Sir David Tweedie  
Chairman  
International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

Berlin, September 5, 2008

Reference: IASB Discussion Paper “Financial Instruments with Characteristics of Equity”

Here: Joint Comments of German Associations and Public Corporations

Dear Sir David,

The Association of German Public Sector Banks (VÖB), the German Cooperative and Raiffeisen Confederation (DGRV), the Federation of German Industries (BDI), the German Federal Chamber of Tax Advisors (BStBK), the Federal Association of German Cooperative Banks (BVR), the Association of German Chambers of Industry and Commerce (DIHK), the German Savings Banks Association (DSGV) and the Association for the Participation in the Development of Accounting Regulations for Family-owned Entities (VMEBF) are pleased to submit their joint comments regarding the Discussion Paper “Financial Instruments with Characteristics of Equity” issued by the International Accounting Standards Board (IASB) in February 2008.
A. General Remarks

Distinguishing between equity and liabilities is one of the core elements of accounting and defines the structure of the liability side of the statement of financial position. Moreover, a coherent concept for capital distinction that is applicable for entities regardless of their legal form or industry is an essential requirement for common financial statement analysis. Therefore, a profound and principle-based approach needs to be developed. Capital classification under such an approach primarily has to reflect the economic substance of a financial instrument rather than its legal form.

We consider the IASB’s approach to develop a high quality capital distinction concept as not appropriate to provide decision-useful information on typical German capital instruments. In order to be able to develop a clear and concise concept the IASB should deliberate the objective of capital classification and generate fundamental criteria to provide an approach, which is applicable to various legal forms and industries. The discussion paper does neither contain a profound discussion of the fundamental theoretical concepts that capital distinction can be based on nor does it adequately balance the pros and cons of each of the described approaches. In addition, the IASB solely refers to the approaches presented in the FASB’s preliminary views on the subject instead of taking into consideration all possible approaches and discussing them in detail. For example, at least the loss absorption approach (LAA) should be added to the discussion as equal option and evaluated in an in-depth analysis.

Another shortcoming of the IASB’s approach is the limited focus of the project on financial instruments. A general concept for capital distinction has to provide comprehensive criteria to distinguish between equity and liabilities for financial instruments as well as for non-financial instruments. In order to classify financial and non-financial instruments by a principle-based methodology it is necessary to employ a clear and concise underlying concept. This may be the entity view or the proprietary view. However, the discussion paper does not provide any analysis of the different views. Moreover, the project has to comply with the conceptual framework project and the fundamental theoretical concept underlying the IFRSs. This seems to require an entity view. Nevertheless, even the consideration in the
discussion papers on the conceptual framework is not based on an adequate conceptual basis. Therefore, the views have to be discussed extensively before one can be chosen as basis for a capital classification concept. The same applies to the matters of measurement and presentation.

We raise our concerns that the approaches described in the discussion paper mainly focus on publicly listed companies. Since financial reporting standards around the world converge and the importance of IFRS accounting for non-publicly listed companies is rising steadily, this appears to be inadequate. We also observe that a major objective of the approaches described seems to be the limitation of structuring opportunities. In our opinion, the primary objective of standard setting should be to develop consistent and principle-based standards for financial reporting and not to avoid abusive structuring practices. Therefore, we do not see any outstanding benefits of the approaches described in the discussion paper.

From our point of view, the IASB and the FASB should launch a joint project to discuss the subject extensively and to deliberate all of the possible options. This requires further in-depth research concerning the benefits and costs of the various approaches as well as the coherences with other matters. In addition, the ongoing projects of the IASB, especially the conceptual framework project, have to be considered in evaluating the consequences of the capital distinction concepts.

**B. Response to Questions**

We would like to voice our positions on the individual questions below.

**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?**
The application of the equity-liabilities distinction criteria of IAS 32 constitutes a problem for many non-publicly listed companies in Germany and all over Europe. These problems have led to the classification and presentation of equity instruments of many European partnerships and cooperatives as liabilities. This is mainly due to the obligation of the issuer to repurchase or redeem the financial instruments when the instrument holder is exercising the legally guaranteed put option. Accordingly, current IAS 32 can lead to meaningless or misleading disclosures that are not reflecting the economic substance. IAS 32 (rev. 2008) should solve some of the above-mentioned problems by a rule-based approach with casuistic exceptions from the initial distinction criteria. Nevertheless, those exceptions integrated in the application guidance can only serve as a provisional solution.

It is our understanding that in mid-term a consistent, principle-based regulation has to be developed that provides decision-useful information for entities regardless of their legal form or industry and meets the requirements of the conceptual framework (as to be developed). Such an approach would allow an economically meaningful classification of financial instruments as equity. We do not think that any of the three approaches meets the mentioned requirements.

**Basic Ownership Approach**

We understand that the basic ownership approach simplifies the accounting requirements for publicly listed companies by reducing complexity in equity classification and does not provide many structuring opportunities. Nevertheless, complexity will be added to liability classification and split accounting. For European partnerships and cooperatives the basic ownership approach is a highly restrictive construction and would most likely lead to a classification of the interests in a partnership or cooperative as a liability. This classification of the partner’s/member’s contributions as a liability and the associated fair value measurement would cause successful companies to report lower or even negative equity and hence, lead to economically meaningless disclosures. As a result, increasing debt ratios would have an unassessable impact on financial statement analysis, capital maintenance, financial rating or debt covenants. Furthermore, the
focus on the most residual claim on liquidation overemphasises the liquidation
criterion as we principally assume the going concern principle effective.

Ownership-Settlement Approach
As for the three approaches described, we consider the ownership-settlement
approach as the approach, which could form an appropriate basis for further
considerations, especially for non-publicly listed companies. Although we see the
complexity of the approach compared to the basic ownership approach, this
approach allows to account for their shares as equity at least some of the
European non-publicly listed legal forms of companies. Nevertheless, the
approach does not define a consistent and profound principle for capital
classification and instead combines different criteria to distinguish between equity
and liabilities. Such a mixture of diverging instruments that are not sharing
common characteristics will not deliver a principle-based solution to the
shortcomings of current IAS 32.

Reassessed Expected Outcomes (REO) Approach
In our opinion the REO approach is too complex and difficult to implement. This
approach should not be followed up any further.

However, all of the approaches discussed are not based on a consistent principle
that reflects the proprietary rights and obligations of the owners of the company
independent of legal form or industry. As we already suggested, the IASB should
deliberate all possible approaches (e.g. the loss absorption approach) and
discuss them as equal options by evaluating them in an in-depth analysis. Thus, a
profound and principle-based approach can be developed that reflects the
economic substance of a financial instrument regardless of the entity’s legal form
or industry.

**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?
We consider the scope to be inappropriate. The scope as outlined in the preliminary views does not form a basis for the development of a consistent and principle-based capital classification concept. A more general scope for a common capital distinction principle should be elaborated instead.

**B3 Are the principles behind the basic ownership instrument 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?**

As already stated under B1 we consider the basic ownership approach as inappropriate. Our main concern is that for European partnerships and cooperatives the basic ownership approach is highly restrictive and would lead to a liability classification of their interests which would not reflect the economic substance. The IASB should provide further in-depth analyses of the approach and its implications before coming to a concluding decision.

**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?**

As described under B1, all of the approaches discussed are not based on a consistent principle and are therefore considered inappropriate. The IASB should redeliberate the approaches along with all other possible approaches especially with the loss absorption approach and discuss them as equal options by evaluating them in an in-depth analysis.

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

We believe that much more consideration is needed regarding the effects of the application of any of the capital distinction concepts within a group context. Additionally, it has to be discussed whether financial reporting should be based on
a proprietary view or an entity view. At the actual state of the discussion we are not able to foresee the impacts of the above-mentioned matters.

For your information we enclose our comment letters to the FASB and EFRAG. Please feel free to contact the representatives of DGRV (Eckhard Ott, ott@dgrv.de, Ulf Jessen, jessen@dgrv.de), if you have any further questions or desire any further exchange of information.

Best regards,

Lothar Jerzembek
Director, Head of Accounting and Financial Reporting Department
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Ulf Jessen
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Joint Comment Letter of 09/05/2008

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Via Email to director@fasb.org

Berlin, May 29, 2008

File Reference: 1550-100 Preliminary Views “Financial Instruments with Characteristics of Equity”

Here: Joint Comments of German Associations and Public Corporations

Dear Ms. Bielstein,

The Association of German Public Sector Banks (VÖB), the German Cooperative and Raiffeisen Confederation (DGRV), the Federation of German Industries (BDI), the German Federal Chamber of Tax Advisers (BStBK), the Federal Association of German Cooperative Banks (BVR), the Association of German Chambers of Industry and Commerce (DIHK), the German Savings Bank Association (DSGV) and the Association for the Participation in the Development of Accounting Regulations for Family-owned Entities (VMEBF) are pleased to submit their joint comments regarding the Preliminary Views “Financial Instruments with Characteristics of Equity” issued by the Financial Accounting Standards Board (FASB) in November 2007.
A. General Remarks

We welcome the revision of the regulations changing the criteria for the classification of financial instruments as equity. The revision is of high importance for European entities also, as US-standards may be adopted by the IASB in the course of the convergence project as well. A new regulation should enable all types of enterprises and companies, regardless of their legal form or industry to distinguish between liabilities and equity in a way that is conducive to economic substance. It is important to ensure that international differences with respect to codified corporate law and financial instruments commonly used by entities are adequately reflected in financial statements. In consideration of these points, it is our opinion that the clear emphasis found in the Preliminary Views on publicly listed companies as the dominant form of entities in global capital markets must be extended to other legal forms of companies.

In many instances the equity classification proposed in the Preliminary Views will surely produce suitable results for instruments issued by publicly listed companies. However, the fact must be considered that in numerous countries likewise in the European Union (EU), even non-publicly listed companies are required to apply IFRS-standards. Consequently, these companies are also affected by developments in international financial reporting.

Company Law in Europe provides special rules for partnerships and cooperatives. As opposed to publicly listed companies where capital commitment reigns, in many types of entities it is much more common to take personal risks and assume responsibility for operations. Legal controls and contracts have been created that place more emphasis on the company fulfilling its business objectives and observing the interests of owners and creditors but less on maximizing value for the individual shareholder. This is far remote from being an equity-generating structuring of individual financial instruments; on the contrary, the contracts reflect the basic conditions of the legal environment and company law. In Germany as in the EU these legal forms of companies are very common. Therefore IFRS require consistent application of standards independent of legal form or industry.
Since international financial reporting around the world converges, US-Statements on financial reporting gain in importance steadily. But as corporate law in many European countries provides special rules for non-publicly listed companies, a focus on listed companies seems to be insufficient. The FASB should take into account the specifics of partnerships and cooperatives in their standard setting process.

With this in mind, we would be very appreciative if the FASB includes as an equal alternative for discussion the “Loss Absorption Approach” (LAA) forwarded by the European Financial Reporting Advisory Group (EFRAG) in January 2008 that was based on the findings of a European joint project. The LAA focuses on providing decision-useful information in consideration of the proprietary rights of the owners of a company in different legal forms and across different jurisdictions. In our opinion, the basic idea of the “Loss Absorption Approach” takes into consideration both investors’ interests and the concerns of non-publicly listed companies operating in legal forms that differ from publicly listed companies. From our point of view the LAA poses an adequate alternative to the other approaches discussed by the FASB.

B. Response to Questions

We would like to voice our positions on the individual questions below.

Questions on the Basic Ownership Approach

Q 1 – Do you believe that the basic ownership approach would represent an improvement in financial reporting? Are the underlying principles clear and appropriate? Do you agree that the approach would significantly simplify the accounting for instruments within the scope of these Preliminary Views and provide minimal structuring opportunities?
In our opinion, using the basic ownership approach would not eliminate the problems we currently are experiencing in equity distinction and therefore would not improve financial reporting. On the contrary, the basic ownership approach would exacerbate the problems especially of partnerships and cooperatives in Europe in many instances. We consider the basic ownership approach largely insufficient with regard to the distinction between liabilities and equity that we have called for.

In our view it is exceedingly problematic that only financial instruments in the most subordinate classes of instruments (i.e. the most residual claim) are classified as equity. This would give rise to equity instruments that, for example, are given preferred settlement over other shareholders within partnership contracts to be classified as liabilities. It is our understanding that equity should primarily serve to protect creditor claims. We cannot see any reason to protect the interests of the partners or shareholders of a company against each other. Moreover, the conditions under which a partner, member or shareholder invests in a company, even in one that does not issue shares, are usually known beforehand. Regardless of legal structure, in our understanding of equity classification, the sole matter is therefore to what extent the instrument is subordinate to third-party creditors that are not associated with the company.

We doubt whether the installation of an upper limitation of the holder’s entitlement to a share of the entities net assets should be a prerequisite for qualifying as equity. An equity investor, acting in a free market, should be free to choose how and to what extent he or she benefits from a company’s performance. With respect to the economic character of equity being risk capital we recommend to focus on the question whether capital is available for covering creditor demands.

**Perpetual Instruments**

Q2 – Under current practice, perpetual instruments are classified as equity. Under the basic ownership approach (and the REO approach, which is described in Appendix B) certain perpetual instruments, such as preferred shares, would be
classified as liabilities. What potential operational concerns, if any, does this classification present?

We believe perpetual instruments like preferred shares should be classified as equity, provided the capital allocated to them is available for creditor claims. As we stated in our response to Question 1, our concern with classifying equity is not the dialogue of shareholders among themselves in a company. Consequently, the single criterion for classifying an instrument as equity must be the ability to absorb losses, or to put it another way, the ability to service the claims of creditors should the worst case occur. Under these conditions, we reject a general classification of perpetual instruments as liabilities.

Q 3 – The Board has not yet concluded how liability instruments without settlement requirements should be measured. What potential operational concerns, if any, do the potential measurement requirements in paragraph 34 present? The Board is interested in additional suggestions about subsequent measurement requirements for perpetual instruments that are classified as liabilities.

In keeping with our remarks in Question 2, we assume that these instruments are equity, which makes the question of subsequent measurement requirements superfluous in our view. We would like to point out that the issue of subsequently measuring perpetual instruments reveals a conceptual error in the basic ownership approach. It is in the nature of liabilities that they become due. Perpetual instruments do not exhibit this characteristic, so the timing and magnitude of an outflow of resources embodying economic benefit is incalculable. This uncertainty makes it quite difficult to provide a general statement on the topic of subsequent measurement requirements. We advocate classifying equity based on subordinate ranking to the company’s third-party creditors’ claims.

**Redeemable Basic Ownership Instruments**

Q 4 – Basic ownership instruments with redemption requirements may be classified as equity if they meet the criteria in paragraph 20. Are the criteria in
paragraph 20 operational? For example, can compliance with criterion (a) be determined?

We expressly support the ruling that redeemable instruments are to be classified as equity. As stated above, however, we don’t believe the criteria for classifying basic ownership instruments are suited for ensuring the distinction between equity and liabilities independent of a company’s legal form. Equity instruments are naturally subordinate to creditors’ claims and can only grant claims to the residuals in case of liquidation. It is rather evident that the assumption of liability of equity instruments is of key importance for each user of the financial statement. Knowing the potential amount of coverage for losses is of great importance for a company’s investors, banks, suppliers and clients. In our view, the classification of a financial instrument as equity clearly necessitates a redemption amount with no lower limit. How a “more” of net assets is distributed should not play a role in equity classification.

**Separation**

Q 5 – A basic ownership instrument with a required dividend payment would be separated into liability and equity components. That classification is based on the Board’s understanding of two facts. First, the dividend is an obligation that the entity has little or no discretion to avoid. Second, the dividend right does not transfer with the stock after a specified ex-dividend date, so it is not necessarily a transaction with a current owner. Has the Board properly interpreted the facts? Especially, is the dividend obligation that the entity has little or no discretion to avoid? Does separating the instruments provide useful information?

IAS 32 already requires the separation of dividend payments, so we cannot discover any differences. We advocate, however, restricting separation obligations explicitly to instruments that assure at the date of issue an ongoing dividend with clear reference to timing and amount of payment. As soon as the warranted dividend payment is tied to conditions, the obligation to separate, and therewith the requirement for valuation of claims, should be omitted. Due to the existing
uncertainties this would produce extremely complex presentation that would be
difficult for the recipients of the financial statement to understand.

Q 6 – Paragraph 44 would require an issuer to classify instruments based on their
substance. To do so, an issuer must consider factors that are stated in the
contract and other factors that are not stated terms of the instrument. That
proposed requirement is important under the ownership settlement approach,
which is described in Appendix A. However, the Board is unaware of any unstated
factors that could affect an instrument’s classification under the basic ownership
approach. Is the substance principle necessary under the basic ownership
approach? Are there factors or circumstances other than the stated terms of the
instrument that could change an instrument’s classification or measurement under
the basic ownership approach? Additionally, do you believe that the basic
ownership approach generally results in classification that is consistent with the
economic substance of the instrument?

The principle of economic substance is one of the basic principles of international
financial reporting and should be included in the criteria used for classifying equity
instruments. As stated previously, the classification criteria proposed here are
essentially geared towards the needs of publicly listed companies. This, however,
means that the classification criteria with regard to equity instruments of non-
publicly listed companies do not reflect the economic substance of those
instruments’ appropriately. Therefore, we advocate creating classification criteria
that disregard a company’s legal form so that the various share instruments can
be classified and depicted as equity instruments in a way that reflects their
economic substance to fulfill creditor claims.

Linkage

Q 7 – Under what circumstances, if any, would the linkage principle in paragraph
41 not result in classification that reflects the economics of the transaction?

No comment.
**Measurement**

Q 8 – Under current accounting, many derivatives are measured at fair value with changes in value reported in net income. The basic ownership approach would increase the population of instruments subjected to those requirements. Do you agree with that result? If not, why should the change in value of certain derivatives be excluded from current-period income?

Call options on a company’s own shares should not be subject to fair value measurement, and consequently gains derived from a change in the fair value of these instruments should not have any effect on the income statement. Fair value changes in these options are ultimately the result of changes in a company’s own shares, which do not produce gains in the sense of company performance.

**Presentation Issues**

Q 9 – Statement of financial position. Basic ownership instruments with redemption requirements would be reported separately from perpetual basic ownership instruments. The purpose of the separate display is to provide users with information about the liquidity requirements of the reporting entity. Are additional separate display requirements necessary for the liability section of the statement of financial position in order to provide more information about an entity’s potential cash requirements? For example, should liabilities required to be settled with equity instruments be reported separately from those required to be settled with cash?

In our view, any requirements that extend beyond a separate disclosure of perpetual and redeemable components of equity are not necessary.

Q 10 – Income Statement. The Board has not reached a conclusion about how to display the effects on net income that are related to the change in the instrument’s fair value. Should the amount be disaggregated and separately displayed. If so, the Board would be interested in suggestions about how to disaggregate and
display the amount. For example, some constituents have suggested that interest expense should be displayed separately from unrealized gains and losses.

No comment.

**Earnings Per Share (EPS)**

**Q 11** – The Board has not discussed the implications of the basic ownership approach for the EPS calculation in detail. However, it acknowledges that the approach will have a significant effect on the computation. How should equity instruments with redemption requirements be treated for EPS purposes? What EPS implications related to this approach, if any, should the Board be aware of or consider?

This question refers exclusively to companies whose equity solely exists in shares. As we firmly advocate a distinction of equity and liabilities independent of the legal form, we refrain from answering this question.

**Questions on the Ownership-Settlement Approach**

**Q 1** – Do you believe the ownership-settlement approach would represent an improvement in financial reporting? Do you prefer this approach over the basic ownership approach? If so, please explain why you believe the benefits of the approach justify its complexity.

Yes, in our view the ownership-settlement approach is superior to the basic ownership approach. The ownership-settlement approach allows the classification as equity of additional perpetual instruments and indirect ownership instruments. In our opinion, it has fewer disadvantages, especially for companies that are not operating as publicly listed companies. Therefore, it allows to account for their shares as equity at least some of the non-publicly listed companies.
Q 2 – Are there ways to simplify the approach? Please explain.

No comment.

Q 3 – Paragraph A40 describes how the substance principle would be applied to indirect ownership instruments. Similarly to the basic ownership approach, an issuer must consider factors that are stated in the contract and other factors that are not stated in the terms of the instrument. Is this principle sufficiently clear to be operational?

No comment.

Presentation Issues

Q 4 – Statement of financial position. Equity instruments with redemption requirements would be reported separately from perpetual equity instruments. The purpose of the separate display is to provide users with information about the liquidity requirements of the reporting entity. What additional, separate display requirements, if any, are necessary for the liability section of the statement of financial position in order to provide more information about an entity’s potential cash requirement? For example, should liabilities required to be settled with equity instruments be reported from those required to be settled with cash?

We do not believe separate disclosures for liabilities are necessary. The separation of perpetual and redeemable equity instruments that is currently stipulated is sufficient.

Separation

Q 5 – Are the proposed requirements for separation and measurement of separated instruments operational? Does the separation result in decision-useful information?

No comment.
Earnings Per Share (EPS)

Q 6 – The Board has not discussed the implications of the ownership-settlement approach for the EPS calculation in detail. How should equity instruments with redemption requirements be treated for EPS purposes? What EPS implications related to this approach, if any, should the Board be aware of or consider?

The question refers exclusively to companies whose equity solely exists in shares. As we firmly advocate a distinction of equity and liabilities independent of legal form, we refrain from answering this question.

Settlement, Conversion, Expiration, or Modification

Q 7 – Are the requirements described in paragraph A35-A38 operational? Do they provide meaningful results for users of financial statements?

No comment.

Questions on the REO Approach

Q 1 – Do you believe that the REO approach would represent an improvement in financial reporting? What would be the conceptual basis for distinguishing between assets, liabilities and equity? Would the costs incurred to implement this approach exceed the benefits? Please explain.

In our opinion the complex REO approach would be difficult to operationalize and should therefore not be pursued any further. That is why we refrain from answering the individual questions asked here.

Please feel free to contact representatives of DGRV (Eckhard Ott, ott@dgrv.de, Ulf Jessen, jessen@dgrv.de), if you have any further questions or desire any further exchange of information.
Best regards,

Lothar Jerzembek
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Dr. Jürgen Möllering
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Joint Comment Letter of 5/29/2008

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Peter Notz
Member of Managing Board

Association for the Participation in the Development of
Accounting Regulations for Family-owned Entities (VMEBF)
Joint Comments of German Associations and Public Corporations on the discussion paper „Distinguishing Between Liabilities and Equity“ published by Pro-Active Accounting Activities in Europe

Dear Sir or Madam,

The Association of German Public Sector Banks (VÖB), the German Cooperative and Raiffeisen Confederation (DGRV), the Federation of German Industries (BDI), the German Federal Chamber of Tax Advisers (BStBK), the Federal Association of German Cooperative Banks (BVR), the Association of German Chambers of Industry and Commerce (DIHK) and the German Savings Bank Association (DSGV) are pleased to submit their joint comments regarding the discussion paper „Distinguishing Between Liabilities and Equity“ published by Pro-Active Accounting Activities (PAAinE) in Europe in January 2008.

A. General Remarks

We extremely welcome the proposal for a further model to distinguish equity and liabilities submitted by the PAAinE as a result of an European joint project. In our opinion the underlying concept of the „Loss Absorption Approach“ can far better, than all other currently discussed proposals, account for the interests of the investors as well as the issues of non-listed companies having a different legal form
than stock corporations. In particular, we estimate exceedingly positive the general focus on the ability of equity to absorb losses.

However, the present paper is so far only of a theoretical nature; therefore, a differentiation of many instruments can hitherto merely be carried out on a hypothetical basis. At the same time, we have observed that also the present paper is in its basic structure orientated on the legal form of a stock corporation rather than from on a neutral view concerning legal forms.

**B. Answers to the questions**

We would like to comment to the questions as follows:

**Q 1 – Do you believe that defining two different classes of capital on the credit side on the balance sheet does provide decision-useful information, even if the entity’s capital structure is in fact multi-dimensional (the so-called “list claims”-approach, pars. 13 ff.) If not, why?**

We consider a distinction into two classes of capital on the credit side as appropriate and decision-useful, as the information about the financial situation corresponds to the circumstances of the entity and allows for an overview of the liquidity situation and the liquidity requirements already arising out of the balance sheet. Even if the characteristics and form of the equity instruments are complex and therefore represent its multidimensional criteria, we consider an explanation or distinction of equity exclusively in the Notes for insufficient, if not even misleading.

**Q2 – Do you believe that listing all claims to the entity’s assets, ranking those claims by a certain criterion and providing additional information on all other characteristics of the claims in the Notes to the financial statements would have merit (pars. 1.3 ff)? Why? If not, why?**

As already explicated in Question 1, we share the view, that a dichotomy in equity and liabilities in the balance sheet offers decision-useful information.

From our point of view, the structure of the credit side of the balance sheet should be developed so adequately, that at least a first overview of the situation of the
equity and liabilities in the balance sheet is possible. Details regarding the form of
the several items and instruments should be presented in the Notes.

**Q 3 – Do you agree with the analysis of the different characteristics of capital as
the basis for distinguishing between equity and liabilities (pars. 1.14 ff.)? If not,
why? Do you think that any other characteristics should be considered? If yes,
which?**

We agree in principle with the analysis and the individual explanation of the char-
acteristics of equity and liabilities. In particular, we consider loss absorbing as the
relevant criterion for distinguishing between liabilities and equity instruments.

We would like to note at this point that the section is largely formulated neutrally,
which we welcome at first. However, in several passages a clear orientation on or-
dinary stock as the basic form of equity instruments can be recognized. Herewith,
however, we do not agree, as we fear that an orientation on the basic form of one
single instrument of equity will regularly lead to problems in interpretation and im-
plementation. We argue insofar for a revision of the paper developing analysis and
criteria in a way that neither conclusions on individual legal forms nor on certain
instruments can be drawn.

**Q 4 – Do you agree with the analysis in the paper on whether to base a capital dis-
tinction on one or more than one criterion (pars. 1.33 ff.)?**

As explained, we consider loss absorbing as the decisive criterion for the classifi-
cation of equity instruments. From our point of view, this criterion is sufficient for
distinguishing between liabilities and equity instruments.

**Q 5 – Do you agree with the analysis in this paper that, in order to classify capital,
either an entity view or a proprietary view has to be applied (pars. 1.40 ff.)? If not,
why not? Do you agree with the paper’s description of the implications of each ap-
proach (pars. 2.35 ff., 3.22 ff.)? If not, why?**

The discussion paper basically depends on the loss absorbing function of capital
as the relevant criterion to distinguish between liabilities and equity. The possibility
of different interpretations of the loss absorbing-criterion subject to an entity view
or a proprietary view and hence a different classification of the same instrument should, however, be further discussed. With respect to the definition of the loss absorbing-criterion, in our view, one of the following perspectives should mandatory be decisive. The entity view, the proprietary view or the creditor view could be considered. Accordingly, we consider further explanation regarding the topic ‘Entity versus Proprietary View’ desirable.

Furthermore, we share the view that for a final evaluation of the loss absorbing-criterion, it needs to be defined mandatory at first, from which perspective a participation in losses has to be assessed.

Q 6 – Do you agree with the analysis of the needs of the users of financial statements in the context of classifying capital (pars. 3.1 ff.)?

We consider that the users of financial information are a multidimensional group. Therefore information provided by the entity is interpreted and assessed differently, respectively, according to the interests of the various stakeholders. According to the IFRS framework, investors in their capacity as providers of risk capital will usually have the most comprehensive information need of all users.

Q 7 – Do you agree that basing the distinction between equity and liabilities on risk capital would provide decision-useful information to a wide range of users of financial statements about entities in different legal forms (pars. 3.5 ff.)? If not, why? Is there any other basis for the distinction that you would consider providing more useful information? If yes, which and why?

We agree that a distinction between equity and liability based on the definition of risk capital provides decision-useful information for users of financial statements. In this case, we understand risk capital as capital, which participates in losses (Section 3.14), hence takes over a loss absorbing function. However, we consider a definition of risk capital and accordingly of the loss absorbing function, which is neutral regarding entities in different legal forms as essential.

Q 8 – Do you agree with the analysis of losses as either economic losses or accounting losses in the context of classifying capital as equity or liabilities (pars. 4.1
ff.)? If not, why? Would you agree that the Loss Absorption Approach should focus on accounting losses?

In the context of classifying capital as equity or liability, the loss absorbing-criterion provides decision-relevant information (Question 7), whereas the question concerning the definition of losses as economic losses or accounting losses is posed. Economic losses are defined as any decrease in the value of an entity in sections 4.2 and 4.3 due to changes in future cash flows. Accounting losses, however, are defined as losses of the current period listed in the profit and loss account pre-tax and pre-distribution of dividends or rather proportions of profit (Sections 4.4 up to 4.15).

Focusing the definition of accounting losses purely on the current reporting periods and on the figures of the profit and loss account seems to be problematic. On the one hand, there is the possibility not to include losses in the profit and loss account but to recognize them directly in equity. On the other hand, the restriction on loss absorbing in the current reporting period suppresses the participation in losses in case of liquidation. As an example, profit transfer agreements should be mentioned, within which minority participators do not participate in the losses of the current period, as the majority participators bear these. In the point of time of liquidation, however, also minority participators bear the losses pro rata. Such a profit and loss transfer agreement is necessary due to tax reasons and is no structuring opportunity. Furthermore, the payments of dividend and compensation of minority shareholders are subject to legal protection provisions, triggering unavoidable obligations for the entity.

Q 9 – Do you think that the Loss Absorption Approach is explained sufficiently clear in this paper (Section 4)? Do you agree with the definition of loss-absorbing capital in par. 4.16? If not, why? How could this definition be improved?

Overall the Loss Absorption Approach depending on the liability function of capital and the criterion of loss absorption is a proper approach. It should, however, be explained elaborately and defined in more detail.

The definition of loss absorbing capital, mentioned in section 4.16, refers to the definitions of risk capital and loss absorption and contains an explicit reference to
the entity view. Thus, the same questions are posed as described in the remarks to questions 7 and 8. For example, it is not fully clear if ordinary shares of minority shareholder would be classified as equity because in profit and loss transfer agreements, legal dividend- or pay off-arrangements loss absorbing in the current period is not provided, although ordinary shares are identified as the purest form of equity.

A further question concerning the definition of loss absorbing capital results from the existence of factual or actual loss-absorption. Here, the example of a capital contributed within a silent partnership agreement should be mentioned, who participates in losses to the full extent of his paid in capital and who does not have a right of cancellation of his own. The capital, however, can be called in on the part of the entity, as far as the dormant partner retrieves at least his deposit made. De facto, the capital serves as a buffer of losses for the entity and is available for them unconditionally. A repayment of the capital on the part of the entity through cancellation, however, can only take place, if no losses are accumulated, which would reduce the amount of the capital. Therefore, the capital is available for the entity as loss-absorbing capital, merely a cancellation and the hence following redemption of the capital in the event of loss cannot take place.

Q 10 – Do you agree that classification of an instrument as equity or liability should be based on the terms and conditions inherent in the instrument?

Do you agree that the passage of time should not be the trigger for reclassification of an instrument (pars. 4.22 ff)? If not, why?

In principle, we agree to the statement that the decision for a classification of an instrument is based on the terms and conditions inherent in the instrument. This classification should also endure in variation in time. Therefore, we consider a reassessment in certain intervals dispensable also with the background of the principle of consistency. For a final evaluation of the circumstance, however, we consider a concretion of the Loss Absorption Approach necessary.

Q 11 – Do you agree with the discussion on linkage (pars. 4.13 ff.)?

No comment.
Q 12 – Do you agree with the discussion on split accounting (pars. 4.36 ff.)?

According to the current state of the discussion, in our view, the question cannot be finally answered, as without concrete criteria of differentiation you can only hardly assess, under which circumstances certain instruments should be split off.

Q 13 – Do you agree with the discussion of the different approaches to distinguish equity from liabilities within a group context in general and with regard to the Loss Absorption Approach in particular (section 5)? If not, why? Would you prefer the approach set out in par 5.1(a) or the approach in par. 5.1 (b)? Why?

An explicit procedure for the identification on the level of (subsidiary) entity cannot clearly be concluded out of the discussion paper. Accordingly, from these criteria hardly any conclusions for the presentation, if done in a group context, can be drawn. For an analysis of the consequences which would result from the chosen procedure further explanation on this topic and the preceding questions (minority interests, profit transfer agreement) would be necessary.

Q 14 – Do the examples in section 6 illustrate the loss-absorption principle well? Would you have reached a different conclusion (or classification)? Why? Are there any other aspects of the Loss Absorption Approach that need to be illustrated?

The described examples of section 6 illustrate well the principles of the Loss Absorption Approach. We would like to note though that this is only an explanatory description so that we thereof assume that in practise cases exist, which cannot be subsumed under the examples described. Consequently, an answer to the question, which includes all alternatives is not possible, as for this purpose firstly the questions and notes, which were contained in the preceding comments are to be clarified.

Q 15 – Do you believe that the Loss Absorption Approach is sufficiently robust to be prescribed in an accounting standard? If not, why? If you are concerned about structuring opportunities what would be your suggestion to limit the structuring opportunities?
As already explicated in our answer relating Q 9, we consider loss absorbing as the basic principle appropriate for a differentiation between equity and liability. However, we consider the current implementation as too theoretical to make a statement regarding the suitability for a future accounting standard and concerning structuring opportunities.

**Q 16 – Do you think the Loss Absorption Approach should be simplified? If yes, how could the Loss Absorption Approach be simplified?**

As the present paper hitherto basically contains theoretical explanations of the Loss Absorption Approach, concrete criteria concerning the final distinction of equity, however, to a large extent are missed, we currently see hardly any possibilities for a significant simplification.

**Q 17 – This Discussion Paper is based on the view that the current IFRS approach to distinguish equity from liabilities has shortcomings. Do you agree with the analysis of the current IFRS approach to distinguish equity from liabilities (section 2)? Do you agree that the current approach has shortcomings as identified in this paper (pars. 2.17 ff.)? If not, why? Do you see any other shortcomings? Do you see advantages of the current approach?**

No comments.

**Q 18 – Do you believe that the Loss Absorption Approach would represent an improvement in financial reporting over the current IFRS approach? Do you think that the distinction based on this approach provides decision-useful information? If not, why? Do you have any other comments?**

No comments.

Please feel free to contact representatives of DGRV (Eckhard Ott, ott@dgrv.de, Ulf Jessen, jessen@dgrv.de), if you have any further questions or desire any further exchange of information.
Best regards,

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