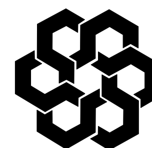

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**International Accounting Standards Board**

*This document is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. It does not represent an official position of the IFRIC. IFRIC positions are set out in Interpretations.*

*Note: These notes are based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because these notes are less detailed, some paragraph numbers are not used.*

**INFORMATION FOR OBSERVERS**

**IFRIC meeting:** **July 2006, London**

**Project:** **Classification of puts and forwards held by minority interests (Agenda paper 10(ii))**

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## Introduction

1. At its December 2005 and April 2006 meetings the IFRIC Agenda Committee considered papers presented by the staff on the treatment under IAS 32 and IFRS 3 of puts and forwards held by minority interests.

2. Those discussions were in response to a request to the IFRIC related to situations where a parent enters into a commitment through a written put or a forward purchase to acquire shares in a subsidiary held by a third party. The settlement amount might be fixed, based on fair value of the shares at the settlement date or based on a formula such as a multiple of EBITDA or net income. This type of contract might be negotiated as part of the purchase of the majority interest or negotiated independently at a later date.

3. Two questions that arise regularly in practice are:

   (a) should the parent recognise a liability for the amount potentially payable under the contract; and

(b) should a minority interest continue to be recognised for the minority's shares that are subject to the agreement?

**Scope**

4. In the scenarios described by the submitter, the obligation is to settle the purchase of a fixed number of shares with a fixed or variable amount of cash. The analysis presented here is limited to this type of arrangement. The analysis does not cover, for example, settlement of the forward or put by the issue of a fixed or variable number of shares in the parent.

5. The staff accept that, although there are other types of put and forward arrangements, the request was in relation to this subset only—presumably because of their prevalence. The staff believe that the scope of this interpretation, or rejection, should be limited to this sub-set of possible settlement methods.

**Analysis**

6. The staff believe that it is clear that IAS 32 requires that the parent recognise a liability when it has an obligation to pay cash in the future to purchase the minority's shares, even if the payment of that cash is conditional on the option being exercised by the holder. The parent must stand ready to purchase the shares if the [non-controlling] minority interest puts them. IAS 32.23 states:

> A contract that contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset gives rise to a financial liability for the present value of the redemption amount (for example, for the present value of the forward repurchase price, option exercise price or other redemption amount). This is the case even if the contract itself is an equity instrument. **One example is an entity's obligation under a forward contract to purchase its own equity instruments for cash.** When the financial liability is **recognised** initially under IAS 39, its fair value (the present value of the redemption amount) is reclassified from equity. Subsequently, the financial liability is measured in accordance with IAS 39. If the contract expires without delivery, the carrying amount of the financial liability is reclassified to equity. An

> entity's contractual obligation to purchase its own equity instruments gives rise to a financial liability for the present value of the redemption amount even if the obligation to purchase is conditional on the counterparty exercising a right to redeem (eg a written put option that gives the counterparty the right to sell an entity's own equity instruments to the entity for a fixed price). [emphasis added]

7. That liability would be measured at the present value of the redemption amount. After initial recognition the liability will be accounted for in accordance with IAS 39. The parent will reclassify the liability to equity if a put expires unexercised.

8. Some IFRIC Agenda Committee members have suggested that the standard is not clear on whether the contra to the liability requires that the [non-controlling] minority interest be derecognised or whether the general reduction in equity is sufficient. This is because IAS 32.23 does state that the present value of the redemption amount is 'recognised' as a liability but it does not state that [non-controlling] minority interests are to be derecognised. It is therefore arguable that IAS 32.23 allows an entity to reduce equity, rather than being required to derecognise minority interests. Under this approach a minority interest would continue to be recognised.

9. The staff considered this view in its analysis of IAS 32 and acknowledges that, read alone, this view is not inconsistent with IAS 32.23. However, the staff has also considered IAS 32.AG29 which addresses the treatment in consolidated financial statements and states:

> In consolidated financial statements, an entity presents minority interests—ie the interests of other parties in the equity and income of its subsidiaries—in accordance with IAS 1 *Presentation of Financial Statements* and IAS 27 *Consolidated and Separate Financial Statements*. When classifying a financial instrument (or a component of it) in consolidated financial statements, an entity considers all terms and conditions agreed between members of the group and the holders of the

> instrument in determining whether the group as a whole has an obligation to deliver cash or another financial asset in respect of the instrument or to settle it in a manner that results in liability classification. **When a subsidiary in a group issues a financial instrument and a parent** or other group entity **agrees additional terms directly with the holders of the instrument** (eg a guarantee), **the group may not have discretion over** distributions or **redemption.** Although the subsidiary may appropriately classify the instrument without regard to these additional terms in its individual financial statements, the effect of other agreements between members of the group and the holders of the instrument is considered in order to ensure that consolidated financial statements reflect the contracts and transactions entered into by the group as a whole. **To the extent that there is such an obligation or settlement provision, the instrument (or the component of it that is subject to the obligation) is classified as a financial liability in consolidated financial statements.** [emphasis added]

10. IAS 32.AG29 suggests that the instrument itself, or the component of it, that is subject to the obligation is classified as a financial liability. This suggests that the [non-controlling] minority interest is classified as a financial liability. Where IAS 32.AG29 is not clear is in explaining whether that classification of [non-controlling] minority interest as a liability applies only in circumstances when the obligation is attached at the time the instruments that represent the [non-controlling] minority interests are issued or whether it also applies when a separate financial instrument is issued. The staff believe that for the reporting entity to be able to 'reflect the contracts and transactions entered into by the group as a whole' it is necessary for either:

    (a) the [non-controlling] minority interests to be reclassified as a liability; or

    (b) the reduction in equity to be associated with the [non-controlling] minority interests for the entity reporting through disclosure.

11. Although there might be some diversity in practice, because some entities derecognise minority interests and others convey the reclassification through

disclosure, the staff believe neither approach prevents the effect on [non-controlling] minority interests of the put or forward from being conveyed clearly to users.

**Recommendation**

12. The staff recommend that the IFRIC decline to take this matter onto its agenda. The suggested 'rejection' is: [deleted for observer note purposes]