

IAS 32 *Financial Instruments: Presentation* (September 2013)

Classification of financial instruments that give the issuer the contractual right to choose the form of settlement

The IFRS Interpretations Committee received a request to clarify how an issuer would classify three financial instruments in accordance with IAS 32 *Financial Instruments: Presentation*. None of the financial instruments had a maturity date but each gave the holder the contractual right to redeem at any time. The holder's redemption right was described differently for each of the three financial instruments; however in each case the issuer had the contractual right to choose to settle the instrument in cash or a fixed number of its own equity instruments if the holder exercised its redemption right. The issuer was not required to pay dividends on the three instruments but could choose to do so at its discretion.

The Interpretations Committee noted that paragraph 15 of IAS 32 requires the issuer of a financial instrument to classify the instrument in accordance with the substance of the contractual arrangement.

Consequently, the issuer cannot achieve different classification results for financial instruments with the same contractual substance simply by describing the contractual arrangements differently.

Paragraph 11 in IAS 32 sets out the definitions of both a financial liability and an equity instrument.

Paragraph 16 describes in more detail the circumstances in which a financial instrument meets the definition of an equity instrument.

The Interpretations Committee noted that a non-derivative financial instrument that gives the issuer the contractual right to choose to settle in cash or a fixed number of its own equity instruments meets the definition of an equity instrument in IAS 32 as long as the instrument does not establish an obligation to deliver cash (or another financial asset) indirectly through its terms and conditions. Paragraph 20(b) of IAS 32 provides the example that an indirect contractual obligation would be established if a financial instrument provides that on settlement the entity will deliver either cash or its own equity instruments whose value is determined to exceed substantially the value of the cash.

The Committee also acknowledged that financial instruments, in particular those that are more structured or complex, require careful analysis to determine whether they contain equity and non equity components that must be accounted for separately in accordance with IAS 32. The Interpretations Committee noted that if the issuer has a contractual obligation to deliver cash, that obligation meets the definition of a financial liability. The Interpretations Committee considered that in the light of its analysis of the existing IFRS requirements, an interpretation was not necessary and consequently decided not to add the issue to its agenda.