Association pour la participation des entreprises françaises à l'harmonisation comptable internationale

Dr Andreas Barckow, Chairman,
International Accounting Standards Board,
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London E14 4HD-United Kingdom
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26 March 2024

Dear Dr Barckow,

Ref: Financial Instruments with Characteristics of Equity—Proposed amendments to IAS 32, IFRS 7 and IAS 1

We are pleased to take this opportunity to comment upon the Exposure Draft Financial Instruments with Characteristics of Equity: Proposed Amendments to IAS 32, IFRS 7 and IAS 1 (the ED). Our detailed comments are laid out in the appendix to this cover letter. Where we have provided no response to particular proposals, it may be assumed that we have no concerns with those proposals.

The principal areas of concern that we have with the proposals contained in the ED are those relating to "The effects of relevant laws or regulations" and "Obligation to purchase an entity's own equity instruments". We disagree strongly with both of these sets of proposals since we think that both will result in information which is at best not relevant and at worst misleading for the user of the financial statements.

(a) The proposal that when an entity is determining the classification of financial instruments, it should effectively ignore relevant and substantial laws or regulations appears to contradict directly the requirement of the Conceptual Framework which states that all terms in a contract should be considered, whether explicit or implicit. This approach also runs counter to the commonly accepted accounting principle that all relevant facts and circumstances should be considered when an accounting assessment is being made. In addition, we think that it does not correspond to current understanding of paragraph 15 of IAS 32 or to the way entities perform this assessment in practice.

(b) The question of the accounting for the obligation to purchase an entity's own equity instruments (NCI Puts) has been of concern to entities ever since the IFRIC made tentative decisions on the topic some ten years ago. Then as now, entities have pointed to the counter-intuitive accounting approach which has been once again proposed in the ED. We think that the effect this proposal will have on the financial statements will be ignored by sophisticated users as being not relevant but will create the risk that less sophisticated shareholders and others will be misled by the apparent message sent by the accounting consequences. We encourage the Board to explore other approaches to this and we make a proposal for an alternative presentation in our detailed response.

Finally, we also have serious concerns about some proposals for presentation and disclosures since we do not understand their rationale and the way we are expected to comply with these new requirements.

If you require any further information about our comments on the ED, please do not hesitate to contact us.

Yours sincerely,

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APPENDIX

Question 1: The effects of relevant laws or regulations (paragraphs 15A and AG24A–AG24B of IAS 32)

While we understand that the issue of the effect of laws or regulation on the classification of instruments has led to a diversity of practice and must therefore be addressed, we are opposed to the proposals put forward in this Exposure Draft (the ED). In fact, as currently drafted, these proposals, if applied to our highly regulated French environment, will raise a number of fundamental questions: which standard applies (IAS 32 or another); which criteria are to be used for classifying our instruments; will these amendments lead to the reclassification as equity of a large number of instruments whose classification as debt has never been questioned? Our regulatory framework today contains a large number of provisions governing the operation of very common instruments. As long as these regulatory provisions exist and the contracts between the parties simply reproduce them without adding any additional provisions, then in accordance with the proposals, they would not be considered, thus removing all obligations from the contracts which would allow for their classification as debt.

We believe that all the examples presented in BC 14 in which an "all inclusive" approach is pursued are valid and should not be dismissed. Furthermore, we do not agree that following the same approach in IAS 32 would result in a fundamental change to the classification requirements in IAS 32. Indeed, considering paragraph 4.60 of the conceptual framework which specifies that all terms in a contract, both explicit and implicit, should be considered and by specifying that "implicit" also refers to those imposed by statute, one could argue that adding such a reference in IAS 32 to define what is meant by contractual rights or contractual obligations in IAS 32.11, would not actually be such a fundamental change to the standard.

However, if the Board is of the opinion that the addition of this reference to the conceptual framework constitutes an excessive change from the original scope of its FICE project, we would encourage it either to review its project definition in order to reach a relevant outcome or not to proceed with an amendment that would compromise current accounting practices which we think are fully relevant.

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

Initial accounting

If we assume that the IASB does not wish to change the current provision of IAS 32.23, which consists in recognising a "gross" liability to represent the cash outflow obligation, then we consider that the proposal to deduct the counterpart of this liability from a component of equity other than NCI constitutes double counting and will distort the overall picture of the Group's share of equity.
Indeed, even though we recognize that NCI holders have two distinct types of rights over the period during which the instrument could be exercised, as explained in BC 78 (i.e. the right to sell their interest to the entity and their current rights or ownership interests), we believe that the gross valuation of both the liability and the NCI Equity is a double valuation of two different exclusive rights. We can accept that both rights co-exist over a period and be recognized, but they cannot be valued at the same

full amount. The two elements are in fact two mutually exclusive situations ... either the NCI holders do not exercise their option and retain rights over ownership interest, or they exercise the option and lose other rights.
One way to depict these two rights without double counting and distorting the relevance of Group's equity share is to apply the "derivative" approach proposed by Mr Uhl (in his alternative view to the ED- first part). However, such an approach fails to represent the obligation for the entity to deliver cash (which is beyond its control) and therefore fails to depict its liquidity risk directly in the primary financial statements.

We therefore propose an alternative solution that will:
- maintain the relevance of the controlling shareholders' rights
- maintain the right of non-controlling shareholders to a share of net assets, while making it clear that this right is subject to a put that would cancel it out
- show the liquidity risk on the balance sheet

We propose to disaggregate the net value of the non-controlling interest between:
1. a gross value representing their current rights to net assets (before the put is exercised)
2. the amount of this NCI subject to a put (any surplus would be deducted from the Group's share)
3. the net value of NCI

Equity attributable to owners of the parent:	51 000
Gross current non-controlling interests:	10 000
Non-controlling interests subject to a put:	(10 000)
Net NCI	0

Initial and subsequent measurement

Even though we do not have any particular concern with the proposed amendment, we do note that it is not merely a clarification. This proposal aims to introduce a specific evaluation model for this kind of liability, a model that is not consistent with IFRS 9.
Please note that we are not opposed to such modifications as long as they bring relevance to the financial statements, and we would even encourage the IASB to do so on other aspects of this issue, particularly on the following question.

Gains or losses on remeasurement of the financial liability

We completely disagree for the following principal reasons:

- Since we disagree with the first proposal to debit the liability to the Group Equity (instead of NCI), we also disagree with paragraph BC87d which states that "*the respective ownership interests of the parent and non-controlling shareholders have not yet changed and will not do so until the instrument is settled or exercised. The remeasurement of the financial liability is, therefore, not a transaction with owners in their capacity as owners*".
  Recognizing a gross liability for the obligation to deliver cash is tantamount to assuming that the put has been exercised and we are therefore convinced that it is the equivalent of "transaction with owners in their capacity as owners. Any subsequent change in the debt

therefore meets the definition of a transaction between shareholders and must therefore be recognised in equity.
A written put option to NCI holders is usually not transferable to an unrelated third party. This liability toward the NCI holder is linked to the legal capacity of the NCI holder, reinforcing the very specific nature of such liability and therefore leading to the conclusion that accounting for the liability as a gross amount is a way to anticipate the put to be exercised by the NCI holders, which will then be accounted for as a “transaction with owners in their capacity as owners”.

- If the Board were not to consider our alternative proposition for the initial accounting, in any event, **the outcome of the proposal to recognise subsequent changes in net income is not relevant since it leads to counterintuitive accounting treatment and is misleading for investors.**
  Recognizing any gains and losses on subsequent remeasurement of the liability does not provide relevant information to users of financial statements. Indeed, we believe that sophisticated users such as analysts will eliminate these gains and losses from the net profit or loss to estimate actual business performance, but that less-sophisticated users will not recognise the significance of this counter-intuitive result nor be able to interpret it. There is thus a risk that the latter will be disadvantageously affected.

  We disagree with the statement that recognizing a financial liability (for the obligation for an entity to purchase its own equity instruments) should automatically require that gains or losses on the remeasurement of the liability be recognised in profit or loss.

  In accordance with the proposals of the ED, similarly to the own credit risk for liabilities at fair value, the better the company performs, the more its net income would be reduced. The Board acknowledged this counterintuitive effect for the own credit risk and addressed it by utilizing OCI. We believe that something similar could be done for NCI Put Liabilities. It would not represent any fundamental change to IAS 32 as initially intended. Indeed, IAS 32 is the standard that determines whether the instrument gives rise to the recognition of a liability or an equity item, with IFRS 9 subsequently specifying the treatment of debt instruments. Only a modification of IFRS 9 would be necessary, a modification that would be ultimately very limited and circumscribed to very specific debts. It would also be possible, as proposed by the IASB regarding the subsequent measurement model (see previous question), to add in IAS 32 a clarification about the recognition in OCI of subsequent changes in this value.
  Once the put is effectively exercised, the amount previously recognised in OCI will be reclassified to Equity.

- Finally, we have surveyed our members, and it appears that there is **no divergence of practice** in the accounting for subsequent changes in the liability for issuers with significant NCI puts. All these entities account for these variations in Equity.
  In the absence of diversity in practice, we believe that the IASB should undertake a deeper project to reach a consistent and relevant outcome. It should therefore exclude the NCI put issue from this draft amendment and dedicate another cross-cutting project to it, instead of trying to resolve these issues within the current narrow-scope project.

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

We agree that the scope of disclosure may be expanded to include equity instruments that deserve explanations on their specific characteristics and judgement exercised for their classification.

Concerning the proposal to disclose separately gains or losses on financial liabilities containing contractual obligations to pay amounts based on the entity's performance or changes in its net assets, we fully share concerns expressed by stakeholders on counterintuitive outcomes as mentioned in BC 181 when the fair value of liabilities is based on entity's performance. However, as mentioned above, we do share the IASB's conclusion that recognising those changes in other comprehensive income would represent a fundamental change to the requirements in IAS 32. As explained in our previous answer:

- allowing the recognizing of changes in OCI may be done by amending IFRS 9, or
- by specifying it in IAS 32, as the IASB has specified the valuation method for such a liability, entailing a departure from IFRS 9.

Regarding the proposed additional information, while we agree with the proposal to disclose the terms and conditions of financial instruments with characteristics of both financial liabilities and equity, we have many more doubts about the disclosure relating to the nature and priority of claims as proposed. Indeed, we see no informational value in this current format, but neither do we want the IASB to impose much more granular information, as this would be costly and cumbersome to implement and would greatly impair the readability of the notes to the financial statements.

Finally, we have also strong reservations about the proposed disclosure on potential dilution since we struggle to understand the link between this, and the information already provided according to IAS 33. If the Board believes that diluted earnings per share disclosure should be improved, then this should be done by amending IAS 33 not by including similar but different disclosures in IFRS 7 as this will add a lot of confusion and may also be misinterpreted.

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

We disagree with this proposal and believe that such requirements do not comply with the objectives and roles dedicated to primary financial statements, that is, to provide “a structured summary of a reporting entity’s recognized assets, liabilities, equity, income, expenses and cash flows.”

Although we understand that users of financial statements need transparency about whether an entity has issued instruments other than ordinary shares, and what their impact on the different primary financial statements is, we believe that such information should be provided only in notes. We are quite surprised to see that the Board is proposing to change primary financial statements, only to avoid users being obliged “to piece together the information needed to calculate ratios, without having to go through multiple notes to the financial statements”. Such an objective, even though we think it is of questionable validity, could also be satisfied by requiring a single note.

Finally, we are not sure how to allocate the amounts between shareholders whenever complex instruments are involved. Furthermore, we are not convinced that the information is not misleading. For example, presenting an allocation of profit equal to the distribution decided for the period when such a distribution to holders of an equity instrument shall be recognised directly in equity, leads to an alternative accounting model. Equally, because such distributions are discretionary, it would be misleading to allocate part of reserves for as long as distribution has not been decided.