Project **IAS 27 *Consolidated and Separate Financial Statements***

Topic **Puts on Non–Controlling Interest**

Purpose of this paper

1. The purpose of the paper is to respond to a request for additional guidance on how an entity should account for changes in the carrying amount of a financial liability for a put option, written to a non-controlling interest shareholder (NCI put), in the consolidated financial statements of a parent.

2. For example, Parent A may own 80% of Subsidiary B's shares. The remaining 20% of Subsidiary B's shares are owned by Non-controlling interest holder C.

3. An NCI put option is written which would allow Non-controlling interest holder C to put its 20% interest in Subsidiary B to Parent A. Exercise of the put would result in Parent A owning a 100% of Subsidiary B's shares.

4. The request identifies that the NCI put may be written either as part, or separately (eg embedded into the formation of a joint venture of partnership) from a business combination. Additionally the NCI put may be exercisable at fair value (or a fair value proxy such as an EBITDA multiple), or at a non-fair value measure (eg fixed price).

5. The issue arises because of a potential conflict between the guidance in IAS 32 *Financial Instruments: Presentation* / IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 27 *Consolidated and Separate Financial Statements*.

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*.

6. Some consider that the guidance in IAS 39 is clear that, because the NCI put is initially recognised as a financial liability, subsequent changes in the carrying amount should be recognised in profit and loss.
7. Others believe that, consistent with the guidance in IAS 27 on transactions with non-controlling interests (NCI), changes in the carrying amount of the NCI put may be recognised in equity.
8. The current relevance of this issue has been highlighted in recent recommendations that were published by a regulator in one IFRS jurisdiction (refer to Appendix A for details). There is also an expectation of future discussion of the issue by other regulators.
9. This paper:
   - (a) provides background information on the request received;
   - (b) analyses the issues raised within the context of IFRSs;
   - (c) makes a staff recommendation for addressing the issues; and
   - (d) asks the Committee whether they agree with the staff recommendation.

Background information

10. The request focuses on the accounting for NCI puts after the 2008 amendments were made to IFRS 3 *Business Combinations*, IAS 27 and IAS 39 (collectively the 2008 Amendments).
11. However, issues relating to the accounting for NCI puts before the 2008 Amendments were discussed previously by the IFRIC.

NCI puts written before adoption of the 2008 amendments

12. In 2005 and 2006 the IFRIC were asked to consider three matters that were creating significant diversity in practice relating to the accounting for NCI puts.

13. These were:

    (a) whether the parent should recognise a liability for the NCI put?

    (b) if a liability is recognised for the NCI put, from which component of equity should the liability be reclassified?

    (c) whether a NCI put issued as part of a business combination is contingent or deferred consideration?

14. In November 2006 the IFRIC published two agenda decisions relating to these issues[1].

15. In these agenda decisions, the IFRIC concluded that:

> 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 classified. However, the IFRIC did not believe that it could reach a consensus on this matter on a timely basis.* Accordingly, the IFRIC decided not to add this item to its agenda.
>
> The accounting for these arrangements, including the circumstances considered by the IFRIC, was being considered by the Board as part of the current redeliberations on the proposed revised IFRS 3 Business Combinations. *The IFRIC expected that the revised IFRS 3 would assist in clarifying whether this type of arrangement includes a component of contingent consideration.* The IFRIC therefore

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[1] file:///Q:\IFRIC%20Projects\01%20Active\IFRS%203R-6%20-%20NCI%20Put\Related%20Prior%20Board%20Papers\IFRIC%20Update%20on%20Final%20Agenda%20Decision.pdf. Refer to the agenda decisions entitled 'Puts and forwards held by minority interests' and 'Are puts or forwards received by minority interests in a business combination contingent consideration'.

> believed that it could not develop guidance more quickly than it was likely to be developed in the Business Combinations project and decided not to take a project on this issue onto its agenda. (emphasis added)

16. As a consequence, the staff understands that for NCI puts issued before the 2008 Amendments became effective, practice has evolved to:

    (a) Initial recognition of a financial liability for the NCI put in accordance with IAS 32.23 and IAS 32.AG29, reflecting a reclassification from equity. This liability is measured at the present value of the redemption amount of the NCI put.

    The staff is unaware of significant diversity in practice in the initial recognition of a financial liability for the NCI put.

    (b) A risks and rewards analysis to determine which component of equity the financial liability is reclassified from on initial recognition. As a result, some diversity in practice exists because of views that the reclassification is from:

        (i) NCI;

        (ii) a component of equity other than NCI; or

        (iii) a combination of NCI and a separate component of equity

    (c) Diversity in practice as to whether subsequent changes in the carrying amount of the NCI put should be recognised:

        (i) in profit and loss in accordance with IAS 39.

        (ii) as contingent consideration by applying a 'partial goodwill method'.

        Prior to the 2008 Amendments, IAS 39.2(f) excluded contingent consideration from its scope. Consequently these changes could be recognised as adjustments to goodwill in accordance with IFRS 3.39.

        For example, this approach may be adopted if, on initial recognition of the NCI put, a reclassification is made from NCI and any difference between the carrying amount of

NCI and the present value of the redemption amount of the NCI put is recognised as goodwill.

(iii) in equity (either NCI or a separate component of equity), consistent with the initial reclassification of the NCI put.

NCI puts written <u>after</u> the 2008 Amendments

17. The 2008 Amendments have, and, because of their effective dates, are expected in the future, to change how practice accounts for NCI puts.

18. It is expected that constituents will continue to recognise a financial liability for the NCI puts in accordance with IAS 32, consistent with the view expressed by the IFRIC in their November 2006 agenda decision and prior practice.

19. However, diversity in practice may continue to exist relating to which component of equity the NCI put liability is determined to be reclassified from.

20. Finally, diversity in practice may also continue to exist relating to how subsequent changes in the carrying amount of the NCI put should be recognised.

21. This diversity is no longer expected to include the partial goodwill approach (see paragraph 16 (c) (ii) above) but is expected to exist between application of the approaches in paragraph 16 (c) (i) and paragraph 16 (c) (iii).

22. This is because some continue to believe these changes should be recognised in profit and loss in accordance with IAS 39 (**View A** of this agenda paper).

23. Others however continue to believe that subsequent changes in the carrying amount of the NCI put may be recognised in equity (either in NCI or as a separate component of equity). They believe this position is supported by the 2008 Amendments, specifically the amendments to IAS 27 (**View B** of this agenda paper).

Staff analysis

24. The staff analysis focuses on the specific situation identified in the request.

25. This is whether subsequent changes in the carrying amount of an NCI put, written after adoption of the 2008 Amendments, should **always** be recognised in profit or loss, or whether some of the changes **may be** recognised outside of profit or loss.

26. Specifically the staff analysis assumes that:

    (a) a financial liability has been recognised for the NCI put in accordance with IAS 32.23 and IAS 32.AG29.

    (b) the issue is to be assessed in the context of the accounting in the consolidated financial statements of the parent, not the separate financial statements of the subsidiary.

    (c) the NCI put is written **after** the reporting entity applies the 2008 Amendments.

    (d) the NCI put is issued either as part as, **or** separately from, a business combination.

27. The staff are aware of a number of other issues that may exist in practice relating to NCI puts. These include;

    (a) the issues noted above relating to the accounting for NCI puts written **before** a reporting entity applies the 2008 Amendments.

    (b) whether an entity can continue its existing accounting policies for NCI puts written before the 2008 Amendments after the 2008 Amendments become effective.

    (c) the diversity in practice noted above relating to which component of equity the NCI put liability is determined to be reclassified from.

    (d) Mechanical issues if some, or all, of the reclassification of the financial liability recognised for the NCI put is from NCI and not a separate component of equity. For example:

(i) Can NCI be reduced below zero if the present value of the redemption amount on initial recognition of the NCI put exceeds the carrying amount of NCI?

(ii) If NCI cannot be reduced below zero, how should the difference between the carrying amount of NCI and present value of the redemption amount on initial recognition of the NCI put be recognised?

(iii) If the reclassification is to be made out of a combination of NCI and a separate component of equity, how should the present value of the redemption amount on initial recognition of the NCI put be allocated between the two components of equity?

(e) Accounting for the settlement or lapsing of the NCI put if some, or all, of the reclassification of the financial liability recognised for the NCI put is from NCI and not a separate component of equity.

(f) Recognition and measurement of NCI puts in the separate financial statements of the subsidiary.

28. This staff analysis will not address these additional issues because they were not the focus of the request.

29. However the staff do think that any conclusions that the Committee make on the issues in this agenda paper may have implications on some of these other issues.

Risks and rewards of ownership of shares subject to the NCI put

30. The staff understand that practice has developed to applying a 'risk and rewards' approach to determine the accounting for NCI puts. This reflects application of the approach described in IAS 27.IG6.

31. If the risks and rewards of ownership of shares subject to the NCI put **are** transferred from the NCI holder to the parent, the parent has in substance acquired the shares. This will be reflected by accounting for the shares as though they have been acquired by the parent with consideration being paid at a later date.

32. If the risks and rewards of ownership of shares subject to the NCI put are **not** transferred from the NCI holder to the parent, the parent has in substance **not** acquired the shares. This will be reflected by accounting for the shares as though they may be acquired by the parent at a later date.

33. In assessing whether the risks and rewards of ownership have transferred, factors to consider include;

    (a) the exercise price of the NCI put (eg fixed, rather than based on fair value).

    (b) any transfer of rights associated with the shares (eg dividend and voting rights).

    (c) related transactions (eg whether the NCI put is issued together with a call, combining to act similarly to a forward, rather than option contract).

Risks and rewards of ownership of shares subject to the NCI put are transferred to the parent

34. The staff does not believe there is significant diversity in practice in the recognition of changes in the carrying amount of an NCI put if, when the put is written, the risks and rewards of ownership of the shares subject to the put transfer from the NCI holder to the parent.

35. In this situation, in accordance with IAS27.IG5, the instrument is generally reclassified from equity to a financial liability and NCI is eliminated. This is because the shares subject to the NCI put are considered to be acquired by the parent.

36. As a result, if the NCI put was issued as part of a business combination, the financial liability reflects contingent consideration. This is accounted for in accordance with IAS 39 because the 2008 Amendments eliminated the previous contingent consideration scope exception from IAS 39.

37. Consequently, changes in the carrying amount of the financial liability arising as a result of events after the acquisition date are recognised in profit and loss in accordance with IAS 39.

Risks and rewards of ownership of shares subject to the NCI put are not transferred to the parent

38. The staff believe there is significant diversity in practice in the recognition of changes in the carrying amount of an NCI put if, when the put is written, the risks and rewards of ownership of the shares subject to the put **are not** transferred from the NCI holder to the parent.

39. This diversity is described in View A and View B below.

View A – Changes in the carrying amount of NCI puts should always be recognised in profit and loss in accordance with IAS 32 and IAS 39

40. View A is that changes in the carrying amount of NCI puts should always be recognised in profit and loss.

41. This reflects the view that the NCI put has been presented as a financial liability in accordance with IAS 32 and consequently, in accordance with IAS 39.55 and IAS 39.56, gains and losses arising from a change in the carrying amount of the NCI put liability shall be recognised in profit and loss:

> 55 A gain or loss arising from a change in the fair value of a financial liability measured at fair value through profit or loss that is not part of a hedging relationship (see paragraphs 89–102), *shall be recognised in profit or loss*.
>
> 56 For financial liabilities measured at amortised cost (see paragraph 47), *a gain or loss is recognised in profit or loss when the financial liability is derecognised, and through the amortisation process*. However, for financial liabilities that are hedged items (see paragraphs 78–84 and Appendix A paragraphs AG98–AG101) the accounting for the gain or loss shall follow paragraphs 89–102. (emphasis added)

Accounting guidance supporting View A

42. Proponents of this view argue that recognition in profit and loss is consistent with:

    (a) IAS 32.23 which states that:

    > 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*. (emphasis added)

(b) IAS 39.AG8 which requires that:

> If an entity revises its estimates of payments or receipts, the entity shall *adjust the carrying amount of the* financial asset or *financial liability* (or group of financial instruments) *to reflect actual and revised estimated cash flows*. The entity recalculates the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate or, when applicable, the revised effective interest rate calculated in accordance with paragraph 92. *The adjustment is recognised in profit or loss as income or expense.* (emphasis added)

(c) The guidance in IFRS 3.58 stating that:

> The acquirer shall account for changes in the fair value of contingent consideration that are not measurement period adjustments as follows:
>
> (a) ….
>
> (b) *Contingent consideration classified as* an asset or *a liability that:*
>
> (i) *is a financial instrument and is within the scope of IAS 39 shall be measured at fair value, with any resulting gain or loss recognised either in profit or loss or in other comprehensive income in accordance with that IFRS.*
>
> (ii) is not within the scope of IAS 39 shall be accounted for in accordance with IAS 37 or other IFRSs as appropriate. (emphasis added)

(d) the previous IFRIC agenda decisions in November 2006 that

> *After initial recognition* any liability to which IFRS 3 is not being applied will be *accounted for in accordance with IAS 39*. (emphasis added)

(e) The requirements of the *Framework* that:

> 92 *Income is recognised in the income statement when* an increase in future economic benefits related to an increase in an asset or a *decrease of a liability has arisen* that can be measured reliably.
>
> 94 *Expenses are recognised in the income statement when* a decrease in future economic benefits related to a decrease in an asset or *an increase of a liability has arisen* that can be measured reliably. (emphasis added)

Consistency with how the NCI put liability is reclassified on initial recognition

43. Proponents of View A consider that it is also supported by the following accounting for the reclassification of the NCI put liability from equity when the NCI put is initially recognised as a financial liability:

    (a) If all of the reclassification is considered to be from a component of equity other than NCI.

        The carrying amount of NCI within equity remains unchanged as a result of the NCI put being written and subsequent changes in the carrying amount of the NCI put liability.

    (b) If the reclassification is allocated between a separate component of equity and NCI.

Additional rationale supporting View A

44. Proponents of View A also believe it is supported by the following arguments:

    (a) The NCI put is a financial instrument contract between the parent and the NCI holder. Other financial instrument contracts between these two parties would be recognised and measured in accordance with IAS 39.

    (b) The risks and rewards associated with the shares subject to the NCI put have not all been transferred. Therefore, in substance, the parent has not acquired the shares subject to the NCI put.

        The NCI put does not represent the parent's interest in the subsidiary until this transfer happens. Consequently, changes in the carrying amount of the NCI put should **not** be accounted for similarly to a change in the percentage of ownership interest that the parent has in its subsidiary.

    (c) Equity should not change before the NCI put is exercised because there is no certainty that the put will actually be exercised and become an equity instrument.

View B – Changes in the carrying amount of NCI puts are <u>not always</u> required to be recognised in profit and loss

45. View B is that changes in the carrying amount of NCI puts are not always required to be recognised in profit and loss. Instead these changes may be recognised directly in equity.

46. This reflects the view that there is a conflict between the;

    (a) guidance in IAS 33/IAS 39 expressed in View A that changes should be recognised in profit and loss; and

    (b) principle in IAS 27, subsequent to the 2008 Amendments, that transactions with NCI should be recognised in equity, **<u>not</u>** profit and loss.

47. Consequently, supporters of View B believe that a reporting entity may make an accounting policy election to follow the guidance in IAS 27 and recognise changes in the carrying amount of NCI puts as a component of equity, rather than profit and loss.

Accounting guidance supporting View B

48. Proponents of this view argue that recognition of the changes within equity is consistent with:

    (a) the NCI put arising from a transaction with NCI (ie a transaction between shareholders) and the accounting treatment for the acquisition or sale of the NCI. In accordance with IAS 27:

    > 30 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).
    >
    > 31 In such circumstances the carrying amounts of the controlling and non-controlling interests shall be adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received shall be *recognised directly in equity* and attributed to the owners of the parent. (emphasis added)

(b) the statement in the Basis for Conclusions for the 2008 amendment to IAS 27 that:

> BC41 The Board decided that after control of an entity is obtained, changes in a parent's ownership interest that do not result in a loss of control are accounted for as equity transactions (ie transactions with owners in their capacity as owners). This means that *no gain or loss from these changes should be recognised in profit or loss*. It also means that no change in the carrying amounts of the subsidiary's assets (including goodwill) or liabilities should be recognised as a result of such transactions. (emphasis added)

(c) Analogy to IFRIC 17 *Distributions of Non-cash Assets to Owners* which requires:

> 13 At the end of each reporting period and at the date of settlement, the entity shall review and *adjust the carrying amount of the dividend payable, with any changes in the carrying amount of the dividend payable recognised in equity* as adjustments to the amount of the distribution. (emphasis added)

The rationale for this approach is discussed in the Basis for Conclusions in IFRIC 17:

> BC36 The IFRIC concluded that, because any adjustments to the best estimate of the dividend payable reflect changes in the estimated value of the distribution, they should be recognised as adjustments to the amount of the distribution. *In accordance with IAS 1 Presentation of Financial Statements (as revised in 2007), distributions to owners are required to be recognised directly in the statement of changes in equity.* Similarly, adjustments to the amount of the distribution are also recognised directly in the statement of changes in equity.
>
> BC37 Some commentators argued that the changes in the estimated value of the distribution should be recognised in profit or loss because changes in liabilities meet the definition of income or expenses in the Framework. However, the IFRIC decided that the gain or loss on the assets to be distributed should be recognised in profit or loss when the dividend payable is settled. This is consistent with other IFRSs (IAS 16, IAS 38, IAS 39) that require an entity to recognise in profit or loss any gain or loss arising from derecognition of an asset. The IFRIC concluded that the *changes in the dividend payable before settlement related to changes in the estimate of the distribution and should be accounted for in equity* (ie adjustments to the amount of the distribution) until settlement of the dividend payable. (emphasis added)

Consistency with how the NCI put liability is reclassified on initial recognition

49. Proponents of View B consider it is also supported if the reclassification of the NCI put liability when the NCI put is initially recognised as a financial liability is considered to be from NCI.

50. This is because the reclassification from NCI is considered similar to a change in NCI. Subsequent changes in the carrying amount of the NCI put liability are then recognised in equity as a component of NCI.

51. They also note that at the end of each reporting period, View B is consistent with the accounting that would be applied if the NCI put is exercised at that date.

Additional rationale supporting View B

52. Proponents of View B also believe it is supported by the following arguments:

    (a) An inconsistent rationale for recognising the changes in profit and loss.

    The economic entity theory embedded in IAS 27 requires transactions with equity holders such as NCI to be recognised in equity, not profit and loss.

    Changes in the carrying amount of the NCI put do not reflect any transfer of value outside of the reporting group and should not create profit and loss.

    (b) If changes are recognised in profit and loss, the results would be counter-intuitive when the NCI put is written at fair value, or based on a fair value proxy.

    An increase in the value of a subsidiary that the parent controls (eg through good management by the parent) leads to an increase in the NCI put financial liability and recognition of an expense in profit and loss.

    (c) Recognition of changes in profit and loss incorrectly implies that the risks and rewards associated with the shares that are subject to the put have transferred from the NCI holder to the Parent.

Implications of the current Financial Instruments with Characteristics of Equity (FICE) Project

53. Certain issues relating to the accounting for NCI puts were raised by the IASB staff and constituents during the 2008 Amendments process. However, in May 2009, the IASB update stated that:

> The Board will address the following issues in its projects on financial instruments and joint ventures:
>
> - contingent consideration: designation (categories of financial instruments) and classification (as equity or a liability);
> - *put options on non-controlling interest* (classification as equity or a liability); and (emphasis added)

54. The FICE project team anticipates issuing an exposure draft (ED) in the second quarter of 2010. Based on the Board's tentative decisions to date, a written put on an entity's own shares (eg an NCI put) continues to be classified as a financial liability.

55. However the ED is expected to change the requirements for presenting and measuring the financial liability.

56. IAS 32 requires a NCI put liability to be presented on a 'gross' basis and measured at the present value of the redemption amount, with an offsetting debit recognised in equity.

57. In accordance with the Board's tentative decisions, the FICE ED will propose a NCI put liability is presented on a 'net' basis. The NCI put liability would be measured consistently with other derivatives, at fair value on initial recognition and at each reporting period, with changes in fair value recognised in profit and loss.

58. When a NCI put is exercisable at fair value, or a proxy to fair value, the amount initially and subsequently recognised as a financial liability when applying the FICE ED is expected to be lower than the financial liability recognised in accordance with IAS 32.

59. Similarly, subsequent changes in the carrying amount of the NCI put liability are expected to be lower when applying the FICE ED than those recognised in accordance with IAS 32.

60. Consequently, when these subsequent changes in the carrying amount of the NCI put liability are recognised in profit and loss in accordance with the new FICE model, it is expected that they would create significantly less income statement volatility than is currently recognised in accordance with IAS 32.

61. This is expected to contrast with the increased income statement volatility that is expected to arise when recognising subsequent changes in the fair value of a NCI put, exercisable at a fixed strike price, in accordance with the new FICE model, rather than IAS 32.

Staff recommendation

62. The staff do not believe that the FICE project will provide sufficient specific guidance that resolves the perceived conflict between the guidance in IAS 32 / IAS 39 and IAS 27.

63. Consequently the staff believe it would be appropriate to provide further guidance on how an entity should account for changes in the carrying amount of an NCI put written after the 2008 Amendments, resolving this perceived conflict.

64. The staff think this guidance could, for NCI puts written after the 2008 Amendments and recognised as a financial liability:

    (a) require all changes in the carrying amount of a NCI put liability to be recognised in profit and loss, consistent with View A above;

    (b) permit entities an accounting choice of whether to recognise changes in the carrying amount of a NCI put liability in profit and loss in accordance with IAS 32 / IAS 39 or in equity in accordance with IAS 27, consistent with View B above; or

(c) require all changes in the carrying amount of a NCI put liability to be recognised in equity in accordance with the principles of IAS 27 after the 2008 Amendments (**View C**).

65. The staff have sympathy for the additional rationale for View B and View C, but believe that the current proposals in the FICE project will address some of these practical concerns because of the proposed changes to presenting and measuring financial liabilities (including NCI puts).

66. However, the staff have concerns for some of the technical arguments that are put forward for View B or View C. This includes whether they create exceptions to the requirements in the *Framework* that:

    (a) changes in a liability are recognised in profit and loss, rather than equity; and

    (b) equity is a residual interest and is not subsequently remeasured after initial recognition.

67. Consequently, the staff believe that View A is more clearly consistent with the current and proposed guidance in IFRSs. Specifically this includes:

    (a) the previous IFRIC view that a financial liability should always be recognised in accordance with IAS 32.23.

    (b) the requirements in IFRSs that, when a financial liability is recognised, the accounting for that liability is subject to the guidance in IAS 32 and IAS 39, regardless of the underlying nature of the financial liability; and

    (c) the expected guidance in the FICE exposure draft.

Agenda criteria assessment for the Committee

68. The staff's preliminary assessment of the agenda criteria is as follows:

    (a) The issue is widespread and has practical relevance.

    Yes. The staff believe the issue has widespread implications and practical relevance. NCI puts are common in certain IFRS jurisdictions.

    They are often used to structure an exit strategy with existing owners/management, grow a presence in a new market or may have certain regulatory/tax benefits if combined with a business combination.

    The puts may relate to material transactions and can have a significant impact on the financial statements of entities.

    The practical relevance of the issue is highlighted in recent public observations reported by a regulator in one IFRS jurisdiction (refer to Appendix A for details).

    (b) The issue indicates that there are significantly divergent interpretations (either emerging or already existing in practice). The Committee will not add an item to its agenda if IFRSs are clear, with the result that divergent interpretations are not expected in practice.

    Yes. Although divergence in existing practice has been limited by the effective dates of the 2008 Amendments, we are aware of previous divergence in practice that is expected to continue subsequent to entities applying the 2008 Amendments.

    (c) Financial reporting would be improved through elimination of the diverse reporting methods.

    Yes. The staff believe financial reporting would be improved through elimination of the diverse reporting methods.

    (d) The issue can be resolved efficiently within the confines of existing IFRSs and the Framework, and the demands of the interpretation process.

    Yes. The staff believe the specific issue identified, and potentially some related issues that exist in practice, can be resolved efficiently within the confines of existing IFRSs, the *Framework* and the demands of the interpretation process.

(e) *It is probable that the IFRIC will be able to reach a consensus on the issue on a timely basis.*

Yes. The staff believe the IFRIC will be able to reach a consensus on the issues on a timely basis.

(f) *If the issue relates to a current or planned IASB project, there is a pressing need to provide guidance sooner than would be expected from the IASB's activities. The IFRIC will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the Committee requires to complete its due process.*

69. No. The staff have discussed this issue with the FICE project team. The staff do not believe the FICE project will provide specific guidance that resolves the perceived conflict between the guidance in IAS 32 / IAS 39 and IAS 27.

70. Based on the assessment of the agenda criteria, the staff recommend that the Committee add the issue to its interpretations agenda.

71. If the Committee agree with this recommendation, the staff believe the interpretation should address the accounting for subsequent changes in the carrying amount of an NCI put, written after adoption of the 2008 Amendments.

72. In addition to this specific issue identified in the request, the staff think the interpretation could also provide guidance on other issues that exist in practice including:

    (a) accounting for the settlement, or lapsing, of the NCI put; and

    (b) transition provisions for NCI puts issued **before** the 2008 Amendments.

Question for the Committee
1. Do the Committee agree with the staff's recommendation to add this issue to its agenda? If not, how does the Committee recommend the staff to proceed?

Appendix A – Extract from AMF Recommendations regarding financial statements for 2009

3.5. Put options on minority interests issued after the effective date of IFRS 3R and IAS 27R: subsequent changes in debt

IAS 27R.30 (and BC41) provides that transactions between the controlling shareholder and minority interests which involve equity instruments but which have no effect on control, should henceforth be recorded as reclassifications within equity. These transactions therefore have no effect on the income statement.

However, as noted in past AMF recommendations, a put option on minority interests constitutes a financial liability within the meaning of IAS 39. According to IAS 39.AG8, any subsequent change in the fair value of a financial liability resulting from revisions to estimated future cash flows must be recognised in the income statement.

A put option whose exercise price corresponds to the fair value of the instrument sold does not transfer to the issuer of the put option the risks and rewards associated with control. Recording changes in fair value in profit or loss within the accounts of the issuer would be equivalent, in a sense, to considering that the issuer of the put bears the risks and rewards associated with control.

IAS 27R therefore appears to raise two inconsistencies:
- between two IASB standards (IAS 39 and IAS 27R); and
- in relation to the logic applied to the control of consolidated entities.

Given that IAS 27R is more recent than IAS 39 and more accurately reflects the principles espoused by the IASB, and also that IAS 27R better reflects the economic reality of this type of transaction, the AMF considers that subsequent changes in the fair value of this type of liability should not affect the income statement. Nevertheless, since an alternative treatment is implicitly permitted by the existence of two standards, either of which might be applied, the issuers concerned should include in the notes an explanation of the accounting method used.

Appendix B – Agenda request

B1. The staff received the following Committee agenda request. All information has been copied without modification by the staff.

IFRIC Potential Agenda Item Request: Changes in the carrying amount of a put option written to a non-controlling shareholder

The XX would like to put forward a potential IFRIC agenda item related to how an entity should account for changes in the carrying amount of a financial liability for a put option written to a non-controlling shareholder ("NCI put") in the consolidated financial statements of the parent. In some cases an NCI put may be written as part of a business combination (transaction in which control is obtained), and in other cases it may be written separately from a business combination.

The issue

An entity may write a put option to the non-controlling shareholders in a subsidiary on the noncontrolling shareholders' shares in that subsidiary. If the put option granted to the non-controlling shareholders provides for settlement in cash or in another financial asset of the entity, then the entity recognises a financial liability at fair value, which in a simple case of a fixed exercise date and price is the present value of the exercise price of the option; this is consistent with the IFRS 3 requirement to measure contingent consideration at fair value in the acquisition accounting. At each reporting date IFRS requires that the liability is remeasured to fair value. [IAS 32.23, IAS 39.47, AG8, IFRS 3.39]

For example, Parent owns a 90 percent interest in Subsidiary and has written a put option on the remaining 10 percent interest in Subsidiary ("NCI put"). The put requires gross physical settlement. The NCI put is recognised as a liability for the present value of the exercise price of the option in the consolidated financial statements of Parent.

The issue is whether subsequent changes in the carrying amount of the put price liability on the NCI should be recognised in profit or loss in accordance with IAS 39 Financial Instruments: Recognition and Measurement, or whether such changes should or may be recognised directly in equity as arising from transactions with non-controlling interests (NCI).

This issue is being raised in the context of NCI puts written under IFRS 3 (2008) Business Combinations, IAS 27 (2008) Consolidated and Separate Financial Statements, and the related 2008 amendments to IAS 39 Financial Instruments: Recognition and Measurement.

Current practice

Although there is not yet a well-developed body of practice under IFRS 3 (2008) and IAS 27 (2008), the accounting for NCI puts has been the subject of much discussion in practice prior to the mandatory effective date of these standards.

In our experience, NCI puts are common in practice. We understand that current views on the appropriate accounting are mixed, and as a result we expect that there will be diversity in practice with a potentially significant impact on profit or loss.

XX's published view is that NCI puts are within the scope of IAS 39 because that standard no longer includes a scope exclusion for contingent consideration in a business combination (formerly paragraph 2(f) of IAS 39). Prior to the deletion of paragraph 2(f) of IAS 39 for periods beginning on or after 1 January 2010, we considered that accounting for changes in the carrying amount of the NCI put liability was outside the scope of IAS 39, regardless of whether the put was written as part of, or separately from, the business combination in which the parent obtained control of the subsidiary.

Consequently we allowed the following accounting policy choice in accounting for changes in the NCI put liability for an entity that has not adopted the 2008 amendments to IFRS 3, IAS 27 and IAS 39 referred to above:

- The IAS 39 approach. Under this approach, changes in the fair value of the liability were recognised in profit or loss.

- The adjustment to initial accounting approach. Under this approach, changes in the carrying amount of the liability were recognised by adjusting the carrying amount of the balancing item affected by the initial recognition of the transaction, e.g., goodwill; this excluded the effect of unwinding the discount, which was recognised in profit or loss.

Once an entity has adopted the amendment to the scope of IAS 39, we believe that the adjustment to initial accounting approach can no longer be supported. Accordingly, in our view, changes in the carrying amount of the NCI put liability should be recognised in profit or loss.

However, we understand that there are alternative views to allow, and in some cases to prefer or require, changes in the carrying amount of the NCI put liability to be recognised directly in equity. We understand that some would accept recognition of changes in equity only when the NCI put is written separately from the business combination in which control is obtained; others would allow such treatment also when the NCI put is written as part of the business combination in which control is obtained; others would accept it only where the exercise price is set as the fair value of the NCI at exercise date.

Supporters of recognition directly in equity emphasise that the NCI put arises from a transaction with NCI, and therefore that recognition directly in equity is appropriate, even when this is a remeasurement rather than initial recognition of the liabilities to the NCI. Some also draw an analogy to IFRIC 17 Non-cash Distributions with Owners, in which changes in the carrying amount of the distribution liability are recognised directly in equity.

Reasons for IFRIC to address the issue

In 2006 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. However, the IFRIC concluded that "it could not develop guidance more quickly than it was likely to be developed in the Business Combinations project and decided not to take a project on this issue onto its agenda."

The IASB discussed the accounting for NCI puts in May 2009 as a part of its Annual Improvements project but, as reported in the May 2009 IASB Update, "the Board deferred this issue to the post-implementation review of IFRS 3 and IAS 27, to be conducted two years after their effective date."

In light of previous deliberations, we consider the resolution of this issue to be important for the comparability of financial statements. Based on our experience, the amounts involved are often material and therefore, if this issue is left unresolved, we expect to see a significant impact on comparability of reported profit or loss.

We believe that the issue is an acute one. We understand that the adjustment to NCI approach is the published preferred view of at least one European market regulator, and that further discussion of this issue may take place with other EU regulators in a future CESR-Fin/EECS session. Absent a view from IFRIC, divergence in practices is likely to arise as soon as IFRS 3 (2008) is implemented.

As far as we are aware, this issue is unrelated to any Board project that is expected to be completed in the near future, and the issue is sufficiently self-contained that it could be dealt with by the IFRIC on a timely basis.