THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND & WALES

23 October 2006

Our ref: ICAEW REP 61/06

Mr Peter Godsall
Accounting Standards Board
5th Floor, Aldwych House
71-91 Aldwych
London WC2B 4HN

Dear Peter

AMENDMENT TO FRS 25 (IAS 32)

Thank you for the opportunity to comment on the proposed *Amendment to FRS 25 (IAS 32) 'Financial Instruments: Presentation' - Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation*. Our detailed comments are set out in the attached memorandum to the International Accounting Standards Board (IASB) on its proposed amendments to IAS 32 and IAS 1. We set out below some general comments and our response to the specific questions raised by the Accounting Standards Board.

There are considerably more practical issues resulting from the application of IAS 32, and thus FRS 25, that deserve earlier consideration than the issue that is the subject of the proposed amendment. The experience shown from the adoption of these standards in 2005 is that they are producing results that are counter-intuitive to the economic substance of the instruments. Given that there is the modified joint project on debt and equity between the FASB and IASB, we do not expect that there will be a fast resolution to these issues. Nevertheless, we expect the ASB to lend its weight to pressing the IASB to push this project to its highest priority and also for the ASB to play an active part in the deliberations.

Our response to the IASB opposes the proposed amendments, for the following principal reasons.

- There is no principle underlying the proposed changes.

- The proposals amount to little more than a form of presentation for a liability within equity. But while instruments within the scope of the proposals are presented within equity for one narrow purpose, these instruments are nevertheless treated as liabilities in relation to, for example, the disclosures that will be required.

- The proposals seek to classify an instrument by reference to the characteristics of the entity issuing the instrument, rather than the instrument itself, which. will lead to different classifications of an identical instrument depending on whether or not the issuer has other equity instruments in issue.

- Because the classification is entity-specific, these instruments will flip between equity and liabilities depending upon the issuer's decision to issue and/or redeem more subordinated classes of instruments.

- The proposals apply only to instruments of a very limited set of entities; other entities, despite having legitimate arguments to suggest that their instruments are misclassified, will not generally meet the criteria.

- We do not in principle support making changes to standards to correct a narrowly-focused problem affecting only a few entities.

- We question whether it is a good use of the Board's limited time and resources to address issues of very limited application, with no conceptual underpinning, and we suggest that it will encourage further special pleading.

Our response to the specific questions raised by the Accounting Standards Board is as follows.

ASB Q1: Are you aware of any UK instruments whose presentation under the proposals would be misleading, or where instruments of similar economic substance would be classified differently as a consequence of adopting the proposed amendments?

As explained in our response to the IASB, we do not agree with these amendments which will result in classification of instruments based on the issuing entity's specific characteristics rather than those of the instrument itself. Consequently, the rules as proposed will invariably result in similar instruments issued by similar entities being classified differently. This will be the case where the issuer has an 'even more subordinated' instrument in issue - for example, many investment vehicles have management shares in issue which rank below the puttable units and thus these units will be classified as liabilities. However, those investment vehicles that do not have such management shares will classify the puttable units as equity. Furthermore, even within a single entity there will be differing presentations between periods depending on the pattern of issue and redemption of 'even more subordinated' instruments.

In our view, these amendments merely amount to a form of presenting a liability (as presently defined) within equity. Given that different entities will adopt different presentations due to differing entity-specific circumstances and the same entity could have different presentations between periods, we would say this will be confusing and inconsistent with the Statement of Principles on Presentation of Financial Information. This may well be interpreted as being misleading.

ASB Q2: Are you are aware of any other issues that would affect those UK entities that will be required to implement the proposals outlined in this exposure draft?

If the proposals are implemented as drafted, we believe that there will be a limited number of UK entities affected. As explained above, the entities affected will not necessarily be one complete class or type of entity as it will be dependent upon their specific characteristics. We are not aware of any additional factors that would affect UK entities that are not discussed in our response to the IASB.

Please contact me if you would like to discuss any of the points raised in this response.

Yours sincerely

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