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International Accounting Standards Board

This document is provided as a convenience to observers at Standards Advisory Council meetings, to assist them in following the Council's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

Note: These notes are based on the staff paper prepared for the Council. Paragraph numbers correspond to paragraph numbers used in the Council paper.

INFORMATION FOR OBSERVERS

SAC Meeting:	**November 2006, London**
Project:	**Liabilities and Equity (Agenda Paper 5A)**

This table summarizes certain key differences among the three approaches. As noted in the cover memo, the Board has not completed the REO approach. The Board will consider whether subsequent measurement and reallocation of the components should be based on the initial transaction price or fair value. Therefore, the table includes a column for both versions of the REO approach, which are tentative descriptions pending further research.

Attribute Being Compared	Ownership-Settlement Approach	Ownership Approach	REO (at transaction price)	REO (at fair value)
Classification				
Ownership relationship (Equity)	Perpetual, direct ownership, and indirect ownership instruments settled with direct ownership instruments.	Perpetual and direct ownership instruments.	Direct ownership and indirect ownership instruments, which include instruments that have inverse payoffs.	Direct ownership and indirect ownership instruments, which include instruments that have inverse payoffs.
Measurement				
Equity share price changes affect income	If an indirect ownership instrument is classified as a liability (or asset) and if an instrument has an inverse payoff.	All equity derivatives (freestanding and embedded).	Reallocation affects interest expense.	All equity derivatives (freestanding and embedded).
Interest expense	Based on the present value of 100 percent maximum obligation multiplied by the straight debt rate.	Included in the gain or loss.	Based on the probability of the liability outcome multiplied by the straight debt rate.	Based on the probability of the liability outcome and included in the gain or loss.
Nonequity instruments and components with varying payoffs are measured at fair value and those with fixed payoffs are accreted.	Yes, Statement 133 is no longer necessary for instruments or components with varying payoffs.	Yes, Statement 133 is no longer necessary for instruments or components with varying payoffs.	Statement 133 is no longer necessary for instruments with varying payoffs, but would be necessary for nonequity components with varying payoffs.	Yes, Statement 133 is no longer necessary for instruments or components with varying payoffs.

Attribute Being Compared	Ownership-Settlement Approach	Ownership Approach	REO (at transaction price)	REO (at fair value)
Measurement (continued)				
How probability affects measurement	Liability component is assumed to be 100 percent likely to be paid if the liability represents a floor.	There is no separation for instruments with two possible payoffs but there is one ultimate outcome. Liabilities with varying payoffs include probability in fair value.	Liability component is probability-weighted based on the current share price.	Liability and equity components are probability-weighted based on all variables affecting fair value.
Linkage				
Degree of linkage required	Extensive. Freestanding and embedded options are measured differently.	Minimal. Some freestanding and embedded options are measured differently.	None. Options and forwards are separated; therefore, freestanding and embedded instruments are accounted for the same. (Linkage may be required for display purposes.)	Minimal. Options and forwards are separated; therefore, freestanding and embedded instruments are accounted for the same. (Linkage may be required for display purposes and for other certain instruments.)
Extinguishment				
Complexity of extinguishment accounting	Extensive	Minimal	Minimal	Minimal

Attribute Being Compared	Ownership-Settlement Approach	Ownership Approach	REO (at transaction price)	REO (at fair value)
Other information				
Dilution (tentative, pending further research)	Shown though EPS. Same as current GAAP.	Shown through the numerator (gains and losses) in EPS.	Shown through the denominator (probability-weighted shares) in EPS.	Shown through both the numerator (gains and losses) and the denominator (probability-weighted shares) in EPS.
Users' ability to assess solvency on the face of the financial statements (Disclosure will be addressed in the Exposure Draft.)	100 percent maximum obligation is recorded for all liability outcomes. Redeemable equity is specially displayed.	Disclosure would be necessary to distinguish between cash and share settlement. Redeemable equity is specially displayed.	Probability of asset or liability outcome is recorded and form of settlement is disregarded. Additional disclosure would be necessary.	Probability of asset or liability outcome is recorded and form of settlement is disregarded. Additional disclosure would be necessary.
Opportunity for accounting arbitrage	Highest, but less than current GAAP.	Lower than Ownership-Settlement but higher than REO.	Lowest	Lowest (None if all financial instruments are recorded at fair value.)