STAFF PAPER

03 November 2011

IFRS Interpretations Committee Meeting

Project	**Put options written over non-controlling interests**
Paper topic	Summary of IASB's discussion at its September 2011 meeting
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Background

The issue

1. Over the course of several meetings, the IFRS Interpretations Committee (the Committee) has discussed the accounting for put options written on shares held by non-controlling interest shareholders (NCI puts) in the consolidated financial statements of the controlling shareholder.[1]

2. Some constituents expressed concerns to the Committee about the diversity in accounting for the subsequent measurement of the financial liability that is recognized for those NCI puts. That issue arises because of a potential inconsistency between the requirements for measuring financial liabilities (IAS 32 *Financial Instruments: Presentation*, IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 *Financial Instruments*) and the requirements for transactions with owners in their capacity as owners (IAS 27 *Consolidated and Separate Financial Statements* and IFRS 10 *Consolidated Financial Statements*).

[1] The Committee has discussed this issue at six meetings—May, July, September and November 2010 and January and March 2011. If Committee members would like copies of previous agenda papers or other background information, please let us know.

3. Specifically:

   (a) Some constituents think that subsequent changes in the liability that is recognised for the NCI put should be recognized in **profit or loss** (P&L) pursuant to the guidance in IAS 32, IAS 39 and IFRS 9.

   (b) Other constituents think that subsequent changes in that liability should be recognised in **equity** pursuant to the guidance in paragraph 30 of IAS 27 and paragraph 23 of IFRS 10.

A potential short-term solution

4. At the Board's request, the Committee discussed several possible short-term solutions to this issue and, in March 2011, it agreed that excluding NCI puts from IAS 32 through a narrow scope amendment was a viable solution. That scope exclusion would change the measurement basis of NCI puts to that used for other derivative contracts.

5. Under the Committee's proposal, NCI puts would be initially and subsequently measured on a 'net' basis at fair value with all changes in fair value recognized in P&L in accordance with IAS 39 or IFRS 9[2]—rather than being measured on a 'gross' basis at the present value of the option exercise price in accordance with paragraph 23 of IAS 32.

6. Since amending IFRSs is not within the mandate of the Committee, it referred the issue and the possible solution to the Board for its consideration. For the convenience of Committee members, the Update from its March 2011 meeting is reproduced in the appendix to this paper.

[2] For simplicity, this paper assumes that the 'cost exception' described in paragraph 47(a) of IAS 39 for derivatives on unquoted equity instruments is not applied.

Purpose of this paper

7. As requested by the Committee, we presented the Committee's recommendation to the Board. This paper summarizes the Board's discussion and asks the Committee how it would like to proceed with this issue.

The Board's discussion in September 2011

8. At its meeting in September 2011 the IASB discussed the Committee's recommendation. The Board decided not to proceed with the proposed amendment to the scope of IAS 32. While some Board members supported the proposal as a practical, targeted solution that was consistent with what the Board has requested, Board members expressed the following concerns with excluding NCI puts from the scope of IAS 32:

   (a) IAS 32 should not be amended until the Board decides how it will proceed in its project on Financial Instruments with Characteristics of Equity (FICE). Ideally, this issue should be addressed comprehensively within the context of that project. However, the Board acknowledged that the timing of the FICE project is uncertain and is subject to the current agenda consultation. While the Committee's recommendation is consistent with the tentative decisions to date in the FICE project, some (or perhaps many) of those decisions are likely to change before that project is finalized.

   (b) Constituents have raised other issues related to the guidance in IAS 32 (eg the accounting for convertible debt that is denominated in a foreign currency). It is not clear why the Board would address the NCI put issue more urgently than others.

   (c) There will be significant confusion about the 'scope of the scope exclusion'—ie why NCI puts are treated differently from other contracts on an entity's own equity. The criticisms about the usefulness of the information provided by the current 'gross' measurement basis are equally applicable to all put options and forward purchase contracts written on an entity's own equity (not only NCI puts).

(d) Consistent with the rationale set out in paragraphs BC11 and BC12, the 'gross' measurement basis required by IAS 32 is appropriate. Therefore, the accounting result of the scope exclusion (ie measuring NCI puts on a 'net' basis) is inappropriate.

(e) The scope exclusion would change the measurement basis of NCI puts but would not address the original issue submitted to the Committee—ie the potential inconsistency between the requirements for measuring financial liabilities and the requirements for transactions with owners in their capacity as owners. In other words, changing the liability from a 'gross' measurement basis to a 'net' measurement basis does not answer the original question about whether subsequent changes in the liability should be recognized in P&L or equity. [We think the Committee's intention was that subsequent changes in the NCI put would be recognized in P&L if it were measured on a 'net' basis.]

9. Although the Board decided not to amend IAS 32 at this time, it expressed support for considering addressing the potential inconsistency described in paragraph 3 of this paper—not by changing the measurement basis of the NCI put but by clarifying the accounting for the subsequent changes in the measurement of that liability.

10. The IASB Update for the Board's discussion in September is reproduced in the appendix to this paper.

Question for the Committee

11. The Board acknowledged the significant amount of work performed by the Committee on this issue and that the Committee had suggested a solution consistent with the Board's previous request. The Board asked the staff to obtain feedback from the Committee on whether it wishes to be involved in

further considering this issue or whether the Board should consider this potential clarification itself.

12. If the Committee wants to continue discussing this issue, we will ask the Board at its November meeting to provide clear guidance on what issues it would like the Committee to discuss.

Question – Proceeding with this issue
Does the Committee want to be involved in further considering this issue?

APPENDIX

A1. The Update from the March 2011 Committee meeting is reproduced below:

IAS 32 *Financial Instruments: Presentation*— put options written over non-controlling interests

Over recent meetings, the Interpretations Committee has discussed aspects of the accounting for put options written over non-controlling interests (NCI puts) in the consolidated financial statements of the controlling shareholder. Constituents have expressed concern about the diversity in accounting for the subsequent measurement of the financial liability recognised for NCI puts.

In January 2011 the Committee discussed possible paths forward including consideration of a scope exclusion from IAS 32. The Committee asked the staff to consider whether excluding NCI puts from the scope of IAS 32 was a viable short-term solution.

At the March 2011 Committee meeting, the Committee continued to discuss a possible scope exclusion. The scope exclusion would change the measurement basis of NCI puts to that used for other derivative contracts. Specifically IAS 32, including the requirements in paragraph 23 to recognise a financial liability at the present value of the option exercise price, would not apply to NCI puts.

Instead the requirements in IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 *Financial Instruments* for derivative contracts would apply.

The scope exclusion would apply only to the consolidated financial statements of the controlling shareholder. In addition, the scope exclusion would apply only to NCI puts with the following features:

- The NCI put is not embedded in another contract.
- The NCI put contains an obligation for an entity in the consolidated group to settle the contract by delivering cash or another financial asset in exchange for the interest in the subsidiary.

The Committee agreed that a scope exclusion from IAS 32 for NCI puts is a viable short-term solution. The Committee asked the staff to consider whether consequential amendments would be necessary to IAS 27 and IAS 39/IFRS 9 if NCI puts were to be excluded from the scope of IAS 32. The Committee recommended that the Board should consider making an amendment to the scope of IAS 32. The staff will present the Committee's recommendation to the Board at a future IASB meeting.

A2. The Update from the September 2011 IASB meeting is reproduced below:

Put options written over non-controlling interests

On the recommendation of the IFRS Interpretations Committee, the IASB discussed a possible scope exclusion to IAS 32 for put options written over the non-controlling interest in the consolidated financial statements of a group. The objective of the scope exclusion would be to address a potential inconsistency between the requirements of IAS 32, IAS 39 and IFRS 9 for measuring financial liabilities and the requirements in IAS 27 and IFRS 10 for accounting for transactions with owners in their capacity as owners; that is, whether the offsetting entry for subsequent measurement changes should be to P&L or to equity. The Board voted not to amend the scope of IAS 32 to exclude these put options over non-controlling interests. However, they expressed support for considering addressing the potential inconsistency, not by changing the measurement basis of the non-controlling interest, but by clarifying the accounting for subsequent changes in the measurement of such puts. They asked the staff to obtain feedback from the Interpretations Committee on how they wish to be involved in further considering this issue.