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Paris, Avril 14, 2010

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n°20

Dear Michael J. Kraehnke,

Following your request for comments on a potential agenda IFRIC item, namely " accounting for changes in the carrying amount of put options on a non controlling interest", we are pleased to provide the ANC's comments.

1. Comments to your question : "What diversity have you seen in practice"

Using put option on non controlling interests is largely widespread not only for large capitalisation groups but also for SMEs as it is a common way to acquire progressively non controlling interests and it is often a main channel for strategic development into many markets abroad.

For instance, when referring to the financial statements published by the listed groups of the CAC 40 index for the year ended 2008, more than half of them have disclosed that they have issued put option on minority interests.

Regarding your request, we understand that the accounting treatment for changes in the value of put options on a-non controlling interest under IFRS3R and IAS 27R includes two different questions :

- the accounting treatment for changes, subsequent to the effective date of IFRS3R, in the value of put options on minority interests issued prior to the effective date of IFRS3R and IAS 27R (issue related to the transition period) ;
- the accounting treatment for changes in the value of put options on a non controlling interest issued after the effective date of IFRS3R and IAS 27R.

Concerning the first question, we would like to emphasize that in almost all cases, the approach retained consists in applying the same accounting treatment for the put on a non controlling interest as the treatment retained to account for the purchase of non controlling interests.

When referring to the financial statement published by listed groups of the CAC 40 index for the year ended 2008, seventy percent of the groups have applied this approach, which consists in adjusting the goodwill for the difference between the present value of the exercise price under the option and the book value of the minority interest acquired. All groups which have followed this approach, account the changes in the value of the liability related to put options on minority interests as adjustments to the amount of goodwill. Other groups, recognised the changes in the value of the liability in equity.

With regard to future practices, we understand from a brief and limited survey conducted, following your request, among groups listed on the CAC 40 index, that in essence French companies will continue to apply the same approach. In particular, the companies who have chosen the "partial goodwill approach" for the initial accounting treatment of put on minority interests under IFRS3 will continue to account for the changes of the carrying amount of the put options within goodwill after the effective date of IFRS3R and IAS 27R.

Concerning the second question, even if IFRS3R and IAS 27R do not clarify how put options should impact the business combination accounting, it is understood that the new guidance provided for the acquisition of non controlling interests should be applied by analogy to puts over non controlling interests and that the "partial goodwill approach" shall no longer be considered as in compliance with IFRS as regards put options on non controlling interests issued after the effective date of IFRS3R and IAS 27R.

The vast majority of the above mentioned companies have not applied IFRS3R and IAS 27R by anticipation. With regard to future practices, we understand from the survey mentioned above that in almost all cases, respondents believe that they will continue to account for the changes of the value of put options on non controlling interests issued after the effective date of IFRS3R and IAS27R consistently with the accounting treatment applicable for the acquisition or sale of minority interests, i.e. within equity.

2-3. Comments to your questions "Any preferred views where diversity does exist and key arguments"

Given the current inconsistencies between the financial instruments standards (IAS32-39) and business combination standards (IAS27R-IFRS3R), several divergent practices can be applied.

Accounting for put options on non controlling interests must follow the same pattern of recognition as a direct purchase of non controlling interests. An approach for accounting the changes in value of put options on non controlling interests based on an analysis of the transaction with the non controlling interests is largely preferred over an approach focusing on current provisions of the standard on financial instruments.

Therefore, accounting for the changes in the carrying amount of the financial liability related to put options on non controlling interests can only be made in equity for the following reasons :

- The new principle is clear :

The underlying principle of both IAS 27R and IFRS 3R is the so-called “economic entity concept", meaning that non controlling interests are a component of equity. As a consequence, transactions between the controlling party and non controlling interests are transactions with owners (IAS 27R.30) and are accordingly accounted for as equity transactions.
This key change of principle compared to IAS 27 impacts the accounting of both i) increases in the controlling equity interests after control is obtained and ii) decreases in the controlling equity interests that do not result in a loss of control. Both increases and decreases should be accounted for as equity transactions (i.e. transactions with owners in their capacity as owners) (IAS 27R.IN8, IAS 27R.30).

Therefore "no gain or loss from these changes in ownership should be recognised in profit or loss" (extract of IAS 27R.BC41).

- Other IFRS references cannot contradict the new principle :

According to 39's principles - as referred to in IAS 32.23 - a put option on non controlling interests is a financial liability, the changes in value of which are recognised in the income statement. In the light of the standards IAS 32 and 39, the ANC considers that this alternative treatment, consistent with the IFRS, leads to major inconsistencies with one of the guiding principles of IAS 27R which requires equity accounting for any transaction with non controlling interests.

- In addition, an alternative approach supporting classification of the changes in the "carrying amount of put options on a non controlling interest " in profit or loss would lead to a counter-intuitive outcome since changes in the value of the put option would result in a deterioration of the profit and loss of the consolidating entity, despite the fact that since the acquisition has not yet taken place, the entity is not entitled to benefit from the additional prorata shares of results (such as dividends or proportions of profit or losses).

- Furthermore, put options on non controlling interests are usually, if not always, a private and non-transferrable agreement between two identifiable parties. We do think it consists in a substantial difference with any financial instruments and further that this may differ from a written put option on treasury shares which can be a market-negotiated financial instrument.

For these reasons, we support that the changes of the "carrying amount of puts on non controlling interests" should be recognised in equity as they arise from transactions with a non controlling interest.

4. Comments to your question : "Any experience of regulatory feedback"

Concerning the " accounting for changes in the carrying amount of put options on a non controlling interest" issued after the effective date of IFRS3R and IAS 27R, the French securities regulator officially recommends that "subsequent changes in the fair value of this type of liability should not affect the income statement" (Please refer to the AMF recommendation regarding financial statement for 2009 in Appendix I -§ 3.5).

5. Comments to your question : "Views on the significance/urgency of the issue"

As indicated above, the ANC believes that this issue is significant and urgent:
- given the significant number of entities which regularly issue put on minority interests,
- the potential impact on financial reporting when valuing at market price such put liabilities,
- the inconsistencies between IAS 32-39 and the new IAS 27R-IFRS3R which are applicable by most companies in 2010.

The ANC believes that the IFRIC should contemplate the two following options:

Option 1: Apply the principles of the most recently issued Standard, which, in this case, would be IAS 27R-IFRS 3R (fair value through equity), which in the view of the ANC is the principle which best reflects the economics of such transactions.

Option 2: Allow a policy choice of applying the principles of IAS 32-39 (fair value through profit and losses) or the principles of IAS 27R-IFRS 3R (fair value through equity), and encourage the Board to address issues relating to the interactions and the inconsistencies between the financial instruments and business combination standards.

Yours sincerely,

Jérôme Haas

3.4. Put options on minority interests recorded prior to the effective date of IFRS 3R and IAS 27R using the 'partial goodwill' method

The 'partial goodwill' method, which is one of the methods considered acceptable given the lack of guidance in the current standards, results in recording a liability for the put options issued, the counterpart of this liability being:

- the elimination of the carrying amount of the corresponding minority interests, and
- the recognition of partial goodwill.

As mentioned earlier, IFRS 3R.65 does not require assets and liabilities arising from a previous business combination to be restated on first-time application of the new standard.

The formulation adopted by the IASB raises at least two questions:

- what should be the treatment of a put option issued between the date that control was acquired and the date of initial application of IFRS 3R? Could a put option issued after the date that control was acquired be treated as unrelated to the business combination, and therefore excluded from the scope of application of IFRS 3R.65?
- to the extent that IFRS 3R.65 deals only with the initial accounting on first-time application of the revised standard, could an entity continue to apply its previous accounting methods to business combinations that occurred before the first-time application of IFRS 3R (and thus continue to use several different accounting methods for business combinations)?

Regarding the first question, the AMF considers that the lack of guidance in the standard means that several different accounting treatments are permitted17:

- a group could apply the principles of IFRS 3R to a put option issued between the date that control was acquired and the date of first-time application of the new standard;
- it could also, consistent with the accounting method used up to the date of first-time application of IFRS 3R, record the put option using the partial goodwill method (and therefore recognise partial goodwill on the put).

3.5. Put options on minority interests issued after the effective date of IFRS 3R and IAS 27R: subsequent changes in debt

IAS 27R.30 (and BC41) provides that transactions between the controlling shareholder and minority interests which involve equity instruments but which have no effect on control, should henceforth be recorded as reclassifications within equity. These transactions therefore have no effect on the income statement.

However, as noted in past AMF recommendations, a put option on minority interests constitutes a financial liability within the meaning of IAS 39. According to IAS 39.AG8, any subsequent change in the fair value of a financial liability resulting from revisions to estimated future cash flows must be recognised in the income statement.

A put option whose exercise price corresponds to the fair value of the instrument sold does not transfer to the issuer of the put option the risks and rewards associated with control. Recording changes in fair value in profit or loss within the accounts of the issuer would be equivalent, in a sense, to considering that the issuer of the put bears the risks and rewards associated with control.

IAS 27R therefore appears to raise two inconsistencies:

- between two IASB standards (IAS 39 and IAS 27R); and
- in relation to the logic applied to the control of consolidated entities.

Given that IAS 27R is more recent than IAS 39 and more accurately reflects the principles espoused by the IASB, and also that IAS 27R better reflects the economic reality of this type of transaction, the AMF considers that subsequent changes in the fair value of this type of liability should not affect the income statement. Nevertheless, since an alternative treatment is implicitly permitted by the existence of two standards, either of which might be applied, the issuers concerned should include in the notes an explanation of the accounting method used.