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**Exposure Draft**  
**Accounting Standards Board**  
Proposed Accounting Standard for Private Enterprises

**Redeemable Preferred Shares  
Issued in a Tax Planning  
Arrangement**

October 2014

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**COMMENTS TO THE AcSB MUST BE RECEIVED BY  
JANUARY 15, 2015**

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A [PDF response form](#) has been posted with this document to assist you in submitting your comments to the AcSB. Alternatively, you may send comments via email (in Word format), to: [ed.accounting@cpacanada.ca](mailto:ed.accounting@cpacanada.ca) addressed to:

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This Exposure Draft reflects proposals made by the Accounting Standards Board (AcSB).

Individuals and organizations are invited to send written comments on the Exposure Draft proposals. Comments are requested from those who agree with the Exposure Draft as well as from those who do not.

Comments are most helpful if they are related to a specific paragraph or group of paragraphs. Any comments that express disagreement with the proposals in the Exposure Draft should clearly explain the problem and include a suggested alternative, supported by specific reasoning. All comments received by the AcSB will be available on the web site shortly after the comment deadline, unless confidentiality is requested. The request for confidentiality must be stated explicitly within the response.

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## Highlights

The Accounting Standards Board (AcSB) proposes, subject to comments received following exposure, to amend FINANCIAL INSTRUMENTS, Section 3856 in Part II of the CPA Canada Handbook – Accounting, to require redeemable preferred shares issued in a tax planning arrangement to be presented as liabilities.

### Main features of the Exposure Draft

The proposals in this Exposure Draft are as follows:

- Paragraph 3856.23, requiring redeemable preferred shares issued in a tax planning arrangement under specific sections of the Income Tax Act to be presented as equity, would be deleted. As a result of this deletion, preferred shares accounted for in accordance with this paragraph would be accounted for consistently with other financial liabilities.
- The effect of recognizing the liability would be presented as a separate component of equity.
- Information regarding the nature of the separate component of equity would be disclosed.
- Retrospective application would be required in accordance with ACCOUNTING CHANGES, Section 1506.

### Plans for finalizing the proposals

The AcSB will redeliberate the proposals in light of comments received. Part of the redeliberation process includes consultations with the AcSB's Private Enterprise Advisory Committee. The Committee assists the AcSB in maintaining and improving accounting standards for private enterprises by providing input and recommendations on potential changes to the standards. The AcSB will provide updates about its redeliberations in its decision summaries and on the [project page](#).

The AcSB plans to issue the final amendments to Section 3856 in the second quarter of 2015, if no significant changes are required to the proposals after deliberating the comments received. In that case, the proposed effective date of the amendments would be for fiscal years beginning on or after January 1, 2016.

### Comments requested

Comments are most helpful if they are related to a specific paragraph or group of paragraphs. Any comments that express disagreement with the proposals in the Exposure Draft should clearly explain the problem and include a suggested alternative supported by specific reasoning.

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While the AcSB welcomes comments on all changes proposed in this Exposure Draft, it particularly welcomes comments on the following:

1. Do you agree that the preferred shares described in FINANCIAL INSTRUMENTS, paragraph 3856.23 are liabilities and that paragraph 3856.23 should be deleted in accordance with the cost/benefit assessment set out in the Basis for Conclusions in this Exposure Draft in order to improve financial reporting? If not, why not? What aspect of the cost/benefit assessment do you disagree with?
2. If you think there are sufficient cost/benefit arguments to justify retention of the equity classification, how should paragraph 3856.23 be amended to address the issues with that paragraph noted in the Basis for Conclusions?
3. Do you agree that the adjustment to equity as a result of recognizing and measuring the liability should be presented in a separate component of equity? If not, how should the adjustment be presented?
4. Do you think that COMPREHENSIVE REVALUATION, Section 1625, should be amended to clarify when the conditions to apply push-down accounting are met for some of the transactions covered by paragraph 3856.23? If so, what aspects of Section 1625 should be clarified? In your view, to what extent would entities apply push-down accounting?
5. Do you agree that the current disclosure requirements in Section 3856 are appropriate for redeemable preferred shares currently accounted for under paragraph 3856.23? If not, why not and how should the disclosures in Section 3856 be amended?
6. Do you agree with the proposed disclosures in EQUITY, Section 3251, in respect of the presentation of the effect of liability recognition as a separate component of equity? If not, why not and what disclosures, if any, should be provided?
7. Do you agree that the proposals should be applied retrospectively in accordance with ACCOUNTING CHANGES, Section 1506? If not, why not?
8. Do you agree with the proposed effective date (i.e., fiscal years beginning on or after January 1, 2016)? If not, why not?

For your convenience, a PDF [response form](#) has been posted with this document. You can save the form both during and after its completion for future reference. Alternatively, written comments may be submitted by email (Word format preferred) to: [ed.accounting@cpacanada.ca](mailto:ed.accounting@cpacanada.ca).

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# Basis for Conclusions

## Executive summary

Redeemable preferred shares are obligations to be paid in the future and meet the definition of a liability. Paragraph 3856.23 was created to provide an exception to account for certain preferred shares as equity based on cost/benefit considerations. The proposal is to eliminate that paragraph based on an updated assessment of cost/benefit, coupled with the resulting improvement to financial reporting.

This Exposure Draft proposes that instruments that are currently accounted for under paragraph 3856.23 be accounted for as financial liabilities and, consequently, be initially measured at fair value. For redeemable preferred shares issued pursuant to an estate freeze that transfers a business from one generation to the next, there are low incremental costs associated with measuring the liability because the fair value is generally equal to the redemption amount, and accordingly will be readily available. Costs associated with communicating with financial statement users should not be onerous because, based on the consultations held to date, users understand the nature of these types of redeemable preferred shares.

Benefits are assessed in relation to user needs. The AcSB consulted multiple lenders, the primary financial statement users in the private enterprise sector. Most of these financial statement users think that redeemable preferred shares issued in a tax planning arrangement should be treated as liabilities, largely because they understand that the shares represent a claim on resources of the entity.

The elimination of paragraph 3856.23 would improve financial reporting as reporting redeemable preferred shares as financial liabilities would reflect their economic nature.

## Introduction

In developing these proposals, the AcSB considered the effects of adopting them relative to the objective of financial statements and the benefit versus cost constraint. The purpose of financial reporting is to “communicate information that is useful to investors, creditors and other users in making their resource allocation decisions and/or assessing management stewardship,” as described in FINANCIAL STATEMENT CONCEPTS, Section 1000. The AcSB thinks that the proposals would significantly improve the relevance, understandability and comparability of financial reporting.

## Effects analysis

Based on these proposals, entities would be required to recognize redeemable preferred shares issued under tax planning arrangements as a liability, initially measured at fair value. This could have a significant effect on the financial statements of entities, specifically to increase the total amount of liabilities and decrease the total amount of equity.

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## Background

Paragraph 3856.23 currently requires certain preferred shares to be presented as equity and measured at their stated, par or assigned value. This requirement was carried forward, largely unchanged, from the pre-changeover standards in Part V of the Handbook. Absent paragraph 3856.23, these shares would be recognized as liabilities because they are redeemable at the option of the holder (see paragraphs 3856.05(j) and 3856.A26), and initially measured at their fair value.

The requirement in paragraph 3856.23 was created over 10 years ago. At the time, liability recognition with initial measurement at fair value for redeemable preferred shares issued in certain tax planning arrangements (i.e., estate freezes that transfer a business from one generation to the next and rollover transactions) was controversial. For redeemable preferred shares issued as a result of an estate freeze transaction that transfers a business from one generation to the next, the redemption amount at the date the shares are issued is the fair value of the business at that date. In such transactions, the issuance of redeemable preferred shares is not accompanied by an inflow of assets and would result in a charge to retained earnings. Accordingly, liability recognition with measurement at fair value would generally result in the entity showing a sizable deficit. The main consideration in developing paragraph 3856.23 was that financial statement users may interpret a sizable deficit to mean that an entity was in immediate financial trouble, and that a great deal of explanation would be necessary to convince lenders that this was not the case. The cost of explaining the results of liability treatment was a key driver in assessing cost/benefit and justifying equity treatment.

Paragraph 3856.23 was designed to have a narrow scope – to only be applied to transfers of a business between generations and rollover transactions. Due to difficulties in defining these terms, paragraph 3856.23 refers to tax planning arrangements issued under specific Sections of the Income Tax Act (Canada) to limit the use of equity classification. Thus, other redeemable preferred shares (i.e., those not within the scope of paragraph 3856.23) are accounted for in accordance with the other requirements of Section 3856.

This narrow scope, and the manner in which it is expressed, have resulted in two current application issues. First, certain redeemable preferred shares issued in a tax planning arrangement are excluded from paragraph 3856.23 on the basis that they are not issued under any of the specified sections of the Income Tax Act. For example, redeemable preferred shares may be issued as a result of a stock dividend. Shares issued as a result of a stock dividend have the same characteristics and purpose as those that are issued under the specific Income Tax Act sections noted in paragraph 3856.23, but are not within the scope of the paragraph. Other instances when redeemable preferred shares issued in a tax planning arrangement are excluded from paragraph 3856.23 have been noted. The result has been inconsistent treatment of redeemable preferred shares issued in tax planning arrangements, which in turn has caused confusion to stakeholders. Stakeholders did not understand why different

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treatment was being given to redeemable preferred shares issued in a tax planning arrangement when the only difference was whether a specific Income Tax Act section was used.

The second issue is that there has been diversity of practice in terms of how paragraph 3856.23 has been applied. Some have been applying paragraph 3856.23 to redeemable preferred shares issued pursuant to a range of transactions such as shares issued as part of a commercial financing arrangement, a business combination, or a key employee incentive program. Paragraph 3856.23 was not intended to be applicable to these types of transactions.

### **Presentation as liability or equity**

When these application issues were raised by stakeholders, the AcSB decided to re-examine paragraph 3856.23. In conducting this re-examination, the AcSB noted that the original intent of paragraph 3856.23 was to address the accounting for redeemable preferred shares issued pursuant to an estate freeze that transfers a business from one generation to the next. The AcSB continues to think that there is no reason that redeemable preferred shares issued in other types of transactions should be classified as equity. Therefore, the AcSB focused its attention on whether equity treatment for redeemable preferred shares issued pursuant to an estate freeze that transfers a business from one generation to the next is justified based on cost/benefit considerations. In carrying out this re-examination, the AcSB received input from its Private Enterprise Advisory Committee.

The AcSB noted that redeemable preferred shares issued in a tax planning arrangement meet the definition of a liability (see FINANCIAL STATEMENT CONCEPTS, paragraphs 1000.28-.30) because they give the holder the right to require the issuer to redeem the shares for a fixed or determinable amount. The AcSB thinks that presenting redeemable preferred shares in a consistent manner as other liabilities results in benefits to users in the form of greater transparency and understandability.

Benefits are assessed in relation to user needs, specifically whether information conveyed under an accounting requirement benefits financial statement users. The AcSB consulted lenders (the primary financial statement users in this sector) from a range of financial institutions in different parts of Canada. The unanimous view was that financial statement users are able to identify and understand the nature of redeemable preferred shares issued in a tax planning arrangement. None of the financial statement users suggested that they would necessarily interpret an entity having negative equity for this reason as meaning that an entity is in immediate financial trouble.

The users indicated that they currently adjust the financial statements as necessary for their purposes. Most noted that they view the shares as liabilities and adjust the financial statements accordingly. Some noted that they only reflect the shares as

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liabilities when certain triggers exist (for example, the existence of a redemption schedule in a unanimous shareholders agreement).

The overall view of the financial statement users consulted is that they have gained a good understanding of this issue since the introduction of equity classification of these redeemable preferred shares over 10 years ago. Many users expressed a preference for having the financial statements report the shares as liabilities because:

- (a) redeemable preferred shares meet the definition of a liability;
- (b) doing so avoids users having to reclassify the shares; and
- (c) it ensures that the nature of the shares is identified – there are cases when users do not identify the nature of the shares under the current requirements.

Some stakeholders, mainly preparers and practitioners, question the relevance of presenting these redeemable preferred shares as a liability, due to the size of redeemable shares on issue (i.e., the fair value of the enterprise), as redemption of all or substantially all of the shares is not feasible. It is also argued that there is a relationship between the holder of the preferred shares and the holder of the common shares that generally results in redemption of the redeemable preferred shares not being demanded if doing so would significantly harm the entity. The AcSB considered these arguments, noting that the definition of a liability does not depend on the size of the liability relative to the value of the entity, the ability to extinguish the liability on demand, or who holds the liability. The AcSB also noted that in some cases the redeemable preferred shares are redeemed over time based on a redemption schedule. In these cases, this “comparative size” argument is undermined as time passes as the relative size of the redeemable preferred shares is reduced.

The AcSB also noted that there are other financial statement users, (for example, unsecured creditors and guarantors). Some of these other users may not understand the nature of the shares if they are recorded as equity (i.e., not realize that they represent a claim on the resources of the entity). Accordingly, these users would benefit from liability classification.

Cost is assessed based on the costs of complying with an accounting requirement. Costs include preparation costs, communication costs, specialized expertise costs and related assurance costs.

The AcSB noted that since redeemable preferred shares are due on demand, the fair value on initial recognition would be equal to the redemption amount unless the redeemable preferred shares are subordinated. In the latter case, paragraph 3856.A12 requires that the shares be discounted based on the maturity of the instrument to which it is subordinated. This would require some entities to determine a discount rate in order to calculate the fair value of the redeemable shares. The AcSB noted that a significant amount of debt that is issued to private entities by financial institutions includes a call feature that would result in current classification of the debt, as set out in CURRENT

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ASSETS AND CURRENT LIABILITIES, Section 1510. When debt to which the redeemable preferred shares are subordinated is classified as current, there would be no need to discount the redeemable preferred shares. The AcSB also noted that all financial liabilities are initially measured at fair value and the costs of determining a discount rate for redeemable shares would be no different than for various other types of financial liabilities. On this basis the AcSB thinks that the incremental costs of initial measurement would not be onerous.

The AcSB noted that there are no direct costs associated with presenting the redeemable preferred shares as liabilities. However, there may be costs related to communication, including costs of informing the financial statement users of the nature of the redeemable preferred shares and also explaining why the financial statements show a sizable deficit subsequent to the issuance of the shares. The AcSB noted the views expressed by financial statement users and agreed that costs of communication would not be significant because users understand the transaction and the nature of the shares. Accordingly, an explanation of the change would not be a significant effort on an ongoing basis.

Several stakeholders noted that the proposed changes may affect loan covenant metrics, requiring renegotiation of loan covenants. The AcSB noted the following with respect to these costs:

- (a) The financial statement users that the AcSB consulted think that renegotiation of covenants would not be problematic or result in significant cost or effort.
- (b) The proposed effective date will allow sufficient time to amend existing covenants.
- (c) The fact that financial reporting requirements evolve and change over time is well understood and would be known to the parties when they enter into an agreement that refers to financial information developed in accordance with accounting standards. While it is up to the parties that enter into a contract to determine whether the agreement should be insulated from the effects of changes to the standards, the AcSB noted that contracts commonly include provisions that contemplate changes in standards.

Some stakeholders suggested that if these redeemable preferred shares are recorded as a liability there may be an impact on the availability of the small business tax deduction. The small business deduction is a tax deduction that is available to certain private entities. The deduction is reduced or eliminated if “taxable capital” (which approximates the total debt and equity of a company) exceeds thresholds established by Canada Revenue Agency. The tax authorities are not considered users for purposes of developing accounting standards that result in general purpose financial statements and the effect on income taxes is not a determining factor in the accounting standard-setting process (as discussed in paragraph 5 of the [“Background Information and Basis for Conclusions for Accounting Standards for Private Enterprises”](#)). However, input on

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this point was sought from several tax experts. All of these tax experts indicated that liability classification would not impact the small business deduction.

On this basis, the AcSB concluded that the costs of recording redeemable preferred shares issued in a tax planning arrangement as liabilities would not be significant and that the benefits of presenting these redeemable preferred shares as liabilities would outweigh those costs. Accordingly, this Exposure Draft proposes to eliminate paragraph 3856.23.

### **Recording the effect of measuring redeemable preferred shares at fair value**

Recognition of a liability for redeemable preferred shares would result in a charge to equity. The AcSB noted that if this effect is recorded directly in retained earnings, the effect on retained earnings would not be directly observable in future periods. Financial statement users expressed a view that it would be helpful to show the effect of liability recognition on the total amount of equity separately as this would illustrate the relationship between the redeemable preferred shares and the balance of retained earnings.

The AcSB noted that EQUITY, Section 3251, requires an entity to present a separate category of equity for each category that is of a different nature. Based on input from users the AcSB thinks that separate presentation would provide useful information. Accordingly, this Exposure Draft proposes that Section 3251 be amended to clarify that the effect of recognizing redeemable preferred shares as a liability should be shown as a separate component of equity and that the balance in this separate category would be reclassified to retained earnings as the preferred shares are redeemed.

### **Comprehensive revaluation**

Some stakeholders noted that they agree with recognition of redeemable preferred shares as a liability measured at fair value, but take issue with the inability to recognize the fair value of the entity's assets. These stakeholders noted that recognition of a liability that is equal to the fair value of the entity at a point in time, without revaluing the assets of the entity, creates a "lop-sided" balance sheet. These stakeholders argue that the application of push-down accounting, as set out in COMPREHENSIVE REVALUATION OF ASSETS AND LIABILITIES, Section 1625, would address this issue. The AcSB noted that push-down accounting can be applied when all of the equity interests in the entity have been acquired, in transactions between non-related parties, by an acquirer who controls the entity after the transaction. The AcSB observed that push-down accounting could be applied to some of the transactions covered by paragraph 3856.23, although there may be a need for guidance on how the criteria to apply push-down accounting should be applied. The AcSB noted that the redemption price is supported by a valuation of the company as a whole (i.e., the entity does not know the fair value of individual assets and liabilities as is required to undertake a comprehensive

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revaluation). Accordingly, to apply Section 1625 additional costs, which may be significant, would be incurred. On this basis, the AcSB thinks that many entities would not want to undertake a comprehensive revaluation and, accordingly, the AcSB does not propose to clarify Section 1625. The AcSB would like the views of stakeholders on whether amending Section 1625 to clarify that the Section applies to this type of transaction would be beneficial and, if so, how Section 1625 should be amended.

### **Subsequent measurement**

The proposals would require the application of the subsequent measurement provisions in Section 3856 to redeemable preferred shares currently accounted for under paragraph 3856.23. The result would generally be subsequent measurement at amortized cost (see paragraph 3856.05(a)), unless the redemption provisions are linked to the performance of the entity. Paragraph 3856.14 requires financial liabilities that are indexed to a measure of the entity's performance or to changes in the value of the entity's equity to be subsequently measured at the higher of:

- (a) the amortized cost of the debt, and
- (b) the amount that would be due at the balance sheet if the formula determining the additional amount was applied at that date.

This may require remeasurement of the redeemable preferred shares to the conversion or intrinsic value. The amount of any adjustment required would be recognized in net income and presented as a separate component of interest expense.

### **Disclosure**

If paragraph 3856.23 is eliminated, the AcSB considered whether the existing disclosure requirements in Section 3856 provide sufficient information in respect of redeemable preferred shares issued in a tax planning arrangement. The AcSB noted that the existing disclosures have been applicable to a range of financial liabilities, including redeemable preferred shares not within the scope of paragraph 3856.23, for some time. Based on input from stakeholders, the AcSB thinks that the existing disclosures are providing sufficient information to financial statement users. User members on the Committee agreed that the existing disclosures would be appropriate for the shares currently accounted for under paragraph 3856.23. The AcSB also noted that if the shares currently accounted for under paragraph 3856.23 are to be accounted for in the same manner as other redeemable preferred shares then the existing disclosures should be appropriate. On this basis, the AcSB proposes that the existing disclosures in Section 3856 should be applied to the shares currently accounted for under paragraph 3856.23.

The AcSB considered what information should be disclosed with respect to the proposed presentation of the effects of liability recognition in a separate component of equity. The AcSB proposes that the following be disclosed:

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- (a) information about the origin of the separate component of equity, including the relationship between the component of equity and the redeemable preferred shares; and
  - (b) that the balance of the separate component of equity is to be reclassified to retained earnings as the redeemable preferred shares are redeemed.

User members on the Committee noted that this information would be useful because presentation of a separate component of equity is unusual in nature, and that this information would clearly illustrate the link between the redeemable preferred shares to the total equity balance. The AcSB noted that the decision model used to develop the disclosures in accounting standards for private enterprises suggests that disclosure should be provided in respect of rare or unusual transactions and, accordingly, proposes that these disclosures should be included in the standards.

### **Transition and effective date**

The AcSB noted that retrospective application would not be onerous for liabilities when the fair value of the redeemable preferred shares is equal to the redemption value because there would be little to no effort in calculating the measurement amount. For the cases when paragraph 3856.23 is being applied to redeemable preferred shares that are indexed to changes in the value of the entity's equity, the AcSB noted that retrospective application of liability classification may be onerous as it would require determination of the value of the entity in previous periods. The AcSB noted that for the cases when retrospective application may be costly, the "impracticability" aspect of Section 1506, particularly the requirement in paragraph 1506.32, may be applicable. On this basis, it proposes that this change be applied retrospectively.

As noted previously, the AcSB understands that elimination of paragraph 3856.23 may affect loan covenant metrics and this may result in the renegotiation of covenants. The AcSB, based on input from the Committee, thinks that the proposed effective date (fiscal years beginning on or after January 1, 2016) will allow sufficient time to revise loan agreements or other contractual agreements.

### **Conclusion**

Having considered the effects of the proposed changes discussed above, the AcSB thinks that the positive effects of the proposals will outweigh any negative effects and that the proposals will result in significant improvements to financial reporting for private enterprises.

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# Redeemable Preferred Shares Issued in a Tax Planning Arrangement

## PROPOSAL

The following Sections would be amended as indicated below. Additional text is denoted by underlining and deleted text by strikethrough.

### EQUITY, Section 3251

.06A As part of a capital transaction involving the issuance of redeemable preferred shares, an entity may report a charge against equity. For example, if redeemable preferred shares are issued in a non-reciprocal transaction (i.e., when there is no corresponding inflow of assets), the amount at which the shares are recognized represents a charge to equity. Similarly, if redeemable preferred shares are issued in exchange for common shares, any excess of the amount at which the redeemable preferred shares are recognized over the amount at which the common shares were previously reported is a charge to equity. Any such charge is excluded from the determination of net income in accordance with CAPITAL TRANSACTIONS, Section 3610, and is recognized as a separate component of equity. When some or all of the redeemable preferred shares are redeemed, the appropriate proportion of the amount recognized in the separate component of equity is charged against retained earnings.

.12A *In respect of a separate component of equity created as a result of paragraph 3251.06A, an entity shall disclose:*

*(a) a description of the transaction that resulted in the separate component of equity, including the relationship of the separate component to the redeemable preferred shares; and*

*(b) that the balance of the separate component of equity will be charged against retained earnings as the preferred shares are redeemed.*

### FINANCIAL INSTRUMENTS, Section 3856

~~.23~~ ~~*An entity that issues preferred shares in a tax planning arrangement under Sections 51, 85, 85.1, 86, 87 or 88 of the Income Tax Act (Canada) shall present the shares at par, stated or assigned value as a separate line item in the equity section of the balance sheet, with a suitable description indicating that they are redeemable at the option of the holder. When redemption is demanded, the issuer shall reclassify the shares as liabilities and measure them at the redemption amount. Any adjustment shall be recognized in retained earnings.*~~

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.60 Deletion of the requirements in paragraph 3856.23 is applicable to annual financial statements relating to fiscal years beginning on or after January 1, 2016. Earlier application is permitted. An entity applies the effect of the deletion of the requirements in paragraph 3856.23, including accounting for relevant transaction costs, retrospectively in accordance with ACCOUNTING CHANGES, Section 1506.

## CONSEQUENTIAL AMENDMENTS

The following significant consequential amendments have been identified. Additional text is denoted by underlining and deleted text by strikethrough.

### SHARE CAPITAL, Section 3240

~~.19 Preferred shares issued in certain tax planning arrangements that are classified as equity in accordance with FINANCIAL INSTRUMENTS, Section 3856, are presented in accordance with the requirements of that Section.~~

### FINANCIAL INSTRUMENTS, Section 3856

~~.20 Except as provided in paragraphs 3856.23, *The issuer of a financial instrument shall classify the instrument, or its component parts, as a liability or as equity in accordance with the substance of the contractual arrangement on initial recognition and the definitions of a financial liability and an equity instrument. (Paragraphs 3856.A22-.A38 provide related application guidance.)*~~

*.47 An entity that issues any of the following financial liabilities or equity instruments shall disclose information to enable users of the financial statements to understand the effects of features of the instrument, as follows:*

*(a) For a financial liability that contains both a liability and an equity element (see paragraph 3856.21), an entity shall disclose the following information about the equity element including, when relevant:*

*(i) the exercise date or dates of the conversion option;*

*(ii) the maturity or expiry date of the option;*

*(iii) the conversion ratio or the strike price;*

*(iv) conditions precedent to exercising the option; and*

*(v) any other terms that could affect the exercise of the option, such as the existence of covenants that, if contravened, would alter the timing or price of the option.*

*(b) For a financial instrument that is indexed to the entity's equity or an identified factor, as described in paragraph 3856.14, an entity shall disclose information that enables users of the financial statements to understand the*

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*nature, terms and effects of the indexing feature, the conditions under which a payment will be made and the expected timing of any payment.*

~~(c) For a preferred share issued in a tax planning arrangement as specified in paragraph 3856.23, an entity shall disclose:~~

~~(i) on the face of the balance sheet, the total redemption amount for all classes of such shares outstanding;~~

~~(ii) the aggregate redemption amount for each class of such shares; and~~

~~(iii) the aggregate amount of any scheduled redemptions required in each of the next five years~~

A26 When a preferred share, ~~other than a share to which paragraph 3856.23 applies,~~ provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the share at or after a particular date for a fixed or determinable amount, the instrument meets the definition of a financial liability and is classified as such. A preferred share that does not establish such a contractual obligation explicitly may establish it indirectly through its terms and conditions. For example, if a financial instrument labelled as a share gives the holder an option to require redemption upon the occurrence of a future event that is highly likely to occur, classification as a financial liability on initial recognition reflects the substance of the instrument. An entity does not change the classification of the financial instrument based on a change in its estimate of the probability of the future event occurring. If occurrence or non-occurrence of the future event does not result in the maturity, expiry, settlement, discharge or cancellation of the financial instrument, the entity derecognizes the original financial instrument and recognizes a new financial liability or equity instrument based on the remaining terms.

A28 A retractable or mandatorily redeemable share, ~~other than a share to which paragraph 3856.23 applies,~~ is classified as a liability unless all of the following criteria are met:

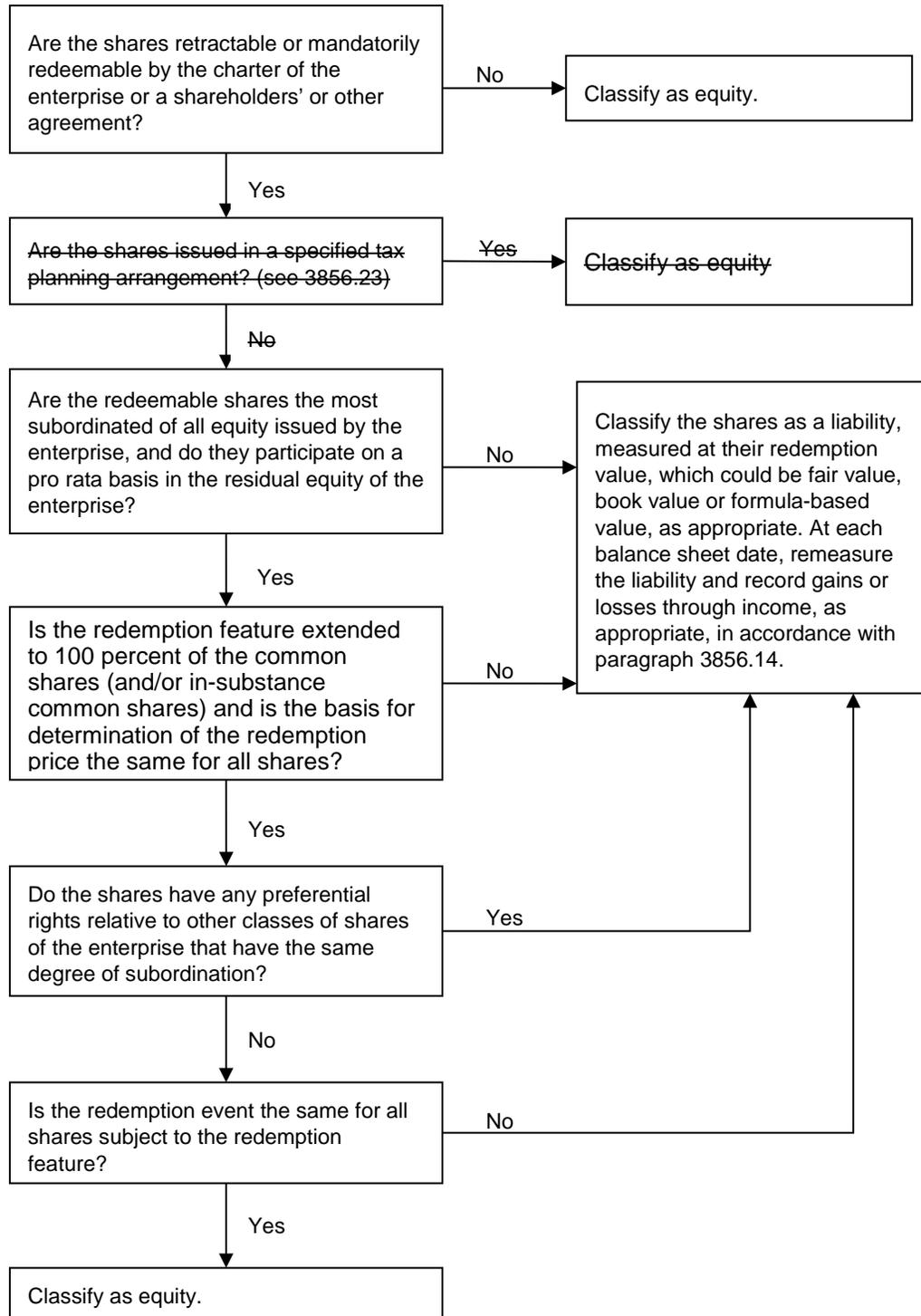
(a) The redeemable shares are the most subordinated of all equity instruments issued by the enterprise (i.e., along with the enterprise's common shares, they represent the "residual equity interest" in the enterprise), and the redeemable shares participate on a pro rata basis in the residual equity of the enterprise. An instrument represents a residual equity interest if its participation in the entity's earnings is substantially similar to the enterprise's common shares. The holders participate in the entity's residual net assets, or undistributed earnings (after any preferred shares are redeemed), on a pro rata basis. Undistributed earnings are allocated to the shares based on their contractual participation rights. Participation will

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include the right to participate in all dividends declared, including dividends that must be declared upon the occurrence of a specified event, the occurrence of which is subject to management discretion or is not objectively determinable (for example, liquidation of the enterprise or declaration of an "extraordinary" dividend).

- (b) The redemption feature is extended to 100 percent of the common shares (and/or in-substance common shares), and the basis for determination of the redemption price is the same for all shares. There cannot be a class of common shares with the same degree of subordination that is not entitled to the same redemption feature. The basis for determination of the redemption price is the same for all shares. However, the redemption price may be determined based on the fair value of the redeemable shares at the redemption date, or it may be based on a formula (which might be book value) that all the shareholders agree on as being equitable, provided the same basis or formula is applied to all of the redeemable shares.
- (c) The shares have no preferential rights relative to other classes of shares of the enterprise that have the same degree of subordination. All of the redeemable shares include substantially similar characteristics to the enterprise's common shares; for example, they do not include any substantive liquidation preferences or dividend distribution preferences.
- (d) The redemption event is the same for all the shares subject to the redemption feature. However, this criterion does not require all of the shares to be redeemed at the same time. Rather, it requires that the same event or events trigger redemption rights for all shares, for example, redemption on the resignation, termination, retirement or death of the shareholder. When an event occurs that triggers the redemption right, the shares are reclassified as liabilities.

A29 Decision tree — Classification of retractable or mandatorily redeemable shares



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