IFRS

STAFF PAPER

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IFRS® Interpretations Committee meeting

Project	**Accounting for Warrants that are Classified as Financial Liabilities on Initial Recognition (IAS 32)**
Paper topic	Comment letters on tentative agenda decision

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Introduction

1. In March 2021, the IFRS Interpretations Committee (Committee) published a tentative agenda decision in response to a submission about whether, applying IAS 32 *Financial Instruments: Presentation,* an issuer reclassifies a derivative financial liability to equity after initial recognition in particular circumstances.

2. Specifically, the submission described a warrant that provides the holder with the right to buy a fixed number of equity instruments of the issuer of the warrant for an exercise price that will be fixed at a future date. At initial recognition, because of the variability in the exercise price, the issuer in applying paragraph 16 of IAS 32 classifies these instruments as financial liabilities. This is because for a derivative financial instrument to be classified as equity, it must be settled by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments ('fixed-for-fixed condition'). The submission asked whether the issuer reclassifies the warrant as an equity instrument following the fixing of the

warrant's exercise price after initial recognition as specified in the contract, given that the fixed-for-fixed condition would at that stage be met.

3. In analysing the submission, the Committee observed that:

   (a) IAS 32 contains no general requirements for reclassifying financial liabilities and equity instruments after initial recognition when the instrument's contractual terms are unchanged;

   (b) similar questions about reclassification arise in other circumstances; and

   (c) reclassification by the issuer has been identified as one of the practice issues the Board will consider as part of its Financial Instruments with Characteristics of Equity (FICE) project.

4. Based on its analysis, the Committee concluded that the matter described in the request is, in isolation, too narrow for the Board or the Committee to address in a cost-effective manner. Instead, the Board should consider the matter as part of its broader discussions on the FICE project. Consequently, the Committee tentatively decided not to add a standard-setting project to the work plan and, instead, published the tentative agenda decision.

5. The objectives of this paper are to:

   (a) analyse comments on the tentative agenda decision (paragraphs 8-13); and

   (b) ask the Committee whether it agrees with our recommendation to finalise the agenda decision (paragraph 14).

6. Appendix A to the paper contains the proposed wording of the agenda decision.

7. Agenda Paper 3A for this meeting reproduces the comment letters.

Comment letter summary

8. We received 8 comment letters by the comment letter deadline. All comments received, including any late comment letters, are available on our website[1]. This agenda paper includes analysis of only the comment letters received by the comment letter deadline, which are reproduced in Agenda Paper 3A.

9. Six respondents (Deloitte, the Malaysian Accounting Standards Board, the Institute of Chartered Accountants of India, the Institute of Chartered Accountants of Nigeria, David Hardidge and Petrobras) agree with the Committee's decision not to add a standard-setting project to the work plan broadly for the reasons set out in the tentative agenda decision.

10. Two respondents (the Group of Latin American Standards Setters [GLASS] and Consejo Mexicano de Normas de Información Financiera [CINIF] (Mexican Standard Setter)) agree with the decision not to address the specific fact pattern in isolation and, instead, consider the matter as part of the broader discussions on the FICE project. However, they are of the view that the requirements in IAS 32 are sufficient to address the fact pattern described in the submission. Further details about the matter raised by these respondents, together with our analysis, is presented below.

Staff analysis

Respondents' comments

11. Both GLASS and CINIF are of the view that the requirements in IAS 32 are sufficient to address the fact pattern described in the submission. These respondents suggest that the agenda decision focus on paragraphs 16E-16F of IAS 32 to support a conclusion that IFRS Standards are sufficient to address the matter submitted. In their view, it is clear that the issuer in applying paragraphs 16E-16F of IAS 32 reclassifies the warrant to equity when the 'fixed-for-fixed' condition is met.

[1] At the date of posting this agenda paper, there were no late comment letters.

Staff analysis

12. We continue to agree with the Committee's observation that IAS 32 contains no general requirements for reclassifying financial liabilities and equity instruments after initial recognition when the instrument's contractual terms are unchanged.

13. We also note that:

(a) paragraphs 16E-16F of IAS 32 set out requirements for reclassifying *specific* instruments—ie puttable instruments and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation (hereafter, collectively referred to as 'puttable instruments'). Applying these requirements, reclassification is required when an instrument meets (or ceases to meet) the relevant conditions and/or has (or ceases to have) all the relevant features set out in paragraphs 16A-16D of IAS 32.

(b) paragraph 96B of IAS 32 specifically states that the requirements for puttable instruments represent a limited scope exception that an entity cannot apply by analogy. The requirements in paragraphs 16E-16F therefore do not apply to the fact pattern described in the submission—or indeed to any instrument other than puttable instruments—and cannot be applied by analogy.

Staff recommendation

14. Based on our analysis, we recommend finalising the agenda decision, as published in IFRIC *Update* in March 2021, with no changes. If the Committee agrees with our recommendation, we will ask the Board whether it objects to the agenda decision at the first Board meeting at which it is practicable to present the agenda decision.

Question for the Committee
Does the Committee agree with our recommendation to finalise the agenda decision as explained in paragraph 14 of this paper?

Appendix A—proposed wording of the agenda decision

A1. We propose the following wording for the final agenda decision, which is unchanged from the tentative agenda decision except to remove the square brackets in the last paragraph.

Accounting for Warrants that are Classified as Financial Liabilities on Initial Recognition (IAS 32)

The Committee received a request about the application of IAS 32 in relation to the reclassification of warrants. Specifically, the request described a warrant that provides the holder with the right to buy a fixed number of equity instruments of the issuer of the warrant for an exercise price that will be fixed at a future date. At initial recognition, because of the variability in the exercise price, the issuer in applying paragraph 16 of IAS 32 classifies these instruments as financial liabilities. This is because for a derivative financial instrument to be classified as equity, it must be settled by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments ('fixed-for-fixed condition'). The request asked whether the issuer reclassifies the warrant as an equity instrument following the fixing of the warrant's exercise price after initial recognition as specified in the contract, given that the fixed-for-fixed condition would at that stage be met.

The Committee observed that IAS 32 contains no general requirements for reclassifying financial liabilities and equity instruments after initial recognition when the instrument's contractual terms are unchanged. The Committee acknowledged that similar questions about reclassification arise in other circumstances. Reclassification by the issuer has been identified as one of the practice issues the Board will consider addressing in its Financial Instruments with Characteristics of Equity (FICE) project. The Committee concluded that the matter described in the request is, in isolation, too narrow for the Board or the Committee to address in a cost-effective manner. Instead, the Board should consider the matter as part of its broader discussions on the FICE project. For these reasons, the Committee ~~[~~decided~~]~~ not to add a standard-setting project to the work plan.