IAS 1 *Presentation of Financial Statements* (November 2006)

Whether the liability component of a convertible instrument should be classified as current or non-current

The IFRIC was asked to consider a situation in which an entity issued convertible financial instruments that, in accordance with IAS 32 *Financial Instruments: Presentation*, were accounted for as two elements—an equity component (ie the holders' rights to convert the instruments into a fixed number of equity instruments of the issuer any time before the maturity date) and a liability component (ie the entity's obligation to deliver cash to holders at the maturity date, which was more than one year after the balance sheet date). The issue was whether the liability component should be presented as current or non-current on the face of the issuer's balance sheet.

The IFRIC observed that both IAS 1 *Presentation of Financial Statements* and the *Framework for the Preparation and Presentation of Financial Statements* state that information about the liquidity and solvency of an entity is useful to users. The IFRIC also noted that the definitions of liquidity and solvency refer to the availability of cash to the entity. On that basis, the IFRIC believed that the liability component should be classified as non-current. On the other hand, the IFRIC noted that paragraph 60(d) of IAS 1 states that a liability should be classified as current if the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the balance sheet date. According to paragraph 62 of the *Framework*, conversion of an obligation into equity is considered as the settlement of a liability. In addition, according to the definition of a financial liability set out in paragraph 16 of IAS 32, a financial liability may be settled through the delivery of a variable number of the issuer's own equity instruments. Settlement of a liability is not confined to delivery of cash or other assets.

The IFRIC believed that the above IFRS requirements appeared to be in conflict. In addition, the IFRIC observed that practice, in determining whether the liability component was classified as current or non-current, focused on when the issuer was obliged to deliver cash or other assets. The IFRIC received a comment letter, supporting an alternative rationale for the non-current classification of the liability component of a compound financial instrument. IAS 32 requires the equity and liability components of a compound financial instrument to be accounted for separately. Because IAS 1 addresses the presentation of liabilities (not equity), the comment letter suggested that the equity component should be ignored in determining whether the liability component should be presented as current or non-current in accordance with IAS 1. The IFRIC decided that both rationales should be drawn to the attention of the Board with a request for clarification. The IFRIC decided not to take the issue onto its own agenda.