Financial liability or equity?

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Global IFRS Institute | Financial instruments

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Proposals could cause changes to classification of financial instruments and add more disclosures

Highlights

- **What's the issue?**
- **What is the IASB proposing?**
- **What's next? – Have your say by 29 March 2024**

Some companies could see changes in the classification of their financial instruments under proposed amendments to IAS 32 *Financial Instruments: Presentation*. The International Accounting Standards Board (IASB®) **proposals** address some common challenges faced by companies in classifying financial instruments as financial liabilities or equity. Many companies would need to disclose substantially more information about equity instruments and certain types of financial liabilities.

What's the issue?

To address some common challenges companies face when classifying financial instruments, the IASB is proposing to amend:

- IAS 32 to clarify some of the underlying principles on classification and add application guidance; and
- IAS 1 *Presentation of Financial Statements* and IFRS 7 *Financial Instruments: Disclosures* to improve the information companies provide on financial instruments they issue.

"We welcome the IASB's proposals to address long-standing practice issues and to enhance information provided to investors."

Mahesh Narayanasami
KPMG global IFRS financial instruments deputy leader

What is the IASB proposing?

The proposals address the following key areas on classification in IAS 32.

Area	Key changes proposed
'Fixed-for-fixed' condition (e.g. equity conversion options in a convertible bond, share warrants)	Specific types of adjustments to the number of equity instruments or the amount of cash to be exchanged (e.g. certain adjustments to the conversion ratio or exercise price) would not violate the condition.

Area	Key changes proposed
Reclassification between financial liabilities and equity	Reclassification would be required when the substance of a contract changes because of a change in circumstances outside the contract (e.g. a change in the functional currency).
Contingent settlement provisions	Clarification on whether to reflect the probability of the contingent event occurring when recognising a financial liability. Guidance on the meaning of terms 'liquidation' and 'non-genuine'.
Obligations to purchase own equity instruments (e.g. put options over non-controlling interest)	Clarification on whether: • to derecognise own equity instruments subject to these obligations; and • the requirements in paragraph 23 of IAS 32 to recognise a financial liability for the present value of the redemption amount would apply when settlement will be made using a different type of own equity instrument. Subsequent remeasurement of the financial liability would be recognised in profit or loss.
Effects of laws or regulations on the contractual terms	Clarification on how these would affect classification.
Settlement of obligations subject to shareholders' decision	New guidance on factors to consider in evaluating whether the shareholders' decision can be treated as that of the company.

The proposals would also expand the disclosure and presentation requirements in IFRS 7 and IAS 1 respectively for certain financial liabilities and equity instruments. These include but are not limited to the following.

- Disclosure of:
  - terms and conditions such as debt-like characteristics in equity instruments (e.g. dividends on preference shares that are based on a fixed rate) and equity-like characteristics in financial liabilities;
  - the priority of all financial liabilities and equity instruments on liquidation of a company;
  - the potential dilution of ordinary shares (e.g. the maximum number of shares to be delivered if convertible bonds are converted and share options are exercised);
  - the amounts initially allocated to the liability and equity components of compound instruments;
  - specified quantitative information about financial instruments that contain an obligation to purchase own equity; and
  - information about financial liabilities containing contractual obligations to pay amounts based on a company's performance or changes in its net assets.

- Separate presentation of certain line items attributable to ordinary shareholders of the parent and to other owners of the parent in the balance sheet and income statement.

What's next? – Have your say by 29 March 2024

Read the proposals and provide your comments to the IASB by 29 March 2024.

Speak to your usual KPMG contact to find out more about the proposals and visit kpmg.com/ifrs to keep up to date with the latest news and discussion.

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