BUSINESSEUROPE

Members of the IASB
IASB
30 Cannon Street,
London EC4M 6XH
United Kingdom

21 January 2013

Dear Board Member,

Re: IFRIC Interpretation X Put Options Written on Non-controlling Interests (DI NCI Puts)

We would like to thank the five members of the Board and the staff who kindly took the time to meet with representatives of BUSINESSEUROPE in November to discuss the issue of NCI Puts. A copy of the slides discussed at that meeting is appended for information.

We would like to follow up on some aspects of that meeting.

For the sake of completeness and the avoidance of misunderstanding we highlight two key areas of the call where we felt common ground had been reached.

A Board member commented that re-measurement of the NCI put liability is just like any other liability, e.g. accrual, provision etc. and so the current IAS 39/IFRS 9 requirements should apply.

After a lengthy discussion, it appeared that all parties acknowledged that the NCI put liability is not just like any other liability for the following reason:

- In the case of a normal liability (provision, accrual etc), P&L charge = cash outflow and this makes economic sense, whereas

- In the case of the NCI put liability, P&L charge = merely the difference between the initial estimate and the final actual amount; this does not represent any real economic phenomenon and is thus devoid of economic sense.

To reinforce this we have documented the examples that were discussed during the call which are appended for further information.

A Staff member commented that, if the NCI put strike price is based on some formula, which is a proxy for fair value, then it doesn't make sense to have a P&L gain/loss on re-measurement of the NCI put, as in the end, you get what you intended to pay for.

AV. DE CORTENBERGH 168
BE-1000 BRUSSELS
BELGIUM
VAT BE 863 418 279

BUSINESSEUROPE a.i.s.b.l.

WWW.BUSINESSEUROPE.EU

TEL +32(0)2 237 65 11
FAX +32(0)2 231 14 45
E-MAIL: MAIN@BUSINESSEUROPE.EU
EU Transparency register 3978240953-79

The members of BUSINESSEUROPE agreed with this. This is the same point that we also made, albeit expressed differently, i.e.

- The transaction continues to be with the NCI shareholder until settlement.

- The P&L impact has no economic meaning. It simply represents the lack of accuracy of the initial estimate.

These two points are key in determining the accounting requirements for an NCI put liability. Consequently, we were disappointed with the conclusion reached in the Agenda Paper 17 for the IFRS IC meeting of this month. In summary, we believe it is unacceptable to conclude that because IAS 39/IFRS 9 already contain guidance for changes in financial liabilities and an NCI put liability is a type of financial liability, then this guidance must apply, even if the resulting outcome makes no sense. After considering the pros and cons in the Agenda Paper 17, we are confused how such a conclusion can be reached as it is clear that the volume and weight of arguments are against the proposal.

Therefore, while we acknowledge that the paper contains an extensive inventory of the comments both for and against this draft interpretation, and we also agree with its recommendation to the Board to reconsider the requirements of IAS 32.23 in the near term, we do not think that the recommendation to proceed with the Interpretation is appropriate. A common thread of many responses to the DI is that, whatever the validity of the interpretation that variations in the liability should be recognised in P&L, the underlying accounting rule of IAS 32.23 is fundamentally flawed as it does not result in useful information. We reiterate some of these below:

- The impact on the P&L of a group is not only a misrepresentation of the economic substance of the transaction, in that in many instances a charge is recognised when the subsidiary performs well and a profit when it performs badly, but the amount can be extremely significant to the results of the group and will be included in its "headline" results. An example of such an effect is given in the attached slides. The unhelpful nature of this is recognised by users we have spoken to, who will in essence ignore the effect, and it may lead to the use of "non-GAAP" presentation.

- The treatment effectively inverses the P&L effect of the risk profile commonly attributed to options: a fixed-price put becomes risk-free (albeit with a charge for the time-value of money) and a fair-value or performance-related put becomes volatile. In passing, we would say there is a view that the more relevant recognition of risk from the group's viewpoint is that which is integrated through its consolidation of the assets and liabilities of subsidiaries.

- The question of whether a transaction with holders of NCI puts are transactions with "owners" appears to rely upon the view that since the NCI put has been reclassified under the exception of IAS 32 to become a gross liability, the interest it represents cannot be an ownership interest as defined in IAS 1 ("Owners are holders of instruments classified as equity"). We are not convinced by this for various reasons:
    - (a) This seems to assume that when the put on NCI has been recognised as a liability that the debit side has been to NCI. This is not necessarily the case as the booking often takes place in retained earnings and therefore it is not the NCI that has been classified as financial liability, but rather the put thereon;
    - (b) As the liability exists only because of an accounting fiction ("as-if liability") nothing really has changed with respect to the fact that non-controlling shareholders hold equity instruments of a group entity and have, for example, dividend rights. It would seem inappropriate, based on the underlying "economic unit concept", to conclude that the "owner" definition of IAS 1 is limited to equity instruments of the parent entity;
    - (c) This conclusion would seem at first sight contradictory to the conclusion reached by the IFRIC in July 2009, with respect transaction costs in connection with NCI;
    - (d) Finally, such a conclusion would, amongst other things, imply that dividends declared for the NCI during the life of the put are not equity transactions and should be charged to expense. We think that this is not intended. In addition, if the NCI is no longer an owner, then the ownership interest of the parent must have changed, and IAS 27.30-31 seems to deal with this appropriately.

Following on from the above, we believe that in directing the IFRS IC towards its consensus, the Board has not sufficiently considered the highly important aspect of the usefulness of the information provided by the proposed accounting, and we would encourage it to consult with a wider range of users on this point. Furthermore, we think that the January Agenda Paper places too much emphasis on the views of oversight bodies who are not regulators themselves, and who may not have a detailed enough understanding of the difficulties the interpretation may cause entities. While we accept that there may be diversity in practice, we believe that only a small number of entities is concerned but the effect on the results of the individual entities could be very significant and potentially damaging, particularly as such a counter-intuitive impact may be misunderstood by many investors. We are also under the impression that undue weight is given to these oversight bodies, while the view of users has not been discussed at all in the paper, although we provided you with two views during our meeting.

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Finally, the recommendation not to treat all the accounting aspects, such as the treatment of dividends, the specific location of the first debit to equity, etc., means that many potential and significant sources of diversity in practice will inevitably remain, even after the imposition of a uniform treatment of the variation in the amount of the liability.

We therefore respectfully urge the Board to reconsider its approach to this subject and suspend the DI pending a broader project dealing fully with all the ramifications of consolidation and financial instruments.

Yours faithfully,

Jérôme P. Chauvin
Director
Legal Affairs Department
Internal Market Department

C.C: *Members of IFRS Interpretations Committee*
Sue Lloyd, IASB
Michael Stewart, IASB
Wayne Upton, IASB