Australian Government

Australian Accounting Standards Board

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Ms Liz Figgie
Senior Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
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Dear Liz

**Discussion Paper – Financial Instruments with Characteristics of Equity**

The staff of the Australian Accounting Standards Board (AASB) is pleased to submit comments on the Discussion Paper – Financial Instruments with Characteristics of Equity. In formulating these comments, the views of Australian Constituents were sought and considered.

Although it is acknowledged that Australian constituents have concerns with the classification requirements of IAS 32 *Financial Instruments: Presentation* generally, the AASB staff is not in favour of any of the approaches as outlined in the FASB Preliminary Views document. Any proposed improvement and simplification should be progressed only once the IASB's and FASB's Conceptual Framework project is finalised, as the elements that are defined in the Framework are likely to impact significantly on the classification of liabilities and equity at the Standards level.

The Basic Ownership Approach in the FASB Preliminary Views paper is particularly concerning give that it assumes a state of liquidation and not one of a going concern, which is the basis on which general purpose financial statements are prepared.

Comments on the IASB's Discussion Paper and the FASB's Preliminary Views paper are set out in the attachment – the AASB staff has addressed only selected issues.

If you have any queries regarding any matters in this submission please contact Joanna Spencer (**jspencer@aasb.gov.au**) or myself.

Yours sincerely,

David Boymal

David Boymal
*Chairman*

**AASB Staff Comments on selected issues on Financial Instruments with Characteristics of Equity**

1. The Basic Ownership Approach may have advantages as a starting point due to its simplistic approach in defining equity. However, simplicity in its own right is not an objective of financial reporting. We do not consider the underlying principles presented in the FASB Preliminary Views paper to be superior to those in IAS 32 and believe that an appropriate starting point would be to address the distinction between equity and liability instruments at a conceptual level.
2. Because of the Basic Ownership Approach's simplicity, we consider that it would be relatively easy to implement, however the focus on subordination means that instruments that are highly similar to Basic Ownership equity instruments, such as preference shares, would not be classified as equity even though they are exposed to the risks and rewards of the entity. We consider that it would be inconsistent with the Conceptual Framework to classify all preference shares as liabilities.
3. The Reassessed Expected Outcomes approach is considered to be overly complex and would add little benefit to an already complex issue.
4. Although classification in the Ownership Settlement Approach is dependent upon the holder's exposure to the residual risk of the entity, we consider that having different measurement models for two financial instruments with the same economic profile but different settlement requirements to be a flawed accounting model, and therefore not suitable for implementation.
5. Although some areas of IAS 32 can be problematic to apply, we do not consider it to be fundamentally flawed. Some of the perceived application issues can only be addressed through the exercise of professional judgement which is expected in a principles based system or model that is a mix of rules and principles, such as the IAS 32 model. Therefore, we consider that any perceived problems can be addressed by amending IAS 32 or addressed through the Conceptual Framework project.
6. The AASB staff note that the scope of the project is narrower than the scope of IAS 32, which covers all financial instruments, except that the Preliminary Views paper appears to capture some instruments connected with share-based payment transactions that are currently within the scope of IFRS 2 (see paragraph 28 of the Preliminary Views paper). We do not consider that this discussion paper project is the appropriate mechanism to address issues within other standards.
7. The Basic Ownership approach only proposes that one type of instrument represent equity which we consider is a flawed approach, as there may be many reasons why ownership interests may exist in different forms within the one entity, such as:
    a. to separate voting rights and entitlements to different profit shares or streams;
    b. to facilitate smooth succession; and
    c. to manage the consequences of different global regulatory and tax regimes.

## IASB Questions

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| B1: Are the three approaches expressed in the FASB Preliminary Views document a suitable starting point for a project to improve and simplify IAS 32? If not, why? |

**See paragraph 1**

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| B1(a): Do you believe that the approaches would be feasible to implement? If not, what aspects do you believe could be difficult to apply and why? |

**See paragraphs 2, 3 and 4**

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| B1(b): Are there alternative approaches to improve and simplify IAS 32 that you would recommend? What are those approaches and what would be the benefit of those alternatives to users of financial statements? |

**See paragraph 5**

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| B2: Is the scope of the project as set out in paragraph 15 of the FASB Preliminary Views document appropriate? If not, why? What other scope would you recommend and why? |

**See paragraph 6**

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| B3: Are the principles behind the basic ownership instrument inappropriate to any types of entities or in any jurisdictions? If so, to which types of entities or in which jurisdictions are they inappropriate, and why? |

**See paragraph 7.**

## FASB Questions

### Questions on the Basic Ownership Approach

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| 1: | Do you believe that the basic ownership approach would represent an improvement in financial reporting? Are the underlying principles clear and appropriate? Do you agree that the approach would significantly simplify the accounting for instruments within the scope of this Preliminary Views and provide minimal structuring opportunities? |

**See paragraph 1**

Perpetual Instruments

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| 2: | Under current practice, perpetual instruments are classified as equity. Under the basic ownership approach (and the REO approach, which is described in Appendix B) certain perpetual instruments, such as preferred shares, would be classified as liabilities. What potential operational concerns, if any, does this classification present? |

**See paragraph 2**