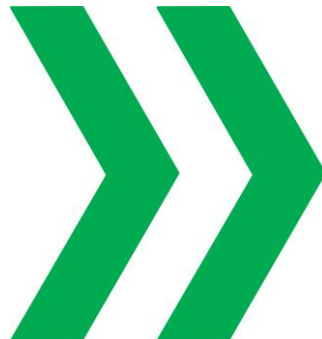


Practical Workshop for NBU Staff

IAS 32: Financial Instruments Presentation

CFRR»»

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Reporting Reform



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Overview

- » IAS 32 to be read in conjunction with IAS 39 and IFRS 7
- » Deals with the definitions, classification, presentation and disclosure of financial instruments
- » Classification into financial assets, financial liabilities, and equity instruments.
- » Classification of related interest, dividends, gains/losses, and offsetting rules.
- » IAS 39 deals with recognition and measurement of instruments.



Introduction

- » IAS 32 sets out the principles for the presentation and classification of financial instruments
- » IFRS 7 sets out disclosures of financial instruments
- » The recognition and measurement of financial instruments are the subjects of
 - » IAS 39 Financial Instruments: Recognition and Measurement, and
 - » IFRS 9 Financial Instruments which is being developed in phases) to ultimately replace IAS 39.



Scope of IAS 32

- » Applies to all financial instruments, EXCEPT:
 - » Interests in subsidiaries, associates and joint ventures . However, IAS 32 applies to all derivatives on such interests
 - » Rights and obligations under employee benefit plans (IAS 19)
 - » Insurance contracts (IFRS 4) . But IAS 32 applies to derivatives on these contracts. Share based payments (IFRS 2)
 - » Contracts to buy or sell non- financial item (NFI) to be settled net in cash, when these contracts held for receipt or delivery of said NFI in accordance with entity's usage requirements



Definitions

- » FI: contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.
- » Example: A owns some shares and some bonds issued by B. These instruments are both financial assets of A
- » For B, its shares are equity instruments and the bonds are a financial liability.
- » A trade receivable is a financial asset of the seller, because the same instrument is a liability for the purchaser.



Financial assets

- » Cash, equity instruments of another entity
- » Contractual right to receive cash (or another financial asset) from another entity or to exchange FA or FL with other entity under potentially favorable conditions
- » Contract that may be settled in own equity instruments in certain conditions (details later)
- » Puttable instruments classified as equity or certain liabilities arising only on liquidation



Financial liabilities

- » Contractual obligation:
 - » to deliver cash or another financial asset to other entity
 - » to exchange FA or FL under potentially unfavorable conditions
 - » Contract that may be settled in own equity instruments under certain conditions (details later)



Equity instruments

- » Equity is defined as $\text{Assets} - \text{Liabilities}$ (Framework)
- » An equity instrument is any contract that evidences such RESIDUAL interest.
- » When there is an obligation for the entity to deliver cash to other entity, the instrument is a liability regardless of the legal denomination. Ex: some preference shares are liabilities
- » Certain liabilities, when arising only on liquidation of the entity are classified as equity instruments



Equity instruments (continued)

- » Preference shares redeemable:
 - » At the discretion of the entity: equity or liability?
- » Preference shares non redeemable, with distribution of dividends to holders (cumulative or non cumulative): necessity to assess whether distributions are at the discretion of the issuer. History does not count.
- » Settlement in the entity's own equity instruments: Entity's obligation to purchase its own shares for cash (a « put »): FL
 - » Contract to be settled in a FIXED number of shares: equity.
 - » Contract to be settled in a VARIABLE number of entity's own shares equal to a FIXED amount: financial liability (or asset)



More definitions

- » Puttable instrument: a FI giving the holder the right to put the instrument back to the issuer for cash or is automatically put back on occurrence of an uncertain future event. These instruments are a FL of the issuer. However; when they arise only on liquidation of entity, they are classified as equity.
- » Derivatives: financial options, futures and forwards, interest rate swaps, currency swaps, call and put options. Derivatives relate to a underlying item. They may be assets or liabilities.



Compound Financial Instruments

- » An issued instrument may in substance contain a liability component and an equity component. Both components are classified accordingly at inception.
- » Ex: a bond convertible by holder into a fixed number of shares of the entity is a compound instrument. It contains a financial liability (obligation to deliver cash) and an equity instrument (a call option, granting the holder the right to convert into shares).
- » These bonds are issued with a below market interest rate. The liability component will be calculated first, as the present value of the cash flows discounted using the market rate, and the difference will be assigned to the equity component.



Treasury shares. Offsetting FA &FL.

- » Offsetting FA &FL only permitted if enforceable legal right to set off recognized amounts.
- » Conditional right to set off such as in a master netting agreement, enforceable only on the occurrence of a future event, do not meet the conditions for offset.
- » Treasury shares (own shares reacquired), never recognized as assets. Deducted from equity, no gain or loss on transaction.



Interest, dividends, losses & gains

- » Interest, dividends, losses or gains relating to a financial asset or liability or to a component that is a financial liability shall be recognized in profit and loss;
- » Distributions to holders shall be recognized directly in equity
- » Transaction costs on equities shall be deducted from equity.



IAS 32 Quiz

» What is IAS 32 about?

1. Financial Instruments: presentation & disclosure
2. Earnings per Share
3. Impairment of Assets
4. Provision, Contingent Liabilities and Contingent Assets



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