11 October 2012

Mr Wayne Upton
IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir,

Re: Draft Interpretation DI/2012/2 Put Options Written on Non-controlling Interests

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Draft Interpretation (D1/2012/2) *Put Options Written on Non-controlling Interests* issued by the IFRS Interpretations Committee ('the Interpretations Committee') on 31 May 2012 (the 'Draft Interpretation').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of a definitive Interpretation in the European Union and European Economic Area.

The Draft Interpretation applies, in the parent's consolidated financial statements, to put options that oblige the parent to purchase shares of its subsidiary that are held by a non-controlling-interest shareholder for cash or another financial asset (NCI puts). Specifically, it addresses how to account for changes in the measurement of the financial liability that is recognised for an NCI put.

EFRAG agrees that diversity in practice exists in accounting for the subsequent measurement of an NCI put that is recognised in a parent entity's consolidated financial statements. We support the Interpretations Committee's efforts to develop a pragmatic short-term solution to address the issue, as financial reporting would benefit from greater comparability of information for those transactions. However, this might be at the expense of relevance of information for some of those transactions, particularly when they have different features and accounting for them in the same way might not reflect their economic substance.

In our view, the subsequent measurement of a NCI put is just one element of a wider range of issues on the accounting for NCI puts. We note that diversity in practice also arises in accounting for the initial recognition of the NCI put, in particular with regard to whether NCI is derecognised or another component of equity debited. This will also affect the respective allocation of profits to NCI and accounting for dividends paid by the subsidiary in the consolidated accounts of the parent entity. We believe that these issues should be addressed without delay by the Interpretations Committee and the Board as part of their responsibility towards maintaining IFRS.

The diversity in practice on subsequent measurement of NCI puts arises from a conflict in principles in IAS 27 *Consolidated and Separate Financial Statements* / IFRS 10 *Consolidated Financial Statements*, which requires non-controlling interests (NCI) to be presented as owners and consequently transactions with NCI without transfer of control to be reflected in equity (in line with IAS 1 *Presentation of Financial Statements* and IFRIC 17 *Distributions of Non-Cash Assets to Owners*), while IAS 32 *Financial Instruments: Presentation* requires NCI puts to be measured as financial liabilities with subsequent remeasurement recognised in profit or loss in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.

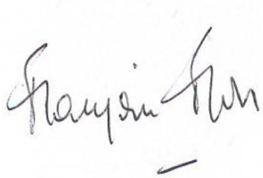
The Interpretations Committee does not explain why it believes that IAS 32/IAS39 should take precedence over IAS 27/IFRS 10 and IFRIC 17, and particularly why it considers that those standards are not relevant when deciding that the correct interpretation of existing standards to address the issue is always the accounting set out in IAS 32 and IAS 39. If the Interpretations Committee decides to go ahead with the Draft Interpretation, we believe that the Interpretations Committee should explain clearly the rationale for its reasoning in the Basis for Conclusions.

We would like to highlight that our due process has indicated that the accounting for NCI puts in the consolidated accounts of an entity is a complex and controversial issue, with some arguing that a single measurement basis for NCI puts is not appropriate in all cases. We note that there are strongly held views that the Draft Interpretation, if finalised, would lead to financial reporting for some transactions that lacks relevance.

As explained in the Appendix, EFRAG supports the Draft Interpretation on the basis that it sets out a pragmatic short-term solution to reduce diversity.

If you would like to discuss our comments further, please do not hesitate to contact Benjamin Reilly or me.

Yours sincerely,



Françoise Flores

EFRAG Chairman

APPENDIX

Need for standard-setting activity beyond the finalisation of the Draft Interpretation

Initial recognition of the NCI put liability

1. The Draft Interpretation only addresses the subsequent measurement of an NCI put. In our view, this is just one element of a wider range of issues on the accounting for NCI puts. We note that diversity in practice also arises in accounting for the initial recognition of the NCI put. In particular, diversity exists on whether NCI is derecognised or another component of equity debited, which will also affect the respective allocation of profits to NCI and accounting for dividends paid by the subsidiary in the consolidated accounts of the parent entity.

2. We believe there are arguments to support the view that the issue is to establish 'when', in substance, the equity transaction has taken place and therefore whether NCI should be derecognised or not, which would affect the subsequent measurement. If NCI is derecognised, it seems to follow that the requirements in IAS 32/IAS 39 would always apply to changes in the measurement of the NCI put liability, as IAS27/IFRS10 would no longer be relevant in that case.

3. Therefore these issues should be addressed without delay by the IASB and the Interpretations Committee as part of their responsibility towards maintaining IFRS.

Wider issues

4. EFRAG accepts that the Draft Interpretation is a pragmatic short-term approach to reduce diversity in practice. However, we would like to highlight that the wide-ranging discussions on accounting for instruments/contracts over own equity show the need for a broader standard-setting effort by the IASB Board. In particular, EFRAG believes that the IASB should restart the project on Financial Instruments with Characteristics of Equity (FICE).

5. We believe that instruments over own equity – such as written put options – are not all identical as they may have different features, which may arise from the basis on which these instruments are priced (i.e. fixed priced versus variable). Also, NCI puts may be part of a larger, more complex fact pattern depending on whether they are issued at the time of a business combination or outside of a business combination.

6. NCI puts and related contracts involving own equity instruments, is a complex subject that has been debated at length both by the Interpretations Committee and by the Board. As explained in paragraph BC11 of the Draft Interpretation, the Interpretations Committee agreed with the view that some derivatives written on an equity's own equity instruments should be accounted for on a net basis at fair value and recommended the IASB to propose a narrow scope amendment to IAS 32 to exclude NCI puts from the requirements of paragraph 23 of IAS 32. However, the IASB rejected this recommendation, and argued that it had considered similar issues and comments from constituents when IAS 32 was revised. It concluded that any treatment other than as a gross liability would require a reconsideration of provisions in IAS 32 that require liability treatment for obligations that are conditional on events or choices that are beyond the entity's control as set out in paragraphs BC11 and BC12 of IAS 32.

7 We further note that IAS 32 contains a number of exceptions from the general principle set out in paragraph 23 of IAS 32, the 'fixed for fixed' criteria, and the requirements arising from the recent amendments to puttable instruments. Consequently contracts over own shares can potentially be accounted for in three different ways: as equity instruments, as financial liabilities (measured on a gross basis in accordance with IAS 32) or as derivatives (measured on a net basis in accordance with IAS 39). EFRAG believes that this variety of treatments also illustrates the need for a wider standard-setting effort to address these broader issues.

Issues to be considered by the Interpretations Committee before finalisation of the Draft Interpretation

Importance of a common understanding of existing principles in IFRS

8 With regard to subsequent measurement, we believe that the diversity in practice arises from a conflict in principles in IAS 27/IFRS 10, which requires non-controlling interests to be presented as owners and consequently transactions with NCI without transfer of control to be reflected in equity (in line with IAS 1 and IFRIC 17), while IAS 32 requires NCI puts to be measured as financial liabilities with subsequent remeasurement recognised in profit or loss in accordance with IAS 39.

9 Paragraph 7 of the Draft Interpretation explains that changes in the measurement of the NCI put liability do not change the relative interests in the subsidiary that are held by the parent and the NCI and therefore are not equity transactions (i.e. they are not transactions with owners in their capacity as owners) as described in paragraph 30 of IAS 27 or paragraph 23 in IFRS 10. We note that currently transactions are accounted for in equity even when there is no change in ownership interests, for example under IFRIC 17 which requires remeasurement of a liability to distribute a non-monetary asset to an owner in its capacity as owner to be recognised in equity. We acknowledge that when IAS 32 was revised the IASB considered whether the holder of an equity instrument is still an owner when the entity has a related obligation to deliver cash. Paragraph BC11 states that the IASB also decided that when an entity has an obligation to purchase its own shares, 'to the extent of the obligation, these shares cease to be equity instruments'. However, this does not explain when the equity transaction has taken place and leaves open the question on whether NCI continues to be recognised.

10 In our view, it is fundamental that there is common understanding for those that apply IFRS why the Interpretations Committee considers that the guidance in IFRS 10 is not relevant when deciding that the correct interpretation of existing standards is the accounting set out in IAS 32 and IAS 39. If the Interpretations Committee decides to go ahead with the Draft Interpretation, we believe that the rationale for this decision should be explained in the Basis for Conclusions.

Answers to the questions asked by the Interpretations Committee

Question 1 – Scope

The Draft Interpretation would apply, in the parent's consolidated financial statements, to put options that oblige the parent to purchase shares of its subsidiary that are held by a non-controlling-interest shareholder for cash or another financial asset (NCI puts). However the Draft Interpretation would not apply to NCI puts that were accounted for as contingent consideration in accordance with IFRS 3 *Business Combinations* (2004) because IFRS 3 (2008) provides the relevant measurement requirements for those contracts.

Do you agree with the proposed scope? If not, what do you propose and why?

EFRAG's response

EFRAG supports a narrow scope as a pragmatic short-term solution to address diversity.

11 We support the scope of the Draft Interpretation on the basis that it is a pragmatic short-term solution to address diversity in practice until further standard-setting efforts are undertaken.

NCI puts as contingent consideration

12 EFRAG agrees that NCI puts accounted for as contingent consideration under IFRS 3 (2004) should continue to be accounted for by changing the cost of investment as this is consistent with the decisions taken when IFRS 3 (2008) was adopted.

13 EFRAG believes that it would aid understanding of the Draft Interpretation if the final sentence in paragraph 5 of the Draft Interpretation explicitly referred to paragraphs 65A to 65E of IFRS 3 (2008).

14 The Draft Interpretation does not state whether it applies to NCI puts that are in effect contingent consideration in a business combination made after an entity adopted IFRS 3 (2008). EFRAG notes that the 2010-2012 Annual Improvements cycle contains a proposed amendment requiring contingent consideration to be measured at fair value through profit or loss. However, paragraph 7 of the Draft Interpretation allows changes in the financial liability for NCI puts to be measured at either amortised cost or fair value.

15 EFRAG believes the Interpretations Committee should clarify whether NCI puts that are in effect contingent consideration should be accounted for under IFRS 3 (2008) or the Draft Interpretation.

Application only to the parent entity's consolidated financial statements

16 The Draft Interpretation limits its scope to 'the parent's consolidated financial statements' in relation to 'put options that oblige the parent to purchase shares of its subsidiary'. This means that NCI puts written by group entities other than the reporting parent would be outside the scope of the Draft Interpretation. EFRAG believes that this is an unnecessary restriction in the scope of the Draft Interpretation. We therefore suggest that the word 'parent' be replaced by 'entity' as this is consistent with the wording in paragraph 23 of IAS 32 and would therefore cover all NCI puts written by entities within a group.

Separate financial statements

17 The Draft Interpretation does not address the accounting in the separate financial statements.

18 EFRAG notes that where a parent has written a put over the shares in its subsidiary, the NCI put would be treated as a derivative in the separate financial statements of the parent entity as this would not be a derivative over 'own equity' of the parent. We believe this should be made clear.

Question 2 – Consensus

The consensus in the Draft Interpretation (paragraphs 7 and 8) provides guidance on the accounting for the subsequent measurement of the financial liability that is recognised for an NCI put. Changes in the measurement of that financial liability would be required to be recognised in profit or loss in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 *Financial Instruments*.

Do you agree with the consensus proposed in the Draft Interpretation? If not, why and what alternatives do you propose?

EFRAG's response

EFRAG accepts that the consensus is consistent with the requirements of IAS 32 and IAS 39.

19 EFRAG accepts that recognition of changes in the measurement of a financial liability for an NCI put in profit and loss is consistent with the requirements of IAS 32 and IAS 39.

20 We accept that the proposed treatment is consistent with that for other contracts written on an entity's own equity within the context of the requirements in IAS 32 and IAS 39, which requires an NCI put to be initially measured as a financial liability, and remeasured in accordance with IAS 39. Furthermore, we acknowledge that the proposed treatment ensures that the shares issued with a separate NCI put are treated in the same way as puttable shares.

21 To the extent that one might believe that the underlying shares and the NCI put should be considered as a single instrument, we note that an NCI share with a separate put option is economically equivalent to a puttable share. On this basis, the accounting requirements for NCI puts should be consistent with the requirements for puttable financial instruments (paragraphs 18 of IAS 32). If a subsidiary issues puttable shares, those shares are classified as liabilities in the consolidated financial statements and subsequent changes in the financial liability will be accounted for in profit or loss. In this context, we note that the users of financial statements confirm that presentation of the gross liability provides them with useful information about potential future cash flows.

22 Conversely, if NCI puts are to be considered separately, we agree that 'owners' are defined by paragraph 7 of IAS 1 as 'holders of instruments classified as equity'. We therefore accept that under IAS 32, a party in its capacity as a holder of an NCI put is not an 'owner' by virtue of the fact that a written put option is a liability.

23 Moreover, we note that paragraphs 4.47 and 4.49 of the Conceptual Framework for Financial Reporting states that income (expense) is recognised when a liability decreases (increases). Therefore, any changes in the liability recognised for an

NCI put should result in recognition of income or expense to be consistent with the Conceptual Framework.

24 However, as explained above, we would like to highlight that our due process has indicated that NCI puts and related contracts involving own equity instruments is a complex and controversial subject. EFRAG notes that a single basis of measurement may not be appropriate in all cases, particularly when NCI puts have different features and accounting for them in the way might not reflect their economic substance. We would recommend the Interpretations Committee to articulate in its Basis for Conclusion why it believes that a single basis for subsequent measurement of NCI puts is appropriate in all cases.

Question 3 – Transition

Entities would be required to apply the Draft Interpretation retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

Do you agree with the proposed transition requirements? If not, what do you propose and why?

EFRAG's response

EFRAG agrees with retrospective application.

25 EFRAG agrees with the Interpretations Committee's view that entities will not face significant challenges in obtaining the information required for retrospective application. We therefore support this transition requirement.