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IFRS Global office
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# IFRS in Focus

# IFRS Interpretations Committee issues Draft Interpretation on Put Options Written on Non-controlling Interests

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**The Bottom Line**

- The proposals clarify that a put option written over a subsidiary's equity shares results in a financial liability in the parent's consolidated financial statements which is subsequently remeasured through profit or loss.
- The proposals would be applied retrospectively, however the proposed interpretation would not apply to written non-controlling interest put options accounted for as contingent consideration under IFRS 3 (2004).
- The comment period on the proposals ends on 1 October 2012.

On 31 May 2012, the International Financial Reporting Standards Interpretations Committee ("the Committee") published draft Interpretation D1/2012/2 *Put Options Written on Non-controlling Interests* ("the draft Interpretation").

## The issue

Parent entities often write put options on subsidiary shares, allowing non-controlling interest holders to demand that the parent purchase those shares in the future. In the parent's consolidated financial statements, the put option is an obligation to purchase the group's own equity and therefore creates a financial liability. In accordance with paragraph 23 of IAS 32 *Financial Instruments: Presentation*, the liability is initially measured at the present value of the option redemption amount.

However, IFRS is less clear with respect to the subsequent measurement of the financial liability. IAS 32 states that financial liabilities of this type are to be measured subsequently in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments* which, in turn, require all changes in the measurement of financial liabilities to be recognised through profit or loss. However, IAS 27 *Consolidated and Separate Financial Statements* and IFRS 10 *Consolidated Financial Statements* require that changes in a parent's ownership interest in a subsidiary which do not result in a loss of control of the subsidiary would be considered a transaction with owners in their capacity as owners and therefore accounted for as an equity transaction.

For more information please see the following websites:

www.iasplus.com

www.deloitte.com

## The proposals

The draft Interpretation proposes to clarify that the financial liability for a put option written on non-controlling interests would subsequently be measured in accordance with IAS 39 or IFRS 9 which would require changes in the measurement of the financial liability to be recognised in profit or loss. In reaching this tentative decision, the Committee indicated that changes in the measurement of the financial liability do not change the relative interests in the subsidiary held by either the parent or the non-controlling interest holders and therefore are not equity transactions with owners in their capacity as owners.

> Observation
>
> The profit or loss impact of non-controlling interest puts will be more pronounced for those with a variable exercise price (e.g., one based on a multiple of earnings before interest, taxes, depreciation and amortisation (EBITDA)) as remeasurements of these liabilities will reflect changes in that exercise price. Put options of this type are often designed to ensure that the parent acquires the non-controlling interests at a price approximating their fair value when the put is exercised.
>
> Profit or loss volatility arising from a future acquisition of non-controlling interests at fair value has proved challenging for preparers to explain to investors.

## Scope

The draft Interpretation applies to a parent's consolidated financial statements when that parent has written a put option which requires it to purchase subsidiary shares held by non-controlling interest holders. However, a written put that was accounted for as contingent consideration in accordance with IFRS 3 (2004) *Business Combinations* would not be in the scope of the draft Interpretation as IFRS 3 (2008) *Business Combinations* did not change the accounting for contingent consideration that arose from a business combination that occurred before the application of IFRS 3 (2008).

## Effective date and transition

The comment period on the proposals ends on 1 October 2012. The draft Interpretation does not specify an effective date. The Committee will determine the effective date after considering the comments they receive on the draft Interpretation.

> Observation
>
> The Committee typically provides a 90 day comment period on their draft interpretations. However, because the Committee believes that this issue may receive heightened attention by constituents, they decided to provide a 120 day comment period.

The draft Interpretation will require retrospective application in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

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