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Comment letter on EFRAG draft comment letter on Discussion Paper
Financial Instruments with Characteristics of Equity

Rome, September 5, 2008

Dear Sir/Madam,

OIC is pleased to reply to the draft comment letter regarding the discussion paper "Financial Instruments With Characteristics Of Equity". In general, OIC agrees with many of the remarks and comments expressed in such draft; nevertheless, because of the complexity of the project and the impact that it can have on the accounting standards, we believe it is necessary to make certain observations.

The EFRAG draft comment letter illustrates its comments in large detail. Hence, in this letter we limit our observations to those matters in which we believe it is necessary and appropriate to express our position.

GENERAL

OIC agrees with the opportunity to carry on the project. Because of the ever increasing complexities which characterize the financial instruments, the originally clear distinction between liabilities (meant as "what is due to third parties") and net equity ("the difference between assets and liabilities") has become over the years less and less neat. There is an increasing number of circumstances where such distinction is confused as well as of cases where both components may be regarded as present in the same transaction.

At the same time, these complexities generated accounting standards more and more complex and onerous to recognize, measure and disclose the underlying transactions in financial instruments. As a consequence, the current standards often create perplexities as to the appropriate interpretation to apply in certain specific circumstances. In the worst cases, they leave also room to subjective interpretation so that the comparability and the intelligibility of the financial statements are weakened.

OIC thus hopes that the completion of the project will result in a clearer definition of the accounting standards criteria as well as in their simplification, contributing to improve their clearness.

However, we express our serious perplexities on the subject discussion paper. Our major concerns (which EFRAG also commented) are, in summary, the following:

1. OIC believes it is not appropriate to examine a significant issue such as the distinction between liabilities and equity independently from the development and the outcome of the project on the "conceptual framework". The implications and the effects of such distinction have a material impact on both the structure and the clearness of financial statements, which, in turn, depend upon the meaning which will be given to the notion of "general purpose financial statements". None of the solutions presented in the discussion paper are consistent with the current IFRS framework. We are conscious that the current accounting standards on financial instruments are not comprehensive and are affected by a number of complexities, but we do not believe that these issues can be resolved by simply improving and simplifying the IFRSs. Rather, we believe that the project should be preceded by a robust revision of the framework – to be shared with the FASB for an effective development of the convergence process.

2. The distinction between liabilities and equity cannot leave out of consideration the necessity to take into account all possible users of financial statements. The current IFRSs assume that the primary users are present and potential investors. However, there are other categories of users that are significant in relation with the specific circumstances and jurisdiction. Presenting an element either as a liability or an equity component has a different significant effect depending on the type of the user's relationship with the entity. Giving a prevalent – or exclusive – significance to the holders of common shares appears a limitation and inconsistent with the basic postulates of IFRSs.

3. The discussion paper does not illustrate the reasons for the necessity of re-defining the criteria to distinguish between liabilities and equity. We believe that such criteria cannot be defined in the absence of a clear and exhaustive explanation of the reasons thereon. Moreover, this lack of illustration does not permit to express preference for any of the solutions set forth in the paper. A well thought-out choice is necessarily based upon an evaluation of which solution best fits with the reasons for the change. We do not agree with the method of illustrating on a case by case basis the possible effects for every proposed solution. In other words, it is necessary to examine the respective logical assumptions prior to illustrating their practical consequences.

4. The discussion paper does not take into any consideration the difference between the separate and the consolidated financial statements. The separate financial statements provide financial and operating information having different and additional purposes than the consolidated statements. Notwithstanding, in our opinion the project should focus on searching for a solution that could be applied in both the separate and consolidated statements. Even if a reasonable compromise is necessary to reach this objective, the coherence between the two kinds of statements is essential for the success of the project. In many jurisdictions the separate statements have significant legal consequences just depending on the criteria adopted to account for equity components (consider, for example, minimum required levels of capital, covenants based on the amount of net equity,

or gearing ratios). It does not appear conceivable that an entity applies different criteria according to the kind of statement it prepares. Should this be the case, it would be a source of confusion rather than of clarity.

5. OIC shares the EFRAG comment as to the difficulty in defining the characteristics of both the liabilities and the equity components. As a matter of fact, if certain financial instruments partly or entirely respond to both the classes, inevitably the attempt to specifically define each class will result in a number of overlapping criteria.

IASB QUESTIONS FOR RESPONDENTS

B1 Are the three approaches expressed in the FASB Preliminary Views document a suitable starting point for a project to improve and simplify IAS 32? If not, why?

(a) Do you believe that the three approaches would be feasible to implement? If not, what aspects do you believe could be difficult to apply, and why?

(b) Are there alternative approaches to improve and simplify IAS 32 that you would recommend? What are those approaches and what would be the benefit of those alternatives to users of financial statements?

Because of the matters set forth in the previous paragraph, OIC does not believe to be able to express a position as to these questions. This is in substance in agreement with paragraph 8 thru 15 of the EFRAG draft comment letter. OIC agrees that the issues set forth in these paragraphs are significant and should be taken into adequate consideration.

The basic ownership approach

Among the three proposed solutions, this approach presents the most significant differences versus the current IFRSs. We subscribe the EFRAG perplexities, as discussed in its draft comment letter in paragraphs 16 thru 19.

In addition to such comments, we wish to pinpoint that the basic ownership approach is an extremely restrictive criterion to measure and disclose the entity's equity, since it excludes from equity a number of components that are as a matter of fact almost universally included. We note also that, curiously, this appear to be in contrast with the notion of "generally accepted accounting principles", expression very typical in the U.S.A..

We note that the restricted meaning of net equity resulting from this approach would measure the net equity "of its owners" (and in the discussion paper, even the notion of "owners" appears rather confused), and not that of the entity. Furthermore, we express our strong perplexities as to the possibility of applying the notion of proprietorship to the consolidated financial statements. Please also make reference to the matter discussed above as to the opportunity that consolidated and separate statements be based on consistent principles.

We also note that, should the basic ownership approach be applied to the separate statements, it would clearly result in a significant contrast with the legal requirements applicable in all (many) jurisdictions where the entity's net equity is

not taken as the residual amount due to the entity's proprietors after having honoured all of the entity's obligations. In these jurisdictions, the entity's net equity is the net value of all those financial components which, taken as a whole, are assumed to be the financial guarantee of the entity's obligations. That is, net equity is regarded under the assumption of a going concern, and not of the entity's liquidation.

The ownership-settlement approach

The ownership-settlement approach, among the different solutions presented in the discussion paper, has a lower number of differences if compared with the current IFRSs. However, the existing differences are still significant, bringing the issue back to the matter of consistency with the current framework, discussed in the "General" paragraph. Therefore, OIC agrees with the comments expressed by EFRAG in its draft comment letter, at paragraph 20. We particularly agree with the comment that the approach described in the discussion paper seems to be essentially rule-based. We believe that accounting standard should generally reflect principle-based positions.

The reassessed expected outcome approach

In our opinion, this approach is extremely complex and very difficult to apply. As a consequence it would result very onerous, time and cost wise, to the entities. This would seem in contrast with the desired change to a simpler standard.

Our main criticism to this approach is that it is essentially based on an extended use of valuation methodologies. Because of that, the reassessed expected outcome approach presents the risk of very subjective estimation processes, which, in the worst cases might even result in abuses as well as in organizing transactions driven by a desired result.

Other possible approaches

OIC agrees with EFRAG in saying that the three approaches discussed in the paper are not necessarily the only possible options, and that in the continuance of the project research and studies other alternatives should be considered and evaluated. For example, the loss absorbing approach proposed by the Pro-active Accounting Activities in Europe (PAAinE) of EFRAG could be one of these. Although certain peculiarities of this approach gives arise to some conceptual perplexities (and, consequently, noting in it both advantages and disadvantages) we believe that an in-depth study of existing alternatives should not exclude aprioristically other different possibilities.

B2 Is the scope of the project as set out in paragraph 15 of the FASB Preliminary Views document appropriate? If not, why? What other scope would you recommend and why?

B3 Are the principles behind the basic ownership approach inappropriate to any types of entities or in any jurisdictions? If so, to which types of entities or in which jurisdictions are they inappropriate, and why?

B4 Are the other principles set out in the FASB Preliminary Views document inappropriate to any types of entities or in any jurisdictions? (Those principles

include separation, linkage and substance.) If so, to which types of entities or in which jurisdictions are they inappropriate, and why?

B5 Please provide comments on any other matters raised by the discussion paper.

OIC agrees with the EFRAG draft comment letter for all these questions.

Yours sincerely,

Angelo Casò
(OIC Chairman)