International Accounting Standards Board®

Press Release

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IASB publishes proposals to improve the financial reporting of particular financial instruments

The International Accounting Standards Board (IASB) today published for public comment proposals to improve the financial reporting of particular types of financial instruments that have characteristics similar to ordinary shares but are at present classified as financial liabilities. The proposals, which respond to requests from entities around the world, are set out in an Exposure Draft of proposed amendments to IAS 32 *Financial Instruments: Presentation* and IAS 1 *Presentation of Financial Statements.*

IAS 32 requires an instrument to be classified as a liability if the holder of that instrument can require the issuer to redeem it for cash. That straightforward principle works well in most situations. However, many instruments that would usually be considered equity, including some ordinary shares and partnership interests, include provisions that allow the holder to 'put' the instrument (to require the issuer to redeem it) for cash. The instruments are therefore considered liabilities, rather than equity, under the existing provisions of IAS 32.

The IASB and the US national standard-setter, the Financial Accounting Standards Board, are working together on a comprehensive project on distinguishing debt from equity. However, that project will take several years to complete. There are many legitimate reasons for put features, and the IASB concluded that its constituents should not be forced to await the outcome of the long-term project. It decided to propose amendments to IAS 32 so that some instruments would be classified as equity rather than as liabilities.

Under the proposed amendments, the following types of financial instruments would be classified as equity, provided that specified criteria are met:

- ordinary shares that are puttable to (ie redeemable from) the issuer at fair value;
- ordinary shares of limited life entities; and

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- partners' interests in a partnership that must liquidate upon exit of a partner (eg on retirement or death).

The amendments also propose disclosures about the instruments affected by the proposals.

Introducing the Exposure Draft, Sir David Tweedie, IASB Chairman, said:

> The proposals to amend IAS 32 and IAS 1 are the result of a short-term, limited scope project to improve the financial reporting for entities that issue ordinary shares puttable at fair value, limited life entities and some partnerships. We plan to review the treatment of these and other financial instruments comprehensively in our long-term project on liabilities and equity. In the meantime, we believe that the proposed amendments respond to a real need for more understandable information by requiring more consistent classification of financial instruments that are largely equivalent to ordinary shares across different entity structures.

The IASB invites comments on the Exposure Draft by 23 October 2006.

The primary means of publishing proposed Standards and amendments to Standards is by electronic format through the IASB's subscriber Website. Subscribers are able to access the Exposure Draft published today through 'online services'. Those wishing to subscribe should contact:

> IASCF Publications Department,
> 30 Cannon Street, London EC4M 6XH, United Kingdom.
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From 3 July 2006 the text of the Exposure Draft will be available freely from the IASB's Website.

Printed copies of Exposure Draft—Proposed Amendments to IAS 32 Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements—*Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation* (ISBN 1-905590-07-5) will be available shortly at £10.00 each, including postage, from IASCF Publications Department (order copies online through the IASCF shop: www.iasb.org).

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Notes to Editors

About the proposed amendments

- Under IAS 32, a financial instrument that gives the holder the right to put it back to (ie redeem it from) the issuer for cash or another financial asset ('a puttable instrument') is a financial liability. Furthermore, changes in the fair value of a puttable instrument are recognised in profit and loss.
- Some entities have issued financial instruments puttable at fair value that have characteristics similar to ordinary shares (eg they give the holder a residual interest in the net assets of the entity). The effect of applying IAS 32 and IAS 39 *Financial Instruments: Recognition and Measurement* to financial instruments puttable at fair value may be that the entire market capitalisation of an entity is recognised as a liability. Consequently, when the entity performs well and the fair value of the liabilities increases, a loss is recognised. When the entity performs poorly and the fair value of the liability decreases, a gain is recognised. The amendments propose to classify these instruments as equity, provided specified criteria are met.
- Issues similar to those described above also apply to the classification of ordinary shares in a limited life entity. The entity is obliged to liquidate because the entity has a limited life. Therefore, IAS 32 requires these shares to be classified as financial liabilities because the entity has an obligation to transfer cash to its shareholders. Hence, a limited life entity would have no equity. Similar issues also apply to some partnerships that are required to liquidate upon the exit of a partner (eg on retirement or death). The amendments propose to classify these instruments as equity, provided specified criteria are met.
- The amendments to IAS 1 propose disclosures about the instruments classified as equity under the proposals, including the fair value of puttable instruments classified as equity.

About the liabilities and equity project

- This project is on the IASB's research agenda, and is being conducted jointly with the US Financial Accounting Standards Board (FASB) using a modified joint approach. Under this approach, the FASB is conducting the initial research and will produce the results of its deliberations and research in the form of a Preliminary Views document. Both boards plan to publish the Preliminary Views document for comment by their respective constituents.

- The project's objective is to develop a comprehensive standard of accounting and reporting for financial instruments with characteristics of equity, liabilities or both, and assets.

About the IASB

The International Accounting Standards Board (IASB), based in London, began operations in 2001. Contributions collected by its Trustees, the IASC Foundation, from the major accounting firms, private financial institutions and industrial companies throughout the world, central and development banks, and other international and professional organisations fund the operations of the IASB.

The 14 Board members (12 of whom are full-time) are drawn from nine countries and have wide international experience and a variety of functional backgrounds. The IASB is committed to developing, in the public interest, a single set of high quality, global accounting standards that require transparent and comparable information in general purpose financial statements. In pursuit of this objective, the IASB co-operates with national accounting standard-setters to achieve convergence in accounting standards around the world.