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28 March 2024

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Dear Dr Barckow

Exposure Draft IFRS Accounting Standard – Financial Instruments with Characteristics of Equity – Proposed amendments to IAS 32, IFRS 7 and IAS 1

Deloitte Touche Tohmatsu Limited is pleased to respond to the International Accounting Standards Board's ("the IASB") IFRS Accounting Standard Exposure Draft, *Financial Instruments with Characteristics of Equity* ("the ED")

We welcome the IASB's efforts to improve the requirements for classification and disclosure of financial instruments with characteristics of equity. We welcome the efforts to reduce the existing diversity in the application of IAS 32. However, we have concerns that in several areas the proposed amendments may lead to new interpretation issues. In our detailed comments, we provide suggestions to minimise new interpretative issues and avoid fundamental changes in the classification of liabilities and equity where we consider that current practice is appropriate.

A significant proportion of questions that arise from applying IAS 32 is in respect of the fixed-for-fixed criteria. We welcome the explicit inclusion of the concepts of preservation and passage-of-time adjustments when applying the criteria. However, we believe the criteria we are concerned that the criteria used have been defined too narrowly such that many adjustments, which we believe should pass the criteria, will instead fail them..

As previously expressed in our comment letter to the discussion paper *Financial Instruments with Characteristics of Equity,* we believe that derivatives over own equity should be measured at fair value through profit or loss. This approach would avoid the issues associated with the gross obligation accounting. Whilst we acknowledge that the amendments proposed in the ED will reduce divergence in practice, many of the issues arising from the gross obligation accounting will remain. If the IASB retains this approach, we strongly believe that gains and losses from remeasuring obligations to purchase an entity's own equity instruments at a *future market price* should be recognised in equity. The proposal that such gains and losses be recognised in profit or loss does not faithfully represent the economics of the transaction because arrangements in which the redemption price reflects the future market price of the underlying equity instruments result in an exchange of cash and equity of equal value.

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In addition, we do not believe that financial liabilities with contingent cash flows should be measured ignoring the probability and estimated timing of occurrence of the contingent event. In our view this approach is conceptually flawed and fails to capture the economic substance of the related instruments, and therefore we believe that it would be more appropriate to measure such financial liabilities applying IFRS 9.

We support the proposal to clarify the effect of laws and regulations on the classification of financial instruments. However, we are concerned that some interpretation questions remain and we have suggested how these may be addressed through examples in the Illustrative Examples and Application guidance.

We welcome the introduction of disclosures of the terms and conditions of financial instruments containing characteristics of equity. Developments in financial engineering have led to an increasing sophistication and complexity of financial instruments which are not fully apparent from the amounts recognised in the financial statements. Disclosure of terms and conditions can help users better understand the economics of such instruments.

However, several other proposed disclosures are, in our view, not necessary and may not lead to meaningful information for the users. Specifically, we have concerns about the introduction of extensive disclosures of the nature and priority of claims on liquidation, particularly in the context of consolidated financial statements. The aggregation and ranking of claims on liquidity is unlikely to be meaningful when they involve claims on various legal entities within the consolidated group. Further, whilst we support disclosure of information on the dilutive effect of financial instruments, we believe it would be more proportionate to require this information to be disclosed only for entities that are required to apply IAS 33 *Earnings Per Share.* For entities not required to apply IAS 33 disclosure of the terms and conditions of financial instruments containing characteristics of equity should be sufficient.

Our detailed responses to the questions in the ED are included in the Appendix to this letter.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0)20 7936 3000.

Yours sincerely

Veronica Poole
Global IFRS and Corporate Reporting Leader

Deloitte.

Appendix

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.

We agree that it is important to differentiate between an obligation that arises from laws and regulations ("statutory obligation") and a contractual obligation for the purpose of classification of financial instruments. However, we disagree with the proposal in the ED that a contractual obligation that goes beyond a statutory obligation must always be regarded as wholly contractual. Further, we believe additional clarity could be provided through Illustrative Examples and Application Guidance illustrating the difference between statutory and contractual obligations.

Distinction between statutory and contractual obligations

We acknowledge that distinguishing between a statutory and a contractual obligation can be challenging where statutory obligations may form part of contractual arrangements. For example, in some jurisdictions the legal system is based on code law, and therefore it is not necessary to include certain key characteristics of a financial instrument into the contractual arrangements since these characteristics apply automatically under the jurisdictional laws and regulations. In other jurisdictions the legal system is based on common law, and therefore the same characteristics may not apply automatically under the relevant laws and regulations, and need to be incorporated into the contractual arrangements in order to achieve the same economic outcome.

We agree with the proposal in IAS 32:15A(a) that only enforceable rights and obligations are considered when classifying a financial instrument and with the related observation in IAS 32:BC30 that this approach is consistent with the principle in IFRIC 2:8. However, we observe that IFRIC 2:5 states "[…] the entity must consider all of the terms and conditions of the financial instrument in determining its classification as a financial liability or equity. Those terms and conditions include relevant local *laws, regulations* and the entity's governing charter […]" (emphasis added). This paragraph in IFRIC 2, which interprets the current requirements in IAS 32, seems to conflict with the proposal IAS 32:15A(b) that a right or obligation created by laws and regulations that would arise regardless of whether the right or obligation is included in the contractual arrangement are not considered in classifying the financial instrument. We are concerned with this apparent conflict since one of the objectives of the project that led to the ED is to not fundamentally change the requirements in IAS 32 (as explained in IAS 32:BC6 and BC16). Accordingly, we believe that it would be useful to clarify how the existing requirements in IFRIC 2:5 interact with IAS 32:15A(b).

IAS 32:15A indicates that contractual rights and obligations include rights and obligations that "are in addition to those created by relevant laws or regulations (such as statutory or regulatory requirements applicable to the instruments)". We agree with this statement but believe further clarity should be

provided through Illustrative Examples and Application Guidance. In particular, it would be useful to clarify that laws and regulations may affect the amount or timing of cash flows from contractual obligations, but this does not change the nature of the obligation being contractual.

Inclusion of the following examples to illustrate application of IAS 32:15A would be helpful:

- The terms of a financial instrument may state that the interest rate is set at a specific rate (or is subject to a cap) established by the applicable laws and regulations or the laws and regulations may establish the right of the borrower to prepay the financial instrument. It would be helpful to clarify that in such cases the effect of the laws and regulations does not change the nature of the obligation to pay interest or settle the instrument being contractual. Rather, the laws and regulations simply determine the amount or timing of the contractual right or obligation.
- In many jurisdictions the tax legislation requires an entity that wishes to benefit from the favourable Real Estate Investment Trust ("REIT") tax status to distribute 90% of its taxable income each year. We believe it would be useful to clarify that the obligation to distribute 90% of profits is a contractual obligation despite the fact that it arises from the entity's decision to avail itself of the REIT tax status.

We also suggest that it would be useful to clarify that rights and obligations that are not considered when classifying a financial instrument (because they are not contractual) may need to be accounted for applying another IFRS Accounting Standard. This would avoid any implication that statutory rights and obligations should be ignored entirely.

Mandatory tender offers

In March 2013, the IFRS Interpretations Committee considered the accounting for mandatory tender offers that arise when the laws and regulations require the acquirer in a business combination to offer to purchase the shares held by non-controlling interests. The IFRS Interpretations Committee did not reach a conclusion on whether such arrangements give rise to a liability in the scope of IAS 32. In May 2013, the IASB considered the topic and acknowledged the similarities to written puts over non-controlling interests for which IAS 32 would require the recognition of a financial liability. It would be helpful if the IASB could include an example in the Application Guidance to illustrate the application of IAS 32:15A in such scenarios, clarifying whether an obligation arising from mandatory tender offer is a statutory obligation and therefore not a financial liability at the date of acquisition and thereafter.

Reassessment arising from changes in laws and regulations

Whilst the ED generally prohibits the reclassification of financial liabilities and equity instruments, a reassessment of the classification is required when there is a change in circumstances external to the contractual arrangement. However, it is not clear whether a change in laws and regulations would trigger a reassessment of the classification. For example, a change in law or regulation may apply to an obligation that was initially determined to be a contractual obligation such that, if a reassessment of the classification is performed, the obligation may now be determined to be statutory. We believe such an event should lead to reclassification applying IAS 32:32B. We suggest that it would be useful to include such an example in the Illustrative Examples and Application Guidance (also see our response to Question 6).

Bifurcation of statutory and contractual provisions

We acknowledge that the IASB, as noted in IAS 32:BC25, determined that an obligation should be classified in its entirely as a financial liability whenever the obligation exceeds a corresponding statutory obligation, on the grounds that the alternative approach of separating the components would not be practicable. We note that IAS 32 already requires the separation of equity and liability components and

this requirement has been applied in practice for a number of years. This demonstrates that it is reasonably practicable to separate a contractual obligation from a statutory one and we believe that this would result in more relevant information.

Consider the following examples:

- A financial instrument is issued in a jurisdiction that requires the payment of a statutory dividend of 10% of profits. The contractual terms of the instrument require the entity to pay a further 20% of profit as dividend, regardless of the statutory dividend rate (i.e. should the law change the amount of the statutory dividend, the issuer will continue to be required to pay an additional 20% of profit as dividend). Accordingly, the additional contractual dividend obligation is clearly identifiable and separable. Nevertheless, the ED proposes that the entity would classify both the statutory dividend and the additional 20% dividend as a financial liability. We believe that the statutory dividend is not a financial liability and that only the additional amount is classified as a financial liability.
- A financial instrument is issued in a jurisdiction that requires the payment of a statutory dividend of 10% of profits. The instrument requires the entity to pay a total dividend of 15% of profits. The ED proposes that the entity would classify the total 15% dividend as a financial liability, whereas entities that issue instruments that pay only the statutory dividend would not classify any amounts of the dividend as a financial liability. We believe that the entity's obligation is represented more faithfully if only the excess 5% of dividend is classified as a financial liability. This approach provides a more relevant comparison of the entity's financial obligations with those of entities that issue financial instruments that pay a dividend of 10% (i.e. the statutory amount) or pay a different additional amount. Under our proposed approach, should the law increase the statutory dividend to 11%, and the entity continues to pay a 15% dividend as per the terms of the contract, the entity would reassess the classification of its obligation and adjust the amount of the financial liability to 4% with the 1% difference being reclassified to equity, reflecting the reallocation between the statutory and contractual components of the dividend. Conversely, should the law change to 9% and the entity continues to pay 15%, it will have a financial liability of 6% with the 1% difference being reclassified from equity to financial liability.
- A bond requires payment of interests only if dividend payments are made on the entity's ordinary shares. If the entity has full discretion over the dividend payment, neither the dividends on ordinary shares nor the interest payments of the bond give rise to a financial liability. However, applying the IAS 32:AG24B, it is not clear how the obligation to pay interest on the bond would be classified if the entity was required to pay a statutory dividend on the ordinary shares. Would the statutory obligation to pay dividend cause the obligation to pay interest on the bond to be also viewed as a statutory obligation? It appears inconsistent that the existence of a statutory dividend has a different impact on the obligation to make payments on the ordinary shares (i.e. a statutory obligation) and on the bond (i.e. a contractual obligation).

We believe that, where the disaggregation of the statutory and contractual obligations is practicable, this approach should be applied as it provides more relevant information and is consistent with the bifurcation principles of IAS 32. We acknowledge that there may be circumstances where it is not practical to separate the statutory and contractual obligations, as noted in IAS 32:BC25. In such cases, we believe an entity should be permitted to classify the entire obligation as a contractual obligation, with appropriate disclosure of that fact.

We note that IAS 32:BC21-23 and BC25 include some examples that the IASB considered in formulating its conclusions on distinguishing between contractual and statutory obligations. We would suggest including

these examples as part of Illustrative Examples and Application Guidance to provide further illustration of the application of IAS 32:15A.

Impact on financial assets

We note that the proposed additional guidance on distinguishing between statutory and contractual rights and obligations will also affect the classification of financial assets, notably whether a financial asset meets the solely payments of principal and interest on the principal outstanding (SPPI) test in IFRS 9. Indeed, we observe that the analysis of Instrument E in IFRS 9:B4.1.13 specifies that the right of the national resolving authority to impose losses on the instrument holder is a term that is *not* considered in assessing whether Instrument E meets the SPPI test because that power and the resulting payments are not contractual terms of the instrument. We suggest that the IASB includes a statement in IAS 32 making it clear that the guidance on differentiating statutory and contractual rights and obligations applies to the classification of financial assets, financial liabilities and equity.

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.

We are generally supportive of the introduction of passage-of-time and preservation adjustments into the fixed-for-fixed criteria. However, we are concerned that the criteria used has been defined too narrowly such that many adjustments, which we believe should pass the criteria, will instead fail it. Our most significant concerns in that respect relate to the guidance on passage-of-time adjustments in IAS 32:22C(b).

Passage-of-time adjustments

We do not believe the ED establishes a clear principle on when adjustments to the contractual terms for passage-of-time are consistent with the fixed-for-fixed criteria. Whether the fixed-for-fixed criteria is applied to a standalone derivative over own equity or a derivative over own equity embedded in a non-derivative instrument, we believe it is reasonable to conclude that the compensation exchanged against the future delivery on an entity's own equity instrument(i.e. deferred delivery of an equity instrument), may vary as a result of the passage-of-time and still pass the fixed-for-fixed criteria. Indeed, in pricing an instrument, the parties can either choose to compensate the deferred settlement through the payment of benchmark interest rates for the period until settlement, or lock-in the value of interest rates at contract inception, keeping the consideration fixed. We believe both are acceptable ways parties may price the amount of consideration an entity wishes to pay or receive for the exchange of equity instruments in the future and this should not affect the classification of the instrument.

For example, a bond that is convertible into a fixed number of the entity's own equity instruments may be convertible prior to its maturity. Such an arrangement can take the form of:

- Bond One for which the holder, in conversion, gives up any accrued interest between the last interest payment date and the conversion date.
- Bond Two for which interest accrued is added to the bond's notional amount and multiplied by a fixed conversion ratio at the conversion date to determine the number of shares that are converted.

Applying the criteria in the ED, it is not clear whether the conversion feature in each of the bonds meets the fixed-for-fixed criteria.

For Bond One, it could be argued that the consideration the holder gives up is always equal to the bond's fixed notional amount such that the fixed-for-fixed criteria is met; yet it could also be argued that the timing of conversion affects the amount of interest the holder forgoes on conversion such that the consideration is variable and the instrument fails the fixed-for-fixed criteria.

For Bond Two, it could be argued that the consideration the holder gives up varies with accrued interest but the ratio of that amount to the number of shares is always fixed so the instrument meets the fixed-for-fixed criteria; yet it could also be argued because the number of equity instruments the holder receives on conversion varies with the amount of accrued interest and the instrument fails the fixed-for-fixed criteria.

In our view, in both cases, the holder has accepted to give up a fixed amount of bond that may or may not include compensation for the time value of money up to the conversion date, and so the conversion feature of both bonds should pass the fixed-for-fixed criteria. Further, we believe that the fixed-for-fixed criteria is met if the consideration, or the number of own equity instruments, varies by an amount which reflects a benchmark interest rate, being either current floating interest rates (see below) or a fixed rate interest priced when the instrument was entered into.

Fixed versus floating interest rates

Example 20 in IAS 32:IE82-86 states that a derivative over a fixed number of own equity instruments in exchange for an amount of cash determined using a strike price that varies with the benchmark interest rate is not an equity instrument. The example explains that the adjustment to the amount of cash 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 if a convertible bond carries interest at a rate which varies with benchmark interest rates, the equity conversion feature fails IAS 32:22C(b) (i.e. the

adjustment is not a passage-of-time adjustment). Yet, Example 14 in IAS 32:IE60-61 describes a convertible bond in which any unpaid coupon may be added to the principal amount and converted into shares and concludes that the conversion option is an equity instrument applying IAS 32:22B (assuming there are no other features that preclude such a classification). We note that Example 14 does not state whether the interest rate on the convertible bond is fixed or floating. It is not clear whether the accrual of interest at a floating rate should be viewed as a passage-of-time adjustment as defined in IAS 32:22C(b). The amendments proposed to IAS 32:16(b)(ii) contribute to this ambiguity as the reference to “settling a fixed amount of its financial liability” for a fixed number of own equity instruments does not clearly exclude accrual of interest at a floating rate. Indeed, we believe that the reference to a fixed amount IAS 32:16(b)(ii) can reasonably be read as a fixed principal amount, which may change only to reflect accrual of interest at a fixed or floating rate.

In addition, IAS 32:22C(b)(iii) limits passage-of-time adjustments to adjustments in which “any difference in the amounts of consideration to be exchanged on each possible settlement date represents compensation proportional to the passage of time.” We believe the use of the term ‘proportional’ is too restrictive and that it will introduce new interpretative issues on how to determine whether compensation is proportional to the passage of time. For example, whether this requires the compensation to reflect compounded interest equivalent to an effective interest rate, using an interest rate which reflects the shape of the yield curve at the date the instrument is contractually agreed. Also, compensation determined using floating rates is not likely to be proportional in amount, given interest rates may change. However, consistent with our comments above, we believe such interest rates should pass the criteria, given the compensation is for the passage-of-time, i.e. it is the current price of the time value of money.

Preservation adjustments

We agree with the inclusion of preservation adjustments in IAS 32:22C. We observe that such adjustments are common in convertible instruments and free-standing derivatives over own equity instruments. We consider that it is appropriate that such adjustments should not prevent the classification of conversion features and equity derivatives as equity instruments.

Our observations include suggested improvements to the drafting to ensure that preservation adjustments are not an impediment to equity classification if they are designed to preserve the economic rights of future holders of the entity’s own equity instruments relative to current holders.

We suggest amending the criteria in IAS 32:22C(a)(ii) to qualify as a preservation adjustment as follows:

> “is designed to preserve~~s~~ the economic interests of the future holders of the entity’s own equity instruments (the future equity instrument holders) to an equal or lesser extent…”

We believe preservation adjustments that are *designed* to preserve the economic interests of the future holders of the entity’s equity instruments should pass the fixed-for-fixed criteria. If the feature is designed to preserve the economic interests of the future holders of equity instruments and is contractually predetermined to operate in the future as designed, then in our view the preservation adjustment should not prevent the instrument from passing the fixed-for-fixed criteria at initial recognition.

When a preservation adjustment applies to current and future holders of equity instruments that are not traded in an active market, it is common that the preservation adjustment is determined based on volume-weighted average price (VWAP) rather than the spot price of the equity instruments at the date of dilution. We believe that adjustments calculated using VWAP inputs should qualify as preservation adjustments as they are designed to ensure the relative economic interests of future and current shareholders are preserved, taking into account the relative illiquidity of the equity instruments. We believe that our suggestion that preservation adjustments should be those that are “designed to”

preserve the economic interest of the future holders of the entity's own equity would appropriately address this situation.

We note that IAS 32:22C refers to "current equity instrument holders". We believe it is not clear whether the "current equity instrument holders" are those who held equity instruments before a dilutive transaction or also includes those who hold instruments as a result of the transaction (for example, when some investors participate in a new share issue). In practice, some anti-dilutive provisions apply only to equity transactions in which all current shareholders participate (such as a right or bonus issue) and others apply also when a subset of shareholders participate (such as an issue of equity to new investors at less than market price). In both cases, the dilutive effect of the equity transaction on the future equity instrument holders is calculated by assessing the total value given to the overall group of existing shareholders (i.e. including pre-existing and new shareholders) as a result of the transaction. We believe such anti-dilutive provisions should meet the preservation adjustment criteria in IAS 32:22C as the adjustment is designed to compensate the future equity instrument holders for the overall value given to existing shareholders (both old and new). Indeed, we do not believe that it is relevant whether an anti-dilutive provision applies to all equity transactions or only to a subset of transactions, as long as the provision is designed to protect the economic interest of the future equity instrument holders.

Therefore, we believe "current holders of equity instruments" should include those who held equity instruments before a dilutive transaction and those who hold instruments as a result of the transaction. We suggest that the IASB clarifies IAS 32:22C accordingly.

Assessing whether the currency denomination is foreign for the purpose of consolidated financial statements

IAS 32:AG29B proposes that a derivative over own equity is classified as equity only if the consideration amount is in the functional currency of the entity within the consolidated group whose equity instruments will be delivered on settlement. We do not believe that this limited definition is justified. Instead, we believe that in the consolidated financial statements it would be appropriate to classify a derivative over own equity as equity if the compensation amount is either in the functional currency of the entity whose equity instruments will be delivered on settlement (as proposed in the ED) or in the functional currency of the entity that issues the derivative.

We believe that in the consolidated financial statements this expanded definition is appropriate on conceptual grounds as the group is a single economic entity under IFRS 10 and there is no such thing as a group functional currency.

We observe that when a group issues debt convertible into shares of a subsidiary, often the debt is issued by the parent, not the subsidiary. This is because the parent owns the interest in the subsidiary that will be delivered upon conversion of the debt. This conversion feature would fail equity classification applying IAS 32:AG29B as proposed in the ED. We do not believe that such a conclusion would be appropriate.

Other observations

We are supportive of the addition of IAS 32:22D addressing exchanges of a fixed amount of equity instruments for a fixed amount of a different class of equity instruments.

We note that IAS 32:IE55 includes the date "June 2026". For consistency with other examples, we suggest this is instead expressed as "June 20X6".

Example 17 illustrates an instrument for which the number of shares issued on conversion depends on the share price in the six-month period prior to conversion. The example stipulates the number of shares that would be issued if the average share price is either CU5 or CU10, without any indication of how many

shares would be issued if the average share price is not one of these two figures. We propose changing the example as follows to reflect a more realistic situation:

> “if Entity X’s average share price is ~~CU5~~ below CU10 in the six-month period before the conversion date, Entity X would deliver 20 shares. If the Entity X’s average share price in that period is greater than CU10, Entity X would deliver 10 shares.”

Example 19 includes a convertible bond with a change of control provision. In describing the instrument, IAS 32:IE76 states that “the conversion ratio will be enhanced to compensate the bondholder for the loss of time value in the option.” The fact pattern appears to be missing a key fact which is that compensation is included because the bondholders are required to either exercise their conversion option or redeem the instrument for cash immediately upon a change of control. In other words, in the absence of the compensation feature, the bondholders would lose their time value because of the requirement to early convert or redeem. Without this additional fact, it could be understood that the convertible bond continues to be outstanding following a change of control with an enhanced conversion ratio which would be at odds with the principle that the compensation is compensating the bondholder for having to choose to exercise the conversion option early. We propose that this additional fact be added to IAS 32:IE76.

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.

Gross obligation accounting versus fair value accounting

In our response to the Discussion Paper F*inancial Instruments with Characteristics of Equity* published in December 2018, we expressed a preference for measuring derivatives over own equity at fair value through profit or loss with classification as equity only when equity instruments are delivered or received under the derivative contract. We highlighted that this approach does not result in the recognition of a gross obligation for the amount an entity will (or may be) required to pay to purchase its entity's own equity instruments and it avoids the issues associated with this "gross obligation accounting", including:

(i) inconsistency with Conceptual Framework given the accounting results in the gross up of two legs of an executory contract where neither party has performed.

(ii) it is an exception to the measurement requirements of IFRS 9 where all derivatives are measured as at fair value through profit or loss, or if they meet the definition of equity in IAS 32 that are not measured at all.

(iii) recognising gains or losses in profit or loss which do not reflect the economic value that the entity bears or benefits from. This is particularly the case where forward purchase or written put agreements will result in the delivery of equity at the future market price as there is no economic gain or loss for the entity as it is a transaction with its shareholders at fair value.

(iv) recognition of debits in equity in advance of the transaction settling with associated interpretative questions as to which line item in equity is affected. Additionally, the debits may then need to be reversed if the transaction does not settle (in the case of written options that are unexercised).

(v) divergence in the accounting for the earnings per share impact of these arrangements given it is not clear conceptually whether the accounting at initial recognition should be treated is as if shares are acquired but are not paid for, or the arrangement should be treated as if it is the grossing up an executory contract for shares to be acquired.

We note the that the IASB has chosen to retain the gross obligation accounting approach. Consequently, it is unfortunate that the observations cited above, if left unaddressed, will continue to apply should the ED be finalised in its current form.

The following observations and suggestions are based on the assumption that the IASB retains the requirement to recognise a gross obligation for the amount an entity will (or may be) required to pay to purchase its entity's own equity instruments.

Interaction with IFRS 9

As we note above the gross up of derivatives for purchases of own equity instruments is an exception in IAS 32. The limited measurement requirements in IAS 32, and in the ED, lead to interpretative issues. Further, these limited measurement requirements are inconsistent with IFRS 9 as the instruments concerned are not measured at fair value or amortised cost which are the only two measurement models in IFRS 9 for financial liabilities. Given this inconsistency we believe there will continue to be interpretative issues as to how to measure gross obligations to purchase own equity if further clarity is not provided.

IAS 32:23 requires that that redemption amount is discounted from the earliest redemption date but provides no guidance which discount rate should be used. For example, it is not clear whether an entity should include non-performance risk, and if so whether it should be calculated as if the liability is a standalone debt obligation such as a purchase of equity funded by an uncollateralised borrowing, or funded by a collateralised borrowing secured on the equity to be purchased, or whether the non-performance risk reflects the risk of the actual contract, i.e. that of a derivative. Similarly, it would be useful to clarify the period used to determine the interest rate given the measurement of the gross obligation is based on the earliest date on which the entity could be forced to settle the obligation, yet it is often the case that the contractual term is significantly longer.

Irrespective of whether the Board chooses to provide such clarity we would welcome the inclusion of a statement that the measurement requirements in IFRS 9 for financial liabilities do not apply. Without such a statement there will continue to be a conflict between the two Standards.

Remeasurement of gross obligations

When the gross obligation reflects a fixed redemption price, whether as part of a forward contract or a written option, we believe that it is appropriate to reflect the unwinding of the present value of the repurchase price in profit or loss.

However, when the redemption price reflects the future market price of the equity instruments, we believe that remeasurement of the gross obligation to profit or loss does not result in relevant information. Such arrangements are in substance liquidity options (rights to buy at market price) or liquidity commitments (obligations to buy at market price) which have a fair value of zero. Yet the remeasurement of the gross obligation for such contracts leads to significant gains or losses in profit or loss reflecting the changes in the fair value of the entity's own equity even though, economically, the entity neither benefits nor suffers a loss from purchasing its own shares at their current market price (i.e. it represents an exchange of cash and shares of equal value). We propose that if a contractual arrangement is designed to require or permit an entity to purchase its own equity instruments at their future market price, the resulting gains or losses from remeasurement of the gross obligation should be recognised directly in equity and not profit or loss. We believe this is analogous to the requirement in IFRS 9 to recognise changes in the fair value of an entity's own credit risk in respect of financial liabilities measured at FVTPL in other comprehensive income without subsequent reclassification to profit or loss.

Presentation within equity

We support the clarification in respect of the component of equity that should be adjusted upon initial recognition of the financial liability, as the current lack of clarity has led to diversity in practice.

Consistent with our preference that an entity's obligation to purchase its own shares should be measured as a derivative at fair value through profit or loss and not as a gross financial liability that creates a debit in equity, we consider that conceptually, and in terms of economics, these contractual arrangements are a *future* purchase of equity. Accordingly, when an entity is required to debit non-controlling interest or issued share capital, we believe that it would be more appropriate to present the resulting amount separately within that component of equity rather than directly deducted from the component of equity. Such a presentation would provide a clearer reflection of the fact that the debit in equity represents a future purchase of equity instruments, as opposed to implying the equity instrument has already been acquired. Therefore, we support the suggestion in paragraph AV5 of the Alternative View that the debit initially recognised in respect of the future purchase of non-controlling interests should be presented as a separate component after non-controlling interests (as calculated by IFRS 10) and within a subtotal for net non-controlling interests.

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.

We support the proposed changes to IAS 32:25. However, we disagree with the addition of IAS 32:25A.

IAS 32:25A addresses the measurement of financial liabilities at initial recognition and subsequently when the related cash flows depend on the occurrence or non-occurrence of uncertain future events. The paragraph states that the probability and estimated timing of occurrence or non-occurrence is ignored. We believe this is a broad statement which conflicts with the requirements in IFRS 9 to measure the cash flows of financial liabilities in a way that reflects their timing and probability (irrespective of whether the liability is measured at amortised cost or fair value). Read literally, IAS 32:25A would apply to a standalone written option that does not involve the entity's own equity instruments even though it is clear that the instrument must be fair valued under IFRS 9, i.e., not measured in the way described in IAS 32:25A. Similarly, IFRS 9 requires a debt with covenants to be measured reflecting the timing and probability of cash flows associated with the conditions of the debt covenant and not as described in IAS 32:25A. We believe the IASB was trying to deal with instruments such as contingent convertibles (as noted in IAS 32:32A) but the requirements introduced by IAS 32:25A would apply, we believe unintentionally, far more broadly.

Our concerns with the outcome of applying IAS 32:25A are both conceptual and economic. Once it has been determined that a financial liability exists and must be accounted for (i.e. it is genuine and not de-minimis) we believe that the financial liability (whether wholly or as a component of a financial instrument) should follow the normal measurement requirements in IFRS 9 and be measured either at amortised cost or fair value through profit or loss. To have an alternative measurement model for some financial liabilities and not others is arbitrary and would likely lead to interpretative questions as to whether the IAS 32 measurement exception or IFRS 9 applies. Additionally, the requirement in IAS 32:25A to measure the financial liability ignoring the probability and estimated timing of occurrence or non-

occurrence of the event conflicts with the pricing (and resulting fair value at initial recognition) of the instrument contractually agreed between the parties.

We observe that preference shares that would otherwise meet the definition of equity instruments may be redeemable at a premium to the proceeds received at initial recognition upon occurrence of certain events outside the entity and holder's control. Applying the ED, the contingent redeemable provision would be initially recognised at the redeemable amount (at a premium to proceeds). The initial recognition of the financial liability for an amount greater than the proceeds results in overstatement of the liability as the carrying amount ignores expected timing and probability of the liability being settled. Conversely, it understates the amount recognised in equity for the preference shareholder's equity interest in the entity. In addition, the application of IAS 32:25A leads to a surplus debit, representing the difference between the proceeds and the measurement of the financial liability on initial recognition. No guidance is provided on how to recognise this surplus debit. As illustrated by this example, whilst the proposals in the ED to ignore the probability and timing of cash flows, on the face of it, would appear simple to apply, they raise further issues and can lead to counter-intuitive accounting that is inconsistent with the general measurement requirements in IFRS 9.

Accordingly, we believe that the general measurement requirements in IFRS 9 should apply to contingent settlement provisions. Measuring contingent settlement provisions in accordance with IFRS 9 is consistent with the requirements applicable to compound instruments, such as convertible debt for which the financial liability element is firstly measured in accordance with the requirements of IFRS 9 and the difference between that amount and the fair value of the instrument as a whole recognised as equity.

We acknowledge that recognising the contingent settlement provision initially at fair value applying IFRS 9 may be viewed by some as resulting in a loss of information as the contingent settlement provision will be less prominent in the statement of financial position. However, the new disclosures proposed in IFRS 7:30C-D require an entity to disclose the terms and conditions of financial instruments with both financial liability and equity characteristics, thereby providing users of financial statements key information even when the financial liability component of a financial instrument may be small on initial recognition relative to the amount of the proceeds.

Therefore, we suggest that 32:25A be deleted such that the measurement requirements applicable to contingent settlement provisions would be those in IFRS 9. We believe that the key issue in applying IAS 32 to contingent settlement provisions is classification (i.e. whether the contingent settlement provision gives rise to a financial liability). This issue is appropriately addressed in IAS 32:25.

IAS 32:AG28 introduces new guidance on how to assess whether a contingent settlement provision is genuine. The paragraph states that a provision linked to an event that is very unlikely to occur could be genuine "if the nature of the contingent event is neither extremely rare nor highly abnormal." We do not understand how the nature of an event is tied to probability or abnormality. Given the example that follows is a regulatory change clause, we believe the IASB may have been considering whether the nature of the event indicates that there is a substantive business purpose for including the contingent event in the instrument's terms and conditions. If so, we suggest referring to "substantive business purpose" to describe the nature of the event.

Deloitte.

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.

We are supportive of the addition of IAS 32:AG28A-C. We agree with the IASB's approach of including a non-exhaustive list of factors to consider as part of assessing whether a shareholder decision is a decision of the entity or a decision of a shareholder acting in their capacity as an investor.

IAS 32:AG28A(b) indicates that shareholder discretion to approve or reject a transaction would have no bearing on classification of an instrument if it relates to transactions initiated by the entity's management. We believe it would be useful to include guidance on how this factor is considered when one or a group of shareholders controls the entity's Board. For example, preference shares may be redeemable upon a change of control, but only if the Board approves the change of control event. If the preference shareholders control the Board's approval of the change of control event (because preference shareholders represent the majority of the Board directors), it is not clear whether that decision is a shareholder decision or an entity decision. IAS 32 would benefit from guidance on such situations.

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.

We support the introduction of guidance on when financial liabilities and equity should be reclassified. This will assist in addressing the divergence in practices that we have observed due to the current lack of guidance.

We support the proposal in IAS 32:32B that reclassification is required when the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement. However, we believe that reclassifications should be required in other circumstances. We are concerned that limiting reclassification to circumstances described in IAS 32:32B may lead to the on-going recognition of a financial liability that no longer meets the definition of a financial liability.

For example, an entity may issue a perpetual instrument that entitles the holder to dividends at the discretion of the issuer. The terms of the instrument may allow the holder to put the instrument back to the issuer at par only for a specified number of years. In our view, the instrument should be considered a compound instrument because it contains both a holder's right to put and a right to discretionary dividends. At the end of the put period, we believe the financial liability should be reclassified to equity as the perpetual instrument no longer includes a financial liability component. We do believe that it would be appropriate to derecognise the financial liability and reclassify that amount to equity without recognition of a gain in profit or loss, as, in substance, the holder has chosen not to exercise their put right in exchange for a continued entitlement to discretionary dividends into perpetuity.

Another example of when reclassification would be appropriate is when an entity has recognised a financial liability for a conversion option that may require the entity to issue a variable number of its own equity instruments. It the variability ceases to exist upon occurrence of a contingent event, following which conversion can only be settled through the issuance of a fixed number of shares for the remaining term of the instrument, we believe it is more relevant to reclassify the financial liability to equity when the contingent event occurs. This would reflect the fact that following the occurrence of the contingent event the conversion feature meets the definition of equity and no longer meets the definition of a financial liability.

We are concerned that some may read the statement in IAS 32:32C that "[c]hanges in circumstances external to the contractual arrangement arise from events not specified in the contract that have not been considered in classifying the financial instrument on initial recognition" as implying that the change affects a factor that was not considered at initial recognition. Whilst this is clarified by the examples of reclassifications in IAS 32:AG35A (i.e. change in functional currency and change in equity instruments delivered from being a non-group entity to a subsidiary), we suggest that it would be clearer if IAS 32:32C read as follows:

> "Changes in circumstances external to the contractual arrangement arise from events not specified in the contract ~~that have not been considered in classifying the financial instrument on initial recognition~~. Such events are not specific to a particular instrument, but would affect an entity's business activities and operations, for example, a change in an entity's functional currency or a change in an entity's group structure.

The above proposed change in wording also removes the term "initial recognition" as it is possible for an instrument to be reclassified, and therefore the change would not be assessed against the circumstances that existed at initial recognition, but instead the last time the instrument was reclassified.

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.

We support the proposal to expand the objective of IFRS 7 to address equity instruments as we believe IFRS Accounting Standards currently lack disclosure in this area. We note that when IFRS 7 was first issued it removed the disclosure requirements previously contained in IAS 32 that included disclosure of terms and conditions of financial instruments, which is now being reintroduced. We welcome this addition.

However, we have some concerns about other proposed disclosures due to the resulting increase in the volume of disclosure, the potential duplication with disclosure requirements in other IFRS Accounting Standards, and the usefulness of some of the information required, particularly the disclosure of priority and amounts payable at liquidation.

Compound instruments

We do not support the addition of IFRS 7:17A as the information it requires is already captured by other requirements. In particular, the requirements in IFRS 7:17A(a) to disclose the terms and conditions of compound instruments is also captured by IFRS 7:30C, which requires the disclosure of information about financial instruments with both financial liability and equity characteristics. The requirements in IFRS 7:17A(b) to disclose the amounts allocated on initial recognition between the liability and equity component do not appear to provide relevant additional information since such amounts appear in the statement of financial position.

Items of income, expense, gains or losses (IFRS 7:20)

We agree with the amendment to IFRS 7:20 to require the separate presentation of gains or losses on financial liabilities that include contractual obligations to pay amounts that vary with the issuing entity's performance or changes in its net assets. We agree that this requirement would provide useful information for the reasons explained in the BC. We do not believe that the preparation of this information would represent an additional burden on the preparers as it only requires the disaggregation of the amounts already presented.

Nature and priority of claims on liquidation arising from financial instruments (IFRS 7:30A-B)

We do not agree with the disclosure requirements proposed in IFRS 7:30A-B. We do not believe disclosure of the carrying amounts of claims grouped into classes which reflect security and subordination will provide relevant information, particularly when the information results in aggregation across subsidiaries in consolidated financial statements.

If a liability is secured, the claimant has a more senior claim on the assets of the entity at liquidation through its priority claim against a specific asset. Should that asset be insufficient to cover the claim, the claimant will have a general unsecured claim against the entity. Therefore, secured borrowing can result in an unsecured claim which will not be known until liquidation when the security is valued. Consequently, we do not believe that the requirements in IFRS 7:30B (and illustrated in IFRS 7:IG14C) to distinguish claims between "secured and unsubordinated" and "unsecured and unsubordinated" provide relevant information.

Additionally, it is not clear how to distinguish between subordinated and unsubordinated claims in the context of these disclosure requirements. Indeed, all claims are senior relative to equity. Conversely, all claims are subordinate relative to the most senior claim. IFRS 7:IG14C illustrates the application of IFRS 7:30B. In this example, the irredeemable preference shares are grouped with other instruments such as ordinary shares and other reserves as being "unsecured and unsubordinated". In our view this illustrates the complexity of rights at liquidation that cannot be conveyed with such a disclosure. Whilst the irredeemable preference shares are less subordinate than other financial liabilities, they represent a more senior claim than ordinary shares. Therefore, grouping the preference shares with ordinary shares together as unsubordinated does not result in relevant information.

We note that liquidation is a legal matter specific to a legal entity, and not to a consolidated group. It is therefore unclear how the requirements of IFRS 7:30B would be applied in the consolidated financial statements as it would appear to require ranking the level of subordination of claims across the various group entities. The aggregation that is required in order to present the disclosure in the consolidated financial statements is unlikely to result in meaningful information. This is particularly the case where a group includes special purpose entities (SPE) with complex 'waterfall' structures, as we do not believe that it would be relevant to aggregate claims of SPEs with non-SPE claims.

We believe further outreach is needed with users of financial statements to determine whether they would find this information meaningful and useful.

Should the IASB decide to retain IFRS 7:30A-B, we believe it would be appropriate to clarify whether the reference to ‘carrying amount’ refers to the current carrying amount of the financial liabilities and equity instruments as per the statement of financial position or the actual amount of the claims related to these instruments. If the latter, it should be clarified whether the amount refers to the amount of the claim that would fall due if liquidation occurred at the reporting date or an estimate of the claim at a future liquidation date. We would not support this latter definition, given the uncertainty about future amounts and timing of liquidation.

Terms and conditions (IFRS 7:30C-D)

We support greater transparency of the terms and conditions of financial instruments with both financial liability and equity characteristics. We believe that this information is important given IAS 32 permits a range of instruments to be classified as equity, including instruments that have different rights to cash flows and result in different degrees of dilution of current shareholders. It seems particularly important to provide users with additional information on how different equity instruments contribute to the capital structure of the entity and how they absorb losses and participate in profits.

We note that IFRS 7:30D specifies that the disclosure requirements do not apply to “stand-alone derivatives”. We recommend that the IASB defines this term. For example, it is not clear whether derivatives that are obligations to buy an entity’s own equity, which are recognised as gross liabilities applying IAS 32, are considered as stand-alone derivatives for purposes of these disclosures.

IFRS 7:B5E indicates that an equity-like characteristic “might result in an entity…paying less than the full amount of the obligation.” We question whether use of the term “obligation” is appropriate to refer to an amount that may not be paid in full as per the contractual terms of an instrument. We believe the IASB had in mind financial instruments where the amount owed may be linked to specified assets so the ultimate amount payable could be less than the principal or notional amount. If this is correct, we would recommend replacing the term ‘obligation’ with ‘principal’ or ‘notional’.

The example in IFRS 7:B5F(a)(iv) refers to ‘payments the issuer has the contractual right to avoid for a specified period of time’. This could include all extension or deferral options regardless of length of extension or deferral, even if they are only of a short duration (for example trade payables), or if interest accrues over the deferral period. We would recommend that the paragraph should refer to payments the issuer has the contractual right to avoid for a ~~specified~~ significant period of time, without compensation for the passage of time”.

Priority on liquidation (IFRS 7:30E)

Consistent with our views on the disclosure of the nature and priority of claims on liquidation arising from financial instruments in accordance with IFRS 7:30A-B (see above), we question whether liquidation information based on priority will provide relevant information, particularly in consolidated financial statements.

Rather than the disclosure proposed in IFRS 7:30E, we suggest that it may be more relevant to require an entity to disclose, by class of financial instruments, whether the amount due at liquidation, assuming the entity was liquidated at the reporting date, would be materially different from the carrying amount in the statement of financial position and if so, the difference between the two amounts.

Should the IASB finalise the proposed disclosure as drafted, it would be useful to clarify the type of situations that may need to be disclosed applying IFRS 7:30E(c). We question whether entities will be able

to provide meaningful information about uncertainty that may exist about laws and regulations that affect priority on liquidation, in particular entities may not be able to have a reasonable expectation on how liquidation law may be enforced in the future (or even at the reporting date).

Passage of time (IFRS 7:30F)

We note that IFRS 7:30F requires disclosure of terms that become effective, or cease to become effective, based on the passage of time but that would not result in reclassification as per IAS 32:32B. This is well explained in IFRS 7:BC130-132. We suggest that it may be useful to clarify in the main body of IFRS 7 the type of features that an entity may be required to disclose.

Potential dilution of ordinary shares (IFRS 7:30G-H)

We welcome greater disclosure of the potential dilution of ordinary shares arising from financial instruments. However, we believe it is more proportionate that this information should be disclosed to support the calculation of earnings per share for those entities required to apply IAS 33 *Earnings Per Share.* We believe that it would be appropriate that entities not required to apply IAS 33 only disclose a description of the terms and conditions of financial instruments containing characteristics of equity.

Puttable financial instruments classified as equity instruments (IFRS 7:30I)

We support moving this disclosure requirement from IAS 1 to IFRS 7.

Financial instruments that include an obligation for an entity to purchase its own equity instruments (IFRS 7:30J)

We question whether the information required to be disclosed by IFRS 7:30J is necessary given the existing requirements in IFRS Accounting Standards. In particular, the amounts removed from equity (paragraph 30J(a)) or transferred to equity (paragraph 30J(d)) or within equity (paragraph 30J(e)) will be recognised in the statement of changes in equity, and amounts recognised in profit or loss (paragraph 30J(b) and (c)) will be separately disclosed, if material, in accordance with IAS 1.

We have also suggested what we believe would be a more relevant presentation of the amounts removed from equity in our response to Question 3.

Should the IASB finalise the disclosure requirements in IFRS 7:30J, we believe that it would be useful to specify that the information should be presented in tabular form that reconciles the opening and closing carrying amounts. We note that this is the format used in the illustration in IFRS 7:IG14I. It would be useful to establish this presentation as a requirement to promote clarity and comparability.

It is clear from IFRS 7:30J(b) that disclosure of the remeasurement gains recognised in profit or loss during the period is required. Yet, IFRS 7:30J(c) refers to disclosure of “any gain or loss recognised on settlement” without reference to amounts being recognised in profit of loss (unlike (paragraph 30J(b), and also uses the term “settlement” even though such arrangements may not be settled but may lapse (for example, unexercised written put options). We consider the amounts that would fall into IFRS 7:30J(c) would fall into IFRS 7:30J(b) given they are remeasurements in profit or loss up to the point the liability is derecognised. We therefore propose merging (b) and (c) to read as follows:

> “the amount of any remeasurement gain or loss recognised in profit or loss during the reporting period up to, and including, the date of derecognition;”.

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.

We generally agree with the proposals. However, we believe that it would be helpful to define 'ordinary shareholders of the parent' and make it clear whether this is on the basis of the definition of "ordinary shares" in IAS 33.

The example in IAS 1:IG6A is helpful to understand how to present the required information but we would recommend expanding the example to explain how the amounts have been attributed. For example, CU15,000 of profit and total comprehensive income is attributable to "Other owners of the parent", with CU51,000 of equity attributable to the same owners, but it is not clear how each amount relates to each other. In our experience, the allocation of profit to non-ordinary shareholders of the parent can be complex and will depend on the specific terms of those instruments. To assist preparers in determining how to allocate profit in their specific circumstances, we propose that IAS 1 makes it clear that the basis for allocation of profit follows the concepts in IAS 33:13-18 that apply to preference shares, irrespective of whether the entity is in the scope of IAS 33.

We note that the requirement in IAS 1:107 to disclose the "related amounts of dividends per share" does not seem to be included in the example in IAS 1:IG6A. We propose that it is included so the example is complete.

Question 9—Transition (paragraphs 97U–97Z o 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.

We generally support the proposed approach to transition.

As noted in our response to Question 1, we believe the guidance on differentiating statutory and contractual provisions in the terms of financial instruments would apply not only to the classification of financial liabilities and equity, but also to financial assets. Given the focus of the project that led to the ED has been on financial liabilities and equity instruments we are concerned that if retrospective application is required there could be cases where the classification of financial assets could inadvertently change because the new guidance is introduced in IAS 32. We acknowledge that this risk may be isolated. Nevertheless, because this was not an intended (or expected) outcome of the new requirements, we suggest that the IASB clarifies that an entity is not required to amend the classification of financial assets as a result of the application of IAS 32:15A. This exception would apply to all financial assets recognised on the statement of financial position as at the date of initial application of the amendments, until the financial asset is derecognised.

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.

We agree with the proposed changes to paragraphs 54 and 124, and the inclusion of paragraph 61B.

We do not support the inclusion of paragraph 61A and 61C, consistent with the view we expressed in respect of the equivalent disclosure proposed in IFRS 7:30A-B and IFRS 7:30E in our response to Question 7.