FINANCIAL REPORTING

EXPOSURE DRAFT

PROPOSED AMENDMENT TO FRS 25 'FINANCIAL INSTRUMENTS: PRESENTATION'

PUTTABLE FINANCIAL INSTRUMENTS AND OBLIGATIONS ARISING ON LIQUIDATION

ACCOUNTING STANDARDS BOARD

For ease of handling, we prefer comments to be sent by email (in Word format) to

asbcommentletters@frc-asb.org.uk

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Comments should be received no later than 16 May 2008 .All replies will be regarded as on the public record, unless confidentiality is requested by the commentator.
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The draft is issued by the Accounting Standards Board for comment. It should be noted that the draft may be modified in light of comments received before being issued in final form.

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PREFACE

Introduction

1. The International Accounting Standards Board ("IASB") originally published an exposure draft ("ED") proposing an amendment to IAS 32 *Financial Instruments: Presentation* in June 2006. These proposals made limited amendments to the IAS 32 classification of financial instruments puttable at fair value and obligations arising on liquidation. Financial Reporting Standard ("FRS") 25 is the converged UK standard that corresponds to IAS 32. The ASB published an exposure draft in July 2006 proposing amendments to FRS 25 to ensure the standard's continued convergence with IAS 32.

2. The IASB published its final amendments to IAS 32 during February 2008. The ASB is inclined to make the corresponding changes to FRS 25. However, because of the changes between the IASB's ED and the final standard discussed further below, the ASB would prefer to consult with constituents to ensure that any unintended consequences of the proposals are identified before these proposals are adopted in the UK.

3. In this ED, the ASB is proposing amendments to FRS 25 *Financial Instruments: Presentation* in relation to the liability-equity classification requirements of FRS 25 for puttable financial instruments. The proposed amendments require that some puttable financial instruments and some financial instruments, that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation, be classified as equity. These are in line with changes made to IAS 32 by the IASB in February 2008 and, if implemented, would ensure that no divergence between FRS 25 and IAS 32 occurs.

The IASB's amendment

4. The IASB's original proposals were presented as a limited scope, short-term solution for financial instruments that were puttable at fair value of a pro rata share of the net assets of the entity and instruments with obligations for a pro rata share of the entity on its liquidation. Those proposals required that such instruments be classified as equity provided certain criteria were met.

5. The IASB subsequently refined the proposals in the ED in response to comments from respondents. The final amendment to the standard was published in February 2008 without a further formal consultation with constituents.

6. The final amendment is different from the original proposals in the ED in some key areas. In particular, the original criteria in the ED for a puttable financial instrument to be classified as equity included that it be puttable at fair value. This requirement was removed in the final published version of the amendment. Instead an equity puttable instrument is now defined as one that entitles its holder to a pro rata share of the entity's net assets in the event of the entity's liquidation.

7. Other criteria for classification of puttable financial instruments as equity are retained; these include the requirement that the puttable instruments constitute the most subordinate class of instrument in the entity.

Purpose of the amendment

8. Under the current requirements of IAS 32, if an issuer can be required to pay cash or another financial asset in return for redeeming or repurchasing a financial instrument, the instrument is classified as a financial liability. This principle applies even if the amount payable is equal to the holder's interest in the net assets of the issuer, or if the amount is only ever payable at

liquidation (and liquidation is certain because, for example, there is a fixed liquidation date).

9. The IASB believes that current requirements lead to counter-intuitive results (e.g. for entities where liquidation is at the option of the holder the instruments that represent the last residual interest in the entity may be recognised as financial liabilities even when the instruments have characteristics that are similar to equity). The IASB's amendment is designed to avoid these outcomes.

10. The IASB amendment categorises as equity some puttable financial instruments and financial instruments that impose on the issuer an obligation to deliver a pro-rata share of net assets of the entity only on liquidation. The amendment outlines separate sets of detailed criteria for both types of instruments that must be met in order to qualify for equity presentation. However, derivatives over these equity instruments do not qualify.

11. For instruments of this nature issued by a subsidiary that are held by non-controlling parties and presented as equity in the subsidiary's financial statements, equity presentation will not be appropriate in the consolidated financial statements as the instrument will not be the most subordinated instrument of the group.

12. The amendment also sets out additional disclosure requirements in IAS 1 *Presentation of Financial Statements* for entities that have puttable instruments presented as equity. These include, quantitative data on the amount classified as equity; qualitative data on the entity's policies and procedures for managing its obligation to repurchase or redeem the instruments; and information on the expected cash flow on redemption or repurchase of the instruments.

The ASB's proposals

13. The ASB was concerned that the original proposals were rules-based and did not seem to follow a clear principle. It noted these concerns in its response to the IASB on the ED. However, it went on to note that it would replicate any changes the IASB makes on pragmatic grounds.

14. The ASB believes that subsequent changes to the proposals are significant and provide sufficient grounds for re-exposure in the UK. In particular, it is concerned about the removal of the criterion that to be granted equity treatment, the financial instrument must be puttable at fair value. It believes that this change has the impact of widening the scope of what was originally a limited exception.

15. Despite this widening of scope, the ASB's view is that the impact of the amendment in the UK will not be major. To date, the ASB has not identified particular situations where the amendment would result in misleading accounting, but believes it would be especially relevant to the funds industry, Limited Liability Partnerships, and mutual and co-operative entities. However, it is concerned to ensure that there are no unintended consequences in the UK that have not been identified and is thus consulting constituents on this point.

16. The IASB has also made consequential amendments to IAS 1, IFRS 7 *Financial Instruments: Disclosures* and IAS 39 *Financial Instruments: Recognition and Measurement*. There is no UK equivalent to IAS 1. However, the capital disclosure requirements of the standard were implemented in the UK as Appendix E to FRS 29 *Financial Instruments: Disclosures*. Therefore, the changes in relation to capital disclosures of IAS 1 are proposed as changes to Appendix E of FRS 29. The amendments to IFRS 7 and IAS 39 are proposed as changes to the

equivalent converged UK standards FRS 29 and FRS 26, respectively.

Regulatory impact

17. The ASB is not aware that the proposal would impose additional costs on entities that would outweigh the benefits of providing this clarification, but would welcome any comments that respondents might have on this issue.

Date from which effective

18. It is proposed that the [draft] FRS will be effective for accounting periods beginning on or after 1 January 2009. Early adoption will be permitted.

Invitation to comment

19. The ASB is requesting comments on any aspect of the Amendment to the FRS by 16 May 2008. This is a shorter than normal consultation period, because the ASB would want the amendments to apply from the same time as those of the IASB.

20. The ASB would welcome comments in particular on the following:

    Q1 Do you consider that the proposals will improve the accounting for the instruments within the scope of the proposed amendment?

    Q2 Are you aware of any unintended consequences or problems that may arise as a result of the proposed amendments for UK entities?

    Q3 Are you aware of any other conflicts with other FRSs that should be addressed at the same time as those stated in the ED?

Q4 Do you agree that the benefits of the proposed amendment would outweigh any costs involved? If not, why not? It would be helpful if any significant costs that would arise on implementation of the proposal could be identified and quantified.

Q5 In line with the IASB's implementation date, the ASB is proposing that the [draft] amendments to FRS 25 be effective for accounting periods beginning on or after 1 January 2009 and it is permitting early adoption. Do you agree with the proposed effective date?

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AMENDMENTS TO IFRSs*

This document sets out amendments to IAS 32 *Financial Instruments: Presentation* and IAS 1 *Presentation of Financial Statements* (as revised in 2007) and consequential amendments to IFRS 7 *Financial Instruments: Disclosures*, IAS 39 *Financial Instruments: Recognition and Measurement* and IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments*. This document also contains amendments to the Basis for Conclusions on IAS 32 and IAS 1 and the illustrative examples accompanying IAS 32. The amendments result from proposals that were contained in an exposure draft of proposed amendments to IAS 32 and IAS 1—*Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation* published in June 2006.

Entities shall apply these amendments for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If entities apply these amendments for an earlier period, they shall disclose that fact.

* *ASB Footnote: This introductory section has been produced by the IASB and is included here in full. Although refernces to specific IFRSs have been amended in the main section of the Standard, references in this section and in the amendment to the Introduction, which describe the revision of IAS 32 and other IFRSs, have been left unchanged. As the IASB's amendment included here was issued in its final form there is no invitation to comment in this section.*

AMENDMENTS TO ~~IAS 32~~ FRS 25 *FINANCIAL INSTRUMENTS: PRESENTATION*

[ASB Note: The text of FRS 25 (IAS 32) 'Financial Instruments: Presentation' includes strike-through and underlining to show changes made by the ASB to the text corresponding to IFRSs. The amended text of FRS 25 set out below adopts the same convention; as a result, it is not practicable to show changes of the standard that are proposed in this exposure draft.]

In the Introduction to IAS 32, the heading before paragraph IN1 and the footnote to paragraph IN1 are amended. A heading and paragraphs IN22—IN24 are added.

Introduction*

Reasons for revising IAS 32 in December 2003

IN1 International Accounting Standard 32 *Financial Instruments: Disclosure and Presentation* (IAS 32)* replaces IAS 32 *Financial Instruments: Disclosure and Presentation* (revised in 2000), and should be applied for annual periods beginning on or after 1 January 2005. Earlier ...

* This Introduction refers to IAS 32 as revised in December 2003. In August 2005 the IASB amended IAS 32 by relocating all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*. In February 2008, the IASB amended IAS 32 by requiring some puttable financial instruments and some financial instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation to be classified as equity.

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* *ASB Footnote: Although references to specific IFRSs have been amended in the main section of the standard, references in the amendment to the introduction, which describe the revision of IAS 32 and other IFRSs, have been left unchanged.*

Reasons for amending IAS 32 in February 2008

IN22 In February 2008 the IASB amended IAS 32 by requiring some financial instruments that meet the definition of a financial liability to be classified as equity. Entities should apply the amendments for annual periods beginning on or after 1 January 2009. Earlier application is permitted.

IN23 The amendment addresses the classification of some:

(a) puttable financial instruments, and

(b) instruments, or components of instruments, that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation.

IN24 The objective was a short-term, limited scope amendment to improve the financial reporting of particular types of financial instruments that meet the definition of a financial liability but represent the residual interest in the net assets of the entity.

> ASB Note: In paragraph 11 of the Standard, the definitions of a financial asset and a financial liability are amended to read as follows: exclude financial instruments classified as equity in accordance with paragraphs 16A to16D; and the definition of a puttable instrument is added after the definition of fair value.

Definitions (see also paragraphs AG3–AG23)

11 **The following terms are used in this Standard with the meanings specified:**

…

A *financial asset* is any asset that is:

(a) …

(d) a contract that will or may be settled in the entity's own equity instruments and is:

(i) …

(ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

A *financial liability* is any liability that is:

(a) a contractual obligation:

(i) to deliver cash or another financial asset to another entity; or

(ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

(b) a contract that will or may be settled in the entity's own equity instruments and is:

(i) a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or

(ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments that are classified as equity instruments in accordance with paragraphs 16A and 16B, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D.

...

A *puttable instrument* **is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.**

ASB Note: The headings before paragraph 15 and paragraph 16 are amended to include references to paragraphs AG13-AG14J and AG29A. New text has been added to paragraph 16 (b) (ii) to exclude derivatives over instruments that meet the conditions of paragraphs 16A to 16D. After paragraph 16, paragraphs 16A to 16F, together with the relevant sub-headings, are added.

Presentation

Liabilities and equity (see also paragraphs AG13-AG14J and AG25–AG29A)

...

16 When an issuer applies the definitions in paragraph 11 to determine whether a financial instrument is an equity instrument rather than a financial liability, the instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met.

(a) ...

(b) If the instrument will or may be settled in the issuer's own equity instruments, it is:

(i) ...

(ii) a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose the issuer's own equity instruments do not include instruments that have all the features and meet the conditions described in paragraphs 16A and 16B or paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the issuer's own equity instruments.

A contractual obligation, including one arising from a derivative financial instrument, that will or may result in the future receipt or delivery of the issuer's own equity instruments, but does not meet conditions (a) and (b) above, is not an equity instrument. As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D.

Puttable instruments

16A A puttable financial instrument includes a contractual obligation for the issuer to repurchase or redeem that instrument for cash or another financial asset on exercise of the put. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all of the following features:

(a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:

(i) dividing the entity's net assets on liquidation into units of equal amount; and

(ii) multiplying that amount by the number of the units held by the financial instrument holder.

(b) The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:

(i) has no priority over other claims to the assets of the entity on liquidation, and

(ii) does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.

(c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features. For example, they must all be puttable, and the formula or other method used to calculate the repurchase or redemption price is the same for all instruments in that class.

(d) Apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, the instrument does not include any contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity, and it is not a contract that will or may be settled in the entity's own equity instruments as set out in subparagraph (b) of the definition of a financial liability.

(e) The total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity over the life of the instrument (excluding any effects of the instrument).

16B For an instrument to be classified as an equity instrument, in addition to the instrument having all the above features, the issuer must have no other financial instrument or contract that has:

(a) total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity (excluding any effects of such instrument or contract) and

(b) the effect of substantially restricting or fixing the residual return to the puttable instrument holders.

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 16A that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the puttable instrument as an equity instrument.

Instruments, or components of instruments, that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation

16C Some financial instruments include a contractual obligation for the issuing entity to deliver to another entity a pro rata share of its net assets only on liquidation. The obligation arises because liquidation either is certain to occur and outside the control of the entity (for example, a limited life entity) or is uncertain to occur but is at the option of the instrument holder. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all of the following features:

(a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:

(i) dividing the net assets of the entity on liquidation into units of equal amount; and

(ii) multiplying that amount by the number of the units held by the financial instrument holder.

(b) The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:

   (i) has no priority over other claims to the assets of the entity on liquidation, and

   (ii) does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.

(c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments must have an identical contractual obligation for the issuing entity to deliver a pro rata share of its net assets on liquidation.

16D For an instrument to be classified as an equity instrument, in addition to the instrument having all the above features, the issuer must have no other financial instrument or contract that has:

(a) total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity (excluding any effects of such instrument or contract) and

(b) the effect of substantially restricting or fixing the residual return to the instrument holders.

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 16C that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the instrument as an equity instrument.

Reclassification of puttable instruments and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation

16E An entity shall classify a financial instrument as an equity instrument in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D from the date when the instrument has all the features and meets the conditions set out in those paragraphs. An entity shall reclassify a financial instrument from the date when the instrument ceases to have all the features or meet all the conditions set out in those paragraphs. For example, if an entity redeems all its issued non-puttable instruments and any puttable instruments that remain outstanding have all of the features and meet all the conditions in paragraphs 16A and 16B, the entity shall reclassify the puttable instruments as equity instruments from the date when it redeems the non-puttable instruments.

16F An entity shall account as follows for the reclassification of an instrument in accordance with paragraph 16E:

(a) It shall reclassify an equity instrument as a financial liability from the date when the instrument ceases to have all of the features or meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D. The financial liability shall be measured at the instrument's fair value at the date of reclassification. The entity shall recognise in equity any difference between the carrying value of the equity instrument and the fair value of the financial liability at the date of reclassification.

(b) It shall reclassify a financial liability as equity from the date when the instrument has all of the features and meets the conditions set out in paragraphs 16A and 16B or paragraphs 16C and 16D. An equity instrument shall be measured at the carrying value of the financial liability at the date of reclassification.

ASB Note: Sections of paragraphs 17–19 are amended to read as follows. The effect of the amendment is to exempt from the requirements of these paragraphs financial instruments that meet the criteria described in paragraphs 16A to 16D.

No contractual obligation to deliver cash or another financial asset (paragraph 16(a))

17 With the exception of the circumstances described in paragraphs 16A and 16B or paragraphs 16C and 16D, a critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation of one party to the financial instrument (the issuer) either to deliver cash or another financial asset to the other party (the holder) or to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavourable to the issuer. ...

18 The substance of a financial instrument, rather than its legal form, governs its classification in the entity's statement of financial position. Substance and legal form are commonly consistent, but not always. Some financial instruments take the legal form of equity but are liabilities in substance and others may combine features associated with equity instruments and features associated with financial liabilities. For example:

(a) ...

(b) a financial instrument that gives the holder the right to put it back to the issuer for cash or another financial asset (a 'puttable instrument') is a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. The financial instrument is a financial liability even when the amount of cash or other financial assets is determined on the basis of an index or other item that has the potential to increase or decrease. The existence of an option for the holder to put the instrument back to the issuer for cash or another financial asset means that the puttable instrument meets the definition of a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. For example, open-ended mutual funds, unit trusts, partnerships and some co-operative entities may provide their unitholders or members with a right to redeem their interests in the issuer at any time for cash, which results in the unitholders' or members' interests being classified as financial liabilities, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. However, classification as a financial liability does not preclude the use of descriptors such as 'net asset value attributable to unitholders' and 'change in net asset value attributable to unitholders' in the financial statements of an entity that has no contributed equity (such as some mutual funds and unit trusts, see Illustrative Example 7) or the use of additional disclosure to show that total members' interests comprise items such as reserves that meet the definition of equity and puttable instruments that do not (see Illustrative Example 8).

19 If an entity does not have an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation, the obligation meets the definition of a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. For example:

...

ASB Note: Paragraphs 22, 23 and 25 are amended to exempt from the requirements of these paragraphs financial instruments that meet the criteria described in paragraphs 16A to 16D. After paragraph 22, paragraph 22A is added.

Settlement in the entity's own equity instruments (paragraph 16(b))

22 Except as stated in paragraph 22A, a contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument. For example, ...

22A If the entity's own equity instruments to be received, or delivered, by the entity upon settlement of a contract are puttable financial instruments with all of the features and meeting the conditions described in paragraphs 16A and 16B, or instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation with all of the features and meeting the conditions described in paragraphs 16C and 16D, the contract is a financial asset or a financial liability. This includes a contract that will be settled by the entity receiving or delivering a fixed number of such instruments in exchange for a fixed amount of cash or another financial asset.

23 With the exception of the circumstances described in paragraphs 16A and 16B or paragraphs 16C and 16D, a contract that contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset gives rise to a financial liability for the present value of the redemption amount (for example, for the present value of the forward repurchase price, option exercise price or other redemption amount). This is the case even if the contract itself is an equity instrument. One example ...

Contingent settlement provisions

25 A financial instrument may require the entity to deliver cash or another financial asset, or otherwise to settle it in such a way that it would be a financial liability, in the event of the occurrence or non-occurrence of uncertain future events (or on the outcome of uncertain circumstances) that are beyond the control of both the issuer and the holder of the instrument, such as a change in a stock market index, consumer price index, interest rate or taxation requirements, or the issuer's future revenues, net income or debt-to-equity ratio. The issuer of such an instrument does not have the unconditional right to avoid delivering cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability). Therefore, it is a financial liability of the issuer unless:

(a) the part of the contingent settlement provision that could require settlement in cash or another financial asset (or otherwise in such a way that it would be a financial liability) is not genuine;

(b) the issuer can be required to settle the obligation in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) only in the event of liquidation of the issuer~~.~~; or

(c) the instrument has all of the features and meets the conditions in paragraphs 16A and 16B.

> ASB Note: Before paragraph 96, the heading is amended to include the word 'transition'. After paragraph 96, paragraphs 96A–96C are added. After paragraph 97B, paragraph 97C is added.

Effective date and transition

96A Puttable Financial Instruments and Obligations Arising on Liquidation (Amendments to ~~IAS 32 and IAS 1~~ FRS 25), issued in February 2008, required financial instruments that contain all of the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D to be classified as an equity instrument, amended paragraphs 11, 16, 17–19, 22, 23, 25, AG13, AG14 and AG27, and inserted paragraphs 16A–16F, 22A, 96B, 96C, 97C, AG14A–AG14J and AG29A. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies these changes for an earlier period, it shall disclose that fact and apply the related amendments to ~~IAS 1, IAS 39, IFRS 7 and IFRIC 2~~ FRS 26, FRS 29 and UITF 39 at the same time.

96B Puttable Financial Instruments and Obligations Arising on Liquidation introduced a limited scope exception; therefore, an entity shall not apply the exception by analogy.

96C The classification of instruments under this exception shall be restricted to the accounting for such an instrument under ~~IAS 1, IAS 32, IAS 39 and IFRS 7~~ FRS 25, FRS 26 and FRS 29. The instrument shall not be considered an equity instrument under other guidance, for example ~~IFRS 2~~ FRS 20 (IFRS 2) *Share-based Payment*.

97C When applying the amendments described in paragraph 96A, an entity is required to split a compound financial instrument with an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation into separate liability and equity components. If the liability component is no longer outstanding, a retrospective application of those amendments to ~~IAS 32~~ FRS 25 would involve separating two components of equity. The first component would be in retained earnings and represent the cumulative interest accreted on the liability component. The other component would represent the original equity component. Therefore, an entity need not separate these two components if the liability component is no longer outstanding at the date of application of the amendments.

ASB Note: In the Appendix *Application Guidance*, paragraphs AG13 and AG14 are amended to include reference to instruments described in paragraph 16A to 16D of the standard. After paragraph AG14, paragraphs AG14A–AG14J, and the associated subheadings, are added.

Equity instruments

AG13 Examples of equity instruments include non-puttable ordinary shares, some puttable instruments (see paragraphs 16A and 16B), some instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation (see paragraphs 16C and 16D), some types of preference shares (see paragraphs AG25 and AG26), and warrants or written call options that allow the holder to subscribe for or purchase a fixed number of non-puttable ordinary shares in the issuing entity in exchange for a fixed amount of cash or another financial asset. An entity's obligation to issue or purchase a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument of the entity (except as stated in paragraph 22A). However, if such a contract contains an obligation for the entity to pay cash or another financial asset (other than a contract classified as equity in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D), it also gives rise to a liability for the present value of the redemption amount (see paragraph AG27(a)). An issuer of non-puttable ordinary shares assumes a liability when it formally acts to make a distribution and becomes legally obliged to the shareholders to do so. This may be the case following the declaration of a dividend or when the entity is being wound up and any assets remaining after the satisfaction of liabilities become distributable to shareholders.

AG14 A purchased call option or other similar contract acquired by an entity that gives it the right to reacquire a fixed number of its own equity instruments in exchange for delivering a fixed amount of cash or another financial asset is not a financial asset of the entity (except as stated in paragraph 22A). Instead, any consideration paid for such a contract is deducted from equity.

The class of instruments that is subordinate to all other classes (paragraphs 16A(b) and 16C(b))

AG14A One of the features of paragraphs 16A and 16C is that the financial instrument is in the class of instruments that is subordinate to all other classes.

AG14B When determining whether an instrument is in the subordinate class, an entity evaluates the instrument's claim on liquidation as if it were to liquidate on the date when it classifies the instrument. An entity shall reassess the classification if there is a change in relevant circumstances. For example, if the entity issues or redeems another financial instrument, this may affect whether the instrument in question is in the class of instruments that is subordinate to all other classes.

AG14C An instrument that has a preferential right on liquidation of the entity is not an instrument with an entitlement to a pro rata share of the net assets of the entity. For example, an instrument has a preferential right on liquidation if it entitles the holder to a fixed dividend on liquidation, in addition to a share of the entity's net assets, when other instruments in the subordinate class with a right to a pro rata share of the net assets of the entity do not have the same right on liquidation.

AG14D If an entity has only one class of financial instruments, that class shall be treated as if it were subordinate to all other classes.

Total expected cash flows attributable to the instrument over the life of the instrument (paragraph 16A(e))

AG14E The total expected cash flows of the instrument over the life of the instrument must be substantially based on the profit or loss, change in the recognised net assets or fair value of the recognised and unrecognised net assets of the entity over the life of the instrument. Profit or loss and the change in the recognised net assets shall be measured in accordance with the relevant ~~IFRSs~~ standards.

Transactions entered into by an instrument holder other than as owner of the entity (paragraphs 16A and 16C)

AG14F The holder of a puttable financial instrument or an instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation may enter into transactions with the entity in a role other than that of an owner. For example, an instrument holder also may be an employee of the entity. Only the cash flows and the contractual terms and conditions of the instrument that relate to the instrument holder as an owner of the entity shall be considered when assessing whether the instrument should be classified as equity under paragraph 16A or paragraph 16C.

AG14G An example is a limited partnership that has limited and general partners. Some general partners may provide a guarantee to the entity and may be remunerated for providing that guarantee. In such situations, the guarantee and the associated cash flows relate to the instrument holders in their role as guarantors and not in their roles as owners of the entity. Therefore, such a guarantee and the associated cash flows would not result in the general partners being considered subordinate to the limited partners, and would be disregarded when assessing whether the contractual terms of the limited partnership instruments and the general partnership instruments are identical.

AG14H Another example is a profit or loss sharing arrangement that allocates profit or loss to the instrument holders on the basis of services rendered or business generated during the current and previous years. Such arrangements are transactions with instrument holders in their role as non-owners and should not be considered when assessing the features listed in paragraph 16A or paragraph 16C. However, profit or loss sharing arrangements that allocate profit or loss to instrument holders based on the nominal amount of their instruments relative to others in the class represent transactions with the instrument holders in their roles as owners and should be considered when assessing the features listed in paragraph 16A or paragraph 16C.

AG14I The cash flows and contractual terms and conditions of a transaction between the instrument holder (in the role as a non-owner) and the issuing entity must be similar to an equivalent transaction that might occur between a non-instrument holder and the issuing entity.

No other financial instrument or contract with total cash flows that substantially fixes or restricts the residual return to the instrument holder (paragraphs 16B and 16D)

AG14J A condition for classifying as equity a financial instrument that otherwise meets the criteria in paragraph 16A or paragraph 16C is that the entity has no other financial instrument or contract that has (a) total cash flows based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity and (b) the effect of substantially restricting or fixing the residual return. The following instruments, when entered into on normal commercial terms with unrelated parties, are unlikely to prevent instruments that otherwise meet the criteria in paragraph 16A or paragraph 16C from being classified as equity:

(a) instruments with total cash flows substantially based on specific assets of the entity.

(b) instruments with total cash flows based on a percentage of revenue.

(c) contracts designed to reward individual employees for services rendered to the entity.

(d) contracts requiring the payment of an insignificant percentage of profit for services rendered or goods provided.

> ASB Note: Paragraph AG27 is amended to exempt from its requirements financial instruments that meet the criteria described in paragraphs 16A to 16D. After paragraph AG29, paragraph AG29A is added.

AG27 The following examples illustrate how to classify different types of contracts on an entity's own equity instruments:

(a) A contract that will be settled by the entity receiving or delivering a fixed number of its own shares for no future consideration, or exchanging a fixed number of its own shares for a fixed amount of cash or another financial asset, is an equity instrument (except as stated in paragraph 22A). Accordingly, any consideration received or paid for such a contract is added directly to or deducted directly from equity. One example is an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed amount of cash. However, if the contract requires the entity to purchase (redeem) its own shares for cash or another financial asset at a fixed or determinable date or on demand, the entity also recognises a financial liability for the present value of the redemption amount (with the exception of instruments that have all the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D). One example is an entity's obligation under a forward contract to repurchase a fixed number of its own shares for a fixed amount of cash.

(b) An entity's obligation to purchase its own shares for cash gives rise to a financial liability for the present value of the redemption amount even if the number of shares that the entity is obliged to repurchase is not fixed or if the obligation is conditional on the counterparty exercising a right to redeem (except as stated in paragraphs 16A and 16B or paragraphs 16C and 16D). One example of a conditional obligation is an issued option that requires the entity to repurchase its own shares for cash if the counterparty exercises the option.

(c) A contract that will be settled in cash or another financial asset is a financial asset or financial liability even if the amount of cash or another financial asset that will be received or delivered is based on changes in the market price of the entity's own equity (except as stated in paragraphs 16A and 16B or paragraphs 16C and 16D). One example is a net cash-settled share option.

(d) ...

AG29A Some types of instruments that impose a contractual obligation on the entity are classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. Classification in accordance with those paragraphs is an exception to the principles otherwise applied in this Standard to the classification of an instrument. This exception is not extended to the classification of non-controlling interests in the consolidated financial statements. Therefore, instruments classified as equity instruments in accordance with either paragraphs 16A and 16B or paragraphs 16C and 16D in the separate or individual financial statements that are non-controlling interests are classified as liabilities in the consolidated financial statements of the group.

Proposed Amendments to ~~IAS 1 *Presentation of Financial Statements* (as revised in 2007)~~ Appendix E of FRS 29 (IFRS 7) 'Financial Instruments: Disclosures'

ASB Note: IAS 1 has not been implemented in the UK and the Republic of Ireland. Disclosures relating to capital included in IAS 1 have been implemented in the UK and Republic of Ireland as Appendix E of FRS 29. Therefore, the following amendments made by the IASB to the capital disclosure requirements of IAS 1 are proposed here as changes to Appendix E of FRS 29.

Definitions

After paragraph ~~8~~ E3, ~~paragraph 8A is~~ paragraphs E4 – E8 are added.

E4 ~~8A~~ The following terms are described in ~~IAS 32~~ FRS 25 *Financial Instruments: Presentation* and are used in this Standard with the meaning specified in ~~IAS 32~~ FRS 25:

(a) puttable financial instrument classified as an equity instrument (described in paragraphs 16A and 16B of ~~IAS 32~~ FRS 25)

(b) an instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and is classified as an equity instrument (described in paragraphs 16C and 16D of ~~IAS 32~~ FRS 25).

Information to be presented either in the statement of financial position or in the notes

E5 ~~80A~~ **If an entity has reclassified**

(a) a puttable financial instrument classified as an equity instrument, or

(b) an instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and is classified as an equity instrument

between financial liabilities and equity, it shall disclose the amount reclassified into and out of each category (financial liabilities or equity), and the timing and reason for that reclassification.

Puttable financial instruments classified as equity

E6 ~~136A~~ **For puttable financial instruments classified as equity instruments, an entity shall disclose (to the extent not disclosed elsewhere):**

(a) summary quantitative data about the amount classified as equity;

(b) its objectives, policies and processes for managing its obligation to repurchase or redeem the instruments when required to do so by the instrument holders, including any changes from the previous period;

(c) the expected cash outflow on redemption or repurchase of that class of financial instruments; and

(d) information about how the expected cash outflow on redemption or repurchase was determined.

Other disclosures

E7 ~~138~~ **An entity shall disclose the following, if not disclosed elsewhere in information published with the financial statements:**

(a) the domicile and legal form of the entity, its country of incorporation and the address of its registered office (or principal place of business, if different from the registered office);

(b) a description of the nature of the entity's operations and its principal activities;

(c) the name of the parent and the ultimate parent of the group~~.~~; and

(d) if it is a limited life entity, information regarding the length of its life.

Transition and effective date

E8 ~~139B~~ Puttable Financial Instruments and Obligations Arising on Liquidation (Amendments to ~~IAS 32 and IAS 1~~ FRS 25), issued in ~~February~~ [date to be inserted after exposure] 2008, ~~amended paragraph 138 and~~ inserted paragraphs ~~8A, 80A and 136A~~ E4 to E7. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact and apply the related amendments to ~~IAS 32, IAS 39, IFRS 7 and IFRIC 2~~ FRS 25, FRS 26, FRS 29 and UITF 39 (IFRIC 2) *Members' Shares in Co-operative Entities and Similar Instruments* at the same time.

Amendments to ~~IFRS 7, IAS 39 and IFRIC 2~~ FRS 26, FRS 29 and UITF 39

Entities shall apply the following amendments to ~~IFRS 7, IAS 39 and IFRIC 2~~ FRS 26, FRS 29 and UITF 39 when they apply the related amendments to ~~IAS 32 and IAS 1~~ FRS 25.

~~IFRS 7~~ FRS 29 (IFRS 7) *Financial Instruments: Disclosures*

ASB Note: Paragraph 3 is amended to add subsection (f).

Scope

3 This IFRS shall be applied by all entities to all types of financial instruments, except:

(a) ...

(f) instruments that are required to be classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D of ~~IAS 32~~ FRS 25. The disclosure requirements for these instruments required to be classified as equity are included in paragraphs E4-E8 of Appendix E to this standard.

After paragraph 44B, paragraph 44C is added.

Effective date and transition

44C An entity shall apply the amendment in paragraph 3 for annual periods beginning on or after 1 January 2009. If an entity applies *Puttable Financial Instruments and Obligations Arising on Liquidation* (Amendments to ~~IAS 32 and IAS 1~~ FRS 25), issued in February 2008, for an earlier period, the amendment in paragraph 3 shall be applied for that earlier period.

~~IAS 39~~ FRS 26 (IAS 39) *Financial Instruments: Recognition and Measurement*

ASB Note: Paragraph 2(d) is amended to exempt financial instruments classified as equity in accordance with paragraphs 16A to 16D of FRS 25.

Scope

2 **This Standard shall be applied by all entities to all types of financial instruments except:**

(d) financial instruments issued by the entity that meet the definition of an equity instrument in ~~IAS 32~~ FRS 25 (including options and warrants) or that are required to be classified as an equity instrument in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D of ~~IAS 32~~ FRS 25. However, the holder of such equity instruments shall apply this Standard to those instruments, unless they meet the exception in (a) above.

After paragraph 103E, paragraph 103F is added.

Effective date and transition

103F An entity shall apply the amendment in paragraph 2 for annual periods beginning on or after 1 January 2009. If an entity applies *Puttable Financial Instruments and Obligations Arising on Liquidation* (Amendments to ~~IAS 32 and IAS 1~~ FRS 25) issued in February 2008, for an earlier period, the amendment in paragraph 2 shall be applied for that earlier period.

~~IFRIC 2~~ *Members' Shares in Co-operative Entities and Similar Instruments*

ASB Note: In the References section, the footnote is amended to describe the changes resulting from this amendment to FRS 25.

* In ~~August~~ December 2005, ~~IAS 32~~ FRS 25 was amended as ~~IAS 32~~ FRS 25 *Financial Instruments: Presentation*. In February 2008 the IASB amended ~~IAS 32~~ FRS 25 by requiring instruments to be classified as equity if those instruments have all the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D of ~~IAS 32~~ FRS 25.

ASB Note: Paragraphs 6 and 9 are amended to incorporate the financial instruments that meet the conditions described in paragraphs 16A to 16D of FRS 25and paragraph 14A is added.

Consensus

6 Members' shares that would be classified as equity if the members did not have a right to request redemption are equity if either of the conditions described in paragraphs 7 and 8 is present or the members' shares have all the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D of ~~IAS 32~~ FRS 25. Demand deposits, including current accounts, deposit accounts and similar contracts that arise when members act as customers are financial liabilities of the entity.

9 An unconditional prohibition may be absolute, in that all redemptions are prohibited. An unconditional prohibition may be partial, in that it prohibits redemption of members' shares if redemption would cause the number of members' shares or amount of paid-in capital from members' shares to fall below a specified level. Members' shares in excess of the

prohibition against redemption are liabilities, unless the entity has the unconditional right to refuse redemption as described in paragraph 7 or the members' shares have all the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D of ~~IAS 32~~ FRS 25. In some cases, the number of shares or the amount of paid-in capital subject to a redemption prohibition may change from time to time. Such a change in the redemption prohibition leads to a transfer between financial liabilities and equity.

Effective date

14A An entity shall apply the amendments in paragraphs 6, 9, A1 and A12 for annual periods beginning on or after 1 January 2009. If an entity applies *Puttable Financial Instruments and Obligations Arising on Liquidation* (Amendments to ~~IAS 32~~ FRS 25 ~~and IAS 1~~), issued in February 2008, for an earlier period, the amendments in paragraphs 6, 9, A1 and A12 shall be applied for that earlier period.

> ASB Note: In the Appendix (Examples of application of the consensus), paragraphs A1 and A12 are amended to exclude financial instruments that meet the criteria described in paragraphs 16A to 16D of FRS 25.

Examples of application of the consensus

A1 This appendix sets out seven examples of the application of the IFRIC consensus. The examples do not constitute an exhaustive list; other fact patterns are possible. Each example assumes that there are no conditions other than those set out in the facts of the example that would require the financial instrument to be classified as a financial liability and that the financial instrument does not have all of the features or does not meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D of ~~IAS 32~~ FRS 25.

Example 4

Classification

A12 In this case, CU750,000 would be classified as equity and CU150,000 would be classified as financial liabilities. In addition to the paragraphs already cited, paragraph 18(b) of ~~IAS 32~~ FRS 25 states in part:

> ...a financial instrument that gives the holder the right to put it back to the issuer for cash or another financial asset (a 'puttable instrument') is a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D. The financial instrument is a financial liability even when the amount of cash or other financial assets is determined on the basis of an index or other item that has the potential to increase or decrease. The existence of an option for the holder to put the instrument back to the issuer for cash or another financial asset means that the puttable instrument meets the definition of a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 16A and 16B or paragraphs 16C and 16D.

ASB Note: In the Basis for Conclusions, paragraph BC7 is amended to exclude financial instruments that meet the criteria described in paragraphs 16A to 16D of FRS 25.

Basis for consensus

BC7 In many jurisdictions, local law or regulations state that members' shares are equity of the entity. However, paragraph 17 of IAS 32 states:

> With the exception of the circumstances described in paragraphs 16A and 16B or paragraphs 16C and 16D, a

critical feature in differentiating a financial liability from an equity instrument is *the existence of a contractual obligation of one party to the financial instrument (the issuer) either to deliver cash or another financial asset to the other party (the holder)* or to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavourable to the issuer. Although the holder of an equity instrument may be entitled to receive a pro rata share of any dividends or other distributions of equity, the issuer does not have a contractual obligation to make such distributions because it cannot be required to deliver cash or another financial asset to another party. [Emphasis added]

APPROVAL OF AMENDMENTS BY THE BOARD

These Amendments to IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements—*Puttable Financial Instruments and Obligations Arising on Liquidation* were approved for issue by eleven of the thirteen members of the International Accounting Standards Board. Professor Barth and Mr Garnett dissented. Their dissenting opinions are set out after the Basis for Conclusions.

Sir David Tweedie	Chairman
Thomas E Jones	Vice-Chairman
Mary E Barth	
Stephen Cooper	
Philippe Danjou	
Jan Engström	
Robert P Garnett	
Gilbert Gélard	
James J Leisenring	
Warren J McGregor	
John T Smith	
Tatsumi Yamada	
Wei-Guo Zhang	

AMENDMENTS TO THE BASIS FOR CONCLUSIONS ON IAS 32 *FINANCIAL INSTRUMENTS: PRESENTATION*

In the Basis for Conclusions, after paragraph BC3, paragraph BC3A is added. After paragraph BC7, paragraph BC7A is added. After paragraph BC49, two headings, paragraphs BC50–BC63, another heading, paragraphs BC64-BC67, another heading, paragraph BC68, another heading and paragraphs BC69–BC74 are added.

BC3A In July 2006 the Board published an exposure draft of proposed amendments to IAS 32 relating to the classification of puttable instruments and instruments with obligations arising on liquidation. The Board subsequently confirmed the proposals and in 2008 issued an amendment that now forms part of IAS 32. A summary of the Board's considerations and reasons for its conclusions is in paragraphs BC50–BC74.

Puttable instruments (paragraph 18(b))

BC7A The Board reconsidered its conclusions with regards to some puttable instruments and amended IAS 32 in February 2008 (see paragraphs BC50–BC74).

Amendments for some puttable instruments and some instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation

Amendment for puttable instruments

BC50 As discussed in paragraphs BC7 and BC8, puttable instruments meet the definition of a financial liability and the Board concluded that all such instruments should be classified as liabilities. However, constituents raised the following concerns about classifying such instruments as financial liabilities if they represent the residual claim to the net assets of the entity:

(a) On an ongoing basis, the liability is recognised at not less than the amount payable on demand. This can result in the entire market capitalisation of the entity being recognised as a liability depending on the basis for which the redemption value of the financial instrument is calculated.

(b) Changes in the carrying value of the liability are recognised in profit or loss. This results in counter-intuitive accounting (if the redemption value is linked to the performance of the entity) because:

  (i) when an entity performs well, the present value of the settlement amount of the liabilities increases, and a loss is recognised.

  (ii) when the entity performs poorly, the present value of the settlement amount of the liability decreases, and a gain is recognised.

(c) It is possible, again depending on the basis for which the redemption value is calculated, that the entity will report negative net assets because of unrecognised intangible assets and goodwill, and because the measurement of recognised assets and liabilities may not be at fair value.

(d) The issuing entity's statement of financial position portrays the entity as wholly, or mostly, debt funded.

(e) Distributions of profits to shareholders are recognised as expenses. Hence, it may appear that profit or loss is a function of the distribution policy, not performance.

Furthermore, constituents contended that additional disclosures and adapting the format of the statement of comprehensive income and statement of financial position did not resolve these concerns.

BC51 The Board agreed with constituents that many puttable instruments, despite meeting the definition of a financial liability, represent a residual interest in the net assets of the entity. The Board also agreed with constituents that additional disclosures and adapting the format of the entity's financial statements did not resolve the problem of the lack of relevance and understandability of that current accounting treatment. Therefore, the Board decided to amend IAS 32 to improve the financial reporting of these instruments.

BC52 The Board considered the following ways to improve the financial reporting of instruments that represent a residual interest in the net assets of the entity:

(a) to continue to classify these instruments as financial liabilities, but amend their measurement so that changes in their fair value would not be recognised;

(b) to amend IAS 32 to require separation of all puttable instruments into a put option and a host instrument; or

(c) to amend IAS 32 to provide a limited scope exception so that financial instruments puttable at fair value would be classified as equity, if specified conditions were met.

Amend the measurement of some puttable financial instruments so that changes in their fair value would not be recognised

BC53 The Board decided against this approach because:

(a) it is inconsistent with the principle in IAS 32 and IAS 39 that only equity instruments are not remeasured after their initial recognition;

(b) it retains the disadvantage that entities whose instruments are all puttable would have no equity instruments; and

(c) it introduces a new category of financial liabilities to IAS 39, and thus increases complexity.

Separate all puttable instruments into a put option and a host instrument

BC54 The Board concluded that conducting further research into an approach that splits a puttable share into an equity component and a written put option component (financial liability) would duplicate efforts of the Board's longer-term project on liabilities and equity. Consequently, the Board decided not to proceed with a project at this stage to determine whether a puttable share should be split into an equity component and a written put option component.

Classify as equity instruments puttable instruments that represent a residual interest in the entity

BC55 The Board decided to proceed with proposals to amend IAS 32 to require puttable financial instruments that represent a residual interest in the net assets of the entity to be classified as equity provided that specified conditions are met. The proposals represented a limited scope exception to the definition of a financial liability and a short-term solution, pending the outcome of the longer-term project on liabilities and equity. In June 2006 the Board published an exposure draft proposing that financial instruments puttable at fair value that meet specific criteria should be classified as equity.

BC56 In response to comments received from respondents to that exposure draft, the Board amended the criteria for identifying puttable instruments that represent a residual interest in the entity, to those included in paragraphs 16A and 16B. The Board decided on those conditions for the following reasons:

(a) to ensure that the puttable instruments, as a class, represent the residual interest in the net assets of the entity;

(b) to ensure that the proposed amendments are consistent with a limited scope exception to the definition of a financial liability; and

(c) to reduce structuring opportunities that might arise as a result of the amendments.

BC57 The Board decided that the instrument must entitle the holder to a pro rata share of the net assets on liquidation because the net assets on liquidation represent the ultimate residual interest of the entity.

BC58 The Board decided that the instrument must be in the class of instruments that is subordinate to all other classes of instruments on liquidation in order to represent the residual interest in the entity.

BC59 The Board decided that all instruments in the class that is subordinate to all other classes of instruments must have identical contractual terms and conditions. In order to ensure that the class of instruments as a whole is the residual class, the Board decided that no instrument holder in that class can have preferential terms or conditions in its position as an owner of the entity.

BC60 The Board decided that the puttable instruments should contain no contractual obligation to deliver a financial asset to another entity other than the put. That is because the amendments represent a limited scope exception to the definition of a financial liability and extending that exception to instruments that also contain other contractual obligations is not appropriate. Moreover, the Board concluded that if the puttable instrument contains another contractual obligation, that instrument may not represent the residual interest because the holder of the puttable instrument may have a claim to some of the net assets of the entity in preference to other instruments.

BC61 As well as requiring a direct link between the puttable instrument and the performance of the entity, the Board also decided that there should be no financial instrument or contract with a return that is more residual. The Board decided to require that there must be no other financial instrument or contract that has total cash flows based substantially on the performance of the entity and has the effect of significantly restricting or fixing the return to the puttable instrument holders. This criterion was included to ensure that the holders of the puttable instruments represent the residual interest in the net assets of the entity.

BC62 An instrument holder may enter into transactions with the issuing entity in a role other than that of an owner. The Board concluded that it is inappropriate to consider cash flows and contractual features related to the instrument holder in a non-owner role when evaluating whether a financial instrument has the features set out in paragraph 16A or paragraph 16C. That is because those cash flows and contractual features are separate and distinct from the cash flows and contractual features of the puttable financial instrument.

BC63 The Board also decided that contracts (such as warrants and other derivatives) to be settled by the issue of puttable financial instruments should be precluded from equity classification. That is because the Board noted that the amendments represent a limited scope exception to the definition of a financial liability and extending that exception to such contracts is not appropriate.

Amendment for obligations to deliver to another party a pro rata share of the net assets of the entity only on liquidation

BC64 Issues similar to those raised by constituents relating to classification of puttable financial instruments apply to some financial instruments that create an obligation only on liquidation of the entity.

BC65 In the exposure draft published in June 2006, the Board proposed to exclude from the definition of a financial liability a contractual obligation that entitles the holder to a pro rata share of the net assets of the entity only on liquidation of the entity. The liquidation of the entity may be:

(a) certain to occur and outside the control of the entity (limited life entities); or

(b) uncertain to occur but at the option of the holder (for example, some partnership interests).

BC66 Respondents to that exposure draft were generally supportive of the proposed amendment.

BC67 The Board decided that an exception to the definition of a financial liability should be made for instruments that entitle the holder to a pro rata share of the net assets of an entity only on liquidation if particular requirements are met. Many of those requirements, and the reasons for them, are similar to those for puttable financial instruments. The differences between the requirements are as follows:

(a) there is no requirement that there be no other contractual obligations;

(b) there is no requirement to consider the expected total cash flows throughout the life of the instrument;

(c) the only feature that must be identical among the instruments in the class is the obligation for the issuing entity to deliver to the holder a pro rata share of its net assets on liquidation.

The reason for the differences is the timing of settlement of the obligation. The life of the financial instrument is the same as the life of the issuing entity; the extinguishment of the obligation can occur only at liquidation. Therefore, the Board concluded that it was appropriate to focus only on the obligations that exist at liquidation. The instrument must be subordinate to all other classes of instruments and represent the residual interests only at that point in time. However, if the instrument contains other contractual obligations, those obligations may need to be accounted for separately in accordance with the requirements of IAS 32.

Non-controlling interests

BC68 The Board decided that puttable financial instruments or instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation should be classified as equity in the separate financial statements of the issuer if they represent the residual class of instruments (and all the relevant requirements are met). The Board decided that such instruments were not the residual interest in the consolidated financial statements and therefore that non-controlling interests that contain an obligation to transfer a financial asset to another entity should be classified as a financial liability in the consolidated financial statements.

Analysis of costs and benefits

BC69 The Board acknowledged that the amendments made in February 2008 are not consistent with the definition of a liability in the *Framework*, or with the underlying principle of IAS 32, which is based on that definition. Consequently, those amendments added complexity to IAS 32 and introduced the need for detailed rules. However, the Board also noted that IAS 32 contains other exceptions to its principle (and the definition of a liability in the *Framework*) that require instruments to be classified as liabilities that otherwise would be treated as equity. Those exceptions highlight the need for a comprehensive reconsideration of the distinctions between liabilities and equity, which the Board is undertaking in its long-term project.

BC70 In the interim, the Board concluded that classifying as equity the instruments that have all the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D would improve the comparability of information provided to the users of financial statements. That is because financial instruments that are largely equivalent to ordinary shares would be consistently classified across different entity structures (eg some partnerships, limited life entities and co-operatives). The specified instruments differ from ordinary shares in one respect; that difference is the obligation to deliver cash (or another financial asset). However, the Board concluded that the other characteristics of the specified instruments are sufficiently similar to ordinary shares for the instruments to be classified as equity. Consequently, the Board concluded that the amendments will result in financial reporting that is more understandable and relevant to the users of financial statements.

BC71 Furthermore, in developing the amendments, the Board considered the costs to entities of obtaining information necessary to determine the required classification. The Board believes that the costs of obtaining any new information would be slight because all of the necessary information should be readily available.

BC72 The Board also acknowledged that one of the costs and risks of introducing exceptions to the definition of a financial liability is the structuring opportunities that may result. The Board concluded that financial structuring opportunities are minimised by the detailed criteria required for equity classification and the related disclosures.

BC73 Consequently, the Board believed that the benefits of the amendments outweigh the costs.

BC74 The Board took the view that, in most cases, entities should be able to apply the amendments retrospectively. The Board noted that IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides relief when it is impracticable to apply a change in accounting policy retrospectively as a result of a new requirement. Furthermore, the Board took the view that the costs outweighed the benefits of separating a compound financial instrument with an obligation to deliver a pro rata share of the net assets of the entity only on liquidation when the liability component is no longer outstanding on the date of initial application. Hence, there is no requirement on transition to separate such compound instruments.

AMENDMENTS TO THE BASIS FOR CONCLUSIONS ON ~~IAS 1 *PRESENTATION OF FINANCIAL STATEMENTS* (AS REVISED IN 2007)~~ APPENDIX E OF FRS 29 *FINANCIAL INSTRUMENTS: DISCLOSURES*

In the Basis for Conclusions for FRS 29, after paragraph EBC16, a heading and paragraph EBC17 - 19 are added.

Amendments to IAS 32 and IAS 1—*Puttable Financial Instruments and Obligations Arising on Liquidation* (2008)*

EBC17 In July 2006 the Board published an exposure draft of proposed amendments to IAS 32 and IAS 1 relating to the classification of puttable instruments and instruments with obligations arising only on liquidation. The Board subsequently confirmed the proposals and in February 2008 issued an amendment that now forms part of IAS 1.

Puttable financial instruments and obligations arising on liquidation

EBC18 The Board decided to require disclosure of information about puttable instruments and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation that are reclassified in accordance with paragraphs 16E and 16F of IAS 32. This is because the Board concluded that this disclosure allows users of financial statements to understand the effects of any reclassifications.

EBC19 The Board also concluded that entities with puttable financial instruments classified as equity should be required

* *ASB Footnote: These additions relate to changes made to IAS 1 by the IASB in February 2008. As IAS 1 has no equivalent in the UK and Republic of Ireland the ASB has incorporated additional equivalent paragraphs in Appendix E of FRS 29 as paragraphs E4 to E8.*

to disclose additional information to allow users to assess any effect on the entity's liquidity arising from the ability of the holder to put the instruments to the issuer. Financial instruments classified as equity usually do not include any obligation for the entity to deliver a financial asset to another party. Therefore, the Board concluded that additional disclosures are needed in these circumstances. In particular, the Board concluded that entities should disclose the expected cash outflow on redemption or repurchase of those financial instruments that are classified as equity and information about how that amount was determined. That information allows liquidity risk associated with the put obligation and future cash flows to be evaluated.

DISSENTING OPINIONS

Dissent of Mary E Barth and Robert P Garnett

DO1 Professor Barth and Mr Garnett voted against the publication of the Amendments to IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements—*Puttable Financial Instruments and Obligations Arising on Liquidation*. The reasons for their dissent are set out below.

DO2 These Board members believe that the decision to permit entities to classify as equity some puttable financial instruments and some financial instruments that entitle the holder to a pro rata share of the net assets of the entity only on liquidation is inconsistent with the *Framework*. The contractual provisions attached to those instruments give the holders the right to put the instruments to the entity and demand cash. The *Framework*'s definition of a liability is that it is a present obligation of the entity arising from a past event, the settlement of which is expected to result in an outflow of resources of the entity. Thus, financial instruments within the scope of the amendments clearly meet the definition of a liability in the *Framework*.

DO3 These Board members do not agree with the Board that an exception to the *Framework* is justified in this situation. First, the Board has an active project on the *Framework*, which will revisit the definition of a liability. Although these Board members agree that standards projects can precede decisions in the *Framework* project, the discussions to date in the *Framework* project do not make it clear that the Board will modify the existing elements definitions in such a way that these instruments would be equity. Second, the amendments would require disclosure of the expected cash outflow on redemption or repurchase of puttable instruments classified as equity. These disclosures are similar to those for financial liabilities; existing standards do not require similar disclosure for equity instruments. The Board's decision to require these disclosures reveals its implicit view these instruments are, in fact, liabilities. Yet, the *Framework* is clear that disclosure is not a substitute for recognition. Third, these Board members see no cost-benefit or practical reasons for making this exception. The amendments require the same or similar information to be obtained and disclosed as would be the case if these obligations were classified as liabilities. Existing standards offer presentation alternatives for entities that have no equity under the *Framework*'s definitions.

DO4 These Board members also do not agree with the Board that there are benefits to issuing these amendments. First, paragraph BC70 in the Basis for Conclusions states that the amendments will result in more relevant and understandable financial reporting. However, as noted above, these Board members do not believe that presenting as equity items that meet the *Framework*'s definition of a liability results in relevant information. Also as noted above, existing standards offer presentation alternatives that result in understandable financial reporting.

DO5 Second, paragraph BC70 states that the amendments would increase comparability by requiring more consistent classification of financial instruments that are largely equivalent to ordinary shares. These Board members believe that the amendments decrease comparability. These instruments are not comparable to ordinary shares because these instruments oblige the entity to transfer its economic resources; ordinary shares do not. Also, puttable instruments and instruments that entitle the holder to a pro rata share of the net assets of the entity only on liquidation will be classified as equity by some entities and as liabilities by other entities, depending on whether the other criteria specified in the amendments are met. Thus, these amendments account similarly for economically different instruments, which decreases comparability.

DO6 Finally, these Board members do not believe that the amendments are based on a clear principle. Rather, they comprise several paragraphs of detailed rules crafted to achieve a desired accounting result. Although the Board attempted to craft these rules to minimise structuring opportunities, the lack of a clear principle leaves open the possibility that economically similar situations will be accounted for differently and economically different situations will be accounted for similarly. Both of these outcomes also result in lack of comparability.

AMENDMENTS TO THE ILLUSTRATIVE EXAMPLES ACCOMPANYING ~~IAS 32~~ FRS 25 *FINANCIAL INSTRUMENTS: PRESENTATION*

ASB Note: Paragraphs IE1 and IE33 are amended to exempt financial instruments that meet the criteria described in paragraphs 16A to 16D.

Accounting for contracts on equity instruments of an entity

IE1 The following examples* illustrate the application of paragraphs 15–27 and IAS 39 to the accounting for contracts on an entity's own equity instruments (other than the financial instruments specified in paragraphs 16A and 16B or paragraphs 16C and 16D).

* In these examples, monetary amounts are denominated in 'currency units' (CU).

Example 8: Entities with some equity

IE33 The following example illustrates a format of a statement of comprehensive income and statement of financial position that may be used by entities whose share capital is not equity as defined in ~~IAS 32~~ FRS 25 because the entity has an obligation to repay the share capital on demand but does not have all the features or meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D. Other formats are possible.

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