

ED: Proposed Amendments to IAS 32 & IAS 1

This Comment Letter was sent by BDO Global Coordination B.V. on behalf of BDO International, to International Accounting Standards Board on 23 October, 2006:

Dear Sir

**Exposure draft: Proposed amendments to IAS 32 'Financial instruments' and IAS 1 'Presentation of financial statements'**

We appreciate the opportunity to comment on the International Accounting Standards Board's proposals to amend the above accounting standards.

Our key comments are summarised below.

We understand the concerns raised by certain constituents in relation to the effect under IAS 32 on their financial statements of financial instruments puttable at fair value and sympathise with their position. We acknowledge that for specific types of entity, the requirements of the existing IAS 32 require the classification of all of their equity to debt even though it can be argued that, in their circumstances, the instruments in substance bear more of the characteristics associated with equity. We therefore agree that this issue requires urgent reconsideration in the context of the requirements of IAS 32.

However, we do not believe this limited and potentially short term amendment to IAS 32 (and IAS 1) is the right approach to address this issue for two main reasons:

- Firstly, the amendment conflicts with the *Framework* and the definition of a liability therein. We believe that such a conflict sets an unhelpful precedent and undermines the importance of the *Framework*.
- Secondly, in view of the ongoing project on the *Framework* and the longer-term project on liabilities and equity we think an amendment to IAS 32 of this nature is inappropriate. We believe this issue should be considered as part of these wider projects with a view to ensuring consistent application of principles, and not by implementing a rules-based solution, which may lead to inconsistent accounting for identical financial instruments, to deal with a specific case.

There are many entities whose balance sheets have been impacted significantly by IAS 32 as a consequence of the reclassification of instruments from equity to liabilities (on first time adoption of IFRS). Whilst the impact on entities with financial instruments puttable at fair value (and similar instruments) may be at the extreme end of the scale we do not believe their position is sufficiently unusual or commonplace to warrant a departure from the *Framework* as envisaged by this proposed amendment.

Furthermore we are concerned, as a point of principle, that rules-based limited amendments to existing IAS or IFRS, based on issues in a specific user group for example, can undermine the principles on which the IAS or IFRS is based. In addition, notwithstanding steps taken to mitigate the risk, such amendments also increase the potential for engineered transactions or structures that exploit those rules.

Our recommendation, given the longer term projects, is that this proposed amendment to IAS 32 is withdrawn. In the short term, relevant companies will need to make use of additional disclosures and adapting the format of the financial statements to mitigate their concerns. However, we believe that the issue being addressed by the proposed amendment to IAS 32 is valid. It needs to be addressed at a principle level as part of a full update of IAS 32. This must be given greater urgency on the Board's agenda.

Our responses on the matters on which comment was requested are set out in the attached Appendix.

We would be pleased to discuss our comments and observations with you further if this would be helpful. Please contact Helen Thomson of BDO Global Coordination B.V. on +32 2 778 01 30.

Yours faithfully,  
BDO Global Coordination B.V.

## Appendix

### Question 1 – Financial instruments puttable at fair value

**Do you agree that it is appropriate to classify as equity financial instruments puttable at fair value? If so, do you agree that the specified criteria for equity classification are appropriate? If not, why? What changes do you propose, and why? If you disagree with equity classification of financial instruments puttable at fair value, why?**

We understand, and have sympathy for, the reclassification from liabilities to equity that this limited amendment to IAS 32 is seeking to introduce. However, we do not support the approach which is set out in the exposure draft, as the proposals conflict with the existing *Framework*. As discussed above we believe this sets an unhelpful precedent.

In addition, we believe the rules-based criteria for equity classification in the amendment, introducing an assessment of subordination, create the potential for two identical instruments being accounted for in different ways through marginal changes in an entity's capital structure. This would conflict with one of the key concepts of IFRS being that similar transactions should be accounted for in the same way. Furthermore we do not believe that the criteria have been adequately assessed or tested for the risks of financial engineering

We are in any event surprised that the Board in its analysis has chosen this option as a solution and do not believe option BC7 (a) has been sufficiently explored. The Board rejects BC7 (a), being an exemption from recognising changes in fair value, in paragraph BC8 of the Exposure Draft. Whilst BC7 (a) would conflict with a principle in IAS 32 and IAS 39, we see this as less contentious than a conflict with the *Framework*. Furthermore, we consider that this approach would bring only a marginal increase in the complexity of IAS 39. Entities would also still be able to use alternative disclosure and presentation formats to mitigate point BC 8(b).

### Question 2 – Obligations to deliver to another entity a pro rata share of the net assets of the entity upon its liquidation

**Do you agree that it is appropriate to classify as equity these types of instruments? If so, do you agree that the specified criteria for equity classification are appropriate? If not, why? What changes do you propose, and why? If you disagree with equity classification for these types of instruments, why?**

The comments in the first and second paragraphs of our response to question 1 also apply here.

### Question 3 – Disclosures

**(a) Do you agree that it is appropriate to require additional information about financial instruments puttable at fair value classified as equity, including the fair values of these instruments? If so, do you agree that the fair value disclosures should be required at every reporting date? If not, why? What changes do you propose, and why?**

**(b) Do you agree that it is appropriate to require disclosure of information about the reclassification of financial instruments puttable at fair value and instruments that impose an obligation arising on liquidation between financial liabilities and equity? If not, why? What changes do you propose, and why?**

In answer to (a) and (b), we share the concerns raised in the dissenting view (AV3) that the proposed disclosures run counter to the treatment of such instruments as equity. In our view this approach – account as equity but disclose as if a liability – creates unnecessary confusion and supports the argument that this issue should be covered by an amendment of principle, rather than by the imposition of a short term rules – based solution.

**Question 4 – Effective date and transition**

**Are the transition provisions appropriate? If not, what do you propose, and why?**

In view of our objections to the amendments proposed in the Exposure Draft (discussed above), we have no comments on the transitional provisions.