

IAS 32

Financial instruments: presentation

1. Objective

IAS 32 lays down a definition of financial assets and financial liabilities, and determines how financial instruments should be presented in the Statement of financial position, either as financial assets, financial liabilities, or as equity. IAS 32 applies to all financial instruments, with the exception of those covered under a specific standard.

The principles in IAS 32 complement the principles for recognising and measuring financial assets and financial liabilities in IFRS 9 “Financial Instruments” and for disclosing information about them in IFRS 7 “Financial Instruments: Disclosures”.

2. Scope

2.1 Financial instruments

IAS 32 defines a **financial instrument** as any contract that gives rise to both a financial asset for one entity and a financial liability or equity instrument for another entity.

The Standard defines a **financial asset** as any asset that is any of:

- cash;
- a contractual right to receive cash or another asset (particularly a financial asset) from another entity;
- a contractual right to exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity;
- an equity instrument of another entity;
- under certain conditions, a contract that may be settled in the entity’s own equity instruments.

The Standard defines a **financial liability** as a contractual obligation to:

- deliver cash or another asset (particularly a financial asset) to another entity; or
- exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
- under certain conditions, a contract that will or may be settled in the entity's equity instruments.

An **equity instrument** is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. The classification of a financial instrument and its components is performed at initial recognition according to the contract and the intentions of the management regarding the management of the instrument.

A **puttable instrument** is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back on the occurrence of an uncertain future event.

2.2 The definition of fair value and market value

The **fair value** of an asset or a liability is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

2.3 Presentation of liabilities and equity

The main criteria used to differentiate financial liabilities and equity is whether or not there is a contractual obligation on the part of one of the parties to the transaction to deliver cash or a financial asset to the other party or to participate in an exchange of financial instruments under conditions that are potentially unfavourable to the issuer.

Issuers of financial instruments which contain both a liability component and an equity component must classify these separately.

Example 1: Differentiating liabilities from equity

An entity issued debt securities worth 10,000,000, to be redeemed as follows: 6,000,000 will be redeemed according to a 5-year schedule, with a 5% fixed annual interest rate paid quarterly.

4,000,000 will be converted into 5-year stock options, with holders given the right to one new share with a par value of 1,000 for one debt security with a par value of 750.

The first component involved in these securities consists of a financial liability because it may **only** be settled by outflows of cash.

The second component of these securities constitutes an equity instrument, since redemption may give rise to the issue of equity shares **at the option of the debt-security holders**.

2.4 Financing expenses and dividends

Interest, dividends, losses or gains derived from a financial instrument must be recognized in the **profit and loss statement**.

Payment of dividends to holders of equity instruments must be charged to equity and shown as a movement on retained profits reserve. Disclosures of tax effects of dividends and related distribution costs are to be recognised in accordance with IAS 12.

2.5 Offsetting financial assets and liabilities

This is only possible if the entity has a legally enforceable right to set off the recognized amounts and intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously.

Example 2: A company enters into a service or supply of goods contract with a provider, where payment is due after two months. In consideration, the provider asked for a guarantee deposit that would automatically be reimbursed at the end of the contract. The amount corresponding to this deposit – constituting a financial asset – may be offset with the debt owing to this provider.

3. Disclosure

Entities must comply with the disclosure requirements contained in IFRS 7.