Accounting for a Financial Instrument that is Mandatorily Convertible into a Variable Number of Shares Subject to a Cap and a Floor (IAS 32 Financial Instruments: Presentation) — May 2014

The Interpretations Committee discussed how an issuer would account for a particular mandatorily convertible financial instrument in accordance with IAS 32 Financial Instruments: Presentation and IAS 39 Financial Instruments: Recognition and Measurement or IFRS 9 Financial Instruments. The financial instrument has a stated maturity date and, at maturity, the issuer must deliver a variable number of its own equity instruments to equal a fixed cash amount — subject to a cap and a floor, which limit and guarantee, respectively, the number of equity instruments to be delivered.

The Interpretations Committee noted that the issuer’s obligation to deliver a variable number of the entity’s own equity instruments is a non-derivative that meets the definition of a financial liability in paragraph 11(b)(i) of IAS 32 in its entirety. Paragraph 11(b)(i) of the definition of a liability does not have any limits or thresholds regarding the degree of variability that is required. Therefore, the contractual substance of the instrument is a single obligation to deliver a variable number of equity instruments at maturity, with the variation based on the value of those equity instruments. Such a single obligation to deliver a variable number of own equity instruments cannot be subdivided into components for the purposes of evaluating whether the instrument contains a component that meets the definition of equity. Even though the number of equity instruments to be delivered is limited and guaranteed by the cap and the floor, the overall number of equity instruments that the issuer is obliged to deliver is not fixed and therefore the entire obligation meets the definition of a financial liability.

Furthermore, the Interpretations Committee noted that the cap and the floor are embedded derivative features whose values change in response to the price of the issuer’s equity share. Therefore, assuming that the issuer has not elected to designate the entire instrument under the fair value option, the issuer must separate those features and account for the embedded derivative features separately from the host liability contract at fair value through profit or loss in accordance with IAS 39 or IFRS 9.

The Interpretations Committee considered that in the light of its analysis of the existing IFRS requirements, an Interpretation was not necessary and consequently decided not to add the issue to its agenda.