IFRS 2, IAS 32 and IAS 33: Modification of Share Purchase Warrants

Excerpt, IFRS Discussion Group Report on Meeting – July 19, 2012

Shares and share purchase warrants are often issued together as private placement units. The shares and warrants are issued to raise capital and are not issued in exchange for goods or services. In circumstances when both the shares and warrants are classified in equity in accordance with IAS 32 *Financial Instruments*: Presentation, the fair value of the proceeds of the units is allocated to separate components of equity – share capital and warrants.

The terms of the warrants may be modified prior to or near maturity by extending the expiry date or changing the exercise price, or a combination of both, and the modification will often affect the fair value of the warrants.

Accounting for modifications to the terms of equity instruments that were not issued in exchange for goods or services (i.e., not granted under IFRS 2 *Share-based Payment*) is not specifically addressed in IAS 32 or in other IFRSs. However, IFRS 2 does contain guidance on modifications to the terms and conditions of equity instruments that were granted in exchange for goods or services.

The issue considered by the Group was what accounting treatment is appropriate, including any effect on earnings per share, when the terms of warrants that were initially classified as equity are modified. The modifications were not in exchange for goods or services and were provided to the whole class of warrant holders.

Issue 1: Are the modifications to the terms of the warrants issued for proceeds (rather than goods or services) subject to IAS 32 (*View A – no adjustment to profit and loss*) or IFRS 2 by analogy (*View B – adjustment to profit and loss*)?

Issue 2: If the modifications to the terms of the warrants are addressed by IAS 32 (*View A*), should an adjustment to equity be recognized (*View A1*) or not recognized (*View A2*), or does an accounting policy choice exist (*View A3*)?

Issue 3: Should the modifications to the terms of the warrants have no affect (*View C*) or have an affect (*View D*) on the computation of basic earnings per share in accordance with IAS 33 *Earnings per Share*?

The Group's Discussion

Group members observed that prior to considering the first issue, an entity should consider whether a modification to the price or number of shares disqualifies the instruments for equity presentation under the "fixed for fixed" requirements in IAS 32, thereby requiring the instruments to be presented as liabilities. Group members noted that the context of the modification should be understood when making this assessment and that these modifications are often given to encourage the warrant-holders to inject additional funds.

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Assuming that it continues to be appropriate to present the instruments in equity, Group members supported the view that modifications to the terms of the warrants in the fact pattern being considered are subject to IAS 32 and do not affect profit and loss (i.e., View A). Group members observed that because the instruments were accounted for under IAS 32 before the modification, the standard continues to apply after the modification and it is inappropriate to apply IFRS 2 by analogy.

When considering Issue 2, many Group members preferred View A1 but would also accept View A2, noting that an accounting policy choice exists (i.e., supporting View A3). When considering Issue 3, some diversity in views was expressed on whether modifications to the terms of the warrants should affect the computation of basic earnings per share. However, Group members noted that a consistent approach should be taken to the second and third issues (i.e., if an adjustment is not recorded to equity, the calculation of earnings per share should not be affected and vice versa).

Group members observed that although Issues 2 and 3 are interesting topics for discussion, these issues are not the most important and, as a result, the difference in views was not explored further. In contrast, Group members noted that the first issue is quite important along with the fact that all Group members supported that a modification to the terms of the warrants in this particular fact pattern does not affect profit and loss (i.e., View A).

The Group agreed that this issue should not be brought to the attention of the IFRS Interpretations Committee because significantly divergent interpretations are not expected to emerge in practice.

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