



4 September 2008

International Accounting Standards Board
1st Floor 30 Cannon Street
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United Kingdom

(By email: commentletters@iasb.org)

Dear Sir

RESPONSE TO DISCUSSION PAPER ON FINANCIAL INSTRUMENTS WITH CHARACTERISTICS OF EQUITY

The Accounting Standards Council (ASC) appreciates the opportunity to comment on the Discussion Paper on Financial Instruments with Characteristics of Equity issued by the International Accounting Standards Board (IASB) in March 2008. Our comments are stated as follows:

General Comments:

2. Firstly, we recognize and are appreciative of the fact that the IASB and the Financial Accounting Standards Board (FASB) are taking proactive steps in trying to make appropriate amendments and simplifications to the existing standards. While the three approaches of Basic Ownership Approach (BOA), Ownership Settlement Approach (OSA) and Reassessed Expected Outcome Approach (REOA) as proposed in the FASB Preliminary Views (PV) document have their own merits and basis, it is important that the IASB study further in detail the pros and cons of all three approaches and try to marry the merits of each approach (e.g. simplicity of the BOA and faithful representation of the OSA) into one single approach, instead of using only one of the three approaches as a starting point for this project. The following presents our views and suggestions on how the equity/liability project can be improved and directed:

- *Inconsistency in definition under the three approaches and the Framework*

3. There appears to be a lack of consistency in the application of the principles under the three approaches and the current IAS 32 and the existing Framework with regard to the definition of an equity. Though it is comforting to note that there is an on-going Conceptual Framework project undertaken by the IASB and FASB to reassess the definition of assets and liabilities, it is noted that none of the approaches proposed in the DP seems to be consistent with the proposed definition of a liability under the Conceptual Framework project. For example, some financial instruments (e.g. redeemable common stock) that meet the definition of a liability under the proposed Conceptual Framework project may be classified as equity under the proposed approaches if certain criteria are met. Thus, that it is important that the IASB closely coordinate this project with the Conceptual Framework project in order to establish a set of internally consistent principles that produce relevant financial information and reduce accounting complexity in this area of financial reporting. Most of the issues should first be resolved within the Conceptual Framework project, followed by the development of an appropriate approach based on the generally applicable definitions being formulated at the conceptual level.

- ***Consideration of conflicting principles across standards***

4. Due to the lack of guidance and clarity in the definition of equity and liability in the currently IAS 32, additional guidance may be provided in other standards where the principles under IAS 32 need not be complied with. For example, in the case of share appreciation rights (SAR) that is accounted for under IFRS 2 *Share-based Payment*, the value of each share issued is variable and would be classified and accounted for as liability under the principles of IAS 32 (i.e. similar to a cash-settled share-based payment). As a result, IFRS 2 (BC110) explains that the debt/equity requirements of IAS 32 whereby some obligations to issue equity instruments are classified as liabilities should not be applied in the IFRS on share-based payment. This creates a difference between IFRS 2 and IAS 32.

5. It is noted that the basic ownership approach will most likely not resolve this difference as options will be not be classified as equity under this approach anyway. Hence, it is important that the IASB review and consider the principles and guidance within other standards (along with the Framework) during this liabilities/equity project in order to fully align the conflicting principles and guidance across the standards.

- ***Guidance for the purchaser of financial instruments***

6. We noted that the current IAS 32 as well as the three proposed approaches appears to be written from the issuer's point of view. We are of the view that the IASB should consider including principles and guidance from the purchaser's point of view as well.

- ***Prospective treatment of changes***

7. We suggest that any changes to the existing IAS 32 (either under the three proposed approach or any other approaches) be made on a prospective basis to avoid restatement of prior year figures which can be a very extensive exercise. For example, entities which have issued preference shares that tend to be either perpetual or have long maturities would have to reclassify such instruments as liability under the BOA and may require much time and effort to trace back the accounting numbers.

We do not have specific comments on all questions in the FASB Paper and IASB DP except for the following:

Question 3 of the FASB Paper on Perpetual Instruments

The Board has not yet concluded how liability instruments without settlement requirements should be measured. What potential operational concerns, if any, do the potential measurement requirements in paragraph 34 present? The Board is interested in additional suggestions about subsequent measurement requirements for perpetual instruments that are classified as liabilities.

8. We disagree with the premise in the question. Liability instruments without settlement requirements should be classified as equity, hence these should not be remeasured. Dividends should be reported as dividends and not interest expense. This is in line with the ownership settlement approach.

Question 8 of the FASB Paper on Measurement

Under current accounting, many derivatives are measured at fair value with changes in value reported in net income. The basic ownership approach would increase the population of instruments subject to those requirements. Do you agree with that result? If not, why should the change in value of certain derivatives be excluded from current-period income?

9. We agree with that result.

Appendix B of the IASB Paper – Additional questions for respondents

Question 1

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?

10. Out of the three approaches, we feel that the BOA is the least complex¹. The principles are clear and require less judgement to be applied to differentiate equity from liability. However, having said this, a balance has to be strike between simplicity and the need to reflect economic reality, which may not be the case if the BOA is adopted. The basic

¹ Currently, regulators and rating agencies are already making various adjustments to accounting's classification of equity and liabilities for their own purpose, including the estimation of insolvency risk. The basic ownership approach will simplify the process that equity analysts undertake to compute "return on equity" (ROE), most commonly defined as return on common equity, as fewer adjustments are required. Applying the basic ownership approach will restrict the equity classification to only common equity and this is likely to be a good common denominator across these important constituents.

ownership approach, in its simplicity, may lead to an inaccurate classification of financial instruments with characteristics of an equity as a liability, which may not truly and fully reflect the economic substance of the financial instrument. Moreover, the BOA needs to be evaluated from the tax perspective. Generally, tax treatment looks at the legal form. For the case of a redeemable preference share, it is an equity in the legal form. However it will be classified as liability under the BOA. For tax submissions, entities will have to explain and justify the discrepancy in treatment to the tax authorities. The tax authorities will also need to opine if the concept underlying the basic ownership approach is suitable for their requirements.

11. Among the three approaches, the OSA most closely reflects the economic reality by classifying financial instruments as equity or liability based on the nature of their return and settlement requirements. This approach is also most consistent with the current accounting treatment under IAS 32 in terms of the number and types of instruments that would be classified as equity and is not expected to create radical changes to the current accounting, providing the most stability to the financial reporting framework. However, having said this, there are still flaws within IAS 32 that fail to capture the economic reality of the business. For example, certain financial instruments that are issued with interest step-up features would economically compel the issuing entity to redeem the instrument even though there is no contractual obligation to do so. This is because the current IFRS 32 considers only contractual obligations and ignores the economic substances of such instruments. As such, improvements is required to be made to the existing IAS 32 and the OSA should only serve as a short-term solution for this project whilst continuing with the development of a simpler and more appropriate model to define equity.

Other Comments:

12. Singapore, being an international financial hub, is currently facing and dealing with financial instruments with increasing complexity. As such, the development of this project is of utmost interest and concern for us. We would be grateful if the IASB could allow us to play an active role in the on-going development of this project as we hope to continue to provide constructive feedback to the IASB, even after the closure of the comment period for this DP. To do so, we have in plan for the near future (in Q3 and Q4 of 2008) to organize more dialogue sessions and discussions with the various relevant constituents in Singapore to further explore the possible issues that could arise from the accounting and classification of financial instruments. We hope that when additional comments and suggestions are surfaced to the IASB after the discussions, the IASB would be receptive and kindly consider them during the next stage of this project (i.e. drafting of the exposure draft).

13. Should you require any further clarification, please kindly contact me. Thank you.

Yours faithfully,

Dexter Tan
Secretary, Accounting Standards Council