STAFF PAPER

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IASB® meeting

Project	Financial Instruments with Characteristics of Equity (FICE)	
Paper topic	Obligations to redeem own equity instruments: practice questions	
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Purpose of this paper

1. In this paper the staff analyse some of the practice questions arising from accounting for obligations to redeem own equity instruments applying paragraph 23 of IAS 32. This paragraph requires a contract that contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset to be recognised as a financial liability. The financial liability is recognised initially at the present value of the redemption amount and is reclassified from equity.

2. At this meeting, the staff seek the IASB's views on the direction of the staff's future work, including initial views on whether IASB members think some or all of the practice issues are within or beyond the scope of the current FICE project. Based on the IASB's feedback provided at this meeting, the staff will develop a proposal for the clarified principles and bring back a further analysis at a future IASB meeting.

3. This paper is structured as follows:

a) Question for the IASB (paragraph 4)

b) Staff analysis of the main practice questions (paragraphs 5-86) including:

(i) what is the issue?

(ii) what do stakeholders think?

(iii) what are potential next steps?

Question for the IASB

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

Question for the IASB
Do IASB members have any comments or questions?

Staff analysis of the main practice questions

5. Based on the background information presented in Agenda Paper 5 of this meeting, the staff summarise below the questions that have arisen in practice when accounting for obligations to redeem own equity instruments applying paragraph 23 of IAS 32:

a) what is the debit entry to equity when the present value of the redemption amount is reclassified from equity and the interaction with other IFRS Accounting Standards;

b) whether changes in the carrying amount of the financial liability are recognised in profit or loss or in equity;

c) does the requirement in paragraph 23 of IAS 32 apply to NCI puts/ that will or may be settled by the delivery of a variable number of the parent's own equity instruments instead of cash or another financial asset;

d) other practice issues such as:

(i) whether NCI puts and NCI forwards should be accounted for differently;

(ii) subsequent recognition of dividends paid on the subsidiary shares subject to the NCI put;

(iii) accounting for the settlement or exercise of an NCI put; and

(iv) accounting for the expiration of an unexercised NCI put.

6. In addition to the practice questions from applying paragraph 23 of IAS 32, some stakeholders have also questioned the appropriateness of the accounting required by this paragraph. In particular, stakeholders have questioned 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).

7. The staff will analyse each of these practice questions and consider whether there are:

a) interactions between the practice issues such that they should be considered together;

b) inconsistencies in IAS 32 requirements that need to be addressed;

c) underlying principles and rationale that need to be clarified; or

d) issues that merit further discussion by the IASB.

8. Finally, the staff will set out their initial views on potential next steps the IASB could consider for each of these practice questions should the IASB decide it can address those issues within the scope of the current FICE project.

9. The staff note that applying IFRS Accounting Standards in the parent's separate financial statements, an NCI put or NCI forward issued by the parent is accounted for on a net basis as a derivative because it is not a contract written on the parent entity's own equity instruments. The subsequent measurement issue for NCI puts (and NCI forwards) is only a question in the consolidated financial statements because all changes in the fair value of the derivative would be recognised in profit or loss in the parent's separate financial statements. On the other hand, for put options and forward contracts written 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.

What is the debit entry?

What is the issue?

10. Paragraph 23 of IAS 32 requires the financial liability to be reclassified from equity but does not specify which component of equity. This is a challenging issue for which there is diversity in practice in how the related equity is classified. For example, in the case of NCI puts, there is diversity in views whether the NCI or equity belonging to the parent should be debited in the consolidated financial statements. The Committee could not previously reach a consensus on this issue.

11. The Committee previously considered several alternative approaches, which included considering whether the parent entity has in substance acquired a present access to the economic benefits from the ownership interests. Where the NCI shareholder retains, in substance, present access to those economic benefits, the NCI could continue to be recognised (ie the debit is recognised in controlling interest/parent equity). However, this approach raised concerns about 'double counting'—both on the statement of financial position and in profit or loss.

12. The perceived double counting arises from the existence of two credit balances on the consolidated statement of financial position that— albeit for different amounts— are recognised in relation to shares subject to the put and leads to a reduction in controlling interest equity. In addition, profit or loss would be affected by both:

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

    b) a portion of the subsidiary's profit or loss for the period is attributable to the non-controlling interest.

13. An alternative approach would be to account for the NCI as an 'in-substance purchase' on initial recognition of the NCI put. However, this approach raised concerns about accounting for the NCI put as a present ownership interest in the

subsidiary although, in substance, the parent does not have a present ownership interest.

14. Similar issues arise for other derivatives to redeem own shares ie whether the initial debit entry is recorded against ordinary shares or another component of equity. The staff note that the decision on where to recognise the debit entry will also directly affect the accounting for subsequent dividends (see paragraphs 51-53 of this paper) and the settlement (see paragraphs 54-61 of this paper) and expiry (see paragraphs 62-71 of this paper) of the put option.

What do stakeholders think?

15. Most respondents to the 2018 DP were concerned with the proposal to derecognise the underlying equity instruments when neither the voting rights nor rights to dividends are extinguished. Stakeholders have previously acknowledged that there is a potential buyback obligation but the writer of the put option does not have the underlying interests, nor the associated voting rights or dividends rights attached to the shares until the put has been exercised. Furthermore, accounting for the NCI put as though it has already been exercised would not be symmetrical with the accounting by the NCI shareholder (who would continue to recognise an interest in the subsidiary until the put is exercised).

16. Many respondents to the 2018 DP argued that these transactions should instead be analysed as transactions with owners acting in their capacity as owners and accordingly a contra-equity account may be recognised instead of derecognising the NCI. The staff note however, that the same argument could be used to justify derecognition of NCI.

17. In addition, many respondents to the 2018 DP raised questions on the interaction with other IFRS Accounting Standards if NCI is derecognised:

   a) IFRS 10 *Consolidated Financial Statements*—whether a portion of the subsidiary’s total comprehensive income should still be attributed to the NCI as required by paragraph B94 of IFRS 10. Some of these respondents also questioned the accounting for any cumulative results of the subsidiary that have not been attributed to the previously derecognised NCI if the NCI put is not exercised.

b) IAS 33 *Earnings per Share* —whether the shares are considered outstanding and whether a share of the subsidiary's earnings is attributed to NCI for the purposes of computing earnings per share. A few respondents mentioned the impact on the diluted EPS calculation of derecognising NCI because the earnings attributable to shareholders of the parent will effectively be subject to dilution if the NCI put is not exercised.

c) IFRS 3 *Business Combinations*— the impact on the calculation of goodwill where the NCI put is part of a business combination. Paragraph 10 of IFRS 3 requires the acquirer to recognise separately from goodwill, the identifiable assets acquired, the liabilities assumed and any NCI in the acquiree as of the acquisition date.

What are potential next steps?

18. IAS 32 could be amended to clarify that on initial recognition of the NCI put liability the debit entry is recognised against parent equity. This is because the put option does not affect the rights and obligations of the NCI shareholders and until the put option is exercised, they retain their rights to profits, dividends and voting.

19. We think this will help to eliminate diversity in practice and would resolve questions about the impact of derecognising NCI before the put is exercised when applying the requirements in IFRS 3, IFRS 10 and IAS 33 and address the concerns raised by respondents to the 2018 DP. The staff do not think debiting parent equity results in double counting; rather it reflects the reduction in parent equity by giving the NCI shareholders an additional right ie the right to put back the shares held in the subsidiary to the group.

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

Changes in the carrying amount of the financial liability/subsequent measurement of the NCI put

What is the issue?

21. This was the primary issue discussed by the Committee from 2010-2014 because it was considered to be the component of the accounting for NCI puts that leads to the most significant diversity in practice ie whether subsequent changes are recognised in profit or loss or in equity. The issue arises because of a perceived conflict between the financial instrument accounting requirements in IAS 32 (paragraph 23 refers to IFRS 9 for subsequent measurement of the financial liability) and the requirements in IFRS 10 (paragraph 23 and B96 refer to equity transactions with owners in their capacity as owners).

22. The Committee noted at that time that the paragraphs in IAS 27 and IFRS 10 gave guidance on the accounting in circumstances when the respective ownership interests of the controlling shareholder and NCI shareholder change. The Committee also noted that the NCI put is a financial liability and its remeasurement does not change the respective ownership interests of the controlling shareholder or the NCI shareholder so those paragraphs are not relevant to the issues being considered. The draft Interpretation published in May 2012 therefore required changes in the NCI put liability to be recognised in profit or loss.

23. The IASB had previously discussed, but decided not to pursue recognising changes in the measurement of the NCI put in other comprehensive income (OCI)—one of the reasons was that it would raise questions about whether those amounts should be recycled (and, if so, when). The 2018 DP proposed that gains or losses, including those arising from subsequent measurement of the liability component, are recognised as income and expense. However, if the NCI is puttable at fair value, the 2018 DP proposed presenting the income or expenses on the financial liability component in OCI.

24. For NCI puts exercisable at fair value, changes in the carrying amount of the financial liability generally arise from changes in the exercise price and from the unwinding of the effect of discounting. For NCI puts exercisable at a fixed

amount at a future date, changes in the carrying amount of the financial liability generally arise from the unwinding of the effect of discounting.

What do stakeholders think?

25. Respondents to the 2012 draft Interpretation expressed mixed views. Supporters of the profit or loss view noted that the NCI put is initially recognised as a financial liability so the subsequent measurement of the NCI put reflects the subsequent measurement of a financial liability in accordance with IFRS 9. They do not view this as a further transaction with owners in their capacity as owners which are accounted for as equity transactions. This is because some of them consider only the writing of the NCI put, and consequently the initial recognition of the NCI put as a financial liability, to be a transaction with owners in their capacity as owners.

26. In contrast, other stakeholders believe that changes in the carrying amount of the NCI put financial liability should always be recognised in equity. They commented that the paragraph 23 requirement to recognise a gross obligation is already an exception to the general IAS 32 requirements and these obligations therefore warrant special requirements on subsequent measurement. They believe recognising changes in the carrying amount of the financial liability for the NCI put in profit or loss is inappropriate when the risks and rewards of ownership of the shares subject to the NCI put have not transferred to the parent. They also 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.

27. Another argument is that the requirements in IAS 32 to gross up the NCI portrays the transaction as if the controlling shareholder has purchased shares held by the NCI shareholder—ie as if the put has been exercised, which is an equity transaction. Any re-measurements 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.

28. Some stakeholders acknowledge that IFRS Accounting Standards require changes in the measurement of the financial liability to be recognised in profit or loss, but they believe such treatment does not result in decision-useful information. They argue that recognising changes in profit or loss related to an NCI put exercisable at fair value is counter-intuitive and results in misleading information. That is because:

    a) the fair value of that NCI put is expected to be zero throughout the life of the instrument (because if the put is exercised and the issuer is required to deliver cash, it will receive shares with an equal value in exchange).

    b) the liability that is recognised for that NCI put will increase and thus a loss will be recognised when the subsidiary performs well (and vice versa).

29. Some respondents to the 2012 draft Interpretation expressed the view that there is not (or might not be) a single interpretation of IFRS Accounting Standards for all NCI puts and indeed it may be inappropriate to impose uniform treatment. These respondents noted that NCI puts are written for different reasons, have different contractual terms and the likelihood of their exercise varies.

30. Many respondents to the 2018 DP suggested the IASB consider IFRS 10 in the analysis of NCI puts, in particular whether the transaction with NCI is a transaction among shareholders which justifies recording changes in the measurement of the NCI puts directly in equity. A few respondents encouraged the IASB to once again discuss and assess the effectiveness and challenges of recognising gains or losses arising from the subsequent measurement of the NCI put liability as changes in equity.

What are potential next steps?

31. The 2012 draft Interpretation previously intended to address this issue in isolation without providing a view on the other aspects of the accounting for NCI puts. This was based on the view that the recommendation to recognise changes in profit or loss would apply regardless of whether NCI or parent equity was debited because the focus was on the financial liability in the scope of IFRS 9. However, the staff think that if IAS 32 is clarified to require the initial debit entry to be recorded against parent equity (see paragraph 18 of this paper),

it will be clearer that the financial liability for the put option does not change the respective ownership interests of the controlling shareholder or the NCI shareholder at initial recognition or subsequently. The transaction is a transaction with owners but they are acting in their capacity as investors of particular instruments because they can decide whether or not to exercise the option.

32. Paragraph 23 of IAS 32 already requires the financial liability to be subsequently measured by applying IFRS 9. Recognising changes in the financial liability in profit or loss is also consistent with paragraphs 4.68 and 4.69 of the *Conceptual Framework for Financial Reporting* which define income and expenses with reference to decreases and increases in liabilities. The staff therefore do not think the subsequent measurement requirement needs to be changed.

Should NCI puts and forwards be accounted for differently?

What is the issue?

33. If the IASB decides to make any clarifications for obligations to redeem own equity instruments, it will be important to determine the scope of those clarifications. The majority of the past discussions were in the context of NCI puts but questions arose as to whether the same issues also apply to NCI forwards or indeed even wider to all put options and forwards on an entity’s own equity instruments.

34. In September 2011, one of the reasons the IASB decided not to proceed with a narrow-scope amendment to exclude NCI puts from IAS 32 was because of concerns about treating NCI puts differently from other derivatives written on an entity’s own equity instruments. The IASB had discussed that criticisms about the usefulness of the information provided by the ‘gross’ measurement basis are equally applicable to all put options and forward purchase contracts written on an entity’s own equity—not just NCI puts ie there is little conceptual basis for accounting for NCI puts differently.

35. The IASB also previously discussed but decided not to pursue, applying the clarification for recognising changes in the measurement of NCI puts in profit or loss, to all derivatives to purchase an entity's own equity. Although several IASB

members observed that there is no compelling reason to treat NCI puts differently than NCI forwards and noted that the concerns raised to the Committee about NCI puts are applicable to all derivatives written on an entity's own equity, the IASB noted that this alternative would significantly widen the scope of the May 2010 submission to the Committee. However, in 2013 after receiving feedback on the 2012 draft Interpretation, the IASB decided to address all derivatives written on an entity's own equity, including NCI puts, comprehensively as part of the FICE project at that time.

What do stakeholders think?

36. In 2016, when the Committee discussed an NCI put to be settled by a variable number of the parent's shares (see paragraphs 41-43 of this paper), some respondents said the issue is not isolated to NCI puts but could equally arise in respect of a forward or put option over an entity's own shares.

37. The majority of respondents to the 2012 draft Interpretation said that the scope of the Interpretation would have been too narrow. They suggested that the Interpretation should also apply to NCI forwards. Some respondents further pointed out that most of the issues are not unique to NCI puts but are applicable to all put options and forward contracts written on an entity's own equity instruments. Accordingly, those respondents expressed the view that the accounting for all such derivatives should be comprehensively reconsidered. However, some respondents that were in favour of recognising subsequent changes in equity said that NCI puts are different from other derivatives written on an entity's own equity instruments because they often are used in different circumstances and for different purposes.

38. Similar comments regarding whether different or consistent accounting models are required for obligations to purchase own shares were made by respondents to the 2018 DP.

What are potential next steps?

39. Given the scope and objective of this project, the staff expect that it is unlikely for the IASB to develop a solution specific to NCI puts that requires a different accounting model from other obligations to repurchase own equity instruments.

40. Paragraph 23 of IAS 32 applies to all obligations to redeem own equity instruments whether they relate to NCI shares or not and whether they arise from forward contracts or written put options. The previous concerns of expanding the scope beyond NCI puts related to concerns about expanding the scope of the issue submitted to the Committee but since this issue is now being considered holistically within the FICE project, there is no need to limit the scope to NCI puts when the same issues apply to other instruments to redeem own equity. The staff think no further clarifications are required to address this issue.

Settlement in a variable number of shares

What is the issue?

41. In 2016 the Committee received a request regarding how an entity accounts for NCI puts in its consolidated financial statements when the NCI put has a strike price that will, or may, be settled by the exchange of a variable number of the parent's own equity instruments (a share-settled NCI put). The question was whether the parent accounts for the share-settled NCI put:

    a) as a financial liability at the present value of the option's strike price on a gross basis; or

    b) as a derivative liability at fair value on a net basis.

42. This question arises because the requirements in paragraph 23 of IAS 32 refer only to obligations to transfer cash or another financial asset and are silent regarding settlement in own shares. Furthermore, paragraph 21 of IAS 32 states that when an entity uses a variable number of own equity instruments as a means to settle the contract, such a contract is a financial liability.

43. The Committee noted that on the basis of its previous discussions on cash-settled NCI puts, the issue was too broad to address efficiently and the IASB was considering the requirements for all derivatives on an entity's own equity comprehensively as part of the FICE project.

44. In April 2020, as part of the FICE project, the IASB discussed the foundation principle for financial instruments settled in own equity instruments. The IASB tentatively decided on equity classification for exchanges of a fixed number of

non-derivative own equity instruments for a fixed number of another type of non-derivative own equity instruments (fixed-for-fixed share exchanges).

45. It was noted at the time that other share-for-share exchanges may involve a variable number of one type of equity instruments on one side of the exchange and a fixed or variable number of another type of equity instruments on the other side of the exchange. This is the case for NCI puts to be settled by a variable number of the parent's shares. The IASB deferred that discussion to when it discusses obligations to redeem own equity instruments.

46. However, as this paper will only address share-for-share exchanges involving a receipt of a fixed number of one type of equity instrument for a variable number of another type of equity instrument, the staff will consider any remaining types of share-for-share exchanges when it brings an analysis of remaining issues to the IASB at a future meeting. Any future decisions on this topic could thus affect the accounting for other similar share-for-share exchanges that do not involve the buying back of own shares.

47. The staff note that this issue is different from net-share settled derivatives because the question arises in the context of using one type of an entity's own shares (eg parent shares) as currency to settle an obligation to repurchase another type of own shares (eg subsidiary shares). In the case of net-share settlement, the entity may receive or deliver the same type of own shares in settlement of the derivative so the derivative cannot be seen as a definite obligation to redeem own equity instruments. The staff are not aware of any significant practice questions relating to net-share settled derivatives.

What do stakeholders think?

48. Respondents to the Committee's 2016 tentative agenda decision were concerned that diversity in practice exists regarding this issue, and also that the lack of accounting guidance in this area opens up the risk of structuring opportunities.

49. An alternative was raised that instead of considering the broader issue of whether, conceptually, an entity should recognise and measure an instrument on a gross or net basis, the focus could be limited to whether paragraph 23 of IAS 32 applies to share-settled NCI puts.

What are potential next steps?

50. Paragraph 23 of IAS 32 could be clarified so that it applies also to an obligation to redeem own equity instruments that is settled in a variable number of another type of own shares. This is because using a variable number of own shares as 'currency' in settlement is consistent with the definition of a financial liability in paragraph 11 of IAS 32 and the requirement in paragraph 21 of IAS 32. Any other clarifications to be made, for example on which component of equity to debit initially, would then affect obligations to redeem own shares that are settled in a variable number of another type of own shares.

Subsequent recognition of dividends paid to NCI shareholders after recognition of the NCI put

What is the issue?

51. The principle in paragraph 109 of IAS 1 is that the payment of dividends to shareholders is a transaction with owners in their capacity as owners and is accounted for as an equity transaction. However, there is diversity in practice (recognising dividends in profit or loss or equity) when dividends are paid to the NCI shareholder after the parent entity has recorded the debit entry against NCI on initial recognition of the NCI put. The same issue could arise for other derivatives on an entity's own shares if the initial debit entry is recorded against ordinary shares.

What do stakeholders think?

52. Respondents to the 2018 DP questioned whether discretionary dividends and distributions paid to NCI shareholders after the NCI account is debited or derecognised on initial recognition of the NCI put would be recognised in profit or loss as interest expense or in equity. They also questioned the accounting treatment of dividends paid to NCI shareholders if any payment of dividends gives rise to an adjustment to the exercise price of the NCI put or if the NCI is puttable at fair value.

What are potential next steps?

53. The staff think the question of how to account for subsequent distributions only arises if NCI is debited on initial recognition of the NCI put. If IAS 32 is clarified to require parent equity to be debited on initial recognition of the NCI put (see paragraph 18 of this paper), the payment of subsequent distributions to NCI shareholders would be recognised in equity consistent with paragraph 109 of IAS 1. No further clarifications on accounting for subsequent distributions would then be required.

Accounting for the settlement (exercise) of an NCI put

What's the issue?

54. In July 2010, the Committee expressed support for the staff to continue analysing the settlement of NCI puts. The question is whether any further clarifications are needed for the accounting on settlement or exercise of an NCI put.

55. An NCI put presented as a financial liability in accordance with IAS 32 is subject to the derecognition requirements of IFRS 9 when it is settled or exercised. Paragraph 3.3.1 of IFRS 9 states:

> An entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished—ie when the obligation specified in the contract is discharged or cancelled or expires.

56. In subsequent reporting periods, paragraph 23 of IAS 32 requires the carrying amount of the financial liability to be remeasured applying IFRS 9. The measurement of the financial liability would reflect the amount of cash expected to be paid to settle the instrument (either the amortised cost would be updated to reflect actual and revised estimated contractual cash flows or the fair value would be updated for such estimates). As a result, we would expect that the carrying amount of the financial liability will equal the amount of the cash paid when the NCI put is exercised, and no profit or loss on settlement of the NCI put would be recognised.

57. If NCI is debited on initial recognition of the NCI put, when the NCI put is exercised, no further adjustments to NCI would be required because the NCI would have already been derecognised.

58. If NCI is not debited on initial recognition of the NCI put, when the NCI put is exercised, the NCI would have to be derecognised. Exercise of the NCI put leads to the parent acquiring the NCI shares 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.

59. Similar issues arise for other derivatives on an entity's own shares depending on whether the initial debit entry is recorded against ordinary shares.

What do stakeholders think?

60. There appears to be no significant diversity in practice for accounting for the settlement of NCI puts. Recent feedback on the 2018 DP did not mention any concerns about accounting for the exercise of the NCI put. Some respondents to the 2012 draft Interpretation acknowledged that according to paragraph 23 of IFRS 10, changes in NCI that do not result in the loss of control are identified as equity transactions; and said that equity is directly affected at initial recognition and settlement of an exercised NCI put.

What are potential next steps?

61. The staff think the requirements for derecognition of the financial liability and derecognition of the NCI upon exercise of the put option are clear. Further we note that the accounting for the settlement of NCI puts as described in this section depends on the accounting on initial recognition of the NCI put. Since we are not aware that the settlement of the obligation to redeem own shares creates any challenges in practice, we think no further clarifications in this regard are required.

Accounting for the expiration of an unexercised NCI put

What is the issue?

62. Paragraph 23 of IAS 32 requires that if the contract 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 NCI put should be allocated to. We understand that the diversity that exists in practice in determining which component of equity to reclassify to is based on the approach taken on initial recognition of the NCI put. This is because when an NCI put expires without being exercised, the financial liability relating to the NCI put is generally reclassified to the same component of equity as that from which it was reclassified on initial recognition.

63. If NCI is debited on initial recognition of the NCI put, the financial liability is reclassified back to the NCI component of equity. In the past, the Committee discussed the measurement of the 're-recognised' NCI including the following options:

a) carrying amount of the financial liability for the NCI put;

b) fair value of the NCI; or

c) NCI recalculated from the date of initial recognition of the NCI put as if it had not been 'derecognised' when the NCI put was written.

The discussion considered that the accounting to 're-recognise' NCI would be recorded as an equity transaction, reflecting a transfer between controlling interest equity and NCI. Therefore, any difference on expiration between the 're-recognised' amount of NCI and the carrying amount of the financial liability recognised for the NCI put would be recognised in controlling interest equity.

64. If NCI is not debited on initial recognition of the NCI put, when the instrument expires without delivery, the financial liability is reclassified back to controlling interest equity. The NCI component of equity would remain unchanged because it continued to be recognised and measured during the life of the NCI put as a separate component of equity.

65. The Committee also discussed whether any adjustments would be required to reverse the recognition of subsequent changes in the carrying amount of the financial liability, specifically, if these changes were recorded in profit or loss.

66. Similar issues arise for other derivatives on an entity's own shares depending on whether the initial debit entry is recorded against ordinary shares.

What do stakeholders think?

67. A few respondents to the 2012 draft Interpretation pointed out that if an NCI put expires, the liability will be derecognised with an offsetting entry to equity—and thus will not offset (or reverse) the changes recognised in profit or loss over the life of the contract. These respondents questioned whether such changes provide useful information to users of financial statements or create structuring opportunities if the NCI put ultimately expires.

68. Some respondents to the 2018 DP pointed out that a further complication arises when written put options lapse unexercised as the entity will be required to recognise a sale of subsidiary's shares to NCI ie in effect reversing the purchase of NCI that did not actually occur. They thought this treatment is unnecessarily complex and does not faithfully depict the current ownership interest of the NCI during the period the option remains outstanding. They specifically questioned whether the issuance and expiry of NCI puts should be accounted for as changes in the proportion of equity held by NCI in accordance with paragraph B96 of IFRS 10 which requires an entity to recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent.

What are potential next steps?

69. 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 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:

70. If IAS 32 is clarified to require parent equity to be debited on initial recognition of the NCI put (see paragraph 18 of this paper), there is no need to clarify the measurement of NCI upon expiry of the NCI put because NCI continued to be recognised and measured during the life of the NCI put as a separate component of equity.

71. Consistent with the accounting upon expiry of any unexercised derivative, the gains or losses previously recognised in profit or loss, should not be reversed. This is because the accounting correctly reflected the measurement of the financial liability in the period before expiry of the put option. 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 put option could be reclassified to another component of equity when the put option expires unexercised.

Gross vs net presentation

What is the issue?

72. The question of whether to account for physically settled forward purchase contracts and physically settled written put options on a gross or net basis was discussed several times in the past by the Committee and the IASB. In 2011 the Committee had previously concluded that excluding NCI puts from IAS 32 through a narrow scope amendment was a viable solution to the issue of accounting for subsequent changes in the measurement of NCI puts. That scope exclusion would have changed the measurement basis of NCI puts to that used for derivative contracts, which was directionally consistent with the 2009 IASB and FASB's discussions in the FICE project on written put options on own shares. The IASB discussed the Committee's recommendation and decided not to proceed with the proposed narrow scope amendment.

73. The IASB disagreed with the conclusion that an entity would provide better information if it were to measure NCI puts at fair value on a net basis. In 2013 after receiving feedback on the 2012 draft Interpretation, the IASB tentatively decided to reconsider the requirements in paragraph 23 of IAS 32, including

whether all or particular put options and forward contracts written on an entity's own equity should be measured at fair value on a net basis. Several Committee members believed that the requirements, to measure particular derivatives written on an entity's own equity instruments on a gross basis at the present value of the redemption amount, did not result in useful information.

74. Gross vs net presentation can have a significant effect on the issuer's accounting:

a) if accounted for on a gross basis applying paragraph 23 of IAS 32, an entity reclassifies the present value of the redemption amount from equity. If the strike price of the written put is equal to the fair value of the underlying equity instrument, a change in the fair value of the shares subject to the NCI put will result in a change in the financial liability, even though the fair value of the put option itself will remain at zero. If the financial liability is recognised for a fixed price, the NCI put liability will generally remain unchanged (other than the unwinding of the effect of discounting), even though the fair value of the put option itself will have changed to reflect the difference between the fair value of the shares and the exercise price.

b) if accounted for on a net basis as a derivative, the underlying equity instrument continues to be classified as equity. The staff note that if the strike price of the written put is equal to the fair value of the underlying equity instrument, the fair value of the standalone written put would be zero. Such an option does not meet the definition of a derivative because its value does not depend on an underlying variable ie the value of the NCI put will not change as the value of the underlying equity changes.

75. IAS 32 requires the NCI put to be measured on a gross basis because is a potential obligation on the entity to purchase its own equity instruments and helps users of financial statements assess estimated future cash outflows. Such accounting is consistent with the recognition of financial liabilities for obligations that are conditional on events or choices that are beyond the entity's control and measured at the full amount of the conditional obligation (the rationale is set out in paragraphs BC11 and BC 12 of the Basis for Conclusions

on IAS 32). It is also consistent with the accounting for puttable shares which paragraph 18(a) of IAS 32 requires to be classified as financial liabilities.

76. The 2018 DP proposed the requirement to recognise a gross financial liability for the present value of the redemption obligation would also apply to net-share-settled derivatives that contain an obligation to redeem own equity instruments in addition to those that are gross physically settled.

77. The staff understand that US GAAP *Topic 480, Distinguishing Liabilities from Equity* requires gross presentation for physically settled forward contracts that require the issuer to repurchase a fixed number of shares for cash at the fair value of the shares at inception (adjusted for any consideration or unstated rights or privileges) but not for written put options or other forward purchase contracts on own stock. These contracts are accounted for in a manner similar to derivatives and measured at fair value with subsequent changes in fair value recorded in earnings.

What do stakeholders think?

78. Proponents of gross presentation have previously provided the following reasoning for their view:

a) the entity cannot avoid settlement for the entire redemption amount in cash, or another financial asset, unless the counterparty decides not to exercise its redemption right. Also, gross presentation addresses concerns that the entity's transfer of cash reduces net assets for the entire amount of the cash outflow unlike other derivatives that involve the receipt of assets.

b) it 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.

79. On the other hand, some stakeholders have previously expressed concerns about whether gross measurement provides useful information for an NCI put exercisable at, or close to, fair value. This is because 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 at fair value would give more meaningful information. Some respondents to the 2012 draft Interpretation expressed support for this view, or expressed support for analysing it further.

80. More recently, a few respondents to the 2018 DP explicitly supported the proposal to recognise a gross liability (based on the obligation to potentially deliver economic resources) saying that it is consistent with a classification providing relevant information on liquidity and solvency and/or consistent with the current requirement in paragraph 23 of IAS 32. They noted that changing this requirement would have a significant impact on practice.

81. On the other hand, some respondents to the 2018 DP believed that all derivatives on own equity should be accounted for consistently ie derivatives to extinguish an equity instrument should not be treated differently from other derivatives on own equity and that net accounting would be a better reflection of the economics. They questioned the appropriateness of having some derivatives grossed-up when the obligation is conditional on the exercise of an option and said it is not consistent with the accounting for other options to recognise unconditional financial liabilities as if the options were already exercised.

82. These respondents therefore urged the IASB to further consider the benefits of measuring all derivatives on own equity in a consistent manner, or asked for further explanation of the rationale for treating them differently. One of the respondents also noted that grossing up two legs of an executory contract and treating them as if they are non-executory is 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). The staff note however that the issuer will be receiving own equity and not an asset.

83. A few respondents to the 2018 DP disagreed with recognising a gross obligation when forward purchases or written put options over own equity are exclusively net-share settled (or where the issuer has a choice of net-share settlement). In these cases, they believe the entity is not obligated to pay the gross amount and recognising a gross obligation results in overstating liabilities (and understating

equity) which will need to be fully or partially reversed when the instrument is actually net-share settled.

84. Another respondent questioned whether the issuer of a contract to purchase its own equity instruments that has the option to settle the contract on either a gross or a net-cash basis should recognise a gross liability based on the full redemption price or measure the instrument at fair value through profit or loss.

What are potential next steps?

85. Gross presentation practice has been established over the years and the objective of the FICE project is not to fundamentally change classification requirements. As not many respondents to the 2018 DP gave specific feedback on this issue, the staff do not think the IASB needs to reconsider the gross vs net presentation issue. The staff further think derivatives to redeem own shares are different to other derivatives because the one leg of the exchange involves the receipt of own shares which is not an asset of the entity. In addition, where the exercise price is equal to the fair value of the own shares redeemed, the instrument does not meet the definition of a derivative and has a value of zero.

86. However, we think adding further explanation or rationale to clarify the underlying principle of gross presentation in the application guidance to IAS 32 would be useful for stakeholders to understand gross presentation, especially those that advocate net presentation.