



IASB  
International Accounting Standards Board

IFRIC  
International Financial Reporting Interpretations

30 Cannon Street  
London EC4M 6XH  
United Kingdom

24 February 2012

Dear Sir or Madam,

**Re: Put options written on non-controlling interests**

We are writing regarding the IASB agenda paper 10, "Put options written on non-controlling interests: Resolving the issue". We are concerned that the paper recommends the Board to amend IFRS 10 such that subsequent measurement of the put option liability will be recognised through profit or loss.

We believe that the arguments for this approach do not reflect the economics of the transaction, but are rather based on a very strict interpretation of existing literature, ignoring that the accounting of such transactions is an exception to the general IAS 32 requirements, and therefore we address each of these arguments used by the IFRS staff in the appendix to this letter.

In this connection, we would appreciate if the IASB could clarify what kind of work the IFRS Interpretation Committee ("Committee") has been doing and how that fits into the IFRIC due process handbook, and what type of due process should have been followed.

We remain at your disposal should you wish to discuss this further.

Yours sincerely,

Jérôme P. Chauvin  
Director  
Legal Affairs Department  
Internal Market Department



## APPENDIX

### Put options written on non-controlling interests

#### Recognising changes in the measurement of NCI puts through profit or loss

For the avoidance of doubt, the transaction in question is one in which an entity writes a put option over non-controlling interests and the settlement is gross in cash, i.e. illustrative example 30 in IAS 32. We note that in most cases this transaction arises because the NCI shareholder is looking to sell the remainder of his business at some point in the future and will often negotiate the terms of the written put at the same time or just after the majority shareholder has taken control of the business. Our comments below are written in the context of this type of transaction.

With the focus of our comments below clearly stated, we would like to indicate that we believe that there are related questions in connection with the treatment of such puts on NCI in the accounting for business combinations, if the target company had already such puts on its subsidiaries. We therefore believe that it would be inappropriate to make any changes to existing literature, before all aspects and consequences of such transactions have been investigated.

#### Paragraph 15a/b of agenda paper 10

*“The NCI put is a financial liability and according to IAS 39 subsequent changes are recognised in profit or loss”.*

We agree that by strictly following current IAS 32 and IAS 39 guidance this is the outcome that would be arrived at. However, and as stated above, the guidance on written put options on NCI follows an “as if” approach, as it requires the option to be accounted for as if the future transaction had already occurred in substance creating a synthetic liability, and being inconsistent with the general accounting for derivatives.

We therefore believe that the accounting for such a “synthetic liability” should not follow necessarily the same accounting as the accounting for “normal liabilities”, as the underlying economics are different. Consequently, many preparers choose to follow guidance in IAS 27 and IFRS 10 instead of IAS 32 and IAS 39 as they believe booking the changes through equity better reflects the economics of the transaction.

The point made above is further supported by the current IAS 32.23 guidance on how to treat written options on NCI which eventually are not exercised. Completely in line with the “as if” approach, the standard requires a simple reclassification from liability to equity.

We therefore believe that IFRS should be modified to better reflect the economics of the transaction rather than just considering what is currently written in IFRS.



Paragraph 15c of agenda paper 10

*“Re-measuring an NCI put is not a transaction with an owner as there is no change in ownership interest”.*

This statement is misleading and counter-intuitive. The transaction with the owner occurs when the NCI option agreement is signed between both parties. At this stage there is no change in ownership interest, however, IAS 32 requires a liability to be booked at the present value of the redemption amount with the debit taken to equity, i.e. a transaction with an owner has occurred (see our comments above with respect to the “as if” approach). Consequently, it does not make sense to then take subsequent changes through profit or loss on the basis that there has not been a transaction with an owner.

Paragraph 15d of agenda paper 10

*“....when the NCI put is measured on a net basis (e.g. because it must be net settled in cash), no one has asserted that the changes in that NCI put liability are recognised in equity – and different accounting (i.e. being measured on gross versus net basis) would not seem to justify a change in NCI put’s nature (i.e. whether it is a transaction with an owner in the capacity of an owner).”*

We do not understand this logic. We can only assume that the paper is referring to net cash settlement as illustrated in IE28 of IAS 32. In such a case there is no liability booked on signing the option agreement (other than the premium received) and consequently, there is no financial liability as the written put is treated as a derivative with changes to profit or loss. This is obviously due to the fact that the accounting for physically settled written put options on own equity instruments are an exception to the normal accounting for derivatives, as pointed out above. Accounting for a net cash settlement as a derivative is appropriate as there is no exchange of shares, only cash and therefore no transaction with the NCI shareholder. Hence, net cash settlement is a different transaction whereby both parties are essentially “trading” rather than selling the remaining shares in the business.

Paragraph 15f of agenda paper 10

*“Creating another exception to IAS 32 decreases comparability and increases complexity in financial reporting. There is no compelling reason to account for NCI puts differently than other derivatives written on an entity’s own equity.”*

First of all, we believe that it would be only consequent to follow the creation of an exception that was included into IAS 32 also in e.g. IAS 39 and therefore believe that allowing a different accounting is not an exception, but rather a logical consequence.

With regard to the “Complexity” - we do not want to increase complexity in financial reporting; quite to the contrary, we would aim for the financial statements reflecting economic reality. As the current accounting does not reflect the economics of the transaction then this in itself is increasing complexity as the layman will not be able to make sense of the transactions recorded in the financial statements.

*Example:*

Consider the case where a financial liability is recorded on writing a put over NCI in year 1, say EUR 50 million. Then in year 2 the liability is significantly reduced by EUR 10 million as the strike was based on a formula using EBITDA estimates which are now replaced by actual results which are significantly lower than forecast. As a result of the inaccurate forecasting the entity will be rewarded by a material gain of EUR 10 million to the income statement in year 2. In year 3 the option can be exercised, however, the NCI shareholder decides not to exercise because he believes it is better to let the option lapse and start negotiations again with the aim of getting better terms than the put option. This is plausible since the majority shareholder would like to own 100% and the future economic outlook is now more favourable than at the time the written put was signed 3 years ago. In year 3 the liability (EUR 40 million) is removed when the option lapses as IAS 32.23 states that “If the contract expires without delivery, the carrying amount of the financial liability is reclassified to equity.” Consequently, the credit entry of EUR 40 million would appear to flow to equity. In such a case the result would be that the company has booked a gain of EUR 10 million in year 2 on the basis of a written put agreement which lapsed and for which there was no cash flows (assuming there was no premium received).

The above situation would be difficult to explain to management and shareholders who would not understand that the P&L volatility was caused by changes in a “fictional” liability which in the end did not exist and resulted in no cash flows. The justification would be that IAS 39 requires changes in financial liabilities through profit or loss, in all circumstances for the sake of comparability with other derivatives over NCI and to reduce complexity in financial reporting, albeit the fact that the economics are completely different. We are not sure management and users would accept this reasoning.

*“No compelling reason to account for written puts differently than other derivatives written on an entity’s own equity”*

Written puts over NCI which are settled net in cash are clearly derivatives as explained above and are appropriately addressed by IAS 32 IE28. However, written puts over NCI which are settled gross (cash for shares) exist because the NCI shareholder wants to have the possibility of selling his/her remaining shareholding at some point in the future. Likewise, the majority shareholder is willing to enter into the written put as he wants to take full ownership of the subsidiary. This is not a trading transaction but a transaction with an NCI shareholder to buy the remainder of the business. Consequently, as the example above illustrates, it does not make sense to have P&L



volatility impacting the entity's operating result for a transaction which is to purchase the remaining shares in one of its subsidiaries.

Paragraph 16 of agenda paper 10

*"...we agree that making an exception for NCI puts could create structuring opportunities or have unintended consequences..."*

If the changes in the liability flow through profit or loss then we believe this can only increase (not decrease) the incentive for structuring. As shown in the example above, the initial booking of the liability can be very subjective (based on future results) and therefore recording the changes through equity would be the more sensible approach, in terms of reducing structuring opportunities.

**Conclusion**

In summary, we believe that the accounting for puts on NCI should not follow the general accounting for liabilities, as the "as if" accounting and creation of a synthetic liability itself is an exception to the general IAS 32 guidelines and as such warrants also a consequential special guidance on the subsequent measurement.

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