

International Accounting Standard 32

Financial Instruments: Presentation

This version includes amendments resulting from IFRSs issued up to 17 January 2008.

IAS 32 *Financial Instruments: Disclosure and Presentation* was issued by the International Accounting Standards Committee in June 1995. Limited amendments were made in 1998 and 2000.

In April 2001 the International Accounting Standards Board (IASB) resolved that all Standards and Interpretations issued under previous Constitutions continued to be applicable unless and until they were amended or withdrawn.

In December 2003 the IASB issued a revised IAS 32.

Since then, IAS 32 and its accompanying documents have been amended by the following IFRSs:

- IFRS 2 *Share-based Payment* (issued February 2004)
- IFRS 3 *Business Combinations* (issued March 2004)
- IFRS 4 *Insurance Contracts* (issued March 2004)
- Amendment to IAS 39—*Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk* (issued March 2004)
- Amendment to IAS 39—*The Fair Value Option* (issued June 2005)
- IFRS 7 *Financial Instruments: Disclosures* (issued August 2005)
- Amendments to IAS 39 and IFRS 4—*Financial Guarantee Contracts* (issued August 2005)
- IAS 1 *Presentation of Financial Statements* (as revised in September 2007)
- IFRS 3 *Business Combinations* (as revised in January 2008)
- IAS 27 *Consolidated and Separate Financial Statements* (as amended in January 2008).

As a result of the amendments made by IFRS 7, the title of IAS 32 was amended to *Financial Instruments: Presentation*.

The following Interpretations refer to IAS 32:

- SIC-12 *Consolidation—Special Purpose Entities* (issued December 1998 and subsequently amended)
- IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments* (issued November 2004)
- IFRIC 11 *IFRS 2—Group and Treasury Share Transactions* (issued November 2006)
- IFRIC 12 *Service Concession Arrangements* (issued November 2006 and subsequently amended).

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International Accounting Standard 32 *Financial Instruments: Presentation* (IAS 32) is set out in paragraphs 1–100 and the Appendix. All the paragraphs have equal authority but retain the IASC format of the Standard when it was adopted by the IASB. IAS 32 should be read in the context of its objective and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

Reasons for revising IAS 32

- IN1 International Accounting Standard 32 *Financial Instruments: Disclosure and Presentation* (IAS 32)^{*} replaces IAS 32 *Financial Instruments: Disclosure and Presentation* (revised in 2000), and should be applied for annual periods beginning on or after 1 January 2005. Earlier application is permitted. The Standard also replaces the following Interpretations and draft Interpretation:
- SIC-5 *Classification of Financial Instruments—Contingent Settlement Provisions*;
 - SIC-16 *Share Capital—Reacquired Own Equity Instruments (Treasury Shares)*;
 - SIC-17 *Equity—Costs of an Equity Transaction*; and
 - draft SIC-D34 *Financial Instruments—Instruments or Rights Redeemable by the Holder*.
- IN2 The International Accounting Standards Board developed this revised IAS 32 as part of its project to improve IAS 32 and IAS 39 *Financial Instruments: Recognition and Measurement*. The objective of the project was to reduce complexity by clarifying and adding guidance, eliminating internal inconsistencies and incorporating into the Standards elements of Standing Interpretations Committee (SIC) Interpretations and IAS 39 implementation guidance published by the Implementation Guidance Committee (IGC).
- IN3 For IAS 32, the Board's main objective was a limited revision to provide additional guidance on selected matters—such as the measurement of the components of a compound financial instrument on initial recognition, and the classification of derivatives based on an entity's own shares—and to locate all disclosures relating to financial instruments in one Standard.[†] The Board did not reconsider the fundamental approach to the presentation and disclosure of financial instruments contained in IAS 32.

The main changes

- IN4 The main changes from the previous version of IAS 32 are described below.

Scope

- IN5 The scope of IAS 32 has, where appropriate, been conformed to the scope of IAS 39.

^{*} This Introduction refers to IAS 32 as revised in December 2003. In August 2005 the IASB amended IAS 32 by relocating all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*.

[†] In August 2005 the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*.

Principle

- IN6 In summary, when an issuer determines whether a financial instrument is a financial liability or an equity instrument, the instrument is an equity instrument if, and only if, both conditions (a) and (b) are met.
- (a) The instrument includes no contractual obligation:
 - (i) to deliver cash or another financial asset to another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.
 - (b) If the instrument will or may be settled in the issuer's own equity instruments, it is:
 - (i) a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
 - (ii) a derivative that will be settled by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose, the issuer's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the issuer's own equity instruments.
- IN7 In addition, when an issuer has an obligation to purchase its own shares for cash or another financial asset, there is a liability for the amount that the issuer is obliged to pay.
- IN8 The definitions of a financial asset and a financial liability, and the description of an equity instrument, are amended consistently with this principle.

Classification of contracts settled in an entity's own equity instruments

- IN9 The classification of derivative and non-derivative contracts indexed to, or settled in, an entity's own equity instruments has been clarified consistently with the principle in paragraph IN6 above. In particular, when an entity uses its own equity instruments 'as currency' in a contract to receive or deliver a variable number of shares whose value equals a fixed amount or an amount based on changes in an underlying variable (eg a commodity price), the contract is not an equity instrument, but is a financial asset or a financial liability.

Puttable instruments

- IN10 IAS 32 incorporates the guidance previously proposed in draft SIC Interpretation 34 *Financial Instruments—Instruments or Rights Redeemable by the Holder*. Consequently, a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset (a 'puttable instrument') is a financial liability of the issuer. In response to comments received on the Exposure Draft, the Standard provides additional guidance and illustrative examples for entities that, because of this requirement, have no equity or whose share capital is not equity as defined in IAS 32.

Contingent settlement provisions

- IN11 IAS 32 incorporates the conclusion previously in SIC-5 *Classification of Financial Instruments—Contingent Settlement Provisions* that a financial instrument is a financial liability when the manner of settlement depends on the occurrence or non-occurrence of uncertain future events or on the outcome of uncertain circumstances that are beyond the control of both the issuer and the holder. Contingent settlement provisions are ignored when they apply only in the event of liquidation of the issuer or are not genuine.

Settlement options

- IN12 Under IAS 32, a derivative financial instrument is a financial asset or a financial liability when it gives one of the parties to it a choice of how it is settled unless all of the settlement alternatives would result in it being an equity instrument.

Measurement of the components of a compound financial instrument on initial recognition

- IN13 The revisions eliminate the option previously in IAS 32 to measure the liability component of a compound financial instrument on initial recognition either as a residual amount after separating the equity component, or by using a relative-fair-value method. Thus, any asset and liability components are separated first and the residual is the amount of any equity component. These requirements for separating the liability and equity components of a compound financial instrument are conformed to both the definition of an equity instrument as a residual and the measurement requirements in IAS 39.

Treasury shares

- IN14 IAS 32 incorporates the conclusion previously in SIC-16 *Share Capital—Reacquired Own Equity Instruments (Treasury Shares)* that the acquisition or subsequent resale by an entity of its own equity instruments does not result in a gain or loss for the entity. Rather it represents a transfer between those holders of equity instruments who have given up their equity interest and those who continue to hold an equity instrument.

Interest, dividends, losses and gains

- IN15 IAS 32 incorporates the guidance previously in SIC-17 *Equity—Costs of an Equity Transaction*. Transaction costs incurred as a necessary part of completing an equity transaction are accounted for as part of that transaction and are deducted from equity.

Disclosure

- IN16–
IN19 [Deleted]
- IN19A In August 2005 the Board revised disclosures about financial instruments and relocated them to IFRS 7 *Financial Instruments: Disclosures*.

Withdrawal of other pronouncements

IN20 As a consequence of the revisions to this Standard, the Board withdrew the three Interpretations and one draft Interpretation of the former Standing Interpretations Committee noted in paragraph IN1.

Potential impact of proposals in exposure drafts

IN21 [Deleted]

International Accounting Standard 32

Financial Instruments: Presentation

Objective

- 1 [Deleted]
- 2 The objective of this Standard is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset.
- 3 The principles in this Standard complement the principles for recognising and measuring financial assets and financial liabilities in IAS 39 *Financial Instruments: Recognition and Measurement*, and for disclosing information about them in IFRS 7 *Financial Instruments: Disclosures*.

Scope

- 4 **This Standard shall be applied by all entities to all types of financial instruments except:**
 - (a) **those interests in subsidiaries, associates and joint ventures that are accounted for in accordance with IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates* or IAS 31 *Interests in Joint Ventures*. However, in some cases, IAS 27, IAS 28 or IAS 31 permits an entity to account for an interest in a subsidiary, associate or joint venture using IAS 39; in those cases, entities shall apply the disclosure requirements in IAS 27, IAS 28 or IAS 31 in addition to those in this Standard. Entities shall also apply this Standard to all derivatives linked to interests in subsidiaries, associates or joint ventures.**
 - (b) **employers' rights and obligations under employee benefit plans, to which IAS 19 *Employee Benefits* applies.**
 - (c) [deleted]
 - (d) **insurance contracts as defined in IFRS 4 *Insurance Contracts*. However, this Standard applies to derivatives that are embedded in insurance contracts if IAS 39 requires the entity to account for them separately. Moreover, an issuer shall apply this Standard to financial guarantee contracts if the issuer applies IAS 39 in recognising and measuring the contracts, but shall apply IFRS 4 if the issuer elects, in accordance with paragraph 4(d) of IFRS 4, to apply IFRS 4 in recognising and measuring them.**
 - (e) **financial instruments that are within the scope of IFRS 4 because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 15-32 and AG25-AG35 of this Standard regarding the distinction between**

financial liabilities and equity instruments. However, these instruments are subject to all other requirements of this Standard. Furthermore, this Standard applies to derivatives that are embedded in these instruments (see IAS 39).

- (f) financial instruments, contracts and obligations under share-based payment transactions to which IFRS 2 *Share-based Payment* applies, except for**
 - (i) contracts within the scope of paragraphs 8–10 of this Standard, to which this Standard applies,**
 - (ii) paragraphs 33 and 34 of this Standard, which shall be applied to treasury shares purchased, sold, issued or cancelled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements.**

5–7 [Deleted]

8 This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

9 There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:

- (a) when the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;
- (b) when the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument, or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);
- (c) when, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and
- (d) when the non-financial item that is the subject of the contract is readily convertible to cash.

A contract to which (b) or (c) applies is not entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements, and, accordingly, is within the scope of this Standard. Other contracts to which paragraph 8 applies are

evaluated to determine whether they were entered into and continue to be held for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirement, and accordingly, whether they are within the scope of this Standard.

- 10 A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, in accordance with paragraph 9(a) or (d) is within the scope of this Standard. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

Definitions (see also paragraphs AG3–AG23)

- 11 The following terms are used in this Standard with the meanings specified:

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

A financial asset is any asset that is:

- (a) cash;
- (b) an equity instrument of another entity;
- (c) a contractual right:
 - (i) to receive cash or another financial asset from another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
- (d) a contract that will or may be settled in the entity's own equity instruments and is:
 - (i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
 - (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

A financial liability is any liability that is:

- (a) a contractual obligation :
 - (i) to deliver cash or another financial asset to another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or

- (b) **a contract that will or may be settled in the entity's own equity instruments and is:**
- (i) **a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or**
 - (ii) **a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.**

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

12 The following terms are defined in paragraph 9 of IAS 39 and are used in this Standard with the meaning specified in IAS 39.

- amortised cost of a financial asset or financial liability
- available-for-sale financial assets
- derecognition
- derivative
- effective interest method
- financial asset or financial liability at fair value through profit or loss
- financial guarantee contract
- firm commitment
- forecast transaction
- hedge effectiveness
- hedged item
- hedging instrument
- held-to-maturity investments
- loans and receivables
- regular way purchase or sale
- transaction costs.

13 In this Standard, 'contract' and 'contractual' refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing.

- 14 In this Standard, 'entity' includes individuals, partnerships, incorporated bodies, trusts and government agencies.

Presentation

Liabilities and equity (see also paragraphs AG25–AG29)

- 15 **The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.**
- 16 When an issuer applies the definitions in paragraph 11 to determine whether a financial instrument is an equity instrument rather than a financial liability, the instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met.
- (a) The instrument includes no contractual obligation:
 - (i) to deliver cash or another financial asset to another entity; or
 - (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.
 - (b) If the instrument will or may be settled in the issuer's own equity instruments, it is:
 - (i) a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
 - (ii) a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose the issuer's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the issuer's own equity instruments.

A contractual obligation, including one arising from a derivative financial instrument, that will or may result in the future receipt or delivery of the issuer's own equity instruments, but does not meet conditions (a) and (b) above, is not an equity instrument.

No contractual obligation to deliver cash or another financial asset (paragraph 16(a))

- 17 A critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation of one party to the financial instrument (the issuer) either to deliver cash or another financial asset to the other party (the holder) or to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavourable to the issuer.

Although the holder of an equity instrument may be entitled to receive a pro rata share of any dividends or other distributions of equity, the issuer does not have a contractual obligation to make such distributions because it cannot be required to deliver cash or another financial asset to another party.

- 18 The substance of a financial instrument, rather than its legal form, governs its classification in the entity's statement of financial position. Substance and legal form are commonly consistent, but not always. Some financial instruments take the legal form of equity but are liabilities in substance and others may combine features associated with equity instruments and features associated with financial liabilities. For example:
- (a) a preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability.
 - (b) a financial instrument that gives the holder the right to put it back to the issuer for cash or another financial asset (a 'puttable instrument') is a financial liability. This is so even when the amount of cash or other financial assets is determined on the basis of an index or other item that has the potential to increase or decrease, or when the legal form of the puttable instrument gives the holder a right to a residual interest in the assets of an issuer. The existence of an option for the holder to put the instrument back to the issuer for cash or another financial asset means that the puttable instrument meets the definition of a financial liability. For example, open-ended mutual funds, unit trusts, partnerships and some co-operative entities may provide their unitholders or members with a right to redeem their interests in the issuer at any time for cash equal to their proportionate share of the asset value of the issuer. However, classification as a financial liability does not preclude the use of descriptors such as 'net asset value attributable to unitholders' and 'change in net asset value attributable to unitholders' in the financial statements of an entity that has no contributed equity (such as some mutual funds and unit trusts, see Illustrative Example 7) or the use of additional disclosure to show that total members' interests comprise items such as reserves that meet the definition of equity and puttable instruments that do not (see Illustrative Example 8).
- 19 If an entity does not have an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation, the obligation meets the definition of a financial liability. For example:
- (a) a restriction on the ability of an entity to satisfy a contractual obligation, such as lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, does not negate the entity's contractual obligation or the holder's contractual right under the instrument.
 - (b) a contractual obligation that is conditional on a counterparty exercising its right to redeem is a financial liability because the entity does not have the unconditional right to avoid delivering cash or another financial asset.

- 20 A financial instrument that does not explicitly establish a contractual obligation to deliver cash or another financial asset may establish an obligation indirectly through its terms and conditions. For example:
- (a) a financial instrument may contain a non-financial obligation that must be settled if, and only if, the entity fails to make distributions or to redeem the instrument. If the entity can avoid a transfer of cash or another financial asset only by settling the non-financial obligation, the financial instrument is a financial liability.
 - (b) a financial instrument is a financial liability if it provides that on settlement the entity will deliver either:
 - (i) cash or another financial asset; or
 - (ii) its own shares whose value is determined to exceed substantially the value of the cash or other financial asset.

Although the entity does not have an explicit contractual obligation to deliver cash or another financial asset, the value of the share settlement alternative is such that the entity will settle in cash. In any event, the holder has in substance been guaranteed receipt of an amount that is at least equal to the cash settlement option (see paragraph 21).

Settlement in the entity's own equity instruments (paragraph 16(b))

- 21 A contract is not an equity instrument solely because it may result in the receipt or delivery of the entity's own equity instruments. An entity may have a contractual right or obligation to receive or deliver a number of its own shares or other equity instruments that varies so that the fair value of the entity's own equity instruments to be received or delivered equals the amount of the contractual right or obligation. Such a contractual right or obligation may be for a fixed amount or an amount that fluctuates in part or in full in response to changes in a variable other than the market price of the entity's own equity instruments (eg an interest rate, a commodity price or a financial instrument price). Two examples are (a) a contract to deliver as many of the entity's own equity instruments as are equal in value to CU100,* and (b) a contract to deliver as many of the entity's own equity instruments as are equal in value to the value of 100 ounces of gold. Such a contract is a financial liability of the entity even though the entity must or can settle it by delivering its own equity instruments. It is not an equity instrument because the entity uses a variable number of its own equity instruments as a means to settle the contract. Accordingly, the contract does not evidence a residual interest in the entity's assets after deducting all of its liabilities.
- 22 A contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument. For example, an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed price or for a fixed stated principal amount of a bond is an equity instrument. Changes in the fair value of a contract arising from variations

* In this Standard, monetary amounts are denominated in 'currency units' (CU).

in market interest rates that do not affect the amount of cash or other financial assets to be paid or received, or the number of equity instruments to be received or delivered, on settlement of the contract do not preclude the contract from being an equity instrument. Any consideration received (such as the premium received for a written option or warrant on the entity's own shares) is added directly to equity. Any consideration paid (such as the premium paid for a purchased option) is deducted directly from equity. Changes in the fair value of an equity instrument are not recognised in the financial statements.

- 23 A contract that contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset gives rise to a financial liability for the present value of the redemption amount (for example, for the present value of the forward repurchase price, option exercise price or other redemption amount). This is the case even if the contract itself is an equity instrument. One example is an entity's obligation under a forward contract to purchase its own equity instruments for cash. When the financial liability is recognised initially under IAS 39, its fair value (the present value of the redemption amount) is reclassified from equity. Subsequently, the financial liability is measured in accordance with IAS 39. If the contract expires without delivery, the carrying amount of the financial liability is reclassified to equity. An entity's contractual obligation to purchase its own equity instruments gives rise to a financial liability for the present value of the redemption amount even if the obligation to purchase is conditional on the counterparty exercising a right to redeem (eg a written put option that gives the counterparty the right to sell an entity's own equity instruments to the entity for a fixed price).
- 24 A contract that will be settled by the entity delivering or receiving a fixed number of its own equity instruments in exchange for a variable amount of cash or another financial asset is a financial asset or financial liability. An example is a contract for the entity to deliver 100 of its own equity instruments in return for an amount of cash calculated to equal the value of 100 ounces of gold.

Contingent settlement provisions

- 25 A financial instrument may require the entity to deliver cash or another financial asset, or otherwise to settle it in such a way that it would be a financial liability, in the event of the occurrence or non-occurrence of uncertain future events (or on the outcome of uncertain circumstances) that are beyond the control of both the issuer and the holder of the instrument, such as a change in a stock market index, consumer price index, interest rate or taxation requirements, or the issuer's future revenues, net income or debt-to-equity ratio. The issuer of such an instrument does not have the unconditional right to avoid delivering cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability). Therefore, it is a financial liability of the issuer unless:
- (a) the part of the contingent settlement provision that could require settlement in cash or another financial asset (or otherwise in such a way that it would be a financial liability) is not genuine; or
 - (b) the issuer can be required to settle the obligation in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) only in the event of liquidation of the issuer.

Settlement options

- 26 **When a derivative financial instrument gives one party a choice over how it is settled (eg the issuer or the holder can choose settlement net in cash or by exchanging shares for cash), it is a financial asset or a financial liability unless all of the settlement alternatives would result in it being an equity instrument.**
- 27 An example of a derivative financial instrument with a settlement option that is a financial liability is a share option that the issuer can decide to settle net in cash or by exchanging its own shares for cash. Similarly, some contracts to buy or sell a non-financial item in exchange for the entity's own equity instruments are within the scope of this Standard because they can be settled either by delivery of the non-financial item or net in cash or another financial instrument (see paragraphs 8–10). Such contracts are financial assets or financial liabilities and not equity instruments.

Compound financial instruments (see also paragraphs AG30–AG35 and Illustrative Examples 9–12)

- 28 **The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a liability and an equity component. Such components shall be classified separately as financial liabilities, financial assets or equity instruments in accordance with paragraph 15.**
- 29 An entity recognises separately the components of a financial instrument that (a) creates a financial liability of the entity and (b) grants an option to the holder of the instrument to convert it into an equity instrument of the entity. For example, a bond or similar instrument convertible by the holder into a fixed number of ordinary shares of the entity is a compound financial instrument. From the perspective of the entity, such an instrument comprises two components: a financial liability (a contractual arrangement to deliver cash or another financial asset) and an equity instrument (a call option granting the holder the right, for a specified period of time, to convert it into a fixed number of ordinary shares of the entity). The economic effect of issuing such an instrument is substantially the same as issuing simultaneously a debt instrument with an early settlement provision and warrants to purchase ordinary shares, or issuing a debt instrument with detachable share purchase warrants. Accordingly, in all cases, the entity presents the liability and equity components separately in its statement of financial position.
- 30 Classification of the liability and equity components of a convertible instrument is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercise of the option may appear to have become economically advantageous to some holders. Holders may not always act in the way that might be expected because, for example, the tax consequences resulting from conversion may differ among holders. Furthermore, the likelihood of conversion will change from time to time. The entity's contractual obligation to make future payments remains outstanding until it is extinguished through conversion, maturity of the instrument or some other transaction.

- 31 IAS 39 deals with the measurement of financial assets and financial liabilities. Equity instruments are instruments that evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore, when the initial carrying amount of a compound financial instrument is allocated to its equity and liability components, the equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component. The value of any derivative features (such as a call option) embedded in the compound financial instrument other than the equity component (such as an equity conversion option) is included in the liability component. The sum of the carrying amounts assigned to the liability and equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole. No gain or loss arises from initially recognising the components of the instrument separately.
- 32 Under the approach described in paragraph 31, the issuer of a bond convertible into ordinary shares first determines the carrying amount of the liability component by measuring the fair value of a similar liability (including any embedded non-equity derivative features) that does not have an associated equity component. The carrying amount of the equity instrument represented by the option to convert the instrument into ordinary shares is then determined by deducting the fair value of the financial liability from the fair value of the compound financial instrument as a whole.

Treasury shares (see also paragraph AG36)

- 33 **If an entity reacquires its own equity instruments, those instruments ('treasury shares') shall be deducted from equity. No gain or loss shall be recognised in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments. Such treasury shares may be acquired and held by the entity or by other members of the consolidated group. Consideration paid or received shall be recognised directly in equity.**
- 34 The amount of treasury shares held is disclosed separately either in the statement of financial position or in the notes, in accordance with IAS 1 *Presentation of Financial Statements*. An entity provides disclosure in accordance with IAS 24 *Related Party Disclosures* if the entity reacquires its own equity instruments from related parties.

Interest, dividends, losses and gains (see also paragraph AG37)

- 35 **Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognised as income or expense in profit or loss. Distributions to holders of an equity instrument shall be debited by the entity directly to equity, net of any related income tax benefit. Transaction costs of an equity transaction shall be accounted for as a deduction from equity, net of any related income tax benefit.**
- 36 The classification of a financial instrument as a financial liability or an equity instrument determines whether interest, dividends, losses and gains relating to that instrument are recognised as income or expense in profit or loss. Thus, dividend payments on shares wholly recognised as liabilities are recognised as

expenses in the same way as interest on a bond. Similarly, gains and losses associated with redemptions or refinancings of financial liabilities are recognised in profit or loss, whereas redemptions or refinancings of equity instruments are recognised as changes in equity. Changes in the fair value of an equity instrument are not recognised in the financial statements.

- 37 An entity typically incurs various costs in issuing or acquiring its own equity instruments. Those costs might include registration and other regulatory fees, amounts paid to legal, accounting and other professional advisers, printing costs and stamp duties. The transaction costs of an equity transaction are accounted for as a deduction from equity (net of any related income tax benefit) to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided. The costs of an equity transaction that is abandoned are recognised as an expense.
- 38 Transaction costs that relate to the issue of a compound financial instrument are allocated to the liability and equity components of the instrument in proportion to the allocation of proceeds. Transaction costs that relate jointly to more than one transaction (for example, costs of a concurrent offering of some shares and a stock exchange listing of other shares) are allocated to those transactions using a basis of allocation that is rational and consistent with similar transactions.
- 39 The amount of transaction costs accounted for as a deduction from equity in the period is disclosed separately under IAS 1. The related amount of income taxes recognised directly in equity is included in the aggregate amount of current and deferred income tax credited or charged to equity that is disclosed under IAS 12 *Income Taxes*.
- 40 Dividends classified as an expense may be presented in the statement of comprehensive income or separate income statement (if presented) either with interest on other liabilities or as a separate item. In addition to the requirements of this Standard, disclosure of interest and dividends is subject to the requirements of IAS 1 and IFRS 7. In some circumstances, because of the differences between interest and dividends with respect to matters such as tax deductibility, it is desirable to disclose them separately in the statement of comprehensive income or separate income statement (if presented). Disclosures of the tax effects are made in accordance with IAS 12.
- 41 Gains and losses related to changes in the carrying amount of a financial liability are recognised as income or expense in profit or loss even when they relate to an instrument that includes a right to the residual interest in the assets of the entity in exchange for cash or another financial asset (see paragraph 18(b)). Under IAS 1 the entity presents any gain or loss arising from remeasurement of such an instrument separately in the statement of comprehensive income when it is relevant in explaining the entity's performance.

**Offsetting a financial asset and a financial liability
(see also paragraphs AG38 and AG39)**

42 **A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:**

- (a) **currently has a legally enforceable right to set off the recognised amounts; and**
- (b) **intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.**

In accounting for a transfer of a financial asset that does not qualify for derecognition, the entity shall not offset the transferred asset and the associated liability (see IAS 39, paragraph 36).

43 This Standard requires the presentation of financial assets and financial liabilities on a net basis when doing so reflects an entity's expected future cash flows from settling two or more separate financial instruments. When an entity has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single financial asset or financial liability. In other circumstances, financial assets and financial liabilities are presented separately from each other consistently with their characteristics as resources or obligations of the entity.

44 Offsetting a recognised financial asset and a recognised financial liability and presenting the net amount differs from the derecognition of a financial asset or a financial liability. Although offsetting does not give rise to recognition of a gain or loss, the derecognition of a financial instrument not only results in the removal of the previously recognised item from the statement of financial position but also may result in recognition of a gain or loss.

45 A right of set-off is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor provided that there is an agreement between the three parties that clearly establishes the debtor's right of set-off. Because the right of set-off is a legal right, the conditions supporting the right may vary from one legal jurisdiction to another and the laws applicable to the relationships between the parties need to be considered.

46 The existence of an enforceable right to set off a financial asset and a financial liability affects the rights and obligations associated with a financial asset and a financial liability and may affect an entity's exposure to credit and liquidity risk. However, the existence of the right, by itself, is not a sufficient basis for offsetting. In the absence of an intention to exercise the right or to settle simultaneously, the amount and timing of an entity's future cash flows are not affected. When an entity intends to exercise the right or to settle simultaneously, presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows, as well as the risks to which those cash flows are exposed. An intention by one or both parties to settle on a net basis without the legal right to do so is not sufficient to justify offsetting because the rights and obligations associated with the individual financial asset and financial liability remain unaltered.

- 47 An entity's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal business practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net or to settle simultaneously. When an entity has a right of set-off, but does not intend to settle net or to realise the asset and settle the liability simultaneously, the effect of the right on the entity's credit risk exposure is disclosed in accordance with paragraph 36 of IFRS 7.
- 48 Simultaneous settlement of two financial instruments may occur through, for example, the operation of a clearing house in an organised financial market or a face-to-face exchange. In these circumstances the cash flows are, in effect, equivalent to a single net amount and there is no exposure to credit or liquidity risk. In other circumstances, an entity may settle two instruments by receiving and paying separate amounts, becoming exposed to credit risk for the full amount of the asset or liquidity risk for the full amount of the liability. Such risk exposures may be significant even though relatively brief. Accordingly, realisation of a financial asset and settlement of a financial liability are treated as simultaneous only when the transactions occur at the same moment.
- 49 The conditions set out in paragraph 42 are generally not satisfied and offsetting is usually inappropriate when:
- (a) several different financial instruments are used to emulate the features of a single financial instrument (a 'synthetic instrument');
 - (b) financial assets and financial liabilities arise from financial instruments having the same primary risk exposure (for example, assets and liabilities within a portfolio of forward contracts or other derivative instruments) but involve different counterparties;
 - (c) financial or other assets are pledged as collateral for non-recourse financial liabilities;
 - (d) financial assets are set aside in trust by a debtor for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation (for example, a sinking fund arrangement); or
 - (e) obligations incurred as a result of events giving rise to losses are expected to be recovered from a third party by virtue of a claim made under an insurance contract.
- 50 An entity that undertakes a number of financial instrument transactions with a single counterparty may enter into a 'master netting arrangement' with that counterparty. Such an agreement provides for a single net settlement of all financial instruments covered by the agreement in the event of default on, or termination of, any one contract. These arrangements are commonly used by financial institutions to provide protection against loss in the event of bankruptcy or other circumstances that result in a counterparty being unable to meet its obligations. A master netting arrangement commonly creates a right of set-off that becomes enforceable and affects the realisation or settlement of individual financial assets and financial liabilities only following a specified event of default or in other circumstances not expected to arise in the normal course of business. A master netting arrangement does not provide a basis for

offsetting unless both of the criteria in paragraph 42 are satisfied. When financial assets and financial liabilities subject to a master netting arrangement are not offset, the effect of the arrangement on an entity's exposure to credit risk is disclosed in accordance with paragraph 36 of IFRS 7.

Disclosure

51–95 [Deleted]

Effective date

- 96 An entity shall apply this Standard for annual periods beginning on or after 1 January 2005. Earlier application is permitted. An entity shall not apply this Standard for annual periods beginning before 1 January 2005 unless it also applies IAS 39 (issued December 2003), including the amendments issued in March 2004. If an entity applies this Standard for a period beginning before 1 January 2005, it shall disclose that fact.
- 97 This Standard shall be applied retrospectively.
- 97A IAS 1 (as revised in 2007) amended the terminology used throughout IFRSs. In addition it amended paragraph 40. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies IAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.
- 97B IFRS 3 (as revised in 2008) deleted paragraph 4(c). An entity shall apply that amendment for annual periods beginning on or after 1 July 2009. If an entity applies IFRS 3 (revised 2008) for an earlier period, the amendment shall also be applied for that earlier period.

Withdrawal of other pronouncements

- 98 This Standard supersedes IAS 32 *Financial Instruments: Disclosure and Presentation* revised in 2000.*
- 99 This Standard supersedes the following Interpretations:
- (a) SIC-5 *Classification of Financial Instruments—Contingent Settlement Provisions*;
 - (b) SIC-16 *Share Capital—Reacquired Own Equity Instruments (Treasury Shares)*; and
 - (c) SIC-17 *Equity—Costs of an Equity Transaction*.
- 100 This Standard withdraws draft SIC Interpretation D34 *Financial Instruments—Instruments or Rights Redeemable by the Holder*.

* In August 2005 the IASB relocated all disclosures relating to financial instruments to IFRS 7 *Financial Instruments: Disclosures*.

Appendix

Application Guidance

IAS 32 *Financial Instruments: Presentation*

This appendix is an integral part of the Standard.

- AG1 This Application Guidance explains the application of particular aspects of the Standard.
- AG2 The Standard does not deal with the recognition or measurement of financial instruments. Requirements about the recognition and measurement of financial assets and financial liabilities are set out in IAS 39.

Definitions (paragraphs 11–14)

Financial assets and financial liabilities

- AG3 Currency (cash) is a financial asset because it represents the medium of exchange and is therefore the basis on which all transactions are measured and recognised in financial statements. A deposit of cash with a bank or similar financial institution is a financial asset because it represents the contractual right of the depositor to obtain cash from the institution or to draw a cheque or similar instrument against the balance in favour of a creditor in payment of a financial liability.
- AG4 Common examples of financial assets representing a contractual right to receive cash in the future and corresponding financial liabilities representing a contractual obligation to deliver cash in the future are:
- (a) trade accounts receivable and payable;
 - (b) notes receivable and payable;
 - (c) loans receivable and payable; and
 - (d) bonds receivable and payable.
- In each case, one party's contractual right to receive (or obligation to pay) cash is matched by the other party's corresponding obligation to pay (or right to receive).
- AG5 Another type of financial instrument is one for which the economic benefit to be received or given up is a financial asset other than cash. For example, a note payable in government bonds gives the holder the contractual right to receive and the issuer the contractual obligation to deliver government bonds, not cash. The bonds are financial assets because they represent obligations of the issuing government to pay cash. The note is, therefore, a financial asset of the note holder and a financial liability of the note issuer.
- AG6 'Perpetual' debt instruments (such as 'perpetual' bonds, debentures and capital notes) normally provide the holder with the contractual right to receive payments on account of interest at fixed dates extending into the indefinite future, either with no right to receive a return of principal or a right to a return of principal under terms that make it very unlikely or very far in the future. For example,

an entity may issue a financial instrument requiring it to make annual payments in perpetuity equal to a stated interest rate of 8 per cent applied to a stated par or principal amount of CU1,000.* Assuming 8 per cent to be the market rate of interest for the instrument when issued, the issuer assumes a contractual obligation to make a stream of future interest payments having a fair value (present value) of CU1,000 on initial recognition. The holder and issuer of the instrument have a financial asset and a financial liability, respectively.

- AG7 A contractual right or contractual obligation to receive, deliver or exchange financial instruments is itself a financial instrument. A chain of contractual rights or contractual obligations meets the definition of a financial instrument if it will ultimately lead to the receipt or payment of cash or to the acquisition or issue of an equity instrument.
- AG8 The ability to exercise a contractual right or the requirement to satisfy a contractual obligation may be absolute, or it may be contingent on the occurrence of a future event. For example, a financial guarantee is a contractual right of the lender to receive cash from the guarantor, and a corresponding contractual obligation of the guarantor to pay the lender, if the borrower defaults. The contractual right and obligation exist because of a past transaction or event (assumption of the guarantee), even though the lender's ability to exercise its right and the requirement for the guarantor to perform under its obligation are both contingent on a future act of default by the borrower. A contingent right and obligation meet the definition of a financial asset and a financial liability, even though such assets and liabilities are not always recognised in the financial statements. Some of these contingent rights and obligations may be insurance contracts within the scope of IFRS 4.
- AG9 Under IAS 17 *Leases* a finance lease is regarded as primarily an entitlement of the lessor to receive, and an obligation of the lessee to pay, a stream of payments that are substantially the same as blended payments of principal and interest under a loan agreement. The lessor accounts for its investment in the amount receivable under the lease contract rather than the leased asset itself. An operating lease, on the other hand, is regarded as primarily an uncompleted contract committing the lessor to provide the use of an asset in future periods in exchange for consideration similar to a fee for a service. The lessor continues to account for the leased asset itself rather than any amount receivable in the future under the contract. Accordingly, a finance lease is regarded as a financial instrument and an operating lease is not regarded as a financial instrument (except as regards individual payments currently due and payable).
- AG10 Physical assets (such as inventories, property, plant and equipment), leased assets and intangible assets (such as patents and trademarks) are not financial assets. Control of such physical and intangible assets creates an opportunity to generate an inflow of cash or another financial asset, but it does not give rise to a present right to receive cash or another financial asset.

* In this guidance, monetary amounts are denominated in 'currency units' (CU).

- AG11 Assets (such as prepaid expenses) for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets. Similarly, items such as deferred revenue and most warranty obligations are not financial liabilities because the outflow of economic benefits associated with them is the delivery of goods and services rather than a contractual obligation to pay cash or another financial asset.
- AG12 Liabilities or assets that are not contractual (such as income taxes that are created as a result of statutory requirements imposed by governments) are not financial liabilities or financial assets. Accounting for income taxes is dealt with in IAS 12. Similarly, constructive obligations, as defined in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, do not arise from contracts and are not financial liabilities.

Equity instruments

- AG13 Examples of equity instruments include non-puttable ordinary shares, some types of preference shares (see paragraphs AG25 and AG26), and warrants or written call options that allow the holder to subscribe for or purchase a fixed number of non-puttable ordinary shares in the issuing entity in exchange for a fixed amount of cash or another financial asset. An entity's obligation to issue or purchase a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument of the entity. However, if such a contract contains an obligation for the entity to pay cash or another financial asset, it also gives rise to a liability for the present value of the redemption amount (see paragraph AG27(a)). An issuer of non-puttable ordinary shares assumes a liability when it formally acts to make a distribution and becomes legally obligated to the shareholders to do so. This may be the case following the declaration of a dividend or when the entity is being wound up and any assets remaining after the satisfaction of liabilities become distributable to shareholders.
- AG14 A purchased call option or other similar contract acquired by an entity that gives it the right to reacquire a fixed number of its own equity instruments in exchange for delivering a fixed amount of cash or another financial asset is not a financial asset of the entity. Instead, any consideration paid for such a contract is deducted from equity.

Derivative financial instruments

- AG15 Financial instruments include primary instruments (such as receivables, payables and equity instruments) and derivative financial instruments (such as financial options, futures and forwards, interest rate swaps and currency swaps). Derivative financial instruments meet the definition of a financial instrument and, accordingly, are within the scope of this Standard.
- AG16 Derivative financial instruments create rights and obligations that have the effect of transferring between the parties to the instrument one or more of the financial risks inherent in an underlying primary financial instrument. On inception, derivative financial instruments give one party a contractual right to exchange financial assets or financial liabilities with another party under conditions that are potentially favourable, or a contractual obligation to exchange financial

assets or financial liabilities with another party under conditions that are potentially unfavourable. However, they generally* do not result in a transfer of the underlying primary financial instrument on inception of the contract, nor does such a transfer necessarily take place on maturity of the contract. Some instruments embody both a right and an obligation to make an exchange. Because the terms of the exchange are determined on inception of the derivative instrument, as prices in financial markets change those terms may become either favourable or unfavourable.

- AG17 A put or call option to exchange financial assets or financial liabilities (ie financial instruments other than an entity's own equity instruments) gives the holder a right to obtain potential future economic benefits associated with changes in the fair value of the financial instrument underlying the contract. Conversely, the writer of an option assumes an obligation to forgo potential future economic benefits or bear potential losses of economic benefits associated with changes in the fair value of the underlying financial instrument. The contractual right of the holder and obligation of the writer meet the definition of a financial asset and a financial liability, respectively. The financial instrument underlying an option contract may be any financial asset, including shares in other entities and interest-bearing instruments. An option may require the writer to issue a debt instrument, rather than transfer a financial asset, but the instrument underlying the option would constitute a financial asset of the holder if the option were exercised. The option-holder's right to exchange the financial asset under potentially favourable conditions and the writer's obligation to exchange the financial asset under potentially unfavourable conditions are distinct from the underlying financial asset to be exchanged upon exercise of the option. The nature of the holder's right and of the writer's obligation are not affected by the likelihood that the option will be exercised.
- AG18 Another example of a derivative financial instrument is a forward contract to be settled in six months' time in which one party (the purchaser) promises to deliver CU1,000,000 cash in exchange for CU1,000,000 face amount of fixed rate government bonds, and the other party (the seller) promises to deliver CU1,000,000 face amount of fixed rate government bonds in exchange for CU1,000,000 cash. During the six months, both parties have a contractual right and a contractual obligation to exchange financial instruments. If the market price of the government bonds rises above CU1,000,000, the conditions will be favourable to the purchaser and unfavourable to the seller; if the market price falls below CU1,000,000, the effect will be the opposite. The purchaser has a contractual right (a financial asset) similar to the right under a call option held and a contractual obligation (a financial liability) similar to the obligation under a put option written; the seller has a contractual right (a financial asset) similar to the right under a put option held and a contractual obligation (a financial liability) similar to the obligation under a call option written. As with options, these contractual rights and obligations constitute financial assets and financial

* This is true of most, but not all derivatives, eg in some cross-currency interest rate swaps principal is exchanged on inception (and re-exchanged on maturity).

liabilities separate and distinct from the underlying financial instruments (the bonds and cash to be exchanged). Both parties to a forward contract have an obligation to perform at the agreed time, whereas performance under an option contract occurs only if and when the holder of the option chooses to exercise it.

- AG19 Many other types of derivative instruments embody a right or obligation to make a future exchange, including interest rate and currency swaps, interest rate caps, collars and floors, loan commitments, note issuance facilities and letters of credit. An interest rate swap contract may be viewed as a variation of a forward contract in which the parties agree to make a series of future exchanges of cash amounts, one amount calculated with reference to a floating interest rate and the other with reference to a fixed interest rate. Futures contracts are another variation of forward contracts, differing primarily in that the contracts are standardised and traded on an exchange.

Contracts to buy or sell non-financial items (paragraphs 8–10)

- AG20 Contracts to buy or sell non-financial items do not meet the definition of a financial instrument because the contractual right of one party to receive a non-financial asset or service and the corresponding obligation of the other party do not establish a present right or obligation of either party to receive, deliver or exchange a financial asset. For example, contracts that provide for settlement only by the receipt or delivery of a non-financial item (eg an option, futures or forward contract on silver) are not financial instruments. Many commodity contracts are of this type. Some are standardised in form and traded on organised markets in much the same fashion as some derivative financial instruments. For example, a commodity futures contract may be bought and sold readily for cash because it is listed for trading on an exchange and may change hands many times. However, the parties buying and selling the contract are, in effect, trading the underlying commodity. The ability to buy or sell a commodity contract for cash, the ease with which it may be bought or sold and the possibility of negotiating a cash settlement of the obligation to receive or deliver the commodity do not alter the fundamental character of the contract in a way that creates a financial instrument. Nevertheless, some contracts to buy or sell non-financial items that can be settled net or by exchanging financial instruments, or in which the non-financial item is readily convertible to cash, are within the scope of the Standard as if they were financial instruments (see paragraph 8).
- AG21 A contract that involves the receipt or delivery of physical assets does not give rise to a financial asset of one party and a financial liability of the other party unless any corresponding payment is deferred past the date on which the physical assets are transferred. Such is the case with the purchase or sale of goods on trade credit.
- AG22 Some contracts are commodity-linked, but do not involve settlement through the physical receipt or delivery of a commodity. They specify settlement through cash payments that are determined according to a formula in the contract, rather than through payment of fixed amounts. For example, the principal amount of a bond

may be calculated by applying the market price of oil prevailing at the maturity of the bond to a fixed quantity of oil. The principal is indexed by reference to a commodity price, but is settled only in cash. Such a contract constitutes a financial instrument.

- AG23 The definition of a financial instrument also encompasses a contract that gives rise to a non-financial asset or non-financial liability in addition to a financial asset or financial liability. Such financial instruments often give one party an option to exchange a financial asset for a non-financial asset. For example, an oil-linked bond may give the holder the right to receive a stream of fixed periodic interest payments and a fixed amount of cash on maturity, with the option to exchange the principal amount for a fixed quantity of oil. The desirability of exercising this option will vary from time to time depending on the fair value of oil relative to the exchange ratio of cash for oil (the exchange price) inherent in the bond. The intentions of the bondholder concerning the exercise of the option do not affect the substance of the component assets. The financial asset of the holder and the financial liability of the issuer make the bond a financial instrument, regardless of the other types of assets and liabilities also created.

- AG24 [Deleted]

Presentation

Liabilities and equity (paragraphs 15–27)

No contractual obligation to deliver cash or another financial asset (paragraphs 17–20)

- AG25 Preference shares may be issued with various rights. In determining whether a preference share is a financial liability or an equity instrument, an issuer assesses the particular rights attaching to the share to determine whether it exhibits the fundamental characteristic of a financial liability. For example, a preference share that provides for redemption on a specific date or at the option of the holder contains a financial liability because the issuer has an obligation to transfer financial assets to the holder of the share. The potential inability of an issuer to satisfy an obligation to redeem a preference share when contractually required to do so, whether because of a lack of funds, a statutory restriction or insufficient profits or reserves, does not negate the obligation. An option of the issuer to redeem the shares for cash does not satisfy the definition of a financial liability because the issuer does not have a present obligation to transfer financial assets to the shareholders. In this case, redemption of the shares is solely at the discretion of the issuer. An obligation may arise, however, when the issuer of the shares exercises its option, usually by formally notifying the shareholders of an intention to redeem the shares.
- AG26 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.

**Settlement in the entity's own equity instruments
(paragraphs 21–24)**

AG27 The following examples illustrate how to classify different types of contracts on an entity's own equity instruments:

- (a) A contract that will be settled by the entity receiving or delivering a fixed number of its own shares for no future consideration, or exchanging a fixed number of its own shares for a fixed amount of cash or another financial asset, is an equity instrument. Accordingly, any consideration received or paid for such a contract is added directly to or deducted directly from equity. One example is an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed amount of cash. However, if the contract requires the entity to purchase (redeem) its own shares for cash or another financial asset at a fixed or determinable date or on demand, the entity also recognises a financial liability for the present value of the redemption amount. One example is an entity's obligation under a forward contract to repurchase a fixed number of its own shares for a fixed amount of cash.
- (b) An entity's obligation to purchase its own shares for cash gives rise to a financial liability for the present value of the redemption amount even if the number of shares that the entity is obliged to repurchase is not fixed or if the obligation is conditional on the counterparty exercising a right to redeem. One example of a conditional obligation is an issued option that requires the entity to repurchase its own shares for cash if the counterparty exercises the option.
- (c) A contract that will be settled in cash or another financial asset is a financial asset or financial liability even if the amount of cash or another financial asset that will be received or delivered is based on changes in the market price of the entity's own equity. One example is a net cash-settled share option.

- (d) A contract that will be settled in a variable number of the entity's own shares whose value equals a fixed amount or an amount based on changes in an underlying variable (eg a commodity price) is a financial asset or a financial liability. An example is a written option to buy gold that, if exercised, is settled net in the entity's own instruments by the entity delivering as many of those instruments as are equal to the value of the option contract. Such a contract is a financial asset or financial liability even if the underlying variable is the entity's own share price rather than gold. Similarly, a contract that will be settled in a fixed number of the entity's own shares, but the rights attaching to those shares will be varied so that the settlement value equals a fixed amount or an amount based on changes in an underlying variable, is a financial asset or a financial liability.

Contingent settlement provisions (paragraph 25)

- AG28 Paragraph 25 requires that if a part of a contingent settlement provision that could require settlement in cash or another financial asset (or in another way that would result in the instrument being a financial liability) is not genuine, the settlement provision does not affect the classification of a financial instrument. Thus, a contract that requires settlement in cash or a variable number of the entity's own shares only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur is an equity instrument. Similarly, settlement in a fixed number of an entity's own shares may be contractually precluded in circumstances that are outside the control of the entity, but if these circumstances have no genuine possibility of occurring, classification as an equity instrument is appropriate.

Treatment in consolidated financial statements

- AG29 In consolidated financial statements, an entity presents non-controlling interests—ie the interests of other parties in the equity and income of its subsidiaries—in accordance with IAS 1 and IAS 27. When classifying a financial instrument (or a component of it) in consolidated financial statements, an entity considers all terms and conditions agreed between members of the group and the holders of the instrument in determining whether the group as a whole has an obligation to deliver cash or another financial asset in respect of the instrument or to settle it in a manner that results in liability classification. When a subsidiary in a group issues a financial instrument and a parent or other group entity agrees additional terms directly with the holders of the instrument (eg a guarantee), the group may not have discretion over distributions or redemption. Although the subsidiary may appropriately classify the instrument without regard to these additional terms in its individual financial statements, the effect of other agreements between members of the group and the holders of the instrument is considered in order to ensure that consolidated financial statements reflect the contracts and transactions entered into by the group as a whole. To the extent that there is such an obligation or settlement provision, the instrument (or the component of it that is subject to the obligation) is classified as a financial liability in consolidated financial statements.

Compound financial instruments (paragraphs 28–32)

- AG30 Paragraph 28 applies only to issuers of non-derivative compound financial instruments. Paragraph 28 does not deal with compound financial instruments from the perspective of holders. IAS 39 deals with the separation of embedded derivatives from the perspective of holders of compound financial instruments that contain debt and equity features.
- AG31 A common form of compound financial instrument is a debt instrument with an embedded conversion option, such as a bond convertible into ordinary shares of the issuer, and without any other embedded derivative features. Paragraph 28 requires the issuer of such a financial instrument to present the liability component and the equity component separately in the statement of financial position, as follows:
- (a) The issuer's obligation to make scheduled payments of interest and principal is a financial liability that exists as long as the instrument is not converted. On initial recognition, the fair value of the liability component is the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied at that time by the market to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option.
 - (b) The equity instrument is an embedded option to convert the liability into equity of the issuer. The fair value of the option comprises its time value and its intrinsic value, if any. This option has value on initial recognition even when it is out of the money.
- AG32 On conversion of a convertible instrument at maturity, the entity derecognises the liability component and recognises it as equity. The original equity component remains as equity (although it may be transferred from one line item within equity to another). There is no gain or loss on conversion at maturity.
- AG33 When an entity extinguishes a convertible instrument before maturity through an early redemption or repurchase in which the original conversion privileges are unchanged, the entity allocates the consideration paid and any transaction costs for the repurchase or redemption to the liability and equity components of the instrument at the date of the transaction. The method used in allocating the consideration paid and transaction costs to the separate components is consistent with that used in the original allocation to the separate components of the proceeds received by the entity when the convertible instrument was issued, in accordance with paragraphs 28–32.
- AG34 Once the allocation of the consideration is made, any resulting gain or loss is treated in accordance with accounting principles applicable to the related component, as follows:
- (a) the amount of gain or loss relating to the liability component is recognised in profit or loss; and
 - (b) the amount of consideration relating to the equity component is recognised in equity.

- AG35 An entity may amend the terms of a convertible instrument to induce early conversion, for example by offering a more favourable conversion ratio or paying other additional consideration in the event of conversion before a specified date. The difference, at the date the terms are amended, between the fair value of the consideration the holder receives on conversion of the instrument under the revised terms and the fair value of the consideration the holder would have received under the original terms is recognised as a loss in profit or loss.

Treasury shares (paragraphs 33 and 34)

- AG36 An entity's own equity instruments are not recognised as a financial asset regardless of the reason for which they are reacquired. Paragraph 33 requires an entity that reacquires its own equity instruments to deduct those equity instruments from equity. However, when an entity holds its own equity on behalf of others, eg a financial institution holding its own equity on behalf of a client, there is an agency relationship and as a result those holdings are not included in the entity's statement of financial position.

Interest, dividends, losses and gains (paragraphs 35–41)

- AG37 The following example illustrates the application of paragraph 35 to a compound financial instrument. Assume that a non-cumulative preference share is mandatorily redeemable for cash in five years, but that dividends are payable at the discretion of the entity before the redemption date. Such an instrument is a compound financial instrument, with the liability component being the present value of the redemption amount. The unwinding of the discount on this component is recognised in profit or loss and classified as interest expense. Any dividends paid relate to the equity component and, accordingly, are recognised as a distribution of profit or loss. A similar treatment would apply if the redemption was not mandatory but at the option of the holder, or if the share was mandatorily convertible into a variable number of ordinary shares calculated to equal a fixed amount or an amount based on changes in an underlying variable (eg commodity). However, if any unpaid dividends are added to the redemption amount, the entire instrument is a liability. In such a case, any dividends are classified as interest expense.

Offsetting a financial asset and a financial liability (paragraphs 42–50)

- AG38 To offset a financial asset and a financial liability, an entity must have a currently enforceable legal right to set off the recognised amounts. An entity may have a conditional right to set off recognised amounts, such as in a master netting agreement or in some forms of non-recourse debt, but such rights are enforceable only on the occurrence of some future event, usually a default of the counterparty. Thus, such an arrangement does not meet the conditions for offset.
- AG39 The Standard does not provide special treatment for so-called 'synthetic instruments', which are groups of separate financial instruments acquired and held to emulate the characteristics of another instrument. For example, a floating rate long-term debt combined with an interest rate swap that involves receiving floating payments and making fixed payments synthesises a fixed rate

long-term debt. Each of the individual financial instruments that together constitute a 'synthetic instrument' represents a contractual right or obligation with its own terms and conditions and each may be transferred or settled separately. Each financial instrument is exposed to risks that may differ from the risks to which other financial instruments are exposed. Accordingly, when one financial instrument in a 'synthetic instrument' is an asset and another is a liability, they are not offset and presented in an entity's statement of financial position on a net basis unless they meet the criteria for offsetting in paragraph 42.

Disclosure

Financial assets and financial liabilities at fair value through profit or loss (paragraph 94(f))

AG40 [Deleted]

Approval of IAS 32 by the Board

International Accounting Standard 32 *Financial Instruments: Disclosure and Presentation* was approved for issue by thirteen of the fourteen members of the International Accounting Standards Board. Mr Leisenring dissented. His dissenting opinion is set out after the Basis for Conclusions.

Sir David Tweedie	Chairman
Thomas E Jones	Vice-Chairman
Mary E Barth	
Hans-Georg Bruns	
Anthony T Cope	
Robert P Garnett	
Gilbert G��lard	
James J Leisenring	
Warren J McGregor	
Patricia L O'Malley	
Harry K Schmid	
John T Smith	
Geoffrey Whittington	
Tatsumi Yamada	

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Basis for Conclusions on IAS 32 *Financial Instruments: Presentation*

This Basis for Conclusions accompanies, but is not part of, IAS 32.

- BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on revising IAS 32 *Financial Instruments: Disclosure and Presentation** in 2003. Individual Board members gave greater weight to some factors than to others.
- BC2 In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 32 and IAS 39 *Financial Instruments: Recognition and Measurement*. The objectives of the Improvements project were to reduce the complexity in the Standards by clarifying and adding guidance, eliminating internal inconsistencies, and incorporating into the Standards elements of Standing Interpretations Committee (SIC) Interpretations and IAS 39 implementation guidance. In June 2002 the Board published its proposals in an Exposure Draft of proposed amendments to IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement*, with a comment deadline of 14 October 2002. The Board received over 170 comment letters on the Exposure Draft.
- BC3 Because the Board did not reconsider the fundamental approach to the accounting for financial instruments established by IAS 32 and IAS 39, this Basis for Conclusions does not discuss requirements in IAS 32 that the Board has not reconsidered.

Definitions (paragraphs 11–14 and AG3–AG24)

Financial asset, financial liability and equity instrument (paragraphs 11 and AG3–AG14)

- BC4 The revised IAS 32 addresses the classification as financial assets, financial liabilities or equity instruments of financial instruments that are indexed to, or settled in, an entity's own equity instruments. As discussed further in paragraphs BC6–BC15, the Board decided to preclude equity classification for such contracts when they (a) involve an obligation to deliver cash or another financial asset or to exchange financial assets or financial liabilities under conditions that are potentially unfavourable to the entity, (b) in the case of a non-derivative, are not for the receipt or delivery of a fixed number of shares or (c) in the case of a derivative, are not for the exchange of a fixed number of shares for a fixed amount of cash or another financial asset. The Board also decided to preclude equity classification for contracts that are derivatives on derivatives on an entity's own equity. Consistently with this decision, the Board also decided to amend the definitions of financial asset, financial liability and equity instrument

* In August 2005, the IASB relocated all disclosures relating to financial instruments to IFRS 7. The paragraphs relating to disclosures that were originally published in this Basis for Conclusions were relocated, if still relevant, to the Basis for Conclusions on IFRS 7.

in IAS 32 to make them consistent with the guidance about contracts on an entity's own equity instruments. The Board did not reconsider other aspects of the definitions as part of this project to revise IAS 32, for example the other changes to the definitions proposed by the Joint Working Group in its Draft Standard *Financial Instruments and Similar Items* published by the Board's predecessor body, IASC, in 2000.

Presentation (paragraphs 15–50 and AG25–AG39)

Liabilities and equity (paragraphs 15–27 and AG25–AG29)

- BC5 The revised IAS 32 addresses whether derivative and non-derivative contracts indexed to, or settled in, an entity's own equity instruments are financial assets, financial liabilities or equity instruments. The original IAS 32 dealt with aspects of this issue piecemeal and it was not clear how various transactions (eg net share settled contracts and contracts with settlement options) should be treated under the Standard. The Board concluded that it needed to clarify the accounting treatment for such transactions.
- BC6 The approach agreed by the Board can be summarised as follows:
- A contract on an entity's own equity is an equity instrument if, and only if:
- (a) it contains no contractual obligation to transfer cash or another financial asset, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; and
 - (b) if the instrument will or may be settled in the entity's own equity instruments, it is either (i) a non-derivative that includes no contractual obligation for the entity to deliver a variable number of its own equity instruments, or (ii) a derivative that will be settled by the entity exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

No contractual obligation to deliver cash or another financial asset (paragraphs 17–20, AG25 and AG26)

Puttable instruments (paragraph 18(b))

- BC7 The Board decided that a financial instrument that gives the holder the right to put the instrument back to the entity for cash or another financial asset is a financial liability of the entity. Such financial instruments are commonly issued by mutual funds, unit trusts, co-operative and similar entities, often with the redemption amount being equal to a proportionate share in the net assets of the entity. Although the legal form of such financial instruments often includes a right to the residual interest in the assets of an entity available to holders of such instruments, the inclusion of an option for the holder to put the instrument back to the entity for cash or another financial asset means that the instrument meets the definition of a financial liability. The classification as a financial liability is independent of considerations such as when the right is exercisable, how the

amount payable or receivable upon exercise of the right is determined, and whether the puttable instrument has a fixed maturity.

- BC8 The Board noted that the classification of a puttable instrument as a financial liability does not preclude the use of descriptors such as ‘net assets attributable to unitholders’ and ‘change in net assets attributable to unitholders’ on the face of the financial statements of an entity that has no equity (such as some mutual funds and unit trusts) or whose share capital is a financial liability under IAS 32 (such as some co-operatives). The Board also agreed that it should provide examples of how such entities might present their income statement* and balance sheet† (see Illustrative Examples 7 and 8).

Implicit obligations (paragraph 20)

- BC9 The Board did not debate whether an obligation can be established implicitly rather than explicitly because this is not within the scope of an improvements project. This question will be considered by the Board in its project on revenue, liabilities and equity. Consequently, the Board retained the existing notion that an instrument may establish an obligation indirectly through its terms and conditions (see paragraph 20). However, it decided that the example of a preference share with a contractually accelerating dividend which, within the foreseeable future, is scheduled to yield a dividend so high that the entity will be economically compelled to redeem the instrument, was insufficiently clear. The example was therefore removed and replaced with others that are clearer and deal with situations that have proved problematic in practice.

Settlement in the entity’s own equity instruments (paragraphs 21–24 and AG27)

- BC10 The approach taken in the revised IAS 32 includes two main conclusions:
- (a) When an entity has an obligation to purchase its own shares for cash (such as under a forward contract to purchase its own shares), there is a financial liability for the amount of cash that the entity has an obligation to pay.
 - (b) When an entity uses its own equity instruments ‘as currency’ in a contract to receive or deliver a variable number of shares whose value equals a fixed amount or an amount based on changes in an underlying variable (eg a commodity price), the contract is not an equity instrument, but is a financial asset or a financial liability. In other words, when a contract is settled in a variable number of the entity’s own equity instruments, or by the entity exchanging a fixed number of its own equity instruments for a variable amount of cash or another financial asset, the contract is not an equity instrument but is a financial asset or a financial liability.

* IAS 1 *Presentation of Financial Statements* (as revised in 2007) requires an entity to present all income and expense items in one statement of comprehensive income or in two statements (a separate income statement and a statement of comprehensive income).

† IAS 1 (revised 2007) replaced the term ‘balance sheet’ with ‘statement of financial position’.

When an entity has an obligation to purchase its own shares for cash, there is a financial liability for the amount of cash that the entity has an obligation to pay.

- BC11 An entity's obligation to purchase its own shares establishes a maturity date for the shares that are subject to the contract. Therefore, to the extent of the obligation, those shares cease to be equity instruments when the entity assumes the obligation. This treatment under IAS 32 is consistent with the treatment of shares that provide for mandatory redemption by the entity. Without a requirement to recognise a financial liability for the present value of the share redemption amount, entities with identical obligations to deliver cash in exchange for their own equity instruments could report different information in their financial statements depending on whether the redemption clause is embedded in the equity instrument or is a free-standing derivative contract.
- BC12 Some respondents to the Exposure Draft suggested that when an entity writes an option that, if exercised, will result in the entity paying cash in return for receiving its own shares, it is incorrect to treat the full amount of the exercise price as a financial liability because the obligation is conditional upon the option being exercised. The Board rejected this argument because the entity has an obligation to pay the full redemption amount and cannot avoid settlement in cash or another financial asset for the full redemption amount unless the counterparty decides not to exercise its redemption right or specified future events or circumstances beyond the control of the entity occur or do not occur. The Board also noted that a change would require a reconsideration of other provisions in IAS 32 that require liability treatment for obligations that are conditional on events or choices that are beyond the entity's control. These include, for example, (a) the treatment of financial instruments with contingent settlement provisions as financial liabilities for the full amount of the conditional obligation, (b) the treatment of preference shares that are redeemable at the option of the holder as financial liabilities for the full amount of the conditional obligation, and (c) the treatment of financial instruments (puttable instruments) that give the holder the right to put the instrument back to the issuer for cash or another financial asset, the amount of which is determined by reference to an index, and which therefore has the potential to increase and decrease, as financial liabilities for the full amount of the conditional obligation.

When an entity uses its own equity instruments as currency in a contract to receive or deliver a variable number of shares, the contract is not an equity instrument, but is a financial asset or a financial liability.

- BC13 The Board agreed that it would be inappropriate to account for a contract as an equity instrument when an entity's own equity instruments are used as currency in a contract to receive or deliver a variable number of shares whose value equals a fixed amount or an amount based on changes in an underlying variable (eg a net share-settled derivative contract on gold or an obligation to deliver as many shares as are equal in value to CU10,000). Such a contract represents a right or obligation of a specified amount rather than a specified equity interest. A contract to pay or receive a specified amount (rather than a specified equity

interest) is not an equity instrument. For such a contract, the entity does not know, before the transaction is settled, how many of its own shares (or how much cash) it will receive or deliver and the entity may not even know whether it will receive or deliver its own shares.

- BC14 In addition, the Board noted that precluding equity treatment for such a contract limits incentives for structuring potentially favourable or unfavourable transactions to obtain equity treatment. For example, the Board believes that an entity should not be able to obtain equity treatment for a transaction simply by including a share settlement clause when the contract is for a specified value, rather than a specified equity interest.
- BC15 The Board rejected the argument that a contract that is settled in the entity's own shares must be an equity instrument because no change in assets or liabilities, and thus no gain or loss, arises on settlement of the contract. The Board noted that any gain or loss arises before settlement of the transaction, not when it is settled.

Contingent settlement provisions (paragraphs 25 and AG28)

- BC16 The revised Standard incorporates the conclusion previously in SIC-5 *Classification of Financial Instruments—Contingent Settlement Provisions* that a financial instrument for which the manner of settlement depends on the occurrence or non-occurrence of uncertain future events, or on the outcome of uncertain circumstances that are beyond the control of both the issuer and the holder (ie a 'contingent settlement provision'), is a financial liability.
- BC17 The amendments do not include the exception previously provided in paragraph 6 of SIC-5 for circumstances in which the possibility of the entity being required to settle in cash or another financial asset is remote at the time the financial instrument is issued. The Board concluded that it is not consistent with the definitions of financial liabilities and equity instruments to classify an obligation to deliver cash or another financial asset as a financial liability only when settlement in cash is probable. There is a contractual obligation to transfer economic benefits as a result of past events because the entity is unable to avoid a settlement in cash or another financial asset unless an event occurs or does not occur in the future.
- BC18 However, the Board also concluded that contingent settlement provisions that would apply only in the event of liquidation of an entity should not influence the classification of the instrument because to do so would be inconsistent with a going concern assumption. A contingent settlement provision that provides for payment in cash or another financial asset only on the liquidation of the entity is similar to an equity instrument that has priority in liquidation and therefore should be ignored in classifying the instrument.
- BC19 Additionally, the Board decided that if the part of a contingent settlement provision that could require settlement in cash or a variable number of own shares is not genuine, it should be ignored for the purposes of classifying the instrument. The Board also agreed to provide guidance on the meaning of 'genuine' in this context (see paragraph AG28).

Settlement options (paragraphs 26 and 27)

- BC20 The revised Standard requires that if one of the parties to a contract has one or more options as to how it is settled (eg net in cash or by exchanging shares for cash), the contract is a financial asset or a financial liability unless all of the settlement alternatives would result in equity classification. The Board concluded that entities should not be able to circumvent the accounting requirements for financial assets and financial liabilities simply by including an option to settle a contract through the exchange of a fixed number of shares for a fixed amount. The Board had proposed in the Exposure Draft that past practice and management intentions should be considered in determining the classification of such instruments. However, respondents to the Exposure Draft noted that such requirements can be difficult to apply because some entities do not have any history of similar transactions and the assessment of whether an established practice exists and of what is management's intention can be subjective. The Board agreed with these comments and accordingly concluded that past practice and management intentions should not be determining factors.

Alternative approaches considered

- BC21 In finalising the revisions to IAS 32 the Board considered, but rejected, a number of alternative approaches:
- (a) To classify as an equity instrument any contract that will be settled in the entity's own shares. The Board rejected this approach because it does not deal adequately with transactions in which an entity is using its own shares as currency, eg when an entity has an obligation to pay a fixed or determinable amount that is settled in a variable number of its own shares.
 - (b) To classify a contract as an equity instrument only if (i) the contract will be settled in the entity's own shares, and (ii) the changes in the fair value of the contract move in the same direction as the changes in the fair value of the shares from the perspective of the counterparty. Under this approach, contracts that will be settled in the entity's own shares would be financial assets or financial liabilities if, from the perspective of the counterparty, their value moves inversely with the price of the entity's own shares. An example is an entity's obligation to buy back its own shares. The Board rejected this approach because its adoption would represent a fundamental shift in the concept of equity. The Board also noted that it would result in a change to the classification of some transactions, compared with the existing *Framework* and IAS 32, that had not been exposed for comment.
 - (c) To classify as an equity instrument a contract that will be settled in the entity's own shares unless its value changes in response to something other than the price of the entity's own shares. The Board rejected this approach to avoid an exception to the principle that non-derivative contracts that are settled in a variable number of an entity's own shares should be treated as financial assets or financial liabilities.

- (d) To limit classification as equity instruments to outstanding ordinary shares, and classify as financial assets or financial liabilities all contracts that involve future receipt or delivery of the entity's own shares. The Board rejected this approach because its adoption would represent a fundamental shift in the concept of equity. The Board also noted that it would result in a change to the classification of some transactions compared with the existing IAS 32 that had not been exposed for comment.

Compound financial instruments (paragraphs 28–32 and AG30–AG35)

- BC22 The Standard requires the separate presentation in an entity's balance sheet* of liability and equity components of a single financial instrument. It is more a matter of form than a matter of substance that both liabilities and equity interests are created by a single financial instrument rather than two or more separate instruments. The Board believes that an entity's financial position is more faithfully represented by separate presentation of liability and equity components contained in a single instrument.

Allocation of the initial carrying amount to the liability and equity components (paragraphs 31 and 32, AG36–AG38 and Illustrative Examples 9–12)

- BC23 The previous version of IAS 32 did not prescribe a particular method for assigning the initial carrying amount of a compound financial instrument to its separated liability and equity components. Rather, it suggested approaches that might be considered, such as:
- (a) assigning to the less easily measurable component (often the equity component) the residual amount after deducting from the instrument as a whole the amount separately determined for the component that is more easily determinable (a 'with-and-without' method); and
 - (b) measuring the liability and equity components separately and, to the extent necessary, adjusting these amounts pro rata so that the sum of the components equals the amount of the instrument as a whole (a 'relative fair value' method).
- BC24 This choice was originally justified on the grounds that IAS 32 did not deal with the measurement of financial assets, financial liabilities and equity instruments.
- BC25 However, since the issue of IAS 39, IFRSs contain requirements for the measurement of financial assets and financial liabilities. Therefore, the view that IAS 32 should not prescribe a particular method for separating compound financial instruments because of the absence of measurement requirements for financial instruments is no longer valid. IAS 39, paragraph 43, requires a financial liability to be measured on initial recognition at its fair value. Therefore, a relative fair value method could result in an initial measurement of the liability component that is not in compliance with IAS 39.

* IAS 1 (as revised in 2007) replaced the term 'balance sheet' with 'statement of financial position'.

IAS 32 BC

- BC26 After initial recognition, a financial liability that is classified as at fair value through profit or loss is measured at fair value under IAS 39, and other financial liabilities are measured at amortised cost. If the liability component of a compound financial instrument is classified as at fair value through profit or loss, an entity could recognise an immediate gain or loss after initial recognition if it applies a relative fair value method. This is contrary to IAS 32, paragraph 31, which states that no gain or loss arises from recognising the components of the instrument separately.
- BC27 Under the *Framework*, and IASs 32 and 39, an equity instrument is defined as any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Paragraph 67 of the *Framework* further states that the amount at which equity is recognised in the balance sheet is dependent on the measurement of assets and liabilities.
- BC28 The Board concluded that the alternatives in IAS 32 to measure on initial recognition the liability component of a compound financial instrument as a residual amount after separating the equity component or on the basis of a relative fair value method should be eliminated. Instead the liability component should be measured first (including the value of any embedded non-equity derivative features, such as an embedded call feature), and the residual amount assigned to the equity component.
- BC29 The objective of this amendment is to make the requirements about the entity's separation of the liability and equity components of a single compound financial instrument consistent with the requirements about the initial measurement of a financial liability in IAS 39 and the definitions in IAS 32 and the *Framework* of an equity instrument as a residual interest.
- BC30 This approach removes the need to estimate inputs to, and apply, complex option pricing models to measure the equity component of some compound financial instruments. The Board also noted that the absence of a prescribed approach led to a lack of comparability among entities applying IAS 32 and that it therefore was desirable to specify a single approach.
- BC31 The Board noted that a requirement to use the with-and-without method, under which the liability component is determined first, is consistent with the proposals of the Joint Working Group of Standard Setters in its Draft Standard and Basis for Conclusions in *Financial Instruments and Similar Items*, published by IASC in December 2000 (see Draft Standard, paragraphs 74 and 75 and Application Supplement, paragraph 318).

Treasury shares (paragraphs 33, 34 and AG36)

- BC32 The revised Standard incorporates the guidance in SIC-16 *Share Capital—Reacquired Own Equity Instruments (Treasury Shares)*. The acquisition and subsequent resale by an entity of its own equity instruments represents a transfer between those holders of equity instruments who have given up their equity interest and those who continue to hold an equity instrument, rather than a gain or loss to the entity.

Interest, dividends, losses and gains (paragraphs 35–41 and AG37)

Costs of an equity transaction (paragraphs 35 and 37–39)

- BC33 The revised Standard incorporates the guidance in SIC-17 *Equity—Costs of an Equity Transaction*. Transaction costs incurred as a necessary part of completing an equity transaction are accounted for as part of the transaction to which they relate. Linking the equity transaction and costs of the transaction reflects in equity the total cost of the transaction.
- BC34– [Deleted]
- BC48

Summary of changes from the Exposure Draft

- BC49 The main changes from the Exposure Draft's proposals are as follows:
- (a) The Exposure Draft proposed to define a financial liability as a contractual obligation to deliver cash or another financial asset to another entity or to exchange financial instruments with another entity under conditions that are potentially unfavourable. The definition in the Standard has been expanded to include some contracts that will or may be settled in the entity's own equity instruments. The Standard's definition of a financial asset has been similarly expanded.
 - (b) The Exposure Draft proposed that a financial instrument that gives the holder the right to put it back to the entity for cash or another financial asset is a financial liability. The Standard retains this conclusion, but provides additional guidance and illustrative examples to assist entities that, as a result of this requirement, either have no equity as defined in IAS 32 or whose share capital is not equity as defined in IAS 32.
 - (c) The Standard retains and clarifies the proposal in the Exposure Draft that terms and conditions of a financial instrument may indirectly create an obligation.
 - (d) The Exposure Draft proposed to incorporate in IAS 32 the conclusion previously in SIC-5. This is that a financial instrument for which the manner of settlement depends on the occurrence or non-occurrence of uncertain future events or on the outcome of uncertain circumstances that are beyond the control of both the issuer and the holder is a financial liability. The Standard clarifies this conclusion by requiring contingent settlement provisions that apply only in the event of liquidation of an entity or are not genuine to be ignored.
 - (e) The Exposure Draft proposed that a derivative contract that contains an option as to how it is settled meets the definition of an equity instrument if the entity had all of the following: (i) an unconditional right and ability to settle the contract gross; (ii) an established practice of such settlement; and (iii) the intention to settle the contract gross. These conditions have

not been carried forward into the Standard. Rather, a derivative with settlement options is classified as a financial asset or a financial liability unless all the settlement alternatives would result in equity classification.

- (f) The Standard provides explicit guidance on accounting for the repurchase of a convertible instrument.
- (g) The Standard provides explicit guidance on accounting for the amendment of the terms of a convertible instrument to induce early conversion.
- (h) The Exposure Draft proposed that a financial instrument that is an equity instrument of a subsidiary should be eliminated on consolidation when held by the parent, or presented in the consolidated balance sheet within equity when not held by the parent (as a minority interest* separate from the equity of the parent). The Standard requires all terms and conditions agreed between members of the group and the holders of the instrument to be considered when determining if the group as a whole has an obligation that would give rise to a financial liability. To the extent there is such an obligation, the instrument (or component of the instrument that is subject to the obligation) is a financial liability in consolidated financial statements.
- (i) [Deleted]
- (j) [Deleted]
- (k) In August 2005, the IASB issued IFRS 7 *Financial Instruments: Disclosures*. As a result, disclosures relating to financial instruments, if still relevant, were relocated to IFRS 7.

* In January 2008 the IASB issued an amended IAS 27 *Consolidated and Separate Financial Statements*, which amended 'minority interest' to 'non-controlling interests'.

Dissenting Opinion

Dissent of James J Leisenring

- DO1 Mr Leisenring dissents from IAS 32 because, in his view, the conclusions about the accounting for forward purchase contracts and written put options on an issuer's equity instruments that require physical settlement in exchange for cash are inappropriate. IAS 32 requires a forward purchase contract to be recognised as though the future transaction had already occurred. Similarly it requires a written put option to be accounted for as though the option had already been exercised. Both of these contracts result in combining the separate forward contract and the written put option with outstanding shares to create a synthetic liability.
- DO2 Recording a liability for the present value of the fixed forward price as a result of a forward contract is inconsistent with the accounting for other forward contracts. Recording a liability for the present value of the strike price of an option results in recording a liability that is inconsistent with the *Framework* as there is no present obligation for the strike price. In both instances the shares considered to be subject to the contracts are outstanding, have the same rights as any other shares and should be accounted for as outstanding. The forward and option contracts meet the definition of a derivative and should be accounted for as derivatives rather than create an exception to the accounting required by IAS 39. Similarly, if the redemption feature is embedded in the equity instrument (for example, a redeemable preference share) rather than being a free-standing derivative contract, the redemption feature should be accounted for as a derivative.
- DO3 Mr Leisenring also objects to the conclusion that a purchased put or call option on a fixed number of an issuer's equity instruments is not an asset. The rights created by these contracts meet the definition of an asset and should be accounted for as assets and not as a reduction in equity. These contracts also meet the definition of derivatives that should be accounted for as such consistently with IAS 39.

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IAS 32 *Financial Instruments: Presentation*

Illustrative examples

These examples accompany, but are not part of, IAS 32.

Accounting for contracts on equity instruments of an entity

- IE1 The following examples* illustrate the application of paragraphs 15–27 and IAS 39 to the accounting for contracts on an entity's own equity instruments.

Example 1: Forward to buy shares

- IE2 This example illustrates the journal entries for forward purchase contracts on an entity's own shares that will be settled (a) net in cash, (b) net in shares or (c) by delivering cash in exchange for shares. It also discusses the effect of settlement options (see (d) below). To simplify the illustration, it is assumed that no dividends are paid on the underlying shares (ie the 'carry return' is zero) so that the present value of the forward price equals the spot price when the fair value of the forward contract is zero. The fair value of the forward has been computed as the difference between the market share price and the present value of the fixed forward price.

Assumptions:

Contract date	1 February 20X2
Maturity date	31 January 20X3
Market price per share on 1 February 20X2	CU100
Market price per share on 31 December 20X2	CU110
Market price per share on 31 January 20X3	CU106
Fixed forward price to be paid on 31 January 20X3	CU104
Present value of forward price on 1 February 20X2	CU100
Number of shares under forward contract	1,000
Fair value of forward on 1 February 20X2	CU0
Fair value of forward on 31 December 20X2	CU6,300
Fair value of forward on 31 January 20X3	CU2,000

(a) Cash for cash ('net cash settlement')

- IE3 In this subsection, the forward purchase contract on the entity's own shares will be settled net in cash, ie there is no receipt or delivery of the entity's own shares upon settlement of the forward contract.

* In these examples, monetary amounts are denominated in 'currency units' (CU).

On 1 February 20X2, Entity A enters into a contract with Entity B to receive the fair value of 1,000 of Entity A's own outstanding ordinary shares as of 31 January 20X3 in exchange for a payment of CU104,000 in cash (ie CU104 per share) on 31 January 20X3. The contract will be settled net in cash. Entity A records the following journal entries.

1 February 20X2

The price per share when the contract is agreed on 1 February 20X2 is CU100. The initial fair value of the forward contract on 1 February 20X2 is zero.

No entry is required because the fair value of the derivative is zero and no cash is paid or received.

31 December 20X2

On 31 December 20X2, the market price per share has increased to CU110 and, as a result, the fair value of the forward contract has increased to CU6,300.

Dr	Forward asset	CU6,300	
	Cr	Gain	CU6,300

To record the increase in the fair value of the forward contract.

31 January 20X3

On 31 January 20X3, the market price per share has decreased to CU106. The fair value of the forward contract is CU2,000 ($[\text{CU}106 \times 1,000] - \text{CU}104,000$).

On the same day, the contract is settled net in cash. Entity A has an obligation to deliver CU104,000 to Entity B and Entity B has an obligation to deliver CU106,000 ($\text{CU}106 \times 1,000$) to Entity A, so Entity B pays the net amount of CU2,000 to Entity A.

Dr	Loss	CU4,300	
	Cr	Forward asset	CU4,300

To record the decrease in the fair value of the forward contract (ie $\text{CU}4,300 = \text{CU}6,300 - \text{CU}2,000$).

Dr	Cash	CU2,000	
	Cr	Forward asset	CU2,000

To record the settlement of the forward contract.

(b) Shares for shares ('net share settlement')

- IE4 Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A's journal entries are the same as those shown in (a) above, except for recording the settlement of the forward contract, as follows:

31 January 20X3

The contract is settled net in shares. Entity A has an obligation to deliver CU104,000 ($\text{CU104} \times 1,000$) worth of its shares to Entity B and Entity B has an obligation to deliver CU106,000 ($\text{CU106} \times 1,000$) worth of shares to Entity A. Thus, Entity B delivers a net amount of CU2,000 ($\text{CU106,000} - \text{CU104,000}$) worth of shares to Entity A, ie 18.9 shares ($\text{CU2,000}/\text{CU106}$).

Dr	Equity	CU2,000	
	Cr	Forward asset	CU2,000

To record the settlement of the forward contract.

(c) Cash for shares ('gross physical settlement')

- IE5 Assume the same facts as in (a) except that settlement will be made by delivering a fixed amount of cash and receiving a fixed number of Entity A's shares. Similarly to (a) and (b) above, the price per share that Entity A will pay in one year is fixed at CU104. Accordingly, Entity A has an obligation to pay CU104,000 in cash to Entity B ($\text{CU104} \times 1,000$) and Entity B has an obligation to deliver 1,000 of Entity A's outstanding shares to Entity A in one year. Entity A records the following journal entries.

1 February 20X2

Dr	Equity	CU100,000	
	Cr	Liability	CU100,000

To record the obligation to deliver CU104,000 in one year at its present value of CU100,000 discounted using an appropriate interest rate (see IAS 39, paragraph AG64).

31 December 20X2

Dr	Interest expense	CU3,660	
	Cr	Liability	CU3,660

To accrue interest in accordance with the effective interest method on the liability for the share redemption amount.

31 January 20X3

Dr	Interest expense	CU340	
	Cr	Liability	CU340

To accrue interest in accordance with the effective interest method on the liability for the share redemption amount.

Entity A delivers CU104,000 in cash to Entity B and Entity B delivers 1,000 of Entity A's shares to Entity A.

Dr Liability	CU104,000	
Cr Cash		CU104,000

To record the settlement of the obligation to redeem Entity A's own shares for cash.

(d) Settlement options

- IE6 The existence of settlement options (such as net in cash, net in shares or by an exchange of cash and shares) has the result that the forward repurchase contract is a financial asset or a financial liability. If one of the settlement alternatives is to exchange cash for shares ((c) above), Entity A recognises a liability for the obligation to deliver cash, as illustrated in (c) above. Otherwise, Entity A accounts for the forward contract as a derivative.

Example 2: Forward to sell shares

- IE7 This example illustrates the journal entries for forward sale contracts on an entity's own shares that will be settled (a) net in cash, (b) net in shares or (c) by receiving cash in exchange for shares. It also discusses the effect of settlement options (see (d) below). To simplify the illustration, it is assumed that no dividends are paid on the underlying shares (ie the 'carry return' is zero) so that the present value of the forward price equals the spot price when the fair value of the forward contract is zero. The fair value of the forward has been computed as the difference between the market share price and the present value of the fixed forward price.

Assumptions:

Contract date	1 February 20X2
Maturity date	31 January 20X3

Market price per share on 1 February 20X2	CU100
Market price per share on 31 December 20X2	CU110
Market price per share on 31 January 20X3	CU106

Fixed forward price to be paid on 31 January 20X3	CU104
Present value of forward price on 1 February 20X2	CU100
Number of shares under forward contract	1,000

Fair value of forward on 1 February 20X2	CU0
Fair value of forward on 31 December 20X2	(CU6,300)
Fair value of forward on 31 January 20X3	(CU2,000)

(a) Cash for cash ('net cash settlement')

IE8 On 1 February 20X2, Entity A enters into a contract with Entity B to pay the fair value of 1,000 of Entity A's own outstanding ordinary shares as of 31 January 20X3 in exchange for CU104,000 in cash (ie CU104 per share) on 31 January 20X3. The contract will be settled net in cash. Entity A records the following journal entries.

1 February 20X2

No entry is required because the fair value of the derivative is zero and no cash is paid or received.

31 December 20X2

Dr	Loss	CU6,300	
	Cr Forward liability		CU6,300

To record the decrease in the fair value of the forward contract.

31 January 20X3

Dr	Forward liability	CU4,300	
	Cr Gain		CU4,300

To record the increase in the fair value of the forward contract (ie CU4,300 = CU6,300 – CU2,000).

The contract is settled net in cash. Entity B has an obligation to deliver CU104,000 to Entity A, and Entity A has an obligation to deliver CU106,000 (CU106 × 1,000) to Entity B. Thus, Entity A pays the net amount of CU2,000 to Entity B.

Dr	Forward liability	CU2,000	
	Cr Cash		CU2,000

To record the settlement of the forward contract.

(b) Shares for shares ('net share settlement')

- IE9 Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A's journal entries are the same as those shown in (a), except:

31 January 20X3

The contract is settled net in shares. Entity A has a right to receive CU104,000 ($\text{CU}104 \times 1,000$) worth of its shares and an obligation to deliver CU106,000 ($\text{CU}106 \times 1,000$) worth of its shares to Entity B. Thus, Entity A delivers a net amount of CU2,000 ($\text{CU}106,000 - \text{CU}104,000$) worth of its shares to Entity B, ie 18.9 shares ($\text{CU}2,000/\text{CU}106$).

Dr	Forward liability	CU2,000	
	Cr Equity		CU2,000

To record the settlement of the forward contract. The issue of the entity's own shares is treated as an equity transaction.

(c) Shares for cash ('gross physical settlement')

- IE10 Assume the same facts as in (a), except that settlement will be made by receiving a fixed amount of cash and delivering a fixed number of the entity's own shares. Similarly to (a) and (b) above, the price per share that Entity A will pay in one year is fixed at CU104. Accordingly, Entity A has a right to receive CU104,000 in cash ($\text{CU}104 \times 1,000$) and an obligation to deliver 1,000 of its own shares in one year. Entity A records the following journal entries.

1 February 20X2

No entry is made on 1 February. No cash is paid or received because the forward has an initial fair value of zero. A forward contract to deliver a fixed number of Entity A's own shares in exchange for a fixed amount of cash or another financial asset meets the definition of an equity instrument because it cannot be settled otherwise than through the delivery of shares in exchange for cash.

31 December 20X2

No entry is made on 31 December because no cash is paid or received and a contract to deliver a fixed number of Entity A's own shares in exchange for a fixed amount of cash meets the definition of an equity instrument of the entity.

31 January 20X3

On 31 January 20X3, Entity A receives CU104,000 in cash and delivers 1,000 shares.

Dr	Cash	CU104,000	
	Cr Equity		CU104,000

To record the settlement of the forward contract.

(d) Settlement options

- IE11 The existence of settlement options (such as net in cash, net in shares or by an exchange of cash and shares) has the result that the forward contract is a financial asset or a financial liability. It does not meet the definition of an equity instrument because it can be settled otherwise than by Entity A repurchasing a fixed number of its own shares in exchange for paying a fixed amount of cash or another financial asset. Entity A recognises a derivative asset or liability, as illustrated in (a) and (b) above. The accounting entry to be made on settlement depends on how the contract is actually settled.

Example 3: Purchased call option on shares

- IE12 This example illustrates the journal entries for a purchased call option right on the entity's own shares that will be settled (a) net in cash, (b) net in shares or (c) by delivering cash in exchange for the entity's own shares. It also discusses the effect of settlement options (see (d) below):

Assumptions:

Contract date	1 February 20X2
Exercise date	31 January 20X3 (European terms, ie it can be exercised only at maturity)
Exercise right holder	Reporting entity (Entity A)
Market price per share on 1 February 20X2	CU100
Market price per share on 31 December 20X2	CU104
Market price per share on 31 January 20X3	CU104
Fixed exercise price to be paid on 31 January 20X3	CU102
Number of shares under option contract	1,000
Fair value of option on 1 February 20X2	CU5,000
Fair value of option on 31 December 20X2	CU3,000
Fair value of option on 31 January 20X3	CU2,000

(a) Cash for cash ('net cash settlement')

- IE13 On 1 February 20X2, Entity A enters into a contract with Entity B that gives Entity B the obligation to deliver, and Entity A the right to receive the fair value of 1,000 of Entity A's own ordinary shares as of 31 January 20X3 in exchange for CU102,000 in cash (ie CU102 per share) on 31 January 20X3, if Entity A exercises that right. The contract will be settled net in cash. If Entity A does not exercise its right, no payment will be made. Entity A records the following journal entries.

1 February 20X2

The price per share when the contract is agreed on 1 February 20X2 is CU100. The initial fair value of the option contract on 1 February 20X2 is CU5,000, which Entity A pays to Entity B in cash on that date. On that date, the option has no intrinsic value, only time value, because the exercise price of CU102 exceeds the market price per share of CU100 and it would therefore not be economic for Entity A to exercise the option. In other words, the call option is out of the money.

Dr	Call option asset	CU5,000	
	Cr	Cash	CU5,000

To recognise the purchased call option.

31 December 20X2

On 31 December 20X2, the market price per share has increased to CU104. The fair value of the call option has decreased to CU3,000, of which CU2,000 is intrinsic value ($[(CU104 - CU102) \times 1,000]$), and CU1,000 is the remaining time value.

Dr	Loss	CU2,000	
	Cr	Call option asset	CU2,000

To record the decrease in the fair value of the call option.

31 January 20X3

On 31 January 20X3, the market price per share is still CU104. The fair value of the call option has decreased to CU2,000, which is all intrinsic value ($[(CU104 - CU102) \times 1,000]$) because no time value remains.

Dr	Loss	CU1,000	
	Cr	Call option asset	CU1,000

To record the decrease in the fair value of the call option.

On the same day, Entity A exercises the call option and the contract is settled net in cash. Entity B has an obligation to deliver CU104,000 ($CU104 \times 1,000$) to Entity A in exchange for CU102,000 ($CU102 \times 1,000$) from Entity A, so Entity A receives a net amount of CU2,000.

Dr	Cash	CU2,000	
	Cr	Call option asset	CU2,000

To record the settlement of the option contract.

(b) Shares for shares ('net share settlement')

- IE14 Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A's journal entries are the same as those shown in (a) except for recording the settlement of the option contract as follows:

31 January 20X3

Entity A exercises the call option and the contract is settled net in shares. Entity B has an obligation to deliver CU104,000 ($\text{CU104} \times 1,000$) worth of Entity A's shares to Entity A in exchange for CU102,000 ($\text{CU102} \times 1,000$) worth of Entity A's shares. Thus, Entity B delivers the net amount of CU2,000 worth of shares to Entity A, ie 19.2 shares ($\text{CU2,000}/\text{CU104}$).

Dr	Equity	CU2,000	
	Cr	Call option asset	CU2,000

To record the settlement of the option contract. The settlement is accounted for as a treasury share transaction (ie no gain or loss).

(c) Cash for shares ('gross physical settlement')

- IE15 Assume the same facts as in (a) except that settlement will be made by receiving a fixed number of shares and paying a fixed amount of cash, if Entity A exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at CU102. Accordingly, Entity A has a right to receive 1,000 of Entity A's own outstanding shares in exchange for CU102,000 ($\text{CU102} \times 1,000$) in cash, if Entity A exercises its option. Entity A records the following journal entries.

1 February 20X2

Dr	Equity	CU5,000	
	Cr	Cash	CU5,000

To record the cash paid in exchange for the right to receive Entity A's own shares in one year for a fixed price. The premium paid is recognised in equity.

31 December 20X2

No entry is made on 31 December because no cash is paid or received and a contract that gives a right to receive a fixed number of Entity A's own shares in exchange for a fixed amount of cash meets the definition of an equity instrument of the entity.

31 January 20X3

Entity A exercises the call option and the contract is settled gross. Entity B has an obligation to deliver 1,000 of Entity A's shares in exchange for CU102,000 in cash.

Dr	Equity	CU102,000	
	Cr	Cash	CU102,000

To record the settlement of the option contract.

(d) Settlement options

- IE16 The existence of settlement options (such as net in cash, net in shares or by an exchange of cash and shares) has the result that the call option is a financial asset. It does not meet the definition of an equity instrument because it can be settled otherwise than by Entity A repurchasing a fixed number of its own shares in exchange for paying a fixed amount of cash or another financial asset. Entity A recognises a derivative asset, as illustrated in (a) and (b) above. The accounting entry to be made on settlement depends on how the contract is actually settled.

Example 4: Written call option on shares

- IE17 This example illustrates the journal entries for a written call option obligation on the entity's own shares that will be settled (a) net in cash, (b) net in shares or (c) by delivering cash in exchange for shares. It also discusses the effect of settlement options (see (d) below).

Assumptions:

Contract date	1 February 20X2
Exercise date	31 January 20X3 (European terms, ie it can be exercised only at maturity)
Exercise right holder	Counterparty (Entity B)
Market price per share on 1 February 20X2	CU100
Market price per share on 31 December 20X2	CU104
Market price per share on 31 January 20X3	CU104
Fixed exercise price to be paid on 31 January 20X3	CU102
Number of shares under option contract	1,000
Fair value of option on 1 February 20X2	CU5,000
Fair value of option on 31 December 20X2	CU3,000
Fair value of option on 31 January 20X3	CU2,000

(a) Cash for cash ('net cash settlement')

- IE18 Assume the same facts as in Example 3(a) above except that Entity A has written a call option on its own shares instead of having purchased a call option on them. Accordingly, on 1 February 20X2 Entity A enters into a contract with Entity B that gives Entity B the right to receive and Entity A the obligation to pay the fair value of 1,000 of Entity A's own ordinary shares as of 31 January 20X3 in exchange for CU102,000 in cash (ie CU102 per share) on 31 January 20X3, if Entity B exercises that right. The contract will be settled net in cash. If Entity B does not exercise its right, no payment will be made. Entity A records the following journal entries.

1 February 20X2

Dr	Cash	CU5,000	
	Cr	Call option obligation	CU5,000

To recognise the written call option.

31 December 20X2

Dr	Call option obligation	CU2,000	
	Cr	Gain	CU2,000

To record the decrease in the fair value of the call option.

31 January 20X3

Dr	Call option obligation	CU1,000	
	Cr	Gain	CU1,000

To record the decrease in the fair value of the option.

On the same day, Entity B exercises the call option and the contract is settled net in cash. Entity A has an obligation to deliver CU104,000 ($CU104 \times 1,000$) to Entity B in exchange for CU102,000 ($CU102 \times 1,000$) from Entity B, so Entity A pays a net amount of CU2,000.

Dr	Call option obligation	CU2,000	
	Cr	Cash	CU2,000

To record the settlement of the option contract.

(b) Shares for shares ('net share settlement')

- IE19 Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A's journal entries are the same as those shown in (a), except for recording the settlement of the option contract, as follows:

31 December 20X3

Entity B exercises the call option and the contract is settled net in shares. Entity A has an obligation to deliver CU104,000 ($CU104 \times 1,000$) worth of Entity A's shares to Entity B in exchange for CU102,000 ($CU102 \times 1,000$) worth of Entity A's shares. Thus, Entity A delivers the net amount of CU2,000 worth of shares to Entity B, ie 19.2 shares ($CU2,000/CU104$).

Dr	Call option obligation	CU2,000	
	Cr	Equity	CU2,000

To record the settlement of the option contract. The settlement is accounted for as an equity transaction.

(c) Cash for shares ('gross physical settlement')

- IE20 Assume the same facts as in (a) except that settlement will be made by delivering a fixed number of shares and receiving a fixed amount of cash, if Entity B exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at CU102. Accordingly, Entity B has a right to receive 1,000 of Entity A's own outstanding shares in exchange for CU102,000 ($\text{CU}102 \times 1,000$) in cash, if Entity B exercises its option. Entity A records the following journal entries.

1 February 20X2

Dr	Cash	CU5,000	
	Cr	Equity	CU5,000

To record the cash received in exchange for the obligation to deliver a fixed number of Entity A's own shares in one year for a fixed price. The premium received is recognised in equity. Upon exercise, the call would result in the issue of a fixed number of shares in exchange for a fixed amount of cash.

31 December 20X2

No entry is made on 31 December because no cash is paid or received and a contract to deliver a fixed number of Entity A's own shares in exchange for a fixed amount of cash meets the definition of an equity instrument of the entity.

31 January 20X3

Entity B exercises the call option and the contract is settled gross. Entity A has an obligation to deliver 1,000 shares in exchange for CU102,000 in cash.

Dr	Cash	CU102,000	
	Cr	Equity	CU102,000

To record the settlement of the option contract.

(d) Settlement options

- IE21 The existence of settlement options (such as net in cash, net in shares or by an exchange of cash and shares) has the result that the call option is a financial liability. It does not meet the definition of an equity instrument because it can be settled otherwise than by Entity A issuing a fixed number of its own shares in exchange for receiving a fixed amount of cash or another financial asset. Entity A recognises a derivative liability, as illustrated in (a) and (b) above. The accounting entry to be made on settlement depends on how the contract is actually settled.

Example 5: Purchased put option on shares

IE22 This example illustrates the journal entries for a purchased put option on the entity's own shares that will be settled (a) net in cash, (b) net in shares or (c) by delivering cash in exchange for shares. It also discusses the effect of settlement options (see (d) below).

Assumptions:

Contract date	1 February 20X2
Exercise date	31 January 20X3 (European terms, ie it can be exercised only at maturity)
Exercise right holder	Reporting entity (Entity A)
Market price per share on 1 February 20X2	CU100
Market price per share on 31 December 20X2	CU95
Market price per share on 31 January 20X3	CU95
Fixed exercise price to be paid on 31 January 20X3	CU98
Number of shares under option contract	1,000
Fair value of option on 1 February 20X2	CU5,000
Fair value of option on 31 December 20X2	CU4,000
Fair value of option on 31 January 20X3	CU3,000

(a) Cash for cash ('net cash settlement')

IE23 On 1 February 20X2, Entity A enters into a contract with Entity B that gives Entity A the right to sell, and Entity B the obligation to buy the fair value of 1,000 of Entity A's own outstanding ordinary shares as of 31 January 20X3 at a strike price of CU98,000 (ie CU98 per share) on 31 January 20X3, if Entity A exercises that right. The contract will be settled net in cash. If Entity A does not exercise its right, no payment will be made. Entity A records the following journal entries.

1 February 20X2

The price per share when the contract is agreed on 1 February 20X2 is CU100. The initial fair value of the option contract on 1 February 20X2 is CU5,000, which Entity A pays to Entity B in cash on that date. On that date, the option has no intrinsic value, only time value, because the exercise price of CU98 is less than the market price per share of CU100. Therefore it would not be economic for Entity A to exercise the option. In other words, the put option is out of the money.

Dr	Put option asset	CU5,000	
	Cr	Cash	CU5,000

To recognise the purchased put option.

31 December 20X2

On 31 December 20X2 the market price per share has decreased to CU95. The fair value of the put option has decreased to CU4,000, of which CU3,000 is intrinsic value $([CU98 - CU95] \times 1,000)$ and CU1,000 is the remaining time value.

Dr	Loss	CU1,000	
	Cr	Put option asset	CU1,000

To record the decrease in the fair value of the put option.

31 January 20X3

On 31 January 20X3 the market price per share is still CU95. The fair value of the put option has decreased to CU3,000, which is all intrinsic value $([CU98 - CU95] \times 1,000)$ because no time value remains.

Dr	Loss	CU1,000	
	Cr	Put option asset	CU1,000

To record the decrease in the fair value of the option.

On the same day, Entity A exercises the put option and the contract is settled net in cash. Entity B has an obligation to deliver CU98,000 to Entity A and Entity A has an obligation to deliver CU95,000 $(CU95 \times 1,000)$ to Entity B, so Entity B pays the net amount of CU3,000 to Entity A.

Dr	Cash	CU3,000	
	Cr	Put option asset	CU3,000

To record the settlement of the option contract.

(b) Shares for shares ('net share settlement')

- IE24 Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A's journal entries are the same as shown in (a), except:

31 January 20X3

Entity A exercises the put option and the contract is settled net in shares. In effect, Entity B has an obligation to deliver CU98,000 worth of Entity A's shares to Entity A, and Entity A has an obligation to deliver CU95,000 worth of Entity A's shares ($\text{CU}95 \times 1,000$) to Entity B, so Entity B delivers the net amount of CU3,000 worth of shares to Entity A, ie 31.6 shares ($\text{CU}3,000/\text{CU}95$).

Dr	Equity	CU3,000	
	Cr	Put option asset	CU3,000

To record the settlement of the option contract.

(c) Cash for shares ('gross physical settlement')

- IE25 Assume the same facts as in (a) except that settlement will be made by receiving a fixed amount of cash and delivering a fixed number of Entity A's shares, if Entity A exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at CU98. Accordingly, Entity B has an obligation to pay CU98,000 in cash to Entity A ($\text{CU}98 \times 1,000$) in exchange for 1,000 of Entity A's outstanding shares, if Entity A exercises its option. Entity A records the following journal entries.

1 February 20X2

Dr	Equity	CU5,000	
	Cr	Cash	CU5,000

To record the cash received in exchange for the right to deliver Entity A's own shares in one year for a fixed price. The premium paid is recognised directly in equity. Upon exercise, it results in the issue of a fixed number of shares in exchange for a fixed price.

31 December 20X2

No entry is made on 31 December because no cash is paid or received and a contract to deliver a fixed number of Entity A's own shares in exchange for a fixed amount of cash meets the definition of an equity instrument of Entity A.

31 January 20X3

Entity A exercises the put option and the contract is settled gross. Entity B has an obligation to deliver CU98,000 in cash to Entity A in exchange for 1,000 shares.

Dr	Cash	CU98,000	
	Cr	Equity	CU98,000

To record the settlement of the option contract.

(d) Settlement options

- IE26 The existence of settlement options (such as net in cash, net in shares or by an exchange of cash and shares) has the result that the put option is a financial asset. It does not meet the definition of an equity instrument because it can be settled otherwise than by Entity A issuing a fixed number of its own shares in exchange for receiving a fixed amount of cash or another financial asset. Entity A recognises a derivative asset, as illustrated in (a) and (b) above. The accounting entry to be made on settlement depends on how the contract is actually settled.

Example 6: Written put option on shares

- IE27 This example illustrates the journal entries for a written put option on the entity's own shares that will be settled (a) net in cash, (b) net in shares or (c) by delivering cash in exchange for shares. It also discusses the effect of settlement options (see (d) below).

Assumptions:

Contract date	1 February 20X2
Exercise date	31 January 20X3 (European terms, ie it can be exercised only at maturity)
Exercise right holder	Counterparty (Entity B)
Market price per share on 1 February 20X2	CU100
Market price per share on 31 December 20X2	CU95
Market price per share on 31 January 20X3	CU95
Fixed exercise price to be paid on 31 January 20X3	CU98
Present value of exercise price on 1 February 20X2	CU95
Number of shares under option contract	1,000
Fair value of option on 1 February 20X2	CU5,000
Fair value of option on 31 December 20X2	CU4,000
Fair value of option on 31 January 20X3	CU3,000

(a) Cash for cash ('net cash settlement')

- IE28 Assume the same facts as in Example 5(a) above, except that Entity A has written a put option on its own shares instead of having purchased a put option on its own shares. Accordingly, on 1 February 20X2, Entity A enters into a contract with Entity B that gives Entity B the right to receive and Entity A the obligation to pay the fair value of 1,000 of Entity A's outstanding ordinary shares as of 31 January 20X3 in exchange for CU98,000 in cash (ie CU98 per share) on 31 January 20X3, if Entity B exercises that right. The contract will be settled net in cash. If Entity B does not exercise its right, no payment will be made. Entity A records the following journal entries.

1 February 20X2

Dr	Cash	CU5,000	
	Cr	Put option liability	CU5,000

To recognise the written put option.

31 December 20X2

Dr	Put option liability	CU1,000	
	Cr	Gain	CU1,000

To record the decrease in the fair value of the put option.

31 January 20X3

Dr	Put option liability	CU1,000	
	Cr	Gain	CU1,000

To record the decrease in the fair value of the put option.

On the same day, Entity B exercises the put option and the contract is settled net in cash. Entity A has an obligation to deliver CU98,000 to Entity B, and Entity B has an obligation to deliver CU95,000 (CU95 × 1,000) to Entity A. Thus, Entity A pays the net amount of CU3,000 to Entity B.

Dr	Put option liability	CU3,000	
	Cr	Cash	CU3,000

To record the settlement of the option contract.

(b) Shares for shares ('net share settlement')

- IE29 Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A's journal entries are the same as those in (a), except for the following:

31 January 20X3

Entity B exercises the put option and the contract is settled net in shares. In effect, Entity A has an obligation to deliver CU98,000 worth of shares to Entity B, and Entity B has an obligation to deliver CU95,000 worth of Entity A's shares ($CU95 \times 1,000$) to Entity A. Thus, Entity A delivers the net amount of CU3,000 worth of Entity A's shares to Entity B, ie 31.6 shares ($3,000/95$).

Dr	Put option liability	CU3,000	
	Cr Equity		CU3,000

To record the settlement of the option contract. The issue of Entity A's own shares is accounted for as an equity transaction.

(c) Cash for shares ('gross physical settlement')

- IE30 Assume the same facts as in (a) except that settlement will be made by delivering a fixed amount of cash and receiving a fixed number of shares, if Entity B exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at CU98. Accordingly, Entity A has an obligation to pay CU98,000 in cash to Entity B ($CU98 \times 1,000$) in exchange for 1,000 of Entity A's outstanding shares, if Entity B exercises its option. Entity A records the following journal entries.

1 February 20X2

Dr	Cash	CU5,000	
	Cr Equity		CU5,000

To recognise the option premium received of CU5,000 in equity.

Dr	Equity	CU95,000	
	Cr Liability		CU95,000

To recognise the present value of the obligation to deliver CU98,000 in one year, ie CU95,000, as a liability.

31 December 20X2

Dr	Interest expense	CU2,750	
	Cr Liability		CU2,750

To accrue interest in accordance with the effective interest method on the liability for the share redemption amount.

31 January 20X3

Dr	Interest expense	CU250	
	Cr Liability		CU250

To accrue interest in accordance with the effective interest method on the liability for the share redemption amount.

On the same day, Entity B exercises the put option and the contract is settled gross. Entity A has an obligation to deliver CU98,000 in cash to Entity B in exchange for CU95,000 worth of shares ($\text{CU}95 \times 1,000$).

Dr	Liability	CU98,000	
	Cr Cash		CU98,000

To record the settlement of the option contract.

(d) Settlement options

- IE31 The existence of settlement options (such as net in cash, net in shares or by an exchange of cash and shares) has the result that the written put option is a financial liability. If one of the settlement alternatives is to exchange cash for shares ((c) above), Entity A recognises a liability for the obligation to deliver cash, as illustrated in (c) above. Otherwise, Entity A accounts for the put option as a derivative liability.

Entities such as mutual funds and co-operatives whose share capital is not equity as defined in IAS 32

Example 7: Entities with no equity

- IE32 The following example illustrates a format of a statement of comprehensive income and statement of financial position that may be used by entities such as mutual funds that do not have equity as defined in IAS 32. Other formats are possible.

Statement of comprehensive income for the year ended 31 December 20X1

	20X1	20X0
	CU	CU
Revenue	2,956	1,718
Expenses (classified by nature or function)	(644)	(614)
Profit from operating activities	2,312	1,104
Finance costs		
– other finance costs	(47)	(47)
– distributions to unitholders	(50)	(50)
Change in net assets attributable to unitholders	2,215	1,007

Statement of financial position at 31 December 20X1

	20X1		20X0
	CU	CU	CU
ASSETS			
Non-current assets (classified in accordance with IAS 1)	91,374	78,484	
Total non-current assets	91,374	78,484	
Current assets (classified in accordance with IAS 1)	1,422	1,769	
Total current assets	1,422	1,769	
Total assets	92,796	80,253	
LIABILITIES			
Current liabilities (classified in accordance with IAS 1)	647	66	
Total current liabilities	(647)	(66)	
Non-current liabilities excluding net assets attributable to unitholders (classified in accordance with IAS 1)	280	136	
	(280)	(136)	
Net assets attributable to unitholders	91,869	80,051	

Example 8: Entities with some equity

IE33 The following example illustrates a format of a statement of comprehensive income and statement of financial position that may be used by entities whose share capital is not equity as defined in IAS 32 because the entity has an obligation to repay the share capital on demand. Other formats are possible.

**Statement of comprehensive income for the year ended
31 December 20X1**

	20X1	20X0
	CU	CU
Revenue	472	498
Expenses (classified by nature or function)	(367)	(396)
Profit from operating activities	105	102
Finance costs		
– other finance costs	(4)	(4)
– distributions to members	(50)	(50)
Change in net assets attributable to members	51	48

Statement of financial position at 31 December 20X1

	20X1		20X0	
	CU	CU	CU	CU
ASSETS				
Non-current assets (classified in accordance with IAS 1)	908		830	
Total non-current assets		908		830
Current assets (classified in accordance with IAS 1)	383		350	
Total current assets		383		350
Total assets		<u>1,291</u>		<u>1,180</u>
LIABILITIES				
Current liabilities (classified in accordance with IAS 1)	372		338	
Share capital repayable on demand	202		161	
Total current liabilities		(574)		(499)
Total assets less current liabilities		<u>717</u>		<u>681</u>
Non-current liabilities (classified in accordance with IAS 1)	187		196	
		(187)		(196)
OTHER COMPONENTS OF EQUITY^(a)				
Reserves eg revaluation surplus, retained earnings etc	530		485	
		530		485
		<u>717</u>		<u>681</u>
MEMORANDUM NOTE – Total members' interests				
Share capital repayable on demand		202		161
Reserves		530		485
		<u>732</u>		<u>646</u>

(a) In this example, the entity has no obligation to deliver a share of its reserves to its members.

Accounting for compound financial instruments

Example 9: Separation of a compound financial instrument on initial recognition

- IE34 Paragraph 28 describes how the components of a compound financial instrument are separated by the entity on initial recognition. The following example illustrates how such a separation is made.
- IE35 An entity issues 2,000 convertible bonds at the start of year 1. The bonds have a three-year term, and are issued at par with a face value of CU1,000 per bond, giving total proceeds of CU2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 per cent. Each bond is convertible at any time up to maturity into 250 ordinary shares. When the bonds are issued, the prevailing market interest rate for similar debt without conversion options is 9 per cent.
- IE36 The liability component is measured first, and the difference between the proceeds of the bond issue and the fair value of the liability is assigned to the equity component. The present value of the liability component is calculated using a discount rate of 9 per cent, the market interest rate for similar bonds having no conversion rights, as shown below.

	CU
Present value of the principal – CU2,000,000 payable at the end of three years	1,544,367
Present value of the interest – CU120,000 payable annually in arrears for three years	303,755
Total liability component	1,848,122
Equity component (by deduction)	151,878
Proceeds of the bond issue	2,000,000

Example 10: Separation of a compound financial instrument with multiple embedded derivative features

- IE37 The following example illustrates the application of paragraph 31 to the separation of the liability and equity components of a compound financial instrument with multiple embedded derivative features.
- IE38 Assume that the proceeds received on the issue of a callable convertible bond are CU60. The value of a similar bond without a call or equity conversion option is CU57. Based on an option pricing model, it is determined that the value to the entity of the embedded call feature in a similar bond without an equity conversion option is CU2. In this case, the value allocated to the liability component under paragraph 31 is CU55 (CU57 – CU2) and the value allocated to the equity component is CU5 (CU60 – CU55).

Example 11: Repurchase of a convertible instrument

IE39 The following example illustrates how an entity accounts for a repurchase of a convertible instrument. For simplicity, at inception, the face amount of the instrument is assumed to be equal to the aggregate carrying amount of its liability and equity components in the financial statements, ie no original issue premium or discount exists. Also, for simplicity, tax considerations have been omitted from the example.

IE40 On 1 January 20X0, Entity A issued a 10 per cent convertible debenture with a face value of CU1,000 maturing on 31 December 20X9. The debenture is convertible into ordinary shares of Entity A at a conversion price of CU25 per share. Interest is payable half-yearly in cash. At the date of issue, Entity A could have issued non-convertible debt with a ten-year term bearing a coupon interest rate of 11 per cent.

IE41 In the financial statements of Entity A the carrying amount of the debenture was allocated on issue as follows:

	CU
Liability component	
Present value of 20 half-yearly interest payments of CU50, discounted at 11%	597
Present value of CU1,000 due in 10 years, discounted at 11%, compounded half-yearly	343
	<u>940</u>
Equity component	
(difference between CU1,000 total proceeds and CU940 allocated above)	60
Total proceeds	<u><u>1,000</u></u>

IE42 On 1 January 20X5, the convertible debenture has a fair value of CU1,700.

IE43 Entity A makes a tender offer to the holder of the debenture to repurchase the debenture for CU1,700, which the holder accepts. At the date of repurchase, Entity A could have issued non-convertible debt with a five-year term bearing a coupon interest rate of 8 per cent.

IE44 The repurchase price is allocated as follows:

	Carrying value	Fair value	Difference
	CU	CU	CU
Liability component:			
Present value of 10 remaining half-yearly interest payments of CU50, discounted at 11% and 8%, respectively	377	405	
Present value of CU1,000 due in 5 years, discounted at 11% and 8%, compounded half-yearly, respectively	585	676	
	962	1,081	(119)
Equity component	60	619 ^(a)	(559)
Total	<u>1,022</u>	<u>1,700</u>	<u>(678)</u>

(a) This amount represents the difference between the fair value amount allocated to the liability component and the repurchase price of CU1,700.

IE45 Entity A recognises the repurchase of the debenture as follows:

Dr Liability component	CU962	
Dr Debt settlement expense (profit or loss)	CU119	
Cr Cash		CU1,081

To recognise the repurchase of the liability component.

Dr Equity	CU619	
Cr Cash		CU619

To recognise the cash paid for the equity component.

IE46 The equity component remains as equity, but may be transferred from one line item within equity to another.

Example 12: Amendment of the terms of a convertible instrument to induce early conversion

IE47 The following example illustrates how an entity accounts for the additional consideration paid when the terms of a convertible instrument are amended to induce early conversion.

IE48 On 1 January 20X0, Entity A issued a 10 per cent convertible debenture with a face value of CU1,000 with the same terms as described in Example 11. On 1 January 20X1, to induce the holder to convert the convertible debenture promptly, Entity A reduces the conversion price to CU20 if the debenture is converted before 1 March 20X1 (ie within 60 days).

IAS 32 IE

- IE49 Assume the market price of Entity A's ordinary shares on the date the terms are amended is CU40 per share. The fair value of the incremental consideration paid by Entity A is calculated as follows:

*Number of ordinary shares to be issued to debenture holders under **amended** conversion terms:*

Face amount	CU1,000
New conversion price	<u>/CU20 per share</u>
Number of ordinary shares to be issued on conversion	<u>50 shares</u>

*Number of ordinary shares to be issued to debenture holders under **original** conversion terms:*

Face amount	CU1,000
Original conversion price	<u>/CU25 per share</u>
Number of ordinary shares to be issued on conversion	<u>40 shares</u>

Number of incremental ordinary shares issued upon conversion

10 shares

*Value of **incremental** ordinary shares issued upon conversion*

CU40 per share x 10 incremental shares	<u>CU400</u>
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- IE50 The incremental consideration of CU400 is recognised as a loss in profit or loss.