Project **Put options written over non-controlling interests**

Topic **Journal Entries**

Purpose of this paper

1. The purpose of this agenda paper is to provide some example journal entries to further assist the IFRS Interpretations Committee (Interpretations Committee) in their review and consideration of the issues discussed in Agenda Papers 4A-4D prepared for the September 2010 Interpretations Committee meeting.
2. These three illustrative examples are included in a separate document that accompanies this agenda paper.

Illustrative examples of the accounting for put options written over non-controlling interests

3. In response to requests by certain members of the Interpretations Committee, the appendix to this agenda paper includes two illustrative examples of the accounting for put options written over non-controlling interests.
4. The first illustrative example, titled **Initial Recognition**, reflects the staff analysis in **Agenda Paper 4B**.
5. The second illustrative example, titled **Business Combination Implications**, reflects the staff analysis in **Agenda Paper 4C**.

Initial Recognition Example Assumptions

6. In developing the Initial Recognition illustrative example, the staff have applied the same assumptions as those used in the examples presented in the July 2010 Interpretations Committee meeting. This enables comparison with the examples previously presented and discussed.

7. Consequently, the Initial Recognition example use the term NCI put option as being a put option written over non-controlling interests that is:

   (a) a puttable instrument in accordance with the definition in IAS 32.11;

   (b) gross physical settled in cash only;

   (c) free-standing;

   (d) issued separately from a transaction that is accounted for as a business combination in accordance with IFRS 3 *Business Combinations*;

   (e) accounted for in the consolidated financial statements of the parent;

   (f) exercisable at fair value **<u>or</u>** at a fixed price at a specified future date;

   (g) written:

      (i) after the 2008 amendments were made to IFRS 3, IAS 27 *Consolidated and Separate Financial Statements* and IAS 39 *Financial Instruments: Recognition and Measurement* (collectively, the 2008 Amendments);

      (ii) after the effective date of the proposed Interpretation;

      (iii) to one NCI shareholder;

      (iv) to be non-transferable by the NCI shareholder to a different counterparty;

      (v) over all of the shares in a subsidiary in which the parent does not hold a present ownership interest;

      (vi) by the parent.

8. The example then assume that:

   (a) Parent A owns 80 per cent of Subsidiary B's shares;

   (b) the remaining 20 per cent of Subsidiary B's shares are owned by Non-controlling interest holder C;

   (c) an NCI put option is written on 1 January 20X0 allowing the Non-controlling interest holder C to put its 20 per cent interest in Subsidiary B to Parent A on 31 December 20X1;

   (d) exercise of the NCI put would result in Parent A owning 100 per cent of Subsidiary B's shares;

   (e) the NCI put option meets the definition of an NCI put used in paragraph 6 of this agenda paper;

   (f) Non-controlling interest holder C is retains all dividend rights relating to the shares subject to the NCI put;

   (g) the carrying amount of NCI is as follows:

      (i) 1 January 20X0 - CU210

      (ii) 31 December 20X1 - CU225 (if it continues to be recognised)

   (h) the fair value of the shares of Subsidiary B are as follows:

      (i) 1 January 20X0 - CU1000 (20% = CU200)

      (ii) 31 December 20X0 - CU1100 (20% = CU220)

      (iii) 31 December 20X1 - CU1250 (20% = CU250).

9. In addition, the illustrative example analyse two NCI puts with the following characteristics:

   (a) Instrument 1 ('Fixed price NCI put'):

      (i) Fixed price NCI put, exercisable on 31 December 20X1 at CU 250;

      (ii) Considered to, in substance, provide the parent entity with an ownership interest in the shares subject to the NCI put when assessed with all other factors;

(iii) The present value of the amount payable to exercise the Fixed price NCI put is:

(a) 1 January 20X0 - CU200

(b) 31 December 20X0 - CU220

(c) 31 December 20X1 - CU250.

(b) Instrument 2 ('Fair value NCI put'):

(i) fair value NCI put, exercisable on 31 December 20X1 at the fair value of the shares subject to the NCI put;

(ii) not considered to, in substance, provide the parent entity with an ownership interest in the shares subject to the NCI put when assessed with all other factors.

10. In order to simplify the examples, the impact of income taxes and discounting has been ignored.

Business Combination Implications Example Assumptions

11. In developing the Business Combination Implications illustrative examples, the staff have applied the same assumptions as those used in Agenda Paper 4C, summarised below:

> Entity A holds 100 per cent of Entity B.
>
> On 1 January 20X0, Entity C acquires 80 per cent of Entity B for CU100 and writes a put option to Entity A over the remaining 20 per cent of Entity B. The premium paid for the put is included within the CU100 of total consideration paid by Entity C.
>
> The put option is exercisable on 31 December 20X2 at CU25 plus an adjustment if Entity B achieves certain performance targets.
>
> The fair value (the present value of the redemption amount) of the put option on 1 January 20X0 is CU32.
>
> The fair value of 100 per cent of Entity B's net assets on 1 January 20X0 is CU90 (fair value of assets of CU300 less fair value of liabilities of CU210).
>
> Entity C measures NCI in Entity B at the proportionate share of net assets acquired.

Entity C applies the 2008 Amendments before 1 January 20X0.

12. In addition, for purposes of the illustrative examples of the subsequent measurement of the put recognised, the staff have assumed that the carrying amount of the financial liability of CU32 recognised in the business combination, increases by CU10 to CU42 at December 31 20X0.