

IFRS Briefing Sheet

Exposure Draft of *Proposed Amendments to IAS 32 and IAS 1 – Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation*

July 2006, **Issue 51**

This IFRS Briefing Sheet summarises the International Accounting Standards Board's (IASB) Exposure Draft (ED) of *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*, which was published on 22 June 2006.

Background and Issue

A financial instrument that creates a contractual obligation to deliver cash or another financial asset to another entity is a financial liability. For entities whose ordinary share capital or its equivalent is puttable to the issuer at fair value, and those entities that wind up after a specific period of time or upon a specified event, this definition means that ordinary share capital is classified as a liability. In addition, the measurement of such liabilities means that many affected entities present little or even negative equity.

Responding to the concerns of constituents, in particular limited life and co-operative entities, the Board developed the ED as a short-term solution prior to the completion of its long-term project on liabilities and equity.

Definition of a Financial Liability Amended

A Rules-based Amendment

The ED proposes that the definition of a financial liability be amended to exclude the following:

Subject to certain conditions, this ED proposes that the following financial instruments be classified as equity:

- those that are puttable at the fair value of a *pro rata* share of the net assets of an entity
- those that require an entity to deliver a *pro rata* share of its net assets upon liquidation.
- an obligation to deliver a *pro rata* share of the net assets of the entity upon liquidation
- an obligation to redeem or repurchase a financial instrument puttable at fair value.

A supplement to KPMG's publication IFRS in Brief

Both of these changes are subject to the condition that the instruments are the most subordinated class of instruments with a claim to the net assets of the entity, i.e., ordinary share capital.

The proposals further define “financial instrument puttable at fair value” and specify the features that must be present in a financial instrument that entitles the holder to a *pro rata* share of the net assets of the entity. For example, financial instruments puttable at fair value cannot meet the definition of a financial liability in other respects; and an instrument that entitles the holder to a *pro rata* share of the net assets of the entity must not contain any preferential rights upon liquidation. In addition, a derivative that is to be settled in such instruments still will be classified as a financial liability.

These proposed changes in definition mean that such instruments would be classified as equity, and would not be remeasured to fair value.

Classification to be Reassessed

The ED proposes that an assessment of whether an instrument is the most subordinated class of instruments with a claim to the net assets of the entity be carried out each time that a “relevant” event occurs, e.g., when instruments are redeemed or new instruments are issued.

Minority Interests Classified as Liabilities

The proposals state that such instruments held by minority interests are classified as a liability in the consolidated financial statements. Such interests do not qualify for equity classification under the ED because they are not the most subordinated class of instruments with a claim to the net assets of the entity.

New Disclosures

The proposals include a number of new disclosures, including summary quantitative data about the amount classified as equity; and information about the objectives, policies and processes followed by an entity for

managing its obligation to repurchase or redeem the instruments.

Effective Date and Transition

The ED proposes retrospective application in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, but no effective date has been proposed.

If the liability component of a compound financial instrument that falls under the proposals is no longer outstanding at the effective date of the amendment, then the instrument would not have to be separated into its liability and equity components.

Response to the IASB

The IASB has invited comments on this ED by 23 October 2006.

If you would like further information on any of the matters discussed in this issue of *IFRS Briefing Sheet*, please talk to your usual local KPMG contact or call any of KPMG firms’ offices.

KPMG International Financial Reporting Group is part of KPMG IFRG Limited.

KPMG International is a Swiss cooperative that serves as a coordinating entity for a network of independent firms operating under the KPMG name. KPMG International provides no audit or other client services. Such services are provided solely by member firms of KPMG International (including sublicensees and subsidiaries) in their respective geographic areas. KPMG International and its member firms are legally distinct and separate entities. They are not and nothing contained herein shall be construed to place these entities in the relationship of parents, subsidiaries, agents, partners, or joint venturers. No member firm has any authority (actual, apparent, implied or otherwise) to obligate or bind KPMG International or any other member firm, nor does KPMG International have any such authority to obligate or bind any member firm, in any manner whatsoever.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

© 2006 KPMG IFRG Limited, a UK company, limited by guarantee. All rights reserved.

KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative.

Publication name: *IFRS Briefing Sheet*

Publication number: Issue 51

Publication date: July 2006