FICE Sub 2

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Mr David Boymal
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Dear Mr ~~Boymal~~ David

DISCUSSION PAPER ON FASB'S PRELIMINARY VIEWS ON FINANCIAL INSTRUMENTS WITH CHARACTERISTICS OF EQUITY

The Heads of Treasuries Accounting and Reporting Advisory Committee welcomes the opportunity to respond to the International Accounting Standards Board's Discussion Paper, *Financial Instruments with Characteristics of Equity*.

HoTARAC strongly supports any proposal by the IASB to improve and simplify IAS 32 *Financial Instruments: Presentation* (as indicated in Question 1 of the *Invitation to Comment*). However, HoTARAC is of the view that a Project of this nature potentially has wider scope than is covered by the Financial Accounting Standards Board's Preliminary Views on *Financial Instruments with Characteristics of Equity*, which only addresses two broad classes of criticisms of the distinction set out in IAS 32 between equity instruments and non-equity instruments.

In general, HoTARAC is of the view that none of the three approaches expressed in FASB's Paper is a suitable starting point for an IASB Project to improve and simplify the requirements in IAS 32. HoTARAC considers that the appropriate starting point would be to identify all the problem areas in IAS 32, to assess those which are of greatest significance to constituents, and these should then be prioritised. Further, HoTARAC noted that FASB's proposed solutions for financial instruments with the characteristics of equity seemed to eliminate instruments that are currently considered, in the Australian context, to be uncontroversial when classified as equity under IAS 32. There also seems little to recommend FASB's definition of equity that is so different from that used in other contexts, including taxation, and admissible capital for supervisory regimes etc. These applications are also relevant to users of financial reports and should not be overlooked.

However, if one of the main criticisms of IAS 32 is that the application of the principles in IAS 32 results in an inappropriate distinction between equity instruments and non-equity instruments, then HoTARAC believes that the starting point to address this issue would be to determine the conceptual basis for distinguishing liabilities from equities. Determining this basis is currently being addressed as part of the joint IASB/FASB Conceptual Framework process, and already, the IASB and FASB have identified several practice problems related to financial instruments, as outlined in Appendix D paragraph 22 of FASB's Preliminary Views.

Further, under FASB's preferred "Basic Ownership Approach", only one type of instrument was proposed to represent equity. HoTARAC believes that this approach is flawed, as there are many reasons why ownership interests may exist in different forms, such as: to separate voting rights and entitlement to profit shares; to facilitate smooth succession; or to manage the consequences of different global regulatory and tax regimes. For example, if a particular ownership structure chosen to enable a preferred outcome under taxation legislation results in fixed payments to capital contributors, then the instrument may under the "Basic Ownership Approach" be classified as a liability rather than equity. HoTARAC believes these realities cannot be ignored, and more generally, the three approaches compared by FASB should not be further considered until the financial instruments issues related to the Conceptual Framework Project are resolved.

Therefore, while HoTARAC supports a review to improve and simplify IAS 32, it strongly encourages the IASB to ensure that it is consistent with the proposed Conceptual Framework.

Please contact Peter Batten at the Victorian Treasury, on 03 9651 2395 if you require any additional information regarding this response.

Yours sincerely

D W Challen
CHAIR
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

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