STAFF PAPER

March 2013

IFRS Interpretations Committee Meeting

Project	**New items for initial consideration**		
Paper topic	Mandatory purchase of non-controlling interests in a business combination		
CONTACT(S)	Liz Figgie	efiggie@ifrs.org	+44 (0)20 7246 6410

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

Background

1. In November 2012 the IFRS Interpretations Committee (the Interpretations Committee) discussed a request to address the accounting for mandatory purchases of non-controlling interests (NCI) in business combinations. The submission noted that IFRS 3 *Business Combinations* does not specifically address the accounting for a sequence of transactions that begins with an acquirer gaining control of an entity and is followed shortly thereafter by the acquisition of additional ownership interests as a result of a regulatory requirement that obliges the acquirer to offer to purchase the ownership interests of NCI shareholders. Agenda Paper 18 from the November 2012 Interpretations Committee meeting has been attached as Appendix A to this paper.

2. The following example illustrates the sequence of transactions:

> Company B is a listed company with a 60% single controlling shareholder and a 40% public ownership. Entity A acquires the 60% ownership block from the controlling shareholder at a price of CU100 per share and obtains control of Company B. Local listing rules require Entity A to make a mandatory tender offer to the remaining 40% public shareholders within 2 months from the acquisition date at the same price per share as it paid for the 60%. The remaining shareholders have the option to either accept or not accept Entity A's offer. It may take

another 2 months to know the final results of the offer. Entity A ends up owning 75% of Company B at the end of the mandatory offer period. The mandatory offer period ends after Entity A's year-end reporting date.

3. At the meeting in November 2012 the Interpretations Committee discussed two issues:

   (a) whether the initial acquisition of the controlling stake and the subsequent mandatory tender offer (MTO) should be treated as separate transactions or as a single acquisition (ie as linked transactions); and

   (b) whether a liability should be recognised for the MTO at the date that the acquirer obtains control of the acquiree.

4. On the first issue, the Interpretations Committee tentatively agreed that the initial acquisition of the controlling stake and the subsequent MTO should be treated as a single acquisition. It tentatively decided to propose that the guidance in IFRS 10 *Consolidated Financial Statements* on how to determine whether the disposal of a subsidiary achieved in stages should be accounted for as one or more transactions should also be applied to circumstances when the acquisition of a business is followed by successive purchases of additional interests in the acquiree. The Interpretations Committee tentatively decided to propose to the IASB that the Board amend IFRS 3 through Annual Improvements.

5. The Interpretations Committee also discussed the second issue. It noted that IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* excludes from its scope contracts that are executory in nature and therefore concluded that no liability needs to be recognised for the MTO. The Interpretations Committee tentatively decided to recommend to the IASB not to amend IFRS 3 for this second issue.

6. This paper discusses only the second issue.

Feedback received after the November 2012 meeting

7. We received some feedback on the Interpretations Committee's tentative conclusion that no liability needs to be recognised for an MTO. The three letters that we received are attached to this paper as Appendix B. Additional feedback was received on a more informal basis (eg emails and discussions).

8. Some expressed the view that the Interpretation Committee's rationale (as set out in the November 2012 IFRIC Update and summarised above in paragraph 5) was unclear. Others disagreed with the tentative conclusion. The following concerns were expressed:

   (a) The wording in the IFRIC Update is unclear. If MTOs are excluded from the scope of IAS 37 because they are **executory contracts**, that would seem to contradict the assertion that they are excluded from the scope of IAS 32 *Financial Instruments: Presentation* because they are **not contracts**. (In other words, how can an MTO be an executory contract if it is not a contract?)

   (b) As currently worded, the Interpretations Committee's tentative conclusion permits the non-recognition of a liability for an MTO but, at the same time, it does not prohibit the recognition of a liability (emphasis added below):

   > …and concluded that no liability **needed to** be recognised for the MTO.

   This wording may not result in greater consistency in the accounting for MTOs.

   (c) The Interpretation Committee's tentative conclusion that a liability does not need to be recognised for an MTO is inconsistent with its tentative decision that the initial acquisition of the controlling stake and the subsequent MTO should be treated as a single acquisition. If the transactions are linked, that means that the occurrence of the second transaction is dependent on the occurrence of the first transaction. Therefore, an obligation to purchase the NCI shareholders' shares is

generated by the acquisition of the controlling stake—and should be reflected in the financial statements as a liability.

(d) The recognition of a liability will be dependent on the facts and circumstances of the transaction and will be influenced by the legal requirements of a particular jurisdiction. The Annual Improvement to IFRS 3 should therefore be silent on the issue of whether a liability needs to be recognised for an MTO, including not providing any comment as to whether such contracts are executory in nature.

(e) If a liability is not recognised, the entity's financial statements will not reflect the acquirer's unconditional obligation to pay cash (or deliver another financial asset) in exchange for the NCI shareholders' shares. It generally takes several months to know the final results of an MTO and the MTO period could end after the acquirer's period-end reporting date.

(f) It seems troubling that the source of the obligation (contractual versus statutory) could result in different accounting outcomes when the underlying economics are similar (or the same). That is, the Interpretation Committee's tentative conclusion on MTOs is inconsistent with the accounting for put options written on non-controlling interests (NCI puts). If the Interpretations Committee believes this is appropriate, the IFRIC Update should explain why.

(g) The requirement to make an offer to NCI shareholders that arises from an MTO effectively creates an NCI put. As a result of an MTO, an NCI shareholder's right to put is an unconditional right that is enforceable by law and becomes part of the contractual terms and conditions embedded in the share held by the NCI shareholder. It might be suggested that since the put option arising from an MTO is not the result of a contractual obligation but rather is the result of a legal/statutory obligation, it does not meet the definition of a liability in IAS 32. However, the legal obligation has an impact on the contractual relationship between the shareholder and the reporting entity and is therefore no different from any other put option on NCI. This is

consistent with paragraph 5 of IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments* (emphasis added below):

> …the entity must consider all of the terms and conditions of the financial instrument in determining its classification as a financial liability or equity. **Those terms and conditions include relevant local laws, regulations and the entity's governing charter in effect at the date of classification**, but not expected future amendments to those laws, regulations or charter.

(h) An MTO meets the definition of a liability in paragraph 4.4(b) of the *Conceptual Framework for Financial Reporting* and therefore should be reflected in the entity's financial statements:

> A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Purpose of this paper

9. In the light of the feedback received on the Interpretations Committee's tentative conclusion, we have performed additional analysis on whether a liability should be recognised for the MTO. We will ask the Interpretations Committee whether it wishes to reconsider the recommendation that it made at its November 2012 meeting.

Analysis and recommendation

10. We think a liability should be recognised for an MTO at the date that an acquirer obtains control of an acquiree.

11. We agree with those parties who pointed out that such an arrangement meets the definition of a liability in the *Conceptual Framework*. Indeed, we think an MTO —like an NCI put—is a present obligation that arises from a past event (ie

obtaining control of the acquiree), the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits (ie cash or another financial asset). We think it would be misleading to investors to omit this liability from the financial statements because it would ignore the acquirer's present unconditional obligation to pay cash—and, as some have pointed out, the MTO period could span several months and cross reporting periods.

12. Furthermore, we agree with those who expressed the view that an MTO should be accounted for in accordance with the requirements for financial instruments (IAS 32 and IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments*). Economically, the MTO described in the submission to the Interpretations Committee is the same as an NCI put; the entity has a present unconditional obligation to purchase the shares held by the NCI shareholders. We acknowledge that the 'form' of an MTO is different from the 'form' of an NCI put because in the latter the parties have entered into a bilateral contract whereas in the former they have not. However, we think the substance of the arrangements is the same—and therefore should have the same accounting treatment.[1]

13. Moreover, we think the rights and obligations that arise from an MTO are inextricably linked to the share contracts that are held by the controlling and NCI shareholders. Specifically, the acquirer (*by virtue of becoming the controlling shareholder*) has an unconditional obligation to offer to purchase the shares held by the NCI shareholders. Correspondingly, the other shareholders (*by virtue of being NCI shareholders*) have an unconditional right to sell their shares to the acquirer. Therefore while the MTO is a statutory requirement, the controlling and NCI shareholders are bound by that arrangement as a result of holding their respective ownership instruments.

[1] We acknowledge that the Interpretations Committee has discussed the accounting for NCI puts over the course of many meetings. In January 2013, the Interpretations Committee decided to ask the IASB to reconsider the requirements in paragraph 23 of IAS 32 for put options and forward contracts written on an entity's own equity. We intend to bring that issue to the Board at a future meeting. This paper is not intended to prejudge the outcome of the IASB's discussion. Rather we believe that the accounting for MTOs should be the same as the accounting for NCI puts—and if the IASB decides to change the accounting for NCI puts (ie from a 'gross' measurement basis to a 'net' measurement basis), we think that decision should also apply to MTOs.

A final observation

14. Finally, if the Interpretations Committee thinks that MTOs are not explicitly within the scope of the financial instruments guidance, we think paragraphs 10 and 11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provide relevant requirements. Paragraph 10 notes that, in the absence of an IFRS that specifically applies to a transaction, management must use its judgement in developing and applying an accounting policy that is (a) relevant to the economic decision-making needs of users and (b) reliable, in that the financial statements represent faithfully the financial position, financial performance and cash flows of the entity; reflect the economic substance of the transaction and not merely its legal form; are neutral (ie free from bias); are prudent; and are complete in all material respects. Paragraph 11 further notes that in making that judgement, management must refer to (and consider the applicability of) the requirements in IFRSs dealing with similar and related issues.

15. MTOs and NCI puts are economically similar. Therefore, we think that the requirements in IAS 8 support accounting for MTOs in accordance with IAS 32 and IAS 39 or IFRS 9 such that they are accounted for in the same way as NCI puts.

Question to the Interpretations Committee
Does the Interpretations Committee agree that a liability should be recognised for an MTO in a manner consistent with IAS 32 at the date the acquirer obtains control of an acquiree? If not, why?

Appendix A

STAFF PAPER

November 2012

IFRS Interpretations Committee Meeting

Project	New items for initial consideration		
Paper topic	Mandatory purchase of non-controlling interests in business combinations		
CONTACT(S)	Daehyun Kim	dkim@ifrs.org	+44 (0)20 7246 6493

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Introduction

1. The IFRS Interpretations Committee (the Interpretations Committee) received a request to address the accounting for mandatory purchase of Non-Controlling Interests (NCI) in business combinations. The submitter notes that IFRS 3 *Business Combinations* does not specifically address the accounting for a sequence of transactions that begins with acquirer gaining control over another entity, followed by acquiring an additional ownership interest shortly thereafter as a result of a regulatory requirement to offer to purchase the additional interest.

2. This agenda paper is organised as follows:

   (a) Issue and staff analysis

   (b) Outreach request

   (c) Annual improvements criteria assessment

   (d) Agenda criteria assessment

   (e) Staff recommendation

   (f) Appendix A—Proposed amendments

   (g) Appendix B—Submission.

Issue and staff analysis

3. The issue is the accounting by an acquirer of the acquisition of an additional interest in an acquired subsidiary from the NCI arising from a Mandatory Tender Offer (MTO) required by the local laws and regulations. The circumstances arise because the local laws and regulations require a party who acquires a controlling interest in a listed company to initiate an MTO to the NCI to buy remaining interests at the same price or higher. This obligation under the law is triggered when the acquirer obtains a controlling stake in a listed company.

4. The submitter thinks that it is not clear whether the MTO should be accounted for as part of the business combination under IFRS 3 or as a separate transaction. This issue is not specifically addressed in IFRS 3.

5. An example from the submitter could be helpful in illustrating the issues.

> B is a listed company with a 60% single controlling shareholder and a 40% public ownership. Entity A acquires the 60% ownership block from the controlling shareholder at a price of 100 per share and obtains control of B. Local listing rules require Entity A to make a mandatory tender offer to the remaining 40% public shareholders within 2 months from the acquisition date at the same price per share as for the 60%. The remaining shareholders have the option to either accept or not accept the offer. It may take another 2 months to know the final results of the offer. Let's assume Entity A ends up owning 75% of B at the end of the mandatory offer period. However, the MTO period ends after the year end reporting date.

6. The two issues that arise are:

   1. Should the initial acquisition of 60 per cent and subsequent 15 per cent purchase following the MTO be treated as separate transactions or as one single acquisition (linked transactions)?

The answer to this question has implications on the amount of goodwill recognised if the entity chooses the option permitted by IFRS 3 to measure the NCI at the present ownership instruments' proportionate share in the recognised amounts of the acquiree's identifiable net assets, as opposed to the fair value of the NCI.

2. Should a liability be recognised for the MTO at the date Entity A obtains control of Company B?

Issue 1: should the initial acquisition of 60 per cent and subsequent MTO be treated as separate transactions or as one single acquisition?

View 1: one single acquisition

7. View 1 is to account for the two transactions as one single acquisition. The offer to the NCI is a mandatory securities law requirement triggered by the acquisition of the controlling interest. The acquirer cannot avoid making the offer. From the acquirer's perspective, it can be viewed as one deal for which the acquirer needs to plan for the subsequent increase in interest including the financing of it. In addition, the two transactions are linked because the spirit and intent of the MTO securities law is to protect the minority shareholders' interest when the controlling interest is sold.

8. Under this view, the acquisition of the initial controlling stake and the following MTO will be accounted for as a single transaction that is completed over a period of time. Consequently, for the example in paragraph 5, goodwill is recognised based on the 75 per cent stake if the proportionate share method is adopted.

View 2: separate transactions

9. View 2 is to account for the two transactions as separate transactions. Although the regulations create a linkage between the initial 60 per cent acquisition and subsequent MTO, each transaction on its own is economically justified. The objective of the 60 per cent acquisition is to obtain control over Company B, and the 60 per cent acquisition is also the result of a separate negotiation between

Entity A and the previous controlling party. Also, the subsequent purchase from NCI has economic substance on its own.

10. Under this view, the first transaction is accounted for as a business combination and any subsequent transactions are accounted for as the acquisition of NCI. Consequently, for the example in paragraph 5, goodwill is recognised based on the 60 per cent stake if the proportionate share method is adopted. The acquisition of the 15 per cent is accounted for when it occurs as an equity transaction in accordance with paragraph 23 of IFRS 10 (or paragraph 30 of IAS 27).

Staff analysis

11. Paragraph B97 of IFRS 10 (or paragraph 33 of IAS 27) provides explicit guidance of when to account for two or more arrangements as a single transaction when a parent loses control of a subsidiary. Paragraph B97 states:

> A parent might lose control of a subsidiary in two or more arrangements (transactions). However, sometimes circumstances indicate that the multiple arrangements should be accounted for as a single transaction. In determining whether to account for the arrangements as a single transaction, a parent shall consider all the terms and conditions of the arrangements and their economic effects. One or more of the following indicate that the parent should account for the multiple arrangements as a single transaction:
>
> (a) They are entered into at the same time or in contemplation of each other.
>
> (b) They form a single transaction designed to achieve an overall commercial effect.
>
> (c) The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.
>
> (d) One arrangement considered on its own is not economically justified, but it is economically justified when considered together with other arrangements. An

example is when a disposal of shares is priced below market and is compensated for by a subsequent disposal priced above market.

12. These factors could be very helpful when assessing whether the acquisition, including the NCI acquired under the MTO should be accounted for as separate transactions or as one single acquisition. It is logical to apply the same factors regardless of whether an acquirer obtains control, or a parent loses control, of a subsidiary.

13. If the acquirer considers the above factors for the MTO of an NCI in business combinations in the example in paragraph 5, the acquirer might evaluate whether:

    (a) the transactions occur within a short period;

    (b) the transactions are not negotiated separately by each counterparty (e.g. the pricing of the MTO is not negotiated separately, but specified by the laws and regulations);

    (c) the acquirer does not have a choice of whether to enter into each transaction separately; and

    (d) the securities law requirement is enforceable, and the acquirer needs to plan for the MTO from the onset.

14. Although the MTO in the example is likely to be accounted for as a single transaction, there should be a level of judgement required because related laws and regulations may vary depending on the jurisdiction. Consequently, guidance would be helpful in making the necessary judgement.

Issue 2: should a liability be recognised for the MTO at the date Entity A obtains control of Company B?

View 1: no liability

15. View 1 is not to recognise any liability for the MTO at the date Entity A obtains control of Company B. The statutory obligation to perform an MTO does not represent a contract between Entity A and the remaining shareholders because a contract requires agreement between two or more parties (as per the definition of

financial instrument under paragraph 11 and 13 of IAS 32 *Financial Instruments: Presentation*), but an MTO is only an offer until an NCI accepts. When the NCI accepts, a contract is established. The liability for the MTO is hence outside the scope of IAS 32 until the NCI accepts the offer, at which point a contract between the NCI and the acquirer is established. Paragraph AG12 of IAS 32 clarifies that "Liabilities or assets that are not contractual (such as income taxes that are created as a result of statutory requirements imposed by governments) are not financial liabilities or financial assets".

16. Under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, no liability should be recognised, because IAS 37 excludes from its scope contracts that are executory in nature, and there is no onerous contract. When the offer is made, neither party has performed any of its obligations, ie the entity has not paid for the shares and the NCI has not delivered the shares.

View 2: liability recognised

17. Economically, the existence of the statutory obligation is not different from a put option granted to NCI, which would be recognised as a financial liability based on the present value of expected payments.

18. When the entity makes the offer to the NCI, it places itself in a position in which it can be obliged to pay cash in return for receipt of the shares held by the NCI. It can therefore be required to pay cash and does not have any means to avoid that. As a result those supporting View 2 assert that the entity has a liability.

Staff analysis

19. We think that the statutory obligation to perform an MTO does not represent a contractual liability under paragraph AG12 of IAS 32.

20. The statutory obligation to perform an MTO is a type of non-contractual obligation. We think that an entity should apply IAS 37 because no other Standard deals with that statutory obligation.

21. Consequently, for the statutory obligation to perform an MTO, we think that the entity should recognise a provision if the recognition conditions are met in accordance with paragraph 14 of IAS 37, which includes a legal obligation.

22. We do not agree with View 1 because this view asserts that IAS 37 excludes from its scope contracts that are executory in nature. The offer to the NCI is not a contract but a legal obligation. We agree with View 2 that a liability should be recognised. We think that the MTO to purchase own equity that is irrevocable and enforceable for a period of time, should be accounted for in accordance with IAS 37 until the offer expires or is accepted.

23. Some might argue that this statutory obligation will evolve into a contractual obligation before being settled and is in the scope of IAS 32. They think that this obligation seems to be somewhere in between a contractual obligation and a non-contractual obligation, and that a statutory obligation to stand ready to enter into a contractual obligation should be treated like a contractual obligation. They also argue that this obligation should be treated as contractual because the obligation arises from the contract to acquire the controlling interest and the obligation will become contractual before it is settled. In that respect, they maintain it is different from the tax obligations and constructive obligations that paragraph AG12 of IAS 32 describes as being outside the scope of IAS 32.

24. However, we think that this obligation may or may not evolve into a contractual obligation depending on whether or not the NCI accepts the offer. Accordingly we do not agree with the view that classifies this statutory obligation as a contractual obligation. Even though the obligation arises from the contract to acquire the controlling interest, this obligation will (or may not) evolve into another contract with another party. Also, paragraph AG12 of IAS 32 explicitly states that “Liabilities or assets that are not contractual (such as income taxes that are created as a result of statutory requirements imposed by governments) are not financial liabilities or financial assets”.

Outreach request

25. We sent a request for information to the International Forum Accounting Standard Setters (IFASS) and securities regulators International Organization of Securities Commissions (IOSCO) and European Securities and Markets Authority (ESMA) in order to help assess the Interpretations Committee's agenda criteria as summarised below:

    Q1. In your jurisdiction, how common is this type of transaction? If it occurs, could you provide us with information that the Interpretations Committee could use to assess how widespread the issue is?

    Q2. In your view, is there diversity in practice in accounting for the initial acquisition of controlling stake and subsequent MTO? Please describe the predominant approach that you observe in your jurisdiction.

26. The views expressed below are informal feedback from members of the IFASS and regulators. They do not reflect the formal views of the boards of those organisations. The geographical breakdown for the responses is as follows:

Geographical area	**Number of respondents**
Asia/Oceania	6
Africa	1
Europe	5
North America	3
Total respondents	**15**

27. Ten respondents answered that they do have similar laws and regulations for the MTO to the NCI in their jurisdictions, and six of them have observed diversity in practice.

28. We noted that five respondents generally favour or observe an approach to treat the initial acquisition of controlling stake and subsequent MTO as linked transactions and recognise it as a liability, but specific reasons were not provided.

29. We also did research for U.S. GAAP because IFRS 3 is a converged Standard. As far as the requirement of MTO is concerned, we understand that U.S. securities

laws do not require an MTO made to the NCI holders. However, U.S. companies may face such laws and regulations in other jurisdictions, in which case they would need to account for the MTO to the NCI holders.

30. Under U.S. GAAP we understand that the NCI would be accounted for at acquisition date fair value, because ASC 805: *Business Combinations* does not provide an option to recognise the NCI as a portion of the recognisable net assets acquired in a business combination.

31. When it comes to the issue on whether the MTO should be accounted for as a financial liability, we understand that there are different views in practice. Some treat the MTO as a non-contractual obligation and recognise a loss based on the probability of occurrence in accordance with ASC 450 *Contingencies*.

32. Others treat the MTO as a contractual obligation and consider it a financial instrument. The question is whether this financial instrument is a freestanding financial instrument or an embedded feature in a financial instrument that is not a derivative in its entirety. If the MTO would qualify as a freestanding financial instrument, it would generally be accounted for as a liability at fair value as if it is a written put option. However, for an embedded feature, it would first need to be assessed whether it is a derivative or not. If it is not a derivative (or qualifies for the exception for derivative accounting) it would be classified as temporary equity and measured at the maximum redemption amount. In the case that the embedded feature is separated from the host contract and accounted for as a derivative, it would be accounted for as a liability at fair value.

Annual improvements criteria assessment

33. In planning whether an issue should be addressed by amending IFRSs within the Annual Improvements project, the IASB assesses the issue against certain criteria. All the criteria (a)–(d) must be met to qualify for inclusion in annual improvements. We have assessed the potential amendment against the annual improvements criteria, which are reproduced in full below:

Annual improvements criteria	Staff assessment of the proposed amendment
(a) The proposed amendment has one or both of the following characteristics: (i) clarifying—the proposed amendment would improve IFRSs by: • clarifying unclear wording in existing IFRSs, or • providing guidance where an absence of guidance is causing concern. A clarifying amendment maintains consistency with the existing principles within the applicable IFRSs. It does not propose a new principle, or a change to an existing principle. (ii) correcting—the proposed amendment would improve IFRSs by: • resolving a conflict between existing requirements of IFRSs and providing a straightforward rationale for which existing requirements should be applied, or • addressing an oversight or relatively minor unintended consequence of the existing requirements of IFRSs. A correcting amendment does not propose a new principle or a change to an existing principle, but may create an exception from an existing principle.	(a) Yes. The proposed amendment provides guidance to apply the same factors to both an acquirer obtaining, and a parent losing, control of a subsidiary. It also provides guidance on the recognition of a liability. This is the provision of guidance where there is an absence, and this guidance is an extension of guidance that is already there.
(b) The proposed amendment is well-defined and sufficiently narrow in scope such that the consequences of the proposed change have been considered.	(b) Yes. The issue is sufficiently narrow in scope to ensure that the proposed amendment has been considered sufficiently and identified.
(c) It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach conclusion on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.	(c) Yes. We think that the IASB will reach a conclusion on this issue on a timely basis.
(d) If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a need to make the amendment sooner than the project would.	(d) Yes. There are no current projects on IFRS 3 although the post-implementation review of IFRS 3 is planned to commence in the first quarter of 2013.

Agenda criteria assessment

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

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

    Yes, the issue arises in practice and the staff agree that it is an issue that needs to be resolved.

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

    On the basis of the outreach result, the issue indicates that there are divergent interpretations of the accounting for mandatory purchase of NCI in business combinations.

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

    Yes.

    (d) *The issue can be resolved efficiently within the confines of existing IFRSs and the Conceptual Framework, and the demands of the interpretation process. The issue should be sufficiently narrow in scope to be capable of interpretation, but not so narrow that it is not cost-effective for the Interpretations Committee and its constituents to undertake the due process associated with an interpretation?*

    Yes.

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

    Yes, we think that the conclusion can be determined.

    (f) *If the issue relates to a current or planned IASB project, there is a pressing to provide guidance sooner than would be expected from the IASB activities. The Interpretations Committee will not add an item to*

its agenda if an IASB project is expected to resolve the issue in a shorter period than the Interpretations Committee requires to complete its due process.

There are no current projects on IFRS 3 although the post-implementation review of IFRS 3 is planned to commence in the first quarter of 2013.

Staff recommendation

35. We support View 1 for Issue 1, which is to account for initial acquisition and subsequent MTO as one single acquisition. While paragraph B97 of IFRS 10 provides explicit guidance on when to account for two or more arrangements as a single transaction when a parent loses control of a subsidiary, it is not clear whether and how to analogise to this guidance when assessing whether to account for multiple arrangements as a single transaction when **gaining** control.

36. We propose additional guidance to apply the same factors to both an acquirer obtaining, and a parent losing ,control of a subsidiary as provided in paragraph B62C of Appendix A to this paper. Because related laws and regulations may vary depending on the jurisdiction, there should be a level of judgement required. Accordingly, guidance would be helpful in making the judgement, based on the facts and circumstances, in determining the appropriate accounting for an MTO.

37. We support View 2 for Issue 2, which is to recognise a liability for the MTO at the date the acquirer obtains control of the acquiree. The statutory obligation to perform an MTO is a type of provision, and no other Standard, except for IAS 37 provides any specific guidance on this. Consequently, IAS 37 should be applied for the MTO to NCI because no other Stanard deals with those transactions.

38. We propose additional guidance to recognise a liability under IAS 37 to clarify the accounting treatment for an MTO as provided in paragraph B62D of Appendix A to this paper.

Question to the Interpretations Committee
Q1. Does the Interpretations Committee agree with the staff recommendation that additional paragraphs to the Application guidance should be added to provide explicit guidance on the accounting for a mandatory tender offer associated with a business combination? Q2. Does the Interpretations Committee agree that a recommendation should be put to the IASB to include the proposed amendment within Annual Improvements?

Appendix A—Proposed amendments

A1. A new heading and paragraphs B62C, B62D and 64H are proposed to be added to IFRS 3.

Mandatory purchase of non-controlling interests in business combinations

B62C A jurisdiction might require an entity that acquires a controlling interest in a listed company to initiate a mandatory tender offer to the non-controlling interests to buy remaining interests at the same price or higher. This obligation under the law is triggered when the acquirer obtains a controlling stake in the listed entity. In determining whether to account for the initial acquisition and subsequent transaction triggered by regulatory law (ie a mandatory tender offer) as a single transaction, the acquirer should consider the factors set out in paragraph B97 of IFRS 10.

B62D The obligation under a mandatory tender offer to purchase own equity that is irrevocable and enforceable for a period of time, should be recognised as a liability and should be accounted for in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* until the offer expires or is accepted.

Effective date

64H *Annual Improvements Cycle 2012–2014* issued in [date] added paragraphs B62C and B62D. An entity shall apply those amendments to all business combinations for which the acquisition date is on or after 1 January 2015. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

Draft Basis for Conclusions on proposed amendments to IFRS 3 *Business combinations*

This Basis for Conclusions accompanies, but is not part of, the proposed amendments.

Mandatory purchase of non-controlling interests in business combinations

BC1 The IASB proposes to provide additional guidance on the accounting for a mandatory tender offer for the purchase of shares held by non-controlling interest shareholders. The IASB proposes that an entity shall apply the same factors to an acquirer obtaining control of a subsidiary as is currently applied by a parent losing control of a subsidiary in relation to determining whether two arrangements should be accounted for as one transaction. The IASB understands that while paragraph B97 of IFRS 10 provides explicit guidance on when to account for two or more arrangements as a single transaction when a parent loses control of a subsidiary, it is not clear whether and how to analogise to this guidance when assessing whether to account for multiple arrangements as a single transaction when gaining control. The IASB thinks that guidance would be helpful in making the judgement, based on the facts and circumstances to determining the appropriate accounting for a mandatory tender offer.

BC2 In addition, the IASB noted that the statutory obligation to perform a mandatory tender offer to purchase own equity that is irrevocable and enforceable for a period of time is a type creates an obligation that gives rise to a provision. The IASB therefore proposes to make clear that IAS 37 should be applied in accounting for the mandatory tender offer to non-controlling interests.

Appendix B—Submission

IFRS IC POTENTIAL AGENDA ITEM

Issue:

The issue is the accounting for an acquirer of an additional interest in an acquired subsidiary from the Non Controlling Interest shareholders (NCI) arising from a Mandatory Tender Offer (MTO) required by the local laws and regulations. A party who acquires a controlling interest in a listed company must initiate a MTO to the NCI to buy remaining interests at same price or more. This law is triggered when the acquirer obtains a controlling stake in a listed company which is accounted for under IFRS 3 'Business Combinations'[1]. It is not clear whether the MTO should be accounted for as part of the business combination under IFRS 3, IAS 27(2008), and IFRS 10 or as a separate transaction. This issue is not specifically addressed in IFRS 3. Most large accounting firm guidance says to apply the factors in IAS 27(2008).33 by analogy. These same factors are included in IFRS 10.B97. The guidance published by the large accounting firms indicates diversity in practice on whether a MTO is a linked or separate transaction from the business combination.

This could be further supplemented through the help of an example:

B is a listed company with a 60% single controlling shareholder and a 40% public ownership. Entity A acquires the 60% ownership block from the controlling shareholder at a price of 100 per share and obtains control of B. Local listing rules require Entity A to make a mandatory tender offer to the remaining 40% public shareholders within 2 months from the acquisition date at the same price per share as for the 60%. The remaining shareholders have the option to either accept or not accept the offer. It may take another 2 months to know the final results of the offer. Let's assume Entity A ends up owning 75% of B at the end of the mandatory offer period. However, the MTO period ends after the year end reporting date.

The two issues which arise are:

1. Should the initial acquisition of 60% and subsequent MTO be treated as separate transactions or as one single acquisition (linked transactions)?
2. Should a liability be recognised for the MTO at the date Entity A obtains control of company B?

Current practice:

There are two views currently with respect to both the issues which are as follows:

Issue 1 – Should the acquisition of the subsequent 15% be accounted for as a separate transaction?

View 1 – No (the two transactions should be accounted for as linked transactions)

The following points support view 1:

- The offer to the NCI is a mandatory securities law requirement triggered by the acquisition of the controlling interest. The acquirer cannot avoid making the offer. The acquirer has no discretion on the price that must be offered to the minority shareholders.
- A judgment that the transactions are separate implies that the securities law is not enforceable or substantive.
- The transaction occurs within short period of time.

[1] Note that local laws and regulations may also mandate a MTO upon acquisition of a non-controlling stake above a certain threshold, say 40%. This paper only deals with the situation of an MTO triggered by the acquisition of a controlling stake.

- Although the acquirer has separately negotiated with the former owner the acquisition of the controlling stake, the acquirer knows from the onset that it will have to launch a MTO. From the acquirer's perspective, it can be viewed as one deal for which the acquirer needs to plan for the subsequent increase in interest (including the financing of it)
- The indicator in IAS 27(2008).33 regarding 'They form a single transaction designed to achieve an overall commercial effect.' supports linked transactions because the spirit and intent of the MTO securities law is to protect the minority shareholders interest when the controlling interest is sold.
- Both transactions should be accounted for one single acquisition because the pricing of the MTO is related to the amount paid for the controlling stake.

The treatment will be as follows, assuming it is concluded on issue 2 that the legal requirement to initiate a MTO does not give rise to a liability:

- The acquisition of the initial controlling stake and the following MTO will be accounted for as a single transaction that is completed over a period of time.
- There will be no NCI recorded at the year-end reporting date because the MTO is finalised after year end reporting date.
- The acquisition of 60% will be based on provisional accounting and additional goodwill for additional 15% stake and NCI of 25% will be recognised after closure of MTO period. Because the additional goodwill for additional 15% stake results from facts and circumstances arising on completion of the MTO (i.e. after the acquisition date), the additional goodwill is not accounted for retrospectively from the acquisition date.
- A company would make the terms of the MTO and the accounting at year-end transparent through disclosures.

Refer to the example in appendix BC, issue 1, view 1 for further detail. Refer to the example in appendix BC , view 3 for the treatment of the MTO as linked transaction when the conclusion on issue 2 is that a liability should be recorded.

View 2 – Yes (the two transactions should be accounted for separately)

The following points support view 2:

- Although the regulations create a linkage between the initial 60% acquisition and subsequent MTO, each transaction on its own is economically justified (i.e., they do not form a single transaction designed to achieve an overall commercial effect).The objective and economic justification of the 60% acquisition is to obtain control over B. It is also the result of a separate negotiation between A and the previous controlling party.
- The objective of the 60% acquisition is to obtain control over B and is separately negotiated between A and the previous controlling party. The MTO and its terms (same price as for the 60%) is more the result of a legal protection of the remaining shareholders rather than a willing decision from A to buy their stake.
- There is no compulsion on the remaining shareholders to accept the offer and it will be subject to a separate decision from their end.
- Local laws and regulations often include a price adjustment mechanism for the MTO, where the NCI will receive a higher price than the price paid for the controlling stake if the market value of the acquiree company has increased above the price paid for the controlling stake. This supports the view that the subsequent purchase from NCI has economic substance on its own.

Goodwill is recognised based on the 60% stake if proportionate share method is adopted. The acquisition of the 15% is treated as acquisition of NCI within equity. Refer to the example in appendix BC, issue 1, view 2 for further detail.

Issue 2 – Does the legal requirement to initiate the MTO meet the definition of a liability at the date control is obtained?

View 1 – No

The following points support view 1:

- The statutory obligation to do a MTO does not represent a contract between A and the remaining shareholders, hence is out of the scope of IAS 32.
- No IAS 37 liability should be recognised because IAS 37 scopes out contracts that are executory in nature, and there is no onerous contract.

Refer to the example in appendix BC, issue 1, view 1 and view 2 for further detail.

View 2 – Yes

The following points support view 2:

- Economically, the existence of the statutory obligation is no different from a put option granted to NCI, which would be recognised as a financial liability based on the present value of expected payments.

Issues 1 and 2 are related. The transactions are more likely to be linked if a liability exists for the MTO at the acquisition date. Refer to the example in appendix BC, issue 2, view 2 for further detail.

Reasons for the IFRS IC / IASB to address the issue:

IFRS 3 does not specifically address the accounting for a sequence of transactions that begins with acquirer gaining control over a business followed by an additional interest being acquired shortly thereafter as a result of a tender offer. The issue occurs frequently and is widespread and practical in nature because many jurisdictions have company law or securities law that requires mandatory tender offers. We believe it is currently resulting in divergent interpretations and treatment in practice. There are mixed views between large firms resulting in an inconsistent approach currently. Refer to appendix D[2] for the guidance developed by some of the large firms.

A particular accounting treatment may impact the amount of goodwill recognised. Further, the amount of NCI to be recognised may differ in different reporting periods. We feel there is scope for an improvement in financial reporting through elimination of this diversity. The issue is currently not directly related to any IASB project. This issue might be considered as part of the post-implementation review of IFRS 3 or as a separate annual improvement project to amend IFRS 10.

A proposed clarification on this issue could avoid further divergence in the accounting for MTOs. See appendix BB for potential narrow amendments that could be done through an annual improvement project.

[2] Not included in this paper

Appendix BA – Relevant IFRS guidance

IAS27(2008).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 (i.e. transactions with owners in their capacity as owners).

IAS27(2008).33 - A parent might lose control of a subsidiary in two or more arrangements (transactions). However, sometimes circumstances indicate that the multiple arrangements should be accounted for as a single transaction. In determining whether to account for the arrangements as a single transaction, a parent shall consider all of the terms and conditions of the arrangements and their economic effects. One or more of the following may indicate that the parent should account for the multiple arrangements as a single transaction:

(a) They are entered into at the same time or in contemplation of each other.

(b) They form a single transaction designed to achieve an overall commercial effect.

(c) The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.

(d) One arrangement considered on its own is not economically justified, but it is economically justified when considered together with other arrangements. An example is when one disposal of shares is priced below market and is compensated for by a subsequent disposal priced above market.

IFRS 10.B97 A parent might lose control of a subsidiary in two or more arrangements (transactions). However, sometimes circumstances indicate that the multiple arrangements should be accounted for as a single transaction. In determining whether to account for the arrangements as a single transaction, a parent shall consider all the terms and conditions of the arrangements and their economic effects. One or more of the following indicate that the parent should account for the multiple arrangements as a single transaction:

a) They are entered into at the same time or in contemplation of each other.
b) They form a single transaction designed to achieve an overall commercial effect.
c) The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.
d) One arrangement considered on its own is not economically justified, but it is economically justified when considered together with other arrangements. An example is when a disposal of shares is priced below market and is compensated for by a subsequent disposal priced above market.

IAS32.11 - A financial liability is any liability that is:

(a) a contractual obligation:

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

IAS32.AG12. Liabilities or assets that are not contractual (such as income taxes that are created as a result of statutory requirements imposed by governments) are not financial liabilities or financial assets. Accounting for income taxes is dealt with in IAS 12. Similarly, constructive obligations, as defined in IAS 37 Provisions, Contingent Liabilities and Contingent Assets, do not arise from contracts and are not financial liabilities.

Appendix BB – Proposed improvement amendments

View 1 & 3: Linked transactions

IFRS 3.B50 The acquirer should consider the following factors, which are neither mutually exclusive nor individually conclusive, to determine whether a transaction is part of the exchange for the acquiree or whether the transaction is separate from the business combination:

(a) the reasons for the transaction—Understanding the reasons why the parties to the combination (the acquirer and the acquiree and their owners, directors and managers—and their agents) entered into a particular transaction or arrangement may provide insight into whether it is part of the consideration transferred and the assets acquired or liabilities assumed. For example, if a transaction is arranged primarily for the benefit of the acquirer or the combined entity rather than primarily for the benefit of the acquiree or its former owners before the combination, that portion of the transaction price paid (and any related assets or liabilities) is less likely to be part of the exchange for the acquiree. Accordingly, the acquirer would account for that portion separately from the business combination.

(b) **how was the transaction initiated** ~~who initiated the transaction—~~ Understanding **how the transaction was initiated** ~~who initiated the transaction~~ may also provide insight into whether it is part of the exchange for the acquiree. For example, a transaction or other event that is initiated by the acquirer may be entered into for the purpose of providing future economic benefits to the acquirer or combined entity with little or no benefit received by the acquiree or its former owners before the combination. On the other hand, a transaction or arrangement initiated by the acquiree**,** its former owners, or **triggered by regulatory law** **as a result of the business combination** is less likely to be for the benefit of the acquirer or the combined entity and more likely to be part of the business combination transaction.

(c) the timing of the transaction—The timing of the transaction may also provide insight into whether it is part of the exchange for the acquiree. For example, a transaction between the acquirer and the acquiree that takes place during the negotiations of the terms of a business combination may have been entered into in contemplation of the business combination to provide future economic benefits to the acquirer or the combined entity. If so, the acquiree or its former owners before the business combination are likely to receive little or no benefit from the transaction except for benefits they receive as part of the combined entity.

View 2: Separate transactions

IFRS 10.23 Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (ie transactions with owners in their capacity as owners) **irrespective of whether the transaction was initiated as a result of another transaction in which control was obtained or lost (ie a mandatory tender offer).**

Appendix BC – Example

Facts: Entity A acquires 60% of listed company B from the previous controlling shareholder at a price of CU300 and obtains control of B. Local listing rules require Entity A to make a mandatory tender offer (MTO) to the remaining interests within 2 months from the acquisition date at the higher of the price per share paid for the 60% or the average highest price traded on the exchange during 90 days prior to the announcement of the MTO. The remaining shareholders have the option to accept or not the offer. It may take another 2 months to know the final results of the offer. Let's assume Entity A ends up owning 85% of B at the end of the mandatory offer period. The price for the additional 25% in the mandatory tender offer is the same as the acquisition date price (e.g., CU125). Assume the net identifiable assets of company B have a fair value of 400. Assume the proportionate share method is used to measure NCI.

Date	**Event**
November 30, 20X1	Acquisition date for 60%
January 30, 20X2	MTO published, share price is the same as acquisition date
March 30, 20X2	MTO closes and shares are tendered for cash for 25%

Issue 1, View 1: No Liability, Linked transactions

November 30, 20X1: Entity A records the following on the acquisition date:

DR	Net Assets		CU400	
	CR	Cash		CU300
	CR	Equity (parent)		CU100[3]

To record the acquisition of company B assuming the MTO will result in 100% ownership.

March 30, 20X2: Entity A has records the mandatory tender offer 4 months after the acquisition date.

DR	Equity (parent)		CU100	
DR	Goodwill		CU85	
	CR	Cash		CU125
	CR	NCI		CU60

To record the final outcome of the mandatory tender offer of 85% ownership. This entry is accounted for prospectively and the period ending December 31, 20X1 is not adjusted.

Fair value of consideration	425
Proportionate share of NCI	60
Subtotal	485
less: recognised value of 100% of net assets	400
Goodwill recognised	85

[3] If the cash paid for the 60% is more than the fair value of the net identifiable assets, then there would be a debit to goodwill instead of a credit to equity.

Issue 1, View 2: No Liability, Separate transactions

November 30, 20X1: Entity A records the following on the acquisition date:

DR	Net Assets	CU400	
DR	Goodwill	CU60	
	CR Cash		CU300
	CR NCI		CU160

To record the acquisition of 60% of company B.

Fair value of consideration	300
Proportionate share of NCI	160
Subtotal	460
less: recognised value of 100% of net assets	400
Goodwill recognised	60

March 30, 20X2: Entity A has records the mandatory tender offer 4 months after the acquisition date.

DR	NCI	CU100	
DR	Equity (parent)	CU25	
	CR Cash		CU125

To record the final outcome of the mandatory tender offer of 85% ownership.

Issue 2, view 2: Liability, Linked transactions

November 30, 20X1: Entity A records the following on the acquisition date:

DR	Net Assets	CU400	
DR	Goodwill	CU100	
	CR Cash		CU300
	CR Liability		CU200

To record the acquisition of company B assuming the MTO will result in 100% ownership.

January 30, 20X2: Entity A re-measures the liability for the increase in share price.

DR	Finance expense	CU0	
	CR Liability		CU0

To re-measure the fair value of the liability. There is no impact in this example because the price did not increase.

March 30, 20X2: Entity A has records the mandatory tender offer 4 months after the acquisition date.

DR	Liability	CU200	
	CR Cash		CU125
	CR NCI		CU60
	CR Goodwill		CU15

To record the final outcome of the mandatory tender offer of 85% ownership.

Appendix B

IFRIC UPDATE NOVEMBER 2012

Issues recommended for inclusion in the next cycle for Annual Improvements

IFRS 3—Mandatory purchase of non-controlling interests in business combinations

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" The Interpretations Committee noted that IAS 37 excludes from its scope contracts that are executory in nature and concluded that no liability needed to be recognised for the MTO. The Interpretations Committee tentatively decided to recommend to the IASB not to amend IFRS 3."

We would like to respectfully recommend that the IC statement about whether a liability should be recognised for the MTO at the date the acquirer obtains control of the acquire be clarified in a coming IC update.

***

We agree that the matter referred is not a subject linked to ifrs3, and that as for a purchase agreement of a controlling stake, and absent any other form of commitment, the recognition of a transaction takes place only upon the transfer of the assets.

However, we believe the current wording is unclear in its rationale :

If a MTO is a (executory) contract it is a contract, this then appears to contradict the non-applicability of IAS32 AG13 (if this this the reasoning followed). Alternatively if a MTO is not viewed as a contract along the staff analysis of IAS32 AG12, it should have been clearly stated.

We are also concerned that the source of the obligation (be it contractual or regulatory) could translate into different accounting outcomes, when the economics are similar. We therefore believe the wording should also explain the IC conclusion with respect to the following staff analysis :

23. Some might argue that this statutory obligation will evolve into a contractual obligation before being settled and is in the scope of IAS 32. They think that this obligation seems to be somewhere in between a contractual obligation and a non-contractual obligation, and that a statutory obligation to stand ready to enter into a contractual obligation should be treated like a contractual obligation. They also argue that this obligation should be treated as contractual because the obligation arises from the contract to acquire the controlling interest and the obligation will become contractual before it is settled. In that respect, they maintain it is different from the tax obligations and constructive obligations that paragraph AG12 of IAS 32 describes as being outside the scope of IAS 32.

24. However, we think that this obligation may or may not evolve into a contractual obligation depending on whether or not the NCI accepts the offer. Accordingly we do not agree with the view that classifies this statutory obligation as a contractual obligation. Even though the obligation arises

from the contract to acquire the controlling interest, this obligation will (or may not) evolve into another contract with another party. Also, paragraph AG12 of IAS 32 explicitly states that "Liabilities or assets that are not contractual (such as income taxes that are created as a result of statutory requirements imposed by governments) are not financial liabilities or financial assets".

Finally, we would like to emphasize that the question of not accounting for the MTO until its closing may affect the financial statements of several periods as a MTO may close several months (around a year in certain cases) after an entity has gained control over another one. During that period, the entity's consolidated equity would not show the non-participating interests right to put their shares during the MTO. A similar situation may occur for MTOs that are required when the controlling shareholder exceed a specified threshold (e.g. 90%) or that are launched to turn a public entity into a private one.

Ernst & Young Global Limited
Becket House
1 Lambeth Palace Road
London SE1 7EU

Tel: +44 [0]20 7980 0000
Fax: +44 [0]20 7980 0275
www.ey.com

International Financial Reporting Standards
Interpretations Committee
30 Cannon Street
London
EC4M 6XH

22 January 2013

Dear IFRS Interpretations Committee members,

Issue recommended for inclusion in the next cycle for Annual Improvements – IFRS 3 *Business Combinations* – Mandatory purchase of non-controlling interests in business combinations

The global organisation of Ernst & Young is pleased to submit its comments on the above draft recommendation of the IFRS Interpretations Committee (the Committee), as published in the November 2012 *IFRIC Update*.

The Committee received a request "to address the accounting for mandatory purchase of non-controlling interests that arise as a result of business combinations."

We agree with the Committee's tentative decision to amend IFRS 3 through Annual Improvements to clarify that the guidance in IFRS 10 (please note the reference should be to IFRS 10, not IFRS 3 as currently worded in the November 2012 *IFRIC Update*) on how to determine whether the disposal of a subsidiary achieved in stages should be accounted for as one or more transactions should also be applied to circumstances when the acquisition of a business is followed by successive purchases of additional interests in the acquiree. However, we believe that the initial and subsequent accounting implications of treating the arrangement as a linked transaction should be highlighted in the tentative decision.

We disagree with the Committee's tentative decision that no liability for the mandatory tender offer need to be recognised at the date the entity obtains control of the acquiree, for the reasons discussed below.

The requirement to make an offer to non-controlling shareholders that arises from a mandatory tender offer effectively creates a put option over non-controlling interests. The right to put is a right that is enforceable by law and becomes part of the contractual rights embedded in the shares held by the non-controlling shareholders. It might be suggested that, since the put option is not the result of a contractual obligation but rather the result of a legal obligation, it does not meet the definition of a liability under paragraph 11 of IAS 32 *Financial Instruments: Presentation*. However, the legal obligation has an impact on the contractual relationship between the shareholder and the reporting entity and is therefore no different from any other put option on non-controlling interest. This is consistent with paragraph 5 of IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments*:

> "... the entity must consider all of the terms and conditions of the financial instrument in determining its classification as a financial liability or equity. Those terms and conditions include relevant local laws, regulations and the entity's governing charter in effect at the

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> date of classification, but not expected future amendments of those laws, regulations or charter".

In addition, we believe that the mandatory tender offer meets the definition of a liability under *The Conceptual Framework for Financial Reporting*:

> "A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits".

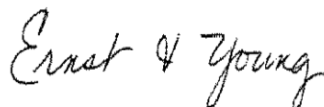
As currently worded, the tentative conclusion allows non-recognition of a liability for the mandatory purchase of non-controlling interests that arise as a result of business combinations. At the same time, it does not prohibit the recognition of a liability (our emphasis added):

> "...and concluded that no liability *needed to* be recognised for the MTO."

We are concerned that this wording may not support greater consistency in the accounting of the mandatory tender offer.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 (0)20 7951 3152.

Yours faithfully



DRSC e. V. • Zimmerstr. 30 • 10969 Berlin

Telefon +49 (0)30 206412-12
Telefax +49 (0)30 206412-15
E-Mail info@drsc.de

Wayne Upton
Chairman of the
IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH

United Kingdom

Berlin, 10 January 2013

Dear Wayne,

IFRS 3 – Mandatory purchase of non-controlling interests in business combinations

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the IFRSIC's tentative decision, published in the November 2012 *IFRIC Update*, to propose to the IASB amending IFRS 3 through Annual Improvements so that the initial acquisition of the controlling stake and the subsequent Mandatory Tender Offer (MTO) be treated as one single acquisition (linked transactions).

While we agree with the IFRSIC's decision, we would like to make the Committee aware of the fact that the term 'controlling stake' may be understood differently depending on whether reference is made to IFRS or to takeover bid law.

Based on IFRS 10 there is a clear definition as to what 'control in an investee' means. However, the term 'control' may be defined differently by takeover bid laws. As an example, according to section 3 of article 5 of the DIRECTIVE 2004/25/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 21 April 2004 on takeover bids the following is stipulated:

> 'The percentage of voting rights which confers control for the purposes of paragraph 1 [of the Directive] and the method of its calculation shall be determined by the rules of the Member State in which the company has its registered office.'

In Germany, for example, the determination has been made as follows in section 2 of paragraph 29 of the German Securities Acquisition and Takeover Act (Wertpapiererwerbs- und Übernahmegesetz, "WpÜG"):

> ‘Control is the holding of at least 30% of the voting rights in a target company.’

To our knowledge, there other countries in the EU where the threshold from which ‘control’ is deemed to exist is lower than the one under IFRS.

In light of the above we recommend that the IFRSIC and / or the IASB remain cognisant of the possibly differing definitions of ‘control’ when making the amendments to the IFRSs.

If you would like further clarification of the issue set out in this letter, please do not hesitate to contact me.

With best regards,

Liesel Knorr
President