Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Our Ref.: C/FRSC

By e-mail CommentLetters@iasb.org and by post

26 October 2006

IAS 32 and IAS 1 Amendments
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

Comments on IASB Exposure Draft of Proposed Amendments to IAS 32 and IAS 1 *Presentation of Financial Statements—Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation*

The Hong Kong Institute of Certified Public Accountants as the financial reporting standard setter for Hong Kong welcomes the opportunity to provide you with our comments on the captioned Exposure Draft. Our responses to the questions raised in your Exposure Draft are set out in the appendix for your consideration.

In general, we do not support the proposed amendments as we consider them to be rule-based rather than principles-based. We also have concerns that the proposed amendments might result in divergence rather than comparability between entities in practice, as the treatment of the financial instruments concerned would depend on whether they can be proved to have the features as set out in the proposed amendments. We believe that the issue should instead be addressed by establishing principles for identifying equity and using those principles in determining the appropriate treatment for financial instruments puttable at fair value and obligations arising on liquidation.

If you have any questions on our comments, please do not hesitate to contact me at patricia@hkicpa.org.hk.

Yours sincerely,

Patricia McBride
Director, Standard Setting

PM/EH/al

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<u>Hong Kong Institute of CPAs</u>

Responses to the questions raised
in the IASB Exposure Draft of Proposed Amendments
to IAS 32 and IAS 1 *Presentation of Financial Statements—Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation*

Question 1 – Financial instruments puttable at fair value

The Exposure Draft proposes that financial instruments puttable at fair value should be classified as equity, provided that specified criteria are met.

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 do not support the proposed amendments. While we appreciate that IAS 32 requires a financial instrument to be accounted for based on its substance rather than its form (such as in the case of a compound instrument), we consider that the proposed amendments, which contravene the Framework, are rule-based. We have concerns about the IASB making this kind of amendment in order to provide a quick fix to a practical problem as it might run the risks of opening the floodgate for requesting further rule-based changes to the Standards. In particular, in this quick fix, the IASB provides no indication in the Exposure Draft as to how the inconsistencies with the Framework arising from the proposed amendments are to be resolved in its future projects.

Given the rule-based nature of the proposed amendments, we also have concerns that the proposed amendments might result in divergence rather than comparability between entities in practice, as the treatment of the financial instruments concerned would depend on whether they can be proved to have the features as set out in the proposed amendments. For example, the proposed amendments would require similar type of financial instruments to be treated differently (one as equity and the other as financial liability) depending on whether the entity has other classes of financial instruments.

We believe that the issue should instead be addressed by establishing principles for identifying equity and using those principles in determining the appropriate treatment for financial instruments puttable at fair value and obligations arising on liquidation.

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

The Exposure Draft proposes that an instrument that imposes on the entity an obligation to deliver to another entity a pro rata share of the net assets of the entity upon its liquidation should be classified as equity, provided that specified criteria are met (eg ordinary shares issued by a limited life entity).

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?

Please see our answer to question 1.

Question 3 – Disclosures

The Exposure Draft proposes disclosures about financial instruments puttable at fair value classified as equity, including the fair values of these instruments, and the reclassification of financial instruments puttable at fair value and instruments that impose an obligation arising on liquidation between financial liabilities and equity.

(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 the case where the IASB decides to proceed with the proposal on reclassification, we would agree with the proposed disclosures referred to in (a) and (b). We believe that the proposed disclosures referred in (a) above would help users assess the risk arising from the ability of the holder to put to the issuer at any time, even though we have some concerns that these disclosures, which mirror those for financial liabilities, contradict the proposal to require the financial instruments concerned to be classified as equity as opposed to financial liabilities. In particular, we are concerned about the fact that the existing Standards on Financial Instruments do not require disclosure of fair value of equity instruments.

Question 4 – Effective date and transition

The proposed changes would be required to be applied retrospectively, from a date to be determined by the Board after exposure (with one exception permitted relating to compound instruments). Earlier application would be encouraged.

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

If the IASB decides to proceed with the proposed amendments, we would agree with the transitional arrangement as proposed. We believe that an entity that has difficulties in applying the transitional rule would also have difficulties in demonstrating that the financial instrument concerned has the feature that its issue price was the fair value of the instrument holder's entitlement to a pro rata share of the net assets of entity and thus such financial instrument could not be classified as a financial instrument puttable at fair value in the first place.