FINANCIAL INSTRUMENTS: PRESENTATION (IAS 32)

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*International Accounting Standard 32 (IAS 32) deals with how **financial instruments** are presented in the financial statements of the **issuer**. It focuses on **classification** (financial asset, financial liability, equity instrument), **presentation** of related income and expenses (interest, dividends, gains and losses), and **offsetting** of financial assets and financial liabilities.*

1. Objective and scope of IAS 32

1.1 Objective

Objective of IAS 32: To establish principles for:

- **Classification** of financial instruments as:
  - **Financial assets**
  - **Financial liabilities**
  - **Equity instruments**
- **Presentation** of:
  - Interest, dividends, losses and gains
- **Offsetting**:
  - When a financial asset and a financial liability may be presented net (offset) in the statement of financial position.

IAS 32 is applied **from the perspective of the issuer** of the financial instrument. It complements:

- **International Financial Reporting Standard 9 (IFRS 9)** – Financial Instruments (recognition and measurement)
- **International Financial Reporting Standard 7 (IFRS 7)** – Financial Instruments: Disclosures (disclosure requirements).

1.2 Scope

IAS 32 applies to **all types of financial instruments**, except for certain items that are covered by other Standards, for example:

- **Interests in subsidiaries, associates and joint ventures** accounted for under:
  - IFRS 10 – Consolidated Financial Statements
  - IAS 27 – Separate Financial Statements
  - IAS 28 – Investments in Associates and Joint Ventures
- **Employer’s rights and obligations** under employee benefit plans (IAS 19 – Employee Benefits)
- **Insurance contracts** (IFRS 17 – Insurance Contracts), except certain derivatives embedded in them
- **Share-based payment transactions** (IFRS 2 – Share-based Payment).

2. Key definitions

For IAS 32, understanding the **definitions** is critical. These definitions are broadly aligned with IFRS 9, but IAS 32 focuses on **presentation**.

2.1 Financial instrument

Financial instrument: Any contract that gives rise to a **financial asset** of one entity and a **financial liability** or **equity instrument** of another entity.

2.2 Financial asset

Financial asset:

A financial asset is any asset that is:

- **Cash**
- **An equity instrument of another entity** (for example, shares held in another company)
- **A contractual right**:
  - To receive cash or another financial asset from another entity; or
  - To exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity
- **A contract** that will or may be settled in the entity's own equity instruments and:
  - Is a **non-derivative** for which the entity may receive a **variable number** of its own equity instruments; or
  - Is a **derivative** that will or may be settled other than by exchanging a **fixed amount** of cash or another financial asset for a **fixed number** of the entity's own equity instruments.

In simple terms: a financial asset represents **value to be received** (cash, other financial assets, or favourable rights).

2.3 Financial liability

Financial liability:

A financial liability is any liability that is:

- **A contractual obligation**:
  - To deliver cash or another financial asset to another entity; or
  - To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity
- **A contract** that will or may be settled in the entity's own equity instruments and:
  - Is a **non-derivative** for which the entity may have to deliver a **variable number** of its own equity instruments; or

    - Is a **derivative** that will or may be settled other than by exchanging a **fixed amount** of cash or another financial asset for a **fixed number** of the entity's own equity instruments.

In simple terms: a financial liability represents **value to be given** (cash, other financial assets, or unfavourable rights).

2.4 Equity instrument

Equity instrument:

An equity instrument is:

- Any contract that evidences a **residual interest** in the assets of an entity after deducting all of its liabilities.

Key features:

- There is **no contractual obligation**:
    - To deliver cash or another financial asset; or
    - To exchange financial assets or financial liabilities under potentially unfavourable conditions.
- The holder's claim is **subordinate** to all other claims (for example, ordinary shares).

2.5 Compound financial instrument

Compound financial instrument:

A compound financial instrument is a financial instrument that:

- Contains **both**:
    - A **financial liability component**; and
    - An **equity component**.

Example: a **convertible bond** that:

- Requires the issuer to pay interest and principal (liability component); and
- Gives the holder the option to convert the bond into a fixed number of ordinary shares (equity component).

2.6 Puttable instrument

Puttable instrument:

A puttable instrument is a financial instrument that:

- Gives the holder the **right to put (sell back)** the instrument to the issuer for cash or another financial asset.

Under normal rules, puttable instruments are **financial liabilities**, because the issuer has a **contractual obligation** to deliver cash if the holder exercises the put option. IAS 32, however, provides **narrow exceptions** where certain puttable instruments may be classified as **equity** if strict conditions are met (see section 5.4).

3. Core principle – liability versus equity classification

3.1 Substance over form

IAS 32 requires classification based on the **substance** of the contractual arrangement, not its **legal form**.

- A financial instrument that is legally called "share capital" may, in substance, be a **financial liability** if it includes a contractual obligation to deliver cash.
- Conversely, an instrument legally called "debt" may be **equity** if it does not create a genuine obligation to deliver cash or another financial asset.

3.2 Key question

The **critical question** for classification is:

Does the issuer have a **contractual obligation** to deliver cash or another financial asset?

If **yes** → the instrument (or part of it) is a **financial liability**. If **no** → the instrument may be an **equity instrument**, provided other conditions are met.

3.3 Conditions for equity classification

An instrument is classified as **equity** only if **both** of the following conditions are met (IAS 32.16):

1. **No contractual obligation**:
    - There is no contractual obligation to deliver cash or another financial asset to another entity.
2. **No obligation to exchange**:
    - There is no obligation to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.

If either condition fails, the instrument is a **financial liability**.

3.4 Unconditional right to avoid payment

If an entity **does not have an unconditional right** to avoid delivering cash or another financial asset to settle a contractual obligation, that obligation is a **financial liability**.

- Contingent settlement provisions (for example, payment only if a certain event occurs) do **not** remove liability classification if the event is **outside the issuer's control**.

4. Classification of common instruments – examples

4.1 Ordinary shares

Ordinary shares (common shares) typically meet the definition of an **equity instrument**:

- No contractual obligation to deliver cash or another financial asset.
- Holders have a residual interest in the net assets of the entity.
- Dividends are usually **discretionary** (the entity can decide whether to pay them).

Example: Entity A issues 1 000 ordinary shares at R10 each.

- Proceeds: R10 000
- Classification: **Equity**
- Presentation: Credited to **Ordinary share capital** and possibly **share premium** (depending on jurisdiction – and only if it is par-value shares).

4.2 Redeemable preference shares

Preference shares can be tricky. Their classification depends on the **terms**:

- If the issuer is **required** to redeem the shares for cash at a fixed date or on demand:
    - There is a **contractual obligation** to deliver cash.
    - Classification: **Financial liability** (even though legally they are "shares").
- If redemption is **discretionary** and dividends are discretionary:
    - Classification: **Equity instrument**.

Example – liability classification: Entity B issues preference shares that:

- Pay a fixed dividend of 8% per year.
- Must be redeemed for cash at par value after 5 years.

The issuer has a contractual obligation to:

- Pay annual dividends; and
- Redeem the shares for cash at maturity.

Therefore:

- The instrument is a **financial liability**.
- The dividends are presented as **interest expense** (finance cost), not as distributions to owners.

4.3 Perpetual bonds

A **perpetual bond** is a bond with no maturity date.

- If the issuer has **no obligation** to redeem the bond and interest payments are **discretionary**, the instrument may be classified as **equity**.
- If interest payments are **mandatory** and the issuer cannot avoid payment, the instrument is a **financial liability**.

Classification depends on the **specific contractual terms**.

4.4 Convertible bonds (compound instruments)

A **convertible bond** is a classic **compound financial instrument**:

- It includes:
    - A **liability component** – obligation to pay interest and principal in cash.
    - An **equity component** – option for the holder to convert into a fixed number of shares.

IAS 32 requires the issuer to **split** the instrument into:

1. **Financial liability component**:
    - Measured at fair value (using IFRS 9 principles).
2. **Equity component**:
    - Measured as the **residual** (total proceeds minus the fair value of the liability component).

Example – compound instrument: Entity C issues a R1 000 000 convertible bond:

- Coupon rate: 5% per year, payable in cash.
- Maturity: 5 years.
- Conversion option: Holder may convert the bond into 100 000 ordinary shares at any time before maturity.

Steps:

1. **Determine the fair value of a similar bond without conversion option** (pure debt).
    - Assume fair value of liability component = R900 000.
2. **Equity component**:
    - Total proceeds: R1 000 000
    - Less liability component: R900 000
    - Equity component: R100 000

Presentation:

- **Financial liability**: R900 000
- **Equity (conversion option)**: R100 000

Subsequent accounting:

- The liability component is measured under IFRS 9 (for example, amortised cost).
- The equity component is **not remeasured**.

5. Special topics in IAS 32

5.1 Contracts settled in own equity instruments – "fixed-for-fixed" rule

IAS 32 pays special attention to contracts that will or may be settled in the entity's **own equity instruments**.

- A contract is an **equity instrument** if it will be settled by exchanging:
  - A **fixed amount** of cash or another financial asset
  - For a **fixed number** of the entity's own equity instruments (the "fixed-for-fixed" condition).
- If the contract involves:
  - A **variable amount** of cash; or
  - A **variable number** of equity instruments, then it is generally a **financial asset** or **financial liability**, not equity.

Example – equity classification: Entity D issues a written call option that allows the holder to buy 10 000 shares for R100 000.

- Fixed amount of cash (R100 000)
- Fixed number of shares (10 000)
- Classification: **Equity instrument** (assuming other conditions are met).

Example – liability classification: Entity E issues a contract that requires it to deliver a **variable number** of its own shares equal to R100 000 divided by the share price at settlement.

- Variable number of shares
- Classification: **Financial liability**.

5.2 Treasury shares

Treasury shares are the entity's own equity instruments that have been **reacquired**.

IAS 32 requires:

- Treasury shares to be **deducted from equity**.
- No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of treasury shares.

Example: Entity F buys back 5 000 of its own shares for R50 000.

- Debit: Treasury shares (negative equity) R50 000
- Credit: Cash R50 000
- No profit or loss is recognised.

5.3 Interest, dividends, losses and gains

IAS 32 sets out how to present **interest**, **dividends**, **losses** and **gains** related to financial instruments.

Key principle:

- **Income and expenses** related to **financial liabilities** are recognised in **profit or loss** (for example, interest expense).
- **Distributions to holders of equity instruments** (for example, dividends on ordinary shares) are recognised **directly in equity**, not in profit or loss.

Examples:

- Interest on a bond classified as a **financial liability**:
  - Recognised as **finance cost** in profit or loss.
- Dividends on ordinary shares classified as **equity**:
  - Recognised as **distribution to owners** in equity.

If a preference share is classified as a **financial liability**, then:

- "Dividends" on that preference share are treated as **interest expense** in profit or loss.

5.4 Puttable instruments and obligations arising on liquidation

Normally, instruments that are **puttable** (holder can demand redemption for cash) or that require delivery of a **pro rata share of net assets on liquidation** are **financial liabilities**.

However, IAS 32 provides **narrow exceptions** where such instruments may be classified as **equity**, if they:

- Represent the **residual interest** in the entity's net assets; and
- Meet **all** specified conditions in IAS 32.16A–16D, including:
  - The instrument is the **most subordinated** class of instruments.
  - The holder is entitled to a **pro rata share** of net assets on liquidation.
  - There are **no other contractual obligations** that would meet the definition of a financial liability.
  - The instrument has **no other features** that would contradict equity classification.

If at any time the instrument **ceases** to meet all conditions:

- It must be **reclassified** from equity to financial liability (or vice versa) from the date of change.

5.5 Reclassification

Reclassification occurs when the **terms or conditions** of an instrument change such that:

- An instrument previously classified as **equity** now meets the definition of a **financial liability**; or
- An instrument previously classified as a **financial liability** now meets the definition of **equity**.

IAS 32 requires:

- Reclassification **from the date** the change occurs.
- On reclassification from equity to liability:
    - The liability is measured at **fair value** at that date.
    - Any difference between the previous carrying amount and the fair value is recognised in **equity**.

6. Offsetting financial assets and financial liabilities

6.1 Principle of offsetting

IAS 32 sets strict conditions for **offsetting** (presenting a financial asset and a financial liability net in the statement of financial position).

A financial asset and a financial liability are offset and the net amount presented only when:

1. The entity **currently has a legally enforceable right** to set off the recognised amounts; and
2. The entity **intends either**:
    - To settle on a **net basis**; or
    - To realise the asset and settle the liability **simultaneously**.

If these conditions are **not** met:

- The asset and liability must be presented **separately**.

6.2 Examples of offsetting

Example – bank overdraft and cash account: Entity G has:

- Cash at Bank: R100 000
- Bank overdraft: R80 000

If:

- The bank overdraft is repayable on demand; and
- The entity has a **legally enforceable right** to offset balances with the same bank; and
- The entity intends to settle on a net basis,

then:

- The entity may present a **net cash balance** of R20 000, as part of Cash and cash equivalents (under current assets).

If these conditions are not met, present separately:

- Cash and cash equivalents: R100 000 (under current assets)
- Bank overdraft: R80 000 (under current liabilities)

Example – derivative positions: Entity H has:

- A derivative asset with Counterparty X: R50 000
- A derivative liability with Counterparty X: R40 000

If:

- There is a **master netting agreement** that is legally enforceable; and
- The entity intends to settle net,

then:

- Net derivative asset: R10 000.

Otherwise:

- Derivative asset: R50 000
- Derivative liability: R40 000

7. Exam-style illustrations and typical pitfalls

7.1 Exam focus areas

In examinations, IAS 32 questions often focus on:

- **Classification**:
  - Is the instrument a financial liability or an equity instrument?
- **Compound instruments**:
  - Correct splitting into liability and equity components.
- **Puttable instruments**:
  - Whether they qualify for equity classification under the exceptions.

- **Presentation**:
  - Interest vs dividends; profit or loss vs equity.
- **Offsetting**:
  - Whether net presentation is allowed.

7.2 Example 1 – classification of preference shares

Scenario: Entity J issues preference shares with the following terms:

- Dividend: 6% per year, cumulative.
- Redemption: Mandatory at par value after 10 years.
- Dividends must be paid annually; if not paid, they accumulate and must be paid before any ordinary dividends.

Required: Classify the instrument under IAS 32 and explain the presentation of dividends.

Analysis:

- Mandatory redemption for cash after 10 years → **contractual obligation** to deliver cash.
- Cumulative mandatory dividends → contractual obligation to deliver cash.
- Therefore, the instrument meets the definition of a **financial liability**.

Answer:

- Classification: **Financial liability**.
- Dividends: Recognised as **interest expense** in profit or loss, not as distributions to owners.

7.3 Example 2 – convertible bond

Scenario: Entity K issues a R500 000 convertible bond:

- Coupon: 4% per year, payable in cash.
- Maturity: 3 years.
- Conversion option: Holder may convert the bond into 50 000 ordinary shares at maturity.

Required: Explain how IAS 32 requires the instrument to be presented.

Analysis:

- Obligation to pay interest and principal → **financial liability** component.
- Conversion option into a **fixed number** of shares for a **fixed amount** of principal → **equity** component (fixed-for-fixed rule).

Answer:

- The instrument is a **compound financial instrument**.
- It must be split into:
    - **Liability component** – measured at fair value (using market interest rate for similar non-convertible debt).
    - **Equity component** – residual amount (total proceeds minus liability component).
- Subsequent measurement:
    - Liability component under IFRS 9 (for example, amortised cost).
    - Equity component is **not remeasured**.

7.4 Example 3 – puttable units in a fund

Scenario: Entity L is a fund that issues units to investors:

- Units are **puttable** – investors can redeem units at any time for a pro rata share of net asset value.
- Units are the **most subordinated** class of instruments.
- On liquidation, unit holders receive a **pro rata share** of net assets.
- There are no other contractual obligations that meet the definition of a financial liability.

Required: Discuss whether the units may be classified as equity under IAS 32.

Analysis:

- Normally, puttable instruments are **financial liabilities**.
- However, IAS 32 provides an **exception** for certain puttable instruments that represent the **residual interest** and meet all conditions in IAS 32.16A–16B.
- In this scenario, the units:
    - Are the most subordinated class.
    - Provide pro rata share of net assets.
    - Have no other liability-like features.

Answer:

- The units may be classified as **equity instruments** under the **puttable exception**, provided all detailed conditions in IAS 32 are met and continue to be met.
- If at any point the conditions cease to be met, the units must be **reclassified** as financial liabilities from that date.

8. Summary – how to approach IAS 32 in practice

When dealing with IAS 32, a structured approach helps:

1. **Identify the instrument**:

   - Read the full contractual terms, not just the legal label.
2. **Ask the key question**:
   - Is there a **contractual obligation** to deliver cash or another financial asset?
3. **Apply the definitions**:
   - Financial asset, financial liability, equity instrument.
4. **Consider special features**:
   - Puttable rights, contingent settlement, conversion options, settlement in own equity instruments.
5. **Check "fixed-for-fixed"**:
   - For contracts settled in own equity instruments.
6. **Identify compound instruments**:
   - Split into liability and equity components.
7. **Determine presentation**:
   - Interest and similar returns on liabilities → profit or loss.
   - Distributions to equity holders → equity.
8. **Assess offsetting**:
   - Only offset when there is a legally enforceable right and an intention to settle net or simultaneously.

9. Links to other chapters and teaching & learning materials

Please also refer to the following materials in the e-book (available to subscribers only):

- **Chapter 4: Share Capital (including a Comprehensive Question Bank)**
- **Share Capital (slideshow)**
- **Redemption of Preference Shares (slideshow)**
- **Addendum A: *Videography:* 6 Class Recordings of approximately 90 minutes each**

10. Comprehensive Question Bank (with Answers & Explanations)

SECTION A — Multiple-Choice Questions (MCQs)

MCQ 1

Under IAS 32, the key factor in distinguishing a **financial liability** from an **equity instrument** is:

A. The legal form of the instrument
B. Whether the instrument is traded on an exchange
C. Whether the issuer has a **contractual obligation** to deliver cash or another financial asset
D. Whether the instrument pays dividends

- **Correct answer:** C
- **Explanation:** IAS 32 requires classification based on **substance**, not legal form. A contractual obligation to deliver cash = **financial liability**.

MCQ 2

Which of the following is **always** classified as equity under IAS 32?

A. Redeemable preference shares
B. Ordinary shares with discretionary dividends
C. Convertible bonds
D. Puttable instruments

- **Correct answer:** B
- **Explanation:** Ordinary shares with discretionary dividends have **no contractual obligation** to deliver cash → equity.

MCQ 3

A contract settled in the entity's own equity instruments is classified as equity only if:

A. It is perpetual
B. It meets the **fixed-for-fixed** condition
C. It is issued to existing shareholders
D. It is issued at a premium

- **Correct answer:** B
- **Explanation:** IAS 32 requires a **fixed amount of cash** for a **fixed number of shares**.

MCQ 4

Which of the following is a **compound financial instrument**?

A. Ordinary shares
B. Preference shares redeemable at the issuer's discretion
C. Convertible bonds
D. Treasury shares

- **Correct answer:** C
- **Explanation:** Convertible bonds contain both a **liability** (interest + principal) and an **equity** component (conversion option).

MCQ 5

Treasury shares must be:

A. Recognised as an asset
B. Deducted from equity
C. Recognised as a liability
D. Measured at fair value through profit or loss

- **Correct answer:** B
- **Explanation:** IAS 32 requires treasury shares to be shown as a **deduction from equity**. No gain/loss is recognised. It is often referred to as "negative equity".

MCQ 6

Offsetting a financial asset and a financial liability is permitted only when:

A. They arise from the same transaction
B. They are with the same counterparty
C. There is a **legally enforceable right** to offset and an **intention** to settle net
D. They are measured at amortised cost

- **Correct answer:** C
- **Explanation:** Both conditions must be met.

MCQ 7

A puttable instrument is normally classified as:

A. Equity
B. Financial liability
C. Compound instrument
D. Derivative

- **Correct answer:** B
- **Explanation:** A puttable instrument gives the holder the right to demand cash → **contractual obligation** → liability, unless the narrow IAS 32 exception applies.

MCQ 8

Dividends on **liability-classified preference shares** are presented as:

A. Equity distributions
B. Finance cost in profit or loss
C. Other comprehensive income
D. Adjustments to retained earnings

- **Correct answer:** B
- **Explanation:** If the preference share is a **liability**, “dividends” are actually **interest expense**.

MCQ 9

A derivative that will be settled by delivering a **variable number** of the entity’s own shares is classified as:

A. Equity
B. Financial asset
C. Financial liability
D. Compound instrument

- **Correct answer:** C
- **Explanation:** Variable number of shares fails the **fixed-for-fixed** rule → liability.

MCQ 10

Reclassification from equity to liability occurs:

A. Only at year-end
B. When the legal form changes
C. When the **terms or conditions** change such that the instrument now meets the definition of a liability
D. Never

- **Correct answer:** C
- **Explanation:** Reclassification is required **from the date** the terms change.

SECTION B — Short-Form Questions (with Answers)

Q1

Define a **financial instrument** under IAS 32.

Answer: A financial instrument is any contract that gives rise to a **financial asset** of one entity and a **financial liability** or **equity instrument** of another entity.

Q2

Explain the meaning of “substance over form” in IAS 32.

Answer: Classification depends on the **economic substance** of the contractual terms, not the legal label. For example, “preference shares” may be liabilities if they contain a contractual obligation to deliver cash.

Q3

What is the “fixed-for-fixed” rule?

Answer: A contract settled in own equity instruments is equity only if it involves a **fixed amount of cash** for a **fixed number of shares**.

Q4

Why are treasury shares deducted from equity?

Answer: They represent the entity’s own equity instruments reacquired or bought back. They are no longer in issue. IAS 32 prohibits recognising gains/losses on these transactions.

Q5

List two conditions required for offsetting.

Answer:

1. A **legally enforceable right** to offset.
2. An **intention** to settle net or simultaneously.

SECTION C — Long-Form Scenario Questions (with Answers)

Scenario 1 — Redeemable Preference Shares

Entity A issues preference shares that:

- Pay a fixed dividend of 7% annually
- Must be redeemed for cash at par value after 8 years
- Dividends are mandatory

Required: Classify the instrument and explain the presentation of dividends.

Answer:

- Mandatory redemption → contractual obligation → **financial liability**
- Mandatory dividends → contractual obligation → liability
- Dividends are presented as **finance costs** in profit or loss.

Scenario 2 — Puttable Units in a Fund

A fund issues units that:

- Are puttable at any time for a pro rata share of net asset value
- Are the most subordinated class

- Entitle holders to a pro rata share of net assets on liquidation
- Have no other contractual obligations

Required: Determine classification.

Answer: Although puttable instruments are normally liabilities, these units meet the **IAS 32 puttable exception** conditions → **equity classification**.

Scenario 3 — Derivative Settled in Own Shares

Entity B issues a contract requiring it to deliver a yet-to-be-determined number of its own shares equal to R200 000 ÷ share price at settlement.

Required: Classify the instrument.

Answer: Variable number of shares → fails fixed-for-fixed → **financial liability**.

Scenario 4 — Contingent Settlement

Entity C issues an instrument that must be redeemed for cash **if** its share price falls below R5. The issuer cannot control the share price.

Required: Classify the instrument.

Answer: Settlement depends on an event **outside the issuer's control** → issuer does **not** have an unconditional right to avoid delivering cash → **financial liability**.

SECTION D — Compound Instrument Calculation Questions

Question 1 — Convertible Bond Split

Entity D issues a R1 000 000 convertible bond:

- Coupon rate: 5%
- Maturity: 5 years
- Convertible into 100 000 shares
- Market rate for similar non-convertible debt: 8%

Required: Split into liability and equity components.

Answer:

1. Calculate present value of cash flows at 8% → **liability component** (e.g., R900 000).
2. Equity component = R1 000 000 – R900 000 = **R100 000**.
3. Liability measured under IFRS 9; equity not remeasured.

Question 2 — Convertible Preference Shares

Entity E issues preference shares:

- Mandatory dividends
- Convertible into a fixed number of shares
- Redeemable at par after 6 years

Required: Classification.

Answer: Mandatory redemption → liability. Conversion option → equity. Instrument is a **compound financial instrument**.

SECTION E — True/False Questions

T/F 1

All preference shares are equity.

- **False** — some redeemable or mandatory-dividend preference shares are liabilities.

T/F 2

Equity components of compound instruments are remeasured each year.

- **False** — equity components are **never** remeasured.

T/F 3

Offsetting requires both a legal right and intention to settle net.

- **True**

T/F 4

Puttable instruments are always liabilities.

- **False** — IAS 32 has a narrow equity exception.

T/F 5

Treasury shares can create gains or losses in profit or loss.

- **False** — IAS 32 specifically prohibits that.

SECTION F — Exam-Style Integrated Case Study

Case Study

Entity F issues the following instruments during the year:

1. **Instrument A:**
    - 10 000 preference shares
    - Mandatory redemption in 5 years
    - Fixed annual dividend of 6%
2. **Instrument B:**
    - Written call option allowing holder to buy 20 000 shares for R200 000
    - Fixed-for-fixed terms
3. **Instrument C:**
    - Convertible bond
    - Coupon rate: 4%
    - Convertible into 50 000 shares
    - Market rate for similar debt: 7%

Required: Classify each instrument and explain the presentation.

Answer:

- **Instrument A:** Financial liability (mandatory redemption + mandatory dividends). Dividends → finance costs.
- **Instrument B:** Equity (fixed-for-fixed).
- **Instrument C:** Compound instrument. Split into liability (PV at 7%) and equity (residual). Liability → IFRS 9; equity → not remeasured.
