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STAFF PAPER

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Project	Financial Instruments with Characteristics of Equity (FICE)
Paper topic	Obligations to redeem own equity instruments

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Purpose of this paper

1. The purpose of this paper is to ask the International Accounting Standards Board (IASB) for tentative decisions on proposed clarifications related to the accounting for obligations to redeem own equity instruments applying IAS 32 *Financial Instruments: Presentation*.

2. At its July 2022 meeting (Agenda Papers 5 and 5A), the IASB discussed some of the long-standing practice questions arising from applying paragraph 23 of IAS 32. This paragraph discusses the accounting for a contract containing an obligation for an entity to purchase its own equity instruments for cash or another financial asset and requires:

   (a) a financial liability to be recognised initially at the present value of the redemption amount, reclassified from equity;[1]

   (b) the financial liability to be subsequently measured in accordance with IFRS 9 *Financial Instruments*; and

[1] Although this paragraph refers to reclassifications between financial liabilities and equity, the word 'reclassified' is used in a broad sense here and is different to the reclassifications between financial liabilities and equity instruments discussed by the IASB in March and June 2022.

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(c) the reclassification of the financial liability to equity if the contract expires without delivery.

3. In July 2022, the IASB also discussed potential next steps to address these practice questions and directed the staff to develop a proposal for the clarified principles. At this meeting, the staff present further analysis taking into account feedback from IASB members and recommend proposed amendments to IAS 32.

4. This paper is structured as follows:

   (a) Staff recommendations;

   (b) Question for the IASB; and

   (c) Staff analysis

Staff recommendations

5. The staff recommend that the IASB proposes the following clarifying amendments to IAS 32:

   (a) paragraph 23 applies also to an obligation to redeem own equity instruments that is settled in a variable number of another type of own equity instruments.

   (b) on initial recognition of the obligation to redeem own equity instruments, the debit entry is recognised against a component of equity other than non-controlling interests (NCI) (in the case of obligations involving NCI) or other than issued share capital (in the case of other obligations to purchase own shares) if the entity does not already have access to the returns associated with an ownership interest.

   (c) on expiry of a written put option on own equity instruments, the financial liability is reclassified to the same component of equity as that from which it was reclassified on initial recognition of the put option.

   (d) on expiry of a written put option on own equity instruments, the cumulative amount in retained earnings related to the put option could be reclassified to another component of equity but amounts previously recognised in profit or loss on remeasuring the financial liability are not reversed.

6. The staff also recommend clarifying that written put options or forward purchase contracts on own equity instruments are presented gross rather than net, to:
   (a) align with the accounting for other obligations that are conditional on events or choices that are beyond the entity's control; and
   (b) assist users of financial statements in assessing the entity's exposure to liquidity risk. Settlement of the obligation reduces net assets by the gross amount of the cash outflow unlike other derivatives that result in the receipt of assets and not own shares.

Question for the IASB

7. The staff would like to ask the following question.

Question for IASB members
Do the IASB members agree with the staff recommendations described in paragraphs 5-6 of this paper?

Staff analysis

8. In Agenda Paper 5A of the July 2022 meeting, the IASB discussed the main questions that have arisen in practice when applying paragraph 23 of IAS 32 to account for obligations to redeem own equity instruments:
   (a) whether the writer of the NCI put option should recognise a financial liability for the present value of the option's exercise price (gross basis) or a derivative liability at fair value (net basis);
   (b) what the initial debit entry is when the present value of the redemption amount is reclassified from equity and the interaction with other IFRS Accounting Standards;
   (c) whether changes in the carrying amount of the financial liability are recognised in profit or loss or in equity;
   (d) whether paragraph 23 of IAS 32 applies to NCI puts that will or may be settled by delivering a variable number of the parent's own equity instruments instead of cash or another financial asset;
   (e) whether NCI puts are accounted for differently from NCI forwards;

(f) where to recognise dividends paid on the subsidiary shares subject to the NCI put;

(g) how to account for the settlement or exercise of an NCI put; and

(h) how to account for the expiration of an unexercised NCI put.

9. The staff think that not all the practice questions raised need to result in clarifications to IAS 32 because either the requirements are sufficiently clear or addressing those issues would be outside the scope of the FICE project. The objective of the FICE project is to address known practice issues by clarifying the underlying principles in IAS 32. Where there is no implicit or explicit principle in IAS 32 for a particular requirement, the IASB could fill this gap by developing a principle and accompanying rationale, but the intention is not to develop new principles that will result in fundamental changes to the requirements.

10. For the avoidance of doubt, any clarifications affecting the application of paragraph 23 of IAS 32 would apply to all obligations to redeem own equity instruments regardless of whether they relate to NCI or other issued shares. Clarifications would also apply to obligations arising from both forward purchase contracts and written put options, as long as they are settled on a gross physical basis (ie consideration is paid in exchange for own equity instruments). [2] If the obligations were net cash settled or net share settled, derivative accounting would apply.

11. The staff do not think any exception is needed for NCI puts or forward purchase contracts compared to other written put options and forward purchase contracts on own equity instruments. In the consolidated financial statements (where NCI is recognised), NCI puts or forwards represent contracts to purchase the group's own equity instruments (equity instruments of a subsidiary are considered to be own equity instruments from the perspective of the consolidated financial statements). NCI puts or forwards therefore have the same characteristics as other written put options or forwards to purchase own equity instruments. Even if NCI puts are used in different circumstances and for different purposes from NCI forwards or other obligations to

[2] Paragraph 23 of IAS 32 cross-refers to paragraphs IE5 and IE30 in the Illustrative Examples to IAS 32 which illustrate gross physical settlement.

purchase own equity instruments, the staff think the accounting treatment should not be differentiated based on the entity's intent or reason for entering into the transaction.

12. The staff set out below our analysis of the four key areas the IASB could clarify to reduce diversity in accounting practice and to provide useful information to users of financial statements:

    (a) What is the rationale for gross presentation?

    (b) What if an NCI put is settled in a variable number of parent shares instead of cash?

    (c) What is the debit entry on initial recognition?

    (d) What is the accounting on expiry of the NCI put?

13. In addition, the staff consider the following:

    (a) Separate financial statements; and

    (b) Disclosures.

What is the rationale for gross presentation?

14. Some stakeholders question the appropriateness of the accounting required by paragraph 23 of IAS 32, particularly whether to account for the obligation arising from gross physically settled written put options and forward purchase contracts on own shares on a:

    (a) gross basis, similar to the recognition of puttable shares (paragraph 18(a) of IAS 32) and financial liabilities for other obligations that are conditional on events or choices that are beyond the entity's control. These instruments are measured at the full amount of the conditional obligation (the rationale is set out in paragraph BC12 of the Basis for Conclusions on IAS 32); or

    (b) a net basis, similar to other derivatives. It would not be consistent with the accounting for other options to recognise financial liabilities as if the options were already exercised.

15. As discussed in July 2022, not much feedback was received on this topic from respondents to the 2018 DP and reconsidering gross vs net presentation would also be outside the scope of the current FICE project. However, some respondents asked for

further explanation of the rationale for treating these written put options and forward purchase contracts on own shares differently from other derivatives.

16. The staff therefore think it would be helpful to clarify the underlying rationale for gross presentation. In our view, the reasons why (potential) obligations to purchase own equity are presented gross, are that it:

    (a) helps users of financial statements assess the entity's exposure to liquidity risk and possible future cash outflows. The transfer of cash on settlement would reduce the entity's net assets for the entire amount of the cash outflow unlike other derivatives that involve the receipt of assets.

    (b) reflects that the entity has no discretion to avoid settlement for the entire redemption amount. Settlement is entirely outside the entity's control.

    (c) reduces structuring opportunities. For example, an entity may issue shares for cash and simultaneously issue a physically settled forward purchase contract for the same shares. The end result is expected to be very similar to the issuance of debt using own shares as collateral.

17. The staff further think it would be useful to clarify that written put options and forward purchase contracts on own shares are different to other derivatives because one leg of the exchange involves the receipt of own shares which is not an asset of the entity. Therefore, gross presentation is not inconsistent with the IFRS accounting requirement which prohibits the separation of the legs of a derivative into an asset (for the inflows) and a liability (for the outflows).

18. Some stakeholders have previously expressed concerns about whether gross presentation provides useful information for an NCI put exercisable at, or close to, fair value. They argue that significant profit or loss volatility is recognised when the fair value of the NCI put itself is expected to be close to zero throughout the life of the instrument, and the put transfers limited risk to the parent until exercised. They therefore argue that measuring the NCI put on a net basis at fair value would give more meaningful information.

19. The staff note that regardless of whether the exercise price is for a fixed amount or equal to the fair value of the shares, the entity has committed to reduce its nets asset by the amount of that exercise price because it is receiving own shares and not assets in exchange.

20. In addition, the staff do not think that gross presentation would necessarily result in significant or more profit or loss volatility than net presentation because the liability may remain measured at the maximum (capped) amount (see paragraph 47 of this paper) or changes in the carrying amount of the financial liability may not be that significant.

21. On the other hand, presentation on a net basis would result in the following:

    (a) if the exercise price or forward price is fixed, the fair value of the put option or forward contract will fluctuate to reflect the difference between the fair value of the shares and the fixed price.

    (b) if the exercise price or forward price is equal to the fair value of the own shares redeemed, the instrument does not meet the definition of a derivative because its value does not depend on an underlying variable. The value of the NCI put is zero and it will not change as the value of the underlying equity changes.

22. If the financial liability is measured on a net basis, users of financial statements would not be provided with information about the potential cash outflows on the instrument through measurement and would need to rely on disclosures.

What if an NCI put is settled in a variable number of parent shares instead of cash?

23. The requirements in paragraph 23 of IAS 32 refer only to obligations to purchase own equity instruments for cash or another financial asset and are silent regarding settlement in own shares. The staff are of the view that the requirements in IAS 32 with regards to settlement in a variable number of shares are clear because the definition of a financial liability in paragraph 11 of IAS 32 includes settlement of a contract by delivering a variable number of own shares. Paragraph 21 of IAS 32 states that when an entity uses a variable number of own equity instruments to settle a contract, such a contract is a financial liability. Other paragraphs in IAS 32 such as paragraph 25 and paragraph AG29 also refer to settling a financial liability in other ways that do not involve cash or another financial asset.

24. In the case of NCI puts and forward purchase contracts, a variable number of parent shares transferred on settlement would therefore be seen as currency used to settle the

group's obligation to purchase the subsidiary's shares. Similarly, for other written put options and forward purchase contracts on own shares, an entity may use a variable number of one class of own shares as currency to settle its obligation to purchase another class of own shares.

25. However, if needed to ensure consistent application of the requirements, the staff think IAS 32 could be clarified so that paragraph 23 applies also to an obligation to redeem own equity instruments that is settled in a variable number of another type of own equity instruments.

26. The question arose whether extending the scope of paragraph 23 to include settlement in a variable number of parent shares would be consistent with IFRS 2 *Share-based Payment.* The staff note that there are known differences in the classification principles between IFRS 2 and IAS 32. For example, applying IAS 32, a contract that will or may be settled in a variable number of the entity's own equity instruments is classified as a financial liability. However, a share-based payment transaction in which the entity receives goods or services as consideration for its own equity instruments is classified as equity-settled even if it will be settled in a variable number of own equity instruments.

27. The scenario when a parent uses its own shares to settle NCI puts on its subsidiary's shares is outside the scope of IFRS 2. The staff have thus focused on the application of the requirements in IAS 32 in line with the scope of the FICE project and not those in IFRS 2.

What is the debit entry on initial recognition?

28. On initial recognition of a contract that contains an obligation for the entity to purchase its own equity instruments, paragraph 23 of IAS 32 requires the financial liability to be reclassified from equity but does not specify which component of equity. For example, in the case of NCI puts, there is diversity in views whether the NCI or the entity's own equity should be debited in the consolidated financial statements.

29. The staff are of the view that clarifying the debit entry on initial recognition will help resolve other practice issues for example, it will directly impact the accounting for dividends subsequently paid to NCI shareholders and the accounting on settlement or expiry of the NCI puts and forward purchase contracts.

30. Many respondents to the 2018 DP suggested the IASB consider any potential interaction with IFRS 10 *Consolidated Financial Statements* in the analysis of NCI puts, in particular whether the transaction with NCI is a transaction among shareholders.

31. Paragraph B47 of IFRS 10 explains that when assessing control, an investor considers its potential voting rights to determine whether it has power. Potential voting rights are rights to obtain voting rights of an investee, such as those arising from convertible instruments or options, including forward contracts. However, the consolidated financial statements are generally prepared on the basis of existing ownership interests (including the attribution of profits to the NCI shareholders).

32. Paragraphs B89 of IFRS 10 states:

> When potential voting rights, or other derivatives containing potential voting rights, exist, the proportion of profit or loss and changes in equity allocated to the parent and non-controlling interests in preparing consolidated financial statements is determined solely on the basis of existing ownership interests and does not reflect the possible exercise or conversion of potential voting rights and other derivatives, unless paragraph B90 applies.

33. Paragraph B90 of IFRS 10 states:

> In some circumstances an entity has, in substance, an existing ownership interest as a result of a transaction that currently gives the entity access to the returns associated with an ownership interest. In such circumstances, the proportion allocated to the parent and non-controlling interests in preparing consolidated financial statements is determined by taking into account the eventual exercise of those potential voting rights and other derivatives that currently give the entity access to the returns.

34. The staff think it would be helpful to amend IAS 32 to clarify that on initial recognition of the NCI put liability, the debit entry is recognised against own equity. This is because generally the NCI shareholders retain their rights (to dividends, profit share and voting) until the put option is exercised. The same is true for NCI forwards until the forward purchase contract is settled. For example, to be eligible for dividends, an investor must own the shares by the 'record date' which is the cut-off date

established by a company to determine which shareholders are eligible to receive a dividend. For these reasons it would not be consistent with IFRS 10 if the NCI was derecognised on initial recognition of the NCI put or forward.

35. The staff therefore think that unless the parent already has access to the returns associated with the shares subject to the NCI put or forward, the possible exercise of the NCI put or future settlement of the NCI forward is not taken into account in preparing consolidated financial statements from an IFRS 10 perspective.

36. In addition, there is no actual change in the parent's ownership interest or the proportion of the equity held by NCI shareholders before the NCI put is exercised or before the NCI forward purchase contract is settled. Therefore, the staff think the issuance and expiry of NCI puts should not be accounted for as changes in the proportion of equity held by NCI as that would not faithfully depict the current ownership interest of the NCI during the period the option remains outstanding.

37. The staff continue to be of the view that paragraph 23 and B96 of IFRS 10 do not apply before the exercise or settlement date. Applying:

    (a) paragraph 23 of IFRS 10, 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).

    (b) paragraph B96 of IFRS 10, when the proportion of the equity held by NCI changes, an entity adjusts the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity recognises directly in equity any difference between the amount by which the NCI are adjusted and the fair value of the consideration paid or received, and attributes it to the owners of the parent.

38. Similarly, for other obligations to redeem own shares, IAS 32 could be clarified to require another component of equity to be debited and not the issued share capital.

39. The staff think this clarification will help eliminate diversity in practice, resolve questions about the impact of derecognising NCI before the put is exercised when applying the requirements in IFRS 3 *Business Combinations*, IFRS 10 and IAS 33 *Earnings per Share* and address the concerns raised by respondents to the 2018 DP.

40. In the past, the proposal to debit own equity led to concerns about double counting because:

    (a) the consolidated statement of financial position would reflect two credit balances (the financial liability and the NCI)— albeit for different amounts— in relation to shares subject to the put, both of which leads to a reduction in own equity.

    (b) the consolidated profit or loss would be affected by both:

        (i) changes in the carrying amount of the grossed-up financial liability; and

        (ii) the portion of the subsidiary's profit or loss for the period that is attributed to the NCI.

41. In the case of written NCI puts and forward purchase contracts, the staff do not think debiting own equity results in double counting in the statement of financial position; rather it reflects the reduction in own equity by giving the NCI shareholders an additional right ie the right to put back the shares held in the subsidiary to the group. The debit to own equity reflects that the group has committed to give value away and incurred an obligation to parties outside the group (the NCI shareholders), and this provides useful information to users of financial statements.

42. The staff also do not think there is double counting in profit or loss. Changes in the carrying amount of the grossed-up financial liability are recognised in profit or loss applying IFRS 9 and this reflects the remeasurement of the additional right given by the group to NCI shareholders. This reduces group profit or loss as would any other expense incurred by the group towards an external party. The calculation of the profit for the period attributed to the non-controlling interests is based on the profit or loss of the subsidiary itself at the reporting date. The profit or loss of the subsidiary has not been reduced by the changes in the financial liability relating to the NCI put or forward purchase contract issued by the parent.

Initial measurement

43. When measuring the financial liability on a gross basis on initial recognition, some stakeholders question whether the notional amount or an estimated amount could be used when there is uncertainty in the redemption amount. For example, if the written

put option on own shares is exercisable at the fair value of the shares subject to a cap on the share price and it is not certain whether the option will be exercised.

44. Paragraph 23 requires the financial liability to be measured at the present value of the redemption amount. If the shares are puttable at any time, the full redemption amount of the obligation would be recognised, ie the financial liability is not discounted. This would be consistent with measuring the fair value of a financial liability with a demand feature at not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid (paragraph 47 of IFRS 13 *Fair Value Measurement*).

45. For obligations to redeem own shares, the probability of exercising the put option is not considered in its initial measurement. Paragraph BC12 of the Basis for Conclusions on IAS 32 states that:

> Some respondents to the Exposure Draft suggested that when an entity writes an option that, if exercised, will result in the entity paying cash in return for receiving its own shares, it is incorrect to treat the full amount of the exercise price as a financial liability because the obligation is conditional upon the option being exercised. The Board rejected this argument because the entity has an obligation to pay the full redemption amount and cannot avoid settlement in cash or another financial asset for the full redemption amount unless the counterparty decides not to exercise its redemption right or specified future events or circumstances beyond the control of the entity occur or do not occur. The Board also noted that a change would require a reconsideration of other provisions in IAS 32 that require liability treatment for obligations that are conditional on events or choices that are beyond the entity's control.
> […]

46. Similarly, in December 2021, when discussing the accounting for instruments with contingent settlement provisions, the IASB tentatively decided to clarify that the liability component of a compound financial instrument with contingent settlement provisions, which could require immediate settlement if a contingent event occurs, is measured at the full amount of the conditional obligation. The probability of the contingent event occurring is not considered in measuring the instrument on initial recognition.

47. On initial measurement of the written put option on own shares:

    (a) if the exercise price is fixed upfront and the put option can be exercised immediately, the financial liability would be initially measured at the full amount of the fixed exercise price. If the put option can be exercised at a specific date in the future, the financial liability would be initially measured at the present value of the fixed exercise price based on the earliest date the option could be exercised.

    (b) if the exercise price is the fair value of the shares, the financial liability would be initially measured at the fair value of the shares at that date. If there is a cap on the redemption amount (which is usually the case), the financial liability would be initially measured at that capped amount as it represents the maximum or full amount the entity could be required to pay to purchase the shares. This would apply regardless of whether the put option can be exercised immediately or at a specific date in the future.

48. The staff acknowledge that the debit entry for the present value of the redemption amount may be significantly more than the price the shares were issued at. It is possible that this could result in overall negative equity for accounting purposes. However, the staff are of the view that such an impact would faithfully represent the economic substance of the obligation the entity has, ie the entity has committed to pay an amount for the NCI or other own shares that exceeds its equity.

Impact on subsequent measurement

49. When accounting for subsequent remeasurements of the NCI put liability, some stakeholders considered there to be a perceived conflict between the requirements in IAS 32 (which refers to IFRS 9 for subsequent measurement of the financial liability) and the requirements in IFRS 10 (which refers to equity transactions with owners in their capacity as owners).

50. If IAS 32 is clarified that the debit entry on initial recognition is recorded against own equity, it will be clearer that recognising the financial liability for the put option does not change the respective ownership interests of the parent and the NCI shareholder at initial recognition or subsequently until the put option is exercised. Further, the remeasurement of that financial liability is not a transaction with owners in their capacity as owners (see paragraphs 54-58 of this paper). Therefore, the subsequent

measurement requirements in paragraph 23 of IAS 32 to apply IFRS 9 to measure the financial liability need not be changed.

51. Recognising the changes in the carrying amount of the financial liability in profit or loss also achieves internal consistency within IAS 32. Paragraph BC11 of the Basis for Conclusions on IAS 32 explains that without a requirement to recognise a financial liability for the present value of the share redemption amount, entities with identical obligations to deliver cash in exchange for their own equity instruments could report different information in their financial statements depending on whether the redemption clause is embedded in the instrument or is a free-standing derivative contract. Paragraph 18(b) of IAS 32 explains that a financial instrument that gives the holder the right to put it back to the issuer for cash or another financial asset (a 'puttable instrument') is a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 16A-16D of IAS 32. For these instruments, the changes in the carrying amount of the financial liability are recognised in profit or loss. Paragraph 41 of IAS 32 states:

> Gains and losses related to changes in the carrying amount of a financial liability are recognised as income or expense in profit or loss even when they relate to an instrument that includes a right to the residual interest in the assets of the entity in exchange for cash or another financial asset (see paragraph 18(b)). Under IAS 1 the entity presents any gain or loss arising from remeasurement of such an instrument separately in the statement of comprehensive income when it is relevant in explaining the entity's performance.

52. The staff acknowledge that the concern about counter-intuitive accounting may remain for some instruments puttable at fair value for example, if the liability recognised for such an NCI put increases, a loss will be recognised when the subsidiary performs well (and vice versa). However, recognising those changes in other comprehensive income (OCI) would represent a fundamental change to the requirements in IAS 32 which is outside the scope of the FICE project.

53. In addition, such income and expenses are different from the gains and losses arising from changes in own credit risk of financial liabilities designated as measured at fair value through profit or loss which IFRS 9 requires to be presented in OCI. The 2018 DP explained that difference as follows: "if the entity repays the contractual amount,

the cumulative effect over the life of the financial instrument of any changes in the liability's credit risk will net to zero because its fair value will ultimately equal the contractual amount. In contrast, changes in the fair value of financial instruments that do not contain an obligation for an amount independent of the entity's available economic resources will not be reversed over the instrument's life."

54. Some stakeholders still consider there to be a transaction with owners in their capacity as owners for other reasons. For example, they believe that NCI shareholders are owners at the consolidated level therefore all transactions that affect that NCI balance are transactions with owners and should not affect profit or loss.

55. Paragraph 106(d)(iii) of IAS 1 *Presentation of Financial Statements* describes transactions with owners in their capacity as owners as being contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control. Paragraph 109 of IAS 1 specifically mentions reacquisitions of the entity's own equity instruments as a transaction with owners in their capacity as owners. Therefore, only once the put option is exercised and the entity's own equity instruments are reacquired will this be a transaction with owners in their capacity as owners. The writing of the put option itself is not a transaction with owners in their capacity as owners because there has not been an actual transfer of shares between the parent/group and the NCI shareholders.

56. Further, in other IFRS Accounting Standards, the examples given of transactions with owners in their capacity as owners that involve a right to buy shares, explain that the right is granted to all existing holders of a particular class of equity instruments:

    (a) with regards to foreign currency denominated rights issuances as described in paragraph 16(b)(ii) of IAS 32, a pro rata issue of rights to all existing shareholders to acquire additional shares is a transaction with an entity's owners in their capacity as owners (paragraph BC4I of the Basis for Conclusions on IAS 32).

    (b) paragraph 4 of IFRS 2 explains that a transaction with an employee (or other party) in his/her capacity as a holder of equity instruments of the entity is not a share-based payment transaction. For example, if an entity grants all holders of a particular class of its equity instruments the right to acquire additional equity instruments of the entity at a price that is less than the fair value of

those equity instruments, and an employee receives such a right because he/she is a holder of equity instruments of that particular class.

57. However, in the case of the NCI puts, the rights to put shares are granted only to a subset of existing holders of a particular class of equity instruments ie holders of ordinary shares other than the parent.

58. At its February 2022 meeting, the IASB also discussed the capacity a shareholder is acting in when it discussed potential factors that could be considered in determining whether a decision of shareholders is treated as a decision of the entity for classification purposes. Similarly, not all transactions between shareholders are in their capacity as owners of the entity. Shareholders may be acting in their capacity as individual investors of particular instruments in the case of NCI puts where the individual shareholder can decide whether or not to exercise the option to sell their shares back to the group. The staff acknowledge that making this distinction requires judgement.

59. Some stakeholders argue that the requirement to recognise a gross liability for the NCI put portrays the transaction as if the controlling shareholder has purchased the shares held by the NCI shareholder—ie as if the put has been exercised, which is an equity transaction. They argue that any remeasurements of the NCI put are simply re-estimations of that equity transaction and therefore should be recognised in equity. In their view, the treatment is consistent with the requirements in IFRIC 17 *Distributions of Non-cash Assets to Owners*, which requires an entity to adjust the carrying amount of the dividend payable and recognise any changes directly in equity as adjustments to the amount of the distribution

60. However, the staff disagree with this argument because recognising a financial liability for the gross amount does not portray the put as exercised but merely depicts the potential outflow of cash to settle the obligation, similar to other instruments puttable at the option of the holder. Further, IFRIC 17 applies when an entity is required to recognise a financial liability because of an obligation to make a distribution of equity, although the amount to be distributed in relation to the obligation is uncertain. In contrast, the NCI put financial liability recognises a potential obligation to acquire an additional interest in the subsidiary, which obligation may not require settlement if the NCI put expires unexercised.

Impact on subsequent distributions

61. If IAS 32 is clarified to require own equity to be debited on initial recognition of the NCI put or forward purchase contract, the payment of subsequent distributions to NCI shareholders would be recognised in equity consistent with paragraph 109 of IAS 1. Similarly, for other obligations to redeem own equity instruments, if IAS 32 is clarified to require another component of equity to be debited (not the issued share capital), the payment of subsequent distributions to shareholders would be recognised in equity.

Impact on settlement of the obligation

62. When the NCI put is exercised or the NCI forward purchase contract is settled, the NCI would have to be derecognised. For example, exercise of the NCI put/settlement of the NCI forward leads to the parent acquiring the subsidiary's shares held by the NCI shareholders and increasing its ownership interest in the subsidiary. This change in the parent's ownership interest in the subsidiary would be accounted for as an equity transaction in accordance with paragraph 23 of IFRS 10.

63. Similarly, for other written put options and forward purchase contracts on own shares, the issued share capital would have to be reduced. Paragraph 33 of IAS 32 explains that if an entity reacquires its own equity instruments, those instruments ('treasury shares') shall be deducted from equity.

64. On exercise or settlement date, the financial liability is derecognised applying IFRS 9. If the carrying amount of the financial liability equals the amount of the cash paid when the written put option is exercised or the forward purchase contract is settled, no profit or loss on settlement would be recognised.

Specifying which component of equity

65. When discussing the accounting within equity in the July 2022 IASB meeting, IASB members acknowledged that this is often driven by legal requirements in local jurisdictions and asked whether a specific component of equity should be specified or whether it would be sufficient to distinguish between:

    (a) own equity and NCI in the case of NCI puts and forward purchase contracts; and

(b) other equity and issued share capital in the case of other written put options and forward purchase contracts on own shares.

66. The staff think that not specifying the component of equity would be consistent with the existing approach in IFRS Accounting Standards. The staff researched the wording related to both recognition in equity and reclassifications within equity in IAS 32 and other IFRS Accounting Standards and found that generally, IFRS Accounting Standards do not specify the exact component within equity.

67. Examples of requirements for recognition in equity that do not specify which component of equity include:

    (a) a gain or loss on a financial asset measured at fair value through other comprehensive income in accordance with paragraph 4.1.2A…shall be recognised in other comprehensive income…When the financial asset is derecognised the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss. […] (paragraph 5.7.10 of IFRS 9)

    (b) an entity shall recognise […] remeasurements of the net defined benefit liability (asset)…in other comprehensive income. (paragraph 120 of IAS 19 *Employee Benefits*)

    (c) […] the cumulative amount of the exchange differences is presented in a separate component of equity until disposal of the foreign operation. […] (paragraph 41 of IAS 21 *The Effects of Changes in Foreign Exchange Rates*).

    (d) if an entity reacquires its own equity instruments, those instruments ('treasury shares') shall be deducted from equity. […] (paragraph 33 of IAS 32)

68. Examples of requirements for reclassifications within equity that do not specify which component of equity include:

    (a) on conversion of a convertible instrument at maturity, the entity derecognises the liability component and recognises it as equity. The original equity component remains as equity (although it may be transferred from one line item within equity to another). […] (paragraph AG32 of IAS 32)

    (b) paragraph 5.7.5 permits an entity to make an irrevocable election to present in other comprehensive income changes in the fair value of an investment in an

equity instrument that is not held for trading. […] Amounts presented in other comprehensive income shall not be subsequently transferred to profit or loss. However, the entity may transfer the cumulative gain or loss within equity. […] (paragraph B5.7.1 of IFRS 9). Paragraph BC5.26 of the Basis for Conclusions on IFRS 9 explains further that in the light of jurisdiction-specific restrictions on components of equity, the IASB decided not to provide specific requirements related to that transfer.

(c) remeasurements of the net defined benefit liability (asset) recognised in other comprehensive income shall not be reclassified to profit or loss in a subsequent period. However, the entity may transfer those amounts […] within equity (paragraph 122 of IAS 19). Paragraph BC100 of the Basis for Conclusions on IAS 19 explains that the 2010 ED proposed to carry forward the requirement that an entity should transfer amounts recognised in other comprehensive income directly to retained earnings. However, IFRSs do not define the phrase 'retained earnings' and the Board has not discussed what it should mean. Moreover, there exist jurisdiction-specific restrictions on components of equity. The amendments made in 2011 permit an entity to transfer the cumulative remeasurements within equity, and do not impose specific requirements on that transfer.

69. Similarly, in the light of jurisdiction-specific restrictions on components of equity, the staff think the IASB should not specify which component of equity should be affected when accounting for written put options or forward purchase contracts on own equity instruments but it should specify that the initial recognition entry is not recognised against NCI[3] (in the case of obligations involving NCI) or issued share capital (in the case of other obligations to purchase own shares).

70. In addition, the entity would be required to consider the following requirements in IAS 1:

[3] Except if the parent already has access to the returns associated with the shares subject to the NCI put or NCI forward, in which case the debit entry is recognised against NCI.

(a) disclose a description of the nature and purpose of each reserve within equity, either in the statement of financial position or the statement of changes in equity, or in the notes (paragraph 79(b) of IAS 1).

(b) present in the statement of changes in equity, a reconciliation between the carrying amount at the beginning and the end of the period for each component of equity (paragraph 106 of IAS 1).

(c) present additional line items, headings and subtotals in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position (paragraph 55 of IAS 1).

What is the accounting on expiry of the NCI put?

71. Paragraph 23 of IAS 32 requires that if the contract to purchase own equity instruments expires without delivery, the carrying amount of the financial liability is reclassified to equity. However, similar to the reclassification on initial recognition, it also does not specify which component of equity the reclassification on expiry of the put option should be allocated to.

72. When an NCI put expires without being exercised, IAS 32 could be clarified to require the financial liability relating to the NCI put to be reclassified to the same component of own equity as that from which it was reclassified on initial recognition of the NCI put. This would be consistent with the accounting on initial recognition of the NCI put.

73. If IAS 32 is clarified to require own equity to be debited on initial recognition of the NCI put, there is no need to clarify the measurement of NCI upon expiry of the NCI put. The NCI component of equity would remain unchanged because NCI continued to be recognised and measured during the life of the NCI put as a separate component of equity.

74. Similar issues arise for other written put options on an entity's own shares. If the put option expires, the financial liability would be reclassified to the same component of equity as that from which it was reclassified on initial recognition of the put. The issued share capital balance would remain unchanged because it continued to be recognised during the life of the put as a separate component of equity.

75. Consistent with the accounting upon expiry of any unexercised derivative, the gains or losses previously recognised in profit or loss, are not reversed. This is because the accounting correctly reflected the measurement of the financial liability in the period before expiry of the put option. The expiry of the put does not change the fact that the original transaction occurred, ie the entity gave the shareholders an additional right—the right to put back their shares.

76. In the case of NCI puts, the parent committed to give value away and incurred an obligation to parties outside the group which was remeasured over the life of the NCI put. The staff therefore think that no reversal should be recognised in profit or loss when the option expires. Furthermore, reversing previously recognised amounts in profit or loss on expiry could lead to structuring opportunities. Similar to other situations, an explanation could be added that the cumulative amount in retained earnings related to the remeasurement of the put liability could be reclassified to another component of equity when the put option expires unexercised.

Separate financial statements

77. In Agenda Paper 5A of the July 2022 meeting, the staff noted that applying IFRS Accounting Standards in the parent's separate financial statements, an NCI put or forward purchase contract issued by the parent is accounted for on a net basis as a derivative because it is not a contract written on the parent's own equity instruments. The staff considered whether the conclusion would be different if a parent accounts for its investment in a subsidiary applying the equity method in its separate financial statements as permitted by paragraph 10 of IAS 27 *Separate Financial Statements*.

78. Paragraph 26 of IAS 28 *Investments in Associates and Joint Ventures* notes that many of the equity method procedures are similar to the consolidation procedures. However, paragraph BC10G of the Basis for Conclusions on IAS 27 explains that there could be situations in which applying the equity method to investments in subsidiaries would give a different result compared to the consolidated financial statements.

79. The staff note the following in applying the equity method in the parent's separate financial statements:

(a) the investment in the subsidiary is initially recognised at cost and the carrying amount is increased or decreased by the parent's share of profit or loss of the subsidiary after the acquisition date.

(b) the subsidiary's assets, liabilities and issued share capital are not included.

(c) the subsidiary's issued share capital and the investment in the subsidiary are not eliminated (as they would be in the consolidated financial statements) and no NCI is recognised.

80. Therefore, as NCI is a concept that only arises in consolidated financial statements because the subsidiary's issued share capital is included and then eliminated against the investment in the subsidiary, the application of IAS 32 to the parent's separate financial statements does not change if the investment in the subsidiary is equity accounted for. If a parent issues a written put option to NCI on the subsidiary's shares, it is not a written put option on own shares in the parent's separate financial statements ie paragraph 23 of IAS 32 does not apply even if the subsidiary is equity accounted.

81. For other written put options and forward purchase contracts on an entity's own equity instruments, the requirements in paragraph 23 of IAS 32 would apply and require the obligation to redeem own equity instruments to be recognised on a gross basis in the separate financial statements.

Disclosures

82. The staff acknowledge that users of financial statements need transparency so that they can understand the accounting treatment for obligations to redeem own equity instruments. IFRS 7 *Financial Instruments: Disclosures* contains requirements for disclosing the carrying amounts of each category of financial liability and the entity's exposure to and management of liquidity risk.

83. In addition, paragraph 79(a)(v) of IAS 1 requires an entity to disclose, either in the statement of financial position or the statement of changes in equity or in the notes, for each class of share capital, the rights, preferences and restrictions attaching to that class including restrictions on the repayment of capital.

84. The staff will consider whether any additional disclosures are required for obligations to redeem own equity instruments in a future meeting when we consider more

comprehensively whether any further disclosures are required as a result of the potential clarifications made to IAS 32 in the FICE project.