



Solution 85A.5

Component	Classification, recognition and measurement of complex financial liabilities for banks
Index	Unconditional right to avoid payment
Short title	Declaration of preference dividend

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

A financial liability is any liability that is [\[IAS32R.11\]](#):

- a) a contractual obligation
 - i. to deliver cash or another financial asset to another entity; or
 - ii. to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
- b) a contract that will or may be settled in the entity's own equity instruments and is:
 - i. a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
 - ii. a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

An equity instrument is defined as any contract that evidences a residual interest in an entity's assets after deducting all of its liabilities [\[IAS32R.11\]](#).

How should management classify shares with complex rights?

Background

Bank P issued series A and series B shares. Series A shares are ordinary shares, issued to all shareholders, and for which management has unfettered discretion over whether to pay a dividend and for what amount. Series B shares are issued to only one shareholder and have the same voting and dividend entitlements as series A shares (i.e. if a dividend is paid on the series A shares, a proportionately equal dividend is paid on the series B shares).



In addition to these rights, the holder of the series B shares is entitled to:

- (a) a dividend based on the financial result of the entity's property division at management's unfettered discretion; and
- (b) the residual value of the property division if P is liquidated.

The series A shareholders are not entitled to this dividend or residual value on liquidation.

Solution

The series B shares should be classified as equity instruments. Payments to the B shareholder are at the discretion of Bank P's management, and can be avoided if management chooses not to declare a dividend. The entity is able to avoid delivering cash or another financial asset on the shares and so the shares do not meet the definition of a financial liability [\[IAS32R.11\]](#).

The fact that the series B shareholder is entitled to the residual value of the property division in the event of a liquidation of bank P confirms the series B shares as equity [\[IAS32R.11\]](#).