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Our ref BOD/288

28 March 2024

Dear Dr. Barckow

Comment letter on Exposure Draft ED/2023/5 *Financial Instruments with Characteristics of Equity – Proposed amendments to IAS 32, IFRS 7 and IAS 1*

We appreciate the opportunity to comment on the International Accounting Standards Board's (IASB®) Exposure Draft 2023/5 *Financial Instruments with Characteristics of Equity – Proposed amendments to IAS 32 Financial Instruments: Presentation, IFRS 7 Financial Instruments: Disclosures and IAS 1 Presentation of Financial Statements* (the ED or the proposals), published on 29 November 2023. We have consulted with, and this letter represents the views of, the KPMG network.

We appreciate and support the IASB's efforts to address stakeholder concerns regarding some of the most common practice challenges in applying the classification requirements in IAS 32.

However, we do not agree with the proposals in the following three areas.

- How "access to returns" is characterised in the context of an obligation for an entity to buy back its own equity instruments — we do not agree with the legalistic characterisation of "access to returns" and recommend that, at a minimum, the wording be aligned with IFRS 10.B90.
- The measurement of financial instruments with a contingent settlement provision — while the measurement proposals would address current diversity in practice, we believe the measurement requirements in IFRS 9 *Financial Instruments* provide more useful information to users of financial statements about the likelihood and timing of redemption.
- The reclassification of financial liabilities and equity instruments — we do not agree with prohibiting reclassification when there is a change in the effective terms of the contract. We believe reclassification in such circumstances would provide more useful information to users of financial statements about the extent and nature of an entity's obligations at the reporting date.

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We broadly agree with the rest of the proposals but have various questions and concerns relating to specific sections of the proposals.

The effects of laws and regulations

We have questions about a number of aspects of the proposals. We recommend the IASB provide further clarity on how they would apply in specific circumstances.

Settlement in an entity's own equity instruments

While we agree with providing principles on the types of adjustments that would not violate the "fixed-for-fixed condition", we have concerns about the practicability of demonstrating that passage of time adjustments are fixed in terms of present value. We also have questions on other aspects of the proposals.

Obligations to purchase own equity instruments

We recommend the IASB provide more application guidance, including illustrative examples, on measurement and accounting subsequent to initial recognition of the financial liability.

Contingent settlement provisions

Should the measurement requirements be finalised as proposed, we recommend the IASB provide more application guidance, in particular on accounting for any difference between the proceeds received for the issuance of an instrument and the measurement of the liability on initial recognition.

Disclosure

We generally support the proposals about disclosures, but we have concerns about disclosing liquidation priority only for financial instruments in the scope of IAS 32, as it could be misleading.

Presentation

We generally support the proposals about presentation but believe there may be significant challenges in attributing amounts of profit or loss and other comprehensive income, rather than attributing total comprehensive income. We recommend the IASB provide more guidance on how to attribute amounts to ordinary shareholders and other owners of the parent.

Transition

We have identified a number of areas that would benefit from transition reliefs, which would reduce the costs of transition without significantly compromising information provided to users of the financial statements.

The appendix to this letter contains our detailed responses to the questions raised in the ED.

Please contact Brian O'Donovan at brian.odonovan@kpmgifrg.com or Mahesh Narayanasami at maheshnarayanasami@kpmg.com if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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Appendix

KPMG's responses to the specific questions raised in the ED

Question 1—The effects of relevant laws or regulations (paragraphs 15A and AG24A–AG24B of IAS 32)
The IASB proposes to clarify that: (a) only contractual rights and obligations that are enforceable by laws or regulations and are in addition to those created by relevant laws or regulations are considered in classifying a financial instrument or its component parts (paragraph 15A); and (b) a contractual right or obligation that is not solely created by laws or regulations, but is in addition to a right or obligation created by relevant laws or regulations shall be considered in its entirety in classifying the financial instrument or its component parts (paragraph AG24B). Paragraphs BC12–BC30 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

We broadly agree with the proposed principles on when the effects of laws and regulations are considered in determining the classification of financial instruments. However, we have a number of questions about how the proposals would apply in specific circumstances and recommend the IASB provide further clarity with respect to the following.

Practical application of the proposed amendments

We recommend the IASB provide more guidance on how to apply the proposals in paragraphs 15A and AG24B in certain circumstances.

For example, certain laws apply as a result of the entity's choice to include particular terms in contracts. We have encountered questions in the past on this matter and it appears that the proposals do not completely address them. To illustrate, in a particular country, when a company chooses to issue non-transferrable shares by including in the contract a prohibition for its shareholders to sell those shares to third parties, the law obliges the company to buy its own shares back if the holder decides to sell. The obligation to buy back shares arises from a law but only applies as a result of the company's decision to include in the contract a prohibition on sales to a third party. It is unclear if the obligation to buy back shares would be considered as part of the contractual terms. Some may argue that the buyback obligation is an example of "statutory requirements applicable to the instrument" as described in paragraph 15A(a)

and would "arise regardless of whether the obligation is included in the contractual arrangement" as described in paragraph 15A(b), leading to equity classification. They may argue that the instrument is no different from that described in paragraph AG24B for which the law requires the issuer to pay a minimum dividend, and if the instrument's contractual terms reflect only that minimum requirement, then there is no financial liability. On the other hand, others may argue that the company's obligation to buy back its own shares is "not solely created by laws or regulations" as described in paragraph AG24A, but arises from the company's decision to include a prohibition on sales to a third party in the contract, leading to financial liability classification.

As another example, in several jurisdictions, the law sets out basic terms and conditions applicable to loans or deposits (for example, the requirement for the borrower to repay the principal). It is unclear in applying paragraph 15A(b) whether those terms stipulated by law should be disregarded in determining the classification, because the obligation to repay would arise regardless of whether that obligation is included in the contractual arrangement.

A question also arose regarding the enforceability of a contractual term that is subject to a contingent event. For example, some bail-in instruments have a contractual contingent mandatory conversion feature that may not be exercisable based on local laws and regulations if bail-in is triggered in certain scenarios. It is unclear as to whether the contractual term is not considered in the classification of the instrument because it may not be legally enforceable in certain scenarios, or whether it is considered legally enforceable up until a contingent event occurs that triggers the bail-in.

What constitutes "laws and regulations"

We believe it is important to have clarity on what constitutes laws and regulations for the purpose of applying the proposals. For example, with respect to the application of the proposals to bail-in instruments, we understand that not all prudential regulators regard the requirements applicable to regulatory capital instruments as laws or regulations – some regard them as guidelines. We recommend the IASB clarify how the proposals would be applied if the regulatory capital requirements were not considered to be laws or regulations.

We also have questions about which jurisdiction's law should be considered in determining whether rights and obligations in the contract are in addition to rights and obligations created by law. For example, if a contract is issued by an entity incorporated in jurisdiction A but is governed by laws in jurisdiction B, in determining whether rights and obligations are in addition to those created by law, should the entity consider laws in jurisdiction A, jurisdiction B or both?

Scope of the proposals

We recommend the IASB clarify whether the proposals regarding the effect of laws and regulations would also apply to other aspects of accounting for financial instruments. For example, would they apply when determining whether the contractual cash flows of

financial assets are solely payments of principal and interest on the principal amount outstanding as required by IFRS 9?

Substance of a contractual obligation

It is unclear as to whether all contractual terms that are legally enforceable should be presumed to be substantive, or whether entities should always assess whether a particular contractual term is substantive and, if so, how.

In January 2014, the IFRS® Interpretations Committee (the Committee) considered a financial instrument that is mandatorily convertible into a variable number of shares (subject to a cap and a floor) but gives the issuer the option to settle by delivering the maximum (fixed) number of shares. The Committee noted that the issuer cannot assume that a financial instrument (or its components) meets the definition of an equity instrument simply because the issuer has the contractual right to settle the financial instrument by delivering a fixed number of its own equity instruments. The Committee also noted that judgement will be required to determine whether the issuer's early settlement option is substantive and discussed factors to consider in making that assessment.

It is unclear whether an entity is always required to make a similar assessment for other fact patterns. It is often challenging to determine to what extent the issuer's economic and business incentives to exercise or not exercise a particular right should be considered. While we acknowledge that this is not a new issue that would result from the proposals in this ED, we recommend that the IASB provides guidance in this regard to help ensure consistent application of the principles in IAS 32.

Question 2—Settlement in an entity's own equity instruments (paragraphs 16, 22, 22B–22D, AG27A and AG29B of IAS 32)

The IASB proposes to clarify when the fixed-for-fixed condition in paragraph 16(b)(ii) of IAS 32 is met by specifying that the amount of consideration to be exchanged for each of an entity's own equity instruments is required to be denominated in the entity's functional currency, and either:

(a) fixed (will not vary under any circumstances); or

(b) variable solely because of:

- (i) preservation adjustments that require the entity to preserve the relative economic interests of future shareholders to an equal or lesser extent than those of current shareholders; and/or
- (ii) passage-of-time adjustments that are predetermined, vary with the passage of time only, and have the effect of fixing on initial recognition the present value of the amount of consideration exchanged for each of the entity's own equity instruments (paragraphs 22B–22C).

The IASB also proposes to clarify that if a derivative gives one party a choice of settlement between two or more classes of an entity's own equity instruments, the entity considers whether the fixed-for-fixed condition is met for each class of its own equity instruments that may be delivered on settlement. Such a derivative is an equity instrument only if all the settlement alternatives meet the fixed-for-fixed condition (paragraph AG27A(b)).

The IASB further proposes to clarify that a contract that will or may be settled by the exchange of a fixed number of one class of an entity's own non-derivative equity instruments for a fixed number of another class of its own non-derivative equity instruments is an equity instrument (paragraph 22D).

Paragraphs BC31–BC61 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

We agree with the IASB permitting specific types of adjustments in derivatives on own equity that do not violate the fixed-for-fixed condition. We also agree with the types of proposed permitted adjustments — i.e. preservation and passage-of-time adjustments. We further agree with the proposal 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.

However, we have concerns and questions relating to certain aspects of the proposals.

Passage-of-time adjustments

It is unclear whether and how the concept of 'passage-of-time' is related to the concept of 'time value of money'. Some interpret the requirement to demonstrate whether an adjustment is 'fixing the exercise price in terms of present value' to imply that a change in exercise price that is compensation for time value of money would be a permitted adjustment. Under this reading, an adjustment based on an interest rate benchmark or inflation index could be a permitted adjustment. However, example 20 in IE 82-86 specifies that strike price variability based on an interest rate benchmark or an inflation index is not an acceptable passage-of-time adjustment. We recommend the IASB clarify further its rationale behind the passage-of-time adjustments and how they differ from the concept of 'time value of money'.

We are concerned about the practicability of demonstrating whether an adjustment has the effect of fixing the exercise price in terms of present value — e.g. whether the discount rate used at inception is appropriate. Even when the conversion/exercise prices are predetermined and specified in the contract, those prices will often include compensation for expected changes in the share price during the exercise period, as well as compensation for time value of money. A single discount rate may not capture

how conversion/exercise prices have been determined. This could lead to the amendments applying only to a narrow set of circumstances.

In addition, it is unclear how to apply this test to situations in which the option holders are compensated for the loss of the option's time value, as illustrated in Example 19. An option's time value is determined by a number of factors, including the underlying share price and its volatility. Example 19 states that the conversion ratio is enhanced to compensate the bondholder for the loss of time value in the option. It is unclear whether the IASB intends that only a subset of a loss of time value in the option is a permitted passage-of-time adjustment— i.e. only compensation that is proportional to the passage-of-time and is unaffected by other variables, such as share price or its volatility. Without further clarification, diverse interpretations will arise.

As an alternative, we would support the approach described in paragraph BC54(a) — i.e. an adjustment that is predetermined at inception of the contract and varies only with the passage of time would be a permitted adjustment. The IASB has explained in paragraph BC56 that it has chosen the proposed approach in the ED over the approach in BC54(a) to limit the risk of structuring opportunities. However, we note that the approach in BC54(a) is broadly consistent with common practice today for certain types of instruments (e.g. Bermudan options) and has not led to significant structuring opportunities. We further note that contracts described in in BC54(a) are economically similar to a series of separate, mutually exclusive derivative contracts that are exercisable at each of the future exercise dates and settled only by an exchange of a fixed amount of consideration for a fixed number of the entity's own equity instruments, as the IASB has observed in BC53.

Preservation adjustments

We recommend the IASB provide more explanation and examples illustrating how to apply the proposals, including the 'equal or lesser extent' test. For instance, we found the example of a permitted preservation adjustment in paragraph AG27A(c) helpful. We believe and it would further help stakeholders to understand the principle if an example were added to explain what would not be a permitted adjustment — e.g. some specific down-round adjustments.

Other clarifications

We understand the key principle of the proposals to be that in order to meet the fixed-for-fixed condition, the conversion ratio (the price per share) needs to be specified as a fixed monetary amount in the entity's functional currency, as explained in paragraph 22B. However, it is unclear how to interpret the meaning of "a fixed amount of another financial asset or settling a fixed amount of its financial liability" referred to in paragraph 22. It is also unclear whether the instrument described in Example 14 would fail the fixed-for-fixed condition if interest is variable, or if the holder has the right to convert the bond's principal amount plus accrued interest at any time. We recommend the IASB clarify the meaning of fixed amount and its interaction with the concept of a fixed conversion ratio.

Given the wording 'either' in paragraphs 22C(a) and (b), it is unclear whether the requirements of those paragraphs would not be met if the adjustments were made to both the amount of consideration to be exchanged and the number of the entity's own equity instruments used to settle the derivative.

In relation to the proposal on share-for-share exchanges (paragraph 22D), it is unclear whether the preservation or passage-of-time adjustment would be permitted, for example, for preference shares that can be converted to a fixed number of ordinary shares, but subject to a preservation or passage-of-time adjustment. We believe a clarification would be helpful.

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.

We generally support the proposals that paragraph 23 would also apply to an obligation to purchase own equity instruments by delivering a variable number of another class of the entity's own equity instruments and that any gains or losses on remeasurement of the financial liability would be recognised in profit or loss.

We also agree with the proposals on accounting for the expiration of options and the presentation of written put options and forward purchase contracts to purchase own equity that are gross physically settled.

However, we have a number of concerns and comments as detailed below.

Assessing "access to returns"

While we agree with using the concept of "access to returns" to determine the accounting for NCI, we disagree with the explanation of what 'access to returns' means and how it should be assessed. We recommend the IASB, at a minimum, align the wording to be consistent with that of paragraph B90 of IFRS 10.

The ED also appears to take a legalistic view of "access to returns". For example, paragraph BC75 indicates that this assessment would consider whether NCI retains rights to vote and rights to dividends, both of which would normally be retained by NCI until the obligations in the scope of paragraph 23 are settled and shares are bought. This is not consistent with how 'access to returns' is currently interpreted under IFRS 10, which uses a substance-based assessment of the economic returns (e.g. driven by whether the put/forward will economically be exercised and the sensitivity of the exercise price to variations in fair value). The substance-based assessment is aligned to how 'access to returns' is interpreted and applied in practice. We therefore recommend that the proposed amendments include clear guidance on the meaning of 'access to returns' and align the wording with IFRS 10.B90.

We note that the proposals do not explicitly require NCI to be derecognised if the parent has "access to returns" associated with ownership of the equity instruments. We believe an explicit requirement would be beneficial in preventing potential diversity in practice. As noted above, NCI does not always have "access to returns" by legally holding the shares and we believe therefore that the proposals should give equal weight to the accounting when the parent has "access to returns", even before the obligations in the scope of paragraph 23 are settled and shares are transferred.

We have encountered questions about modifications to the terms of a contract that contain an obligation to purchase an entity's own equity. We understand different views exist as to whether such modifications should be accounted for in the same way as a modification of a financial liability, or treated as an expiry of a contract without delivery and the recognition of a new financial liability. We recommend the IASB provide guidance in this regard.

It is also unclear whether the determination of which party has "access to returns" should be reassessed subsequent to initial recognition. If the IASB believes that reassessment is required, we would recommend it clarify whether and how to derecognise NCI, including in cases in which the parent subsequently obtains present access before NCI puts or forwards are settled. In such circumstances, the parent would have debited a component of equity other than NCI on initial recognition.

Removing the initial amount of the financial liability from equity

With respect to NCI puts and forwards, we had mixed views on the proposal to remove the amount from the parent's equity. Some agreed with the IASB's rationale as to why the proposal does not lead to 'double counting' whereas others were concerned that the proposals would understate the parent's claim against the subsidiary.

On balance, we support the IASB proposal in this regard. However, we observe that derecognition of NCI on initial recognition of the liability is the more prevalent practice in some jurisdictions and the proposals would require significant changes in practice. We believe a related transition relief and revising the current proposals on what constitutes "access to returns" would significantly help both transition and ongoing application of the proposed requirements (see our response to Question 9).

Measurement

We recommend the IASB provide further guidance on how to apply the measurement proposals, as they make it clear IFRS 9 does not apply to both initial and subsequent measurement. Additional clarifications would be important to promote consistent application on matters such as:

- whether a discount rate is set on initial recognition (similar to amortised cost measurement) or updated at each reporting date (similar to fair value measurement);
- how to determine the discount rate; and
- what constitutes 'gains or losses on remeasurement' (such as whether it includes changes due to modification or partial derecognition).

Other matters

Paragraph BC64 explains the rationale for expanding the scope of IAS 32.23 to contracts to purchase own equity that are settled in a variable number of own equity by referring to requirements applicable to non-derivative contracts (i.e. obligations to deliver a variable number of own equity instruments) whereas the contracts in the

scope of IAS 32.23 would in most cases be derivative contracts. We recommend the IASB provide a clarification.

Paragraph AG27D proposes that, if an obligation to purchase own equity instruments could be net settled (at the election of the issuer or the holder), derivative accounting would apply. We observe that this is inconsistent with Illustrative Examples 1 and 6 in IAS 32 (paragraphs IE6 and IE31). If the IASB were to finalise the proposals in their current form, those paragraphs should be revised.

Question 4—Contingent settlement provisions (paragraphs 11, 25, 25A, 31, 32A, AG28 and AG37 of IAS 32)
The IASB proposes to clarify that: (a) some financial instruments with contingent settlement provisions are compound financial instruments with liability and equity components (paragraphs 25 and 32A); (b) the initial and subsequent measurement of the financial liability (or liability component of a compound financial instrument) arising from a contingent settlement provision would not take into account the probability and estimated timing of occurrence or non-occurrence of the contingent event (paragraph 25A); (c) payments at the issuer's discretion are recognised in equity even if the equity component of a compound financial instrument has an initial carrying amount of zero (paragraphs 32A and AG37); (d) the term 'liquidation' refers to the process that begins after an entity has permanently ceased its operations (paragraph 11); and (e) the assessment of whether a contractual term is 'not genuine' in accordance with paragraph 25(a) of IAS 32 requires judgement based on the specific facts and circumstances and is not based solely on the probability or likelihood of the contingent event occurring (paragraph AG28). Paragraphs BC94–BC115 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

We broadly agree with the proposals, except for the measurement proposals for financial instruments with contingent settlement provisions.

Measurement

We acknowledge that the proposals would address current diversity in practice and are consistent with the rationale in BC12 of the current version of IAS 32. However, the

proposals are inconsistent with the general measurement requirements in IFRS 9. As concluded in the recent post-implementation review, we believe IFRS 9 measurement requirements provide more useful information to users of financial statements about the likelihood of redemption and information that is more comparable with other types of financial liabilities. Although settlement at the option of the holder and settlement contingent on an event outside the control of the issuer and the holder are both beyond the issuer's control, we do not think their measurement should be the same as the IASB has noted in BC100 of the ED. The value of an unconditional right for the holder to demand repayment at any time would be different from the value of a right to repayment only on the occurrence of a contingent event. Therefore, the price that would be paid to transfer a liability with a contingent settlement provision will be different from the price of a liability with a demand feature.

We understand from following the IASB discussions that the intention is that paragraph 25 would cover financial instruments that are classified as a financial liability (or a liability component) only as a result of a contingent settlement provision. These instruments would therefore be measured assuming the earliest possible settlement date. If, on the other hand, a financial instrument includes a contingent settlement provision that only changes the timing of settlement (i.e. the financial instrument would meet the definition of a financial liability without the contingent settlement feature), such an instrument is not in the scope of this paragraph, and would therefore be measured using the general requirements in IFRS 9. We question whether this difference in outcome is appropriate. Furthermore, it is unclear what the intended scope of paragraphs 25 and 25A is from reading the paragraphs as drafted.

We note that it is possible for the amount of the proceeds received, which would usually be the fair value at the time of issuance (considering the likelihood of the contingent event occurring), to be different from the amount the financial liability is recognised on initial recognition (which would ignore the likelihood of the contingent event occurring). In this circumstance, it is unclear how to account for the difference between these two amounts – whether they are recognised in profit or loss, or in equity, or treated as a day one gain or loss.

In addition, it is unclear what value it would provide to users of financial statements to reflect an arm's length transaction as if it were an uneconomic transaction. This would occur when, for example, an issuer receives CU100 for an instrument that is settleable for CU105 when a contingent event occurs. The proposals would require recognition of the financial liability at CU105, which would be uneconomic. We believe the liability should instead be recognised at CU100. Liquidity risk disclosures per IFRS 7 would provide the necessary additional information to the users in these circumstances.

It is also unclear how these proposals would interact with the embedded derivative requirements in IFRS 9; for example, whether they are mutually exclusive requirements or if they are not, whether a separated embedded derivative is required to be measured at fair value, taking into account the expected timing of settlement or based on the earliest settlement date.

Interaction with the IAS 1 amendments Non-current Liabilities with Covenants

It is unclear whether the proposed measurement guidance in paragraph 25A of IAS 32 would have any effect on the balance sheet classification of the liability as current or non-current. For an instrument that is classified as a financial liability because of a contingent settlement provision (e.g. a perpetual instrument with discretionary dividends that is redeemable when there is a change of control of the issuer), the proposals require measurement on the basis that settlement will occur at the earliest possible date. However, the instrument may be considered a loan arrangement in the scope of paragraph 72B of IAS 1, for which settlement depends on compliance with 'conditions' (also referred to as covenants) — the condition in this case being the occurrence of the contingent settlement event — i.e. change of control. Assuming the contingent settlement event has not occurred at the reporting date, the instrument is not otherwise due to be settled within 12 months of the reporting date. The issuer of the instrument would classify it as non-current.

While the IAS 1 classification conclusion in this circumstance appears to be clear under existing requirements (after 2022 IAS 1 amendments came into effect), questions have arisen as to whether the assumption used in measuring the liability under the proposals would affect classifying the liability as current or non-current. In order to ensure consistent interpretation of IAS 1, we recommend that the IASB address the interaction of the measurement requirements in paragraph 25A of IAS 32 with classification requirements under IAS 1 (e.g. in the Basis for Conclusions). We note that the IASB discussed this interaction in December 2021 (Agenda Paper 5A). However, the discussion was based on the proposed amendments to IAS 1 in Exposure Draft 2021/9, which included proposals relating to 'other conditional settlement terms'. The final IAS 1 amendments do not address such terms.

Other matters

Paragraph 25A states that the occurrence or non-occurrence of uncertain future events described in paragraph 25 are outside the issuer's control, while paragraph 25 applies only when such events are outside the control of both the issuer and the holder. Although we understand the point the IASB is making in paragraph 25A, it may cause confusion as to the scope of paragraphs 25 and 25A.

We also note that paragraph 31 specifically mentions paragraph 25A as an exception to the general measurement requirements in IFRS 9. We believe paragraph 23 is also an exception and should be referenced in paragraph 31.

Question 5—Shareholder discretion (paragraphs AG28A–AG28C of IAS 32)

The IASB proposes:

(a) to clarify that whether an entity has an unconditional right to avoid delivering cash or another financial asset (or otherwise to settle a financial instrument in such a way that it would be a financial liability) depends on the facts and circumstances in which shareholder discretion arises. Judgement is required to assess whether shareholder decisions are treated as entity decisions (paragraph AG28A).

(b) to describe the factors an entity is required to consider in making that assessment, namely whether:

  (i) a shareholder decision would be routine in nature—made in the ordinary course of the entity's business activities;

  (ii) a shareholder decision relates to an action that would be proposed or a transaction that would be initiated by the entity's management;

  (iii) different classes of shareholders would benefit differently from a shareholder decision; and

  (iv) the exercise of a shareholder decision-making right would enable a shareholder to require the entity to redeem (or pay a return on) its shares in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) (paragraph AG28A(a)–(d)).

(c) to provide guidance on applying those factors (paragraph AG28B).

Paragraphs BC116–BC125 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

We generally support the proposals and the addition of factors an entity is required to consider in making that assessment. However there would still be a significant level of judgement involved in the assessment.

To further reduce diversity in practice, we recommend the IASB provide examples illustrating how the proposed factors can be applied to some common fact patterns. One potential example would be an obligation that arises in the event of a change of control that is required to be approved by shareholders at its general meeting. This is a common fact pattern in practice and we observe that there are differing interpretations about the capacity in which the shareholders are acting when they vote on the change of control transaction at the general meeting.

Question 6— Reclassification of financial liabilities and equity instruments (paragraphs 32B–32D and AG35A of IAS 32)

The IASB proposes:

(a) to add a general requirement that prohibits the reclassification of a financial instrument after initial recognition, unless paragraph 16E of IAS 32 applies or the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement (paragraphs 32B–32C).

(b) to specify that if the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement, an entity would:

  (i) reclassify the instrument prospectively from the date when that change in circumstances occurred.

  (ii) measure a financial liability reclassified from equity at the fair value of that financial liability at the date of reclassification. Any difference between the carrying amount of the equity instrument and the fair value of the financial liability at the date of reclassification would be recognised in equity.

  (iii) measure an equity instrument reclassified from a financial liability at the carrying amount of the financial liability at the date of reclassification. No gain or loss would be recognised on reclassification (paragraph 32D).

(c) provide examples of changes in circumstances external to the contractual arrangement requiring reclassification (paragraph AG35A).

Paragraphs BC126–BC164 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Would the proposal to reclassify the instrument prospectively from the date when a change in circumstances occurred give rise to any practical difficulties? If so, please describe those practical difficulties and the circumstances in which they would arise.

We disagree with the proposals to prohibit reclassification in cases when an existing contractual term stops being effective with the passage of time. For example, assume an entity has issued two otherwise identical instruments except for a feature in one instrument (e.g. holder's put right) that makes it liability classified, while the other is equity classified. If the put expires unexercised, a prohibition from reclassification would result in having identical instruments classified differently as liabilities and equity in the statement of financial position. We believe reclassification in such circumstances would provide more useful information to users of financial statements about the extent and nature of obligations the entity has at the reporting date and should be required. We

believe the benefits would outweigh the costs. We believe reclassification would a far more effective tool than disclosure in communicating the change in the nature of the obligation contained in the instrument.

We also disagree with the rationale provided in paragraph BC143, that measurement of financial liabilities will be updated to reflect the change in the substance of the contractual arrangement. For example, consider a warrant issued where the exercise price becomes fixed such that it meets the fixed-for-fixed condition at a later point. Without reclassification, such a warrant would continue to be fair valued and changes in its fair value recognised in profit or loss, which does not reflect the substance that the warrant is now an equity instrument of the issuer.

We acknowledge the IASB's rationale in BC149, that the proposals are consistent with the principles on the reclassification of financial assets in IFRS 9. However, we consider the effects of reclassification between financial liabilities and equity to be different from those of reclassification between different measurement categories of financial assets. The former has a more prominent effect on the statement of financial position, has more significant measurement effects and often has more fundamental effects on the entity's key performance indicators.

Other matters

In addition, we recommend the IASB consider, adding guidance on how to assess and account for modifications made to equity or compound instruments. There is guidance in IFRS 9 on how to assess and account for substantial modifications made to financial liabilities and it is currently unclear what requirements to apply when modifications are made to equity or compound instruments (e.g. preferred shares or convertible debt instruments).

Question 7— Disclosure (paragraphs 1, 3, 12E, 17A, 20, 30A–30J and B5A–B5L of IFRS 7)
The IASB proposes: (a) to expand the objective of IFRS 7 to enable users of financial statements to understand how an entity is financed and what its ownership structure is, including potential dilution to the ownership structure from financial instruments issued at the reporting date (paragraph 1). (b) to delete the reference to derivatives that meet the definition of an equity instrument in IAS 32 from paragraph 3(a) of IFRS 7. (c) to move paragraphs 80A and 136A from IAS 1 to IFRS 7. These paragraphs set out requirements for disclosures relating to financial instruments classified as equity in accordance with paragraphs 16A–16B and/or paragraphs 16C–16D of IAS 32 (paragraphs 12E and 30I). The IASB also proposes to expand paragraph 80A to cover reclassifications if there are changes in the substance of the

contractual arrangement from a change in circumstances external to the contractual arrangement.

(d) to amend paragraph 20(a)(i) of IFRS 7 to require an entity to disclose gains or losses on financial liabilities containing contractual obligations to pay amounts based on the entity's performance or changes in its net assets, separately from gains or losses on other financial liabilities in each reporting period.

(e) to include disclosure requirements for compound financial instruments in IFRS 7 (paragraph 17A).

The IASB proposes to require an entity to disclose information about:

(a) the nature and priority of claims against the entity on liquidation arising from financial liabilities and equity instruments (paragraphs 30A–30B);

(b) the terms and conditions of financial instruments with both financial liability and equity characteristics (paragraphs 30C–30E and B5B–B5H);

(c) terms and conditions that become, or stop being, effective with the passage of time (paragraph 30F);

(d) the potential dilution of ordinary shares (paragraphs 30G–30H and B5I–B5L); and

(e) instruments that include obligations to purchase the entity's own equity instruments (paragraph 30J).

Paragraphs BC170–BC245 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with the proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

We generally support the proposed disclosures. However, we have some concerns about the following.

Priority on liquidation

We are concerned that disclosing priority for only some, but not all claims against the entity could be misleading (e.g. tax payables or liabilities relating to employee benefits). We believe it would be beneficial for users of financial statements to be made aware of the limitation of this disclosure. One of the ways may be to require entities to disclose limitations of the disclosure and if applicable, assumptions the entity made in providing the disclosure.

Also, it is unclear why the scope of the disclosure is financial liabilities in the scope of IAS 32. Given these disclosure requirements would be located in IFRS 7, application to instruments in the scope of IFRS 7 might be preferable.

Terms and conditions

For some disclosures, we question whether the benefits would outweigh the costs and are concerned about potential disclosure overload. For example, information about some 'equity-like' features in financial liabilities may already be provided by existing disclosures (such as liquidity disclosures under IFRS 7) or another disclosure proposed in this ED (such as payments that are directionally consistent with changes in the issuer's financial performance in IFRS 7.B5F(a)(i) and gains or losses on financial liabilities that include contractual obligations to pay amounts that vary with the issuing entity's performance or changes in its net assets in IFRS 7.20(a)(i)). We recommend the IASB consider the potential overlaps with existing disclosures and, between proposed disclosures, in assessing the costs and benefits of the proposed disclosures before finalising the amendments.

Net gains or loss on a certain type of financial liabilities

We are unclear about the applicability of proposed disclosure requirements in the ED. In IFRS 7.20(a)(i), which applies to financial assets or financial liabilities measured at fair value through profit or loss, the ED would require disclosure of net gains or net losses on financial liabilities that include contractual obligations to pay amounts that vary with the issuing entity's performance or changes in its net assets. BC183 states that "[…] such *financial liabilities would generally be measured at FVTPL, because (a) they are standalone derivatives, or (b) they contain an embedded derivative not closely related to the host and therefore separated, or (c) they are hybrid contracts designated at FVTPL because they contain an embedded derivative that would otherwise be separated."* However, based on our experience, such financial liabilities would generally not meet the definition of a derivative or contain an embedded derivative, because a feature related to an entity's own performance (EBITDA, profit, revenue etc.) would be considered as a non-financial variable specific to a party to the contract.

For those financial liabilities at amortised cost without separated embedded derivatives and for financial liabilities recognised per paragraph 23 of IAS 32, the proposed disclosure would not be applicable. We acknowledge the proposed disclosure in the Classification and Measurement Exposure Draft, but those proposals require different information with a different focus.

Furthermore, we note that some revisions will be made to those disclosures per the February 2024 IASB discussion. If the IASB's objective is to capture a broader set of financial liabilities and their remeasurement impact on the current period profit or loss, we recommend the IASB reconsider the scope of this proposal.

Question 8—Presentation of amounts attributable to ordinary shareholders (paragraphs 54, 81B and 107–108 of IAS 1)
The IASB proposes to amend IAS 1 to require an entity to provide additional information about amounts attributable to ordinary shareholders. The proposed amendments are that: (a) the statement of financial position shows issued share capital and reserves attributable to ordinary shareholders of the parent separately from issued share capital and reserves attributable to other owners of the parent (paragraph 54); (b) the statement of comprehensive income shows an allocation of profit or loss and other comprehensive income attributable to owners of the parent between ordinary shareholders and other owners of the parent (paragraph 81B); (c) the components of equity reconciled in the statement of changes in equity include each class of ordinary share capital and each class of other contributed equity (paragraph 108); and (d) dividend amounts relating to ordinary shareholders are presented separately from amounts relating to other owners of the entity (paragraph 107). Paragraphs BC246–BC256 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why. Would the proposed requirement to allocate issued share capital and reserves between ordinary shareholders and other owners of the parent give rise to any practical difficulties in determining the required amounts? If so, please describe the possible difficulties and specify areas in which further guidance would be helpful.

We generally support the proposals, but believe there may be significant challenges in attributing profit or loss and other comprehensive income, rather than total comprehensive income between ordinary shareholders and other owners of the parent. For example, there may be challenges in attributing amounts included in other comprehensive income such as foreign currency translation adjustments, hedging gains/losses, remeasurements of defined benefit liabilities/assets. In addition, for instruments that pay a fixed rate coupon at the discretion of the issuer, attribution of profit or loss in addition to other comprehensive income would not provide additional useful information.

We recommend the IASB consider requiring attribution of total comprehensive income (instead of profit or loss and other comprehensive income) as it is possible that the latter would achieve the IASB's objective of providing transparent information of returns

attributable to ordinary shareholders vs other owners, while alleviating the cost-benefit concerns.

Furthermore, we believe it would be necessary for the IASB to provide guidance on how to attribute amounts between ordinary shareholders and other owners of the parent. For example, for instruments that pay a fixed rate coupon but the issuer has the right to defer payment until its liquidation and the undeclared amounts accumulate, a clarification would be helpful as to whether profit or loss and comprehensive income should be attributed to other owners of equity only when dividends/coupons are declared, or whether any undeclared amounts are required to be accumulated and attributed.

We also have a number of comments relating to the clarity of the proposed amendments as outlined below.

Statement of financial position

The proposed illustrative statement of financial position in IG6A Part 1, presents a line item for the total of “Equity attributable to other owners of the parent”, whereas proposed IAS 1.54(r)(ii) seems to require presentation of 'issued capital' and 'reserves' attributable to other owners of the parent separately. We recommend that the presentation requirements and the illustrative presentation of the requirements be aligned.

Statement of changes in equity

It is unclear why there are no proposed conforming amendments to paragraph 106(a) of IAS 1. We recommend the IASB make amendments consistent with those proposed for paragraphs 54(r) and 81B, or explain why conforming amendments are not required.

Information to be presented in the statement of changes in equity or in the notes

We expect that the intention is that dividends disclosed in accordance with IAS 1.107 are disclosed separately for ordinary shareholders and other owners respectively — i.e. not as a single total amount. However, this is not entirely clear from the proposed amendments to this paragraph. We recommend that the requirements are clarified so that the intention is clear. If our understanding is correct, the following edit may help to clarify the requirement.

> “An entity…the amount<u>s</u> of dividends recognised as distributions to ordinary shareholders and to other owners during the period…”

IAS 33 Earnings per Share

We note that the ED does not propose to amend IAS 33 and we question whether some consequential amendments may be necessary. Some examples are highlighted below.

- Terminology used in IAS 33 – the existing language in IAS 33 is limited in its reference to ‘preference shares’ and could benefit from being broadened given the proposed changes to IAS 1 to distinguish between ordinary shareholders and other

owners of the parent. For example, IAS 33.12 could benefit from some indication that the requirements expressed in relation to 'preference shares' apply equally to other equity-classified instruments with preferential rights to distributions over those held by ordinary equity holders of the parent. In addition, we note that "profit or loss attributable to ordinary shareholders of the parent" (IAS 1.81B(a)(i)) and "profit or loss attributable to ordinary equity holders of the parent entity (the numerator)" (IAS 33.10) are very similar terms. Since a focus of the proposed amendments is to improve the information provided about equity instruments, it would be helpful if terms were aligned where appropriate or differences explained.

- Clarity of "earnings per share" description/label used in the statement of profit or loss — the proposed illustrative statement of profit or loss and comprehensive income in paragraph IG6A Part 1, presents profit (and total comprehensive income) attributable to ordinary shareholders and other owners of the parent, as well as 'earnings per share'. We understand that 'earnings per share' is presented based on the existing requirements of IAS 33.66. However, it may be unclear to users of the financial statements that the "earnings per share" amount relates only to ordinary shareholders and not to other owners when read in conjunction with the attribution proposed in this ED.

Terminology used in IAS 1

IAS 1 uses different terms to describe equity balances that appear to be similar in nature. For example, IAS 1 includes various references to "issued capital", "issued share capital", "paid-in capital", "equity capital" and "contributed equity", but does not provide definitions for these terms. Since a focus of the proposed amendments is to improve the information provided about equity instruments, it would be helpful if terms were aligned where appropriate or differences explained.

Please note that in our responses to Question 8, all comments that relate to IAS 1 apply equally to forthcoming IFRS 18.

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.

We generally agree with the transition proposals, but we would recommend additional transition reliefs. These additional transition reliefs are intended to be limited and targeted in effect, and would help alleviate the costs of transition without compromising information provided to users of the financial statements. These would exempt entities from:

(a) reversing a prior reclassification for a change in the effective term of a contract;

(b) restating business combinations that occurred in prior periods involving NCI puts/forwards;

(c) applying the requirements retrospectively to financial instruments that do not exist (i.e. have been derecognised) at the time of initial application of the amendments, similar to the approach taken in other recent IFRS Accounting Standards;

(d) reclassifying financial assets — e.g. from reclassifying investments in equity instruments when the entity had applied the OCI presentation election but the

instrument would not meet the definition of an equity instrument under the amendments; and

(e) full retrospective application of the requirements when hedge accounting has been applied, including exemption from reversing the effects of hedge accounting should the amendments lead to previously applied hedge accounting no longer qualifying or effective.

For example, for compound instruments that had been accounted for entirely as financial liabilities (with a zero value equity component) and whose foreign exchange or interest rate risk had been hedged, if interest payment is recognised in equity after transition, retrospective application would give rise to open derivatives with fair value changes that would impact profit or loss, thereby causing accounting mismatches. This situation would not result in useful information provided to the users of financial statements. We believe the concern would be alleviated if the impact on de-designation could be recognised in the opening retained earnings on transition, instead of being required to restate comparative periods.

Question 10—Disclosure requirements for eligible subsidiaries (paragraphs 54, 61A–61E and 124 of [IFRS XX])
The IASB proposes amendments to the draft Accounting Standard [IFRS XX *Subsidiaries without Public Accountability: Disclosures*], which will be issued before the proposals in the Exposure Draft are finalised. [IFRS XX] will permit eligible subsidiaries to apply the recognition, measurement and presentation requirements in IFRS Accounting Standards with reduced disclosures. The IASB's proposals select appropriate disclosure requirements from those proposed for IFRS 7, based on the IASB's agreed principles for reducing disclosures. Paragraphs BC257–BC261 explain the IASB's rationale for the selected disclosures. Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why, taking into consideration the reduced disclosure principles described in BC258.

We generally agree with the proposals to permit eligible subsidiaries to apply reduced disclosure requirements as proposed.

We recommend the IASB require eligible subsidiaries to make the disclosure set out in paragraph 12E of IFRS 7. Although the reclassification discussed in this paragraph might be expected to occur infrequently, we believe it would be important for financial statement users to understand the effects if it occurs.