

STAFF PAPER

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Introduction

1. The objective of this paper is to:
 - (a) explore how the Gamma approach could be applied to classify liability/equity exchange derivatives.
 - (b) discuss possible ways of addressing the challenges that arise.
2. This paper is structured as follows:
 - (a) Background (paragraphs 3–16)
 - (b) Instruments that redeem or repurchase a liability in exchange for equity (paragraphs 17–27)
 - (c) Instruments that redeem or repurchase equity in exchange for a liability (paragraphs 28–57)
 - (d) Interaction between the requirements for derivatives on own equity (paragraphs 58–80)

Background

3. In **Agenda Paper 5B – Derivatives on ‘own equity’**, we explained that:
 - (a) For asset/equity exchanges, both of the underlying financial asset to be received, and the underlying equity to be delivered, are not existing financial assets or equity of the entity. Thus, when the contract is settled it results in an increase in the assets of the entity and an increase in the equity of the entity.
 - (b) For liability/equity exchanges, the financial liability or equity that is to be extinguished when the contract is settled must be, by definition, an existing financial liability or equity of the entity. Because of this relationship, derivatives that are liability/equity exchanges need to be considered together with the underlying claim that will be, or might be, extinguished.
4. We discussed the application of the Gamma approach to asset/equity exchanges in **Agenda Paper 5C – Applying Gamma to asset/equity exchange derivatives**.
5. In that paper, we concluded that classifying derivatives on own equity using the existing fixed-for-fixed condition would be consistent with the Gamma approach, except for net-share settled fixed-for-fixed derivatives and the foreign currency rights issue exception. We suggested in that paper that the separate presentation requirements could be used to mitigate the issue of changes in the residual amount being classified as liabilities.
6. In this paper, we consider the application of the Gamma approach to liability/equity exchanges. We explore whether additional requirements are required (such as the redemption obligation requirements) given that we are classifying derivatives in their entirety, and the special nature of liability/equity exchanges that we note in paragraph 3(b).
7. There are two different types of liability/equity exchange derivatives:
 - (a) derivatives to redeem or repurchase a liability in exchange for issuing equity. These are typically embedded conversion options, for example in convertible bonds, however they could also be standalone

derivatives. We consider standalone derivatives of this type first in paragraphs 17–27.

- (b) derivatives to redeem or repurchase equity in exchange for a liability. These are typically standalone derivatives, for example written puts on own equity, however they could also be embedded redemption obligations, such as in puttable shares. We consider these types of derivatives further in paragraphs 28-57.

Summary of the Gamma approach

- 8. Under the Gamma approach, a liability includes an obligation:
 - (a) to transfer economic resources at particular points in time other than at liquidation or
 - (b) for a specified amount independent of the economic resources of the entity.
- 9. All other claims will be classified as equity. This means that instruments classified as equity:
 - (a) do not require transfer of economic resources prior to liquidation; and
 - (b) are an obligation for an amount that depends on the residual amount.
- 10. In Agenda Paper 5C, we applied the Gamma approach to an asset/equity exchange derivative in its entirety. We then looked at whether the features of the derivative *as a whole*:
 - (a) do not require transfer of economic resources prior to liquidation; and
 - (b) are an obligation for an amount that depends on the residual amount.

Summary of IAS 32 requirements for comparison

- 11. As part of the analysis in this paper, we compare the classification of derivatives under the Gamma approach to the classification under the existing requirements of IAS 32 *Financial Instruments: Presentation*.
- 12. There are a number of IAS 32 requirements that apply to liability/equity exchange contracts:
 - (a) the fixed-for-fixed condition (as discussed in Agenda Paper 5C);

- (b) the redemption obligation requirements; and
 - (c) the compound instrument requirements.
13. The redemption obligation requirements are in paragraph 23 of IAS 32. These requirements are derived from the definition of a financial liability. They require an entity to classify any obligation to repurchase ‘own equity’ as a financial liability for the present value of the full discounted redemption amount. These requirements apply to all obligations to repurchase ‘own equity’ even if:
- (a) the obligation is conditional on the counterparty exercising a right to redeem; or
 - (b) the obligation is part of a standalone derivative that meets the fixed-for-fixed condition.
14. The repurchase obligation requirements are subject to one exception. That exception is the ‘puttables exception’ that we discussed in September 2015 ([Agenda Paper 5A](#)), the requirements for which are found in paragraphs 16A–16D of IAS 32. We will be discussing the puttables exception in a future meeting.
15. Paragraphs 28–32 of IAS 32 contain requirements for the accounting for compound instruments. They require an entity to classify separately liability and equity components of a non-derivative financial instrument. They also require the entity to measure the liability component at the fair value of a financial liability with similar features excluding the equity component at initial recognition and subsequently. In many cases the other component will be a derivative on ‘own equity’.
16. The redemption obligation requirements and the compound instrument requirements are related. Those requirements result in similar accounting for all contracts that impose an outcome that meets the definition of a financial liability, regardless of how those contracts are structured. However, that relationship is not explicit in IAS 32. As we will show in paragraphs 58-80, this results in some inconsistencies in the accounting outcomes because they are achieved through different sets of requirements.

Instruments that redeem or repurchase a liability in exchange for equity

Instruments classified as equity under the Gamma approach

17. Similarly to Agenda Paper 5C, liability/equity exchange derivatives would be classified as equity under the Gamma approach if both of the conditions are met:
- (a) it does not require the entity to transfer cash or other financial assets other than at liquidation; and
 - (b) the amount of the derivative depends on the residual amount.
18. In the staff's view, for liability/equity exchange derivatives, this would only be the case if both of the following conditions are met:
- (a) if the derivative redeems or repurchases a liability in exchange for issuing equity, and is physically settled. This is because there would be no requirement to transfer economic resources other than at liquidation. This contrasts with a net-cash settled derivative, which would require a transfer of economic resources prior to liquidation.
and
 - (b) if the amount of the derivative is determined by receiving a liability of a fixed amount in exchange for delivering a fixed number of equity instruments. This is because the value of such a derivative in its entirety would be determined as the difference between the amount of the liability to be received and the value of the equity to be delivered. Because the value of the liability leg is for a certain amount, the value of the derivative in its entirety will be solely determined by the equity leg. That is, the amount of the derivative solely depends on the residual amount.
19. The basis for the above would be equivalent to the classification of fixed-for-fixed asset/equity exchange derivatives as discussed in Agenda Paper 5C. Consistent with that analysis, liability/equity exchange derivatives that have the features in paragraph 18 would also be classified as equity under IAS 32.

Instruments classified as liabilities under the Gamma approach

20. Similarly to Agenda Paper 5C, derivatives would be classified as liabilities under the Gamma approach if:
- (a) they are net-settled in *cash* (regardless of whether they otherwise meet the fixed-for-fixed condition).¹
 - (b) they require the entity to *deliver a variable number of equity instruments* equal to an amount independent of the entity's economic resources.
21. The basis for the above would be equivalent to the classification of net-cash settled derivatives, and derivatives for the delivery of a variable number of equity instruments, as discussed in Agenda Paper 5C.
22. Consistent with that analysis, these instruments would also be classified as liabilities under IAS 32.

Instruments that present challenges for the Gamma approach

23. The classification of a contract for the redemption or repurchase *of a liability of a variable amount* in exchange for delivering *a fixed number of equity instruments* (variable-for-fixed derivatives) presents challenges for the Gamma approach.
24. Similarly to the equivalent asset/equity exchange derivative, the challenge for such a contract does not arise because of the settlement requirements. If such a contract is net cash settled, then it would be a liability. If physically settled, or net-share settled, then the contract would not require the entity to transfer economic resources other than at liquidation.
25. However, as we discussed in Agenda Paper 5C, the challenge arises when determining whether the derivative *as a whole* is for an amount independent of the entity's economic resources, or for an amount that depends on the residual amount.
26. If the liability leg is for a *variable* amount that is independent of the entity, and the equity leg is for a *fixed* number of equity instruments, then, **the amount of the**

¹ In fact, if they are net-settled in cash, then they would simply be net cash settled asset/equity exchange.

obligation is neither completely independent of the entity's economic resources, nor solely dependent on the residual amount.

27. However, we will return to this issue after we have discussed derivatives that redeem or repurchase equity in exchange for issuing a liability (see paragraphs 58-80)

Instruments that redeem or repurchase equity in exchange for a liability

What is the issue?

28. If we apply the Gamma approach to a standalone written option or forward for the redemption or repurchase of a fixed number of the entity's own equity instruments in exchange for a liability, then the fact that the derivative establishes a liability, in exchange for extinguishing an existing equity instrument of the entity becomes relevant. The combined effect of the derivative would be to exchange an equity instrument for a liability.
29. We have already discussed obligations to redeem that are embedded in instruments (see Agenda Paper 5A), and in those discussions, for example, we have concluded that a share that is redeemable at fair value would be a liability. Separating the redemption clause in a separate instrument does not change the outcome of the arrangement. Another way to view such an arrangement would be to analogise to sale and repurchase arrangements. The entity has 'sold' 100 ordinary shares, however the repurchase agreement negates the 'sale' and replaces it with a financial liability.
30. In the staff's view, entities with identical obligations that meet the definition of a liability should report the same information in their financial statements regardless of whether the redemption clause is:
- (a) embedded in the instrument being redeemed; or
 - (b) a standalone derivative instrument.²

² A similar statement is made in the basis for the existing IAS 32, paragraph BC11.

31. Therefore, the Gamma approach should apply a similar redemption obligation requirement as in IAS 32.
32. The basis that identical obligations should be accounted for similarly is also valid under the Gamma approach. However, in the staff's view, the requirement to gross up the written put option to the redemption amount is a bit stronger given that the underlying rationale of the Gamma approach is to provide a user with information to help them assess:
- (a) The extent to which the entity has sufficient resources to meet its obligations to transfer resources as they fall due.

Writing an option that grants the holder the right to put shares back to the entity for cash means that the entity is assuming an obligation to transfer resources at a point in time other than at liquidation.

- (b) The extent to which the entity has sufficient resources to meet the amount of its obligations at a particular point in time.

Writing an option that grants the holder the right to put shares back to the entity for a fixed amount means that the entity is assuming an obligation for an amount independent of the entity's economic resources. That is, the issuer is **guaranteeing a return to the holder**.

Illustrative examples

33. We will use some simple examples of liability/equity exchanges to demonstrate the above analysis:
- (a) Example 1: Written put option on 'own equity' (paragraphs 35–45)
- (b) Example 2: Simple convertible bond (paragraphs 46–50)
34. All of the contracts above will contain an obligation to pay cash equal to an amount independent of the entity. However a similar analysis would apply under the Gamma approach if the fixed number of equity instruments were being extinguished in exchange for:
- (a) an amount of cash equal to the fair value of the equity instruments; or
- (b) a variable number of equity instruments equal to a fixed amount.

We revisit these types of derivatives in our summary in paragraphs 51–57.

Example 1: Written put option on ‘own equity’

35. The entity separately issues 100 ordinary shares and a written put option. One year from date of issuance the counterparty has the right (but not the obligation) to receive an amount equal to CU110 in cash, in exchange for extinguishing the rights to the 100 ordinary shares (ie the shares can be ‘put back’ to the entity). The entity receives CU100 in cash at the date of issuance for the 100 shares and the written put option. The counterparty cannot receive both the CU110 in cash and retain the 100 shares, it must choose one or the other.
36. In our simple example the claim does not pay dividends in the intervening period, the claim is not convertible, or redeemable by the counterparty or the entity prior to one year, and does not meet puttable instrument exception.
37. The obligation to pay CU110 in cash in one year, on demand of the holder, meets the definition of a liability under the Gamma approach.³ However, that payment is in exchange for extinguishing the 100 ordinary shares issued by the entity. That is, the ‘equity’ receivable leg of the written put option changes the character of the 100 ordinary shares issued. The issuer’s and holder’s rights and obligations related to the 100 ordinary shares are not the same as other ordinary shares.
38. Applying the redemption obligation requirement under the Gamma approach will result in the entity recognising, measuring and presenting the obligation to pay CU110 in cash as a liability. This would show that the entity has an obligation to pay and amount of cash that is independent of the entity (ie regardless of what the shares are worth) in one year’s time. It would show both the cash payment requirement and the sufficiency of the entity’s assets to meet the amount of the obligation, because of the requirement to gross up the written put option consistently with IAS 32.
39. Some question whether the liability recognised for a put option, which is **conditional**, should be the same as a forward contract, which is **unconditional**.

³ It also meets the definition of a liability under IAS 32.

40. It is true that the put option is conditional. However, the same accounting is only with respect to the liability component, which, for both the put option and forward contract, excludes the effect of any equity outcome. Unlike the forward contract where the equity extinguishment is unconditional, under the put option the equity outcome is conditional. This simply means that the equity component of the written put arrangement is more valuable than that of the forward contract.
41. The equity component of the written put is more valuable because it provides the holder with an option to waive the cash payment and share in potential upside by continuing to hold the shares, even though the put option protects the holder's downside. The downside protection, which is the liability component, is the same for both the written put and the forward, whereas the equity component is different for the put and the forward.
42. As we show in paragraphs 51–54, the equity component for the put option arrangement is similar to the conversion option in a convertible bond arrangement.
43. Therefore, the accounting for the written put arrangement as a whole is different to the accounting for the forward contract arrangement, because under the written put option (and convertible bond), there will typically be a residual value that would represent the equity component. For the unconditional contract, this would simply be nil or non-existent.⁴ This difference would also be reflected in the price of the written put option compared to a forward contract.
44. The accounting described above for the written put option and 100 ordinary shares under the Gamma approach is similar to IAS 32.
45. Currently, IAS 32 would require the issuer to account for the written put option arrangement as follows:
- (a) the entity would recognise the 100 ordinary shares issued;

⁴ In our example, there are no dividends payable in the intervening period. However, in reality the holder of the shares might have the right to receive dividends in the intervening period, in which case there might be some value ascribed to the right to receive dividends, which would be an equity component.

- (b) the entity would recognise a financial liability for the present value of the redemption amount (the CU110 payable, discounted to a present value, say CU95);
- (c) the amount recognised for the financial liability would be ‘reclassified’ from equity, thus the difference between:
 - (i) the fair value at issuance of the combined 100 ordinary shares and the put option (CU 100); and
 - (ii) the liability ‘leg’ (CU95)
 would continue to be recognised in equity; and
- (d) at the exercise date, the entity would either recognise the payment made, or the reclassification of the carrying amount of the liability to equity if the payment is not made.

Example 2: Simple convertible bond

- 46. The entity issues a bond that requires the entity to pay to the holder an amount equal to CU110 in cash one year from date of issuance. At the same date, the counterparty has the right to elect to receive 100 ordinary shares of the entity, in lieu of the payment of CU110. The entity receives CU100 in cash at the date of issuance in exchange for the convertible bond. The counterparty cannot receive both the CU110 in cash and the 100 shares, it must choose one or the other.
- 47. In our simple example the claim does not have any unconditional payments and the claim is not convertible, or redeemable by the counterparty or the entity prior to one year.
- 48. Similar to the written put option, the obligation to pay CU110 in cash in one year meets the definition of a liability under the Gamma approach.⁵ The written conversion option to issue 100 ordinary shares is an equity component.
- 49. Under the Gamma approach, recognising, measuring and presenting the obligation to pay CU110 in cash as a liability would show that the entity has an obligation to pay and amount of cash that is independent of the entity (ie regardless of what the shares are worth) in one year’s time. It would show both the cash payment

⁵ It also meets the definition of a liability under IAS 32.

requirement and the sufficiency of the entity's assets to meet the amount of the obligation.

50. The accounting described above for the convertible bond under the Gamma approach is similar to IAS 32. For the convertible bond, IAS 32 would require the issuer to account for the claim as follows:
- (a) the entity would recognise a financial liability for the claim at an amount equal to the fair value of the same bond issued without the conversion feature (eg the CU110 payable, discounted to a present value, say CU95);
 - (b) any difference between the amount for the liability and the fair value of the convertible bond would be recognised at issuance in equity (ie the equity component, say CU5); and
 - (c) at the exercise date, the entity would either recognise the payment made, or reclassify the carrying amount of the liability to equity if the holder elected to receive shares in lieu of the payment.

Summary and question for the Board

51. Both Example 1 and Example 2 share similar sets of features:
- (a) they are both issued for CU100 in cash; and
 - (b) they both give the counterparty the right to choose, one year from issuance, to either:
 - (i) demand a payment from the entity of CU110; or
 - (ii) continue to invest in the entity with rights to 100 ordinary shares.
52. However, the sets of features in Example 1 and Example 2 **are expressed** in different ways in terms of the structure of the arrangement:
- (a) the convertible bond is expressed as a typical bond, together with a written option to convert the bond to ordinary shares; and

(b) the written put option on ordinary shares is expressed as an ordinary share, together with a standalone written option to put the shares back to the entity in exchange for CU110 in cash.

53. In reality, there may be other differences (additional rights or obligations) between the two that some might also include in their analysis. Any additional rights and obligations that are independent of that issue are considered separately. For example, the convertible bond might require payment of coupons or interest. If interest payments are required in the intervening period until the bond is convertible, then, they would be a financial liability regardless of the other features of the arrangement.

54. In the staff’s view, applying the Gamma approach, the similarities in the features mean that they should be accounted for in the same way (see Table 5):

- (a) The right of the counterparty to demand CU110 in cash at the end of one year **establishes a financial liability**. This is both an amount independent of the entity’s economic resources and requires transfer of economic resources prior to liquidation. Of course, the counterparty can exercise that right even if it is not favourable, however that does not change the entity’s obligation for the CU110 until the counterparty waives that right.
- (b) The equity component has only incremental value above this amount.

Table 5

	Example 1	Example 2
	Written put option on ‘own equity’ + underlying own share	Simple convertible bond
Amount received	100	100
Financial liability	95	95
Equity	5	5

55. Accounting for the simple convertible bonds and written put options that we have illustrated is relatively straightforward under the Gamma approach.
56. Conceptual challenges for written put options on own shares that have arisen in the past typically relate to whether the transfer leg meets (or should meet) the definition of a financial liability. This includes:
- (a) if the redemption price is equal to the value of the underlying share (so called ‘fair value puts’). Many people question under IAS 32 why the entity is required to gross up, given that the value of the standalone option is nil.
 - (b) if the written put option is settled in a variable number of shares (so called ‘variable share settled puts’). This is because the redemption obligation requirement in paragraph 23 refers only to obligations to transfer cash or another financial asset.
57. In the staff’s view, clarifying the underlying rationale of the Gamma approach could answer the questions raised as follows:
- (a) For fair value puts, the redemption requirement should still apply to written put options to repurchase equity instruments by transferring a variable amount of cash equal to the value of the underlying shares. If the derivative requires the entity to transfer economic resources other than at liquidation, then it is a liability under the Gamma approach. The written put option would result in the shares being, in substance, shares redeemable at fair value. Furthermore, the separate presentation requirements would apply for liabilities that depend on the residual amount.
 - (b) For variable share settled puts, if the amount of shares to be delivered is determined by an amount independent of the entity’s economic resources, then the obligation is a liability under the Gamma approach.

Question for the Board

Does the Board agree that the Gamma approach should apply a requirement similar to the existing redemption obligation requirement in IAS 32?

Interaction between the requirements for derivatives on own equity

58. We have demonstrated the application of Gamma to exchanges of liabilities and equity (paragraphs 17–27). In addition, as with the current requirements in IAS 32, we have also demonstrated the consistency of the fixed-for-fixed requirements with the requirements for compound instrument accounting (paragraphs 17–27)
59. We have also demonstrated the need for the redemption obligation requirements for such exchanges under Gamma along with the consistency of the same with the current requirements in IAS 32 (paragraphs 28–57).
60. However, the above does not address all the challenges that arise from such exchanges. A key challenge that arises relates to the consistency of the requirements for compound instrument accounting and the redemption obligation requirements. The issue arises from the application of the fixed for fixed requirements to the redemption obligation requirements.
61. We illustrate these challenges by modifying Examples 1 and 2 to make the liability indexed to foreign currency.

Examples 3 and 4 – Foreign currency

62. Consider similar arrangements to Examples 1 and 2. However, in this case, instead of requiring the payment of CU110 in the entity's functional currency, the written put and convertible bond require payment of FCU110.⁶
63. Under the existing requirements of IAS 32:
- (a) The whole convertible bond, including the conversion option, would be classified as a liability in its entirety. The obligation to pay cash would be a liability. Also, because the conversion option is to exchange a variable amount of cash (ie FCU110) for a fixed amount of shares, the conversion option would also be classified as a liability.
 - (b) For the written put option, the obligation to pay FCU110 would be a liability as per the requirements in IAS 32. However, IAS 32 does not have any requirement to account for the option feature as it only

⁶ We use FCU to denote foreign currency units.

stipulates the recognition of the liability. This element in a written put option arrangement usually remains within equity.

64. In other words, the accounting for the two arrangements is different under IAS 32, even though the outcomes are the same.

Table 6

	Example 3	Example 4
	FX convertible bond	FX written put option on ‘own equity’ + underlying own share
Amount received	100	100
Financial liability	100	95
Equity	-	5

65. In the case of a foreign currency denominated convertible bond, foreign exchange differences are recognised in profit or loss on the translation of the host liability component of the convertible bond under IAS 21 *The Effects of Changes in Foreign Exchange Rates*⁷. The embedded conversion option (which is not currently classified as equity) is measured at fair value through profit or loss reflecting both changes in the underlying share price and changes in foreign exchange rates.
66. In the case of a foreign currency denominated written put option, foreign exchange differences are recognised in profit or loss on the translation of the ‘gross’ liability under IAS 21.

⁷ 21.28 – “Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different than those at which they were translated on initial recognition during the period or in previous financial statements shall be recognised in profit or loss in the period in which they arise...”

Staff analysis

67. In the staff's view, it would be desirable to account for similar arrangements in similar ways. There are two potential ways of achieving this:
- (a) Ensure that all accounting for liability/equity exchanges conforms to the requirements for convertible bonds. That is, in addition to recognising the liability component the equity conversion option is also classified consistently. For example, in case of a written put option the requirements would imply that not only the recognition of the gross liability for the put option, but also the optionality that is inherent in such an instrument.
 - (b) Ensure that all accounting for liability/equity exchanges conforms to the current accounting requirements for written put options.
68. The above choice distils itself into the question of whether the fixed-for-fixed condition also applies for the redemption obligation under Gamma.
69. The decision as to whether or not to extend the fixed-for-fixed requirement to all liability/equity exchanges is complicated as compared to asset/equity exchanges.
70. Unlike asset/equity exchanges, for liability/equity exchanges the effect of foreign currency is shown separately on the statement of financial position and through profit or loss through the recognition of the gross liability. Therefore, for liability/equity dual indexed exchanges, some of the consequences of equity classification for asset/equity dual indexed exchanges fall away. The non-equity exposure is not 'hidden', therefore regardless of the structure of the liability equity exchange, the liability component will be measured first, and the equity component will be measured as a residual.
71. If the fixed-for-fixed condition were **not** applied to all liability/equity exchanges, then a foreign currency convertible bond (Example 3) would be accounted for as follows:
- (a) the entity would recognise a financial liability (the liability 'component') for the claim at an amount equal to the fair value of the same foreign currency bond issued without the conversion feature (eg the FCU110 payable, discounted to a present value, say FCU95);

- (b) any difference between the amount for the liability ‘component’ and the fair value of the convertible bond would be recognised at issuance in equity (ie the residual equity ‘leg’, say CU5);
- (c) subsequent to initial recognition, any variation in the foreign currency would require a remeasurement of the FCU110 payable, resulting in foreign currency gains and losses recognised in profit or loss.
- (d) at the exercise date, the entity would either recognise the payment made, or reclassify the carrying amount of the liability ‘leg’ to equity if the holder elected to receive shares in lieu of the payment.

72. Having said the above, recognising the foreign currency liability element does not resolve all the challenges. The value of the conversion option in a foreign currency denominated convertible bond is driven both by underlying share price factors (volatility, dividend yield etc) and foreign currency factors (ie the conversion option is ‘dual indexed’). Therefore, the conversion option classified as equity would, to an extent, include foreign currency effects that means that it would not solely depend upon the residual amount. Thus, under the Gamma approach, it would be included in the liability component of a convertible bond rather than being included in the residual value attributable to equity.

73. However, in the staff’s view, it is not practicable to construct a method whereby some meaningful value relating to the foreign currency element within the conversion option is attributed to the liability component (and with changes therefore being recognised in profit or loss). Any method used would raise significant questions with regard to what the amount actually represented, as well as subsequent measurement issues.

74. IAS 32 states that the same accounting treatment should apply regardless of whether the rights and obligations are in one contract (a convertible bond) or two contracts (bond with early settlement provisions and detachable warrants), since the economic effect is substantially the same. The rationale for separating the conversion option in a convertible bond is that the conversion option is equivalent to a stand-alone derivative and, therefore, the same accounting treatment should apply.

75. Therefore, in the staff's view:
- (a) 'ring-fencing' the fixed-for-fixed condition to apply only to asset/equity exchanges is inconsistent with this approach.
 - (b) hence, the redemption obligation requirements should be amended to apply the fixed-for-fixed condition. This would require any implied conversion option that does not meet the fixed-for-fixed condition should be classified as liability.
76. If the fixed-for-fixed condition were applied to liability/equity exchanges, then a foreign currency written put (Example 4) would be accounted for as follows:
- (a) the entity would recognise a financial liability for the present value of the redemption amount (the CU110 payable, discounted to a present value, say CU95);
 - (b) the entity would recognise an embedded derivative representing the implied option to convert the foreign currency liability to 100 ordinary shares at the exercise date.
 - (c) any residual would continue to be recognised as an equity component (for example, any rights to receive dividends in the period until the exercise date); and
 - (d) at the exercise date, the entity would either recognise the payment made, or the reclassification of the carrying amount of the liability components to equity if the payment is not made.

Summary and questions for the Board

77. Based on the above, the staff's preferred approach would be to continue to apply fixed-for-fixed for classification of derivatives as liabilities or equity, and clarify and reconcile the interaction of:
- (a) the fixed-for-fixed condition;
 - (b) the compound instrument requirements; and
 - (c) the redemption obligation requirements.

78. However, we think that it might be possible to use the proposed separate presentation within liabilities to mitigate some of the consequences of such an approach. This would result in a statement of financial position that includes claims that solely depend on the residual amount within equity, but mitigate the issue of classifying as liabilities claims that partially depend on the residual amount through separate presentation.
79. We will discuss the separate presentation requirements further at the next meeting.

Question for the Board

Does the Board agree that the Gamma approach should only classify liability/equity exchange derivatives as equity if they are solely dependent on the residual amount (consistently with asset/equity exchanges), and reconcile the interaction with the redemption obligation requirements?