Commission Regulation (EC) No 1073/2005 of 7 July 2005 amending Regulation (EC) No 1725/2003 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council, as regards IFRIC 2 (Text with EEA relevance)

COMMISSION REGULATION (EC) No 1073/2005

of 7 July 2005

amending Regulation (EC) No 1725/2003 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council, as regards IFRIC 2

(Text with EEA relevance)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community.

Having regard to Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards[(1)], and in particular Article 3 (1) thereof,

Whereas:

(1) By Commission Regulation (EC) No 1725/2003[(2)] certain international standards and interpretations that were extant at 14 September 2002 were adopted.

(2) On 17 December 2003 the International Accounting Standard Board (IASB) published revised International Accounting Standard (IAS) 32 *Financial Instruments: Disclosure and Presentation*. IAS 32 establishes basic principles for the classification of instruments as liabilities or equity and was adopted by the European Commission by Commission Regulation (EC) No 2237/2004[(3)] as of 29 December 2004.

(3) Following bilateral discussions with representatives of the cooperative world and due to a request by the Commission, the IASB invited its International Financial Reporting Interpretation Committee (IFRIC), to develop an interpretation to facilitate the application of the revised IAS 32.

(4) IFRIC 2 *Members' Shares in Cooperative Entities and Similar Instruments* was published on 25 November 2004. The Interpretation clarifies that the classification of members' shares as financial liabilities or as equity depends upon the characteristics of such shares, especially the redemption features. The effective date of application of this interpretation is the same as that for IAS 32, as already indicated in Recital 3 of Regulation (EC) No 2237/2004 as of 29 December 2004 adopting IAS 32.

(5) The consultation with technical experts in the field support that IFRIC Interpretation 2 Members' Shares in Cooperative Entities and Similar Instruments meet the technical criteria for adoption set out in Article 3(2) of Regulation (EC) No 1606/2002.

(6) Regulation (EC) No 1725/2003 should therefore be amended accordingly.

Changes to legislation: *There are currently no known outstanding effects for the Commission Regulation (EC) No 1073/2005. (See end of Document for details)*

(7) This amendment should exceptionally take effect for company's financial year starting on or after 1 January 2005, i.e. from a point in time before the publication of this regulation. The retrospective application is exceptionally justified as to enable cooperatives the preparation of accounts in accordance with IAS 32, as construed by IFRIC 2, and as the companies concerned could legitimately expect such application already at the point of the adoption of IAS 32.

(8) The measures provided for in this Regulation are in accordance with the opinion of the Accounting Regulatory Committee.

HAS ADOPTED THIS REGULATION:

Article 1

Annex to Regulation (EC) No 1725/2003 is amended as follows:

The text of the Interpretation IFRIC 2 *Members' Shares in Cooperative Entities and Similar Instruments* set out in the Annex to this Regulation, is inserted.

Article 2

This Regulation shall enter into force on the third day following its publication in the *Official Journal of the European Union*.

It shall apply to each financial year of a company starting on or after 1 January 2005 at the latest.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 7 July 2005.

For the Commission

Charlie McCREEVY

Member of the Commission

***Changes to legislation:** There are currently no known outstanding effects for the Commission Regulation (EC) No 1073/2005. (See end of Document for details)*

ANNEX

INTERNATIONAL FINANCIAL REPORTING STANDARDS

IFRIC 2	*Members' Shares in Cooperative Entities and Similar Instruments*

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IFRIC INTERPRETATION 2 Members' Shares in Cooperative Entities and Similar Instruments

References

— IAS 32 *Financial Instruments: Disclosure and Presentation* (as revised in 2003)

— IAS 39 *Financial Instruments: Recognition and Measurement* (as revised in 2003)

Background

1 Cooperatives and other similar entities are formed by groups of persons to meet common economic or social needs. National laws typically define a cooperative as a society endeavouring to promote its members' economic advancement by way of a joint business operation (the principle of self-help). Members' interests in a cooperative are often characterised as members' shares, units or the like, and are referred to below as 'members' shares'.

2 IAS 32 establishes principles for the classification of financial instruments as financial liabilities or equity. In particular, those principles apply to the classification of puttable instruments that allow the holder to put those instruments to the issuer for cash or another financial instrument. The application of those principles to members' shares in cooperative entities and similar instruments is difficult. Some of the International Accounting Standards Board's constituents have asked for help in understanding how the principles in IAS 32 apply to members' shares and similar instruments that have certain features, and the circumstances in which those features affect the classification as liabilities or equity.

Scope

3 This Interpretation applies to financial instruments within the scope of IAS 32, including financial instruments issued to members of cooperative entities that evidence the members' ownership interest in the entity. This Interpretation does not apply to financial instruments that will or may be settled in the entity's own equity instruments.

Issue

4 Many financial instruments, including members' shares, have characteristics of equity, including voting rights and rights to participate in dividend distributions. Some financial instruments give the holder the right to request redemption for cash or another financial asset, but may include or be subject to limits on whether the financial instruments will be redeemed. How should those redemption terms be evaluated in determining whether the financial instruments should be classified as liabilities or equity?

Consensus

5 The contractual right of the holder of a financial instrument (including members' shares in cooperative entities) to request redemption does not, in itself, require that financial instrument to be classified as a financial liability. Rather, the entity must consider all of the terms and conditions of the financial instrument in determining its classification as a financial liability or equity. Those terms and conditions include relevant local laws, regulations and the entity's

Changes to legislation: *There are currently no known outstanding effects for the Commission Regulation (EC) No 1073/2005. (See end of Document for details)*

governing charter in effect at the date of classification, but not expected future amendments to those laws, regulations or charter.

6 Members' shares that would be classified as equity if the members did not have a right to request redemption are equity if either of the conditions described in paragraphs 7 and 8 is present. Demand deposits, including current accounts, deposit accounts and similar contracts that arise when members act as customers are financial liabilities of the entity.

7 Members' shares are equity if the entity has an unconditional right to refuse redemption of the members' shares.

8 Local law, regulation or the entity's governing charter can impose various types of prohibitions on the redemption of members' shares, e.g. unconditional prohibitions or prohibitions based on liquidity criteria. If redemption is unconditionally prohibited by local law, regulation or the entity's governing charter, members' shares are equity. However, provisions in local law, regulation or the entity's governing charter that prohibit redemption only if conditions — such as liquidity constraints — are met (or are not met) do not result in members' shares being equity.

9 An unconditional prohibition may be absolute, in that all redemptions are prohibited. An unconditional prohibition may be partial, in that it prohibits redemption of members' shares if redemption would cause the number of members' shares or amount of paid-in capital from members' shares to fall below a specified level. Members' shares in excess of the prohibition against redemption are liabilities, unless the entity has the unconditional right to refuse redemption as described in paragraph 7. In some cases, the number of shares or the amount of paid-in capital subject to a redemption prohibition may change from time to time. Such a change in the redemption prohibition leads to a transfer between financial liabilities and equity.

10 At initial recognition, the entity shall measure its financial liability for redemption at fair value. In the case of members' shares with a redemption feature, the entity measures the fair value of the financial liability for redemption at no less than the maximum amount payable under the redemption provisions of its governing charter or applicable law discounted from the first date that the amount could be required to be paid (see example 3).

11 As required by paragraph 35 of IAS 32, distributions to holders of equity instruments are recognised directly in equity, net of any income tax benefits. Interest, dividends and other returns relating to financial instruments classified as financial liabilities are expenses, regardless of whether those amounts paid are legally characterised as dividends, interest or otherwise.

12 The Appendix, which is an integral part of the consensus, provides examples of the application of this consensus.

Disclosure

13 When a change in the redemption prohibition leads to a transfer between financial liabilities and equity, the entity shall disclose separately the amount, timing and reason for the transfer.

Effective date

14 The effective date and transition requirements of this Interpretation are the same as those for IAS 32 (as revised in 2003). An entity shall apply this Interpretation for annual periods beginning on or after 1 January 2005. If an entity applies this Interpretation for a period beginning before 1 January 2005, it shall disclose that fact. This Interpretation shall be applied retrospectively.

***Changes to legislation:** There are currently no known outstanding effects for the Commission Regulation (EC) No 1073/2005. (See end of Document for details)*

Appendix

EXAMPLES OF APPLICATION OF THE CONSENSUS

This appendix is an integral part of the Interpretation.

A1 This appendix sets out seven examples of the application of the IFRIC consensus. The examples do not constitute an exhaustive list; other fact patterns are possible. Each example assumes that there are no conditions other than those set out in the facts of the example that would require the financial instrument to be classified as a financial liability.

UNCONDITIONAL RIGHT TO REFUSE REDEMPTION (paragraph 7)

Example 1

Facts

A2 The entity's charter states that redemptions are made at the sole discretion of the entity. The charter does not provide further elaboration or limitation on that discretion. In its history, the entity has never refused to redeem members' shares, although the governing board has the right to do so.

Classification

A3 The entity has the unconditional right to refuse redemption and the members' shares are equity. IAS 32 establishes principles for classification that are based on the terms of the financial instrument and notes that a history of, or intention to make, discretionary payments does not trigger liability classification. Paragraph AG26 of IAS 32 states:

When preference shares are non-redeemable, the appropriate classification is determined by the other rights that attach to them. Classification is based on an assessment of the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument. When distributions to holders of the preference shares, whether cumulative or non-cumulative, are at the discretion of the issuer, the shares are equity instruments. The classification of a preference share as an equity instrument or a financial liability is not affected by, for example:

(a) a history of making distributions;

(b) an intention to make distributions in the future;

(c) a possible negative impact on the price of ordinary shares of the issuer if distributions are not made (because of restrictions on paying dividends on the ordinary shares if dividends are not paid on the preference shares);

(d) the amount of the issuer's reserves;

(e) an issuer's expectation of a profit or loss for a period; or

(f) an ability or inability of the issuer to influence the amount of its profit or loss for the period.

Example 2

Facts

A4 The entity's charter states that redemptions are made at the sole discretion of the entity. However, the charter further states that approval of a redemption request is automatic unless the entity is unable to make payments without violating local regulations regarding liquidity or reserves.

Classification