4 October 2012

Our ref: ICAEW Rep 148/12

Mme Françoise Flores
Chair
European Financial Reporting Advisory Group
13-14 Avenue des Arts
B-1210 Brussels

By email: commentletter@efrag.org

Dear Mme Flores

Put Options Written on Non-controlling Interests

ICAEW welcomes the opportunity to comment on EFRAG's draft comment letter in respect of the proposed Interpretation *Put Options Written on Non-controlling Interests* published by the IFRS Interpretations Committee on 31 May 2012.

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 138,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

The Financial Reporting Faculty is recognised internationally as a leading authority on financial reporting. The Faculty's Financial Reporting Committee is responsible for formulating ICAEW policy on financial reporting issues, and makes submissions to standard setters and other external bodies. The faculty also provides an extensive range of services to its members, providing practical assistance in dealing with common financial reporting problems.

Attached as an appendix to this letter is a copy of ICAEW's response to the IASB. The principal themes and specific detail of our response is set out in that document; in this letter we respond specifically to the questions that EFRAG has posed to its constituents. We appreciate the reservations that EFRAG has about the Interpretation but we do not concur with the resolution proposed. In our opinion the shortcomings with the Interpretation stem from a lack of guidance regarding the presentation of financial instruments with the characteristics of equity. The IASB released a discussion paper on this subject back in 2008, but the project has not been completed. We suggest that the core issues EFRAG is concerned about would be best addressed through continuation of that project. However, as that will not be possible within the forthcoming three year agenda period, in our mind this is a longer-term aspiration. For now the Interpretation is an acceptable practical solution.

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EFRAG'S QUESTIONS TO CONSTITUENTS

Do you agree that the Interpretations Committee should develop a broader interpretation that is consistent with IFRS 3, IFRS 10/IAS 27, IAS 32 and IFRIC 17?

No. As explained above, although these criticisms could be levelled at the Interpretation we do not believe it is desirable to extend its scope at this time. The Interpretation is an acceptable practical expedient.

To what extent do you believe diversity in practice arises on initial recognition of NCI puts?

We are conscious that in general diversity does exist in the treatment of own-equity derivatives. The Interpretation makes a useful contribution toward reducing this, but in our opinion the issue can only be comprehensively addressed through finalisation of the IASB project on financial instruments with characteristics of equity.

How do you believe NCI puts should be accounted for?

We agree with view 1 (the approach taken in the Interpretation) as a practical expedient.

Do you believe that whether or not NCI has been derecognised should determine the accounting for NCI puts?

Do you believe that the exercise price of NCI puts (e.g. fixed, fair value or formula-based) should determine the accounting for NCI puts?

No, we agree with view 1. It is unnecessarily complex to put in place rules for re-measurement in equity in particular circumstances. A better solution would be to clarify the principles surrounding classification on initial recognition through completion of the IASB's financial instruments with characteristics of equity project. However, as noted above this is not feasible in the shorter term and therefore we support the Interpretation as a practical expedient.

Yours sincerely

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APPENDIX – ICAEW COMMENT LETTER TO THE IFRSIC

Put Options Written on Non-controlling Interests

ICAEW welcomes the opportunity to comment on the Draft Interpretation *Put Options Written on Non-controlling Interests* published by the IFRS Interpretations Committee on 31 May 2012.

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We agree that there is a need for further clarity in this area. In practice there are differences of opinion as to whether the effect of subsequent changes in the measurement for such liabilities should be taken to equity or profit/loss. It is useful that the Committee has clarified how these effects should be treated and that subsequent changes should not be taken to equity.

Nevertheless, it should be noted that the need for an Interpretation arises because of wider ambiguity about the presentation of equity and non-equity items. The IASB attempted a more comprehensive exploration of this issue in its 2008 discussion paper *Financial Instruments with Characteristics of Equity (FICE)*, and in the longer-term the continuation of this project is desirable if we are to reach a principles based solution to the range of problems that the lack of guidance in this area continues to gives rise to. Indeed, although we agree that the Interpretation reaches a technically correct answer, because this issue has not been resolved the explanation that underpins the consensus does not effectively explain the decision reached. The key question here relates to the classification of derivatives over own equity on initial recognition, ie, whether or not these should be recognised in equity. Once this has been clarified, the subsequent measurement issue that the Interpretation addresses would be easily resolved. Therefore, while we agree with publication of the Interpretation as a pragmatic solution to this issue and concur with the Committee that its scope should be limited in the way proposed, in the longer term we feel that the FICE project should be reopened to comprehensively deal with the issues in this area.

In addition, by linking to IFRS 9 the Interpretation highlights some broader issues with that standard. The Interpretation concludes that under paragraphs 5.7.1 and 5.7.2 of IFRS 9 the effects of subsequent measurement would go to profit/loss. We think it would be more helpful to assist preparers in determining the appropriate IFRS 9 classification for the liability under either IFRS 9 paragraph 4.2.1 or IFRS 9 paragraph 4.2.2 (including its reference to paragraphs 4.3.5 to 4.3.7) rather than refer immediately to the subsequent measurement paragraphs of IFRS 9. In some cases, the put option may contain an embedded derivative and, if so it is unclear to us why the contract would not be treated in the same way as any other financial liability with an embedded derivative under IFRS 9. This would result in the fair value movement relating to own credit being recognised in OCI rather than in profit or loss.

We believe some of the confusion caused by the reference to paragraphs 5.7.1 and 5.7.2 is exacerbated by the ambiguity within IFRS 9 itself. Our response to ED/2012/1 *Annual improvements to IFRS: 2010-2012 cycle* (ICAEW REP 127/12) sets out our concerns regarding the proliferation of categories within IFRS 9 and the lack of clear signposting between them. Given that work to finalise IFRS 9 is still on-going we urge the Committee to suggest to the Board that this issue be resolved such that application of the Interpretation can be eased.

It is particularly important to note that unless readers understand that the term 'financial liability designated as at fair value through profit or loss' means the fair value option, and that this is different from 'financial liability that is measured at fair value [through profit or loss]', they could end up rather confused. Our response (ICAEW REP 127/12) suggests some editorial changes to IFRS 9 to ensure that consistent terminology is used to describe the two categories.

Question 1: Do you agree with the proposed scope? If not, what do you propose and why?

The Interpretation is a pragmatic solution to an urgent issue, and therefore in this context we agree that its scope should be limited to put options over subsidiaries shares held by non-controlling interests and should not set a wider precedent. We also agree with the exclusion of contingent consideration although in the paragraphs above we note that there are some problems with the accounting for such financial liabilities under IFRS 9.

Question 2: Do you agree with the consensus proposed in the draft Interpretation? If not, why and what alternative do you propose?

We agree that the consensus reaches a technically correct answer. However, in the paragraphs above we note that the issues underlying the Interpretation cannot be fully addressed without completing the Financial Instruments with Characteristics of Equity project. Given that this project cannot be re-started within the Board's forthcoming three year agenda period, a comprehensive solution is likely to be achieved only in the longer term. Therefore as a practical expedient we support publication of the Interpretation. We also highlight some wider issues with IFRS 9 which the Interpretation serves to illustrate.

Question 3: Do you agree with the proposed transition requirements? If not, what do you propose and why?

We agree that the Interpretation should have retrospective application. We note that the draft Interpretation does not suggest an effective date and we appreciate that the link to IAS 39 will allow European Adopters to adopt the Interpretation in the absence of action by EFRAG to endorse IFRS 9. However, the fact that IFRS 9 is incomplete, is not yet accepted in Europe, and is being re-opened for further work by the Board, mean that there is no stable platform for financial liability reporting. And although the Interpretation is useful in pointing preparers toward the financial instruments standard, in practical terms its issue does coincide with a period of significant upheaval in the underlying accounting framework to which it is referring. This may complicate application and the Committee should be mindful of this in finalising the Interpretation. At the least this wider context might be relevant when selecting an appropriate effective date.