



European Financial Reporting Advisory Group

INVITATION TO COMMENT ON THE EFRAG'S ASSESSMENTS OF THE AMENDMENTS TO IAS 32 AND IAS 1 "PUTTABLE FINANCIAL INSTRUMENTS AND OBLIGATIONS ARISING ON LIQUIDATION"

Comments should be sent to commentletter@efrag.org by 28 April 2008

EFRAG has been assessing the Amendments to IAS 32 and IAS 1 "Puttable Financial Instruments and Obligations Arising on Liquidation" (the amendments) against the criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from their implementation in the EU.

A brief summary of the amendments is set out in Appendix 1.

EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record unless the respondent requests confidentiality. In the interests of transparency EFRAG will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

1 Please provide the following details about yourself:

(a) Your name or, if you are responding on behalf of an organisation or company, its name:

Dr. Alexander Mentz

(b) Are you/ls your organisation or company a:

Preparer User Other (please specify) Lawyer (Rechtsanwalt)

(c) Please provide a short description of your activity/ the general activity of your organisation or company:

I am a German lawyer (advising clients mainly in connection with mergers and acquisitions and corporate restructurings).

(d) Country where you/your organisation or company is located:

Cologne (Germany)

(e) Contact details including e-mail address:

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2 EFRAG's initial assessment of the amendments is that they meet the technical criteria for endorsement. In other words, they are not contrary to the true and fair principle and they meet the criteria of understandability, relevance, reliability and comparability. EFRAG's reasoning is set out in Appendix 2.

(a) Do you agree with this assessment?

Yes No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

(b) Are there any issues that are not mentioned in Appendix 2 that you believe EFRAG should take into account in its technical evaluation of the amendments? If there are, what are those issues and why do you believe they are relevant to the evaluation?

See Annex.

3 EFRAG is also assessing the costs that will arise for preparers and for users to implement the amendments both in year one and in subsequent years. Some initial work has been carried out, and the responses to this Invitation to Comment will be used to complete the work. The results of the initial assessment are set out in Appendix 3. To summarise, the amendments will:

- (a) involve preparers incurring some year one costs—in order to read, understand and implement the new requirements—but that those costs will not be significant (see Appendix 3 paragraphs 1-7) ;
- (b) not involve preparers incurring significant incremental ongoing costs (see Appendix 3 paragraphs 1-7) ; and
- (c) involve users incurring only insignificant incremental year one and no incremental ongoing costs. Indeed, the amendments might reduce the ongoing costs to some users by making it easier to understand and analyse the financial statements of entities issuing instruments of the type addressed in the amendments (see Appendix 3 paragraph 8).

Do you agree with this assessment?

Yes No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be?

Yes, except for my comments made in relation to item 2 (b) above (see Annex).

- 4 As EFRAG believes (as explained in Appendix 3) that the amendments will improve the quality of the financial information provided and its implementation will involve on an overall level additional costs that will not be significant, it has tentatively concluded that the benefits to be derived from applying the amendments will exceed the costs involved.

Do you agree with this assessment?

Yes No

If you do not, please explain why you do not and what you think the implications should be for EFRAG's endorsement advice?

Yes, except for my comments made in relation to item 2 (b) above (see Annex).

- 5 EFRAG is not aware of any other factors that should be taken into account in reaching a decision as to what endorsement advice it should give the European Commission on the amendments.

Do you agree that there are no other factors?

Yes No

If you do not, please explain why you do not and what you think the implications should be for EFRAG's endorsement advice?

Ad 2(b):

EFRAG might wish to consider taking the following issue regarding disclosures into account in its technical evaluation of the amendments (the *Amendments*):

Pursuant to IAS 1.136 A (c) (rev. 2008), for Puttable Instruments classified as equity instruments an entity shall have to disclose “the expected cash outflow on redemption or repurchase of that class of financial instruments”.

At least for German partnerships, it may in certain cases be quite burdensome (or even impossible) to comply with that requirement.

This is so, **firstly**, because in such cases the partners may have provided for long or very long ordinary termination periods in their partnership agreement. Not infrequently, these periods can be 10, 20 or even 30 years (whereby a 30-year termination period is still deemed to be valid, legally speaking, by German case law). In those cases, it is probably impossible (or meaningless) to estimate the amount of the relevant applicable compensation payment, i.e. the then prevailing fair value of the relevant partnership interests or the applicable compensation amounts otherwise validly agreed in the partnership agreement, e.g. based on the book value or based on the book value plus a certain mark-up (see *Schmidt*, BB 2008, 434 et seq.).

Secondly, an additional complication in that context seems to be the following:

If a German partnership agreement contains a book value or similar compensation clause which results in a value significantly different from the fair value, then German courts will regularly not accept that value for the purpose of calculating the compensation amount, but will adjust it based on a balancing of the interests of the exiting partner on the one hand and the partnership on the other hand with a view to arriving at a compensation amount that can be deemed to be "fair" under the given circumstances, considering all facts surrounding the case and the relevant interests involved (see *Mentz*, DStR 2007, 453 et seq.). The final compensation amount arrived at by the German courts will in most such cases range between the book value and the fair value. It goes without saying that the final compensation amount so arrived at by the German courts cannot be predicted with certainty, but it can at best only be estimated within a relatively wide range of discretion, which even exacerbates the burden created by the said disclosure requirement for certain preparers, e.g. German partnerships.