

IAS 32 *Financial Instruments: Presentation* (November 2006)

Changes in the contractual terms of an existing equity instrument resulting in it being reclassified to financial liability

The IFRIC was asked to consider a situation in which an amendment to the contractual terms of an equity instrument resulted in the instrument being classified as a financial liability of the issuer. Two issues were discussed: (i) on what basis the financial liability should be measured at the date when the terms were changed and (ii) how any difference between the carrying amount of the previously recognised equity instrument and the amount of the financial liability recognised at the date when the terms were changed should be accounted for.

The IFRIC noted that at the time when the contractual terms were changed, a financial liability was initially recognised, and, furthermore, that a financial liability on initial recognition is measured at its fair value in accordance with paragraph 43 of IAS 39 *Financial Instruments: Recognition and Measurement*. The IFRIC observed that Example 3 of IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments* deals with a similar situation. In that example, at the time when the financial liabilities are recognised, when the terms are changed, they are recognised at their fair value.

The IFRIC observed that the change in the terms of the instrument gave rise to derecognition of the original equity instrument. The IFRIC noted that paragraph 33 of IAS 32 *Financial Instruments: Presentation* states that 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. The IFRIC, therefore, believed that, at the time when the terms were changed, the difference between the carrying amount of the equity instrument and the fair value of the newly recognised financial liability should be recognised in equity.

The IFRIC believed that the requirements of IFRS, taken as a whole, were sufficiently clear and that the issue was not expected to have widespread relevance in practice. The IFRIC, therefore, decided that the issue should not be taken onto the agenda.