Think Ahead ACCA

IASB/ ED/2023/5 Financial Instruments with Characteristics of Equity

Exposure Draft issued by the IASB in November 2023

Comments from ACCA
26 March 2024

ACCA (the Association of Chartered Certified Accountants) is a globally recognised professional accountancy body providing qualifications and advancing standards in accountancy worldwide.

Founded in 1904 to widen access to the accountancy profession, we've long championed inclusion and today proudly support a diverse community of over **247,000** members and **526,000** future members in **181** countries.

Our forward-looking qualifications, continuous learning and insights are respected and valued by employers in every sector. They equip individuals with the business and finance expertise and ethical judgment to create, protect, and report the sustainable value delivered by organisations and economies.

Guided by our purpose and values, our vision is to develop the accountancy profession the world needs. Partnering with policymakers, standard setters, the donor community, educators and other accountancy bodies, we're strengthening and building a profession that drives a sustainable future for all. Find out more at: www.accaglobal.com

Further information about ACCA's comments on the matters can be requested from:

Aaron Saw
Head of Corporate Reporting Insights – Financial
aaron.saw@accaglobal.com

ACCA
+44 (0)20 7059 5000
info@accaglobal.com
www.accaglobal.com
The Adelphi 1/11 John Adam Street London WC2N 6AU United Kingdom

GENERAL COMMENTS

ACCA welcomes the opportunity to provide views in response to the IASB's exposure draft (ED) for *Financial Instruments with Characteristics of Equity* that aims to improve the requirements for classifying financial instruments with 'debt-like and equity-like characteristics' and to improve the information an entity provides on such instruments.

This was done with the assistance of ACCA's Global Forum for Corporate Reporting. Our general comments on the respective topics are as follows:

The effects of relevant laws or regulations

There is scope to improve the proposed approach to consider laws and regulations. On one hand, considering only contractual rights and obligations that are enforceable by laws or regulations when classifying a financial instrument is sensible. But we have concerns that the sole focus on contractual obligations seems too narrow, and risks not considering the substance of the transaction. Separating a contractual obligation from the relevant laws or regulations may be complex and risk introducing new application challenges. We believe that interactions with legal obligations should be considered.

We suggest the IASB considers another approach that will be closer to the Conceptual Framework (2018) in determining financial liabilities and so distinguishing them from equity. We also suggest the IASB clarify if, and how an entity should account for future changes in relevant laws or regulations. See the details in our comments to question 1.

Settlement in an entity's own equity instruments

We welcome the proposals that clarify circumstances that meet the fixed-for-fixed condition including permissible adjustments and the treatment of share-for-share exchange arrangements.

We also suggest some changes to improve understanding of the different accounting treatment for an entity's own equity instruments and the derivatives (rights, options and warrants) that it offers pro rata to all existing owners of the same class of its own non-derivative equity instruments. See the details in our comments to question 2.

Obligations to purchase an entity's own equity instruments

We disagree with the proposed approach to measure the financial liability arising from an entity's obligation to purchase its own equity instruments. While we acknowledge there are merits to the proposed approach, there are some significant concerns that need to be addressed by the IASB.

As for the proposed approach to remove the initial amount of the financial liability from a component of equity, we suggest the IASB consider the accounting treatment for circumstances where an entity has accumulated losses and does not have other components of equity besides issued share capital or non-controlling interests. See the details in our comments to question 3.

Contingent settlement provisions

We agree with the proposals that clarified:

- the term 'liquidation',
- that some financial instruments with contingent settlement provisions may be compound financial instruments with liability and equity components, and

- that 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.

We also agree with maintaining a principles-based approach and requiring the use of judgement in assessing whether a contingent settlement provision is genuine.

We, however, disagree with the proposed measurement approach. While there are merits to the proposed approach to measure the financial liability arising from a contingent settlement provision, we have some significant concerns that need to be addressed by the IASB. See the details in our comments to question 4.

Shareholder discretion
We support the proposed objective and the proposed factors for assessing whether shareholders are making individual decisions as investors (ie for their own interest) or making decisions for the entity. However, we suggest making the principle more definitive. Also, the concept of "interdependencies between shareholder decision-making rights" may not be easily understood and would require some examples to support understanding and application. See the details in our comments to question 5.

Reclassification of financial liabilities and equity instruments
We welcome the proposed clarification that generally prohibits the reclassification of a financial liability or an equity instrument after initial recognition, unless a change in circumstances external to the contractual arrangement occurs that changes the substance of the contractual arrangement. We believe the proposed approach would disincentivise opportunistic structuring to achieve a particular classification outcome at initial recognition, and also save preparers from reassessing the classification of each financial instrument at each reporting date. It also differentiates 'reclassification' from modification to the contract that may result in the recognition of a new financial instrument following the derecognition of a financial liability.

However, we suggest the IASB consider permitting a relief for situations when the 'date of change in circumstances' is not determinable. See the details in our comments to question 6.

Disclosure
We received mixed views from stakeholders when discussing the proposed disclosure of terms and conditions of financial instruments. On one hand, the disclosure may help users understand the instrument's (or its component's) nature and its classification as either financial liability or equity. However, the usefulness of such granular information may diminish when an entity has many contracts with both financial liability and equity characteristics during a reporting period.

Meanwhile, we believe the proposed disclosure requirements to help users comprehend the potential change in an entity's debt-to-equity ratio, and the maximum potential dilution of ordinary shares are important. See the details in our comments to question 7.

Presentation of amounts attributable to ordinary shareholders
We generally do not agree with the proposed presentation of amounts attributable to 'ordinary shareholders of the parent' and 'other owners of the parent'. See the details in our comments to question 8.

Transition
The proposed transition approach and the proposed transition reliefs are pragmatic. However, this ED introduces a high volume of new information to be disclosed when the proposed amendments to IAS 32, IAS 1 and IFRS 7 become effective at the same time. The required information may not be readily available for disclosure. We suggest the IASB consider the time that entities would reasonably need to get ready when deciding the effective date and consider providing specific reliefs when applying the full retrospective approach may involve undue cost or effort. See the details in our comments to questions 7 and 9.

Disclosure requirements for eligible subsidiaries
We have concerns about the volume of information to be disclosed and the usefulness of the information that needs to be disclosed by subsidiaries without public accountability. Given these entities do not have public accountability, the benefits of providing the proposed disclosures may not outweigh the costs. See the details in our comments to question 10.

Our detailed responses to the specific questions asked are set out below.

RESPONSES TO SPECIFIC QUESTIONS RAISED

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.

ACCA response

Paragraph 15A(a)
We support the proposed paragraph 15A(a) to consider only contractual rights and obligations that are enforceable by laws or regulations when classifying a financial instrument. We believe this will clarify and reinforce the requirement in paragraph 13 of IAS 32.

Paragraph 15A(b)
We do not agree with the proposed paragraph 15A(b).

The proposed paragraph 15A(b) as currently drafted is difficult to comprehend. On the one hand, it appears to require entities to evaluate contractual rights or obligations that are incremental to a right or obligation established by relevant laws or regulations. But the way it is written appears to disregard relevant laws and regulations and rely solely on the terms and conditions in a contract to assess the classification of the financial instrument as either a financial liability, a financial asset or an equity instrument. The sole focus on contractual obligation seems too narrow, leading to a risk that the substance of transactions is not fully considered. Paragraph 15 of IAS 32 requires the issuer of a financial instrument to classify the instrument, or its component parts, on initial recognition in accordance with the *substance of the contractual arrangement* and the definitions of a financial liability, a financial asset and an equity instrument. We believe that interactions with legal obligations should be considered.

Disregarding laws or regulations would be inconsistent with other standards such as IAS 37 and IFRS 15 that require considering the applicable laws and regulations.

In addition, separating a contractual obligation from the relevant laws or regulations, and accounting for each element individually (ie those elements arising from the contract, and those elements established by relevant laws or regulations) may be complex, and difficult to apply in practice. It would also be difficult to assess whether contractual terms are in addition to rights or obligations that are created by laws and regulations. This proposal risks introducing new application challenges.

We note the IASB's thought process in paragraphs BC20 and BC22 of the ED to focus on rights or obligations that are negotiated between parties of the contract and that relevant laws or regulations would affect all instruments subject to those laws or regulations regardless of whether they are included (or not) in the contract. This appears to be applying a hierarchy in assessing the rights and obligations created by relevant laws or regulations, and then followed by assessing the rights or obligations included in the contractual arrangement.

We also note this hierarchy in assessment is reflected in the proposed paragraph AG24B which is intended to help entities apply paragraphs 15 and 15A. The application guidance forms an integral part of IAS 32. However, the guidance in paragraph AG24B appears to contradict the requirement in the proposed paragraph 15A(b).

Therefore, we have concerns that the proposed paragraph 15A(b), as currently drafted, may produce a different outcome if entities disregard altogether the rights or obligations that were created by relevant laws or regulations. Besides, paragraph 15A(b) may present opportunities for structuring as the IASB has already noted in paragraph BC19 of the ED.

We suggest the IASB consider another approach that will be closer to the Conceptual Framework (2018) in determining financial liabilities and so, distinguishing them from equity – ie an approach that helps an entity assess whether it has practical ability to avoid an obligation to transfer an economic resource to another party as a result of past events (paragraphs 4.26 and 4.29 of the Conceptual Framework (2018)).

Future change in laws or regulations

The proposed paragraph AG24A mentioned, *'a change in relevant laws or regulations would affect all instruments subject to those laws or regulations.'* However, there is no further elaboration. We suggest the IASB clarify if an entity needs to, and how it should account for a change in relevant laws or regulations that happen after the initial recognition of a financial instrument.

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.

ACCA response

Paragraphs 16(b)(ii) and 22
We support the amendments to paragraphs 16(b)(ii) and 22 of IAS 32 to clarify the requirements also apply to the settlement of the entity's financial liability.

Paragraphs 22B
We agree with the proposed paragraph 22B that clarifies the amount of consideration to be exchanged for the entity's own equity instruments needs to be denominated in the entity's functional currency. As such, the amount of cash in the entity's functional currency to be exchanged for each unit of equity instrument is fixed.

However, it will be very difficult for entities to understand that this clarification applies only to one part of paragraph 16(b)(ii). It will potentially introduce confusion for the treatment of *'rights, options and warrants that an entity offers pro rata to all existing owners of the same class of its own non-derivative equity instruments'* which are also in paragraph 16(b)(ii).

Without reading the basis for conclusion for this ED, in particular paragraph BC43, an entity may not know that the proposed clarification (ie paragraph 22B) *'does not change the application of the requirement in paragraph 16(b)(ii) of IAS 32 to foreign currency rights, options and warrants that an entity offers pro rata to all existing owners of the same class of its own non-derivative equity instruments. For such instruments, the currency in which the consideration amount is denominated would not affect their classification'.*

We suggest moving the content of the proposed paragraph AG27A(a) upfront, and nearer to paragraph 22B to help entities better understand the interaction between paragraph 22B and paragraph 16(b)(ii).

The addition of paragraph 22B(b) would clarify circumstances where adjustments to the amount of consideration to be exchanged or the number of the entity's own equity instruments are allowed, such that the amount of consideration to be exchanged per equity instrument delivered does not vary.

Paragraphs 22C
We support the proposed paragraph 22C(a) and (b). Paragraph 22C(a) would enable entities to make adjustments that preserve the relative interest of current and future holders of the entity's equity instruments before and after the occurrence of a contractually specified future event, while meeting the fixed-for-fixed condition. We suggest moving this sentence from the proposed paragraph AG27A(c) into paragraph 22C(a) to improve its understandability, *'If any such adjustment benefits the future shareholder to a greater extent than a current shareholder, that adjustment is not a preservation adjustment.'*

We also note the use of 'and' between paragraphs 22C(a) and 22C(b) imply that the requirements in both paragraphs must be satisfied for the purposes of paragraph 22B(b). However, this contradicts paragraph 22B(b). For consistency, the conjunction noun 'or' should be used.

Paragraph 22D
We agree with the proposed paragraph 22D that clarifies the treatment for a contract that is settled by exchanging a fixed number of one class of the entity's own non-derivative equity instruments for a fixed number of another class of its own non-derivative equity instruments.

Paragraphs AG27A(a), (b) and (c)
We support the addition of paragraphs AG27A(a). However, please note our comment above on the placement of paragraph AG27A(a).

We note that the proposed paragraph AG27A(b) is consistent with the principle in paragraph 26 of IAS 32, and we are supportive.

If using an example in paragraph AG27A(c) is the best way to help entities interpret what may constitute a preservation adjustment, we suggest adding more examples besides the issuance of dividends, including examples that illustrate what would not constitute a preservation adjustment.

Paragraphs AG29B
We support the addition of AG29B to clarify the treatment in the consolidated financial statements of a parent when the equity instrument of an entity within the group would be delivered on settlement.

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.

ACCA response

Paragraph 23

In measuring the liability arising from an entity's obligation to purchase its own equity instruments, there are merits to specifying that the *'redemption amount'* should be discounted from the earliest possible redemption date specified in the contract as the issuer is unlikely to be able to control when holders of the instrument will exercise the right to redeem. Removing the need to estimate the probability and timing of exercising an option makes it relatively simpler to measure the liability. Thus, the proposed measurement approach seems pragmatic and may reduce diversity in practice when applying the requirements of paragraph 23 of IAS 32.

However, there are concerns that the liability measured using the proposed approach may not faithfully represent the most likely amount at which the liability will be settled, such as in situations where the amount may vary. The proposed measurement approach also does not comprehensively address the questions that arose in practice and have come to the IASB's attention in paragraph BC81.

We note the IASB's reasoning in paragraph BC82 for not amending the fundamental measurement requirements in paragraph 23 of IAS 32 to avoid significantly delaying the completion of this project because any attempt to resolve the practice questions in paragraph BC81 would require a major standard-setting project.

However, the proposed measurement approach would affect many entities around the world that apply the IFRS Accounting Standards, and it will remain in IAS 32 for a long time as the IASB rightly do not amend the standard frequently.

On balance, we suggest the IASB consider developing a comprehensive measurement approach that would enable entities to more faithfully represent its liability arising from an obligation to purchase its own equity instruments, or to consider field testing the proposed measurement approach in this ED, specifically in subsequent measurements, to gauge whether it will provide decision useful information to primary users. This way, any delays in amending the measurement approach in paragraph 23 of IAS 32 will be well justified.

Paragraph AG27B

We support the addition of paragraph AG27B to IAS 32. The proposal to bar entities from removing the initial amount of the financial liability from non-controlling interests or issued share capital may be aligned with the laws or regulations in certain jurisdictions that restrict the use of issued share capital. However, we suggest the IASB consider the accounting treatment for circumstances where an entity has accumulated losses and does not have other components of equity besides issued share capital or non-controlling interests.

Paragraph AG27C
We support the proposed paragraph AG27C in applying the requirements of paragraph 23 on contracts for an entity to purchase its own equity instruments that expires without delivery. We support providing an option in paragraph AG27C(b) to transfer the cumulative amount of gains or losses previously recognised from remeasuring the financial liability from retained earnings to another component of equity.

Paragraph AG27D
We support the proposed paragraph AG27D.

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.

ACCA response

Paragraph 25
We support the proposed amendments to paragraph 25 which help to clarify that some financial instruments with contingent settlement provisions may be compound financial instruments with liability and equity components.

Paragraph 25A
We support requiring any gains or losses on remeasurement of the financial liability to be recognised in the profit or loss account.

As for the proposed measurement approach, there are merits to removing the need to estimate the probability of the uncertain future event occurring, or its timing, as the entity does not have an unconditional right to avoid settlement of the liability component.

However, there are several concerns about the proposed measurement approach for the IASB's consideration:

- The measurement approach depends on having the 'earliest possible settlement date' specified in the contract. We suggest the IASB provide guidance for circumstances when there is no date, or when the 'earliest possible settlement date' is not specified in the contract.
- The proposed paragraph 25A may be construed as applicable to all financial liabilities. We suggest the IASB clarify that the requirements in paragraph 25A apply only to the liability component of compound financial instruments.
- The liability measured using the proposed approach may not faithfully represent the most likely amount that the liability will be settled, such as in situations where the amount may vary.

While the proposed measurement approach seems pragmatic and may reduce diversity in practice when applying the requirements of paragraph 25A of IAS 32, we could not ignore the concerns mentioned above as the proposed measurement approach would affect many entities around the world that apply the IFRS Accounting Standards, and it will remain in IAS 32 for a long time as the IASB rightly do not amend the standard frequently.

As the proposed measurement approach is similar to paragraph 23 of IAS 32, please refer to our suggestion in question 3 for details.

Paragraph AG28
We support the proposed amendments to paragraph AG28 that clarifies the assessment of when a contingent settlement provision is not genuine include assessing its nature, and the specific facts and circumstances. And clarifying that the assessment is not based solely on its probability of occurring. As facts and circumstances may vary from one contract to another, we agree with maintaining a principles-based approach and require the use of judgement in assessing whether a contingent settlement provision is genuine, or not. We also welcome the example that illustrates this principle.

Paragraph 31
We support the proposed amendment to paragraph 31 that will align it with the proposed paragraph 25A.

Paragraph 32A and AG37
We support the addition of paragraph 32A that specifies the respective requirements to be applied in identifying and measuring the liability component with contingent settlement provision in a compound financial instrument.

We agree with the proposed requirement to recognise payments at the issuer's discretion in equity even if the equity component of a compound financial instrument has an initial carrying amount of zero. This would reflect, and is consistent with, the existence of that equity component as mentioned in paragraph BC104. Therefore, we also agree with the associated proposed amendments to paragraph AG37.

Paragraph 11
We agree with the proposed definition of 'liquidation' which clarifies that the term refers to *'the process that begins after an entity has permanently ceased its operations'*. The phrase '*an entity has permanently ceased its operations'* should remove doubt that the entity itself (instead of merely a component of the entity) will not revive its operations in the future.

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.

ACCA response

We support the proposed paragraphs AG28A, AG28B and AG28C that provide the objective and the relevant factors for the assessment of shareholder decision-making rights.

We agree with the objective of the assessment in paragraph AG28A that serves as the overarching principle, ie *'to assess whether such shareholder decisions are treated as entity decisions that result in it having an unconditional right to avoid delivering cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability).'*

We suggest making the principle more definitive such as, 'If shareholder decisions are treated as entity decisions, […]'.

The four proposed factors should help entities assess whether shareholders are making individual decisions as investors (ie for their own interest) or making decisions for the entity. We support specifying in paragraph AG28B that the four proposed factors are not exhaustive and that other factors might be relevant in assessing whether a shareholder decision is treated as an entity decision. We also support requiring entities to consider relevant factors, weight each relevant factor based on the specific facts and circumstances, and to assess the persuasiveness of each relevant factor based on the specific circumstances.

However, it is difficult to understand how to assess the *'interdependencies between shareholder decision-making rights affect whether, overall, it 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)'*. We suggest moving the example in paragraph BC123 into AG28B to help entities understand this requirement to assist with its application. The example from paragraph BC123 says: *'An example is a financial instrument that pays coupons if the issuer pays dividends on ordinary shares. Management could decide not to propose dividends on ordinary shares and thus avoid paying coupons on the financial instrument. However, the holders of that financial instrument also have the power to force the entity to liquidate, at which point the financial instrument would become repayable in cash at its par value. Assuming no other obligations, the entity is required to have the right to avoid cash settlement in both scenarios for the financial instrument to be classified as equity.'*

We also support restricting entities from applying the proposed approach in paragraphs AG28A and AG28B by analogy when applying the requirements in other IFRS Accounting Standards to transactions involving shareholders or management, as they may serve different purposes.

Lastly, the guidance in paragraphs AG28A – AG28C may be placed earlier in the Application Guidance of IAS 32 as they support the application of paragraph 19. Placing them after paragraph AG28 which supports the application of paragraph 25 is not intuitive for entities to locate them.

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.

ACCA response

Paragraphs 32B, 32C and AG35A

We support the proposed paragraphs 32B and 32C that generally prohibits the reclassification of a financial liability or an equity instrument unless a change in circumstances external to the contractual arrangement occurs that changes the substance of the contractual arrangement. We believe this proposed approach would disincentivise opportunistic structuring to achieve a particular classification outcome at initial recognition, and also save preparers from the cost and effort to reassess the classification of each financial instrument issued at each reporting date. This approach also differentiates 'reclassification' from modification (or renegotiation) to

the contract that may result in the recognition of a new financial instrument following the derecognition of a financial liability.

The explanation of what constitute change in circumstances and the examples in paragraphs 32C and AG35A would be helpful to preparers in applying the requirements in paragraph 32B.

Paragraph 32D
We support the proposed paragraph 32D. We agree with reclassifying the financial liability or equity instrument prospectively from the date the change in circumstances occurs. However, there may be other change in circumstances that are not change in the entity's functional currency or change in its group structure (examples in paragraph 32C), where the date of change in circumstances is not determinable. For such circumstances, we suggest the IASB consider permitting the reclassification, prospectively, at the end of the reporting period in which the change in circumstances occurs.

We also agree with the proposed measurement approaches in paragraph 32D(a) and (b) for financial liability and equity instrument, and the accounting for gains or losses, at the date of reclassification.

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.

ACCA response

Paragraphs 1, 3 and 20 of IFRS 7
We agree with the proposed amendments to paragraphs 1, 3 and 20.

Paragraph 12E of IFRS 7
We agree with the proposed addition of paragraph 12E.

Paragraphs 17A of IFRS 7
We received mixed views from stakeholders when discussing the proposed paragraph 17A. On one hand, disclosing the terms and conditions of a financial instrument that determine the classification of its financial liability and equity components on initial recognition is sensible and will be helpful to understand the nature of the instrument. However, the usefulness of such granular information, as proposed in paragraph 17A(a), may diminish when an entity has many contracts with both financial liability and equity characteristics during a reporting period.

This is unlike disclosing the terms and conditions for financial assets that the entity has pledged as collateral (paragraph 14(c) of IFRS 7), or the terms and conditions associated with the use of collaterals (financial or non-financial assets) that the entity holds (paragraph 15(c) of IFRS 7). For these cases, the terms and conditions would help users to understand the restriction (if any) on the use of the related financial or non-financial assets.

We also have doubts about the benefits of disclosing the amounts allocated on initial recognition to the liability and equity components, as proposed in paragraph 17A(b). The incremental benefits of the disclosure, compared to carrying amounts of

financial liabilities and equity instruments at the reporting date, may not outweigh the costs.

Paragraph 30C of IFRS 7
We do not support the proposed paragraph 30C. Requiring entities to disclose the terms and conditions of financial instruments with both financial liability and equity characteristics may result in disclosure overload and potentially obscure other information.

We have concerns about the usefulness of such granular information when an entity has many contracts with both financial liability and equity characteristics during a reporting period.

Paragraph 30D of IFRS 7
We received mixed views from stakeholders when discussing the proposed paragraph 30D. The disclosure requirement in the proposed paragraph 30D(a) is similar to the proposed paragraph 17A(a). As such, please refer to our comments above for paragraph 17A(a).

We are supportive of the proposed paragraph 30D(b) to disclose the cash flow characteristics of financial instruments that are not representative of the classification, ie the ‘debt-like characteristics’ for instruments classified as equity instruments, and the ‘equity-like characteristics’ for instruments classified as financial liabilities. We agree this information will be relevant to understanding the nature of those financial instruments.

Paragraphs 30A, 30B, 30E – 30J of IFRS 7
We are supportive of the disclosure requirements proposed in paragraphs 30A, 30B, 30E, 30F, 30G, 30H, 30I and 30J.

The disclosure requirements in paragraphs 30G – 30J are important to help users comprehend the potential change in the entity’s debt-to-equity ratio, and the maximum potential dilution of ordinary shares, as a result of contracts that are outstanding at the reporting date.

However, these new disclosure requirements would cause entities to prepare and disclose a high volume of information that they may not have readily available for disclosure. Therefore, entities should be given at least two years, from the date these amendments are issued, to get ready.

Paragraphs B5A – B5L of IFRS 7
We are supportive of the application guidance that are proposed in paragraphs B5A – B5L. The proposed application guidance is pragmatic, in particular paragraphs B5I – B5L.

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.

ACCA response

Paragraph 54 of IAS 1

We do not agree with the proposed amendments to paragraph 54. The term 'owners' is defined as *'holders of instruments classified as equity'* in paragraph 54 of IAS 1. We do not agree with requiring further subclassification.

We note that paragraph 55 of IAS 1 requires an entity to *'present additional line items (including by disaggregating the line items listed in paragraph 54), headings and subtotals in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position'*. Since entities are already required to present additional line items with appropriate headings when such information is material, the proposed subclassification to present *'other owners of the parent'* is unnecessary and may potentially be counter-productive if entities present 'other owners' in the statement of financial position when such information is not material.

Paragraph 81B of IAS 1
We do not agree with the proposed amendments to paragraph 81B to allocate profit or loss and other comprehensive income for the period to 'ordinary shareholders of the parent' and 'other owners of the parent'.

As these are equity instruments of the parent, the entity does not have a contractual obligation to make any distribution of profits because it cannot be required to deliver cash or another financial asset to another party (paragraph 17 of IAS 32).

If there has not been any distribution of profits to owners during the period, the allocation of profit or loss and other comprehensive income for the period to 'ordinary shareholders of the parent' and 'other owners of the parent' will be potentially difficult and arbitrary. Such information would not be useful to users of financial statements.

Paragraphs 107 and 108 of IAS 1
We do not agree with the proposed amendments to paragraphs 107 and 108. Please refer to our comments above for the proposed amendments to paragraph 54.

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.

ACCA response

In general, we are supportive of a full retrospective approach proposed in paragraph 97U and 97V. However, there are concerns over the cost/benefit of such an approach and we suggest the IASB provides specific reliefs where applying the amendments on a full retrospective basis would involve undue cost or effort.

We would also recommend that on transition, financial instruments that have expired should be exempted from restatement and that classification of financial instruments should be reassessed based on the contractual rights and obligations that have not expired at the date of initial application.

The transition reliefs in paragraphs 97W – 97Y are pragmatic for preparers.

On disclosures, this ED will introduce a high volume of new information that entities would be required to disclose. The proposed amendments to IFRS 7 and IAS 1 would be effective at the same time as the amendments to IAS 32, as proposed in paragraph 44LL of IFRS 7 and paragraph 139X of IAS 1. Therefore, we suggest the IASB take into consideration the time that entities would reasonably need to get ready for disclosure when deciding the effective date for the proposals in this ED. See our comments in question 7.

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.

ACCA response

Paragraphs 54 and 124
We agree with the proposed amendments to paragraphs 54 and 124.

Paragraph 61A and 61C
We do not support the proposed paragraph 61A and 61C. We have concerns about the volume of information that needs to be disclosed about the nature and priority of claims on liquidation for subsidiaries without public accountability. Given these entities do not have public accountability, the benefits of providing the proposed disclosures may not outweigh the costs.

Paragraph 61B
We support the proposed paragraph 61B(b). However, we have concerns about the usefulness of the information proposed in paragraph 61B(a) when an entity has many contracts with both financial liability and equity characteristics. Requiring entities to disclose the terms and conditions that determine the classification of financial instruments as financial liabilities or equity instruments may result in disclosure overload and potentially obscure other information.

Paragraphs 61D and 61E
We support the proposed paragraphs 61D and 61E.