



Solution 110.1

Component	Share capital and equity instruments
Index	Initial recognition
Short title	Redeemable convertible preference shares

Attention: This guidance is based on the revised standards and interpretations that are mandatory for accounting periods commencing 1 January 2005. A company may early adopt an individual revised standard, but only in its entirety. Guidance based on the previous version of the standards is included in the “Applying IFRS 2004” guidance.

Issue

An equity instrument is any contract that evidences a residual interest in an entity’s assets after deducting all of its liabilities [IAS32R.11].

How should an entity recognise redeemable preference shares when the issuer can redeem them or convert them into a variable number of ordinary shares?

Background

An entity has issued preference shares at par and can redeem them in cash at any time before the end of 20X4. These preference shares will automatically convert into a variable number of the issuer’s ordinary shares (common stock) on 1 January 20X5 if the issuer does not redeem them before that date. The number of shares will be determined by dividing the face value of the preference shares into the market value of the ordinary shares at conversion date.

Solution

The preference shares are financial liabilities since they provide for mandatory redemption by the issuer for a variable number of shares at the maturity date of the instrument [IAS32R.18(a)].

The liability is recognised in the balance sheet at its fair value at inception (the fair value of the consideration received) adjusted for any transaction costs. Dividends on the preference shares are recognised as finance costs in the income statement using the effective interest rate.