initial recognition, the shares of the subsidiary that are subject to the NCI put may receive a discretionary dividend.
4. Constituents have different views of how these dividends should be recognised in the consolidated financial statements of the parent.
5. In a similar way as with the accounting for changes in the carrying amount of the financial liability recognised for the NCI put, discussed in agenda paper 4C, views on recognition of dividends typically reflect the rationale for the accounting of the initial recognition of the NCI put.
6. Specifically, this relates to which component of equity the financial liability initially recognised for the NCI puts is considered to be reclassified from, and to whether NCI should continue to be recognised after issuance of the NCI put.
7. This paper:
   (a) discusses how dividends that the parent receives, relating to shares subject to the NCI put, should be recognised;

(b) discusses how dividends that the NCI shareholder receives, relating to shares subject to the NCI put, should be recognised;

(c) considers the implications of the *Financial Instruments with Characteristics of Equity* (FICE) project for the accounting for dividends relating to shares subject to a NCI put;

(d) makes a staff recommendation on:

   (i) whether the accounting for dividends relating to shares subject to the NCI put should be included within the scope of the proposed Interpretation; and

   (ii) if so, how those dividends should be recognised;

(e) asks the Committee whether they agree with the staff recommendation.

Background information

8. The accounting for dividends relating to subsidiary shares subject to the NCI put has not been previously addressed by the Committee.

9. Furthermore, this issue was not analysed in the staff agenda paper on NCI puts that was presented in the May 2010 Committee meeting.

Staff analysis

10. In some instances, because of the contractual terms of the NCI put, the party (either the parent or the NCI shareholder) who, in substance, has a present ownership interest in the shares subject to the NCI put, may be different to the party (either the parent or the NCI shareholder) that receives dividends relating to shares subject to the NCI put.

11. This may create a conflict between the contractual terms of the shares subject to the NCI put (which may require dividends to be paid to the NCI shareholder) and the accounting for the substance of the NCI put (which may require the parent to no longer recognise NCI).

12. The table below summarises the different fact patterns relating to the payment of dividends on shares subject to the NCI put that are analysed in this agenda paper:

	NCI continues to be recognised	**NCI is no longer recognised**
Dividends are paid to parent	Case 1	
Dividends are paid to the NCI shareholder	Case 2A	Case 2B

Case 1 - How should dividends that the parent receives, relating to shares subject to the NCI put, be recognised?

13. The staff are not aware of significant diversity in practice relating to the accounting for dividends that the parent receives relating to shares subject to the NCI put (Case 1).

14. Regardless of whether or not, in substance, the parent has a present ownership interest in the shares subject to the NCI put, or continues to recognise NCI after issuance of the NCI put, the accounting for any dividends received by the parent is the same as the accounting for dividends received on shares in the subsidiary in which the parent has an **actual**, rather than in substance, ownership interest.

15. As a result, in accordance with paragraph 30 of IAS 27 *Consolidated and Separate Financial Statements*, these dividends are transactions with owners in their capacity as owners, and should be accounted for within controlling interest equity as an equity transaction in the consolidated financial statements of the parent.

16. This is also consistent with the examples of transactions with owners in their capacity as owners in paragraph 109 of IAS 1 *Presentation of Financial Statements*:

> Changes in an entity's equity between the beginning and the end of the reporting period reflect the increase or decrease in its net assets during the period. Except for changes resulting from *transactions with owners in their capacity as owners (such as* equity contributions, reacquisitions of the entity's own equity instruments and *dividends*) and transaction costs directly related to such

> transactions, the overall change in equity during a period represents the total amount of income and expense, including gains and losses, generated by the entity's activities during that period. (emphasis added)

Case 2 - How should dividends that the NCI shareholder receives relating to shares subject to the NCI put be recognised?

17. In determining how to recognise dividends paid to the NCI shareholder that relate to shares subject to the NCI put, constituents consider whether NCI continues to be recognised after initial recognition of the NCI put.

Case 2A - NCI continues to be recognised

18. Sometimes dividends are paid to NCI shareholders relating to shares subject to the NCI put when the parent continues to recognise NCI in accordance with IAS 27.

19. This occurs when, in accordance with Situation 2 identified in agenda paper 4B, on issuance of the NCI put, an entity determines that in substance, the NCI shareholder retains present access to the economic benefits associated with the ownership interest subject to the NCI put, and the entity applies View A[1] or View C[2] in agenda paper 4B.

20. As a result, the accounting for any dividends to the NCI shareholder would be reflected in the calculation of NCI.

21. This is consistent with the normal accounting for dividends paid to NCI shareholders.

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[1] View A in agenda paper 4B is that the NCI shareholder retains, in substance, present access to the economic benefits associated with the shares of the NCI. The NCI component of equity continues to exist and a financial liability is recognised for the NCI put.

[2] View C in agenda paper 4B is that NCI continues to exist, but is reclassified as a financial liability, rather than equity instrument.

Case 2B - NCI is no longer recognised.

22. In other circumstances, dividends are paid to NCI shareholders relating to shares subject to the NCI put when the parent no longer recognises NCI after issuing the NCI put is written.

23. These circumstances may exist in:

    (a) Situation 2 identified in agenda paper 4B, when, on issuance of the NCI put, an entity determines that, in substance, the NCI shareholder retains present access to the economic benefits associated with the ownership interest subject to the NCI put, and an entity applies View B[3]; or

    (b) Situation 1 identified in agenda paper 4B, when a parent may, on issuance of the NCI put, determine that, in substance, it has acquired present access to the economic benefits associated with the ownership interest that is subject to the NCI put.

24. The staff have identified the following approaches to addressing this issue:

    (a) equity presentation approach; or

    (b) finance cost approach.

[3] View B in agenda paper 4B is that the financial liability initially recognised for the NCI put reflects the reclassification of the NCI shares subject to the put from equity to a financial liability. NCI no longer exists.

The equity presentation approach

25. The equity presentation approach is consistent with Situation 1 identified in agenda paper 4B, when a parent determines, on issuance of the NCI put, that, in substance, it has acquired present access to the economic benefits associated with the ownership interest that is subject to the NCI put.

26. This accounting on initial recognition reflected a view that, even though the NCI shareholder receives dividends relating to those shares, the:

    (a) shares subject to the NCI put were considered to be, in substance, acquired by the parent when the NCI put is written; and

    (b) accounting relating to these subsidiary shares is consistent with that applied if the parent owns 100 per cent of the shares of the subsidiary.

27. However, the equity presentation approach still considers that, in accordance with IAS 27.30 and IAS 1.109, the dividend payment to the NCI shareholders, similarly to a dividend payment that is made to the shares the parent owns, is a transaction with owners in their capacity as owners and should be accounted for as an equity transaction.

28. This is because the transaction is a payment of a dividend to the NCI shareholders relating to the subsidiary shares. The transaction is not directly related to the financial liability (the NCI put instrument).

29. Consequently, even though NCI is no longer recognised, the equity presentation approach proposes that the dividend that a NCI shareholder receives should be clearly identified and presented within the statement of changes in equity.

30. This presentation would show in the statement of changes in equity:

    (a) an amount equal to the dividends paid to the NCI shareholder is transferred from retained earnings to NCI to “fund” the dividend; and

    (b) the dividend is shown as a distribution from NCI, leaving a zero balance on.

This reflects that, in substance, the parent has acquired present access to the economic benefits associated with the ownership interest of the NCI shareholder on issuance of the NCI put, and so the parent no longer recognises NCI.

31. This is illustrated in the example below of the statement of changes in equity for the six months ended 30 June 20X1 (in CU):

	CI	**NCI**	**Total Equity**
1 January 20X1	100	-	100
Transfer from CI	(2)	2	-
Dividends	-	(2)	(2)
30 June 20X1	98	-	98

32. The decrease in total equity reflects the payment of a CU2 dividend in cash to the NCI shareholders.

Proponents of this approach believe it is consistent with the:

(a) present access to economic benefits approach supported by the staff in agenda paper 4B;

(b) principles in IFRSs that the payment of dividends to shareholders is a transaction with owners in their capacity as owners and is accounted for as equity transactions; and

(c) provision of a practical and transparent solution to the issue.

The finance cost approach

33. The finance cost approach reflects a view that, on initial recognition of the NCI put, the NCI is effectively reclassified from equity to a financial liability in accordance with IAS 32.

34. This approach may be applied when:

    (a) Situation 1 identified in agenda paper 4B, exists and a parent determined on issuance of the NCI put, that in substance, it acquired present access to the economic benefits associated with the ownership interest that is subject to the NCI put; or

    (b) Situation 2 identified in agenda paper 4B, exists and on issuance of the NCI put, an entity determined that, in substance, the NCI shareholder retains present access to the economic benefits associated with the ownership interest subject to the NCI put, and an entity applies View B.

    As noted above, View B applies the 'in substance purchase' approach in agenda paper 4B, and leads to the strict application of the 'profit or loss' view in agenda paper 4C when accounting for subsequent changes in the carrying amount of the financial liability.

35. The finance cost approach considers that, because the NCI is, in substance, accounted for as a financial liability, the dividend payment by the subsidiary to the NCI shareholder is a return on the NCI put financial liability.

36. As a result, the dividend is not a transaction with owners in their capacity as owners, and is not recognised as an equity transaction. Instead, the dividend is recognised in profit or loss as a finance cost.

37. Proponents of this approach also think that it represents the economics of the dividend payment, noting that if the NCI put is issued with a:

    (a) fair value exercise price, the dividend would be expected to create a change in the fair value of the financial liability recognised for the NCI put.

This change in the fair value of the financial liability would, in accordance with the profit or loss view in agenda paper 4D, be recognised in profit or loss and would largely offset the finance cost recognised for the dividend obligation.

(b) fixed exercise price that does not adjust if a dividend payment is made to the NCI shareholders, it then seems appropriate that the parent should recognise an expense in profit or loss relating to the dividend obligation to the NCI shareholder.

This is because the fair value of the NCI put has declined as a result of the dividend payment transferring assets to the NCI shareholders who are outside of the consolidated group.

(c) fixed exercise price that has an adjustment clause that reduces the fixed exercise price if a dividend payment is made to the NCI shareholders.

This change in exercise price would change the present value of the redemption amount of the financial liability, and, in accordance with the profit or loss view in agenda paper 4C, would be recognised in profit or loss, and would largely offset the finance cost recognised for the dividend obligation.

Implications of the **Financial Instruments with Characteristics of Equity** *(FICE) project on the accounting for dividends relating to shares subject to a NCI put*

38. As noted in the May 2010 Committee Agenda Papers, on the basis of the Board's tentative decisions to date, the ED will propose that a freestanding put option on the NCI should be presented on a 'net' basis, to be consistent with the accounting for derivative instruments in accordance with IAS 39. This would be initially measured at the fair value of the NCI put instrument, rather than being measured on a gross basis (eg at the present value of the redemption amount of the NCI put).

39. In addition, the ED would require a NCI puttable instrument that does not qualify as equity in its entirety, to be separated into a liability component (ie the NCI put instrument) and an equity component (ie shares of the NCI).

40. As a result, it would seem that application of the ED would mean that if the parent does not, in substance, have a present ownership interest in the shares subject to the NCI put, then an equity component to which dividends can be attributed will continue to be recognised.

Staff recommendation

How should dividends relating to the shares subject to the NCI put be recognised?

Dividend paid to parent

41. When the parent receives dividends relating to shares subject to the NCI put, the staff think that current IFRSs are clear that these dividends should be recognised as an equity transaction in accordance with IAS 27.30 and IAS 1.109.

Dividend paid to NCI shareholder

42. In considering a scenario when the NCI shareholder receives dividends relating to the shares subject to the NCI put, the staff think the accounting depends on whether the parent continues to recognise NCI as a component of equity after initial recognition of the NCI put.

43. If the parent **does continue to recognise NCI** after initial recognition of the NCI put, the staff believe that these dividends should continue to be attributed to the NCI component of equity, in conformity with the current guidance in IAS 27.

44. However, the staff do not think that IFRSs provide clear guidance if the parent **does not continue to recognise NCI** as a component of equity after initial recognition of the NCI put.

45. In this scenario, the staff support the equity presentation approach. This proposes that the dividend a NCI shareholder receives should be clearly identified and presented as an NCI equity transaction within the statement of changes in equity.

46. The staff believe that this approach is consistent with the overall approach to accounting for NCI puts that the staff recommends, and that it provides a practical solution to the issue.

47. The staff rejected the finance cost approach to this scenario, because although it may be viewed as consistent with the guidance in the financial instruments literature, the staff believe that it:

   (a) conflicts with the principle in IFRSs that dividends are transactions with owners in their capacity as owners; and

   (b) does not distinguish between the accounting for dividends paid to the NCI shareholder in situations where the parent has, or has not, in substance, acquired present access to the economic benefits associated with the shares subject to the NCI put.

The compound financial instrument approach

48. The staff are aware that some believe that an alternative compound financial instrument approach should be applied to overcome some of the issues arising with the accounting for dividends paid on shares subject to an NCI put.

49. This approach considers that the NCI put contains both a liability and an equity component. Consequently, the NCI put is initially recognised, and subsequently measured as a compound financial instrument in accordance with paragraphs 28 and 29 of IAS 32 *Financial Instruments: Presentation*.

50. The staff reject applying the compound financial instrument approach to this scenario, because the staff believe that it creates:

   (a) a model for initial recognition of the NCI put that is different from the ‘present access to economic benefits’ approach that is discussed by the staff in agenda paper 4B;

   (b) significant complexity in the accounting for NCI puts, without generating a corresponding benefit of an improvement to the quality of financial reporting; and

(c) the need for additional rules, rather than principles (eg the accounting for dividends paid to NCI shareholder when allocation of the dividend to the NCI component of equity would create a negative amount of NCI).

51. The staff have analysed the compound financial instrument approach separately in Appendix A to this agenda paper.

Should guidance on how dividends relating to the shares subject to the NCI put should be recognised be within the scope of the proposed Interpretation?

52. The staff believe that guidance on how dividends relating to shares of the subsidiary that are subject to the NCI put should be within the scope of the proposed Interpretation.

53. This is because current IFRSs do not provide clear guidance on this issue, specifically in a scenario when the NCI shareholder receives dividends relating to the shares subject to the NCI put, but the parent entity no longer recognises NCI.

54. The staff think that providing this guidance would help to reduce diversity that may emerge or already exists in practice in relation to this issue.

Question 1 for the Committee
Does the Committee agree with the staff's recommendation that: i) when the parent receives dividends relating to the shares subject to the NCI put, these dividends should be recognised as an equity transaction in accordance with IAS 27.30 and IAS 1.109? ii) when the NCI shareholder receives dividends relating to shares subject to the NCI put, the accounting depends on whether the parent continues to recognise the NCI component of equity after initial recognition of the NCI put? If the parent does continue to recognise NCI these dividends should be recognised as a change in the NCI component of equity.

If the parent does not recognise NCI these dividends should be clearly identified, and presented as an equity transaction within the statement of changes in equity.

iii) the proposed Interpretation should address the accounting for dividends relating to shares of the subsidiary that are subject to the NCI put?

If not, what does the Committee recommend?

Appendix A ─ The compound financial instrument approach

A1. The compound financial instrument approach considers that the NCI put contains both a liability component and an equity component.

A2. Consequently, the NCI put is initially recognised, and subsequently measured as a compound financial instrument in accordance with paragraphs 28 and 29 of IAS 32 *Financial Instruments: Presentation*.

A3. Although the NCI put is considered to provide the parent, in substance, with a present ownership interest in the shares subject to the put, part of the economic benefits associated with the subsidiary shares remain with the NCI shareholder (specifically, the right to receive dividends).

A4. On initial recognition of the NCI put, in applying the compound financial instrument approach, the liability component reflects the fair value (present value of the redemption amount) of the NCI put financial liability.

A5. The difference between the measurement of the liability component and, depending upon the approach proposed, the:

(a) carrying amount of the NCI component of equity; or

(b) fair value of NCI

is considered a residual interest in accordance with IAS 32.32 and is allocated to controlling interest equity.

A6. This difference is usually a debit entry that reduces controlling interest equity.

A7. Dividends relating to shares subject to the NCI put would first be allocated to the NCI component of equity, and then to controlling interest equity when NCI is reduced to zero.

A8. Supporters of the compound financial instrument approach believe that it is consistent with the:

(a) current requirements in IAS 32;

(b) notion of risks and rewards that forms the basis of the present access to economic benefits approach supported by the staff in agenda paper 4B; and

(c) view that an NCI put typically transfers some, rather than all or none, of the economic benefits associated with the ownership interest subject to the NCI put from the NCI shareholder to the parent.

A9. The staff rejects the compound financial instrument approach for the reasons given in paragraph 50 of this paper.

Agenda paper 4D - Subsequent measurement - Dividend journal entries

Instrument	Present access to economic benefits?	Initial recognition approach (Agenda paper 4B)	Does NCI continue to be recognised?	Subsequent measurement of dividend (Agenda paper 4D)	30 June 20X1 Journal entries				Notes
					Debit	CU	Credit	CU	
Instrument 1 (‘Fixed price NCI put’)	Yes - Situation 1 in agenda paper 4B	Present access to economic benefits	Yes	Compound financial instrument	CI equity	8	CI equity	8	Dividend on parent 80% share is an equity transaction
					NCI equity	2	Cash	2	Payment in cash of NCI 20% share
			No	Equity presentation	CI equity	8	CI equity	8	Dividend on parent 80% share is an equity transaction
					NCI equity	2	Cash	2	Payment in cash of NCI 20% share
					CI equity	2	NCI equity	2	NCI 20% share reclassed to CI to "fund" the dividend, and prevent the NCI balance falling below zero
			No	Finance cost	CI equity	8	CI equity	8	Dividend on parent 80% share is an equity transaction
					Profit or loss	2	Cash	2	Payment in cash of NCI 20% share
Instrument 2 (‘Fair value NCI put’)	No - Situation 2 in agenda paper 4B	View A - No present access to economics	Yes	Change in NCI	CI equity	8	CI equity	8	Dividend on parent 80% share is an equity transaction
					NCI equity	2	Cash	2	Payment in cash of NCI 20% share
		View B - In substance acquisition	No	Finance cost	CI equity	8	CI equity	8	Dividend on parent 80% share is an equity transaction
					Profit or loss	2	Cash	2	Payment in cash of NCI 20% share
		View C - Combination of IAS 27 & IAS 32	Yes	Change in NCI	CI equity	8	CI equity	8	Dividend on parent 80% share is an equity transaction
					NCI equity	2	Cash	2	Payment in cash of NCI 20% share

Key Assumptions

(i) Dividends of CU2 relating to the shares subject to the NCI put (20 per cent of shares of the subsidiary) are paid to the NCI shareholder

(ii) Dividends of CU8 relating to the shares not subject to the NCI put (80 per cent of shares of the subsidiary) are paid to the parent