STAFF DRAFT

AMENDMENT TO INTERNATIONAL ACCOUNTING STANDARD

IAS32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements

Puttable Financial Instruments and Obligations Arising on Liquidation

This draft of proposed amendments to IAS 32 and IAS 1 has been prepared by the Staff of the IASB.

The IASB has not approved this staff draft. The draft is being made publicly available for the purpose of holding public round-table discussions. The IASB does not request comments on this draft, and the staff will not be in a position to consider or respond to any comments.

The aim of the roundtables is to understand the potential impact and consequences of the proposed amendments, participants are asked to specifically address the following three issues during the discussion:

1. The proposed amendment is the result of a limited scope, short term project aimed at creating a limited scope exception to the classification requirements of IAS 32. Does the exception contained in the proposed amendments meet the project objectives? If not, why not and what would you propose?
2. Are the proposals operational? If not, why not and what changes would you propose?
3. Are there any issues that are not addressed in the staff draft that should be addressed? If so, what are they and why should they be addressed?

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AMENDMENT TO INTERNATIONAL ACCOUNTING STANDARD

IAS32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements

Puttable Financial Instruments and Obligations Arising on Liquidation

CONTENTS

Amendments to IAS 32 *Financial Instruments: Presentation*

This document sets out amendments to IAS 32 *Financial Instruments: Presentation*. The amendments relate to proposals that were contained in an exposure draft of proposed amendments to IAS 32 and IAS 1 Presentation of Financial Statements—*Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation* published in June 2006.

Entities shall apply the amendments set out in this document for annual periods beginning on or after 1 January 2009. Early adoption is permitted.

In the Introduction to IAS 32, the footnote to paragraph IN1 and paragraphs IN6, IN7, IN10 and IN11 are amended (new text is underlined). Paragraphs IN2–IN5, IN8 and IN9 are included here for ease of reference but are not proposed for amendment.

Introduction

Reasons for revising IAS 32

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 application is permitted. The Standard also replaces the following Interpretations and draft Interpretation:

- SIC-5 *Classification of Financial Instruments—Contingent Settlement Provisions*;
- SIC-16 *Share Capital—Reacquired Own Equity Instruments (Treasury Shares)*;
- SIC-17 *Equity—Costs of an Equity Transaction*; and
- draft SIC-D34 *Financial Instruments—Instruments or Rights Redeemable by the Holder*.

IN2 The International Accounting Standards Board developed this revised IAS 32 as part of its project to improve IAS 32 and IAS 39 *Financial Instruments: Recognition and Measurement*. The objective of the project was to reduce complexity by clarifying and adding guidance, eliminating internal inconsistencies and incorporating into the Standards elements of Standing Interpretations Committee (SIC) Interpretations and IAS 39

[*] 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*. <u>In [month and year to be inserted], 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 entity a pro rata share of the net assets of the entity upon liquidation to be classified as equity.</u>

implementation guidance published by the Implementation Guidance Committee (IGC).

IN3 For IAS 32, the Board's main objective was a limited revision to provide additional guidance on selected matters—such as the measurement of the components of a compound financial instrument on initial recognition, and the classification of derivatives based on an entity's own shares—and to locate all disclosures relating to financial instruments in one Standard.* The Board did not reconsider the fundamental approach to the presentation and disclosure of financial instruments contained in IAS 32.

The main changes

IN4 The main changes from the previous version of IAS 32 are described below.

Scope

IN5 The scope of IAS 32 has, where appropriate, been conformed to the scope of IAS 39.

Principle

IN6 In summary, when considering whether a financial instrument is a financial liability or an equity instrument, an issuer classifies it as an equity instrument if, and only if, conditions (a) and (b) are met.

(a) The instrument includes no 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 issuer.

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

(i) a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or

(ii) a derivative that will be settled 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 puttable

* In August 2005 the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*.

financial instruments that are classified as equity instruments, instruments that impose on the entity an obligation to deliver to another entity a pro rata share of the net assets of the entity upon its liquidation that are classified as equity instruments, or instruments that are themselves contracts for the future receipt or delivery of the issuer's own equity instruments.

IN7 In addition, when an issuer has an obligation to purchase its own shares for cash or another financial asset there is a liability for the amount that the issuer is obliged to pay, except for those instruments classified as equity instruments in accordance with paragraphs 16A-16D.

IN8 The definitions of a financial asset and a financial liability, and the description of an equity instrument, are amended consistently with this principle.

Classification of contracts settled in an entity's own equity instruments

IN9 The classification of derivative and non-derivative contracts indexed to, or settled in, an entity's own equity instruments has been clarified consistently with the principle in paragraph IN6 above. In particular, when an entity uses its own equity instruments 'as currency' in a contract to receive or deliver a variable number of shares whose value equals a fixed amount or an amount based on changes in an underlying variable (eg a commodity price), the contract is not an equity instrument, but is a financial asset or a financial liability.

Puttable instruments

IN10 IAS 32 incorporates the guidance previously proposed in draft SIC Interpretation 34 *Financial Instruments—Instruments or Rights Redeemable by the Holder*. Consequently, a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset (a 'puttable instrument') is a financial liability of the issuer, except for those instruments classified as equity instruments in accordance with paragraphs 16A-16D. In response to comments received on the Exposure Draft, the Standard provides additional guidance and illustrative examples for entities that, because of this requirement, have no equity or whose share capital is not equity as defined in IAS 32.

Contingent settlement provisions

IN11 IAS 32 incorporates the conclusion previously in SIC-5 *Classification of Financial Instruments—Contingent Settlement Provisions* that a financial instrument is a financial liability when the manner of settlement depends on 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. Contingent settlement provisions are ignored when they apply only in the event of liquidation of the issuer, ~~or~~ are not genuine or are the feature of an instrument that meets the conditions in paragraphs 16A and 16B or 16C and 16D.

In the Standard, paragraph 11 is amended (new text is underlined). The definitions of a financial asset and a financial liability are amended. The definitions of a financial instrument, an equity instrument and fair value are included here for ease of reference but are not proposed for amendment.

International Accounting Standard 32 *Financial Instruments: Presentation*

Definitions (see also paragraphs AG3–AG24)

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

A *financial instrument* is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

A *financial asset* is any asset that is:

(a) cash;

(b) an equity instrument of another entity;

(c) a contractual right:

(i) to receive cash or another financial asset from another entity; or

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

(d) 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 receive 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 <u>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 entity a pro rata share of the net assets of the entity upon its liquidation classified as</u>

<u>equity instruments in accordance with paragraphs 16C and 16D, or</u> instruments that are themselves 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 <u>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 entity a pro rata share of the net assets of the entity upon its liquidation classified as equity instruments in accordance with paragraphs 16C and 16D, or</u> instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

An *equity instrument* is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

***Fair value* is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.**

<u>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.</u>

STAFF DRAFT
AMENDMENT TO INTERNATIONAL ACCOUNTING STANDARD
IAS32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements
Puttable Financial Instruments and Obligations Arising on Liquidation

Paragraph 16 is amended (new text is underlined and deleted text is struck through). After paragraph 16, a heading, paragraphs 16A and 16B, another heading, paragraphs 16C and 16D, another heading and paragraphs 16F and 16G are inserted. Paragraph 15 is included here for convenience but is not proposed for amendment.

Presentation

Liabilities and equity (see also paragraphs AG25–AG29)

15 The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.

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) The instrument includes no 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 issuer.

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

(i) a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or

(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 the features and meet the conditions described in paragraphs 16A-16D, or instruments that are themselves 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.

Puttable instruments

16A A puttable financial instrument includes a contractual obligation for the issuer to purchase its own shares for cash or another financial asset because on exercise of the put the entity must repurchase or redeem the instrument for cash or another financial asset. 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 unit amount by the ratio of the number of the units held by the financial instrument holder to the total number of units.

(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, in either the calculation of the amount due on liquidation or the timing of payment of that amount, 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 be all be puttable, and the formula or other method used to calculate the repurchase or redemption price is the same for every instrument in that class.

(d) Other than the contractual obligation for the issuer to purchase the instrument for cash or another financial asset, the instrument does not include any other 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 net profit or loss or the change in the net assets of the entity (excluding any possible effect the instrument may have on net profit or loss or net assets). An instrument with total cash flows that are either fixed or guaranteed to any extent, before or at liquidation, does not meet this condition.

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 total cash flows based substantially on the net profit or loss or changes in net assets of the entity (computed before the reduction in net profit or loss for such instrument or contract) and has the effect of substantially restricting or fixing the residual return to the puttable instrument holders. If the entity cannot determine that this condition is met, it shall not classify the instrument as an equity instrument.

Instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity 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 upon its liquidation. The obligation arises because liquidation is either 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 unit amount by the ratio of the number of the units held by the financial instrument holder to the total number of units.

(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, in either the calculation of the amount due on liquidation or the timing of payment of that amount, 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 include a 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 total cash flows based substantially on the net profit or loss or changes in net assets of the entity (computed before the reduction in net profit or loss for such instrument or contract) and such an instrument has the effect of substantially restricting or fixing the residual return to the puttable instrument holders. 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 on liquidation.

16E An entity shall classify a financial instrument as an equity instrument in accordance with paragraphs 16A-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 in paragraphs 16A and 16B, the entity should 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 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 to equity from the date when the instrument has all of the features and meets the conditions set out in paragraphs 16A and 16B or in paragraphs 16C and 16D. An equity instrument shall be measured at the carrying value of the financial liability at the date of reclassification.

Paragraphs 17–19 are amended (new text is underlined and deleted text is struck through). Paragraph 20 is included here for ease of reference but is not proposed for amendment.

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

17 With the exception of the circumstances described in paragraphs 16A-16D~~A~~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.

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) a preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability.

(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-16D. This is so 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~~, or when the legal form of the puttable instrument gives the holder a right to a residual interest in the assets of an issuer~~. 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-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~~equal to their proportionate share of the asset value of the issuer~~, which results in the unitholders' or members' interests being classified as financial liabilities, except for those instruments classified as equity in accordance with paragraphs 16A-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' on the face of 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-16D. For example:

(a) a restriction on the ability of an entity to satisfy a contractual obligation, such as lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, does not negate the entity's contractual obligation or the holder's contractual right under the instrument.

(b) a contractual obligation that is conditional on a counterparty exercising its right to redeem is a financial liability because the entity does not have the unconditional right to avoid delivering cash or another financial asset.

20 A financial instrument that does not explicitly establish a contractual obligation to deliver cash or another financial asset may establish an obligation indirectly through its terms and conditions. For example:

(a) A financial instrument may contain a non-financial obligation that must be settled if, and only if, the entity fails to make distributions or to redeem the instrument. If the entity can avoid a transfer of cash or another financial asset only by settling the non-financial obligation, the financial instrument is a financial liability.

(b) A financial instrument is a financial liability if it provides that on settlement the entity will deliver either:

(i) cash or another financial asset; or

(ii) its own shares whose value is determined to exceed substantially the value of the cash or other financial asset.

Although the entity does not have an explicit contractual obligation to deliver cash or another financial asset, the value of the share settlement alternative is such that the entity will settle in cash. In any event, the holder has in substance been guaranteed receipt of an amount that is at least equal to the cash settlement option (see paragraph 21).

Paragraphs 22, 23 and 25 are amended (new text is underlined and deleted text is struck through). After paragraph 22, paragraph 22A is inserted. Paragraphs 21 and 24 are included here for ease of reference but are not proposed for amendment.

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

21 A contract is not an equity instrument solely because it may result in the receipt or delivery of the entity's own equity instruments. An entity may have a contractual right or obligation to receive or deliver a number of its own shares or other equity instruments that varies so that the fair value of the entity's own equity instruments to be received or delivered equals the amount of the contractual right or obligation. Such a contractual right or obligation may be for a fixed amount or an amount that fluctuates in part or in full in

response to changes in a variable other than the market price of the entity's own equity instruments (eg an interest rate, a commodity price or a financial instrument price). Two examples are (a) a contract to deliver as many of the entity's own equity instruments as are equal in value to CU100,[*] and (b) a contract to deliver as many of the entity's own equity instruments as are equal in value to the value of 100 ounces of gold. Such a contract is a financial liability of the entity even though the entity must or can settle it by delivering its own equity instruments. It is not an equity instrument because the entity uses a variable number of its own equity instruments as a means to settle the contract. Accordingly, the contract does not evidence a residual interest in the entity's assets after deducting all of its liabilities.

22 Except as stated in paragraph 22A ~~A~~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, an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed price or for a fixed stated principal amount of a bond is an equity instrument. Changes in the fair value of a contract arising from variations in market interest rates that do not affect the amount of cash or other financial assets to be paid or receive, or the number of equity instruments to be received or delivered, on settlement of the contract do not preclude the contract from being an equity instrument. Any consideration received (such as premium received for a written option or warrant on the entity's own shares) is added directly to equity. Any consideration paid (such as the premium paid for a purchased option) is deducted directly from equity. Changes in the fair value of an equity instrument are not recognised in the financial statements.

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

[*] In this Standard, monetary amounts are denominated in 'currency units'(CU).

23 With the exception of the circumstances described in paragraphs 16A-16D, ~~A~~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 is an entity's obligation under a forward contract to purchase its own equity instruments for cash. When the financial liability is recognised initially under IAS 39, its fair value (the present value of the redemption amount) is reclassified from equity. Subsequently, the financial liability is measured in accordance with IAS 39. If the contract expires without delivery, the carrying amount of the financial liability is reclassified to equity. An entity's contractual obligation to purchase its own equity instruments gives rise to a financial liability for the present value of the redemption amount even if the obligation to purchase is conditional on the counterparty exercising the right to redeem (eg a written put option that gives the counterparty the right to sell an entity's own equity instruments to the entity for a fixed price).

24 A contract that will be settled by the entity delivering or receiving a fixed number of its own equity instruments in exchange for a variable amount of cash or another financial asset is a financial asset or financial liability. An example is a contract for the entity to deliver 100 of its own equity instruments in return for an amount of cash calculated to equal the value of 100 ounces of gold.

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 chance 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; ~~or~~

(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) <u>The instrument has the features and meets the conditions in paragraphs 16A and 16B or 16C and 16D.</u>

After paragraph 96, paragraph 96A is inserted and after paragraph 97A, paragraph 97B is inserted. Paragraphs 97 and 97A are included here for ease of reference but are not amended.

96A ***Puttable Financial Instruments and Obligations Arising on Liquidation*** **(Amendments to IAS 32 and IAS 1), issued in [January 2008], required particular financial instruments that contained the features and met the conditions in paragraphs 16A-16C or paragraphs 16D-16F to be classified as equity, and amended paragraphs 11, 16, 17-19, 22, 23, AG13, AG14 and AG27, and inserted paragraphs 16A-16F, 22A, 97B, AG14A-AG14I 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 and IFRIC 2** ***Members' Shares in Co-operative Entities and Similar Instruments*** **at the same time.**

97 **This Standard shall be applied retrospectively.**

97A **IAS 1 (as revised in 2007) amended the terminology used throughout IFRSs. In addition it amended paragraph 40. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies IAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.**

97B **When applying the amendments described in paragraph 96A, an entity is required to split a compound financial instrument with an obligation for a pro rata share of the net assets of the entity upon its liquidation into separate liability and equity components. If the liability component is no longer outstanding, a retrospective application of those amendments to IAS 32 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.

In the Appendix *Application Guidance,* paragraphs AG13 and AG14 are amended (new text is underlined and deleted text is struck through). After paragraph AG14, a heading, paragraphs AG14A and AG14B, another heading, paragraph AG14C, another heading paragraphs AG14D–AG14G, another heading paragraph AG14H, another heading and paragraph AG14I are added.

Equity instruments

AG13 Examples of equity instruments include non-puttable ordinary shares, some puttable instruments (see paragraphs 16A-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 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-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 oblig~~at~~ed 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.

Puttable financial instruments (paragraphs 16A and 16B)

AG14A One of the features of a puttable instrument that is classified as an equity instrument in accordance with paragraphs 16A and 16B is that the total cash flows of the instrument are substantially based on the net profit or loss or net assets of the entity. Examples of an instrument with such a feature include:

(a) an instrument that is issued and redeemed at an amount that is arrived at by applying a formula that is substantially based on the net profit or loss or net assets of the entity.

(b) an instrument that is issued and redeemed at a negotiated amount, but that negotiated amount is substantially based on the net assets of the entity.

AG14B Instruments may be puttable at the discretion of the instrument holder, or automatically on either the occurrence of an uncertain event that is outside the control of either party, or on the retirement or death of the instrument holder. Such instruments are required to be classified as equity instruments if they have all of the features and meet the conditions set out in paragraphs 16A and 16B or 16C and 16D.

Obligations arising on liquidation (paragraph 16C and 16D)

AG14C A financial instrument that entitles the holder to a pro rata share of the entity's net assets on liquidation includes a contractual obligation to deliver cash or other financial assets to another entity when liquidation is certain to occur (for example, a limited life entity) or liquidation is uncertain to occur but would be at the option of the holder of the instrument. Instruments that have such an obligation arising on liquidation are required to be classified as equity instruments if the instrument has all of the features and meets the conditions set out in paragraphs 16C and 16D.

The class of instruments that is subordinate to all other classes (paragraphs 16A-16D)

AG14D One of the features in paragraphs 16A and 16C is that the financial instrument is in the class of instruments that is subordinate to all other classes.

AG14E 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.

AG14F 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.

AG14G A limited partnership may include limited and general partners. Some general partners may provide a separate guarantee and are remunerated for providing that guarantee. In such situations an entity shall regard both classes of partner as equally subordinate.

Profit or loss sharing arrangements

AG14H Some entities have profit or loss sharing arrangements that allocate annual net profit or loss to the instrument holders on the basis of services rendered during the current and previous years, longevity, and the nominal amount of the instrument relative to others in the class. Such arrangements do not violate the features listed in paragraph 16A and 16C or the conditions in paragraph 16B and 16D provided that the basis for allocating the annual net profit or loss applies equally to all instruments in the class.

No other financial instrument or contract with total cash flows that are substantially based on the entity's net earnings and having the effect of substantially fixing or restricting the entity's net assets.

AG14I A condition for classifying as equity either puttable instruments or instruments that impose an obligation on liquidation is that the entity has no other instruments whose total cash flows are substantially based on the net profit or net assets of the entity that also has the effect of substantially fixing or restricting the entity's net assets. 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 16C from being classified as equity:

- instruments with total cash flows substantially based on specific assets within the entity
- instruments with total cash flows based on a percentage of turnover
- contracts designed to reward individual employees for services rendered to the entity
- contracts requiring the payment of an insignificant percentage of net profit for services or goods rendered to the entity.

Paragraph AG27 is amended (new text is underlined) and after paragraph AG29, paragraph AG29A is added. Paragraphs AG28 and AG29 are included here for ease of reference but are not proposed for amendment.

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 assets 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 the circumstances described in paragraphs 16A-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-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-16D). One example is a net cash-settled share option.

(d) A contract that will be settled in a variable number of the entity's own shares whose value equals a fixed amount or an amount based on changes in an underlying variable (eg a commodity price) is a financial asset or a financial liability. An example is a written option to buy gold that, if exercised, is settled net in the entity's own instruments by the entity delivering as many of those instruments as are equal to the value of the option contract. Such a contract is a financial asset or financial liability even if the underlying variable is the entity's own share price rather than gold. Similarly, a contract that will be settled in a fixed number of the entity's own shares, but the rights attaching to those shares will be varied so that the settlement value equals a fixed amount or an amount based on changes in an underlying variable, is a financial asset or a financial liability.

Contingent settlement provisions (paragraph 25)

AG28 Paragraph 25 requires that if a part of a contingent settlement provision that could require settlement in cash or another financial asset (or in another way that would result in the instrument being a financial liability) is not genuine, the settlement provision does not affect the classification of a financial instrument. Thus, a contract that requires settlement in cash or a variable number of the entity's own shares only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur is an equity instrument. Similarly, settlement in a fixed number of an entity's own shares may be contractually precluded in circumstances that are outside the control of the entity, but if these circumstances have no genuine possibility of occurring, classification as an equity instrument is appropriate.

Treatment in consolidated financial statements

AG29 In consolidated financial statements, an entity presents non-controlling interests—ie the interests of other parties in the equity and income of its subsidiaries—in accordance with IAS 1 *Presentation of Financial Statements* and IAS 27 *Consolidated and Separate Financial Statements.* When classifying a financial instrument (or a component of it) in consolidated financial statements, an entity considers all terms and conditions agreed between members of the group and the holders of the instrument in determining whether the group as a whole has an obligation to deliver cash or another financial asset in respect of the instrument or to settle it in a manner that results in liability classification. When a subsidiary in a group issues a financial instrument and a parent or other group entity agrees additional terms directly with the holders of the instrument (eg a guarantee), the group may not have discretion over distributions or redemption. Although the subsidiary may appropriately classify the instrument without regard to these additional terms in its individual financial statements, the effect of other agreements between members of the group and the holders of the instrument is considered in order to ensure that consolidated financial statements reflect the contracts and transactions entered into by the group as a whole. To the extent that there is such an obligation or settlement provision, the instrument (or the component of it that is subject to the obligation) is classified as a financial liability in consolidated financial statements.

AG29A Some types of instruments that impose a contractual obligation on the entity are classified as equity instruments in accordance with paragraphs 16A-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.

In the Illustrative Examples, paragraph IE1 is amended (new text is underlined).

Illustrative Examples

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-16D).

In Example 8, paragraph IE33 is amended (new text is underlined).

Example 8: Entities with some equity

IE33 The following example illustrates an income statement and balance sheet format that may be used by entities whose share capital is not equity as defined in IAS 32 because the entity has an obligation to repay the share capital on demand at a fixed price. Other formats are possible.

Income statement for the year ended 31 December 20X1

	20X1	**20X0**
	CU	CU
Revenue	472	498
Expenses (classified by nature or function)	(367)	(396)
Profit from operating activities	105	102
Finance costs		
– other finance costs	(4)	(4)
– distributions to members	(50)	(50)
Change in net assets attributable to members	51	48

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

Balance sheet at 31 December 20X1

		20X1		20X0
	CU	CU	CU	CU
ASSETS				
Non-current assets (classified in accordance with IAS 1)	908		830	
Total non-current assets		908		830
Current assets (classified in accordance with IAS 1)	383		350	
Total current assets		383		350
Total assets		1,291		1,180
LIABILITIES				
Current liabilities (classified in accordance with IAS 1)	372		338	
Share capital repayable on demand	202		161	
Total current liabilities		(574)		(499)
Total assets less current liabilities		717		681
Non-current liabilities (classified in accordance with IAS 1)	187		196	
		(187)		(196)
RESERVES[(a)]				
Reserves eg revaluation reserve, retained earnings etc	530		485	
		530		485
		717		681
MEMORANDUM NOTE – Total members' interests				
Share capital repayable on demand		202		161
Reserves		530		485
		732		646

(a) In this example, the entity has no obligation to deliver a share of its reserves to its members.

Proposed Amendments to IAS 1 *Presentation of Financial Statements*

In the Standard, after paragraph 8, paragraph 8A is inserted as follows:

8A The following terms are defined in paragraphs 16A and 16B and 16C and 16D of IAS 32 *Financial Instruments: Presentation* and are used in this Standard with the meaning specified in IAS 32:

(a) puttable financial instrument classified as an equity instrument

(b) a financial instrument that entitles the holder to a pro rata share of the net assets of the entity upon its liquidation classified as an equity instrument.

After paragraph 80, paragraph 80A is inserted as follows:

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 entity a pro rata share of the net assets of the entity upon its liquidation 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.

After paragraph 136, a new heading and paragraph 136A is inserted as follows. Paragraph 138 is amended (new text is underlined and deleted text is struck through). Paragraph 137 is not proposed for amendment but is included here for ease of reference.

Puttable financial instruments classified as equity

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

137 An entity shall disclose in the notes:

(a) the amount of dividends proposed or declared before the financial statements were authorised for issue but not recognised as a distribution to equity holders during the period, and the related amount per share; and

(b) the amount of any cumulative preference dividends not recognised.

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; ~~and~~

(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.

After paragraph 139, paragraph 139A is inserted as follows:

139A *Puttable Financial Instruments and Obligations Arising on Liquidation* (Amendments to IAS 32 and IAS 1), issued in [date to be inserted after exposure], amended paragraph 138 and inserted paragraphs 8A, 80A and 136A. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. 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 32, IAS 39 and IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments* at the same time.

STAFF DRAFT

AMENDMENT TO INTERNATIONAL ACCOUNTING STANDARD

IAS32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements

Puttable Financial Instruments and Obligations Arising on Liquidation