



Organización Internacional de Comisiones de Valores
International Organisation of Securities Commissions
Organisation internationale des commissions de valeurs
Organizaçao Internacional das Comissões de Valore

September 13, 2004

D8 Comment Letters
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH
United Kingdom

Dear IFRIC Members:

RE: Exposure Draft of IFRIC Interpretation D8—*Members' Shares in Co-operative Entities*

We appreciate the opportunity to respond to the invitation to comment on IFRIC's Exposure Draft of Interpretation D8—*Members' Shares in Co-operative Entities*. We commend the Committee's efforts to provide interpretive guidance on the liability or equity classification of certain financial instruments under International Accounting Standard 32 (IAS 32), *Financial Instruments: Disclosure and Presentation*. Subject to our comments that follow, we support the guidance in the Draft Interpretation.

Scope of the Interpretation

We believe this interpretation covers issues that exist in entities other than co-operative entities and that a different title would be more representative of the broader scope of the issues addressed in the consensus than is suggested by the current title.

While much of the discussion in the interpretation focuses on puttable shares, the issues related to issuer discretion to redeem can also arise for instruments that are in form mandatorily redeemable, that is, instruments that the issuer is required to redeem and the holder is required to present for redemption. We suggest that the interpretation make clearer that the conclusions of the consensus are not limited to instruments that are in form puttable, since the scope of the consensus includes all financial instruments within the scope of IAS 32 (excluding those that will or may be equity-settled). In cases where the company has an unconditional right to refuse redemption, some discussion of the substance of the mandatory redemption requirement appears warranted.

IAS 32 and Regulatory Prohibitions

We point out that if this interpretation is finalized in its current form, an amendment of IAS 32 may be necessary to reconcile the Draft Interpretation to the language in that standard. Paragraph 8 of the consensus describes a distinction between prohibitions on redemption that are unconditional

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and those based on liquidity criteria and states that prohibitions can be imposed by local law, regulation, or the entity's governing charter. If the prohibition is unconditional, then the instrument is equity; if it depends on liquidity then the instrument is a liability. Paragraph AG25 of IAS 32, if read literally, appears to contradict the conclusion in the consensus. That paragraph states:

The potential inability of an issuer to satisfy an obligation to redeem a preference share when contractually required to do so, whether because of a lack of funds, a *statutory restriction* [emphasis added] or insufficient profits or reserves, does not negate the obligation.

While portions of this sentence reference liquidity or similar constraints, the reference to "statutory restriction" has no qualifier related to liquidity. Thus, read literally, the reference to statutory restriction implies that being restricted by law, no matter what the nature of the restriction, does not negate the obligation. We believe that, at a minimum, the apparent conflict between the consensus' conclusions and a literal reading of paragraph AG25 of IAS 32 should be specifically addressed in the basis for conclusions.

Prohibition versus Restriction

The appendix and basis for conclusions of the Draft Interpretation discuss the distinction between a prohibition and a restriction. Notwithstanding the discussion, we believe the interpretation does not succeed in explaining the difference. It is argued in paragraphs A12 and BC13 that prohibitions prevent an entity from incurring a liability regardless of its ability to pay; in contrast the effects of restrictions are evident only when a redemption request occurs. The consensus places no limits on what can constitute a prohibition other than excluding any constraints based on liquidity criteria. Even so, many legal prohibitions, while they may be stated in terms of number of shares or total amounts of paid in capital, may have been based on an underlying legislative concern about liquidity or solvency. In addition, liquidity constraints can be assessed prior to the date a redemption occurs in the same manner as constraints on the number of shares or level of paid-in-capital; that is, at any specific balance sheet date the entity's number of shares or liquidity level is either under or over the limitation specified in the prohibition or restriction. We recommend that IFRIC provide greater clarification of the basis for the distinction between prohibition and restriction because the existing guidance is not sufficiently operational.

Reclassifications between Liability and Equity

We are concerned that if this interpretation is finalized in its current form either IAS 32 or IAS 39 or both will need to be amended to address the accounting for reclassifications between liability and equity. The accounting for reclassifications is implicit in paragraph 12 of the consensus and discussed in paragraph BC17 of the consensus' basis for conclusions. These paragraphs indicate that if a prohibition on redemption changes from period to period then a reclassification is made between equity and liabilities with no gain or loss. Reference is then made to paragraph 49 of International Accounting Standard 39 (IAS 39), *Financial Instruments: Recognition and Measurement*, which addresses the fair value of demand deposits. It appears that the rationale for no gain or loss on reclassification is that the fair value of a demand liability should be no less than the amount payable on demand. Thus, one could argue that the liability is already at fair value as defined in IAS 39, thus no gain or loss would arise on the reclassification to equity. However, the guidance of IAS 39 indicates that the fair value of a demand liability should be "no less than the amount payable on demand". That implies that the fair value of a demand liability could be higher

than the amount payable on demand suggesting there could be situations where the income statement could be affected in a reclassification from liabilities to equity.

There does not appear to be any provision within either IAS 32 or IAS 39 that specifically addresses "reclassifications" between debt and equity. If there is guidance in these standards that is on point, it should be cited in the basis for conclusions. If not, either IAS 32 or IAS 39 or both may need to be amended to provide guidance consistent with the consensus.

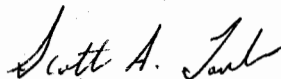
Other Issues

Paragraph 6 of the consensus indicates that if either of the conditions described in paragraphs 7 and 8 is present, then members' shares that are redeemable would be considered equity. However, in the last sentence of paragraph 8, the language describes circumstances where a portion of the shares would be classified as liabilities. Perhaps this last sentence could be rephrased to state that shares below the prohibition would be equity to be consistent with the wording of paragraph 6.

Example 3 (paragraphs A6 – A9), discusses a case in which "the entity's charter states that it can redeem a maximum of 20 per cent of the highest number of shares ever outstanding." It is not clear in the example, whether the corporate charter provision relates to shares on a cumulative basis (no more than 20 per cent of the highest number can ever be redeemed); at a point in time (on any date only 20 per cent of the highest number are subject to redemption, such that the total number of shares outstanding can never fall below 80 per cent of the highest level); at a point in time (on any date only 20 per cent of the highest number are subject to redemption, but on the next day another 20 percent could be redeemed); or for a period of time (no more than 20 per cent of the highest number can be redeemed in any year). Under the criteria of the consensus, we believe that the first two interpretations of the corporate charter provision would result in equity treatment for a portion of the entity's shares, while the last two interpretations would not. We suggest clarifying how the corporate charter provision in the example is to be interpreted. Also, we believe it would be helpful to include an example in which the entity's corporate charter contains a provision that restricts repurchases to a fixed percentage of shares each year to illustrate that such a provision does not result in equity treatment for any of the entity's shares.

We appreciate the opportunity to provide our comments. If you have any questions concerning our response, please contact me at 1.202.942.4400.

Sincerely,



Scott A. Taub
Chair
IOSCO Standing Committee No. 1