



Accounting Standards Board

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24 July 2008

Dear Paul

EFRAG's Draft Comment Letter on the IASB Discussion Paper 'Financial Instruments with Characteristics of Equity'

This letter sets out the UK Accounting Standards Board's (ASB's) comments on EFRAG's draft comment letter on the IASB Discussion Paper 'Financial Instruments with Characteristics of Equity' (DP).

The ASB supports the main concerns raised by EFRAG in relation to the proposals in the IASB DP that:

- there must be discussion of the purpose of distinguishing between equity and liability and the shortcomings of the current principles used in this area before a solution can be devised;
- this project and the conceptual framework project must be linked; and
- the chosen approach has to work for both separate and consolidated financial statements.

We agree that the basic ownership approach or the ownership-settlement approach do not address any of the above concerns. We enclose our response to the IASB for your information. It makes the above points and requests that the IASB ensure that the project is conceptually grounded and its scope is broader than just financial instruments with characteristics of Equity.

The ASB has some suggested changes for EFRAG to consider that are set out below:

- On page 1 (second paragraph) the EFRAG draft comment letter notes that a fundamental review of the equity/liability distinction is "urgently needed". The ASB agrees that such a fundamental review is needed but does not consider it to be an urgent priority for the IASB. As such the ASB would prefer to see this issue dealt with in the conceptual framework debate first

before the distinction for financial instruments is dealt with. Our suggestion would be that you delete the references to “urgently” in that sentence. Similarly, page 3 (paragraph 3) also makes references to the project being “a priority for Europe”. We would suggest rather that the project is “important” for Europe and would recommend that you make this amendment.

- On page 11 (paragraph 34 (b)) the draft comment letter notes that EFRAG is not in favour of “including anti-abuse clauses in accounting standards”. The ASB is in favour of principles that hinder abuse but does not favour specific anti-abuse rules. Therefore, we would recommend that you change that statement to refer to anti-abuse rules rather than clauses.
- As you would note from the enclosed ASB response to the IASB one of the recommendations is that the IASB and FASB take a longer term approach on this project. The response recommends that an interim solution to the problems of divergence in guidance in the US in this area would be for US GAAP to adopt IAS 32 until such a time as a revised international standard can be developed. The ASB would recommend that the EFRAG comment letter makes a similar recommendation to the IASB.

The ASB has no additional examples of instruments that may be affected by the IASB’s proposals over and above those already included in the draft comment letter. However, our response to the IASB elaborates more on the background of some of the examples used in your draft comment letter.

If you would like to discuss any of the comments made above then please contact Seema Jamil-O’Neill on 020 7492 2422 or myself on 020 7492 2434.

Yours sincerely



Ian Mackintosh

Chairman

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Enclosed: ASB response to the IASB Discussion Paper ‘Financial Instruments with Characteristics of Equity’



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24 July 2008

Dear Sir

IASB Discussion Paper 'Financial Instruments with Characteristics of Equity'

This letter sets out the UK Accounting Standards Board's ('ASB') comments on the above IASB Discussion Paper (DP).

The ASB agrees that there needs to be an IASB project to improve the equity-liability classification requirements in IAS 32 'Financial Instruments: Presentation'. The requirements of IAS 32 in this area have caused difficulties and the Board would recommend that the IASB take this project on its active agenda.

However, the ASB has a number of major concerns with the proposals outlined in the DP. The key concerns are set out below and discussed in more detail in Appendix A to this letter. Answers to the questions in the IASB DP are included in the Appendix B to this letter.

- The ASB is concerned that the IASB DP does not contain any preliminary views from the IASB on the relevance of the FASB PV findings in the international setting or how they may impact the principles in IAS 32. This has resulted in a DP that makes assertions with little or no justification for them. The ASB would have preferred to have seen material included in the DP that provided constituents with the IASB's perspective on the proposals.
- It is important that a project dealing with the definition of equity has conceptual grounding. The DP and PV make little attempt to align the proposals of the project with the current focus of the IASB and FASB's project on the conceptual framework. This inconsistency is particularly apparent in the entity approach adopted in the conceptual framework project and the emphasis in the FASB document on reporting the most residual claims in an entity, a proprietary perspective. (See paragraphs 1-9 of Appendix A)

- The scope of the project is very US-centric i.e. focuses on trying to deal with the problems in US GAAP. As a result, the scope of the project has been limited to the three approaches presented in the FASB PV so that other potentially viable approaches such as the claims, mezzanine and loss absorption approaches have been dismissed without much explanation. On initial review, these alternative approaches appear to be more in line with the international standards than the three approaches discussed in the PV. (See paragraphs 10-14 of Appendix A)
- The definitions of equity explored in the FASB PV make no reference to the liabilities definition. If no attempts are made to link the two the possibility of gaps emerging between the definitions of equity and liability is far greater than is currently the case. (See paragraphs 15-16 of Appendix A)
- The decisions taken in this project on the classification; initial and subsequent measurement; and presentation of the financial instruments with characteristics of equity will have wider consequences for other IASB standards that deal with these requirements for non-financial instruments. However, currently neither document has dealt with the impact on existing standards. (See paragraphs 17-18 of Appendix A)
- It is currently difficult to envisage the benefits for the wider IASB constituency (outside the US) of adopting the proposals put forward in the FASB PV. In order to ensure continued short term convergence between IFRS and US GAAP it may be more advisable and practical to consider other solutions that address the US problems of diverse guidance in this area (e.g. the adoption of some version of IAS 32 in US GAAP). This approach will allow time for a more international approach to be taken on this project. (See paragraphs 19-20 of Appendix A)

In conclusion, we recommend that both the IASB and FASB take a long-term view of this project to ensure that:

- time is given to comprehensively reviewing the alternatives available (including the loss absorption and claims approaches);
- the various aspects (classification, measurement and presentation) are considered in detail; and
- the final approach adopted is consistent with the Framework and other IFRS literature.

Adoption by the FASB of a version of IAS 32 as an interim standard is one possibility which would enable the IASB to take the longer-term approach as well as providing the FASB constituents with a solution to their short-term problem of diverse and confusing guidance in this area.

If you would like to discuss any of the comments made above or in the Appendices, then please contact Seema Jamil-O'Neill on 020 7492 2422 or myself on 020 7492 2434.

Yours sincerely



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Appendix A

General Concerns with the IASB DP and FASB PV

Importance of a conceptual grounding for the project

1. The ASB believes that the determination of whether a financial instrument qualifies as liability or equity is interlinked with the distinction between liabilities and equity. As such, the principles level question must be addressed before the standards level question can be answered. In the first instance, such principles level discussion would consider issues such as:
 - what does equity represent?
 - why and how is it different from liabilities?
 - why is it important to users to distinguish between liabilities and equity?
 - how should equity be measured and presented in the financial statements?
2. In its *Statement of Principles* (SoP), the ASB dealt with this issue by providing definitions of the key elements of financial reporting and the associated recognition and measurement criteria. More detailed rules dealing with the specifics of capital instruments and securitisations etc were then set out in accounting standards. This is also the approach currently taken in IFRS. The elements of financial statements are set out in the IASB's Framework for the Preparation and Presentation of Financial Statements. IAS 32, which deals specifically with presentation of financial instruments, then applies the principles to financial instruments held by entities.
3. Of the currently active projects, Phase B of the IASB's conceptual framework project deals specifically with the elements of financial reporting. That phase is dedicated to exploring the definitions of the three key elements of financial reporting: assets, liabilities and equity. However, so far that project has not dealt with the issue of the definition of equity and its interaction with liabilities.
4. The ASB believes that it is more appropriate in the long-term to first consider the wider questions in the appropriate phases of conceptual framework debate, including: *what* is equity in Phase B; and *how* should it be measured in Phase C. The Boards should then fully develop the standards level guidance for financial instruments. Developing the standard before the conceptual debate has been attempted is very likely to result in disjoints between the Framework and the financial instruments standards similar to those existing today between the IASB Framework and IAS 32. Additionally, providing rules to address such basic questions in accounting can lead to a number of complications and answers that are counter-intuitive and do not reflect the economic reality (as demonstrated by the problems with IAS 32).
5. The ASB is concerned that there appear to be no direct links between the three approaches outlined in the DP and the discussions in the elements phase of the conceptual framework project. In particular, it is difficult to reconcile the approach of the elements phase of the conceptual framework project (which

defines liability and it appears equity will be defined by reference to it) and that in the DP (which attempts to define equity itself).

6. Additionally, paragraph 60 of the FASB PV rather dismisses examining the entity or proprietary perspectives, noting that “both perspectives determine how information should be reported in the financial statements, not what types of instruments should be included in equity”. As noted above, the ASB considers these questions to be interlinked, as the type of instrument would determine how it is reported in the financial statements. The IASB appears to acknowledge this in the exposure draft (ED) issued in May 2008 on the Objectives of Financial reporting which proposes that the Framework would be based on the entity perspective. In particular, it sets out in paragraph BC 1.12 that:

“under the entity perspective (also known as the entity theory) the reporting entity is deemed to have substance of its own, separate from that of its owners. Economic resources provided by capital providers become resources of the entity and cease to be resources of the capital providers. In exchange for the resources provided, capital providers are provided claims on the economic resources of the reporting entity. Claims of different capital providers have different priorities and different rights with respect to the reporting entity, but they all represent claims on the economic resources of the reporting entity. Therefore, financial reporting from the perspective of the entity involves reporting on the economic resources of that entity and the claims on those resources held by its capital providers.”

7. The above quote from the IASB ED seems almost to advocate the claims approach to reporting equity and liability. However, the FASB PV specifically rules out the claims approach as it would not answer the question of ‘which recognized claims will affect net income’ (paragraph E8). At the same time the FASB PV concedes that the three approaches described are also inconsistent with the current FASB Concepts statement 6 (in paragraph D1) and goes on to note that staff were unable to compare to the current project on the Framework as no conclusions had been taken.
8. The FASB has reached a preliminary view that “the basic ownership approach provides more decision-useful information to investors while significantly simplifying accounting requirements for issuers and their auditors”. With its focus on reporting the most residual claims in an entity this approach is clearly based on a proprietary perspective. By contrast, the IASB’s conceptual framework ED concludes that the entity perspective should be adopted. This is because this perspective is considered more likely to convey that an entity is the object of general purpose financial reporting and not its owners or others who may have an interest in it.
9. Although the ASB is not expressing a view in this comment letter on which perspective should be adopted, we believe that the financial reporting of equity should arise directly from the perspective (entity or proprietary)

adopted in the conceptual framework. Severing this link has the potential of creating inconsistencies between the framework and the standards.

10. The financial statement presentation project of the IASB is considering another aspect of this distinction, i.e. how to present the various elements in the balance sheet and the income/ expense arising from them in the income statement. The decisions taken on that project so far indicate that the income statement will be analysed between an operating section and a financing section. This project is likely to be the key to answering the question of how should the equity and the related income/ expense should be presented.

Scope of DP

11. The scope of the FASB PV, and as a result the IASB's DP, is limited to financial instruments with characteristics of equity. The ASB recognises that within US GAAP accounting guidance has lagged the development of financial instruments in this area, thus making the issue of this DP important for the FASB's constituents. However, IFRS requirements in this area are primarily set out in IAS 32 'Financial Instruments: Presentation' and are fundamentally different from those under US GAAP.
12. Furthermore, US GAAP deals specifically with the situation in the US where only incorporated companies listed on the stock exchange are required to produce financial statements complying with GAAP. This is evident in the references in paragraph 15 of the FASB document which attempts to provide a listing of instruments that may be classified as equity under the basic ownership approach by including ownership interests in an entity "in legal form" as well as "basic ownership instruments (whether or not they are ownership instruments in legal form)". By contrast, the IFRS definition of equity makes no reference to the legal form and is currently being applied to entities in a number of very different legal jurisdictions e.g partnerships in Germany and cooperatives in New Zealand. It is difficult to see how the views put forwards in the FASB PV document would affect these and other entities in countries where legal terminology may differ from that used in the US.
13. The recommendations of the PV are an illustration of this. It notes in paragraph 16 that "the Basic Ownership approach is the appropriate method for determining which instruments should be classified as equity instruments." This method requires that the most residual claim is classified as equity and in a legal entity context would be the ordinary shares issued by the company. However, it is unclear how this principle will be applied to entities that are not legal entities in the US context, for example, investment companies in the UK that are required by regulation to issue different types of shares, with the same voting and other rights, to ensure that various tranches of investments are protected.
14. The FASB PV has limited the scope of the project to the three approaches described in the document. Other approaches that may have been viable such as the claims, the mezzanine and the loss absorption approaches have been

dismissed after brief discussion in Appendix E of the FASB PV. As discussed in paragraph 7 above, these approaches appear to be closer to the tentative decisions taken by the IASB and FASB in the conceptual framework project than those discussed in the FASB PV.

15. In particular, the claims approach appears to have more merit in that context than has been credited in the documents. The FASB PV notes the question of “which recognized claims will affect net income” is not answered by the claims approach (FASB PV Appendix E, paragraph E8). The ASB notes that if discussed in context of the financial statement presentation project then it may be possible to arrive at a solution e.g. by splitting income between financing and operating.

Definition of equity

16. As noted in the DP (paragraph 43) the definition of an equity instrument in IAS 32 cannot stand alone: it depends entirely on the definition of a financial asset and financial liability. As mentioned above, the FASB PV document appears to be attempting to provide a standalone definition of equity. It provides three possible approaches to distinguishing equity from liabilities and all three propose a particular definition of equity that makes no reference to the liability definition. This represents a departure from the current practice under IFRS where an equity instrument is defined as the financial instrument that is not a financial asset or a financial liability.
17. The ASB is concerned that if equity is defined without any reference to liability then one of two possibilities may arise: either there are gaps between the two definitions so that some instruments do not qualify for liability or equity classification; or the two definitions overlap thus making it difficult to ascertain the classification for some mezzanine instruments. As such, the only way that would obviously avoid these two consequences is that currently followed by IAS 32 of defining equity by reference to the definition of a liability.
18. Additionally, even the narrow definition of equity provided by the FASB PV has not been fully developed, so that no more than a single tier approach to equity is considered in the document. As noted above, this has the peculiar effect of leaving out of equity the same instruments that currently prove difficult to define and are behind a number of the criticisms levelled at IAS 32 and the revisions made to that standard.

Impact on existing standards

19. As mentioned above, this is not a standalone project and is likely to have much wider implications than currently those explored by either the IASB or FASB documents. The classification of an instrument as equity or liability has a direct impact on its measurement. The FASB document recommends the basic ownership instruments under the basic ownership approach will be initially measured at transaction price and subsequently will not be remeasured. The exceptions to this are basic ownership instruments with

redemption requirements which would be “remeasured at each reporting date at the current redemption value” (the fair value of the consideration that would be paid if the instrument was redeemed at the reporting date). This rule appears to contradict the amendment to IAS 32 published by the IASB in February 2008 dealing with the classification of puttable financial instruments and obligations arising on liquidation. There the IASB preferred to classify such instruments as equity and therefore exempt them from subsequent remeasurement.

20. Although the DP and PV are limited in scope to financial instruments with characteristics of equity the conclusions drawn here has implications for the wider Liabilities/Equity project. As such, the decisions taken in this project on the classification; initial and subsequent measurement; and presentation of the financial instruments with characteristics of equity will have wider consequences for other IASB standards that deal with these requirements. However, currently neither document has dealt with this issue.

Short term convergence with US GAAP

21. The ASB understands the need for this DP arises from the requirements of the MoU and short-term convergence focus of IFRS and US GAAP. However, the ASB is mindful of the differences between the two GAAPs in this area, the possible deadline of IFRS adoption by US companies in 2011, and the time it is likely to take to resolve these very complex issues (if using the IASB’s project on puttables as an indicator). The Board would prefer the IASB and FASB to explore other possible solutions that may prove to be more appropriate in practice. Some of the solutions the FASB could explore include:
- *FASB adopts IAS 32 in its current form as an interim standard.* This option has the advantage of replacing the diverse requirements in this area for the FASB constituents with a single standard whilst allowing the IASB time to consider all the possible global issues, both at a conceptual level and those specific to this area, and to help produce a principles based global standard.
 - *FASB adopts an amended form of IAS 32 which contains simple modifications.* This amendment could be simple (minor amendments to remove some of the existing flaws) or more comprehensive (retaining the principles but a rewrite of the remaining rules that flow from them). This option has the same advantages for the IASB as before.
22. The above solution would mean that a smaller constituency would be affected (i.e. those US companies currently only applying only US GAAP) by the change than would be the case if the FASB project was rushed through as an IFRS solution prior to the 2011 convergence deadline. It is currently difficult to envisage the benefits for the wider IASB constituency of adopting the proposals put forwards in the FASB document, in particular when considering that some would have recently implemented the amendment to IAS 32 published in February 2008.



Appendix B

Response to IASB questions

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?

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

Suitable starting point and practical implementation

1. The ASB does not believe that the approaches set out in the FASB PV document are a suitable starting point for the project to improve and simplify IAS 32 for the reasons set out in the following paragraphs.
2. IAS 32 plays a pivotal role in the classification and presentation of financial instruments. As noted in the IASB DP it has attracted much criticism over the years. However, its main attraction is that it is based on a straightforward principle i.e. that if a financial instrument does not meet the definition of a financial asset or liability it is qualified as equity. This enables the residual interest in an entity after deducting all its liabilities to be classified as equity. This principle in IAS 32 is based on the IASB conceptual framework premise that financial statements are most relevant to the owners of the business, whose share is subordinate to that of the other creditors of the business. This principles based approach has enabled the use of IAS 32 in many diverse jurisdictions across the world.
3. Therefore, any approach that replaces IAS 32 must similarly be principles-based to enable application to a wide range of legal jurisdictions. The ASB would expect a standard that is to replace IAS 32 to take into account the following:
 - Whether it is conceptually sound and consistent with other requirements in the standards. In this context we would expect a discussion of the need for a liability equity distinction.
 - Whether it is principles based and thus can be used by a wide range of entities in diverse legal jurisdictions?
 - Whether it addresses the deficiencies in IAS 32?
4. The three approaches put forwards in the FASB PV document have not started from these principles. Instead, they have been developed as attempts to address the specific problems in the US environment of classification of obligations. According to the PV document (paragraph 7) the strict application of the definition of a liability (as set out in FASB Concepts

Statement No 6) has led to classification of obligations of entities based on the form of the instrument which, the FASB believes, is essentially a structuring choice.

5. The IASB in its DP has attempted to set out the criticisms of IAS 32 as well as the possible implications for IFRSs of the three approaches in the FASB document. However, it does not go beyond comparing the categorisation of various types of financial instruments as equity or liability under IAS 32 and the three approaches put forwards in the FASB document. No attempt has been made to consider whether the deficiencies in IAS 32 will be addressed by the proposals in the FASB PV.
6. In fact, on initial review it appears that some of the criticisms levelled at IAS 32 may well remain even if the PV's recommended approach, the basic ownership approach, is adopted. For example, the IASB DP notes that one criticism of IAS 32 is that the application of its principle can be problematic when applied in specific situations e.g. determining whether a contractual obligation exists when the instrument holder has multiple relationships with the entity (as owner, manager and investor). However, in such a case (i.e. the multiple relationships) it may equally be difficult to ascertain whether "the holder is entitled to a percentage of the assets of the entity that remain after all higher priority claims have been satisfied" (one of the characteristics of a basic ownership instrument set out in paragraph 18 b of the FASB PV).
7. There may be other similar examples, however, without going through detailed analysis of whether the deficiencies in IAS 32 have been addressed it is difficult to ascertain whether the three approaches would be feasible to implement in an international arena.
8. The basic ownership approach would further restrict what would be classified as equity under IFRS (even instruments that are in substance equity) and exacerbate further the situation whereby entities would have few or no equity instruments, in particular given the proposal to classify perpetual instruments (other than basis ownership instruments) as liabilities. For those who stress the importance of comparability between entities, different entities may classify the same financial instrument differently, depending on whether or not it is representative of the most subordinated claim.
9. The ASB's reading of the basic ownership approach reflects a proprietary perspective. However, the IASB has taken an entity perspective in the conceptual framework project ED. If the proposals in the FASB PV and the IASB conceptual framework DP are both adopted they would result in contradictions between the framework and the standard.
10. While the ownership-settlement approach is the closest of the three FASB alternatives to the current version of IAS 32, the ASB believes that the way it is presented in the FASB PV document would not represent an improvement to IAS 32 (even allowing for the flaws in the current standard). While some may be attracted to this approach as possibly the area of least change from the

current position, and perhaps more reflective of the substance of particular instruments, the ASB is concerned at the implications highlighted by the IASB (see paragraph 4.11 above).

11. While the REO approach may classify instruments independent of their form, the ASB found it too difficult and complex, and so would agree with the FASB's view not to pursue it.

Alternative approaches

12. As mentioned in Appendix A above, the ASB would prefer the IASB and FASB to take a longer-term approach to this project and explore the three other approaches that have been discarded with little explanation. In particular, it appears to the ASB that the claims approach may have merits when taken in context of the current direction of the IASB's conceptual framework project. Similarly, the mezzanine approach, although not dealing with the bright lines issue goes some way to addressing the problems with measurement and presentation of the resulting pure liability and equity elements. This differentiation has the advantage of putting the spotlight on the treatment of the middle tier and would likely result in enhancing the users understanding.
13. The loss absorption approach as put forwards by the pro-Active Accounting Activities in Europe (PAAinE) discussion paper "Distinguishing between Liabilities and Equity" attempts to start from basic principles and attempts to address the users' needs. It is also significant that this approach is followed by ratings agencies such as Fitch Ratings in order to rank instruments on a debt-to-equity continuum.
14. We understand from our constituents that these alternative approaches are more attractive to users of financial statements who are interested in their order of priority in the claims against an entity.

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?

15. As mentioned in Appendix A above, we believe the scope of this project is too narrowly focused being US-centric and specific to financial instruments with characteristics of equity. It starts from the premise of resolving the US GAAP problem of overly complex and dispersed guidance in this area and so omits the conceptual level debate on the equity liability distinction that is currently underway.
16. The ASB believes that the issue of equity and liability classification is far too fundamental to be resolved in such a narrow context. It would prefer that the issue is first considered at a conceptual level prior to standards level guidance on financial instruments, or a subset such as instruments with characteristics of equity, are discussed.

B3 Are the principles behind the basic ownership approach 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?

17. The basic ownership approach follows the historic view of the most residual interest in the entity being defined as equity. The FASB PV explains in paragraph 54 that the “basic ownership approach is designed to draw the necessary line in the simplest and most informative way that the Board could devise”. The FASB also believes that this approach would reduce the possibility of structuring.
18. However, as mentioned above in our letter, there are a number of entities that currently apply IFRS that may have difficulty in applying the legal entity basis of the approach. Examples of these entities include:
 - a. Limited liability partnerships. These are often set-up with all partners having similar rights (voting rights, share of income, etc) but the most residual share is given to a general partner who performs the administrative duties for the LLP. The general partner does not represent the in-substance residual share in the business.
 - b. Authorised funds and unit trusts. These funds are set-up with a number of different classes of shares or units that differentiate between income and accumulation units. The distinction is only in place to ensure compliance with regulatory requirements and in-substance the two types of units not different in any other way.
 - c. Investment companies. These issue various different classes of shares for the sole reason of protection and allocation of various injections of cash. Once the cash has been invested the shares are no different to the other shares issued by the investment company.
 - d. Co-operative entities. These have a number of different types of structures but are often characterised with shares issued that are redeemable at fair value or otherwise.

B4 Are the other principles set out in the FASB Preliminary Views document inappropriate to any types of entities or in any jurisdictions? (Those principles include separation, linkage and substance.) If so, to which types of entities or in which jurisdictions are they inappropriate, and why?

19. We are particularly concerned about the concept of linkage. This is described in paragraphs 41-43 of the FASB PV which notes that two or more instruments should be accounted for as if they are a single instrument if they are contractually linked, were entered into at the same time with the same or related counter-party, together achieving an overall economic outcome that could have been achieved with a single instrument and reporting them separately would achieve a different result. The ASB is unsure how this will be applied in practice to the examples set out in paragraph 17 above.

20. In particular, the examples although often issued at the same time, occasionally contractually linked, and undertaken to achieve an overall economic outcome (e.g. raising funds for the entity) are often not conducted with the same counter-party. This would imply that economically similar transactions would be treated differently under these rules.

B5 Please provide comments on any other matters raised by the discussion paper.

21. The ASB would prefer to see more assessment of the implications of the proposals in the context of a group. Paragraph 29 of the FASB PV notes that basic ownership interests of a subsidiary or a consolidated variable interest entity (VIE) would be identified at the subsidiary or VIE level. Those instruments would retain their basic ownership nature in the consolidated financial statements unless their characteristics are different in the context of the consolidated financial statements. One of the criteria for defining a basic ownership instrument is that represents the most subordinated claim (which must be determined legally) in the event of a liquidation (paragraph 18a of the FASB PV). But in many jurisdictions, liquidation only occurs at the level of a single entity, so it is unclear how this requirement would be applied at the level of the group.



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24 July 2008

Dear Sirs

PAAinE Discussion Paper: 'Distinguishing between Liability and Equity'

The UK Accounting Standards Board (ASB) is pleased to have this opportunity to respond to EFRAG and the DRSC on the PAAinE discussion paper: 'Distinguishing between Liability and Equity' (DP).

The ASB has considered the DP in context of the overall international debate on distinguishing between equity and liability and as such, we have not answered the specific questions set out in the DP. In general, the Board welcomes the PAAinE DP as a valuable and timely contribution to the international discussion. The ASB acknowledges that the loss absorption approach put forward in the DP has not been fully developed due to the time limitations. However, it is encouraging to see that the DP:

- performs a through analysis of the distinction between liabilities and equity under current IFRS and the perceived shortcomings of the principle used; and then
- arrives at a solution that appears to deal with a number of criticisms levelled at the current principle.

The ASB would like to see this approach developed more fully and considered as part of the international debate on the distinction between equity and liability. The ASB's response to the IASB on its DP 'Financial Instruments with Characteristics of Equity' is enclosed for your information. You will note that the ASB has recommended that the IASB and FASB reconsider the conceptual grounding and the scope of the international project. The Board goes on to recommend that the IASB and FASB give due consideration to approaches other than those included in the FASB Preliminary Views Document. In that context, we would like to see the loss absorption approach put forward in the PAAinE DP considered further and developed more fully before arriving at the final international position.

If you would like to discuss any of the comments made above then please contact Seema Jamil-O'Neill on 020 7492 2422 or myself on 020 7492 2434.

Yours sincerely



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IASB Discussion Paper 'Financial Instruments with Characteristics of Equity'

This letter sets out the UK Accounting Standards Board's ('ASB') comments on the above IASB Discussion Paper (DP).

The ASB agrees that there needs to be an IASB project to improve the equity-liability classification requirements in IAS 32 'Financial Instruments: Presentation'. The requirements of IAS 32 in this area have caused difficulties and the Board would recommend that the IASB take this project on its active agenda.

However, the ASB has a number of major concerns with the proposals outlined in the DP. The key concerns are set out below and discussed in more detail in Appendix A to this letter. Answers to the questions in the IASB DP are included in the Appendix B to this letter.

- The ASB is concerned that the IASB DP does not contain any preliminary views from the IASB on the relevance of the FASB PV findings in the international setting or how they may impact the principles in IAS 32. This has resulted in a DP that makes assertions with little or no justification for them. The ASB would have preferred to have seen material included in the DP that provided constituents with the IASB's perspective on the proposals.
- It is important that a project dealing with the definition of equity has conceptual grounding. The DP and PV make little attempt to align the proposals of the project with the current focus of the IASB and FASB's project on the conceptual framework. This inconsistency is particularly apparent in the entity approach adopted in the conceptual framework project and the emphasis in the FASB document on reporting the most residual claims in an entity, a proprietary perspective. (See paragraphs 1-9 of Appendix A)

- The scope of the project is very US-centric i.e. focuses on trying to deal with the problems in US GAAP. As a result, the scope of the project has been limited to the three approaches presented in the FASB PV so that other potentially viable approaches such as the claims, mezzanine and loss absorption approaches have been dismissed without much explanation. On initial review, these alternative approaches appear to be more in line with the international standards than the three approaches discussed in the PV. (See paragraphs 10-14 of Appendix A)
- The definitions of equity explored in the FASB PV make no reference to the liabilities definition. If no attempts are made to link the two the possibility of gaps emerging between the definitions of equity and liability is far greater than is currently the case. (See paragraphs 15-16 of Appendix A)
- The decisions taken in this project on the classification; initial and subsequent measurement; and presentation of the financial instruments with characteristics of equity will have wider consequences for other IASB standards that deal with these requirements for non-financial instruments. However, currently neither document has dealt with the impact on existing standards. (See paragraphs 17-18 of Appendix A)
- It is currently difficult to envisage the benefits for the wider IASB constituency (outside the US) of adopting the proposals put forward in the FASB PV. In order to ensure continued short term convergence between IFRS and US GAAP it may be more advisable and practical to consider other solutions that address the US problems of diverse guidance in this area (e.g. the adoption of some version of IAS 32 in US GAAP). This approach will allow time for a more international approach to be taken on this project. (See paragraphs 19-20 of Appendix A)

In conclusion, we recommend that both the IASB and FASB take a long-term view of this project to ensure that:

- time is given to comprehensively reviewing the alternatives available (including the loss absorption and claims approaches);
- the various aspects (classification, measurement and presentation) are considered in detail; and
- the final approach adopted is consistent with the Framework and other IFRS literature.

Adoption by the FASB of a version of IAS 32 as an interim standard is one possibility which would enable the IASB to take the longer-term approach as well as providing the FASB constituents with a solution to their short-term problem of diverse and confusing guidance in this area.

If you would like to discuss any of the comments made above or in the Appendices, then please contact Seema Jamil-O'Neill on 020 7492 2422 or myself on 020 7492 2434.

Yours sincerely



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Appendix A

General Concerns with the IASB DP and FASB PV

Importance of a conceptual grounding for the project

1. The ASB believes that the determination of whether a financial instrument qualifies as liability or equity is interlinked with the distinction between liabilities and equity. As such, the principles level question must be addressed before the standards level question can be answered. In the first instance, such principles level discussion would consider issues such as:
 - what does equity represent?
 - why and how is it different from liabilities?
 - why is it important to users to distinguish between liabilities and equity?
 - how should equity be measured and presented in the financial statements?
2. In its *Statement of Principles* (SoP), the ASB dealt with this issue by providing definitions of the key elements of financial reporting and the associated recognition and measurement criteria. More detailed rules dealing with the specifics of capital instruments and securitisations etc were then set out in accounting standards. This is also the approach currently taken in IFRS. The elements of financial statements are set out in the IASB's Framework for the Preparation and Presentation of Financial Statements. IAS 32, which deals specifically with presentation of financial instruments, then applies the principles to financial instruments held by entities.
3. Of the currently active projects, Phase B of the IASB's conceptual framework project deals specifically with the elements of financial reporting. That phase is dedicated to exploring the definitions of the three key elements of financial reporting: assets, liabilities and equity. However, so far that project has not dealt with the issue of the definition of equity and its interaction with liabilities.
4. The ASB believes that it is more appropriate in the long-term to first consider the wider questions in the appropriate phases of conceptual framework debate, including: *what* is equity in Phase B; and *how* should it be measured in Phase C. The Boards should then fully develop the standards level guidance for financial instruments. Developing the standard before the conceptual debate has been attempted is very likely to result in disjoints between the Framework and the financial instruments standards similar to those existing today between the IASB Framework and IAS 32. Additionally, providing rules to address such basic questions in accounting can lead to a number of complications and answers that are counter-intuitive and do not reflect the economic reality (as demonstrated by the problems with IAS 32).
5. The ASB is concerned that there appear to be no direct links between the three approaches outlined in the DP and the discussions in the elements phase of the conceptual framework project. In particular, it is difficult to reconcile the approach of the elements phase of the conceptual framework project (which

defines liability and it appears equity will be defined by reference to it) and that in the DP (which attempts to define equity itself).

6. Additionally, paragraph 60 of the FASB PV rather dismisses examining the entity or proprietary perspectives, noting that “both perspectives determine how information should be reported in the financial statements, not what types of instruments should be included in equity”. As noted above, the ASB considers these questions to be interlinked, as the type of instrument would determine how it is reported in the financial statements. The IASB appears to acknowledge this in the exposure draft (ED) issued in May 2008 on the Objectives of Financial reporting which proposes that the Framework would be based on the entity perspective. In particular, it sets out in paragraph BC 1.12 that:

“under the entity perspective (also known as the entity theory) the reporting entity is deemed to have substance of its own, separate from that of its owners. Economic resources provided by capital providers become resources of the entity and cease to be resources of the capital providers. In exchange for the resources provided, capital providers are provided claims on the economic resources of the reporting entity. Claims of different capital providers have different priorities and different rights with respect to the reporting entity, but they all represent claims on the economic resources of the reporting entity. Therefore, financial reporting from the perspective of the entity involves reporting on the economic resources of that entity and the claims on those resources held by its capital providers.”

7. The above quote from the IASB ED seems almost to advocate the claims approach to reporting equity and liability. However, the FASB PV specifically rules out the claims approach as it would not answer the question of ‘which recognized claims will affect net income’ (paragraph E8). At the same time the FASB PV concedes that the three approaches described are also inconsistent with the current FASB Concepts statement 6 (in paragraph D1) and goes on to note that staff were unable to compare to the current project on the Framework as no conclusions had been taken.
8. The FASB has reached a preliminary view that “the basic ownership approach provides more decision-useful information to investors while significantly simplifying accounting requirements for issuers and their auditors”. With its focus on reporting the most residual claims in an entity this approach is clearly based on a proprietary perspective. By contrast, the IASB’s conceptual framework ED concludes that the entity perspective should be adopted. This is because this perspective is considered more likely to convey that an entity is the object of general purpose financial reporting and not its owners or others who may have an interest in it.
9. Although the ASB is not expressing a view in this comment letter on which perspective should be adopted, we believe that the financial reporting of equity should arise directly from the perspective (entity or proprietary)

adopted in the conceptual framework. Severing this link has the potential of creating inconsistencies between the framework and the standards.

10. The financial statement presentation project of the IASB is considering another aspect of this distinction, i.e. how to present the various elements in the balance sheet and the income/ expense arising from them in the income statement. The decisions taken on that project so far indicate that the income statement will be analysed between an operating section and a financing section. This project is likely to be the key to answering the question of how should the equity and the related income/ expense should be presented.

Scope of DP

11. The scope of the FASB PV, and as a result the IASB's DP, is limited to financial instruments with characteristics of equity. The ASB recognises that within US GAAP accounting guidance has lagged the development of financial instruments in this area, thus making the issue of this DP important for the FASB's constituents. However, IFRS requirements in this area are primarily set out in IAS 32 'Financial Instruments: Presentation' and are fundamentally different from those under US GAAP.
12. Furthermore, US GAAP deals specifically with the situation in the US where only incorporated companies listed on the stock exchange are required to produce financial statements complying with GAAP. This is evident in the references in paragraph 15 of the FASB document which attempts to provide a listing of instruments that may be classified as equity under the basic ownership approach by including ownership interests in an entity "in legal form" as well as "basic ownership instruments (whether or not they are ownership instruments in legal form)". By contrast, the IFRS definition of equity makes no reference to the legal form and is currently being applied to entities in a number of very different legal jurisdictions e.g partnerships in Germany and cooperatives in New Zealand. It is difficult to see how the views put forwards in the FASB PV document would affect these and other entities in countries where legal terminology may differ from that used in the US.
13. The recommendations of the PV are an illustration of this. It notes in paragraph 16 that "the Basic Ownership approach is the appropriate method for determining which instruments should be classified as equity instruments." This method requires that the most residual claim is classified as equity and in a legal entity context would be the ordinary shares issued by the company. However, it is unclear how this principle will be applied to entities that are not legal entities in the US context, for example, investment companies in the UK that are required by regulation to issue different types of shares, with the same voting and other rights, to ensure that various tranches of investments are protected.
14. The FASB PV has limited the scope of the project to the three approaches described in the document. Other approaches that may have been viable such as the claims, the mezzanine and the loss absorption approaches have been

dismissed after brief discussion in Appendix E of the FASB PV. As discussed in paragraph 7 above, these approaches appear to be closer to the tentative decisions taken by the IASB and FASB in the conceptual framework project than those discussed in the FASB PV.

15. In particular, the claims approach appears to have more merit in that context than has been credited in the documents. The FASB PV notes the question of “which recognized claims will affect net income” is not answered by the claims approach (FASB PV Appendix E, paragraph E8). The ASB notes that if discussed in context of the financial statement presentation project then it may be possible to arrive at a solution e.g. by splitting income between financing and operating.

Definition of equity

16. As noted in the DP (paragraph 43) the definition of an equity instrument in IAS 32 cannot stand alone: it depends entirely on the definition of a financial asset and financial liability. As mentioned above, the FASB PV document appears to be attempting to provide a standalone definition of equity. It provides three possible approaches to distinguishing equity from liabilities and all three propose a particular definition of equity that makes no reference to the liability definition. This represents a departure from the current practice under IFRS where an equity instrument is defined as the financial instrument that is not a financial asset or a financial liability.
17. The ASB is concerned that if equity is defined without any reference to liability then one of two possibilities may arise: either there are gaps between the two definitions so that some instruments do not qualify for liability or equity classification; or the two definitions overlap thus making it difficult to ascertain the classification for some mezzanine instruments. As such, the only way that would obviously avoid these two consequences is that currently followed by IAS 32 of defining equity by reference to the definition of a liability.
18. Additionally, even the narrow definition of equity provided by the FASB PV has not been fully developed, so that no more than a single tier approach to equity is considered in the document. As noted above, this has the peculiar effect of leaving out of equity the same instruments that currently prove difficult to define and are behind a number of the criticisms levelled at IAS 32 and the revisions made to that standard.

Impact on existing standards

19. As mentioned above, this is not a standalone project and is likely to have much wider implications than currently those explored by either the IASB or FASB documents. The classification of an instrument as equity or liability has a direct impact on its measurement. The FASB document recommends the basic ownership instruments under the basic ownership approach will be initially measured at transaction price and subsequently will not be remeasured. The exceptions to this are basic ownership instruments with

redemption requirements which would be “remeasured at each reporting date at the current redemption value” (the fair value of the consideration that would be paid if the instrument was redeemed at the reporting date). This rule appears to contradict the amendment to IAS 32 published by the IASB in February 2008 dealing with the classification of puttable financial instruments and obligations arising on liquidation. There the IASB preferred to classify such instruments as equity and therefore exempt them from subsequent remeasurement.

20. Although the DP and PV are limited in scope to financial instruments with characteristics of equity the conclusions drawn here has implications for the wider Liabilities/Equity project. As such, the decisions taken in this project on the classification; initial and subsequent measurement; and presentation of the financial instruments with characteristics of equity will have wider consequences for other IASB standards that deal with these requirements. However, currently neither document has dealt with this issue.

Short term convergence with US GAAP

21. The ASB understands the need for this DP arises from the requirements of the MoU and short-term convergence focus of IFRS and US GAAP. However, the ASB is mindful of the differences between the two GAAPs in this area, the possible deadline of IFRS adoption by US companies in 2011, and the time it is likely to take to resolve these very complex issues (if using the IASB’s project on puttables as an indicator). The Board would prefer the IASB and FASB to explore other possible solutions that may prove to be more appropriate in practice. Some of the solutions the FASB could explore include:
- *FASB adopts IAS 32 in its current form as an interim standard.* This option has the advantage of replacing the diverse requirements in this area for the FASB constituents with a single standard whilst allowing the IASB time to consider all the possible global issues, both at a conceptual level and those specific to this area, and to help produce a principles based global standard.
 - *FASB adopts an amended form of IAS 32 which contains simple modifications.* This amendment could be simple (minor amendments to remove some of the existing flaws) or more comprehensive (retaining the principles but a rewrite of the remaining rules that flow from them). This option has the same advantages for the IASB as before.
22. The above solution would mean that a smaller constituency would be affected (i.e. those US companies currently only applying only US GAAP) by the change than would be the case if the FASB project was rushed through as an IFRS solution prior to the 2011 convergence deadline. It is currently difficult to envisage the benefits for the wider IASB constituency of adopting the proposals put forwards in the FASB document, in particular when considering that some would have recently implemented the amendment to IAS 32 published in February 2008.



Appendix B

Response to IASB questions

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?

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

Suitable starting point and practical implementation

1. The ASB does not believe that the approaches set out in the FASB PV document are a suitable starting point for the project to improve and simplify IAS 32 for the reasons set out in the following paragraphs.
2. IAS 32 plays a pivotal role in the classification and presentation of financial instruments. As noted in the IASB DP it has attracted much criticism over the years. However, its main attraction is that it is based on a straightforward principle i.e. that if a financial instrument does not meet the definition of a financial asset or liability it is qualified as equity. This enables the residual interest in an entity after deducting all its liabilities to be classified as equity. This principle in IAS 32 is based on the IASB conceptual framework premise that financial statements are most relevant to the owners of the business, whose share is subordinate to that of the other creditors of the business. This principles based approach has enabled the use of IAS 32 in many diverse jurisdictions across the world.
3. Therefore, any approach that replaces IAS 32 must similarly be principles-based to enable application to a wide range of legal jurisdictions. The ASB would expect a standard that is to replace IAS 32 to take into account the following:
 - Whether it is conceptually sound and consistent with other requirements in the standards. In this context we would expect a discussion of the need for a liability equity distinction.
 - Whether it is principles based and thus can be used by a wide range of entities in diverse legal jurisdictions?
 - Whether it addresses the deficiencies in IAS 32?
4. The three approaches put forwards in the FASB PV document have not started from these principles. Instead, they have been developed as attempts to address the specific problems in the US environment of classification of obligations. According to the PV document (paragraph 7) the strict application of the definition of a liability (as set out in FASB Concepts

Statement No 6) has led to classification of obligations of entities based on the form of the instrument which, the FASB believes, is essentially a structuring choice.

5. The IASB in its DP has attempted to set out the criticisms of IAS 32 as well as the possible implications for IFRSs of the three approaches in the FASB document. However, it does not go beyond comparing the categorisation of various types of financial instruments as equity or liability under IAS 32 and the three approaches put forwards in the FASB document. No attempt has been made to consider whether the deficiencies in IAS 32 will be addressed by the proposals in the FASB PV.
6. In fact, on initial review it appears that some of the criticisms levelled at IAS 32 may well remain even if the PV's recommended approach, the basic ownership approach, is adopted. For example, the IASB DP notes that one criticism of IAS 32 is that the application of its principle can be problematic when applied in specific situations e.g. determining whether a contractual obligation exists when the instrument holder has multiple relationships with the entity (as owner, manager and investor). However, in such a case (i.e. the multiple relationships) it may equally be difficult to ascertain whether "the holder is entitled to a percentage of the assets of the entity that remain after all higher priority claims have been satisfied" (one of the characteristics of a basic ownership instrument set out in paragraph 18 b of the FASB PV).
7. There may be other similar examples, however, without going through detailed analysis of whether the deficiencies in IAS 32 have been addressed it is difficult to ascertain whether the three approaches would be feasible to implement in an international arena.
8. The basic ownership approach would further restrict what would be classified as equity under IFRS (even instruments that are in substance equity) and exacerbate further the situation whereby entities would have few or no equity instruments, in particular given the proposal to classify perpetual instruments (other than basic ownership instruments) as liabilities. For those who stress the importance of comparability between entities, different entities may classify the same financial instrument differently, depending on whether or not it is representative of the most subordinated claim.
9. The ASB's reading of the basic ownership approach reflects a proprietary perspective. However, the IASB has taken an entity perspective in the conceptual framework project ED. If the proposals in the FASB PV and the IASB conceptual framework DP are both adopted they would result in contradictions between the framework and the standard.
10. While the ownership-settlement approach is the closest of the three FASB alternatives to the current version of IAS 32, the ASB believes that the way it is presented in the FASB PV document would not represent an improvement to IAS 32 (even allowing for the flaws in the current standard). While some may be attracted to this approach as possibly the area of least change from the

current position, and perhaps more reflective of the substance of particular instruments, the ASB is concerned at the implications highlighted by the IASB (see paragraph 4.11 above).

11. While the REO approach may classify instruments independent of their form, the ASB found it too difficult and complex, and so would agree with the FASB's view not to pursue it.

Alternative approaches

12. As mentioned in Appendix A above, the ASB would prefer the IASB and FASB to take a longer-term approach to this project and explore the three other approaches that have been discarded with little explanation. In particular, it appears to the ASB that the claims approach may have merits when taken in context of the current direction of the IASB's conceptual framework project. Similarly, the mezzanine approach, although not dealing with the bright lines issue goes some way to addressing the problems with measurement and presentation of the resulting pure liability and equity elements. This differentiation has the advantage of putting the spotlight on the treatment of the middle tier and would likely result in enhancing the users understanding.
13. The loss absorption approach as put forwards by the pro-Active Accounting Activities in Europe (PAAinE) discussion paper "Distinguishing between Liabilities and Equity" attempts to start from basic principles and attempts to address the users' needs. It is also significant that this approach is followed by ratings agencies such as Fitch Ratings in order to rank instruments on a debt-to-equity continuum.
14. We understand from our constituents that these alternative approaches are more attractive to users of financial statements who are interested in their order of priority in the claims against an entity.

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?

15. As mentioned in Appendix A above, we believe the scope of this project is too narrowly focused being US-centric and specific to financial instruments with characteristics of equity. It starts from the premise of resolving the US GAAP problem of overly complex and dispersed guidance in this area and so omits the conceptual level debate on the equity liability distinction that is currently underway.
16. The ASB believes that the issue of equity and liability classification is far too fundamental to be resolved in such a narrow context. It would prefer that the issue is first considered at a conceptual level prior to standards level guidance on financial instruments, or a subset such as instruments with characteristics of equity, are discussed.

B3 Are the principles behind the basic ownership approach 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?

17. The basic ownership approach follows the historic view of the most residual interest in the entity being defined as equity. The FASB PV explains in paragraph 54 that the “basic ownership approach is designed to draw the necessary line in the simplest and most informative way that the Board could devise”. The FASB also believes that this approach would reduce the possibility of structuring.
18. However, as mentioned above in our letter, there are a number of entities that currently apply IFRS that may have difficulty in applying the legal entity basis of the approach. Examples of these entities include:
 - a. Limited liability partnerships. These are often set-up with all partners having similar rights (voting rights, share of income, etc) but the most residual share is given to a general partner who performs the administrative duties for the LLP. The general partner does not represent the in-substance residual share in the business.
 - b. Authorised funds and unit trusts. These funds are set-up with a number of different classes of shares or units that differentiate between income and accumulation units. The distinction is only in place to ensure compliance with regulatory requirements and in-substance the two types of units not different in any other way.
 - c. Investment companies. These issue various different classes of shares for the sole reason of protection and allocation of various injections of cash. Once the cash has been invested the shares are no different to the other shares issued by the investment company.
 - d. Co-operative entities. These have a number of different types of structures but are often characterised with shares issued that are redeemable at fair value or otherwise.

B4 Are the other principles set out in the FASB Preliminary Views document inappropriate to any types of entities or in any jurisdictions? (Those principles include separation, linkage and substance.) If so, to which types of entities or in which jurisdictions are they inappropriate, and why?

19. We are particularly concerned about the concept of linkage. This is described in paragraphs 41-43 of the FASB PV which notes that two or more instruments should be accounted for as if they are a single instrument if they are contractually linked, were entered into at the same time with the same or related counter-party, together achieving an overall economic outcome that could have been achieved with a single instrument and reporting them separately would achieve a different result. The ASB is unsure how this will be applied in practice to the examples set out in paragraph 17 above.

20. In particular, the examples although often issued at the same time, occasionally contractually linked, and undertaken to achieve an overall economic outcome (e.g. raising funds for the entity) are often not conducted with the same counter-party. This would imply that economically similar transactions would be treated differently under these rules.

B5 Please provide comments on any other matters raised by the discussion paper.

21. The ASB would prefer to see more assessment of the implications of the proposals in the context of a group. Paragraph 29 of the FASB PV notes that basic ownership interests of a subsidiary or a consolidated variable interest entity (VIE) would be identified at the subsidiary or VIE level. Those instruments would retain their basic ownership nature in the consolidated financial statements unless their characteristics are different in the context of the consolidated financial statements. One of the criteria for defining a basic ownership instrument is that represents the most subordinated claim (which must be determined legally) in the event of a liquidation (paragraph 18a of the FASB PV). But in many jurisdictions, liquidation only occurs at the level of a single entity, so it is unclear how this requirement would be applied at the level of the group.