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International
Accounting Standards
Board

INFORMATION FOR OBSERVERS

Board Meeting: **January 2009, London**

Project: **Financial Instruments with Characteristics of Equity**

Subject: **Cover Note: Redeemable Instruments (Agenda Paper 11)**

INTRODUCTION

1. The next step in this project is to determine how puttable and mandatorily redeemable instruments with characteristics of equity should be classified. We have identified four alternatives the Boards could consider:
   a. **Alternative 1—**Develop an approach that would require all perpetual and some redeemable instruments to be classified as equity.
   b. **Alternative 2—**Separate redeemable instruments into equity and non-equity components.
   c. **Alternative 3—**Develop rules-based requirements for determining which redeemable instruments should be classified as equity.
   d. **Alternative 4—**Classify all redeemable instruments as liabilities.
2. Agenda Paper 11A describes one possible version of Alternative 1. Agenda paper 11B discusses some advantages and disadvantages of Alternative 2.

3. Alternative 3 is the general approach taken by the IASB in its amendments to IAS 32 and IAS 1, *Puttable Financial Instruments and Obligations Arising on Liquidation.* We recommend against taking this approach except as a last resort after all others have been eliminated.

4. While Alternative 4 is the most straight-forward approach, we do not believe board members would support it. At least, it is not consistent with the initial views expressed by members of both boards at the November meetings. The primary reason that we would not recommend pursuing Alternative 4 is that certain types of entities issue only equity instruments with redemption features. At least some of those redemption features are intended only to maintain control of closely held businesses, provide a market for non-public shares or extend and restrict membership privileges. Those are not features normally associated with liabilities. On the other hand, the degree of subordination is associated with equity classification.

5. Moreover, classifying all redeemable instruments as liabilities is inconsistent with much of the constituent input that the boards have received in recent years.

6. After the Boards have discussed the accompanying agenda papers and this cover paper, we will ask the Boards which alternative we should develop.