STAFF PAPER

IFRS Interpretations Committee Meeting

July 2013

Project	**IFRS 10 *Consolidated Financial Statements* and IAS 32 *Financial Instruments: Presentation*—Classification of puttable instruments that are non-controlling interests**

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Introduction

1. The IFRS Interpretations Committee ('the Interpretations Committee') received a request for guidance on the classification, in the consolidated financial statements of the group, of puttable instruments that are issued by a subsidiary of the reporting entity but are not held, directly or indirectly, by the parent. In particular, the submitter asked the Interpretations Committee to clarify whether financial instruments within the scope of paragraphs 16A-16D of IAS 32 *Financial Instruments: Presentation* ('puttable instruments') that are issued by a subsidiary but are not held, directly or indirectly, by the parent should be classified as equity or liability in the consolidated financial statements of the group.

2. We performed outreach on this topic with national accounting standard-setters and regulators. The results of this outreach are included as part of the staff's analysis of this issue.

3. The submission is reproduced in full in Appendix B to this paper.

Objective

4. The objective of this paper is to:

   (a) provide background information on the issue raised in the submission;

   (b) provide an analysis of the issue, including a summary of the outreach responses received;

   (c) present an assessment of the issue against the Interpretations Committee's agenda criteria and the annual improvements criteria;

   (d) make a recommendation that the Interpretations Committee should not take this issue onto its agenda; and

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

Background information

5. IFRS 10 defines non-controlling interests (NCI) as: *equity in a subsidiary not attributable, directly or indirectly, to a parent.*

6. Paragraph 22 of IFRS 10 *Consolidated Financial Statements* states that:

> 22 A parent shall present non-controlling interests in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent.

7. Paragraph AG29A of IAS 32 states that [emphasis added]:

> AG29A Some types of instruments that impose a contractual obligation on the entity are classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. Classification in accordance with those paragraphs is an exception to the principles otherwise applied in this Standard to the classification of an instrument. This exception is not extended to the classification of non-controlling interests in the consolidated financial statements. Therefore, **instruments classified as equity instruments in accordance with either paragraphs 16A and 16B or paragraphs 16C and 16D in the separate or individual financial statements**

> **<u>that are non-controlling interests</u> are classified as liabilities in the consolidated financial statements of the group**.

8. According to paragraph 16A a puttable financial instrument includes a contractual obligation for the issuer to repurchase or redeem that instrument for cash or another financial asset on exercise of the put. Puttable financial instruments are classified as equity instruments if they have all the features set out in paragraphs 16A and 16B.

9. According to paragraph 16C financial instruments that include a contractual obligation for the issuing entity to deliver to another entity a pro rata share of its net assets only on liquidation are classified as equity instruments if they have all the features set out in paragraphs 16C and 16D.

Staff analysis

Description of the issue

10. The submitter notes that paragraph 22 of IFRS 10 is not consistent with paragraph AG29A of IAS 32, because:

    (a) according to paragraph 22 of IFRS 10 a parent shall present NCI in the consolidated statement of financial position within **equity**; but

    (b) paragraph AG29A of IAS 32 states that [emphasis added]: "instruments classified as equity instruments in accordance with either paragraphs 16A and 16B or paragraphs 16C and 16D in the separate or individual financial statements **that are non-controlling interests are classified as liabilities** in the consolidated financial statements of the group."

11. The submitter asks the Interpretation Committee to clarify this inconsistency.

12. For example: a reporting entity has a part-owned subsidiary that has issued puttable shares that are its most subordinated class of instrument. These puttable instruments meet the definition of financial liabilities but qualify to be presented as equity of the subsidiary in the subsidiary's separate financial statements. The question is whether the puttable instruments held by third parties (ie not held directly or indirectly by the reporting entity) should be classified as financial

liabilities or as NCI equity in the reporting entity's consolidated financial statements.

13. The submitter notes that two views exist in practice:

    (a) **View 1: puttable instruments that are NCI should be classified as equity in consolidated financial statements**. This approach is consistent with paragraph 22 of IFRS 10; there are no exceptions in this paragraph.

    (b) **View 2: puttable instruments that are NCI should be classified as a financial liability in consolidated financial statements.** This approach is consistent with paragraph AG29A of IAS 32. Paragraphs 16A-16D created an exception to IAS 32 by requiring that particular puttable instruments are classified as equity. However, that exception applies only to separate or individual financial statements, and does not extend to the consolidated financial statements.

14. We will analyse these views in the following paragraphs.

View 1—puttable instruments that are NCI should be classified as equity

15. Proponents of this view note that:

    (a) IFRS 10 defines a NCI as "equity in a subsidiary not attributable, directly or indirectly, to a parent"; and

    (b) paragraph 22 of IFRS 10 states that "a parent shall present non-controlling interests in the consolidated statement of financial position within equity, separately from the equity of the owners of the parent."

16. They note that these paragraphs are clear and do not contain any exceptions, so in their view puttable instruments that are issued by a subsidiary (but that are not held, directly or indirectly, by the parent) should be classified as equity.

View 2—puttable instruments that are NCI should be classified as liability

17. Proponents of View 2 note that paragraphs 16A-16D of IAS 32 state that puttable instruments and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation are

classified as equity *as an exception to the definition of financial liability* . This exception applies only to separate or individual financial statements, and does not extend to the classification of NCI in the consolidated financial statements (see paragraph AG29A of IAS 32).

18. They note that paragraph 23 of IAS 32 clearly explains 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."

19. They think that paragraph 68 of the Basis for Conclusions of IAS 32 is very clear: financial instruments within the scope of paragraphs 16A-16D of IAS 32 should be classified as a financial liability in the consolidated financial statements. The paragraph states that [emphasis added]:

> The Board decided that puttable financial instruments or instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation should be classified as equity in the separate financial statements of the issuer if they represent the residual class of instruments (and all the relevant requirements are met). **The Board decided that such instruments were not the residual interest in the consolidated financial statements and therefore that non-controlling interests that contain an obligation to transfer a financial asset to another entity should be classified as a financial liability in the consolidated financial statements**.

20. They note that puttable instruments meet the definition of a financial liability[1]. Puttable instruments should be classified as equity in the separate financial statements of the issuer only if they represent a residual interest in the net assets of the issuer (and all the relevant requirements are met). Puttable instruments issued by a subsidiary that are not held, directly or indirectly, by the parent are financial

[1] See paragraph BC50 of IAS 32

liability in consolidated financial statements, because the IASB decided that they are not the residual interest in the consolidated financial statements.

21. They think that the exception created by paragraphs 16A-16D cannot be applied by analogy[2] and that the guidance in IFRS 10 cannot be considered to classify puttable instruments as equity, because according to paragraph 96C of IAS 32 "the classification of instruments under this exception shall be restricted to the accounting for such an instrument under IAS 1, IAS 32, IAS 39, IFRS 7 and IFRS 9. The instrument shall not be considered an equity instrument under other guidance, for example IFRS 2".

22. They think that IAS 32 provides specific guidance on how a entity should classify puttable instruments in consolidated financial statements and that this guidance cannot be overridden by the definition of NCI.

Staff analysis and view

23. We support View 2 for the reasons mentioned in paragraphs 17-22 of this paper. In our view, according to IAS 32 puttable instruments should be classified as financial liabilities (this is the general requirement in IAS 32), while paragraphs 16A-16D provide an exception to the principles of IAS 32 for the separate and individual financial statements of the issuer. This exception is a limited scope exception to the definition of a financial liability[3] and it does not apply to the consolidated financial statements of the group. Paragraph AG29A clearly states that "…This exception is not extended to the classification of non-controlling interests in the consolidated financial statements…".

24. We also note that paragraph 22 of IFRS 10 was carried forward from IAS 27 *Consolidated and Separate Financial Statements*; indeed paragraph 27 of IAS 27 (2008) required that NCI should be presented in the consolidated statement of

[2] Paragraph 96B of IAS 32 states that: "*Puttable Financial Instruments and Obligations Arising on Liquidation* introduced a limited scope exception; therefore, an entity shall not apply the exception by analogy".

[3] See paragraph BC55 of IAS 32

financial position within equity. Consequently, in our view, this issue has not been caused by IFRS 10.

Outreach requests

25. We asked IOSCO, ESMA and national standard-setters to provide us with information on whether the issue raised in the submission:

    (a) is widespread and has practical relevance; and

    (b) indicates that there are significant divergent interpretations (either emerging or existing in practice).

26. We asked the following two questions:

    (a) *How common is this issue? If it is common, could you provide us with information that the Interpretations Committee could use to assess how widespread the issue is?*

    (b) *In your view, is there diversity in practice in classifying puttable instruments that are NCI in consolidated financial statements? Please describe the predominant approach that you observe in practice.*

Responses from national standard-setters and regulators

27. We received responses from the following 17 jurisdictions: Europe (7), Asia (5), Americas (3), Oceania (1) and Africa (1).

28. In five jurisdictions the issue is common. In none of them diversity in practice has been noted.

29. We understand that in many jurisdictions the predominant approach used in practice is View 2.

Agenda criteria assessment

30. Our assessment of the Interpretations Committee's agenda criteria is as follows:

Source of issue
Issues could include: the identification of divergent practices that have emerged for accounting for particular transactions, cases of doubt about the appropriate accounting treatment for a particular circumstance or concerns expressed by investors about poorly specified disclosure requirements (5.14).

Criteria	
We should address issues(5.16):	
that have widespread effect and have, or are expected to have, a material effect on those affected; where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial Reporting*.	No. On the basis of our outreach there is no diversity in practice in classifying puttable instruments in consolidated financial statements.
In addition:	
Can the Interpretations Committee address this issue in an efficient manner (5.17)?	Not applicable. We think that there is no conflict between IFRS 10 and IAS 32.
Will it be effective for a reasonable time period (5.21)? Only take on the topic of a forthcoming Standard if short-term improvements are justified.	Yes, the issue does not relate to a current or planned IASB project.

Staff recommendation

31. On the basis of our assessment of the Interpretations Committee's agenda criteria and the annual improvements criteria, we recommend that the Interpretations Committee should not take this issue onto its agenda, because IAS 32 provides sufficient guidance for classifying puttable instruments that are NCI in consolidated financial statements. Indeed we are not aware of diversity in practice.

32. Our proposed tentative agenda decision is included in Appendix A of this paper.

Questions for the Interpretations Committee

1. Does the Interpretations Committee agree that puttable instruments that are not held, directly or indirectly, by the parent should be classified as financial liabilities in consolidated financial statements?

2. Does the Interpretations Committee agree with the staff's recommendation that the Interpretations Committee should not take this issue onto its agenda?

4. Does the Interpretations Committee have any comments on the proposed wording for the tentative agenda decision in Appendix A?

Appendix A—Proposed wording for tentative agenda decision

A1 The proposed wording for the tentative agenda decision is presented below.

IFRS 10 *Consolidated Financial Statements*—Classification of puttable instruments that are non-controlling interests

The Interpretations Committee received a request for guidance on the classification, in the consolidated financial statements of the group, of puttable instruments that are issued by a subsidiary but that are not held, directly or indirectly, by the parent. In particular, the submitter asked the Interpretations Committee to clarify whether puttable instruments classified as equity instruments in the separate financial statements of the issuer in accordance with paragraphs 16A-16B of IAS 32 *Financial Instruments: Presentation* ('puttable instruments') that are not held, directly or indirectly, by the parent should be classified as equity or liability in the consolidated financial statements of the group.

The submitter claims that paragraph 22 of IFRS 10 *Consolidated Financial Statements* is not consistent with paragraph AG29A of IAS 32, because:

(a) IFRS 10 defines non-controlling interests as equity in a subsidiary not attributable, directly or indirectly, to a parent;

(b) according to paragraph 22 of IFRS 10 a parent shall present non-controlling interests (NCI) in the consolidated statement of financial position within equity; but

(c) according to paragraph AG29A of IAS 32 instruments classified as equity instruments in accordance with paragraphs 16A-16D of IAS 32 in the separate or individual financial statements of the issuer that are NCI are classified as liabilities in the consolidated financial statements of the group.

The Interpretations Committee noted that paragraphs 16A-16D of IAS 32 state that puttable instruments and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation meet the definition of financial liability. These instruments are classified as equity in the separate or individual financial statements of the issuer as an exception to the definition of financial liability if they represent the residual class of instruments (and all relevant requirements are met). Paragraph AG29A clarifies that this exception applies only to separate or individual financial statements of the issuer, and does not extend to the classification of puttable instruments that are not held, directly or indirectly, by the parent in the consolidated financial statements of the group. Therefore, these financial instruments should be classified as a financial liability in the consolidated financial statements.

Consequently, the Interpretations Committee concluded that in the light of the existing requirements of IAS 32, an interpretation or an amendment to IFRS was not necessary and consequently [decided] not to add this issue to its agenda.

Appendix B—Request

B1 We received the following request. All information has been copied without modification, except for details that would identify the submitter of the request and details that are subject to confidentiality.

> I just wanted to ask that IASB consider making a slight improvement to IFRS 10 for an inconsistency that was carried over from IAS 27.
>
> IFRS 10.22 clearly states "a parent shall present non-controlling interests in the consolidated statement of financial position within equity….."
>
> The above principle is stated with such certainty, clarity and no exception wording that a reasonable person will rely it and do no further assessment and this could result in an honest misapplication of principles.
>
> As an example subsidiary with redeemable shares which are classed as equity in accordance with IAS 32.16A/B on an entity level may continue to be classed as equity at a consolidated level because IFRS 10.22 clearly states that non-controlling interests are equity, no exceptions. However this position as a non-controlling interest as equity under IFRS 10.27 conflicts with the classification of these same shares under IAS 32.AG29A, which indicates there is an exception. Which IFRS takes precedent or priority.
>
> I believe that users, preparers and auditors would be well served if this very small exception was made more visible. For instance IFRS 10.22 should be change to indicate explicitly that a non-controlling interest must be assessed in accordance with the principles of IAS 32 to be determine whether it represents a residual interest or a contractual obligation of the consolidated entity, which may differ from the legal entity.
>
> Secondly the exception as outlined in IAS 32.AG29A should be cross referenced to IFRS 10.22-24 or maybe even included in the guidance in IFRS 10.B94-B96 to indicate that securities which have been assessed as equity at a legal entity in accordance with IAS 32.16A/B and form part of the non-controlling interests in the subsidiary are considered debt of the consolidated entity.

I believe that the current exception in IAS 32.AG29A is too obscure, especially considering that consolidated financial statements are very common.