Project	**IAS 32 *Financial Instruments: Presentation***
Topic	**Put options written over non-controlling interests**

Purpose of this paper

1. This paper provides an update on discussions held by the IFRS Interpretations Committee (the Interpretations Committee) about a request that they received for guidance on the accounting for changes in the carrying amount of a financial liability for a put option, written over shares held by a non-controlling interest shareholder ('NCI put'), in the consolidated financial statements of a parent entity.

2. These discussions, which began in the May 2010 Interpretations Committee meeting, resulted in the following being included as a tentative agenda decision in the September 2010 IFRIC Update:

> The Committee received a request for guidance on how an entity should account for changes in the carrying amount of a financial liability for a put option, written over shares held by a non-controlling interest shareholder ('NCI put'), in the consolidated financial statements of a parent entity. The request focuses on the accounting for a NCI put after the 2008 amendments were made to IFRS 3 *Business Combinations*, IAS 27 *Consolidated and Separate Financial Statements* and IAS 39 *Financial Instruments: Recognition and Measurement*.
>
> The Committee observed that paragraph 23 of IAS 32 requires the financial liability recognised for a NCI put to be subsequently measured in accordance with IAS 39. The Committee also observed that paragraphs 55 and 56 of IAS 39 require changes in the carrying amount of financial liabilities to be recognised in profit or loss. However, the Committee noted that additional accounting concerns exist relating to the accounting for NCI puts.

> *Therefore, the Committee [decided] not to add this issue to its agenda but to recommend that the Board address these additional accounting concerns as part of the Financial Instruments with Characteristics of Equity (FICE) project.* The Committee observed that it would expect entities to apply the guidance in IAS 1 *Presentation of Financial Statements* in determining whether additional information relating to the accounting for NCI puts should be disclosed in the financial statements, including a description of the accounting policy used. (emphasis added)

3. At the September IASB Board meeting, the staff prepared an agenda paper[1] that:
   (a) provided background information on the request received by the Interpretations Committee;
   (b) summarised the main issues and concerns raised by the Interpretations Committee during their deliberations; and
   (c) notified the Board of the recommendations made by the Interpretations Committee in their tentative agenda decision, specifically the recommendation emphasised above.
4. The purpose of this agenda paper is to:
   (a) summarise the comment letters received by the Interpretations Committee relating to this tentative agenda decision;
   (b) provide an overview of the discussions held by the Interpretations Committee in reviewing the comment letters and considering the status of the Financial Instruments with Characteristics of Equity (FICE) project, in their November 2010 meeting; and
   (c) explain the Interpretations Committee's views on the next steps for addressing the issue and the opinions that they request from the Board before proceeding with these next steps.

[1] Agenda Paper 18 - September 2010 IASB Board Meeting

Comment letters received on the tentative agenda decision

5. The Interpretations Committee received 14 comment letters relating to the tentative agenda decision. The staff observe that this is significantly more comment letters than are usually received on tentative agenda decisions, highlighting the importance of the issue to interested parties.

6. The staff believe that two key themes emerge in many of the comments letters received. These relate to the existence of a perceived conflict in the standards relating to the issue and concern over to how the tentative agenda decision might be enforced if it were finalised.

Conflicting standards

7. Many of the comment letters suggested that the tentative agenda decision should be reworded to make it explicit that a conflict arises between the financial instruments guidance in IAS 32 *Financial Instruments: Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement* and the guidance in IAS 27 *Consolidated and Separate Financial Statements*.

8. These comment letters supported their arguments by:

   (a) expressing concerns as to whether appropriate due process is being followed by issuing a tentative agenda decision that could be read as an interpretation that the financial instruments guidance, not IAS 27, should be applied despite a perceived conflict in the standards. They note that this perceived conflict is evidenced by the existence of significant diversity in practice; and

   (b) noting that, despite the perceived conflict between the standards, the tentative agenda decision does not provide any rationale for the reference to changes in the financial liability being recognised in profit or loss in accordance with IAS 39.

Enforceability

9. Comment letters were also received from regulators expressing a concern relating to how the tentative agenda decision could be enforced if it were finalised.

10. The comment letters received from these regulators identified that significant diversity in practice exists relating to the accounting for NCI puts and that either the Interpretations Committee or the IASB should address the issue as a matter of priority by providing authoritative guidance.

Overview of the Interpretations Committee discussion in November 2010

11. The Interpretations Committee discussed the comments received on the tentative agenda decision in the November 2010 Interpretations Committee meeting.

12. In addition, the Interpretations Committee discussed the implications of the Board having acknowledged in October 2010, after publication of the tentative agenda decision, that it does not have the capacity currently to devote the time necessary to deliberate issues relating to the FICE project. The Board stated that they will return to this project when they have the requisite capacity. This is expected to be after June 2011.

13. As a result, the Interpretations Committee decided to add this issue to its agenda, with the objective of addressing on a timely basis the current significant diversity that exists in practice.

14. The Interpretations Committee believe that this is responsive to the comment letters received, specifically given the Board's recent decision to revise the timetable for the FICE project.

15. However, the Interpretations Committee expressed a desire to address this issue in a way that is consistent with the Board's views and requested that the staff should seek guidance from the Board before undertaking further analysis.

Proposals for the next steps

16. The Interpretations Committee discussed the implications of adding this issue to the agenda, specifically given the revised FICE project timetable. This included identifying a range of different paths forward that they could take to address the issue.

17. They observed that one path forward could be to issue a narrow interpretation.

18. This draft interpretation could focus on the guidance in IAS 32 that requires a financial liability to be recognised for an NCI put and the requirement that financial liabilities should be subsequently measured in accordance with IAS 39. Such an interpretation could require changes in the carrying amount of a financial liability recognised for an NCI put to be recognised in profit or loss in accordance with paragraphs 55 and 56 of IAS 39.

19. However, many of the Interpretations Committee members expressed concern as to whether such an interpretation would be an appropriate improvement to financial reporting. These concerns included whether useful information is provided if, when accounting for a put that is exercisable at, or close to, fair value, significant profit and loss volatility is recognised when the fair value of the put derivative instrument 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.

20. Instead, many members expressed a preference for the staff to analyse alternative approaches to providing guidance to address the accounting for NCI puts. These alternative approaches include:

    (a) requiring the NCI put to be recognised as a derivative liability that would be measured on a ‘net basis’, rather than ‘gross basis’.

        This measurement approach would be consistent with the current proposals in the FICE project, but inconsistent with the guidance in IAS 32; or

    (b) focusing on the presentation requirements in IAS 27.

This would require changes in the measurement of an NCI put to be considered a transaction with owners in their capacity as owners and accounted for as equity transactions in accordance with IAS 27.30.

21. However, the Interpretations Committee acknowledged that these alternative approaches, which they believe may provide the most useful financial information, may require the Board to make amendments to IFRSs (eg creating exceptions for the accounting for NCI puts from the current guidance in IAS 32 and/or IAS 39).

Request for views of the Board on the next steps

22. In determining the next steps in the project, the Interpretations Committee expressed a preference for requesting that the staff should:

    (a) work with the FICE project team to identify approaches to providing guidance on the accounting for NCI puts that would provide the most useful financial information;

    (b) not be confined in their analysis to a narrow interpretation of current IFRSs;

    (c) analyse alternatives that would include the two approaches identified in paragraph 20 in this agenda paper; and

    (d) identify the nature of any amendments to other IFRSs that may be required as part of the proposed guidance.

23. In doing so, the Interpretations Committee noted that the guidance that they develop in addressing this issue may require further decisions to be taken by the Board before it would be published. These decisions could, for example, form part of the FICE project or take the form of approving amendments to IFRSs.

24. However, the Interpretations Committee believe that this is the most appropriate path forward, subject to the views of the Board., because of the:

    (a) current Board agenda;

(b) significance of this issue in current practice; and

(c) objective of providing guidance that provides the most useful financial information.

25. In suggesting this path forward, the Interpretations Committee expressed a willingness to undertake further work on the issue which may at a later date be incorporated into a Board project.

Question for the Board
What are the Board's views on the Interpretations Committee's proposals on the next steps?