ICAEW
REPRESENTATION 32/24

FINANCIAL INSTRUMENTS WITH CHARACTERISTICS OF EQUITY

Issued 28 March 2024

ICAEW welcomes the opportunity to comment on the Exposure Draft, Financial Instruments with Characteristics of Equity, published by IASB on 29 November 2023, a copy of which is available from this link.

For questions on this submission please contact the Corporate Reporting Faculty at crf@icaew.com quoting REP 32/24.

We are supportive of the Board's efforts to clarify the classification requirements in IAS 32 *Financial Instruments: Presentation*, address known practice issues, and reduce the associated diversity in practice. However, we have some concerns that the proposed amendments, as drafted, may not fully achieve these intended aims.

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KEY POINTS

INTRODUCTORY COMMENTS

1. ICAEW welcomes the opportunity to provide views on this important Exposure Draft. We support the Board's decision to not pursue the proposed classification approach set out in the 2018 Discussion Paper. We welcome the proposals to clarify existing debt-equity classification requirements, however, we have identified some areas that we believe the Board should consider before finalising its proposals as set out further below.

THE EFFECTS OF LAWS AND REGULATIONS

2. We do not recommend that the Board proceeds with the proposals relating to the effects of relevant laws and regulations. We appreciate the intention to clarify how laws and regulations impact the presentation of financial instruments as either equity or liabilities of the issuer, however, we are not convinced that the proposed changes would lead to improvements. We have some concerns that the expected benefits of the proposed clarifications may be outweighed by the risks of unintended consequences.
3. We have also identified some areas that, in our view, need much more clarification. These areas include what entities need to do in scenarios where a contract might be subject to the laws and regulations of multiple jurisdictions, where changes to laws or regulations occur, or situations where substantially all the contract terms of an instrument reflect the laws or regulations. More details are provided in our answer to Question 1 below.

SETTLEMENT IN AN ENTITY'S OWN EQUITY INSTRUMENTS

4. We welcome the Board's proposals to clarify when the fixed-for-fixed condition is met but have some concerns in respect of the proposed passage-of-time adjustments. We believe a better approach would be to remove the specific reference to present value in the passage of time proposals. Instead, the proposal could simply require that the price per own equity share is predetermined at inception of the contract.

OBLIGATIONS TO PURCHASE AN ENTITY'S OWN EQUITY INSTRUMENTS

5. We acknowledge that currently there is diversity in practice with regard to obligations to purchase an entity's own equity instruments, and we therefore believe clarification of the guidance will help to reduce this diversity. However, we suggest the Board makes clear that the assessment of "access to returns" is a substance-based assessment aligned with the principles in IFRS 10 *Consolidated Financial Statements*, and addresses the appropriate accounting where the non-controlling interests do not have present access to returns.

CONTINGENT SETTLEMENT PROVISIONS

6. The objective of IAS 32 *Financial Instruments*: Presentation is to establish principles for presenting financial instruments, whereas the proposals with respect to contingent settlement provisions and obligations to purchase own equity instruments clearly address measurement principles. Consequently, our view is that the proposals are going beyond the intended scope of IAS 32 which is not appropriate.
7. Additionally, we are concerned that the measurement proposals do not appear to be consistent with the measurement principles in IFRS 9 *Financial Instruments*. In our view, applying either a measurement model based on amortised cost, which reflects the estimated timing of the contingent event, or a fair value model to liabilities arising from contingent settlement provisions would be more consistent with IFRS 9 and therefore would be more appropriate.

RECLASSIFICATION

8. We believe that limiting the changes that trigger a reclassification to only those changes that arise outside of the contractual arrangements is too restrictive. We do not believe that continuing to present a liability in respect of an instrument where the only liability feature has expired provides useful information to stakeholders. An appropriate solution may be to also require reclassifications due to changes in effective terms caused by one or more of the features expiring.

DISCLOSURES

9. While we are supportive of the Board's efforts to enhance the quality of disclosures, we recommend that the Board takes steps to ensure that the additional disclosure requirements are proportionate, and the benefits outweigh the costs of preparing them if the Board proceeds with the proposed changes. We expand on this, and we have specific further thoughts on the proposed liquidation disclosures, in our answer to Question 7 below.
10. We also have concerns relating to the requirement to disclose information about the potential dilution of ordinary shares as the proposal suggests that all entities need to apply this requirement. We suggest limiting this to entities that are in scope of IAS 33 *Earnings per Share*.

PRESENTATION OF AMOUNTS ATTRIBUTABLE TO ORDINARY SHAREHOLDERS

11. We believe that there are likely to be significant practical challenges in attributing profit and loss, other comprehensive income, and reserves between ordinary shareholders of the parent and other owners. For example, some equity instruments with debt like features theoretically entitle holders to fixed cumulative returns, however all payments are discretionary and may ultimately bear little resemblance to the stated entitlement. Allocating total comprehensive income and reserves to such instruments could involve significant estimation and could be misleading.

TRANSITION

12. We are not convinced that requiring a fully retrospective approach for these amendments has benefits that outweigh the respective costs. We encourage the Board to consider allowing a modified retrospective approach to transition in addition to providing specific additional transition exemptions to mitigate some of the potential costs associated with transition that entities are likely to incur.

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ANSWERS TO SPECIFIC QUESTIONS

Question 1 - The effects of laws and regulations (paragraphs 15A and AG24A–AG24B of IAS 32).

The IASB proposes to clarify that:

> ***(a) only contractual rights and obligations that are enforceable by laws or regulations and are in addition to those created by relevant laws or regulations are considered in classifying a financial instrument or its component parts (paragraph 15A); and***
>
> ***(b) a contractual right or obligation that is not solely created by laws or regulations, but is in addition to a right or obligation created by relevant laws or regulations shall be considered in its entirety in classifying the financial instrument or its component parts (paragraph AG24B).***

Paragraphs BC12–BC30 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

13. While we support the Board's decision not to proceed with an 'all-inclusive' approach to classification as described in BC14, ignoring laws and regulations may have a fundamental impact on the presentation of financial instruments as either equity or liabilities of the issuer. We do not have any significant concerns about how practice has developed in this area and therefore, we believe that the Board should carefully consider the expected benefit of further clarifications against the risks of unintended consequences, before proceeding with the proposals. If the Board proceeds with the changes, we suggest that the following aspects are further clarified.

Different jurisdictions

14. It is not clear, under the current proposals, which laws and regulations apply, especially when different parties to the contract are in different jurisdictions and therefore subject to different laws and regulations. Generally, we would expect only the laws and regulations applicable to the issuer to be considered. However, this may give rise to counter-intuitive outcomes such as, for example, in a multi-national group where economically similar instruments may be classified differently by companies based in different jurisdictions, introducing inconsistency across the group.

Changes in laws and regulations

15. It is also unclear how changes in laws and regulations should be considered. For example, our understanding of the proposals is that if the law states that an entity must pay a minimum dividend of 15%, and the terms of the instrument similarly state that it must pay a dividend of 15%, then that contractual term would be ignored in classifying the instrument as debt or equity. If the law was then to change, so that the minimum dividend was only 10% but the contract still states that it pays a minimum dividend of 15%, then it appears that the classification of the instrument should be reassessed, treating the whole of the 15% minimum dividend as a contractual obligation to pay cash.
16. It also appears that the outcome would be different if the contract had stated the obligation was to "pay a minimum dividend as required by the law" rather than "pay a minimum dividend of 15%" (being the legal requirement when the contract was written).

Situations where substantially all the terms of an instrument reflect the laws and regulations

17. We believe it is particularly important to provide greater clarity on classification of an instrument where the key terms of an instrument only reflect the laws and regulations, ie, the contractual terms do not add any requirements beyond the legal requirements.

18. In such cases, paragraph 15A(b) of the proposals suggests that the key terms of the instrument would not be considered in classifying it as either debt or equity. We understand that there are divergent views on how to approach this scenario, with some stakeholders believing that, in the absence of any incremental contractual obligations (beyond those required by laws and regulations), the instrument should be classified as an equity instrument, whereas other stakeholders felt that IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* should be applied as there are effectively no relevant contractual terms.

Question 2 – Settlement in an entity's own equity instruments (paragraphs 16, 22, 22B-22D, AG27A and AG29B of IAS 32).

The IASB proposes to clarify when the fixed-for-fixed condition in paragraph 16(b)(ii) of IAS 32 is met by specifying that the amount of consideration to be exchanged for each of an entity's own equity instruments is required to be denominated in the entity's functional currency, and either:

> ***(a) fixed (will not vary under any circumstances); or***
>
> ***(b) variable solely because of:***
>
> > ***(i) preservation adjustments that require the entity to preserve the relative economic interests of future shareholders to an equal or lesser extent than those of current shareholders; and/or***
> >
> > ***(ii) passage-of-time adjustments that are predetermined, vary with the passage of time only, and have the effect of fixing on initial recognition the present value of the amount of consideration exchanged for each of the entity's own equity instruments (paragraphs 22B–22C).***

The IASB also proposes to clarify that if a derivative gives one party a choice of settlement between two or more classes of an entity's own equity instruments, the entity considers whether the fixed-for-fixed condition is met for each class of its own equity instruments that may be delivered on settlement. Such a derivative is an equity instrument only if all the settlement alternatives meet the fixed-for-fixed condition (paragraph AG27A(b)).

The IASB further proposes to clarify that a contract that will or may be settled by the exchange of a fixed number of one class of an entity's own non-derivative equity instruments for a fixed number of another class of its own non-derivative equity instruments is an equity instrument (paragraph 22D).

Paragraphs BC31–BC61 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

19. We welcome the Board's proposals to clarify existing practices by providing more guidance on the conditions for when the fixed-for-fixed criterion is met. However, we have some concerns with respect to the proposed passage-of-time adjustment. We have made some suggestions for the Board in this regard.

More clarity in respect of passage-of-time adjustments

20. The interpretation of the wording in para (b)(ii) “have the effect of fixing on initial recognition the present value of the amount of consideration exchanged for each of the entity’s own equity instruments”, appears complex and judgemental. We also suggest clarifying what ‘predetermined’ means ie, if it’s a fixed monetary amount or based on a formula. It would be helpful to provide more application guidance and examples on how to assess whether a change in the fixed consideration per own equity instrument represents compensation proportional to the passage of time.

21. BC54(c) implies that this is a formulaic assessment that does not consider whether the adjustment was reasonable or reflected an appropriate time value of money. However, it was unclear to us how to assess whether present value of the consideration per own equity instrument was fixed at initial recognition without assessing reasonableness in some way.

22. We suggest adopting the approach outlined in BC54(a) by removing 22C(b)(iii), and therefore requiring that the amount of consideration to be paid or received for each of an entity’s own equity instruments on each possible settlement date is predetermined at inception of the contract. We are generally of the view that as long as the conversion ratio is predetermined (ie, a set monetary amount) for each conversion date, the instrument should meet the fixed-for-fixed criterion. We believe that this would be easier to apply and reduce diversity in practice.

23. It would also be helpful for more examples to be added of scenarios when the fixed-for-fixed criterion will be met. For instance, example 14 of the Implementation Guidance (paragraphs IE 60-61) illustrates a situation that meets the fixed-for-fixed criterion, where the principal plus accrued interest on a bond is converted at a fixed conversion ratio. It would be helpful if the Board could clarify that the fixed-for-fixed criterion would be met regardless of whether the interest rate on the bond was fixed or was linked to a floating benchmark interest rate.

Reconsider the conclusion in change of control provisions (Example 19)

24. Example 19 (paragraph IE80) of the Implementation Guidance, states that an adjustment to compensate the derivative holder of the loss of optionality upon the change of control of the issuer would fail the fixed-for-fixed test. We believe this should be reconsidered. In our view, such adjustments have elements of both the passage of time (as the time value of the option captures the passage of time) and preservation (as the relative economic interests of the bondholders and the shareholders are maintained given the bondholder is compensated for the lost time value). Accordingly, we believe that allowing such adjustments to meet the fixed-for-fixed test would provide better information for investors.

Additional clarification regarding paragraph 22D

25. Paragraph 22D states that “a contract that will or may be settled only by the exchange of a fixed number of one class of an entity’s own non derivative equity instruments for a fixed number of another class of the entity’s own non-derivative equity instruments is an equity instrument”. We believe this principle should also apply to non-derivative equity instruments that may be settled by delivering a fixed number of the issuer’s own equity instruments or by redemption in cash at the option of the issuer.

26. For example, take an additional tier 1 (AT1) instrument, where payment of dividends and redemption are solely at the discretion of the issuer. Assume that it is also convertible into a fixed number of the issuer’s own equity instruments at the option of the issuer or upon the occurrence of a loss absorption event. We believe that the conversion option should not be assessed as an embedded derivative as the instrument is a non-derivative instrument which is equity in its entirety as it does not give rise either to an obligation to pay cash or to deliver

a variable number of own equity instruments. We think that paragraph 22D could be helpfully clarified to make this clearer.

Preservation adjustments

27. We think that the wording in respect of preservation adjustments could be clearer. The current wording refers to "an equal or lesser extent" whereas we think "approximately equal to" would be clearer and better convey the intention of the adjustments. We also believe that whether the adjustments preserve the economic interests of the future shareholders to "an equal or lesser extent" will only be known in the future. So, if this wording is retained, we suggest referring to adjustments that "are designed to" preserve the economic interests of future holders of the entity's own equity instruments.

Question 3 – Obligations to purchase an entity's own equity instruments (paragraphs 23 and AG27B–AG27D of IAS 32)

The IASB proposes to clarify that:

(a) the requirements in IAS 32 for contracts containing an obligation for an entity to purchase its own equity instruments also apply to contracts that will be settled by delivering a variable number of another class of the entity's own equity instruments (paragraph 23).

(b) on initial recognition of the obligation to redeem an entity's own equity instruments, if the entity does not yet have access to the rights and returns associated with ownership of the equity instruments to which the obligation relates, those equity instruments would continue to be recognised. The initial amount of the financial liability would, therefore, be removed from a component of equity other than non-controlling interests or issued share capital (paragraph AG27B).

(c) an entity is required to use the same approach for initial and subsequent measurement of the financial liability—measure the liability at the present value of the redemption amount and ignore the probability and estimated timing of the counterparty exercising that redemption right (paragraph 23).

(d) any gains or losses on remeasurement of the financial liability are recognised in profit or loss (paragraph 23).

(e) if a contract containing an obligation for an entity to purchase its own equity instruments expires without delivery:

> ***(i) the carrying amount of the financial liability would be removed from financial liabilities and included in the same component of equity as that from which it was removed on initial recognition of the financial liability.***
>
> ***(ii) any gains or losses previously recognised from remeasuring the financial liability would not be reversed in profit or loss. However, the entity may transfer the cumulative amount of those gains or losses from retained earnings to another component of equity (paragraph AG27C).***

(f) written put options and forward purchase contracts on an entity's own equity instruments that are gross physically settled—consideration is exchanged for own equity instruments—are required to be presented on a gross basis (paragraph AG27D).

Paragraphs BC62–BC93 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

28. We acknowledge that currently there is diversity in practice with regard to obligations to purchase an entity's own equity instruments, and we believe that additional guidance to

reduce this diversity will be helpful. However, we have some concerns with the proposal as explained below.

Interaction with IFRS 10

29. It is not clear how these requirements would interact with the IFRS 10 *Consolidated Financial Statements* requirements (IFRS 10.B90) or how the debit to equity should be presented if the parent does have present access to the rights and returns associated with ownership of the equity instruments. We interpret the application guidance in IFRS 10.B90 as requiring a substance-based assessment and we agree with this view that the substance of the agreement should drive the accounting treatment. However, the proposed wording in BC75 states that "non-controlling shareholders usually retain their rights associated with ownership (such as rights to vote and rights to dividends and other distributions)", and we interpret this to imply that the assessment required by the proposals will be more legalistic in nature. For example, in some scenarios the non-controlling interests may retain a legal right to dividends but facts and circumstances indicate that it not reasonably expected that substantial dividends would actually be declared during the term of the arrangement.
30. We suggest providing additional guidance on what is meant by 'present access to returns' and that this application guidance is aligned with the principle in IFRS 10.B90. As currently drafted, the proposals imply that almost all non-controlling interests would be considered to have access to returns (based on a legalistic assessment). Therefore, non-controlling interests would not be adjusted when the liability is recognised in respect of an obligation to purchase the non-controlling interests' equity instruments. We believe that adjusting the non-controlling interests is likely to give more useful information to stakeholders when the entity, in substance, has obtained access to the returns associated with ownership of those interests.
31. We also believe that despite the clarification in BC78, there are still concerns around double counting and we suggest the Board provides further explanation of how it is seeking to address these concerns.

IAS 32 is a presentation standard

32. We are concerned that the proposals stray too far into measurement requirements which is beyond the scope of IAS 32. These concerns are similar to those explained in greater detail in question 4 below.

Question 4 – Contingent settlement provisions (paragraphs 11, 25, 25A, 31, 32A, AG28 and AG37 of IAS 32)

The IASB proposes to clarify that:

(a) some financial instruments with contingent settlement provisions are compound financial instruments with liability and equity components (paragraphs 25 and 32A);

(b) the initial and subsequent measurement of the financial liability (or liability component of a compound financial instrument) arising from a contingent settlement provision would not take into account the probability and estimated timing of occurrence or non-occurrence of the contingent event (paragraph 25A);

(c) payments at the issuer's discretion are recognised in equity even if the equity component of a compound financial instrument has an initial carrying amount of zero (paragraphs 32A and AG37);

(d) the term 'liquidation' refers to the process that begins after an entity has permanently ceased its operations (paragraph 11); and

(e) the assessment of whether a contractual term is 'not genuine' in accordance with paragraph 25(a) of IAS 32 requires judgement based on the specific facts and circumstances and is not based solely on the probability or likelihood of the contingent event occurring (paragraph AG28).

Paragraphs BC94–BC115 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

33. We acknowledge that the proposal, in (b) above, is consistent with paragraph BC12 in the currently effective version of IAS 32, which refers to "the treatment of financial instruments with contingent settlement provisions as financial liabilities for the full amount of the conditional obligation". However, we have some concerns with this measurement proposal as described below.

Measurement basis

34. We are concerned that the measurement proposal will formally introduce a new measurement basis which is neither amortised cost nor fair value. We believe the introduction of a new measurement basis goes beyond the scope of IAS 32.

35. Whilst we accept that the measurement proposal addresses the current diversity in practice, we note that the measurement proposal is not consistent with the measurement principles in IFRS 9. In our view, applying either an amortised cost-based measurement model which allows an entity to reflect the estimated timing of the contingent event, or a fair value model, to liabilities arising from contingent settlement provisions would be better understood and more consistent with IFRS 9.

36. Additionally, we note the proposals could result in counter-intuitive outcomes as the measurement would be based on the amount payable at the earliest possible redemption date despite the fact this might be quite different from the initial consideration received or the amount payable under the expected redemption outcome. Also, certain contingent features may have a low likelihood of being exercised. In line with the comments above, we believe a measurement basis that better reflects expected outcomes (in line with the principles of IFRS 9) would provide more useful information to stakeholders.

Liquidation

37. BC112 refers to the going concern assumption in explaining the rationale for the definition of 'liquidation' as the process that begins after an entity has permanently ceased its operations. However, we believe that the wording in the proposed definition is not consistent with the wording in IAS 1 which refers to intending to liquidate the entity or to cease trading.

Question 5 - Shareholder discretion (paragraphs AG28A–AG28C of IAS 32)

The IASB proposes:

(a) to clarify that whether an entity has an unconditional right to avoid delivering cash or another financial asset (or otherwise to settle a financial instrument in such a way that it would be a financial liability) depends on the facts and circumstances in which shareholder discretion arises. Judgement is required to assess whether shareholder decisions are treated as entity decisions (paragraph AG28A).

(b) to describe the factors an entity is required to consider in making that assessment, namely whether:

(i) a shareholder decision would be routine in nature—made in the ordinary course of the entity's business activities;

(ii) a shareholder decision relates to an action that would be proposed or a transaction that would be initiated by the entity's management;

(iii) different classes of shareholders would benefit differently from a shareholder decision; and

(iv) the exercise of a shareholder decision-making right would enable a shareholder to require the entity to redeem (or pay a return on) its shares in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) (paragraph AG28A(a)–(d)).

(c) to provide guidance on applying those factors (paragraph AG28B).

Paragraphs BC116–BC125 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

38. We do not have any significant concerns with the shareholder discretion proposals. However, we suggest that some additional guidance and examples are provided. In particular, we believe that additional examples would be helpful in respect of private equity backed entities, as they often issue various classes of both debt and equity interests to the private equity investor who also has board representation. In our experience, there is some diversity in practice in how shareholder discretion is interpreted in these scenarios, especially on a change of control. We believe that examples of how the proposals can be applied to these types of scenarios would be useful.

Question 6 - Reclassification of financial liabilities and equity instruments (paragraphs 32B–32D and AG35A of IAS 32)

The IASB proposes:

(a) to add a general requirement that prohibits the reclassification of a financial instrument after initial recognition, unless paragraph 16E of IAS 32 applies or the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement (paragraphs 32B–32C).

(b) to specify that if the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement, an entity would:

(i) reclassify the instrument prospectively from the date when that change in circumstances occurred.

(ii) measure a financial liability reclassified from equity at the fair value of that financial liability at the date of reclassification. Any difference between the carrying amount of the equity instrument and the fair value of the financial liability at the date of reclassification would be recognised in equity.

(iii) measure an equity instrument reclassified from a financial liability at the carrying amount of the financial liability at the date of reclassification. No gain or loss would be recognised on reclassification (paragraph 32D).

(c) provide examples of changes in circumstances external to the contractual arrangement requiring reclassification (paragraph AG35A).

Paragraphs BC126–BC164 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Would the proposal to reclassify the instrument prospectively from the date when a change in circumstances occurred give rise to any practical difficulties? If so, please describe those practical difficulties and the circumstances in which they would arise.

39. We are supportive of providing additional guidance on reclassification to reduce the diversity in practice that has developed in this area. However, it was unclear to us how the proposal interacts with the IFRS 9 derecognition requirements, particularly when a contractual term (that caused the instrument to be classified as a liability) expires with the passage of time.

40. It appears that the proposals would require the instrument to continue to be classified as a liability, despite the obligation having expired. We do not believe that continuing to present a liability in respect of an instrument where the only liability feature has expired provides useful information to stakeholders. To illustrate, we set out the following examples:

    - In situations whereby the instrument initially failed the fixed-for-fixed criterion but subsequently meets the condition, it would continue to be classified as a financial liability under the current proposal.
    - In situations when an entity issues preference shares redeemable in cash should a contingent event such as a change of control occur within 12 months. If no such event occurs, subsequent dividends are discretionary, and redemption is not required until liquidation. Under the current proposal, the preference shares will continue to be classified as a financial liability whereas in substance they would be equity once the 12-month period has passed.

41. We believe an appropriate solution would be to require reclassifications due to changes in effective terms caused by one or more of the features expiring.

Question 7 - Disclosure (paragraphs 1, 3, 12E, 17A, 20, 30A–30J and B5A–B5L of IFRS 7)

The IASB proposes:

(a) to expand the objective of IFRS 7 to enable users of financial statements to understand how an entity is financed and what its ownership structure is, including potential dilution to the ownership structure from financial instruments issued at the reporting date (paragraph 1).

(b) to delete the reference to derivatives that meet the definition of an equity instrument in IAS 32 from paragraph 3(a) of IFRS 7.

(c) to move paragraphs 80A and 136A from IAS 1 to IFRS 7. These paragraphs set out requirements for disclosures relating to financial instruments classified as equity in accordance with paragraphs 16A–16B and/or paragraphs 16C–16D of IAS 32 (paragraphs 12E and 30I). The IASB also proposes to expand paragraph 80A to cover reclassifications if there are changes in the substance of the contractual arrangement from a change in circumstances external to the contractual arrangement.

(d) to amend paragraph 20(a)(i) of IFRS 7 to require an entity to disclose gains or losses on financial liabilities containing contractual obligations to pay amounts based on the entity's performance or changes in its net assets, separately from gains or losses on other financial liabilities in each reporting period.

(e) to include disclosure requirements for compound financial instruments in IFRS 7 (paragraph 17A).

The IASB proposes to require an entity to disclose information about:

(a) the nature and priority of claims against the entity on liquidation arising from financial liabilities and equity instruments (paragraphs 30A–30B);

(b) the terms and conditions of financial instruments with both financial liability and equity characteristics (paragraphs 30C–30E and B5B–B5H);

(c) terms and conditions that become, or stop being, effective with the passage of time (paragraph 30F);

(d) the potential dilution of ordinary shares (paragraphs 30G–30H and B5I–B5L); and

(e) instruments that include obligations to purchase the entity's own equity instruments (paragraph 30J).

Paragraphs BC170–BC245 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with the proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

42. We are supportive of the Board's efforts to enhance the quality of disclosures. However, we recommend that the Board takes steps to ensure that the additional disclosure requirements are proportionate, and the benefits outweigh the costs of preparing them if the Board proceeds with the proposed changes. We outline our suggestions and concerns below.

Materiality

43. We believe any additional disclosures ought to strike the right balance to ensure they provide users with the information they need without giving rise to excessive information and obscure information relevant to readers. We suggest limiting the disclosures to key judgements concerning the classification of, and key terms and conditions of, individually material instruments.

Liquidation disclosures

44. The wide-ranging disclosures on priority of claims on liquidation may be practically onerous, especially in group situations, and provide limited information that would not anyway have been disclosed as part of the key terms and conditions of individually material items. The disclosure requirements may be particularly more challenging in case of Special Purpose Vehicles (SPVs) with complex waterfall payment structures.

45. We also note that these disclosures are only likely to be really meaningful when the entity is not a going concern. We have already commented on the proposed definition of liquidation in Question 4 above.

Potential dilution of ordinary shares

46. We question the objective behind these additional disclosures in IFRS 7 and how they reconcile to the disclosures required by IAS 33. If the Board decides to proceed with these requirements, we suggest that they limit the scope to entities that are required to provide IAS 33 disclosures.

47. We are also unclear as to how these requirements would apply to equity instruments that are not ordinary shares and the Board should consider providing further clarification.

48. We agree that investors are likely to be interested in disclosures to help them understand the likelihood of maximum dilution (in line with the proposed requirement in para 30G(d)). However, we believe the level of detail provided in illustrative example (IG14H) is insufficient to achieve this objective, as it is not disclosed in the example whether the convertibles are in or out of money, or by how much.

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Question 8 - Presentation of amounts attributable to ordinary shareholders (paragraphs 54, 81B and 107–108 of IAS 1)

The IASB proposes to amend IAS 1 to require an entity to provide additional information about amounts attributable to ordinary shareholders. The proposed amendments are that:

> ***(a) the statement of financial position shows issued share capital and reserves attributable to ordinary shareholders of the parent separately from issued share capital and reserves attributable to other owners of the parent (paragraph 54);***
>
> ***(b) the statement of comprehensive income shows an allocation of profit or loss and other comprehensive income attributable to owners of the parent between ordinary shareholders and other owners of the parent (paragraph 81B);***
>
> ***(c) the components of equity reconciled in the statement of changes in equity include each class of ordinary share capital and each class of other contributed equity (paragraph 108); and***
>
> ***(d) dividend amounts relating to ordinary shareholders are presented separately from amounts relating to other owners of the entity (paragraph 107).***

Paragraphs BC246–BC256 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Would the proposed requirement to allocate issued share capital and reserves between ordinary shareholders and other owners of the parent give rise to any practical difficulties in determining the required amounts? If so, please describe the possible difficulties and specify areas in which further guidance would be helpful.

49. Whilst we support the intent of the proposals, we believe that there are likely to be significant practical challenges in applying them in practice.

Practical challenges

50. We believe attributing profit and loss, other comprehensive income, and reserves between ordinary shareholders of the parent and other owners is likely to be particularly challenging. This is especially true for equity instruments with debt like features where the amounts an entity expects to pay out in the most likely scenario may be very different to what an entity would be required to pay on liquidation. For example, it is not clear how an entity could allocate profit or loss to unpaid dividends on cumulative preference shares that are only payable on liquidation. Allocating total comprehensive income and reserves to such instruments could involve significant estimation and the result could be misleading in some cases.

51. We suggest that limiting the scope of the proposal to entities that are in scope of IAS 33 and providing practical examples could help to alleviate these concerns.

Question 9 - Transition (paragraphs 97U–97Z of IAS 32)

The IASB proposes to require an entity to apply the proposed amendments retrospectively with the restatement of comparative information (a fully retrospective approach). However, to minimise costs, the IASB proposes not to require the restatement of information for more than one comparative period, even if the entity chooses or is required to present more than one comparative period in its financial statements.

For an entity already applying IFRS Accounting Standards, the IASB proposes:

> ***(a) to require the entity to treat the fair value at the transition date as the amortised cost of the financial liability at that date if it is impracticable (as defined in IAS 8***

Accounting Policies, Changes in Accounting Estimates and Errors) for the entity to apply the effective interest method in IFRS 9 Financial Instruments retrospectively (paragraph 97X);

(b) not to require the entity to separate the liability and equity components if the liability component of a compound financial instrument with a contingent settlement provision was no longer outstanding at the date of initial application (paragraph 97W);

(c) to require the entity to disclose, in the reporting period that includes the date of initial application of the amendments, the nature and amount of any changes in classification resulting from initial application of the amendments (paragraph 97Z);

(d) to provide transition relief from the quantitative disclosures in paragraph 28(f) of IAS 8 (paragraph 97Y); and

(e) no specific transition requirements in relation to IAS 34 Interim Financial Reporting for interim financial statements issued within the annual period in which the entity first applies the amendments.

For first-time adopters, the IASB proposes to provide no additional transition requirements.

Paragraphs BC262–BC270 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Would the proposal to apply the proposed amendments retrospectively give rise to any other cases in which hindsight would be necessary? If so, please describe those cases and the circumstances in which the need for hindsight would arise.

52. We are not convinced that requiring a fully retrospective approach for these amendments has benefits that outweigh the respective costs, particularly for those other than large, listed entities. We strongly encourage the Board to consider allowing a modified retrospective approach akin to that applied to IFRS 15 *Revenue from Contracts with Customers*, IFRS 16 *Leases* and IFRS 17 *Insurance Contracts* in order to help reduce the burden of transition.

53. We believe that additional specific guidance on transition is required. We suggest the Board provides specific exemptions to reduce the costs associated with transition, particularly in relation to:

    - Restating previous business combinations for changes arising from changes in measurement of NCI-puts and forwards.
    - Requiring reassessment of the classification of instruments only at the date of transition based on the terms effective at that date.
    - Specific transition requirements for amounts measured in accordance with IAS 32.23 and IAS 32.25A, such as clarifying that the entity assesses the measurement in accordance with the proposed IAS 32.23 or IAS 32.25A at the date of transition based only on the facts and circumstances and that date.
    - Relief for entities where the proposals lead to reclassification of liabilities to which hedge accounting had previously been applied.

54. We also suggest the Board clarifies how first-time adopters should apply the requirements in the proposals.

Question 10 - Disclosure requirements for eligible subsidiaries (paragraphs 54, 61A–61E and 124 of [IFRS XX])

The IASB proposes amendments to the draft Accounting Standard [IFRS XX Subsidiaries without Public Accountability: Disclosures], which will be issued before the proposals in the Exposure Draft are finalised.

[IFRS XX] will permit eligible subsidiaries to apply the recognition, measurement and presentation requirements in IFRS Accounting Standards with reduced disclosures.

The IASB's proposals select appropriate disclosure requirements from those proposed for IFRS 7, based on the IASB's agreed principles for reducing disclosures.

Paragraphs BC257–BC261 explain the IASB's rationale for the selected disclosures.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why, taking into consideration the reduced disclosure principles described in BC258.

55. We support reducing the disclosure requirements for subsidiaries without public accountability, however we believe that the proposals for such entities could be streamlined further. For example, the proposed disclosures in respect of priority on liquidation (paragraphs 61A and 61B) may be overly extensive in respect of a 100% owned subsidiary.

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