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INVESTOR IN PEOPLE

International Financial Reporting Standards Interpretations Committee
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28 March 2024

Dear IASB members,

Exposure Draft ED/2023/5 Financial Instruments with Characteristics of Equity - Proposed amendments to IAS 32, IFRS 7 and IAS 1

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on the International Accounting Standards Board's (IASB or the Board) Exposure Draft ED/2023/5 Financial Instruments with Characteristics of Equity – Proposed amendments to IAS 32, IFRS 7 and IAS 1.

We support the Board's approach of addressing known practice issues rather than revising the underlying concepts of IAS 32 *Financial Instruments: Presentation*. We consider that IAS 32 generally works well and classifies financial instruments in a way that provides information in the financial statements that is relevant, reliable and useful to users. Performing a fundamental review of IAS 32 is, therefore, not necessary and would also be time consuming, which would delay the resolution of the known practice issues.

We consider that many of the proposed amendments provide helpful clarification in areas where there is currently inconsistent treatment between entities. With respect to other elements of the proposals, we have some observations which are summarised below:

- We are concerned that the proposals for laws and regulations present various difficulties in application, and it would be beneficial if they could be addressed in the final amendments. We suggest that if it is not possible to resolve the challenges identified in our detailed feedback, the IASB may wish to consider withdrawing these proposals and maintaining the status-quo.
- We highlight some concerns with the proposals for obligations to purchase non-controlling interests. These relate to consistency with existing guidance in IAS 32, interaction with IFRS 10 and the counterintuitive accounting which can result in some common scenarios.
- For the proposals on the measurement of obligations to purchase own equity and contingent settlement obligations, we identify some broad concerns. In addition to suggesting how the proposals may be improved, we note the IASB may wish to withdraw them and address measurement issues as part of the amortised cost measurement project.

- For reclassifications, we query whether the proposals would result in an improvement to financial reporting. We suggest that there may be instances when reclassification is appropriate, and the amendments should accommodate this possibility.
- We broadly support the proposed expansion of the related disclosure requirements.

A summary of our response to the questions are set out in the Appendix to this letter. Should you wish to discuss the contents of this letter with us, please contact Michiel van der Lof at the above address, or on +44 (0)20 7951 3152.

Yours faithfully

Ernst + Young Global Limited

<u>Appendix – Detailed responses to specific questions</u>

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

<u>Overall observations</u>

1. We understand the intention of the proposed amendments, which is to provide clarification in an area where there are some differences in practice.
2. The proposed amendments introduce some new areas of judgement in applying the guidance to assess laws and regulations that would benefit from further clarification in the final amendments. We have some concerns regarding paragraph 15A, the potential consequences of the amendments and how they will apply in practice in certain instances. In summary, we consider that additional guidance and examples are needed to clarify:
   i) Whether the decision to issue an instrument which is subject to a legal or regulatory feature makes those features contractual, and should therefore be considered for the purpose of classification; and
   ii) How to differentiate additional contractual features which should be analysed in isolation for the purpose of the classification assessment, versus those which cannot be disaggregated from the legal terms and should therefore be ignored.
3. The examples below attempt to identify the areas where we consider that further clarification is needed.
4. We recognise the complexities involved and consider that it may be very difficult for the IASB to address the points we raise in a way that allows for consistent application of the guidance for laws and regulations across different jurisdictions and entities. We note that there is a risk that solving problems in some areas will simply create new problems in others. We, therefore, encourage the IASB to potentially consider withdrawing the proposed amendments for laws and regulations, on the grounds that maintaining the status quo may be preferable to creating new areas of uncertainty and complexity.

<u>Application examples</u>

5. For example, in France, for the Livret A savings products, all the terms and conditions are set by law and carry across an interest rate which is set by decree on a periodic basis. There are no other

contractual add-ons other than to identify the depositor, the amount deposited and when they make deposits (up to the maximum amount set by law). One reading of the proposals in paragraph AG24B could result in the payment of interest not being considered a liability of the entity because all the terms of the product are set by laws or regulations. If so, the payment of statutory interest would be treated as an equity distribution, which seems counterintuitive. An alternative reading could be that because an individual depositor has to sign-up for the Livret A product, for which the interest and redemption amounts are determined by the amount and timing of the deposits made, this creates contractual terms in addition to laws or regulations, resulting in classification as a financial liability. We suggest the IASB include the Livret A as an example to illustrate the application of these proposals.

6. Another example relates to the application of paragraph 15A(a) to instruments such as AT1s and how the phrase,'… are in addition to …' should be understood and applied. For these instruments the coupon payments are often discretionary and the loss absorption feature, if triggered, results in the exchange of the instrument for own shares (for some AT1s the number of shares exchanged is variable and for others it is fixed). In some jurisdictions, prudential regulation requires that the coupon payments are at the discretion of the issuer. If the loss absorption feature is a contractual term, applying the amendments, it could be interpreted that the coupon's discretionary characteristic should be ignored for the purpose of classification. This would result in AT1s with mandatorily discretionary coupons that are exchanged into a variable number of shares being classified entirely as a financial liability. An alternative reading of the amendments could be that the regulatory discretionary characteristic would still lead to the identification of an equity component (even if not contractual) or that, in choosing to set the discretionary coupon at a particular level, it becomes more specific than the general requirement set by prudential regulation and applying the principle in AG24B, the discretionary coupon would be contractual. Therefore, the discretionary coupon would be classified as an equity component. We suggest that in clarifying what is meant by 'are in addition to' in paragraph 15A(a), an example such as that described here would be helpful.

7. Another example arises in relation to those Canadian banks that have issued preferred shares with a pre-determined contractual conversion formula that converts to a variable number of ordinary shares in the contingent event of the issuer becoming non-viable (i.e., equivalent to bail-in events). These instruments may have contractual terms that are added (such as a cap on the maximum number of shares a preferred share would convert into) to comply with the principle-based guidance published by the bank's prudential regulator, to obtain a specific capital treatment for those instruments. They raise three different questions in relation to whether contractual terms are 'in addition to' under paragraph 15A. It would be helpful to clarify whether:

    (i) The laws and regulations referred to in the amendments include regulatory guidance issued by a prudential regulator.

    (ii) For a regulatory feature in the scope of 15A, the bank's decision to issue an instrument which includes such regulatory feature is considered as a contractual obligation 'in addition to' laws or regulations, that needs to be combined with the regulatory feature and analysed in its entirety in classifying that obligation.

    (iii) Setting a pre-determined conversion formula that is included in the final terms of the instrument to comply with principle-based laws or regulations, is considered a contractual feature 'in addition to' laws or regulations that needs to be combined with the obligation created by laws or regulations and analysed in its entirety in classifying that obligation.

8. We recommend that the assessment of whether a contractual right or obligation is in addition to laws or regulations should be made in the context of the specific laws or regulations that govern

the particular type of instrument issued. Setting precise contractual terms to comply with principle-based laws or regulations should not be considered in addition to laws or regulations, provided those contractual terms are not contrary to the principle-based laws or regulations.

Interaction between paragraphs 15A(a) and 15A(b)

9. We observe that the interaction between paragraph 15A(a) and 15A(b) is not clear, as the requirements seem to be overlapping. Paragraph BC29 explains the overall rationale for paragraph 15A but not for the separate requirements in 15A(a) and 15A(b). We note that the second part of paragraph 15A(a) describes that only contractual terms that are in addition to laws or regulations should be considered, whilst 15A(b) excludes from the assessment those rights or regulations that would arise regardless, i.e., the paragraphs appear to state the same requirement expressed from a different perspective, which may not be necessary. We suggest that 15A(b) may not be required, or if the IASB consider that it is, the reason for it should be explained.

Mandatory Tender Offers

10. In many jurisdictions it is a legal requirement that once an investor owns more than a certain percentage of the shares of an entity (often 30%), a Mandatory Tender Offer (MTO) must be made to other shareholders to purchase the remaining shares. A question that arises is the timing for when a financial liability should be recognised as a result of an MTO.

11. We suggest that it is not when the legal requirement to make an MTO is initially triggered. Recognition of a financial liability would be required once the formal offer has been issued, which describes the timing, price and other contractual details, creating a financial instrument, e.g., a written put option. As the MTO requirement exists in most jurisdictions, it would be helpful if the amendments could provide clarification in this area.

Minimum statutory dividends

12. An aspect of the proposals which is not clear, is the accounting entries required when a statutory minimum dividend is paid. If the payment made is only that which is required by law, should a liability for the dividend payable be recognised when the shareholders declare a dividend or is a liability never recognised (because the declaration does not create a new obligation so the original classification continues) and the accounting entries are booked only on the payment of the dividend? It would be helpful if this point could be clarified.

Interaction between IAS 37 and IAS 32

13. In many jurisdictions, there are legal entities, often unit trusts, that are required by law to allow investors to redeem their units at the share of the net asset value of the entity. Under existing IAS 32 these units are often classified as debt instruments.

14. Applying the proposed amendments, which require the legal redemption clause to be ignored, would appear to result in them being classified as equity. Whilst for the purpose of classification there may not be a contractual obligation, we recognise that there may still be a legal obligation that needs to be recognised, potentially under IAS 37.

15. It would be helpful if, for these common types of structure and in general, the IASB could clarify, through an example, whether a liability is recognised applying IAS 37 and the interaction with the recognition of an equity component under IAS 32.

Understanding all applicable laws and regulations

16. Under the proposals, entities will be required to have a detailed understanding of all the laws and regulations to judge what contractual terms of a financial instrument are in addition to, and what are just repeating the laws and regulations.

17. Generally, we understand that, historically, the working assumption has been that if a term has not been stated in a contract, then it is not considered for the purpose of determining classification. We suggest that under the proposals, entities should not be expected to have performed an in-depth analysis of the articulation between the laws and regulations applicable to their financial instruments, but that they are required to make a 'reasonable' effort.

Application of laws and regulations for measurement purposes

18. The proposals with respect to laws and regulations most directly relate to classification, as described in paragraph 15A. Whilst it is clear that laws and regulations are not considered for the purposes of classification, it is not entirely clear from the proposals if they should also be excluded for measurement purposes. We suggest that this is clarified in the final amendments.

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.**

19. We support the proposed clarifications, which are largely consistent with developed practice and provide a more robust framework to support it. We have some questions and requests for where further clarification is provided, as discussed below:

<u>Preservation adjustments</u>

20. For the proposed guidance on preservation adjustments, we note the wording in paragraph 22C(a)(ii), which states that the adjustment preserves the economic interests of the future holders of the entity's own equity instruments to an equal or lesser extent, relative to the economic interests of the 'current equity instrument holders'. Further guidance is provided in paragraph AG27A(c). If the preservation adjustment takes into consideration shares issued by the entity at a discount to new shareholders only (as opposed to current shareholders), with a similar compensation not being applied to current shareholders, this would fail the fixed-for-fixed test.

21. This type of preservation adjustment is reasonably common practice in certain Asia Pacific markets for holders of convertible debt, to protect their interests from dilution due to equity being issued at a discount to new shareholders, which are not 'current' shareholders at the time of the issuance of the convertible debt. Under the proposals, it is our understanding that this type of

preservation adjustment would not satisfy the fixed-for-fixed requirement. It would be helpful if this example were used in the basis for conclusions to explain the focus on 'current' shareholders and the IASB's rationale for it.

Passage of time adjustments

22. We note that the requirement in paragraph 22C(b)(iii) that for a passage of time adjustment, the compensation is proportional, is a new concept for IAS 32. Whilst we understand that entities will need to apply judgement when assessing whether any change in compensation is proportional, there are some aspects which are not clear. For example, if there is only one adjustment to the amount of consideration exchanged for an equity instrument, it is not clear from the proposals whether there needs to be alignment between the time and rate of increase, at the time of the issue. Similarly, if there is more than one increase, it is not clear if they only need to be proportional to each other (even if large). BC54(c) seems to indicate that an increase could still be proportional even if it is very large. It states that the passage of time adjustment is to be analysed using a present value calculation, but that this assessment is not intended to assess whether there is compensation for the time value of money and is not related to any effective interest rate calculation. The articulation between 'using a present value calculation' and 'not related to any effective interest rate calculation' could be better explained. We suggest that more of the discussion from the April 2020 staff paper 5B covering the adjustment principle could be included. Paragraph 20(b) and footnote 5 is relevant:

> '…the quantum of the adjustment would need to be analysed further as to whether the adjustments over time are done in a proportionate manner to represent compensation for passage of time [5]… it would not question the reasonableness of the discount rate used, or the 'fairness' of the changes in the exchange ratio for different settlement dates …. [5] The staff acknowledge that the adjustment may not necessarily result in a fixed increment for a given period of interval between exercise dates.'

23. We suggest that the inclusion of some additional application guidance or examples to explain further what is meant by proportional, in particular, that a single discount rate should be used but the entity would not be required to assess whether it is reasonable, would be helpful.

Exchange ratio

24. Another area where further clarification would be beneficial, is with respect to the fixed for fixed test where an exchange ratio is applied and assessing whether the passage of time criteria is met. Implementation Guidance Example 14 provides an illustration for when the exchange ratio remains fixed, but the amount outstanding changes in line with an interest rate, and whether the issuer decides to add unpaid coupons to the principal amount, such that the fixed for fixed test is passed.

25. It would be helpful if it could be made clearer that the fixed-for-fixed test could also be met if the amount outstanding were linked to changes in a floating benchmark interest rate or relevant floating inflation index, which is unleveraged. As currently drafted Example 14 is not clear whether this is the case. By comparison, in Example 20, changes in an interest rate or an inflation index vary the strike price, with the result that the exchange ratio is not constant so the fixed for fixed test is not met. It would be helpful if this distinction is highlighted.

Foreign currency denominated AT1s

26. For foreign currency denominated AT1s, issued by banks, applying the wording in paragraph 16(b)(i) would appear to allow such instruments to be classified as equity because the non-derivative liability includes no contractual obligation for the issuer to deliver a variable number of

its own equity instruments. However, a question has arisen because the wording in BC42 (which relates most directly to derivatives) could be understood as indicating such instruments would not satisfy fixed for fixed, as '…the amount of cash … an entity would exchange on settlement is not fixed in its functional currency…'. It would be helpful if it could be made clear in the main body of the final standard that for non-derivatives, this does not apply.

Definition of fixed amount

27. For the proposed changes to paragraph 16(b)(ii), we note that additional wording has been added to clarify that 'a fixed amount' of another financial asset or financial liability is exchanged. It would be helpful if it could be explained why 'a fixed amount' has been added and in what respect it is fixed, e.g., fair value, carrying value, nominal value or something else, as this is not presently clear. We presume this means 'fixed amount outstanding' as indicated by example 14 (which refers to 'amount outstanding'), but to avoid confusion this should be clarified either in paragraph 16(b)(ii) or in the application guidance. The explanation should not be just in the basis for conclusions since the term is fundamental to applying the fixed-for-fixed test.

Functional currency

28. Paragraph AG29B proposes that to satisfy the fixed for fixed test, the amount of consideration to be exchanged must be in the functional currency of the entity within the group whose instruments will be delivered on settlement. In some instances, the functional currency of the group entity that is a party to the contract may be the more relevant consideration. For example, the proposals would result in the combination of two equity instruments resulting in a derivative, as follows:

- Scenario 1: Parent (with € functional currency) enters into a contract with a third party that allows the third party to receive either a fixed number of parent's shares or a fixed number of subsidiary's shares (£ functional currency) in exchange for €10. As € is not the functional currency of the subsidiary whose instruments will be delivered on settlement, the instrument is not an equity instrument.
- Scenario 2: Parent (with € functional currency) enters into two contracts with the same third party that would allow the third party:
    - Contract 1: to receive a fixed number of parent's shares in exchange for €10
    - Contract 2: To exchange a fixed number of parent's shares for a fixed number of subsidiary's shares (£ functional currency).

29. In scenario 2, both contracts considered separately would be equity instruments under the amendments, while their combined economic effect is equivalent to scenario 1. This illustrates a scenario where it may be more relevant to consider the functional currency of the group entity that is a party to the contract with the third party, rather than the entity whose equity instruments will be delivered on settlement.

30. Whilst BC44 describes the decision reached by the IASB, it does not explain their rationale. We are concerned that the example above, which shows a combination of transactions within a group, illustrates an accounting outcome that may be inconsistent with why the board reached its decision on this topic. We suggest the IASB may have intended that exposure to exchange rate fluctuations would fail fixed-for-fixed (as indicated by the discussion in BC42), in which case, the functional

currency of the entity that will receive the consideration from a third party should provide the functional currency against which the fixed-for-fixed test is assessed.

31. We suggest that the IASB considers if the outcome as illustrated in the example above is consistent with its intention. Our view is that these scenarios indicate an example of when the fixed-for-fixed test should be passed. It would also be helpful if the IASB's rationale could be further explained in the final amendments.

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**

32. We note that the proposal for the initial and subsequent measurement of the financial liability for the obligation to repurchase an entity's own equity instruments appears to extend the changes beyond the original scope of the FICE project. This is the proposal that the initial and subsequent measurement of financial liabilities arising from an obligation for an entity to purchase its own equity instruments should reflect the earliest possible redemption date, ignoring the probability and estimated timing of the counterparty exercising its right to redeem.

Measurement of redemption liability

33. We are concerned that the proposal will not provide useful information in some instances. This could be the case, for example, if a liability is measured at an amount at which it is very unlikely to be redeemed by the holder, including where this amount is below that at which it is likely to be redeemed. This could present a structuring opportunity, where the earliest possible redemption date reflects a value which is different to the value at a later date, when redemption is most likely. In this scenario, the difference at initial recognition between the value of the liability and the fair value of any consideration received by the entity for entering into the obligation, would potentially be deducted from equity and then a gain would be recognised on remeasurement. Whilst we are concerned by this possible outcome, we also note that it is not clear whether this would be the accounting required (e.g., the initial debit could plausibly be taken to profit and loss instead) and suggest that the final amendments should clarify the treatment of losses that arise on initial recognition of a redemption option.

34. Another example where the proposals are not clear is if the redemption value applies a multiple of EBITDA. This is often used to price the purchase of a non-controlling interest following a business combination. It is not clear whether the measurement of the redemption value which is due to take place at a fixed future point in time, should reflect the current EBITDA, the future forecast EBITDA or some other measure. We suggest that the amendments provide an excellent opportunity for the IASB to clarify the treatment in this area, where there is presently variation in current practice.

Put options over non-controlling interests

35. Many entities that have written put options over non-controlling interests (NCI), will be affected by the proposals, as there is presently diversity in practice in the accounting applied. Whilst we support the efforts of the IASB to bring greater consistency in this area, we are aware of some significant concerns with the proposals, which we suggest the IASB considers further.

36. The proposed approach described in paragraph 23 and AG27B gives rise to the concern by some that it results in the double counting of the claims that puttable NCI have on the group net assets (as discussed in BC77). It also conflicts with the existing requirements of IAS 32, explained in IAS 32.BC11, which state that the obligation for an entity to repurchase its own shares gives rise to a maturity date of the contract and to the extent of the obligation '… those shares cease to be equity instruments when the entity assumes the obligation.' This is also described in paragraph AG29, which states in the context of obligations such as puttable NCI that, 'To the extent that there is such an obligation or settlement provision, the instrument (or component of it that is subject to the obligation) is classified as a financial liability in consolidated financial statements', even when, '… the subsidiary may appropriately classify the instrument without regard to these additional terms'. This strongly suggests that a subsidiary's shares appropriately classified as equity in the subsidiary's individual financial statements might need to be classified as liabilities in consolidated financial statements to the extent of the group's obligation to redeem those shares.

37. Under IFRS 10, a non-controlling interest is defined as 'Equity in a subsidiary not attributable, directly or indirectly, to a parent.' If, under IAS 32.AG29 puttable shares held by NCI cease to be equity instruments to the extent of an obligation to purchase the shares, it would seem consistent with IFRS 10 for the NCI to be recognised only if they have a residual interest in equity beyond that obligation. The IASB considered these concerns as described in BC77 of

the amendments and noted the view that the NCI holders '... are either entitled to their proportion of the equity held or their right to sell their interest back to the entity, but not both.'

38. The reasons why the IASB disagree with this are described in BC78 of the amendments. However, each of the reasons provided can be challenged on the basis that those who support debiting NCI do not consider that NCI claims have been extinguished. Rather they view that the NCI is *presented* as a financial liability instead of equity, *to the extent of the obligation to redeem the NCI*. They also believe that if NCI have financial interests beyond their right to cash, these rights should also be reflected separately. This is similar to the accounting for a convertible bond; convertible bond holders are either entitled to cash or to shares. The equity component reflects that to be entitled to shares, bondholders will have to forfeit their right to cash. Similarly, NCI residual interest (if any) should take into account that for the underlying shares to regain their full equity status, NCI holders need to forfeit their right to redemption.

39. Inherent in these concerns it appears that two separate units of account are recognised for NCI simultaneously. The shares continue to be recognised as NCI if the entity does not yet have access to the rights and returns associated with ownership of the equity instruments. At the same time a liability is recognised for the NCI put option.

40. Under this approach, some reasonably common scenarios give rise to what may be considered as anomalous financial reporting. For example, for an NCI put option where the shares are puttable at their fair value, the liability is measured at the fair value of the NCI and a share of net assets and profit and loss continues to be allocated to NCI. When dividends are paid, the dividend would first reduce NCI and because the liability reflects in the fair value the rights to future dividends, then all else being equal, the liability would be remeasured to a lower fair value, leading to the recognition of a profit. We question whether this provides useful information.

41. We also note that in the proposed approach, since the NCI in effect reflects unpaid dividends, it seems to conflict with paragraph AG37, which says in the context of a compound instrument '... if any unpaid dividends are added to the redemption amount, the entire instrument is a liability. In such case, any dividends are classified as interest expense'.

42. For NCI that is puttable at fair value, whether there should remain an equity component is questionable as described above, since as the NCI holder has no residual interest in the equity of the subsidiary beyond the amount recognised as a financial liability, it is unclear why NCI should be allocated a share of net assets, a share of profit and loss and a share of changes in equity. In other situations, such as when there is a put option with a fixed exercise price or formula-based price, it may be appropriate to recognise a share of net assets, a share of profit and loss and a share of changes in equity for the residual interest. However, IFRS 10 does not provide any guidance to address the question of whether or how such an allocation should be made.

43. We also note that put options over NCI often arise in the context of business combinations such that IFRS 3 is relevant. Where this applies, it would be helpful if the IASB could clarify whether puttable NCI can be initially recognised at the proportionate share of net assets before the effect of the put option is recognised, rather than at fair value, which would indirectly have the effect of writing off a portion of goodwill (which relates to the NCI) against consolidated equity.

44. Whilst the basis for conclusions of the amendments recognises the conceptual challenges associated with the proposed approach and some of the points noted above, we encourage

the IASB to give further consideration to whether it is, on balance, the best way to improve the existing requirements. One avenue the IASB may wish to consider is to include the accounting for NCI puts as part of a wider project, considering potential changes to other standards (including IFRS 3 and IFRS 10) and amending them at the same time that this area of IAS 32 is amended.

<u>Uncertainty over when to recognise a redemption liability</u>

45. An area in which we observe diversity in practice that has not been discussed in the proposed amendments, relates to how to determine the existence of a financial liability when the issuer has discretion not to purchase or redeem NCI, but using that discretion will result in a loss of control of the subsidiary.

46. We describe four scenarios below that illustrate these concerns when a loss of control can arise which raises questions for how to assess the existence of a financial liability. In the examples below, Company X is the reporting entity:

- Scenario 1: Company X has a 40% interest in entity A and a call option over the remaining 60% interest. The call option contains potential voting rights and allows Company X to conclude that it controls entity A. There is no put option. The call option is not deeply in the money.

  This scenario is not contentious since as Company X has a call option, there is no liability. Moreover, based on IFRS 10.B89, the proportion of profit and loss and changes in equity allocated to the parent / NCI does not reflect the possible exercise of the call option.

- Scenario 2: Company X and Investor 2 each own 50% of entity A. Company X and Investor 2 have a shareholder agreement whereby decisions that relate to relevant activities require consent of both parties. However, should Company X and Investor 2 disagree and a deadlock situation occur, Company X would be able to take the final decision which would trigger the possibility for Investor 2 to put their shares to Company X (referred to as a 'deadlock put option'). Company X concludes that the deadlock mechanism allows Company X to control entity A and it, therefore, consolidates entity A.

  The analysis for this scenario is more contentious than scenario 1 (although they may seem very similar), since Company X controls entity A through its casting vote. However, using that power could trigger the obligation to purchase the NCI (i.e., Investor 2). In both scenarios 1 and 2, using the discretion not to redeem NCI implies for the controlling investor (Company X) that it forfeits its right to use its power.

In some circumstances, an entity may lose control of strategic assets if it does not redeem an instrument (e.g., losing control of a structured entity holding these assets). Scenarios 3 and 4 illustrate why it would be helpful to clarify those instances when it may be appropriate to allow NCI to be classified as equity holders.

- Scenario 3: Company X has a portfolio of owner-occupied properties (or other strategic assets) that are transferred into a newco fully owned by Company X. Newco enters into lease agreements (fixed lease payments) with sister companies that use the properties for their operations. The lease term is 5 years. Newco then issues shares to Investor B so that B has a 20% interest in Newco. Company X has a call option with a 5-year term over the shares issued to Investor B. If the call has not been exercised after the end of a 5-year period, Investor B can find a new investor and if Investor B finds a potential acquirer for its 20% holding that is willing to purchase the shares for an amount that cannot be lower than the exercise price of the call option, Company X may be obliged to sell its 80% based on the same price per share.

Currently, applying IAS 32 to this scenario, Company X would not be required to recognise a financial liability as it has the ability to avoid a cash outflow.

- Scenario 4: Company X has a portfolio of owner-occupied properties or other strategic assets that are transferred in a newco fully owned by Company X. Newco enters into lease agreements (fixed lease payments) with sister companies that use the properties for their operations. Lease term is 5 years. Newco issues shares to Investor B so that Investor B has a 20% interest in newco. Company X has a call option with a 5-year term over the shares issued to Investor B. If the call has not been exercised after the end of a 5-year period, Investor B can require Company X to sell the properties held by Newco (provided the selling price is not below fair value as determined by an independent expert) and then liquidate newco so that Company X and Investor B will each receive their share of the proceeds.

  Similar to scenario 3, Company X would not be required to recognise a financial liability as it has the ability to avoid a cash outflow.

47. We suggest the scenarios above illustrate why the IASB should use the opportunity presented by the FICE project to address the questions on the existence of a financial liability when the issuer of shares has discretion not to purchase or redeem NCI but using that discretion will result in a loss of control of a subsidiary or strategic assets. This could include discussion of how the principles described in IAS 32 paragraph 20 apply for NCI when an obligation may exist even when a financial instrument does not explicitly establish a contractual obligation for an entity to deliver cash or another financial asset.

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.

Overall observations

48. We note the proposed measurement approach for financial liabilities with contingent settlement provisions is consistent with the measurement of obligations to purchase own equity instruments. In particular, the requirement that the initial and subsequent measurement should reflect the earliest possible redemption date, ignoring the probability and estimated timing of the counterparty exercising its right to redeem. We make similar observations on this measurement approach as those described in our response to question 3 above, that for initial and subsequent measurement the timing and likelihood of the contingent event occurring may not result in improved financial reporting in certain instances.

49. We offer some suggestions for how the proposed amendments could potentially be improved. We also note that the IASB may wish to withdraw the proposals for the measurement of contingent settlement provisions and address measurement as part of its project on amortised cost measurement, which is currently in the IASB's research project pipeline.

Scope of proposed amendments for contingent settlement provisions

50. We understand that paragraph 25A is intended to only apply to compound financial instruments that include a financial liability component due to a contingent settlement provision. This includes compound financial instruments that are classified as financial liabilities in their entity. Therefore, paragraph 25A does not apply to other financial liabilities that contain contingent settlement provisions, which continue to be accounted for under IFRS 9.

51. We suggest that the scope of paragraph 25A could be clarified, since it has the potential to be interpreted to have wider relevance, including to any financial liability with a contingent settlement provision. The explanation provided in BC106 to BC109 could identify this point more clearly. In addition, the scope of IFRS 9 should be amended to identify that any financial liabilities (or financial liability components) within the scope of IAS 32 paragraphs 23, 25A, 31 and 32A are outside the scope of IFRS 9 for initial and subsequent measurement.

Application to similar instruments

52. We are concerned that a different accounting treatment could result for different instruments which are economically very similar. For example, if an entity issued what could be referred to as straight debt with covenants, IFRS 9 would be applied. The amortised cost measurement would reflect the likelihood of the covenants being triggered, but the covenants would not normally dominate the measurement. Compare this to a similar debt instrument that is only different because the coupon is discretionary and qualifies as equity, which would, therefore, be accounted for as a compound instrument. For the second instrument, under the proposals it would be measured at the full value at the earliest possible settlement. We consider it unhelpful for financial instruments which are economically and contractually very similar, to be measured differently and we question whether this potential inconsistency would improve financial reporting.

Recognition of negative equity

53. We have concerns in certain scenarios with the proposed measurement of a contingent settlement provision in a compound financial instrument.

54. IAS 32 paragraph 31, which is largely unchanged by the amendments, describes the accounting entries required to recognise the equity and financial liability components of a compound financial instrument. It states that, 'The sum of the carrying amounts assigned to the liability and equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole.' Where the financial liability arising from a contingent settlement provision measured under the proposed amendments is greater than the fair value of the compound financial instrument issued by the entity, a compensating debit entry to equity would be required under paragraph 31.

55. We question whether this results in information that is useful to users of the financial statements, particularly considering that the parties to the instrument would have priced it very differently. Furthermore, for entities such as banks for which the amount of equity is a key measure and drives regulatory capital, grossing up the liability and reducing equity could be problematic.

Contractual terms which are not genuine

56. Currently, IAS 32 paragraphs BC19 and BC49(d) refer to 'not genuine' in the context of contingent settlement provisions. The amendments bring this term into the main body of the standard in paragraph AG28. In addition, in IAS 32 paragraph 15, there is discussion of the importance for classification of 'the substance of the contractual arrangement', and in paragraph 18 that '.. the substance of a financial instrument, rather than its legal form, governs its classification …'.

57. We note that the IFRIC agenda decision in January 2014 on financial instruments convertible into a variable number of shares, identified various factors to identify whether a contractual feature is 'substantive', including whether there are actual economic or other business reasons for exercising the option, whether the instrument would have been priced differently if a contractual feature had been excluded, and for pricing the option, the width of the range between the cap and the floor, the issuer's share price and volatility. We suggest that more of this guidance is brought into the main body of the standard to provide guidance on what is meant by 'substantive'.

58. In addition, to support the assessment of whether a contractual term is 'not genuine', we suggest it may be helpful to explain the relationship to references elsewhere in IFRS to 'non-substantive'. These include in IFRIC 12, *Service Concession Arrangements,* paragraph AG3 ('… Non-substantive features, such as a cap that will apply only in remote circumstances, shall be ignored…') and IFRS 16, paragraph BC94 '… the rigour that lessees are expected to apply when determining the lease term…should reduce the risk of non-substantive break clauses being inserted …'. This guidance could be added to the main body of the standard or to the basis for conclusions, to explain the relationship between the two terms, which would help entities in making the judgements required.

<u>Measurement of contingent settlement provisions</u>

59. The concerns that we raise in our response to question 3 on the measurement of redemption liability, are relevant for contingent settlement provisions. There we describe an instrument where the settlement price references EBITDA and raise concerns which apply equally for the measurement of contingent settlement provisions.

<u>Identification of compound instruments</u>

60. With respect to paragraph 32A on compound instruments and the interaction with the guidance on discretionary dividends in AG37, some further explanation would be helpful on how the requirements apply to an instrument puttable by the holder immediately on demand (i.e., not only after a future date or upon a future contingent event outside of the control of the issuer or holder) but where dividends are discretionary. It is not clear whether this would be a compound instrument or a liability in its entirety, as the amendments only describe instruments that are puttable by the holder after a future date or upon a contingent event outside the control of the issuer or holder. The classification affects whether dividends would be expensed through profit and loss or charged directly to equity. It would be helpful if this were clarified, perhaps with an example.

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.

61. We agree that this is an area where diverse practice currently exists. We, therefore, welcome the proposed amendments as potentially providing helpful clarification.

62. We note that the inclusion of factors to consider, encourages the use of a principles-based approach. We consider this to be important because it allows entities to apply judgement in assessing the many different examples of shareholder discretion that presently exist (which are more diverse than any list of examples could realistically hope to cover in full) and those which could arise in future as corporate governance practices continue to develop. We also suggest that the articulation provided in the first paragraph of AG28A, could be helpfully included in the main body of the standard, e.g., to show how the shareholders' decisions are distinct from the entity. This could be added to paragraph 19 (or a new paragraph 19A).

<u>Guidance on factors to consider</u>

63. We note that the proposed approach challenges what is currently a reasonably commonly held view that the shareholders' meeting is an extension of the entity and, hence, any decision submitted for the approval of shareholders is within the control of the entity. We recognise that a more detailed analysis may sometimes be appropriate, consistent with the proposed amendments, but we have some concerns that the proposed guidance is too strict, in particular, the 'routine' feature.

64. Regarding paragraph AG28A and the factors an entity is required to consider, identifying the origin of a shareholder decision may be difficult to judge, such as where management may propose an action but equally shareholders may propose the same action. An example could be where the shareholders have the right to require the payment of a dividend, as a matter of the entity's constitution or of general legislation in the jurisdiction concerned, irrespective of the wishes of management. Whether or not a decision is routine may also be a difficult judgement, as well as potentially being too narrowly defined.

65. BC119 indicates that both the nature of the decision and the decision-making process are relevant when assessing if a decision is routine in nature. In making the judgements required, AG28B identifies the need to consider the specific facts and circumstances of the entity's situation, which we support. It would also be helpful to add that this assessment should understand the relationship between the entity and its members. This would include identifying what decisions are made as part of the entity's normal corporate governance decision making process (like actions reserved for the entity's shareholders in general meetings) and those which are made by shareholders in their capacity as holders of particular instruments. This could be done by expanding the guidance in paragraph AG28B.

<u>Addition of illustrative examples</u>

66. We suggest it would be helpful to include in the Illustrative Examples, some common scenarios to demonstrate how the factors are applied. These could include the following:

    i) Where a preference share redeemable in the event of a change in control and shareholder approval is required. The guidance would appear to indicate that these preference shares would likely be a liability as the decision is non-routine, it is not initiated by management and different classes of shareholders may benefit differently from the decision.

    ii) Where shareholder approval is required to extend the life of a limited-life entity that will otherwise be dissolved and its net assets distributed to shareholders. The guidance would mean that the decision may or may not be considered routine, with factors to consider including the life of the entity, the entity's purpose, and how different investors would be affected.

67. We note in paragraph AG28C, the statement that the proposed approach shall not be applied by analogy in other accounting standards to transactions involving shareholders or management, as also mentioned in BC125. We are not sure why this statement is necessary as the boundaries would be different when the issue arises in other standards. The IASB's objective may be served by removing the comment from AG28C and noting in the BC that the guidance is not intended by the IASB to be applied by analogy to other standards (but it is not ruled out).

Question 6 – Reclassifications 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.

68. We observe that IAS 32 does not presently provide any general guidance for reclassifications of financial liability and equity instruments, so we support the IASB's intention to clarify this area.

69. Whilst we understand that the IASB has developed the proposals with a view to enhancing consistency and comparability, we question whether they would result in an overall improvement to financial reporting. We are concerned that the proposals could result in financial instruments with a classification that no longer reflects their contractual substance if this has changed significantly since initial recognition. We consider that it would be preferable for the reclassification requirements to give greater priority to representing the contractual substance of financial instruments at each reporting date. The proposal that reclassification should only take place when there is a change which is external to the contract is too narrow, in our view. This is because to provide useful financial reporting, there will be instances when the classification of a financial liability or an equity instrument should be changed, which the proposed amendments would not allow.

70. We provide the following examples to illustrate our concerns:

- Example 1: Equity instrument to financial liability. A company issues a put option on a certain class of shares to the holder of NCI which is exercisable from year 5. Up until year 5, the company also has an option that it can exercise at its discretion, to convert the class of shares to ordinary shares, which meets the fixed-for-fixed test and which leads to the termination of the option. The company can, therefore, avoid an outflow of cash provided it elects to convert by year 5. Under current IAS 32, the instrument would be accounted for as equity until year 5 and then, if nothing had changed, it would be reclassified to a financial liability from then onwards. Under the proposed amendments, as circumstances external to the contract have not changed, it seems that the initial classification as equity would remain from year 5 onwards. If so, we question whether this would give useful financial reporting. An alternative treatment could be to derecognise the equity instrument as its contractual terms have expired and replace it with a financial liability. This could potentially have a similar result as reclassification under current IAS 32, which we would support. If this is also the IASB's expectation, it should be made clear in the final amendments.
- Example 2: Financial liability to equity instrument. An entity issues a bond which is mandatorily convertible in 4 years to a variable number of the issuer's shares being the lower of 100 shares or the number of shares determined according to a formula based on the share price at the end of year 1. At issuance the instrument would be classified as a financial liability, but after 1 year the number of shares that will be delivered on conversion can be determined and becomes fixed. At issuance the financial instrument would be classified as a liability. After 1 year, under current IAS 32, the liability component that relates to the conversion feature would be considered to have expired and would be derecognised and replaced by an equity component. Under the proposed amendments, our view is that this treatment would still apply but it would be helpful if the amendments could clarify if this is the case.
- Example 3: Change in functional currency. An entity issues a convertible bond denominated in its functional currency at the time, which includes an equity component. Subsequently, the entity's functional currency changes but the bond remains outstanding. Under the proposed amendments, the reclassification would occur as the change in functional currency is a change in circumstances external to the contractual arrangement. Under current IAS 32, in the absence of definitive guidance, entities could make an accounting policy choice whether reclassification is required. We support requiring reclassification when there is a change in external circumstances, which as well as a change in functional currency could also include the loss of control of a subsidiary as well as other scenarios.

Limitations of disclosure

71. Whilst the disclosures required by IFRS 7, paragraph 12E would provide information on reclassifications as and when they occur, we do not think they overcome the limitations of the accounting as described above under examples 1 and 2 if the original classification is retained. This is consistent with the guidance in IAS 1, paragraph 18 that inappropriate accounting polices cannot be rectified by disclosure or explanatory material.

Derecognition requirements

72. As suggested in examples 1 and 2 above, we recognise that the derecognition requirements could potentially provide an alternative solution to reclassification in some instances. If the IASB chooses to explore this approach further, it would be helpful for the accounting entries that would arise to be described.

Question 7- Disclosure (paragraphs 1, 3, 12[E], 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

73. We broadly support the proposed amendments to the disclosure requirements. Given the complexity and variety of financial instruments that fall within the classification of financial liabilities and equity instruments, users stand to gain significant benefit from having additional information to help them understand entities' capital structure. The proposed disclosures achieve this.

74. With respect to the proposal for IFRS 7 paragraph 30G and 30H to disclose the maximum number of additional ordinary shares the entity might be required to deliver for each class of potential ordinary shares outstanding at the end of the reporting period and related information, we question whether it is necessary and will be helpful. IAS 33 already requires

disclosure of dilutive and anti-dilutive instruments, which we consider is more relevant. We encourage the IASB to give further consideration to whether the proposed disclosure is necessary.

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.

75. We consider that the proposed changes to presentation should provide useful information to users of the accounts to help them understand how financial liabilities and equity instruments affect the position and performance of the entity.

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 82 (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.

76. We understand the IASB's rationale for proposing the requirement for fully retrospective application of the amendments, to ensure that users of the financial statements receive information which is as consistent and comparable with prior periods as possible.

77. We support the approach proposed in the amendments and observe that, in many instances, the effect on prior periods will be limited, as when financial instruments have expired or have been settled, the effects will have worked through retained earnings. Limiting restatement to a single comparative period should result in useful information without being excessively burdensome.

78. One area which may be challenging is where the retrospective application of the amendments to prior periods affects the recognition of goodwill or the accounting for NCI puts. We note that the

practicability exemption in IAS 8 could be applied if required. We, therefore, do not see the need for any additional transition relief in this respect.

79. We also note that for financial instruments designated in hedging relationships, if their classification changes under the proposed amendments, entities may need to discontinue these hedging relationships when the amendments become effective (e.g., if a financial liability, previously designated in a hedging relationship, is reclassified as an equity instrument, which is not an eligible hedged item under IAS 39 or IFRS 9, and for a compound financial instrument presently classified as a liability, the compensation is reclassified from expense to equity). Entities have experienced similar changes to hedging relationship upon initial adoption of IFRS 9 for which no specific reliefs were provided and for that reason we do not think any such reliefs are needed for the amendments.

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.

80. We have no comments or concerns with the proposals.