Comments on Exposure Draft and comment letters: Financial Instruments with Characteristics of Equity—Proposed amendments to IAS 32, IFRS 7 and IAS 1

Comment 1

Obligations to purchase an entity's own equity instruments.

Paragraph 23 of IAS 32 sets out requirements for contracts containing an obligation for an entity to purchase its own equity instruments. Examples of such contracts include a forward contract to purchase the entity's own shares and a written put option that gives the holder the right to require the entity to purchase its own shares. Practice issues arise relating to the application of these requirements.

IAS 32 requires an entity to recognise a financial liability at the present value of the redemption amount. This amount is removed from equity and included in financial liabilities. The IASB proposes to clarify which component of equity this amount is removed from and how to measure the financial liability at the present value of the redemption amount.

Sometimes the put option is included in a share purchase agreement (Fixed for fixed criteria is met) to protect the interests of the private equity investors. For example, put option is activated if IPO is not completed within agreed timeline. However, even though the timeline is not met, it is impracticable for an investor to exercise the put option considering the company does not have sufficient funds to buy back the shares. As such, the investor is not able to exercise the put option. In such cases, please include guidance so as to whether as an exception, the company can still continue to classify the instrument in "Equity" instead of "Liability."

Comment 2

Reclassification of financial liabilities and equity instruments

Paragraph 15 of IAS 32 requires the issuer of a financial instrument to classify the instrument on initial recognition as a financial liability or an equity instrument, based on the substance of the contractual arrangement and the definitions of a financial liability and an equity instrument.

However, the Standard does not contain any general requirements on whether or when to reclassify the instrument after initial recognition. Practice issues arise about:

(a) whether or when such reclassifications are required, permitted or prohibited; and
(b) if reclassifications are required or permitted, how to account for those reclassifications.

These issues arise if the substance of the contractual arrangement changes without a modification to its contractual terms. The substance of the contractual arrangement could change because of a change in circumstances external to the contractual arrangement—for example, a change in an entity's functional currency or its group structure.

Please provide examples relating on

- Reclassification from equity to financial liability (measurement of the financial liability at the date of amendment to the terms and treatment of any difference between the carrying amount of the previously recognised equity instrument and the amount of the financial liability recognised.
- Reclassification from financial liability to equity on change in the terms of the instruments.
- Changes in classification due to passage of time (For example number of shares and price to be issued is fixed closer to the date of the maturity of the instrument)