27 February 2024

Andreas Barckow
Chair
International Accounting Standards Board (IASB)

Exposure Draft - Financial Instruments with Characteristics of Equity (FICE)

Dear Andreas,

We are responding to your invitation to comment on Exposure Draft - Financial Instruments with Characteristics of Equity (Proposed amendments to IAS 32, IFRS 7 and IAS 1) (the Exposure Draft) on behalf of the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity. This response summarises the views of member firms that contributed to our consultation during the comment period.

We support the objective to clarify some requirements in IAS 32 to reduce diversity in practice and address known practice issues. We agree that a number of the proposals will increase comparability between entities. However, comparability is just one of multiple factors that together achieve the objective of providing useful information to investors. In some cases, we think changes to proposals are needed so that the outcome, while reducing diversity, results in useful information. Lastly, there are some proposals for which, whilst we appreciate the IASB's efforts, we suggest the IASB consider not proceeding with because we think they could increase rather than reduce diversity in practice.

The appendix to this letter sets out our responses to the questions in the Exposure Draft. Our three priority issues are:

- **The effects of relevant laws or regulations:** we do not have significant concerns about how practice has developed in this regard, and we think these proposals could cause disruption without necessarily achieving more useful information for investors. As such, we suggest not proceeding with this proposal.

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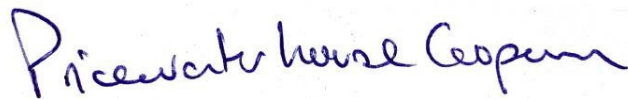
- **Obligations to purchase an entity's own equity instruments:** while the proposal would reduce diversity in practice, there are a number of anomalies and concerns relating to the outcome. We set these out so that the costs and benefits can be carefully considered and, importantly, discussed with investors, before finalising the proposals.
- **Contingent settlement provisions:** we disagree with the proposed measurement model to disregard the expected timing and probability of occurrence of the contingent event. We suggest that IFRS 9 measurement be used for initial and subsequent measurement.

Please contact Marie-Claude Kling (marie.kling@pwc.com) or myself (henry.daubeney@pwc.com) if you'd like to discuss our responses, we would be happy to provide further details and examples relating to our views.

Yours sincerely



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Appendix

1—The effects of relevant laws or regulations
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).

We agree with the IASB's decision not to make a fundamental change to IAS 32 to take an 'all-in' approach that would be consistent with other IFRS Accounting Standards, such as IFRS 16 and IFRS 17. Whilst, if we were starting with a blank sheet of paper, this would be preferable, as far as we are aware, there are no major pervasive issues with the outcome of applying IAS 32 that would justify such a fundamental change at this time.

We appreciate the IASB's efforts to clarify these requirements, which have in the past led to a number of application questions. However, we observe that practice appears to be largely settled by now, and consistent interpretations seem to have been reached within each jurisdiction considering local legal and regulatory frameworks. Whilst there might be differences between jurisdictions, these differences appear to result from applying judgement to differing circumstances and legal frameworks. We do not see this as an area of significant diversity that affects comparability across, or within, jurisdictions.

In our view, whatever application guidance is provided, the distinction between what is created by law versus created by the contract will never be black and white and there is no 'one size fits all' approach to making this assessment, given the different legal frameworks in place. In particular some jurisdictions operate within a civil legal framework where many of the characteristics and terms of common financial products (loans, deposits, unit trusts) are defined by law. Others operate within a common law framework where common terms are established based on legal precedent.

Given that the IASB is maintaining this distinction between law and contract, and given we are not aware of any situations for which significant concern exists about conclusions previously reached in this area, we think the proposals could result in significant disruption without a significant benefit.

For many fact patterns, significant judgement based on specific circumstances is needed to make this distinction. The proposed guidance places increased emphasis on this distinction, and so we expect this would not only resurface past questions, but give rise to many new application questions in this area. One specific fact pattern of many that have come to our attention relates to instruments that will convert into a variable number of the issuer's shares upon a non-viability event. That conversion feature is defined by the law and must be included in the terms of the instrument (by way of reproducing the law) for it to achieve a particular regulatory capital outcome. The term is not mandated by law on an instrument basis. Absent any other terms that preclude equity classification,

it is not clear how an issuer classifies those instruments in accordance with paragraph 15A when these specific terms are included in the contract. Some might argue that the conversion feature does not create obligations of the issuer in addition to what is imposed by the law because it only duplicates a legal term, and so it is not a contractual feature. Others might argue that it is a contractual feature because including it in the contract is voluntary to achieve the desired regulatory outcome.

Based on the above, we suggest the IASB does not proceed with this aspect of the proposals. Instead, we support requiring robust disclosures about the judgements that have been made in this regard. As explained in paragraph B5A of IFRS 7, we would expect to see such disclosures in the context of disclosing material accounting policy information.

2—Settlement in an entity's own equity instruments

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).

Overall, we support the IASB clarifying the 'fixed-for-fixed' condition, which has in the past led to a number of application questions. We suggest some changes below to address circumstances prevalent in practice.

Functional currency denomination

In some territories, the market for funding in local currency – which is often the functional currency of entities in that territory – is not sufficiently liquid to provide financing at a reasonable cost. As

such, entities rely on funding, including convertible bonds, in foreign currencies. Accordingly, applying current requirements/practice and the proposals, the conversion options in such bonds would not meet the fixed-for-fixed condition, and therefore would not be classified as an equity component. However, given equity is a non-monetary item, some fundamentally challenge the relevance of the functional currency to the classification of the instrument.

Putting aside this fundamental issue, the Exposure Draft proposes that in a consolidated group, the assessment should be based on the functional currency of the entity whose equity instruments will be delivered on settlement. We agree, in light of the narrow scope of this project, with the IASB's rationale for why the functional currency of the underlying equity issuer is relevant to the analysis. However, given a gross settled derivative includes both the receipt of consideration and delivery of the underlying equity instruments, we consider the functional currency of the issuer of the instrument to be equally relevant. In a consolidated group, the proposal in paragraph AG29B could result in a subsidiary issuing a convertible bond, denominated in its own functional currency and convertible into a fixed number of the parent's shares, failing the fixed-for-fixed condition due to a difference between the functional currency of the parent and of the subsidiary. This would be a change from current practice, and we believe that this would not provide useful information.

Accordingly, we recommend that the proposal in paragraph AG29B is amended such that for a contract to meet the requirements in paragraph 22, the consideration to be exchanged is denominated in the functional currency of either the issuer of the instrument or the issuer of the underlying shares.

Preservation adjustments

We generally agree with the proposals relating to preservation adjustments, which will capture many common anti-dilution provisions in the market.

However, it is unclear whether the proposal would capture one very common anti-dilution provision —an adjustment compensating for the dilutive effect of a below-market issuance, which might not be offered on a pro-rata basis to all existing shareholders. The effect of this adjustment would compensate the derivative holder based on how the discount below fair value has diluted the total shares in issue. It is unclear how the preservation adjustment test would be applied in these cases, and whether 'current shareholders' would include the beneficiaries of the below market issuance. We suggest amending paragraph 22C(a) to include these future shareholders.

Passage-of-time adjustments

We agree with allowing a passage-of-time adjustment that is predetermined at inception and varies only with the passage of time. However, we disagree with the proposal to require the adjustment to have the effect of fixing on initial recognition the present value of the amount of consideration to be exchanged for each of the entity's own equity instruments. This condition is unduly restrictive, and it is unclear how it would apply to a broad range of contractual provisions that are generally accepted as meeting the fixed-for-fixed condition in practice. We consider the conditions in (b)(i) and (b)(ii) of paragraph 22C to be sufficient to clarify the objective, and suggest deleting the condition in (b)(iii).

Change-of-control adjustments

We suggest that the proposed allowable adjustments are expanded to allow for common change-of-control adjustments. We observe that the Exposure Draft (paragraph IE76 of Example 19 to IAS 32) illustrates one common change-of-control adjustment which is accepted in practice. Another common type, illustrated in paragraph IE80 of Example 19 to IAS 32, is an adjustment intended to compensate the derivative holder for loss of optionality upon a change of control of the issuer. These adjustments seek to approximate the lost time value of the option. Paragraph IE81 of Example 19 to IAS 32 states that, applying the proposals, such an adjustment would not be an allowable adjustment. However, in our view, such adjustments have elements of both the passage-of-time adjustment (since the time value of an option captures the passage of time) and the preservation adjustment (since the relative economic interests of the bondholders and the shareholders are maintained given the bondholder is compensated for the lost time-value). Accordingly, such adjustments should be permitted. We believe this would provide better information for investors.

Other clarifications

For the reasons set out in the Basis for Conclusions, we agree with the proposed clarifications in paragraphs 22D and AG27A(b) relating to classification of share-for-share exchanges and derivatives that give one party a choice of settlement between two or more classes of the entity's own equity instruments.

3—Obligations to purchase an entity's own equity instruments
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).

Overall, we support requiring entities to apply a consistent approach to account for obligations to purchase an entity's own equity instruments. However, it is difficult to identify which approach would best achieve the objective of providing useful information to investors given the many advantages and disadvantages to be considered—particularly relating to consistency with existing IAS 32 and IFRS 10 requirements.

The IASB could consider whether as an alternative to a 'one size fits all' approach, more than one approach could be applied depending on the terms of the obligation to redeem own equity. For example, we understand that practice often differentiates between a non-controlling interest (NCI) put option with a strike price that is:

- fixed or formulaic— often the NCI is derecognised, and the financial liability is measured through profit or loss; versus
- at fair value—often the NCI continues to be accounted for, and changes in the measurement of the financial liability are recognised directly in equity.

Absent such a more significant change in the overall approach, we believe the following issues at a minimum, should be carefully considered and discussed with primary users.

Debit to parent equity on initial recognition of the financial liability

As discussed in the Basis for Conclusions, there are several benefits to the IASB's proposal to record the debit in parent equity, including that this approach results in NCI equity representing actual legal ownership, rather than potential ownership. However, reflecting the NCI put holders' right to the gross amount of the cash obligation separately from their claims on the net assets of the NCI may be viewed as 'double counting'.

If the IASB proceeds with the proposal, to alleviate concerns regarding this 'double counting', we suggest the IASB consider whether additional requirements are needed to distinguish NCI that is subject to a put from NCI that is not subject to a put in the primary financial statements (for example, labelling such as "NCI subject to a written put").

Gains and losses on remeasurement

In our experience, the presentation of changes in the value of the redemption obligation is one of

the most controversial issues related to accounting for NCI puts, in particular when the NCI is puttable at fair value.

We acknowledge that the proposal to record gains and losses in the income statement achieves an internally consistent principle within IAS 32 and IFRS 9. However, it also appears to contradict paragraph B96 of IFRS 10. Applying the proposal, a portion of the difference between the consideration paid (that is, the difference between the initial measurement of the liability and the final amount paid) and the carrying amount of the NCI would have been recorded through profit or loss over the life of the liability. In contrast, paragraph B96 of IFRS 10 requires that the difference between the carrying amount of the NCI and the consideration paid be recognised in equity. If the IASB chooses to finalise the proposal for remeasurement presentation, paragraph B96 at a minimum should be amended to clarify that the remeasurement of the consideration payable follows IFRS 9.

Additionally, relating to when the NCI is puttable at fair value, there are two other issues that need to be considered before finalising the proposal:

- There is an apparent 'double counting' in the net profit attributable to the parent. This is because net profit attributable to the parent is decreased by both the remeasurement of the put liability (as the subsidiary's fair value has presumably increased) and the normal allocation of net profit to the NCI. These two components are not mutually exclusive, hence the apparent 'double counting.'
- Similarly, if the subsidiary pays a dividend, this dividend reduces the redemption obligation liability, and is deducted from NCI within equity. As the dividend payment can be recorded only once, it will result in a gain through profit or loss in the consolidated financial statements. In contrast, for puttable instruments in a subsidiary that fail the exception in paragraphs 16A and 16B and are accounted for applying paragraph AG29A of IAS 32, the payment of a dividend simply reduces the liability without a profit or loss impact.

One way to address this 'double counting' could be to introduce additional presentation requirements in the primary financial statements to ensure transparency on the nature of these remeasurement amounts.

Measurement guidance

In our view, there is a fundamental difference between contingent obligations and those that are solely controlled by the holder, and this difference should be reflected in the measurement model.

For obligations controlled by the holder, such as written puts, the proposal to measure the obligation at the present value of the redemption amount (ignoring expected timing and probability) appears to be inconsistent with paragraph 47 of IFRS 13 which states that the measurement for a demand liability should be 'not less' than the amount payable on demand. This proposal could result in entities presenting the obligation at a significantly undervalued amount when the terms of the contract provide a significant incentive to redeem at a later date, such as an increase in the redemption price. Accordingly, we suggest the IASB require measurement at fair value in accordance with IFRS 9, subject to the floor established by paragraph 47 of IFRS 13.

Accounting for the expiry of a written put option

Subject to our comments above, if the IASB finalises its proposals regarding the initial recognition of written puts, we support the proposal relating to the expiry of a written put.

Settlement options for written puts

We support the IASB providing clear guidance on settlement options for obligations for an entity to purchase its own equity instruments.

However, we note that the proposal (that derivative accounting applies to written puts with a net settlement option, regardless of who controls net settlement) appears to be an exception to the general principle in paragraph 23 of IAS 32. The principle underlying paragraph 23 of IAS 32 centres around an obligation that the entity cannot avoid. This is illustrated in paragraph IE6 of Example 1, which states "[i]f one of the settlement alternatives is to exchange cash for shares … Entity A recognises a liability for the obligation to deliver cash… Otherwise, Entity A accounts for the forward contract as a derivative." The proposal to apply derivative accounting even when net settlement is controlled solely by the holder seems to contradict this principle, as the issuer would have no ability to avoid its obligation to settle on a gross basis.

As such, we suggest that the IASB explains why instruments with settlement alternatives within the control of the holder would be accounted for differently to instruments within the scope of paragraph 23.

Settlement in another class of an entity's own equity instruments

We acknowledge that it could be argued that the settlement of a written put using a variable number of another class of an entity's own shares should not be recorded as a gross financial liability because there is no gross outflow of economic resources. Proponents of this view argue that derivative accounting might be more appropriate.

However, in our view, the IASB's proposal is consistent with the definition of a financial liability in paragraph 11 of IAS 32. An alternative conclusion would require a more fundamental change to the Standard. Accordingly, in the context of the limited scope of the project, we support the proposal.

4—Contingent settlement provisions
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).

Subject to our comments below, we generally support the IASB's overall approach for clarifying specific aspects of this guidance that have created significant diversity in practice.

Measurement of a financial liability arising from a contingent settlement provision

We agree with the IASB's intention to align the initial and subsequent measurement for financial liabilities arising from contingent settlement provisions. However, we disagree with the proposed measurement model to ignore the probability and expected timing of the contingent event because:

- a liability that is contingent on an event outside of both parties' control is different from a demand liability for which exercise is within the control of the holder. For the former, ignoring the contingency when measuring the liability is inconsistent with how a market participant would price such an instrument. Consequently, the proposed model may not appropriately capture the value of the entity's obligation when the redemption price changes over time, or, when the redemption amount may be very high, but the contingency has a low likelihood of occurring.
- it could result in recognising a liability in excess of the proceeds received, which is inconsistent with the assumption that the transaction was negotiated at arm's-length, and results in a negative equity component (for which we are unclear of the technical basis and informational value to an investor).

Accordingly, we suggest that the IASB align the measurement of contingent settlement provisions with compound instruments that do not have a contingent settlement feature. That is, to measure the liability applying IFRS 9 factoring in the probability and expected timing of the contingent event. This approach has the same advantage as the IASB's proposal of providing consistency between

initial and subsequent measurement, while also providing broad consistency with the measurement of non-contingent financial liabilities and compound instruments.

The meaning of 'liquidation'

While we are not aware of widespread diversity in the interpretation of 'liquidation,' we support providing a definition of the term to provide greater clarity in its application.

Based on what we have observed in practice, the fundamental principle underlying liquidation is that it is an irreversible process. In some cases, operations can continue while the entity is being liquidated. As such, the proposed definition based on the cessation of operations would appear to be narrower than is currently accepted in practice, because it would not include such scenarios even when the process is irreversible and the only outcome is the ultimate liquidation of the entity. As such, we suggest as an alternative definition:

Liquidation is the irreversible process by which an entity converts its assets to cash or other assets and settles its obligations with creditors in anticipation of the entity ceasing all operations.

The meaning of 'not genuine'

While we are not aware of widespread diversity in the interpretation of 'not genuine', we support clarifying that, consistent with what we see as best practice, 'genuine' is not based solely on the probability of the event occurring.

In our view, the proposed example of a regulatory change clause in paragraph AG28 could create application questions. While we agree that the probability of such a clause being triggered should not be considered when determining whether the clause is genuine, there could be other facts and circumstances that may lead to such a determination. For example, in some jurisdictions the industry regulator might not apply such changes retrospectively.

As such, we suggest that the IASB remove the proposed example in AG28 or modify it to simply state that the assessment of whether such a clause is genuine is not based solely on the probability of the event occurring.

Other proposals

We agree with the proposals to clarify that financial instruments with contingent settlement provisions can be compound financial instruments, and that discretionary payments related to an equity component are recognised in equity.

We note that, in practice, instruments with contingent settlement features and discretionary dividends may contain a variety of additional put and call options, settlement options, foreign currency exposures and other features that may need to be considered when assessing whether an equity component exists. We suggest the IASB confirms that there can be an equity component (for discretionary dividends for example) even if, for example, the amount immediately repayable upon a contingent event is indexed to a foreign currency or other financial variable (ie it doesn't meet the fixed-for-fixed condition).

5—Shareholder discretion

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).

We agree with the direction of the proposals. In particular, we agree with the guidance in paragraph AG28B that the factors that are relevant in determining whether a shareholder decision is an entity decision will depend on the specific facts and circumstances. Careful judgement will be needed when deciding how to weigh various factors when they point in different directions. However, some drafting changes are needed to paragraph AG28A(a)-(d) to avoid misapplication of the guidance.

In our view, the factors in paragraph AG28A(a)-(d) of IAS 32 are reasonable and relevant to consider in most circumstances. However, the use of "unlikely" and "likely" in those paragraphs, when explaining the outcome of the factors, could be read as too determinative.

For example, read in isolation, paragraph AG28A(d) could be interpreted to mandate that a shareholders' vote over ordinary or special dividends is not an entity decision. However, in our view, such a decision can be an entity decision because it is a collective decision made as part of the entity's governance structure that generally benefits the shareholder group as a whole. Accordingly, we believe that these decisions are in the scope of (a) of paragraph AG28A.

We therefore suggest that these directional indicators be removed, or that the language used be less determinative, to allow for judgement considering the specific circumstances at hand.

6—Reclassification of financial liabilities and equity instruments

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).

We agree with the proposal to require an entity to reclassify an instrument when the substance of the contractual arrangement changes because of changes external to the contractual arrangement. We also agree with the accounting proposed when reclassification occurs.

Expiry of a financial liability

Consistent with paragraph 3.3.1 of IFRS 9 and paragraph 16E of IAS 32, we suggest the IASB amend the proposal to also require reclassification from financial liabilities to equity when the liability feature of an instrument, or a component of an instrument, has expired (for example, when a conversion ratio that failed the fixed-for-fixed condition at initial recognition subsequently meets the condition in accordance with the contractual terms). In our view, continuing to recognise a financial liability when an instrument ceases to meet the definition of a financial liability reduces the usefulness of information, in particular by impairing comparability.

We question whether the reassessment would increase costs and complexity as stated in paragraph BC145, given that, in performing the measurement of the liability at a particular reporting date applying IFRS 9, an issuer will be required to understand whether any of the features of the instrument have changed or have expired.

7—Disclosure
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.

(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).

Overall, we support requiring disclosures that complement the classification and presentation of financial instruments that an entity issues.

However, the number of proposed disclosures is quite extensive and we have a concern that some of these might create application challenges. In particular, we challenge the usefulness of the proposed disclosures relating to the potential dilution of ordinary shares, and the nature and priority on liquidation, as described below.

Potential dilution of ordinary shares

We question whether this proposal fits within the objective of the project to address diversity in practice and application challenges relating to IAS 32.

Entities applying IAS 33 already determine the dilutive effect of instruments. The calculation of maximum dilution for the purposes of paragraphs 30G and 30H of IFRS 7 is based on different principles from those in IAS 33. It is not clear to us what objective these additional disclosures in IFRS 7 would serve, and how they reconcile to the disclosures required by IAS 33. If the IASB

finalises this proposal, we suggest that it is added to IAS 33 instead of IAS 32, which would appropriately and consistently limit the scope of entities that would be required to provide this disclosure.

Nature and priority on liquidation

We are not clear how the disclosures on priority on liquidation (in paragraphs 30A, 30B, and 30E of IFRS 7) would be applied by an entity that operates in multiple jurisdictions, each with different liquidation rules. Such a group cannot itself be liquidated, and the priority on liquidation at a subsidiary level or standalone parent entity level could, to a significant extent, be dependent on the order of liquidation under the respective liquidation framework. Further complexities could arise from intra-group financing arrangements that will not be visible in consolidated financial statements, but could affect the priorities of the external creditors. In light of these complexities, we challenge whether the objective of this proposed disclosure requirement could be met in a manner that results in useful information for a variety of practical use cases.

8—Presentation of amounts attributable to ordinary shareholders
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).

The Exposure Draft provides no application guidance nor clear objective for these proposals, and so we are concerned that they would not be applied consistently in practice. In particular, there is no guidance provided to determine how an entity would take into account the effect of various equity instruments other than ordinary shares (such as equity derivatives and preference shares) when determining the amount to attribute to ordinary shares. This gives rise to questions such as:

- On what basis would profit or loss and other comprehensive income be allocated to equity derivatives?
- How would an entity treat unpaid dividends on cumulative preference shares if they are payable only upon liquidation?

We observe that an illustrative numerical example is provided in paragraph IG6A of IAS 1.

However, we challenge its usefulness because it does not provide any guidance on the approach followed to perform that allocation.

As such, we suggest that the IASB does not proceed with this proposal at this time as this represents a fundamental change that warrants more work to ensure its usefulness to investors.

9—Transition
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) for the entity to apply the effective interest method in IFRS 9 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 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.

We agree with the transition proposals.

Additionally, we suggest providing a transition relief for entities that will need to reclassify financial liabilities for which hedge accounting is applied. One possible solution could be to allow entities to cease the hedging relationship retrospectively from inception of the hedging relationship (so that, effectively, hedge accounting has never been applied for that hedged item).

Other clarifications suggested

Freestanding derivatives

For freestanding derivatives, we note that paragraph 22B of IAS 32 focuses only on the ratio of the conversion or exercise price to the number of shares, and ignores the volume of shares to be exchanged. Consider an example in which an entity writes a call option that gives the counterparty a right to acquire a fixed percentage of the entity's shares at a fixed price per share at the date of

exercise. If the entity later issues new shares to its existing shareholders at market price, these shareholders' economic interests would be unaffected. The derivative holder, on the other hand, would economically benefit from new share issuances, provided that the market price of the shares is above the strike price of the derivative. This issue would not arise for convertible bonds given the notional would be fixed based on the principal amount.

We have interpreted paragraph 22B in the context of the definitions and requirements in paragraphs 16 and 22C(a). But, to avoid ambiguity, we suggest clarifying that in addition to a fixed ratio of the exercise price for each share, a fixed notional amount would also be required.

Application of preservation adjustments to paragraphs 16(b)(i) and to 22D

We note that paragraph 22C(a) applies to the requirements related to derivatives in paragraph 16(b)(ii). In practice, some of the concepts applied in determining whether a derivative contract meets the fixed-for-fixed condition are also applied in determining whether a non-derivative contract meets the requirement in paragraph 16(b)(i) - for example, a prepaid forward to deliver a fixed number of equity instruments will usually contain standard anti-dilution provisions.

Similarly, contracts to exchange a fixed number of one class of an entity's own non-derivative equity instruments for a fixed number of another class of the entity's own non-derivative equity instruments would also typically include standard anti-dilution provisions.

We suggest the IASB clarifies that the preservation adjustments guidance in paragraph 22C(a) applies to non-derivative instruments within the scope of paragraph 16(b)(i), and to contracts to exchange one class of equity for another within the scope of paragraph 22D.