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Submitted via website

Brussels, 20 March 2024

Subject: Exposure Draft: Financial Instruments with Characteristics of Equity - Proposed amendments to IAS 32, IFRS 7 and IAS 1

Dear Mr. Barckow,

Dear Mr. Klinz,

We are pleased to respond to the International Accounting Standards Board (IASB or the Board) Exposure Draft: Financial Instruments with Characteristics of Equity - Proposed amendments to IAS 32, IFRS 7 and IAS 1 (ED) as well as the EFRAG Draft Comment Letter (DCL) thereon.

The effects of relevant laws or regulations

We agree with the IASB's objective of improving consistency in financial reporting. However, we draw the Board's attention that such an objective shouldn't be at the expense of providing useful information to users. We are particularly concerned that the IASB's focus on contractual terms that are incremental to laws and regulations may lead to greater inconsistency and counter intuitive outcomes in the financial reporting of similar instruments.

We therefore encourage the Board to reconsider the project direction on this issue and we continue to consider that the best way forward would be to adopt an "all-inclusive" approach whereby all obligations are taken into account regardless of their origin (contract, law or regulation). We nevertheless acknowledge that adopting such a principle may result in significant change to the current requirements and therefore to the current practice and may have to be accompanied by some limited exceptions to address some specific situations (e.g. bail-in features).

Obligations to purchase an entity's own equity instruments

The majority of our members expressed a support for the "gross accounting method" for recognition and measurement of the liability but disagreed with the ED proposal to always remove the liability's amount from the group equity. Instead, the majority of our members believe that the debit should be recognised against non-controlling interests (NCI) therefore avoiding any "double accounting" issues. Two alternative views supported by some of our members are further detailed in our answer to question 3 in the appendix.

With regards to the subsequent measurement, our members had mixed views on the preferred approach. No agreement was reached on where to record the remeasurement of the liability's fair value. Therefore, we do not express a preference in this respect.

Shareholder discretion

We agree with the IASB that differences of view on how to treat shareholders' decisions created divergence in practice. In this regard, we welcome the proposed guidance. We however observe that the level of judgement will remain significantly high. We therefore encourage the Board to complement this guidance with examples to further illustrate the underlying principles of the proposal and help minimise the risk of diversity in application.

Reclassification

We support the introduction of guidance on reclassifications of financial liabilities and equity given the lack of guidance currently in IAS 32 and consequently the differing practices that may have been applied. However, we disagree with the approach proposed by the ED. We are concerned that it could be counter-intuitive and misleading for the readers of the Financial Statements that instrument remains classified as a financial liability even after the point where there is no contractual obligation to pay cash. We therefore encourage the Board to reconsider this proposal.

We kindly refer to Annex 1 and Annex 2 of this letter for our detailed responses.

Please do not hesitate to contact Nael Braham (nael@accountancyeurope.eu) in case of any questions or remarks.

Sincerely,

Olivier Boutellis-Taft

Chief Executive Officer

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Annex 1: IASB ED – Questions for respondents

We are pleased to present below our detailed responses to the questions raised in the IASB's Exposure Draft (ED) on Financial Instruments with Characteristics of Equity.

Question 1 - The effects of relevant laws or 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.

(1) We welcome the IASB efforts in trying to address the diversity in practice arising from the current requirements of IAS 32.

(2) We observed that in current practice, under some circumstances, an obligation created by law is ignored when assessing whether the entity has a contractual obligation (such as for a mandatory distribution of dividends or a mandatory tender offer). However, in other cases, entities have not thought through whether a contractual obligation that they have was the result of a legal requirement or came solely from a negotiation between the parties. For example, some mutual funds' shares failed to meet equity definition because of a put option even though such a put is required by law in their jurisdiction. We are therefore convinced that current practice is inconsistent.

(3) We agree with the IASB's objective of improving consistency in financial reporting. However, we are concerned that such an objective shouldn't be at the expense of providing useful information to users. We consider that the consistent application of a poor principle will not be of benefit to users if it creates inconsistency in the way identical payment obligations are reflected under IFRS solely because of the source of that obligation. We are particularly concerned that the IASB's focus on contractual terms that are incremental to laws and regulations may lead to greater inconsistency in the financial reporting of similar instruments. For example:

- Diversity in legal environment: similar obligations would have a different accounting impact depending on the legal environment of the entity and even potentially within the same consolidated group.
- The level of judgement required in implementing this principle resulting in complexity and diversity: Preparers would be required to assess the degree to which rights and obligations arising from an instrument are incremental to statutory rights and obligations. This is an additional, potentially difficult, judgement that is required by the IASB's approach.
- There may be unintended consequences for some instruments whose terms and conditions are closely derived from law and regulation.

(4) An example of such unintended consequences are specific banking instruments in some European countries that contain a statutory redemption feature. These instruments are typically classified as liability instruments because of their redemption feature, but under the proposed amendments might now meet equity classification requirements. In contrast an identical instrument with an equivalent redemption feature might be accounted for differently in another country only on the basis that the redemption feature is solely contractual. This would lead to diversity in how the same instrument (and related obligations) is classified in one country compared with the other.

(5) Accountancy Europe continues[1] to consider that from a conceptual basis, an "all-inclusive" approach (that is considering contractual rights and obligations as well as obligations established by laws and regulations) would be more consistent and provide more useful information to the users of Financial Statements.

(6) We acknowledge that such a change may go beyond the IASB's scope for this project and that it would result in a significant change compared to current practice (both from a standard setting and classification impact point of view). Specific exceptions may even be required to address properly some situations caused by regulation. A consensus was reached on the need to address the situation of a bail-in feature for example, but we encountered mixed views on whether exceptions would be needed for situations required by law such as dividend distribution or put features for specific forms of legal entities. We nevertheless consider that this "all-inclusive" principle is a better direction for the project than the one considered in the ED.

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.

(7) We are generally supportive of the amendments in this area.

(8) We however express significant concerns in respect of the wording of para 22, 22B and their interaction with examples 14 and 20. We do not believe the amendments are clear on how variable interest rate convertible instruments should be analysed.

(9) Example 20 in IAS 32.IE82-86 states that a derivative over a fixed number of an entity's own equity in exchange for an amount of cash where the strike price varies with a benchmark interest rate fails the equity definition. It is not a passage-of-time adjustment because "the inputs vary not only with the passage of time, but also with an interest rate benchmark." This could be read to mean that a convertible bond where the interest rate on the debt component varies with benchmark interest rates results in the equity conversion feature failing IAS 32:22C(b).

[1] Cf: Accountancy Europe response to the IASB 2018 DP

(10) Yet, Example 14 in IAS 32.IE60-61, describes a convertible bond with accrued interest where the conversion option passes IAS 32.22B (assuming there are no other features that fail equity classification). Example 14 does not state whether the interest rate that accrues is fixed or floating so it is ambiguous whether a floating / variable rate of interest in this case passes the criteria in IAS 32.22B (i.e. amount of consideration is fixed).

(11) In addition, IAS 32.16(b)(ii) has been amended and indicates that "settling a fixed amount of its financial liability" is deemed 'fixed' for the purpose of equity classification. We think a fixed amount in this case could be read as a fixed principal amount of the liability where the amount never changes, and that if it does, due to variable interests, forgiven accrued interest or other feature (e.g. ESG / inflation component) the conversion option fails the equity classification.

(12) To remove the ambiguity, and to ensure that the criteria in IAS 32.22 and 22B apply equally to standalone derivatives over own equity, and to those embedded in debt (funded instruments) we believe that paragraph 22 should be reworded and avoid the notion of "settling a fixed amount of its financial liability" and it should be clarified that what matters for convertible instruments is that the conversion ratio is fixed and that both fixed rates and variable interest rates of interest pass the fixed-for-fixed test.

(13) A few of our members however believe that the fixed conversion ratio should not be considered as a condition met when the interest rates are variable.

Preservation adjustments

(14) We are supportive of the inclusion of preservation adjustments in IAS 32.22C. We observe that such adjustments are common in convertible instruments and consider such adjustments as being reasonable in classifying conversion features as equity.

(15) However, with respect to preservation adjustments in IAS 32:22C(a)(ii), we propose changing the criteria so that it reads: "is designed to preserve the economic interests of the future holders…"

(16) We believe that preservation adjustments (designed to preserve the economic interests of the future holders of the entity's equity instruments) should pass the fixed-for-fixed criteria given that, in the future, it is not possible to ensure that the condition will always preserve the economic interests precisely as intended.

(17) For example, it is common in convertible bonds containing a change in control clause that results in early conversion that the compensation paid to the convertible bond holder for their lost time value is based on a schedule included in the terms and conditions of the instrument when it is issued that is designed to estimate the time value of the conversion option at future dates should a change of control occur at those dates.

(18) In practice, the actual time value of the option at the date of the change of control could differ from the one set out in the schedule, but we believe that if the schedule is designed to preserve the economic interests of the holders of the equity instruments this should pass the fixed-for-fixed criteria.

Currency

(19) We understand the conceptual basis behind the "functional currency" criteria, which is consistent with the IFRS framework. We note however that, in some countries, entities may be obliged to issue their capital in the local currency while they use another (generally considered as stronger) currency for their business. In this situation, the functional currency aspect might lead instruments to fail the fixed for fixed test.

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.

(20) We take note of the IASB's proposals, and the rationale as laid out in the Basis for Conclusions. We concur with the Board's objective to find a way to bring consistency in the accounting treatment of such transactions.

(21) The majority of our members expressed a support for the "gross accounting method" for recognition and measurement of the liability but disagreed with the ED proposal to always remove the liability's amount from the group equity.

(22) The majority of our members believe as well that the debit should be recognised against non-controlling interests (NCI), regardless whether the parent has access to the returns associated with ownership of those instrument. They note that maintaining the equity attributable to NCIs while recognising a gross financial liability does result in double accounting for the rights of the NCIs: on the one hand, a share in equity measured in accordance with applicable accounting standards; on the other hand, a financial liability measured at the present value of the exercise price. While the rights of non-controlling interests holders on these equity and liability items are mutually exclusive. Non-controlling interests holders will not receive both the benefits and net assets they are entitled to as shareholders and the cash associated with the put option: they will receive either one, or the other, but not both.

(23) Those members also note that Paragraph BC11 of IAS 32 requires the shares held by NCIs to be classified as a financial liability "an entity's obligation to purchase its own shares establishes a maturity date for the shares that are subject to the contract. Therefore, to the extent of the obligation, those shares cease to be equity instruments when the entity assumes the obligation". In other words, paragraph BC11 observes that the put option operated a fundamental change in the nature of the equity instrument when the entity assumed the obligation. The same paragraph further notes that the way the obligation was structured, either as a redemption clause embedded within the equity instrument, or as a free-standing derivative contract, has no impact on the conclusion. This BC is further confirmed by AG 29 and BC68. As NCI are defined by "equity in a subsidiary not attributable, directly or indirectly, to a parent", and since the shares held by the NCIs ceased to meet the definition of equity, it follows from such definition that NCIs should be derecognised from the consolidated financial statements and no P&L/equity should be allocated to them.

(24) Others think that judgement should be applied in determining whether to record the debit against parent equity or NCI. Such judgement would be made on the basis of whether the instrument gives the parent access to the returns associated with ownership of those instruments. They cite the guidance in IFRS 10 Appendix B90, and note that the proposed AG27B (along with the explanation in BC76 of the ED) appear to support this view. If this is the IASB's intention, we would ask the IASB to make this clearer and to give guidance on how to judge whether an entity has "access to the [rights and] returns associated with the ownership of those equity interests". They nevertheless acknowledge that such an approach may not significantly reduce the diversity in accounting for such put features.

(25) We encourage the Board to reconcile and/or clarify how its proposal articulates with BC11, AG 29, BC68 of IAS 32 and the definition of NCI provided by appendix B of IFRS 10 and B95 which suggest NCI can only exist if they meet the definition of equity while shares that are puttable no longer meet such definition at group level.

(26) A few of our members supported the IASB's proposals in debiting the parent's equity . They note that NCI shall not be derecognised as they still have a right in the net assets of the entity

(27) With regards to the subsequent measurement, our members had mixed views on the preferred approach. No agreement was reached on how to account for the remeasurement of the liability's fair value. Therefore, we do not express a preference in this respect.

(28) A few members supported the "net accounting method" for initial and subsequent accounting (similar to the dissenting view expressed in the ED) but recognised that such an approach would represent a fundamental change to the current IAS 32 requirements and would also represent a departure from the conceptual framework.

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.

(29) Even though some of our members noted that taking into account the probability of occurrence in the measurement of the liability would provide relevant information to users, we generally support the proposal which will address some of the diversity observed.

(30) We think however, the IASB should refine the principle when the amounts that might have to be repaid might vary and when such amounts could exceed the initial fair value of the instrument. We don't believe the initial measurement of the liability component should give rise to a negative amount for the equity component which the IASB's proposal could lead to. Any redemption feature for an amount above the initial fair value of the instrument should be recognised as an embedded derivative.

(31) We agree with the principle proposed in (c) however we draw the attention of the Board on the resulting consequences on the ongoing DRM project as such approach may transfer existing managed exposures to an equity classification.

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.

(32) We agree with the IASB that differing views on how to treat shareholders' decisions created divergence in practice. In this regard, we welcome the guidance proposed by the ED.

(33) We are nevertheless concerned that criterion (b)(iv) in isolation, could be read as requiring that a shareholder vote over a decision to redeem an instrument is not an entity's decision. In our view, such a decision could still be considered as part of the entity's decision if it is a collective decision made as part of the entity's governance structure where all the shareholders participate in the decision and not only one class of shareholders. We encourage the Board to clarify that the proposed criterion shall not be considered in isolation to the others.

(34) Even with these proposals, we expect the level of judgement required to perform such assessment to remain significantly high. We therefore encourage the Board to complement this guidance with examples to illustrate further the underlying principles of the proposal and help minimise the risk of diversity in application. Additional guidance in a situation where multiple classes of shareholders exist would be especially welcome to clarify the Board's intention on how such guidance shall be applied in such a situation.

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.

(35) We support the introduction of guidance on reclassifications of financial liabilities and equity given the lack of guidance currently in IAS 32 and differing practices that may have been applied.

(36) However, the proposals in 32B would preclude reclassifications in cases other than changes external to the contract. While this might reduce diversity in the case of fixed-for-fixed reassessment, we are concerned that the ban on reclassification goes wider to non-derivative situations (for example BC131(c)). This could result in outcomes which are not useful and create confusion and potential for diversity on the distinction between reclassification and derecognition.

(37) We also find counter-intuitive, and potentially misleading for the readers of the Financial Statements, that a compound instrument remains classified as a financial liability even after the point where there is no contractual obligation to pay cash following the expiration of one of its contractual feature. (e.g. a holder's put option has expired without being exercised). Should the same feature (e.g. a put option) be a standalone instrument, it would have been accounted for differently (the liability caused by a stand alone put option on NCI is reclassified to Equity when it expires leading to the derecognition of the financial liability when the contractual obligation expires). In addition, we are not convinced that reclassification would increase costs as implied by BC 145. IAS 32 is often more practical to implement by looking at current contractual terms.

(38) We also note that such approach on reclassification would be simply consistent with the one retained by the Board for transition purpose in paragraph 97W.

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.

(39) We concur with the IASB that the claims priority could provide useful information to users.

(40) We question however the operationality of this requirement. We are unsure that the ED requirements can be implemented without undue cost and effort, and presented in a way that is useful to users.

(41) We also call for consistency with IAS 33 Earnings per Share requirements on dilutive instruments.

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.

(42) At this stage, we disagree with the proposals. We are uncertain how the allocation could be applied consistently. The ED provides no application guidance nor a clear objective for these proposals, and so we are concerned that they would not be applied consistently in practice. In particular, there is no guidance provided to determine how an entity would take into account the effect of various equity instruments other than ordinary shares (such as derivatives on ordinary shares and preference shares convertible into ordinary shares) when determining the amount to attribute to ordinary shares.

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.

(43) We agree with the general principle of a retrospective application. However, we invite the IASB to analyse further how to deal with and assess the cost benefit ratio of situations in which the change in classification of an instrument leads to a change in the hedging relationship documented where the instrument was the hedged item (or part of it).

(44) We would also suggest the IASB consider transition relief for instruments that have been derecognised before initial application of the amendments.

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.

Annex 2: EFRAG DCL – Questions to constituents

We are pleased to provide below our detailed responses to the questions to constituents in EFRAG's DCL on Financial Instruments with Characteristics of Equity.

Question to Constituents (paragraph 16-18 of the DCL)

When applying the IASB proposals on the effects of applicable laws on the contractual terms of financial instruments, do you expect any classification changes on instruments such as (i) bail-in instruments, (ii) ordinary shares with statutory minimum dividends, (iii) IFRIC 2-type instruments or (iv) any other financial instruments or situations (e.g., limited life companies or limited partnerships)?

Do you consider that the IASB should address MTOs?

EFRAG was made aware that the IASB's proposal, when read in conjunction with the Basis for Conclusions, could have unintended consequences in terms of either excluding certain banking products, such as loans or banking saving deposits, from the scope of IFRS 9 / IAS 32, or in classifying such instruments as equity. In the latter case, those instruments would end up being classified as equity instruments (classified as equity in the entity's financial statements and with a corresponding debit entry as financial asset measured at fair value through profit or loss).

Do you consider that the IASB's proposal could lead to the accounting of some banking products in their jurisdiction, such as loans or banking saving deposits, being disrupted by the proposal. Please explain.

(45) Please refer to our response in paragraphs 1-6 above.

Question to constituents (paragraph 40 of the DCL)

Do you consider that the IASB's proposals on passage-of-time adjustments will lead to classification changes for options that can be exercised at different pre-determined dates (as described above)? If so, how pervasive would these classification changes be?

(46) Please refer to our response in paragraphs 7-18 above.

Question to Constituents (paragraph 52-53 of the DCL)

Regarding the accounting for the obligations to purchase an entity's own equity instruments (NCI written put option), do you support

(a) the gross presentation, as outlined by the IASB, whereby an entity initially recognises a financial liability for the redemption amount with the debit side going against the parent's equity if the entity does not yet have access to the returns associated with ownership of those equity instruments? If so, are you not concerned that the accounting depends on whether the entity does have access to the returns associated with ownership of the equity instruments? Please explain.

(b) Do you support the gross presentation whereby an entity initially recognises a financial liability for the redemption amount with the debit side going against noncontrolling interests on the basis that not doing so would not reflect the economic substance of the transaction and would result in double-count of the noncontrolling interest as highlighted in paragraph BC77 of the Basis for Conclusions or as argued by Mr Uhl in paragraph AV5 of the Basis for Conclusions? Please explain.

(c) Do you support the net approach resulting in the recognition of a stand-alone derivative measured at fair value as indicated by Mr Uhl in the Basis for Conclusions (paragraphs AV1 to AV6)? Please explain.

Do you have any views on how NCI puts should be accounted for in the separate financial statements? Please explain.

(47) Please refer to our response in paragraphs 19-27 above.

Questions to constituents (paragraph 59-60 of the DCL)

Assuming that the gross presentation is retained, do you consider that subsequent changes to the carrying amount of the financial liability should be presented

(a) in profit or loss (as proposed by the IASB),

(b) within equity (on the basis that it is a transaction with owners in their capacity as owners, particularly if NCI and other owners of the parent retain ownership rights), or

(c) based on any other approach, such as in OCI in full or a split between profit or loss and OCI? Please explain.

Assuming that the net approach is retained, do you consider that subsequent changes to the fair value of the stand-alone derivative should be presented

(a) in profit or loss (in line with all other derivatives) or

(b) within equity (on the basis that the derivative stems from a transaction with owners in their capacity as owners)?

(48) Please refer to our response in paragraphs 19-27 above.

Questions to constituents (paragraph 75-77 of the DCL)

Do you have concerns that the initial and subsequent measurement of the financial liability (or liability component of a compound financial instrument) arising from a contingent settlement provision would ignore probability? Please explain.

From the IASB's proposals, do you expect a classification change on how payments to holders are recognised in the financial statements (in the statement of profit or loss or equity)? Will such a change affect your hedge accounting?

Do you consider that the clarifications of the terms 'liquidation' and 'non-genuine' are sufficient? If not, what issues remain?

(49) Please refer to our response in paragraphs 28-30 above.

Questions to constituents (paragraph 86-87 of the DCL)

Do you expect changes in classification from the IASB proposals, particularly changes to the classification of financial instruments from equity to liability? What would cause these expected changes to classification?

Where local regulation or law is not clear about whether shareholders are part of the governance of the entity, should the IASB consider

> *(a) mandating a particular treatment, thereby not leaving room for judgement in order to avoid lack of comparability, or*
>
> *(b) leaving room for judgement based on proposed factors and, if so, which other factors (in addition to those given by the IASB) should be considered? Please explain.*

(50) Please refer to our response in paragraphs 31-33 above.

Questions to constituents (paragraph 139-141 of the DCL)

Are there any significant operational concerns in providing the disclosure requirements? Please explain.

Terms and conditions of financial instruments with both financial liability and equity characteristics:

Do you agree with the guidance provided on debt-like characteristics and equity-like characteristics (in paragraphs B5B–B5G of IFRS 7), including providing both quantitative and qualitative information? Please explain.

Do you consider that there are other characteristics which should be considered? Please explain.

(51) Please refer to our response in paragraphs 37-39 above.

Question to constituents (paragraph 156 of the DCL)

Considering the guidance provided by the IASB, will you be able to allocate profit or loss to 'ordinary shareholders of the parent' and 'other owners of the parent'?

(52) Please refer to our response in paragraphs 40 above.

Question to constituents (paragraph 174 of the DCL)

Do constituents have any concerns on suggested retrospective transition requirements in addition to the ones described above? If so, please describe your concerns and provide suggested solutions.

(53) Please refer to our response in paragraphs 41-42 above.