audit

UAB Raimda auditas
Code 302509547
VAT LT100005399614
Laisves al.101A, Kaunas
Lithuania
www.raudit.lt

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European Financial Reporting Advisory Group

***Classification of Claims* – EFRAG DISCUSSION PAPER**

UAB Raimda auditas welcomes opportunity to respond regarding to **EFRAG DISCUSSION PAPER** *Classification of Claims.*

Looking from the strategic site and (or) from scientific site Discussion Paper (later in context DP) *Classification of Claims* is very sophisticated and good investigated work. Overall we suppose that this DP *Classification of Claims* could support IASB work regarding to financial instruments areas. According to our opinion it could be treated like *more detail recommendations in the classification of claims* regarding to the application of financial instruments issue. Also we recommend providing more details explanations/investigation regarding to Classification of Claims/financial instruments issues.

Otherwise, we suppose that this DP has some unfavourable points such as:

a) It is too theoretical document. In reality, application of this DP could be quite confusing.
b) The essence of this document is very complicated.
c) Sometimes this DP 'goes' in too more details, sometimes there is no close interaction between Articles.
d) Investigation of *glossary* is very favourable in DP *Classification of Claims.* Without absolutely doubt *glossary* was very useful in this DP. Otherwise the question is open 'is it useful (favourable) to investigate additionally 46 (forty-six) definitions?'

As we mentioned previously, according to our opinion it is very well investigated work, otherwise we suppose that it is too 'radical'' at the moment.

The collapse of Leman &Brothers in 2008 was very painful for the world. One of the reasons of this bankrupt: application of different accounting standards in USA and Europe. *Classification of claims* is financial instrument area and according to our opinion it should be the same (or similar) accounting treatment through the entire world.

All commentaries are provided in the Appendix 1.

Yours sincerely,
UAB Raimda auditas Director – Auditor
A member of the Lithuanian Chamber of Auditors

Daiva Zumbakiene

Overall objectives

1 Question

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 Answer

According to our opinion it 'goes too detail' to the overall objectives to be used when assessing classification requirements. Articles 22(an entity's liquidity/solvency/financial performance/returns to the holders of a particular class of instrument) - 26 are too theoretical. We don't support the view that these objectives should be wider depicted. It is could be treated as the main principle – conceptions that are applied to anyone entity.

Classification choices

2 Question

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 that have been identified?

2 Answer

As we mentioned previously in our introduction, according to our opinion, this section (Question2) is not clear enough. Article 38 states that '…some of these choices would need to be made at the Conceptual Framework level, with decisions at the standards level…'

Article 39 states that'…the choices themselves, and the consequences of them, are explored from page 16 onwards…'

At the 16 page, there is hedging 'The number of elements'. It was not enough clear stated that it is 'continuation'of relevant choices in other words it could be said that it was 'lack of consistency'.

We suppose that overall DP *Classification of Claims* should be more clearly structured.

Elements

3 Question

If you support 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?

UAB Raimda auditas Company code: **302509547** VAT number : **LT100005399614**
Regist. address : Dobilų g. 8, Neveronys, Kauno raj., LT-44291 Office address: **Laisvės al. 101 A, Kaunas**
Website: **www.raudit.lt** Email: **info@raudit.lt** Tel: **(8-37) 206980** Mobile: **+3706 1654450**

Appendix 1 (2)

3 Answer

No, we don't agree with the proposed ***claim approach***. According to our assumption the proposed changes in Article 52 are too complicated.

4 Question

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?

4 Answer

Positive definition of equity within (i) a proprietary perspective to financial reporting and positive definition of equity within (ii) an entity perspective to financial reporting are quite controversial.

Article 107 states that 'entities could be allowed a free choice of how they identify 'ownership instruments'. Looking from one site it is favourable point, otherwise it could be aloud for the different accounting treatment on the same issue.

In summary, Articles 90 – 114 provides a lot of information as well as in (i) actual in real life and (ii) problems that are not solved, yet.

Overall according to our opinion problems stated in Articles 98/100/101 'most residual instrument' are not explained/defined correctly.

We do not support the view, that 'it should be the requirement to define equity positively'.

5 Question

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?

5 Answer

Positively define liabilities consist of two notions (i) an ***obligation must exist*** and (ii) the obligation must be to transfer economic resources.

We support the view explained in Article 119 *criteria that should exist in order to identify existence of obligation.*

Also we support the view of Article 124 that explained '…an obligation to transfer claims on equity of the entity is an obligation of the entity but is not an obligation to transfer economic resources [of the entity]…'.

In summary all issues mentioned in Articles 125-138 are identified correctly.

Looking from theoretical site, overall 'question 5' could be answered – No. Otherwise we do not support the view that 'there is a requirement to *define liabilities positively*'.

Appendix 1 (3)

6 Question

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?

6 Answer

We do not agree that the inclusion of an additional element could assist in meeting some of the identified objectives.

We strictly do not agree with the three additional elements such as:

(a) Participating obligations.

It is very 'theoretical' study. Application of this element could be extremely difficult in practise. We support the main thesis stated in the Article 180 *Disadvantages* of the application of this element.

(b) Obligations to transfer claims on equity and

(c) Instruments that are contractually bail-inable.

We do not support to the elements as they stated/explained in the points (b) and (c), as a result –they are too complicated and (c) could be quite rare in some cases.

Dilution

7 Question

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?

7 Answer

There are good examples in the Articles 162, 163 regarding to some different classes of instruments.

Sometimes it could be very 'mince thread' between (i) *potential claim on equity-obligation* and (ii) *potential claim on equity- that is not obligation.* The problems could exist within the determination of 'event within the control of an entity'. According to our opinion there are a lot of 'events' that classification depends on the management decisions. It is not possible to 'include strict rules in all slippery areas'.

Different treatment of 'preference shares' according to different legal systems (in provided case German/UK) is more *legal issue*, not accounting. In the BC (*basis for conclusion* for the appropriate Standard) could be provided more explanation what does it mean 'preference shares'.

In the Article 169 was mentioned that 'The requirements of IAS 33 are based around a simple **corporate structure** in which the only claims on equity are ordinary shares and preference shares; the inherent assumptions it makes about **corporate structure** may not always be applicable'.

We suppose that the main issue, in this context, is not about '**corporate structure**' but 'claims on equity' or in other words 'what is the classification/definition of **equity**'.

According to our opinion we do not support the main explanation as stated in the Article 170. It will be the consequences of too difficult/complicated disclosures.

Wider explanation regarding to 'equity meaning' through all relevant Standards (e.g. IAS 33) could be the solution of '**7 question**'.

Glossary

8 Question
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?

8 Answer
According to our opinion *Glossary* was well investigated in this, particular, Discussion Paper *Classification of Claims.* It supported the overall context, i.e. it was like 'extension' of the main text. Otherwise, according to our opinion investigation of 46 definitions is too 'radical'. We suppose that one of the requirements for the IASB is to provide accounting standards as more as possible – simplified. Inclusion of 46 definitions, the result will be vice versa – accounting standards will be complicated.

Any other issues

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

9Answer
No, we have no additionally commentaries.

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