Project	**Put options written over non-controlling interests**
Topic	**Settlement or expiration**

Purpose of this paper

1. The purpose of this agenda paper is to consider how the settlement or expiration of NCI puts should be accounted for.

2. This paper:

    (a) analyses how an NCI put that is settled (exercised) could be accounted for;

    (b) analyses how a NCI put that expires without delivery (not exercised) could be accounted for;

    (c) considers the implications of the *Financial Instruments with Characteristics of Equity* (FICE) project for the accounting for the settlement or expiration of NCI puts;

    (d) makes a staff recommendation on:

        (i) whether the accounting for the settlement and/or expiration of NCI puts should be included within the scope of the proposed Interpretation; and

        (ii) if so, how the settlement and/or expiration of NCI puts should be accounted for; and

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

Background information

3. The question of how to account for the settlement or expiration of NCI puts was not specifically addressed in the May 2009 agenda paper[1] or in previous IFRIC agenda decisions.

Staff analysis

How should an NCI put that is settled (exercised) be accounted for?

Accounting for the financial liability

4. As noted in agenda paper 4B, on initial recognition, an NCI put is presented as a financial liability in accordance with IAS 32 *Financial Instruments: Presentation*, and is subject to the recognition and measurement requirements of IAS 39 *Financial Instruments: Recognition and Measurement*.

5. Consequently, when the NCI put is settled with cash, the parent entity should apply the guidance in IAS 39.39, which states that:

> An entity shall *remove a financial liability* (or a part of a financial liability) from its statement of financial position *when, and only when, it is extinguished*—ie when the obligation specified in the contract is discharged or cancelled or expires. (emphasis added)

6. In applying IAS 39.39, when the parent settles the NCI put with cash, the financial liability relating to the NCI put is derecognised because it has been extinguished.

7. In accordance with IAS 39, the NCI put financial liability is initially recognised at fair value (the present value of the redemption amount).

[1] http://www.iasb.org/NR/rdonlyres/148401DE-3856-4D10-94A9-AFEB18A3446B/0/1005ap11obsIFRICIAS27NCIPuts.pdf

8. In subsequent reporting periods, this financial liability is then measured at either fair value through profit and loss, or at amortised cost in accordance with IAS 39. Consequently, the carrying amount of the financial liability would be remeasured at each reporting period to reflect the amount of cash expected to be paid to settle the instrument.

9. As a result, the carrying amount of the financial liability will equal the amount of the cash paid when the NCI put is exercised, and no profit or loss on settlement of the NCI put is recognised.

10. The staff believe that this guidance is clear that the financial liability should be derecognised when the put is exercised. The staff understand that this is reflected in the lack of significantly divergent interpretations in current practice when accounting for settlement of the NCI put.

Accounting for NCI – NCI eliminated on initial recognition

11. In accordance with agenda paper 4B, in:

    (a) Situation 1 (when an entity determines that, in substance, it has acquired present access to the economic benefits associated with the ownership interest that is subject to the NCI put); and

    (b) Situation 2 (an entity may determine it has, in substance, not acquired present access to the economic benefits associated with the ownership interest that is subject to the NCI put) when View B[2] is applied,

    NCI is eliminated on the initial recognition of the NCI put.

12. Consequently, when the NCI put is exercised, no further adjustments to NCI are required, because the NCI has already been derecognised.

[2] 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.

Accounting for NCI – NCI is not eliminated on initial recognition

13. In accordance with agenda paper 4B, in Situation 2, when View A or View C is applied, NCI is continues to exist after the initial recognition of the NCI put.

14. As a result, when the NCI put is exercised, the NCI is acquired and would be derecognised.

15. Exercise of the NCI put leads to the parent acquiring the NCI shares and increasing its ownership interest in the subsidiary. This change in the parent's ownership interest in the subsidiary would be accounted for as an equity transaction in accordance with the guidance in paragraph 30 of IAS 27 *Consolidated and Separate Financial Statements*, which states:

> Changes in a parent's ownership interest in a subsidiary that do not result in a loss of control are *accounted for as equity transactions* (ie transactions with owners in their capacity as owners). (Emphasis added.)

16. Consequently, the carrying amount of the NCI on the date that the NCI put is exercised is reclassified from the NCI component of equity to controlling interest equity. There is no impact on profit or loss.

17. The staff believe that this guidance is clear, that the NCI is derecognised as an equity transaction, and that it is applied consistently in practice.

How should an NCI put that expires without delivery (is not exercised) be accounted for?

Accounting for the financial liability

18. Because, on initial recognition, an NCI put is presented as a financial liability, the accounting for the expiration or lapsing of the unexercised NCI put is similar to the approach for settlement of NCI puts and should comply with the guidance in IAS 32 and IAS 39.

19. IAS 32.23 provides guidance on accounting for financial instruments that may be settled in the entity's own equity instruments, including NCI puts. It states that:

> With the exception of the circumstances described in paragraphs 16A and 16B or paragraphs 16C and 16D, a contract that contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset gives rise to a financial liability for the present value of the redemption amount (for example, for the present value of the forward repurchase price, option exercise price or other redemption amount). This is the case even if the contract itself is an equity instrument. One example is an entity's obligation under a forward contract to purchase its own equity instruments for cash. When the financial liability is recognised initially under IAS 39, its fair value (the present value of the redemption amount) is reclassified from equity. Subsequently, the financial liability is measured in accordance with IAS 39. *If the contract expires without delivery, the carrying amount of the financial liability is reclassified to equity.* An entity's contractual obligation to purchase its own equity instruments gives rise to a financial liability for the present value of the redemption amount even if the obligation to purchase is conditional on the counterparty exercising a right to redeem (eg a written put option that gives the counterparty the right to sell an entity's own equity instruments to the entity for a fixed price). (emphasis added)

20. On the basis that the NCI put was originally recognised as a financial liability in accordance with IAS 32 (see agenda paper 4B), the staff believe that, if the NCI put expires without delivery, the carrying amount of the financial liability is reclassified to equity.

21. The staff note that, consistent with the guidance on initial recognition of the financial liability, that IAS 32 does not prescribe which component of equity the reclassification should be allocate to on expiration of the NCI put.

22. Consequently, divergent interpretations exist in practice in determining which component of equity is affected by the expiration of the NCI put.

23. These divergent interpretations reflect the different approaches to initial recognition of the NCI put, and specifically whether NCI continues to be recognised after the NCI put is written.

Accounting for NCI – NCI eliminated on initial recognition

24. In accordance with agenda paper 4B, in Situation 1, and Situation 2 when View B is applied, NCI is eliminated on the initial recognition of the NCI put.

25. Consequently, if the NCI put expires without delivery of the NCI shares from the NCI shareholder to the parent, then, on expiration of the NCI put, the

financial liability is reclassified back to the NCI component of equity and NCI is re-recognised.

26. One approach to re-recognising the NCI is to consider expiration of the NCI put as being equivalent to the sale of the NCI shares by the parent back to the NCI shareholder.

27. On initial recognition of the NCI put, the accounting was recognised as an ‘in substance purchase’ of the NCI shares. Consequently, on expiration of the NCI put, the accounting could be considered to reflect an ‘in substance disposal’ of the NCI shares.

28. In applying this approach, NCI would be re-recognised at the date of expiration of the NCI put, and would be required to be measured either at the:

    (a) carrying amount of the financial liability for the NCI put; or

    (b) fair value of the NCI.

    This would be consistent with the guidance in IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments* and is one of the options provided in IFRS 3.19, which states:

    > For each business combination, the acquirer shall measure any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets.

    As a result, any difference on expiration between the fair value of the NCI equity instrument and the carrying amount of the financial liability recognised for the NCI put would be recognised in controlling interest equity.

29. An alternative approach would be to consider expiration of the NCI put as equivalent to the non-occurrence of the ‘in substance purchase’ of the NCI shares.

30. In applying this approach, NCI would be recalculated from the date of the initial recognition of the NCI put as if it had not been derecognised when the NCI put was written.

31. This approach recognises that the NCI shares were never acquired by the parent, and considers that the NCI should, with hindsight, have always been recognised.

32. Any difference on expiration between the recalculated amount of NCI and the carrying amount of the financial liability recognised for the NCI put would be recognised in controlling interest equity.

33. In applying either approach, in accordance with the guidance in IAS 27.30, the accounting to re-recognise NCI would be recorded as an equity transaction, reflecting a transfer between controlling interest equity and NCI.

Accounting for NCI – NCI is not eliminated on initial recognition

34. In accordance with agenda paper 4B, in Situation 2 when View A or View C is applied, NCI continues to exist after the initial recognition of the NCI put.

35. This is because the financial liability initially recognised for the NCI put is either reclassified from controlling interest equity (View A), with the NCI component of equity continuing to exist, or is considered to reflect NCI, notwithstanding that the NCI component of equity is now presented as a financial liability. (View C),

36. If View A in agenda paper 4B was applied on initial recognition of the NCI put, and the instrument expires without delivery, the financial liability is reclassified back to controlling interest equity.

37. The NCI component of equity would remain unchanged, because it continued to be recognised and measured during the life of the NCI put as a separate component of equity.

38. If View C in agenda paper 4B was applied on initial recognition of the NCI put, and the instrument expires without delivery, the financial liability is reclassified back to the NCI component of equity.

39. If this view is taken, any difference on the expiration date between the carrying amount of the NCI put financial liability, and the amount that would have been recognised in the NCI component of equity if the NCI put had not been issued, is classified to the NCI component of equity.

Accounting for the changes in the carrying amount of the financial liability after initial recognition

40. Agenda papers 4C and 4D analysed issues relating to the accounting for subsequent changes in the carrying amount of a financial liability that is initially recognised for an NCI put.

41. These subsequent changes in the carrying amount of a financial liability may include the impacts of discount accretion, changes in the fair value of shares of the subsidiary and the impact of changes to the exercise price of the NCI put.

42. When the NCI put expires unexercised, a question arises as to whether any adjustments are required to reverse the recognition of these changes in the carrying amount of the financial liability; specifically, if these changes were recorded in profit or loss.

43. The staff do not think that the accounting for subsequent changes in the carrying amount of a financial liability should be reversed if the NCI put expires unexercised. This is because:

    (a) IAS 32 and IAS 39 do not require the reversal of amounts previously recorded in profit or loss in relation to financial instruments that expire without being exercised; and

    (b) IAS 32 requires expiry of the NCI put to be recognised as an equity transaction, consistent with the initial recognition of the instrument. Consequently, there should not be any impact upon profit and loss.

Implications of the* Financial Instruments with Characteristics of Equity *(FICE) project on the accounting for the settlement or expiration of NCI puts

44. Based on the Board's tentative decisions to date, the Exposure Draft is not expected to affect the staff analysis above relating to the settlement or expiration of NCI puts.

Staff recommendation

45. The staff believe in applying a general principle to the accounting for the settlement or expiration of NCI puts that it should be consistent with the accounting on initial recognition of the NCI put instrument.

46. Consequently, when a NCI put is settled through being exercised, or expires without being exercised:

    (a) The debit entry should reflect the extinguishment of the financial liability initially recognised for the NCI put.

    (b) If the instrument is settled, the entity should eliminate any NCI that continued to be recognised after initial recognition of the NCI put.

    (c) If the instrument expires, the rationale for the credit entry should reflect a reversal of the reclassification of the NCI put from equity to a financial liability when it was initially recognised.

How should an NCI put that is settled (exercised) be accounted for?

47. The staff believe that the guidance in IAS 39.39 is clear that when the parent settles the NCI put with cash, the financial liability relating to the NCI put is extinguished.

48. The staff also think that any existing NCI relating to the shares subject to the NCI put should be derecognised when the NCI put is exercised. The staff believe that IAS 27.30 is clear that this reflects a change in the parent's ownership interest in the subsidiary, and that it is accounted for as an equity transaction.

Should guidance on the settlement (exercise) of a NCI put be within the scope of the proposed Interpretation?

49. The staff believe that guidance on the settlement of an NCI put should be within the scope of the proposed Interpretation.

50. Although the staff think that the current guidance in IFRSs is clear, the staff also believe that including this guidance within the proposed Interpretation would be useful to constituents and would assist in providing a complete set of guidance on the accounting for NCI puts.

Question 1 for the Committee
Does the Committee agree with the staff's recommendation that when an NCI put is settled (exercised): i) the financial liability relating to the NCI put should be derecognised because it has been extinguished? ii) all NCI relating to the shares subject to the NCI put should be derecognised? iii) that derecognition of the NCI reflects a change in the parent's ownership interest in the subsidiary, and should be accounted for as an equity transaction with no impact on profit or loss? iv) the proposed Interpretation should address the accounting? If not, what does the Committee recommend?

How should an NCI put that expires without delivery (is not exercised) be accounted for?

51. The staff believe that, when the financial liability for the NCI put is derecognised in accordance with IAS 32.23, it should be reclassified **to** the same component of equity on expiration that it was reclassified **from** on initial recognition. The staff think that this approach ensures:

(a) symmetry with the accounting for the initial recognition of the NCI put financial liability; and

(b) consistency with most current practice.

52. The staff also think that if NCI relating to the shares subject to the NCI put needs to be re-recognised when the NCI put expires, then NCI should be measured at the date of expiration at fair value.

53. This reflects the fact that the financial liability relating to the NCI put has been extinguished through the recognition of NCI, and, in substance, that the shares subject to the NCI put have been disposed.

54. Consequently, the NCI should be measured at fair value on the date that it is re-recognised, in conformity with the guidance in IFRS 3 and IFRIC 19.

55. This re-recognition of the NCI component of equity reflects a change in the parent's ownership interest in the subsidiary, and is accounted for as an equity transaction.

56. Consequently, to be consistent with the accounting for the purchase of an entity's own shares, no profit or loss would be recognised on expiration of the NCI put.

Should guidance on the settlement of an NCI put that expires (is not exercised) be in scope of the proposed Interpretation?

57. The staff think that the Committee can consider the following alternatives to providing guidance on the equity entry relating to expiration of an NCI put:

    (a) refer to the guidance in IAS 32.23 and not provide any clarification on which component of equity that the financial liability is to be reclassified to;

    (b) provide specific guidance on which component of equity that the financial liability is to be reclassified to.

    As with the issue of initial recognition described in agenda paper 4B, the staff think that this guidance might require reclassification to either NCI, a component of equity other than NCI, or a combination of both; or

    (c) require the financial liability to be reclassified **to** the same component of equity on expiration that it was reclassified **from** on initial recognition.

58. The staff recommend that the proposed Interpretation should require, on expiration of the NCI put, that the financial liability should be reclassified **to** the same component of equity on expiration that it was reclassified **from** on initial recognition.

59. The staff also believe that the proposed Interpretation should also provide guidance on the re-recognition and remeasurement of NCI on expiration of an NCI put, in the case when NCI was derecognised on initial recognition of the instrument.

Question 2 for the Committee

Does the Committee agree with the staff's recommendation that, when an NCI put expires without being exercised:

i) the financial liability relating to the NCI put should be derecognised and reclassified to the same component of equity on expiration that it was reclassified from on initial recognition?

ii) and NCI relating to the shares subject to the NCI put needs to be re-recognised and remeasurement, that NCI should be measured at the date of expiration at fair value?

iii) that this re-recognition and remeasurement of NCI reflects a change in the parent's ownership interest in the subsidiary and should be accounted for as an equity transaction?

iv) the proposed Interpretation should address the accounting?

If not, what does the Committee recommend?

Agenda paper 4E - Settlement journal entries

Instrument	Present access to economic benefits?	Initial recognition approach (Agenda paper 4B)	31 December 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	Financial liability	250			NCI previously eliminated on initial recognition of the NCI put.
					Cash	250	
Instrument 2 ('Fair value NCI put')	No - Situation 2 in agenda paper 4B	View A - No present access to economics	Financial liability	250			NCI not eliminated on initial recognition. NCI eliminated on exercise of NCI put.
					Cash	250	
			NCI equity	225			
					CI equity	225	
		View B - In substance acquisition	Financial liability	250			NCI previously eliminated on initial recognition of the NCI put.
					Cash	250	
		View C - Combination of IAS 27 & IAS 32	Financial liability	250			NCI not eliminated on initial recognition. NCI eliminated on exercise of NCI put.
					Cash	250	
			NCI equity	225			
					CI equity	225	

Key Assumptions

(i) Fixed price NCI put exercised for cash of CU 250 on 31 December 20X1. The put liability has already been remeasured to this amount prior to settlement through accretion of discount.

(ii) Fair value NCI put exercised at the fair value of the shares subject to the NCI put at 31 December 20X1 of CU250. The put liability has already been remeasured to the redemption amount

(iii) Carrying amount of NCI at 31 December 20X1 is CU225 if it continues to be recognised after initial recognition of the NCI put

Agenda paper 4E - Expiration (without exercise) journal entries

Instrument	Present access to economic benefits?	Initial recognition approach (Agenda paper 4B)	Expiration approach (Agenda paper 4E)	31 December 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	In substance disposal	Financial liability	250	NCI equity	250	NCI re-recognised and measured at fair value.
			Non-occurrence of in substance purchase	Financial liability	250	NCI equity CI equity	225 25	NCI re-recognised and measured as though it had always been recognised.
Instrument 2 ('Fair value NCI put')	No - Situation 2 in agenda paper 4B	View A - No present access to economics	NCI continued to be recognised in equity	Financial liability	250	CI equity	250	NCI unchanged as has always been recognised.
		View B - In substance acquisition	In substance disposal	Financial liability	250	NCI equity	250	NCI re-recognised and measured at fair value.
			Non-occurrence of in substance purchase	Financial liability	250	NCI equity CI equity	225 25	NCI re-recognised and measured as though it had always been recognised.
		View C - Combination of IAS 27 & IAS 32	NCI continued to be recognised, but as a financial liability	Financial liability	250	NCI equity	250	Financial liability reclassed back to NCI Equity.

Key Assumptions

i) Fair value of the NCI put financial liability at 31 December 20X1 when the NCI put expires is CU250

ii) Fair value of NCI as at 31 December 20X1 when the NCI put expires is CU250

(iii) Carrying amount of NCI at 31 December 20X1 is CU225 if it continues to be recognised after initial recognition of the NCI put