Federation of European Accountants
Fédération des Experts comptables Européens

Ms. Françoise Flores
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E-mail: commentletters@efrag.org

4 November 2014

Dear Ms. Flores,

Re: FEE comments on EFRAG's discussion paper – "Classification of Claims"

(1) FEE (the Federation of European Accountants, www.fee.be) is pleased to provide you below with its comments on the EFRAG's discussion paper – "Classification of Claims" ("Paper" or "DP").

(2) FEE welcomes EFRAG's initiative for stimulating the discussion on the classification of claims, and for exploring possible changes to their categorisation under IFRS.

(3) We agree with EFRAG that depicting liquidity and solvency are key objectives to bear in mind when evaluating the relevance of the classification of claims. We also agree that financial reporting is an additional key objective but we regret the DP does not explain in more detail the role of the classification of claims in depicting financial performance. As we noted in our response to the IASB DP *A Review of the Conceptual Framework for Financial Reporting,* we believe that it would be important to define positively the concept of performance as something other than simply the changes in assets and liabilities. Further, we believe it is important to rank the relative importance of the depicting objectives. This would assist in the assessment of the various approaches considered for the classification of claims, since none of the alternatives explored in the DP meets all the objectives identified.

(4) FEE continues to support a binary classification of claims based on a positive definition of liabilities and a negative definition of equity. We believe that the other alternative, i.e. positively defining equity, could provide meaningful information, however a positive definition of equity would necessarily involve legal criteria. This is not a desirable outcome in the context of international standards, like the IFRSs, as this would limit the application of the standards to jurisdictions that use similar definitions.

(5) However, FEE does not support pursuing the classification of claims in more than two classification categories, as proposed in the paper. Using more than two categories would require more than one positively defined element. In FEE's view, apart from liabilities, there is not an easily identifiable positive definition for equity or another element that would be consistent with the global character of IFRSs. We believe that achieving a robust definition of liabilities, considering the specific issues arising from hybrid instruments and derivatives over own shares, would be a more sound approach from a conceptual point of view.

(6) FEE also disagrees with the approach of a single element and classification according to a predetermined picking order. In FEE's opinion, the binary split between equity and liabilities provides more useful information to the users of financial statements.

(7) Finally, we commend EFRAG's efforts in developing a comprehensive glossary that constituents can use when referring to claims and their classification. This is a useful contribution that should assist in the discussion surrounding the development of the IASB conceptual framework as well as with future projects.

Please refer to the appendix for our responses to the specific questions asked in the DP.

For further information on this letter, please contact Pantelis Pavlou, Manager from the FEE Team on +32 (0)2 285 40 74 or via e-mail at pantelis.pavlou@fee.be.

Yours sincerely,

André Kilesse
President

Olivier Boutellis-Taft
Chief Executive

Question 1: Do you believe EFRAG has appropriately identified the objectives to be used when assessing classification requirements? If not what other objectives do you think should be included or should any of the objectives be removed?

(1) FEE welcomes EFRAG's efforts to identify the objectives to be used when assessing classification requirements. We believe that this is an important first step to ensure that the principles retained for classification of claims result in providing more relevant and useful information to users. However, we have some concerns regarding the objectives proposed and their hierarchy, as explained below.

(2) FEE agrees with EFRAG that depicting liquidity and solvency are key objectives for classifying claims.

(3) FEE agrees that depicting financial performance is a key objective. Due to the importance of this concept, we regret that the DP does not explain in more details the role of the classification of claims in depicting financial performance. As we noted in our response to the IASB DP *A Review of the Conceptual Framework for Financial Reporting,* we believe that it would be important to define positively the concept of performance as something other than simply the changes in assets and liabilities. We encourage EFRAG to explore the possibility in dissociating the presentation of gains and losses (in performance or elsewhere) from the presentation of the related instrument as liability or equity as a way forward in establishing principles that achieve relevant information from both a balance sheet and performance statement perspective.

(4) We do not believe that depiction of the returns the holders of a particular class of instruments should be retained as an objective as the financial statements' users (as defined in the Conceptual Framework) are not limited to the holders of a specific class of instruments/claims. Further, we note that the table provided in figure 2 shows that this objective does not appear to be met under any of the scenarios envisaged by EFRAG, except where a proprietary perspective is retained. Such a perspective does not appear consistent with IFRSs.

(5) Furthermore, FEE believes it is important to rank the depicting objectives starting with the most significant. This would assist in the assessment of the various approaches considered for the classification of claims, since none of the alternatives explored in the DP meets all the objectives identified. Having a hierarchy of the objectives would enable constituents to understand the different alternatives and assess which option best depicts the most important objectives.

Question 2: Do you believe EFRAG has appropriately identified the relevant choices that need to be made in determining classification requirements?

If not, what other choices do you think need to be made and how do they fit with those that have been identified?

(6) FEE agrees with the research that EFRAG has undertaken on the matter of choices for classification of claims as illustrated in Figure 1 on page 15 of the DP.

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Question 3: If you support classifying all claims as a single element (the claims approach) how do you think the accounting residual and unclaimed equity should be accounted for?

How should financial performance be depicted?

(7) FEE does not support classifying all claims as part of a single element on the credit side of the balance sheet. We believe that distinguishing between claims as liabilities or equity is relevant to users of financial reporting.

Question 4: Do you think it is possible to positively define equity such that more of the identified objectives are met?

If so, how should it be defined?

(8) While we believe that defining equity positively could provide meaningful information, we do not consider that this would be achievable. Indeed, past attempts to provide a definition that is not somehow linked to legal definitions have failed. In the context of international standards, like the IFRSs, defining an element based on a legal definition is not an option as this would limit the application of the standards to jurisdictions that use similar definitions.

Question 5: Do you think it is possible to positively define liabilities such that more of the identified objectives are met?

If so, how should it be defined?

(9) We favour a binary classification of claims based on a positive definition of liabilities. We believe that such an approach is possible as demonstrated in the current framework, even though we support revisions to the current classification criteria.

(10) Indeed, the current definition of liabilities provides a good starting point for pursuing further research towards a robust and reliable definition of liabilities. FEE agrees with the analysis in paragraph 122 of the DP regarding consistency with the identified objectives of the classification of claims.

(11) Using the definition of liabilities from the IASB 2013 Conceptual Framework Discussion Paper, a liability should meet the 'existence' and the 'transfer of economic benefits' criteria. We agree with the DP that the latter criterion adds complexity and is the key reason the definition of liability fails to depict the classification objectives for claims that may be settled without a transfer of economic benefits.

(12) For example, puttable rights over Non-Controlling Interests (NCI) or instruments that can be settled using a variable number of shares of the entity (i.e. using the shares of the entity as a "currency" to repay the liabilities of the entity) do not strictly meet the definition of liabilities. These examples demonstrate the need for further research in this area. Therefore, we encourage EFRAG to continue its research on these specific items that cause inconsistency in depicting the objectives as defined in the DP through the classification of claims.

Question 6: Do you think the inclusion of an additional element could assist in meeting some of the identified objectives?

If so, what should that element be and how should it interact with the existing elements?

(13) We do not believe that an additional element could assist in meeting any of the identified objectives. In FEE's view, an additional class would only add to complexity in financial reporting and would most probably cause more problems than it would solve.

(14) Having an additional element means that at least one more positive definition would be required in addition to the definition of liabilities. As discussed earlier, we strongly believe that positively defining equity is not a viable option for international standards.

(15) We believe that achieving a robust definition of liabilities, considering the specific issues arising from hybrid instruments and derivatives over own shares, would be a more sound approach from a conceptual point of view.

Question 7: How do you think dilution should be depicted?

If more than one class of instruments were to be classified as equity how should the returns to the various classes be depicted?

(16) FEE believes that dilution is better depicted through the appropriate disclosures in the financial statements.

(17) We are concerned that the acknowledged difficulties of positively defining equity in an international context would also be a source of difficulties in defining multiple classes of equity.

Question 8: Do you agree with the proposed descriptions/definitions contained within the glossary?

If not what changes would you suggest? Can you identify any additional descriptions/definitions you believe would assist in developing a common understanding of the issues?

(18) FEE welcomes EFRAG's initiative to develop a Glossary that can be used by the financial reporting constituents in an effort to eliminate or mitigate the divergence in definitions. We generally agree with the proposed definition.

Question 9: Do you have any other comments in relation to classification of claims?

(19) We identify two additional areas that we believe are worth exploring in the context of this research.

(20) The first relates to the link between income and expenses to the classification on the Statement of Financial Position (SoFP). Currently the treatment of income and expenses in the comprehensive income statement is directly linked to the classification in the SoFP. As noted in our response to Question 1, a possible way forward is to redefine income and expenses in order to break the link to the SoFP allowing more flexibility in the classification of claims.

(21) One additional concept that should be explored is the unit of account. We note that some of the issues raised in the DP with respect to the unit of account (e.g., treatment of participating instruments) might be addressed if the definition of performance did not solely rest on the balance sheet classification.

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