In May 2012, the IFRS Interpretations Committee (the Committee) issued for public comment Draft Interpretation DI/2012/2 Put Options Written on Non-controlling Interests (the DI). The comment period closed on 1 October 2012. In this publication, we highlight our views on the proposals and the direction we believe the project should take going forward.

The DI clarifies that a put option written on the shares of a subsidiary held by a non-controlling interest (NCI) is a contract to purchase the group’s own equity, which gives rise to a financial liability for the present value of the redemption amount in accordance with IAS 32 Financial Instruments: Presentation. Subsequently, the financial liability is measured in accordance with either IAS 39 Financial Instruments: Recognition and Measurement or IFRS 9 Financial Instruments and changes in the measurement of the financial liability are recognised in profit or loss.

Background
A parent entity may write a put option granting the holders of non-controlling interests the right to sell their shares to the parent at a future date. Often these transactions occur as part of a business combination, but they may also occur as separate transactions. IFRS does not provide clear guidance on how to account for these options, and so an entity must make an accounting policy decision regarding whether to apply IAS 32 Financial Instruments: Presentation. Subsequently, the financial liability is measured in accordance with either IAS 39 Financial Instruments: Recognition and Measurement or IFRS 9 Financial Instruments and changes in the measurement of the financial liability are recognised in profit or loss.

Scope issues
The DI applies to the parent’s consolidated financial statements, for put options that oblige the parent to purchase shares of its subsidiary that are held by an NCI shareholder. The DI does not apply to NCI puts that were accounted for as contingent consideration under IFRS 3 Business Combinations (2004), as these contracts are dealt with in IFRS 3 (2008).

Whilst we support the proposed accounting for NCI Puts, as we highlighted in our comment letter to the Committee, we have a number of concerns that the DI is too narrow in scope.

What you need to know
- The Draft Interpretation clarifies that when a put option is issued by a parent entity, a financial liability is recognised at the present value of the redemption amount. The financial liability is measured in accordance with either IAS 39 or IFRS 9 and changes in the measurement are recognised in profit or loss.
- We support the Committee’s efforts to publish the DI and believe it will reduce diversity in practice.
- However, the DI is very narrow in scope and addresses only one element of the accounting for NCI puts.
- We believe that the Committee should have an ongoing project to address other aspects of accounting for NCI puts that continue to cause diversity in practice.
Initial recognition of the put option

The DI addresses the subsequent measurement of the NCI put liability, but it does not address the initial recognition of the instrument. When an entity writes a put option on the shares of a subsidiary held by an NCI shareholder, some entities debit the NCI balance, whilst other entities debit other components of equity. This impacts the financial statement presentation going forward, as only those entities that recognise NCI will attribute income to the NCI shareholders.

We have suggested that the Committee should also consider addressing which component of equity should be debited when the liability is initially recognised.

Forward contracts

The DI only addresses put options, not similar contracts issued on NCIs, such as forward contracts. Although the Committee did discuss whether to include forward contracts in the scope, they decided not to do so.

We believe that this may lead to diverse accounting treatments for these contracts and we suggested that the Committee should consider addressing them.

Financial liability arising from settlement in the shares of the parent

The DI does not make it clear whether the Committee considered situations where a put option may be settled in a fixed or variable number of equity instruments of the parent, as opposed to in cash or another financial asset.

We believe that there are a number of instances of diverse accounting treatment, whereby some entities record the financial liability on a gross basis, whilst others record a liability for the net derivative.

We have suggested that the Committee consider how these transactions should be treated.

Application to other entities in the group

The DI states that it applies “in the parent’s consolidated financial statements, to put options that oblige the parent to purchase shares or its subsidiary that are held by a non-controlling interest shareholder.” We believe this is very narrow as it is drafted and should be amended to include put options written by any entity in the group that issues put options to NCI in the group.

Our understanding of the application of the proposals in the DI to other group companies, can be demonstrated in the following group structure:
Our analysis of the accounting by UP is set out in the table below:

<table>
<thead>
<tr>
<th>Scenario</th>
<th>In DI scope?</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>UP writes put on NCI of P</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>UP writes put on NCI of S2</td>
<td>Yes</td>
<td>Requires clarification</td>
</tr>
<tr>
<td>UP writes put on NCI of S1a</td>
<td>Yes</td>
<td>Requires clarification</td>
</tr>
<tr>
<td>P writes put on NCI of S2</td>
<td>No</td>
<td>Requires clarification</td>
</tr>
<tr>
<td>P writes put on NCI of S1a</td>
<td>No</td>
<td>Requires clarification</td>
</tr>
<tr>
<td>S1 writes put on NCI of S2</td>
<td>No</td>
<td>Requires clarification</td>
</tr>
<tr>
<td>S1 writes put on NCI of S2</td>
<td>No</td>
<td>Requires clarification</td>
</tr>
</tbody>
</table>

Following on from the above, we believe the DI should include put options written by any entity in the group. We have suggested that the Committee consider amending the wording in the DI to make this clear, if this is what it intended.

**Other issues related to NCI puts**

There are a number of other accounting issues related to NCI puts that are not addressed in the DI. These include:

- How dividends attributable to the NCI should be treated
- How any premium received from the NCI shareholders should be dealt with
- How the financial liability should be derecognised if the put expires before it has been exercised.

These issues should not delay the process of issuing the final Interpretation, in our view. We have suggested that the Committee continue their work on the accounting for NCI puts to address these issues, after the Interpretation has been finalised.

**Effective date and transition**

The DI does not propose an effective date, but it states that early application will be permitted.

The DI proposes retrospective application in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Whilst we support retrospective application, we believe the Committee should consider limiting it to put options that are outstanding at the beginning of the comparative period when the DI is first applied. Applying the DI to options that have lapsed will only result in adjustments to categories of equity and cost of determining those adjustments may outweigh any benefit of doing so.

**Next steps**

We expect that the Committee will begin redeliberations on the DI early in 2013.
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