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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: **February 2008, London**

Project: **Liabilities and Equity**
(Agenda Paper 4)

INTRODUCTION

1. The purpose of this paper is to update the SAC about the IASB discussion paper *Financial Instruments with Characteristics of Equity* that will be published in the first quarter of 2008.

2. At the SAC meeting, we will discuss the IASB's communication plan for the forthcoming discussion paper. We would like comments and suggestions from SAC members as to how the IASB could most effectively communicate with constituents the purpose of the discussion paper.

PROJECT BACKGROUND

3. In November 2007, the FASB published a Preliminary Views document *Financial Instruments with Characteristics of Equity*. That document considers three approaches for distinguishing between liability and asset instruments and equity instruments. The FASB has reached a preliminary view that one of the approaches (the basic ownership approach) is the appropriate approach for determining which instruments should be classified as equity.

4. The IASB did not participate in the development of the FASB document and has not deliberated any of its conclusions.

5. In February 2006, the IASB and the FASB published a Memorandum of Understanding affirming their commitment to convergence. One of the goals for 2008 is to have issued a due process document on the distinctions between liabilities and equity.

6. The IASB discussion paper, which contains the FASB document and an IASB Invitation to Comment, fulfils the MOU commitment. The purpose of the IASB discussion paper is to ask respondents whether

   (a) the approaches discussed in the FASB PV are a good starting point for the Board's deliberations on distinguishing between liabilities and equity,

   (b) the principles in the three approaches are appropriate for all types of entities and in all jurisdictions, and

   (c) there are other approaches to improve and simplify current requirements.

OVERVIEW OF THE DISCUSSION PAPER

7. The IASB Invitation to Comment includes background information relevant to IFRSs. It also includes some questions for respondents that are in addition to those asked in the FASB document. Paragraphs 8 through 15 of this agenda paper outline the content of the Invitation to Comment.

Summary of Relevant IFRS Requirements

8. IAS 32 *Financial Instruments: Presentation* sets out the relevant guidance for distinguishing between financial assets, financial liabilities and equity instruments. IAS 32 defines an equity instrument as any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

Problems with IAS 32

9. In general, there are two broad classes of problems with the current requirements in IAS 32:

   (a) how the principles should be applied and

(b) whether the application of those principles results in an appropriate distinction between financial liabilities and equity instruments.

Approaches in the FASB Preliminary Views Document

10. The FASB document describes three approaches to distinguish between equity and liabilities —basic ownership, ownership-settlement and reassessed expected outcomes (REO).

Summary Comparison with IAS 32

11. The definition of an equity instrument in IAS 32 cannot stand alone; it depends entirely on the definitions of a financial asset and a financial liability.

12. In contrast, all three approaches in the FASB document use the definition of a *basic ownership instrument.* That definition can stand alone and does not rely on the definitions of financial assets and financial liabilities.

Possible Implications of the Three Approaches in the FASB Document for IFRSs

13. All three approaches would have implications for IFRSs. Those implications include:

(a) the numbers and types of financial instruments classified as equity

(b) remeasurement of instruments and the impact on profit or loss

(c) separation of components of an instrument, linkage of two or more instruments, and the substance of the instrument's stated terms

Appendix A: Comparison of existing and proposed approaches

14. Table 2 in Appendix C of the FASB PV document sets out how 25 instruments are classified under US GAAP and would be classified under each of the three approaches. The table is replicated in Appendix A of the Invitation to Comment with an additional column for classification under IAS 32.

Appendix B: Additional questions for respondents

15. Appendix B of the Invitation to Comment includes some questions for respondents that are in addition to those asked in the FASB document.

(a) 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 not?

   (i) 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?

   (ii) Are there any other alternative approaches to improve and simplify IAS 32 that you would recommend? What would be the benefit of those alternatives to users of financial statements?

(b) Is the scope of the project as set out in paragraph 15 of the FASB Preliminary Views appropriate in all jurisdictions? If not, why not? What other scope would you recommend and why?

(c) Are the principles behind the basic ownership instrument appropriate to all types of entities and in all jurisdictions? If not, which types of entities or jurisdictions are they not appropriate in, and why? What would you recommend?

(d) Are the other principles set up in the FASB Preliminary Views appropriate to all types of entities and in all jurisdictions? (Those principles include separation, linkage and substance.) If not, which types of entities or jurisdictions are they not appropriate in, and why? What would you recommend?

(e) Please provide comments on any other matters raised by the discussion paper.