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Press Release

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IASB'S STANDING INTERPRETATIONS COMMITTEE (SIC)
ISSUES TWO DRAFT INTERPRETATIONS

The Standing Interpretations Committee (SIC) today published two Draft Interpretations to clarify the approach to certain issues under International Accounting Standards. The Draft Interpretations are available both in hard copy format and also on IASB's Web Site http://www.iasb.org.uk. Comments should be submitted in writing by **5 November 2001.** The Draft Interpretations are:

- SIC – D33: *Consolidation and Equity Method – Potential Voting Rights*, and
- SIC – D34: *Financial Instruments – Instruments or Rights Redeemable by the Holder*

Commenting on the new Draft Interpretations, Paul Cherry, Chairman of the Standing Interpretations Committee, said: "Share call options and convertible debt are examples of instruments that typically provide potential for the holder to increase its voting rights in relation to decision-making that affect the financial and operating policies of an another enterprise. The Draft Interpretation clarifies that such instruments can affect an assessment of whether control or significant influence exists and therefore should be taken into account when making the assessment. However, unless these instruments have been exercised or converted, they should not be included in the determination of the proportion allocated to a parent and minority interest when preparing consolidated financial statements or the proportion allocated to an investor applying the equity method when accounting for an investment in an associate. The proportions should be determined solely based on present ownership interests."

Paul Cherry continued: "Determining the classification of financial instruments can be difficult. It requires a careful analysis of an instrument's terms and conditions, and an assessment of its substance within the context of the definitions of a financial liability and an equity instrument. The Committee considered the classification of a financial instrument where the holder has a right to put it back to the issuer for cash or another financial asset and the amount is determined based on an index or something else that has the potential to increase and decrease. Units issued by open-ended mutual funds and rights granted by certain co-operative enterprises are examples of the type of instrument just described. The consensus clarifies that these instruments should be classified in their entirety as liabilities. The consensus also clarifies how the instrument should be measured and, in the case when the instrument can be put back at any time, the effect of the consensus is to require that the instrument be measured at the redemption amount that would be paid at the balance sheet date if the holder were to exercise the right."

In closing, Paul Cherry noted "It will be especially important for mutual funds and other investment management enterprises to provide us with comments on the proposals in D34 as the consensus could have a significant impact on their financial statements. As the Committee intends to consider comments before finalizing the Interpretation at its next meeting on November 12, respondents should send their comments without delay."

Printed copies of Draft Interpretations SIC-D33 and SIC-D34 will be mailed to subscribers to IASB's "SIC Interpretations Subscription Package" and to subscribers to the IASB "Comprehensive Package" services next week. The SIC publications include a loose-leaf binder containing Draft and Final SIC Interpretations, the SIC Operating Procedures, a member list and other additional information. Detailed information on subscription services and on ordering other IASB publications can be obtained from IASB's publication department, 7th Floor, 166 Fleet Street, London EC4A 2DY, United Kingdom. Telephone: +44 (020) 7427-5927. Fax: +44 (020) 7353-0562. E-mail: publications@iasb.org.uk Internet: http://www.iasb.org.uk

For Press Enquiries:

Jim Saloman, Technical Director, IASB, Telephone: +44 (020) 7246-6460; e-mail: jsaloman@iasb.org.uk

Frank Palmer, SIC Project Manager, IASB, Telephone: +44 (020) 7246-6455; e-mail: fpalmer@iasb.org.uk

Paul Cherry, SIC Chairman, Telephone: +1 (416) 204-3456; e-mail: paul.cherry@cica.ca

NOTE TO EDITORS:

- SIC – D33: *Consolidation and Equity Method – Potential Voting Rights*

  An enterprise may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to either give the enterprise additional voting power or reduce another party's voting power over the financial and operating policies of another enterprise (potential voting rights). The Draft Interpretation addresses whether the existence and effect of potential voting rights are considered when assessing whether control under IAS 27 or significant influence under IAS 28 exists. The SIC agreed that their existence and effect, if presently exercisable or convertible, should be considered.

  The Draft Interpretation also addresses whether the proportion allocated to the parent and minority interest in preparing consolidated financial statements under IAS 27, and the proportion allocated to an investor that accounts for its investment in an associate using the equity method under IAS 28 should be determined based on present ownership interests or ownership interests that would be held if the potential voting rights were exercised or converted. The SIC agreed that the proportion allocated should be determined solely based on present ownership interests.

- SIC – D34: *Financial Instruments – Instruments or Rights Redeemable by the Holder*

  An enterprise may issue a financial instrument or provide a right (Puttable Instrument) that gives the holder the right to put the instrument or right back to the issuer for cash or another financial asset. The amount payable upon redemption is determined based on an index or other item that has the potential to increase and decrease.

  In some circumstances, the legal form of such an instrument or right includes a right to a residual interest in the assets of the enterprise after deducting certain of its liabilities. For example, open-ended mutual funds and certain co-operative enterprises may provide their unitholders or members with a right to redeem their interests in the enterprise at any time for cash equal to their proportionate share of the net asset value of the enterprise.

  The Draft Interpretation addresses how the issuer should classify a Puttable Instrument. The SIC agreed that the entire instrument should be classified as a liability. The Draft Interpretation also addresses whether a Puttable Instrument is a hybrid financial instrument that consists of both a host contract and an embedded derivative that should be measured separately, and if so,

  (a) how the issuer should measure each component;

  (b) whether the issuer should present the components separately or on a net basis in the balance sheet; and

  (c) how the issuer should present any gain or loss arising from remeasurement in the income statement.

The SIC agreed that a Puttable Instrument is a hybrid financial instrument consisting of two components:

(a) a host contract that is similar to a deposit repayable for a fixed amount; and

(b) an embedded non-option derivative that represents a principal payment indexed to an underlying variable.

When recognised initially, the SIC agreed that the host debt component should be measured at cost, net of transaction costs, and the embedded derivative should be measured at zero. Subsequent to initial recognition, the host debt component should be measured at amortised cost, and the embedded derivative should be measured at fair value.

As regards presentation, the SIC agreed that an issuer should present the host contract and embedded derivative components of a Puttable Instrument on a net basis in the balance sheet, and may present any gain or loss arising from remeasurement on a net basis in the income statement. In the extreme circumstance when an issuer has no equity as a result of issuing a Puttable Instrument, the SIC agreed that the issuer may also amend the descriptions in its income statement and present the net gain (net loss) separately with an appropriate description on the face of the income statement before profit or loss from ordinary activities.