30 Cannon Street, London EC4M 6XH, England
Phone: +44 (0)20 7246 6410, Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: http://www.iasb.org

International
Accounting Standards
Board

This document is provided as a convenience to observers at the Analyst Representative Group meeting, to assist them in following the discussions. 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 papers prepared for the ARG meeting. Paragraph numbers correspond to paragraph numbers used in the ARG agenda paper.

INFORMATION FOR OBSERVERS

ARG Meeting: **June 2008, London**

Project: **Discussion Paper*: Financial Instruments with Characteristics of Equity*** (Agenda Paper 4)

International
Accounting Standards
Board

Discussion Paper
Financial Instruments with Characteristics of Equity

ARG meeting

Agenda paper 5

25 June 2008

Why is this project important?

To improve and simplify IFRS requirements

1. **Develop a better distinction between equity and non-equity instruments**
   - How to apply IAS 32?
   - Is the distinction between equity and non-equity instruments appropriate?

2. **Commitment to converged guidance**
   - Both IFRS and US GAAP requirements have been criticized

Criticisms of IFRS requirements

1. **Application of the requirements**
   - Does a *contractual obligation* exist?
   - What does ‘fixed for fixed’ mean?
   - When is a contingent settlement provision ‘not genuine’?
2. **Is the current distinction appropriate?**
   - The instrument can be equity if redemption is almost certain but is not contractual
   - Some entities have no equity
   - Definitions in IAS 32 are inconsistent with the *Framework*

The two aspects of this project

1. **Presentation in the Statement of Financial Position**
2. **Effect on the Statement of Comprehensive Income**
   - Remeasurement of the instrument, with changes in profit or loss
   - Distributions to holders (eg dividends and interest)

<u>Equity instruments</u>: items do not affect profit or loss

<u>Non-equity instruments</u>: items do affect profit or loss

Project timeline

IASB did not deliberate the FASB PV and does not have a preliminary view

The next phase of the project is expected to be undertaken jointly with the FASB

FASB Preliminary Views November 2007

IASB Discussion Paper February 2008

Exposure Draft

IFRS

Input from constituents

Comparison: IAS 32 and FASB PV

IAS 32	Three approaches in FASB PV
▪ Equity is defined indirectly ▪ Existence of a *contractual obligation* is critical to the definition of a financial liability (and therefore is critical to the definition of equity)	▪ Equity is defined directly ▪ Existence of a *contractual obligation* is not critical to the definition of equity

Approaches in the FASB PV

Three approaches in the FASB PV
1. Basic ownership 2. Ownership-settlement 3. Reassessed expected outcomes (REO)

All 3 approaches use the definition of a basic ownership instrument (BOI)

Characteristics of a BOI
If the entity were to liquidate on the date of classification: **1. Lowest priority** **2. Claim to a percentage of the entity's assets**

Equity in the FASB PV

1. **Basic ownership approach**
   - Basic ownership instruments
2. **Ownership-settlement approach**
   - Basic ownership instruments
   - \+ Other perpetual instruments
   - \+ Indirect ownership instruments settled by issuing basic ownership instruments (for example, a physically settled written call option)
3. **REO approach**
   - Basic ownership instruments
   - \+ Instruments (or components) that have a payoff directly or inversely related to the price of the basic ownership instrument (for example, a written or purchased call or put option)

Questions for ARG members

1. What information would these approaches provide that you do not have today? What information would you lose?

2. If you believe that these approaches would provide less useful information than is provided today, please describe the types of instruments that you are considering.

3. Are any of the principles in the three approaches inappropriate for any types of entities or in any jurisdictions? If so, please explain.

4. Do you prefer one of the three approaches? If not, what would you prefer?