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IAS 32 and IAS 1 Amendments
International Accounting Standards Board
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**Proposed Amendments to IAS 32 *Financial Instruments: Presentation* and IAS 1 *Presentation of Financial Statements*: Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation**

The Australian Accounting Standards Board (AASB) thanks the IASB for the opportunity to comment on the Exposure Draft of Proposed Amendments to IAS 32 *Financial Instruments: Presentation* and IAS 1 *Presentation of Financial Statements*: Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation. In formulating these comments, the AASB has sought and considered the views of Australian constituents (these responses are published on the AASB's website www.aasb.com.au).

Whilst we appreciate that the amendments proposed by this Exposure Draft are regarded as a short-term solution to a particular liability/equity classification issue, we have a number of concerns.

We are concerned that the amendments are rules based, will be inconsistent with the conceptual framework, and will reduce the comparability and increase the complexity of financial reports. We have heard it said that the difficulties with principles-based standards only arise when such standards contain carve outs or exceptions to the general rule. Accordingly, we are surprised the IASB is continuing to perpetuate this problem in the proposed amendments.

These amendments are very narrowly focused and would allow the use of an equity classification for some entities and not other entities with similar funding arrangements which will still have to classify as debt, amounts that they consider in substance to be equity. These other entities arguably deserve the same consideration. Two types of entities we have identified within the Australian environment that perhaps deserve relief but are not given relief under the proposed amendments are:

a) unit trusts with mandatory dividend distribution obligations; and
b) some trading co-operatives in which the shares are puttable at other than fair value.

Within the Australian environment, unit trusts typically have two unique features, a limited life and, due to taxation considerations, a mandatory dividend distribution obligation written into their constitutions, whereby the annual profits of the trust must

be distributed each year to unitholders. Whilst we acknowledge the limited life issue has been adequately addressed in this Exposure Draft, we believe that the proposed amendments have not addressed all the issues associated with limited life entities and unit trusts. In particular, the issue is that the mandatory dividend distribution obligation still imposes an obligation on the entity to deliver cash and as such, these issued instruments will remain classified as financial liabilities. Some unit trusts have been able to amend their constitutions (at a cost) to remove this mandatory distribution obligation, however many others have been unable to do so, at times only because it is difficult to contact or locate all members. Further, it is our understanding that the entities that have removed this distribution requirement will nevertheless continue to distribute all of their profits because of the commercial imperative to do so, due to taxation laws. This creates an anomaly whereby unit trusts that have issued essentially the same type of financial instruments will have to classify these instruments either as a liability or as equity depending on whether they have been able to amend their constitution. As such, this situation will result in reduced comparability between the financial reports of entities that are in substance issuing the same type of financial instrument.

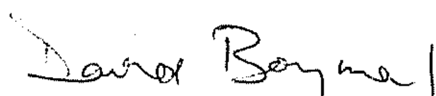
The second type of entity not given relief under the proposed amendments are trading co-operatives in which members purchase (sometimes for a significant amount) a right to trade with the co-operative and to receive yearly returns. These members have the right to put back their share to the co-operative, but the member is only entitled to the amount for which they purchased the share, rather than putting back the share at fair value. Since redemption is for a predetermined amount and is not puttable at fair value, these co-operatives will continue to classify as a liability such puttable financial instruments, even if the IASB proceeds with its proposals. Members of such co-operatives are the ultimate risk takers in the entity and typically receive rebates or calls if the amounts they pay for the co-operatives services during the year exceed or fall short of actual costs incurred by the co-operative. In substance, these instruments are the same as those issued by other co-operatives that use a formula to determine the members share redemption value.

Due to these inconsistencies, we urge the IASB to accelerate its Liabilities/Equity research project with the aim of providing comparative treatment for what are in substance the same types of financial instrument.

Notwithstanding our comments above, if the IASB goes ahead with the amendments, the AASB will support them and provides the following responses to the specific questions in the attachment to this letter.

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

Yours sincerely



David Boymal
Chairman

**Exposure Draft of Proposed Amendments to AASB 132 *Financial Instruments: Presentation* and AASB 101 *Presentation of Financial Statements*: Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation**

## Q1 – Financial Instruments puttable at fair value

> The Exposure Draft proposes that financial instruments puttable at fair value should be classified as equity, provided that specified criteria are met.
>
> *Do you agree that it is appropriate to classify as equity financial instruments puttable at fair value? If so, do you agree that the specified criteria for equity classification are appropriate? If not, why? What changes do you propose, and why? If you disagree with equity classification of financial instruments puttable at fair value, why?*

Although we believe that the scope of the Exposure Draft is too narrow and will lessen the comparability of financial reports we acknowledge that it does go some way to amending the liability/equity classification problem which arose due to the implementation of IAS 32.

## Q2 – Obligations to deliver to another entity a pro rata share of the net assets of the entity upon its liquidation

> The Exposure Draft proposes that an instrument that imposes on the entity an obligation to deliver to another entity a pro rata share of the net assets of the entity upon its liquidation should be classified as equity, provided that specified criteria are met (eg ordinary shares issued by a limited life entity).
>
> *Do you agree that it is appropriate to classify as equity these types of instruments? If so, do you agree that the specified criteria for equity classification are appropriate? If not, why? What changes do you propose, and why? If you disagree with equity classification for these types of instruments, why?*

As with our response to Q1, we believe that the scope of the amendments is too narrow and consideration needs to be given to other types of entities such as trading co-operatives whose instruments have similar characteristics to the entities whose issues are being addressed by this Exposure Draft.

## Q3 – Disclosures

> The Exposure Draft proposes disclosures about financial instruments puttable at fair value classified as equity, including the fair values of these instruments, and the reclassification of financial instruments puttable at fair value and instruments that impose an obligation arising on liquidation between financial liabilities and equity.
>
> *(a)* *Do you agree that it is appropriate to require additional information about financial instruments puttable at fair value classified as equity, including the fair values of these instruments? If so, do you agree that the fair value disclosures should be required at every reporting date? If not, why? What changes do you propose, and why?*
>
> *(b)* *Do you agree that it is appropriate to require disclosure of information about the reclassification of financial instruments puttable at fair value and instruments that impose an obligation arising on liquidation between financial liabilities and equity? If not, why? What changes do you propose, and why?*

The AASB supports the proposed disclosure amendments as presented in the Exposure Draft.

**Q4 – Effective Date and Transition**

The proposed changes would be required to be applied retrospectively, from a date to be determined by the Board after exposure (with one exception permitted relating to compound instruments). Earlier application would be encouraged.

*Are the transition provisions appropriate? If not, what do you propose, and why?*

The AASB is aware of the IASB's intention not to require the application of new IFRSs under development or major amendments to existing standards before 1 January 2009. However, we are unsure, given that no effective date was included in the Exposure Draft, whether these amendments would be classified as "major" and if so whether they would be subject to the stated policy. If this is to be the case, the AASB supports a 1 January 2009 application date on the proviso that early adoption (as stated) remains as an option.