Telefónica

Madrid, 24 September 2012

Françoise Flores
European Financial Reporting Advisory Group
35 Square de Meeûs
B-1000 Brussels
Belgium

Re: Draft Interpretation D1 2012/2 *Put Options Written on Non-controlling Interests*

Dear Françoise,

I am writing on behalf of Telefónica, S.A. one of the world's largest telecommunications companies by market cap.

Telefónica is very pleased to provide comments on the Draft Comment Letter concerning the Draft Interpretation (D1/2012/2) *Put Options Written on Non-controlling Interests* issued by the IFRS Interpretations Committee (the "IFRIC") on May 31 2012 (the "Draft Interpretation" or the "Draft").

The Draft Interpretation addresses the subsequent measurement of put options written on shares held by non-controlling shareholders ('NCI puts') in the consolidated financial statements of the parent entity. Telefónica supports the IFRIC's efforts to address the issue of the existing diversity in practice in accounting for the subsequent measurement of the financial liability that is recognised in a parent entity's consolidated financial statements for an NCI put.

However, we share EFRAG's concerns regarding the proposals and the use of an Interpretation to resolve the issue and encourage the IFRIC to urge the IASB to prioritize their project on financial instruments with characteristics of equity.

If you would like to discuss any of the issues described herein, please do not hesitate to contact Marta Soto, Head of Accounting Practice, at +34914828534 or by e-mail to marta.sotobodi@telefonica.es.

Yours sincerely,

Marta Soto

Telefónica's responses to the questions asked in the Draft Comment Letter

Question to EFRAG's 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 (as recommend in paragraph 8 above)? Please explain why.

To what extent do you believe diversity in practice arises on initial recognition of NCI puts? If you are not aware of wider practice, please explain how your organisation accounts for the debit entry of an NCI put liability.

We agree with the EFRAG that the Draft Interpretation should address all relevant aspects of accounting for contracts written over non-controlling interests, including NCI puts and similar instruments, in a manner that is consistent with the principles underlying IFRS 3, IFRS 10/IAS 27, IAS 32 and IFRIC 17 as this would result in a more robust and principles-based solution. We therefore agree with EFRAG's proposed response to Question 1 that the scope is too narrow in limiting applicability to NCI puts written by the parent itself.

Upon initial recognition of an NCI put, Telefónica takes the initial debit to NCI, sometimes completely derecognising NCI, any excess being debited to goodwill.

Question to EFRAG constituents

How do you believe NCI puts should be accounted for? Please explain why.
Do you believe that whether or not NCI has been derecognised should determine the accounting for NCI puts? Please explain why.
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? Please explain why.

EFRAG has not reached a consensus on whether it believes remeasurement in profit or loss is appropriate. The Draft Comment Letter therefore sets out the views of EFRAG members and asks constituents for their comments.

Overall, Telefónica could support that remeasurement in profit or loss is appropriate in some cases (View 3), whereas in other cases remeasurement in equity produces relevant information, as set out in View 2. Telefónica agrees that remeasurement in equity, rather than profit or loss, is appropriate, since the recognition of changes in profit or loss is not consistent with IAS 1 *Presentation of Financial Statements* which specifies that transactions with owners in their capacity as owners should not be reflected in the income statement. Moreover, IFRS 10/IAS 27 regards NCI as equity in the consolidated financial statements, and specifies that (IFRS 10p23) "changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (i.e. transactions with owners in their capacity as owners)", prohibiting the recognition of gains or losses arising on such transactions in profit or loss. We agree with the view that an NCI put contract involves a change in the ownership of a subsidiary that does not result in the parent losing control of the subsidiary, only that the "change" occurs at a later stage – if and when the NCI put option is exercised. Thus we support that it could be argued that the NCI put is part of the transaction with owners of the entity that triggers the anticipated change in a parent's ownership interest in a subsidiary.

Furthermore, we are not sure whether recognition in profit or loss would produce relevant information, reflecting the economic reality underlying NCI puts. Remeasurement changes recorded in profit or loss results in counterintuitive accounting for NCI puts exercisable at fair value (or an amount determined by a formula, such as a multiple of earnings): an increase in the value of the underlying shares, for example because of improved performance by the subsidiary, results in recognition of a loss.

We admit, however, that if a parent entity has determined that it has, in substance, acquired an ownership interest as a result of a transaction that gives it access to the returns associated with an ownership interest then NCI will have been derecognised. Only in these cases, as the NCI has been acquired, it is not an owner anymore and therefore paragraph 23 of IFRS 10 does not apply, and recognition in profit or loss would be appropriate.

However, we acknowledge that recognition of remeasurement changes in equity for NCI puts is inconsistent with the accounting under IAS 32 for all other contracts over own equity, and would be different to that of an economically similar puttable share. Therefore, Telefónica would like to encourage IFRIC to revisit the alternative approach that requires amending IAS 32 to change the measurement basis of all puts over own equity instruments (including NCI puts) in the parent's consolidated financial statements, so that all derivatives are measured on a net basis at fair value, consistently with derivatives that are within the scope of IAS 39 and IFRS 9 (as explained in BC11). From a technical and conceptual standpoint we consider that this would be the best way to deal with NCI puts, as we find no reason why one type of derivatives should be accounted differently from other derivatives under IAS 39 and IFRS 9. In this scenario, we agree with the EFRAG that the IFRIC should report back to the IASB who should consider prioritising their project on financial instruments with characteristics of equity in order to address the complexity and broad range of issues that arise in connection with contracts written on an entity's own equity in a comprehensive manner, including aspects of initial and subsequent recognition of NCI puts and similar instruments.