October 2006

AUSTRIAN FINANCIAL REPORTING AND AUDITING COMMITTEE

Comment Letter

"Exposure Draft of 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"

AUSTRIAN FINANCIAL REPORTING AND AUDITING COMMITTEE

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The AFRAC Financial Instruments Working Group prepares comment letters on recent IASB publications and on publications of other standard-setting bodies pertaining to IFRS for final approval by AFRAC. Principal authors of this comment letter were Peter Bitzyk, Gerald Kogler, Roland Nessmann and Michael Rab. More information about the Working Group and AFRAC is available under www.afrac.at.

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Outline

1. General comments

In the light of the continuing development of international reporting requirements and the emphasis on international comparability of financial statements, Small & Medium Sized Entities (SMEs) have increasingly shown an interest in adopting International Financial Reporting Standards (IFRSs). We therefore appreciate the efforts of the IASB to abolish some of the main problems which might prevent certain entities voluntarily adopting IFRS on the grounds that they cannot show as equity what they consider to be equity. We believe that the ED is a step in the right direction, but we want to direct your attention to some issues which, in our opinion, are not resolved in the ED.

2. Specific comments

A large number of SMEs and other enterprises in Europe are organised as partnerships or cooperatives. Under the current definition in IAS 32 and the ED, the majority of interests in partnerships and cooperatives would not meet the definition of equity. For example, many partnerships admit new partners more frequently in order to secure the benefits of their knowledge and expertise rather than by issuing interests based on fair value for cash. As we do not see a difference in principle between contracts based on fair value and those based on personal qualifications, we are not of the opinion that in these circumstances such instruments require to be classified as liability.

With respect to cooperatives, we wish to draw your attention to two other problems: cooperatives frequently issue additional shares at nominal value, or promise the holder to reacquire such interests – either in their entirety, or within specified limits – also at nominal value. In both cases these funds would not qualify to be shown as equity, because they are neither issued nor reacquired at fair value, or because the enterprise has issued other classes of capital instruments, to which these interests are not subordinated.

We also wish to draw your attention to the fundamental point that, in our understanding, equity is outside the scope of IAS 32 and IAS 39, and the distinction between equity and liability should therefore be made not in a standard which regulates financial instruments but in some other standard, e.g., IAS 1.

Given these fundamental concerns, our answers to the questions are given because – as we explain above – we think the ED is in general a step in the right direction:

- Q1: We agree with the classification of these types of instruments as equity but – as explained above – are of the opinion that there are many problems still to be resolved.
- Q2: We agree with the classification of these types of instruments as equity but – as explained above – are of the opinion that there are many problems still to be resolved.
- Q3: We do not see a need for disclosure of the fair value of equity instruments. Rather than acknowledging the existence of such a need, we would point out that in order to fulfil the disclosure requirements, it would be necessary to value the whole enterprise at fair value at every balance sheet date, resulting in a huge administrative burden for such enterprises, far outweighing any benefits of this information. (It should be borne in mind that the majority of such enterprises are not listed, and that therefore the measurement of fair value is costly, difficult, and based on unverifiable assumptions).
- Q 4: We agree that the changes should be applied retrospectively.