Collated feedback

Financial instruments and liabilities working group meeting
IASB DP/2018-1 *Financial Instruments with Characteristics of Equity*

(Korea, Japan, India and Hong Kong have provided comprehensive staff views in writing as of 9 November 2018)

#	Analysis and Question	Staff preliminary views	Comprehensive views by both staff and stakeholders
1	*This is Question 3 in FICE DP* The Board's preferred approach to classification (section 2 in the DP) would classify a claim as a liability if it contains: • an unavoidable obligation to transfer economic resources at a specified time other than at liquidation (timing feature) ; and/or • an unavoidable obligation for an amount independent of the entity's available economic resources (amount feature). This is because, in the IASB's view, information about both of these features is relevant to	(All views below are preliminary views of WG members staff only and do not necessarily represent the views of their respective boards or constituents) 1 Hong Kong commented that IASB's preferred approach changes certain classification outcomes that are quite well understood under IAS 32 but sufficient explanations have not been provided in the DP as to why these changes are needed and how the new classification outcomes under the DP would be better. They also highlighted that the DP introduces new classification principles and new terminology which are currently not in IAS 32. Therefore having more guidance on the	

	assessments of the entity's financial position and financial performance, as summarised in paragraph 2.50. The IASB's preliminary view is that information about other features of claims should be provided through presentation and disclosure. When comparing the IASB's preferred approach with current requirements in IAS 32, a key difference is the introduction of the 'amount' feature. This feature will affect the classification of instruments that do not require the transfer of economic resources before liquidation but the claim is for a fixed amount that is independent of the entity's available economic resources. (a) Do you think introducing new, or newly articulated, classification principles as mentioned above will be useful or will confuse the users and prepares who have understood the existing principles? Why, or why not? (b) Would you agree with classifying a financial instrument which only meets one of the above feature as a financial liability? Why, or why not?	amount feature would be very helpful, in particular, on the notion of amount independent of the entity's economic resources. 2 India said that they are still analysing the proposals but they think the proposals seems fine from a preliminary view point. They also said the rationale is not clear when a different classification outcome arises under the DP compared to IAS 32. Irredeemable preference shares are not allowed to be issued in India, but they are not convinced that it makes sense to be classified as a liability where timing is postponed till liquidation. 3 Japanese Staff have concerns about hybrid instruments and also the link between this project and the Conceptual Framework project. They also agreed with Hong Kong staff comments and said that it is difficult to understand new terminologies. They were not clear how the notion of unavoidable obligation would work upon liquidation. It is confusing how claim amounts can be independent of the entity's available economic resources upon liquidation	

	Certain challenges may also arise with the articulation of the timing feature. For example, the timing feature focuses on 'liquidation', when companies prepare financial statements on a going concern basis. (c) What are your views on the introduction of the amount feature? (d) Do you think it is an appropriate principle in distinguishing liabilities and equity? Why or why not?	since all claims including the entity's available economic resources (i.e. residual amount) are dependent on the entity's assets/economic resources when the entity is being liquidated. 4 Korea commented that the definitions of the two key concepts (i.e. the entity's available economic resources and amount that is independent of the entity's available economic resources) would need to be clarified further. The claims that are settled only at liquidation should be sub-classified further (e.g. derivative instruments should be different to cumulative preference shares (only settled at liquidation) as there would be a huge difference from timing of settlement perspective. Korea Staff are not convinced that the amount feature should be the primary distinction for the instruments that have no obligation to transfer economic resources at a specified time other than at liquidation. More significant factor would be the priority order of claims. In this regard, it is questionable whether it is reasonable to classify irredeemable non-cumulative preference share as equity while	

		irredeemable cumulative preference share as liability, only based on the difference that cumulative preference share has an amount independent of the entity's available economic resources. 5 Singapore Staff commented that they can appreciate the two features, which appear consistent with the concept of equity as the residual interest in the Conceptual Framework. However, the amount feature will change some existing classification outcomes, with potentially significant implications for an entity's reported financial position and performance. Furthermore, clarifications may be necessary on the amount feature, in particular the new concept of amount independent of an entity's available economic resources. 6 Australia suggested that whilst the DP fixes some practical challenges, it does not fix others and it creates new ones (for example fair value measurement of cumulative perpetual preference shares that would currently be classified as equity under IAS 32 but would be	

		classified as liabilities under the IASB's preferred classification method in the DP). There is also a concern with having 'and/or'. If they removed the 'or' and just keep the "and" it would be better – even though then it would just be back to what's in IAS 32. They also commented that the DP proposals are changing certain classification outcomes which are well understood and did not have any issues under IAS 32.	
2	Different classification outcomes may arise when applying IASB's preferred approach and the principles in the *Conceptual Framework* (CF). Eg Irredeemable cumulative preference shares The conflict between the CF and IASB's preferred approach may lead to contracts that are economically similar in terms of values and risks being classified differently. As per paragraph B5 of the DP, the scope of the FICE project is focused on financial instruments	1 Hong Kong and Australia said that the DP doesn't really address differences between DP proposals and the Conceptual Framework and how these conflicts would be resolved. Australia said that different classification outcomes would arise when applying DP proposals and definitions in the CF. Hong Kong mentioned that the explanation provided in Appendix B is not sufficient and the IASB should explain the next steps on whether the definition of liabilities in the CF and the DP, when and if finalised, would be aligned more broadly with timelines. 2 Japan staff also have concerns on how these	

	and its aim is to investigate, and suggest solutions to, the specific challenges of distinguishing financial liabilities from equity instruments when applying IAS 32. If the IASB ultimately decides to implement the preliminary views in this Discussion Paper, the IASB might consider possible implications for the *Conceptual Framework*. Do you think the liability classification in IAS 32 and CF should be changed to align to the IASB's preferred approach in the DP?	proposals would impact the conceptual framework.	
3	Do you think that the IASB's proposals are necessarily addressing areas that are causing issues in practice? Why or why not?	1 Australia commented that the IASB have insufficiently addressed the practical issues such as NCI puts and anti-dilutive provisions. Therefore, whilst they acknowledge the extent of work that the IASB has done so far, they think there is still a lot more work on practical challenges. 2 Singapore Staff commented that the DP does not appear to have addressed certain issues in practice, such as the challenges with NCI puts and situations in when an entity does not have claims that qualify for classification as equity	

		because the instruments meet the definition of liability but fail to meet the puttable exception.	
4	(a) Do you agree that the challenges/issues identified by the IASB and the suggested proposals are important to users of financial statements and are pervasive enough to require standard-setting activity? (b) Do you agree that this project is worthwhile pursuing? Yes/No - Please explain reasons for your answer.	1 Australia's preliminary views is that what the IASB have included in the DP has not made significant improvement to IAS 32 and therefore may not be worth pursuing. Whilst there appeared to be some improvements with the preferred approach suggested by the IASB, overall there wasn't a big enough improvement to warrant a new Standard. The practical issues flagged to IFRIC in relation to IAS 32 like the issues with NCI written puts do not seem to have been resolved with the proposals in the DP. Further, with the removal of classification exception for rights issues/options in foreign currency and the lack of clarify about the rationale behind the 'independent amount' feature, more issues seem to arise under the proposals of the DP. 2 HK considers that there are some challenges in IAS 32 that still need to be addressed. Staff are not convinced that the DP provides sufficient	

		clarification as to why the proposed classification outcomes are better and how they have addressed the current issues in practice under IAS 32. 3 India said they are still trying to understand the implications of the project including understanding different types of instruments in India. Preliminary staff views are that some of the issues have not yet been addressed. For example foreign currency convertible bonds which are classified as equity in India, but liability under IAS 32 and still a liability under the DP proposals. This aspect needs to be analysed. 4 Japanese staff said that their preliminary views is not positive because the proposal rationalises current practice rather than addressing issues. 5 Korea Staff said that the IASB appear to be just clarifying what is in IAS 32 but also said the IASB is going in the right direction as starting with a user needs perspective. However, they have concerns on some of the outcomes (eg cumulative preference shares being classified as liability). The IASB's preferred approach would	

		change the classification of a particular type of hybrid instrument in Korea (similar to typical contingent convertible bond which is known as Coco bond), which is issued in large volume by many Korean companies. The issue over the classification of this hybrid instrument drew much public attention a few years ago, resulting in the instrument being classified as equity. As this instrument would be classified a liability under the IASB's preferred approach in the DP, there might be a strong resistance to the new approach from Korean preparers. They also did not agree with removing foreign currency right issue exception. The IASB had not explained how the issues raised in 2009 have been resolved or how removing this exception would be justified based on BC4F to BC4I in IAS 32.	
5	The IASB decided that, while the objective of the FICE project is to respond to challenges in distinguishing financial liabilities from equity instruments when applying IAS 32, any potential solution should limit unnecessary changes to classification outcomes that are	1 Refer to Korea's response above in Question 4. Other than irredeemable preference shares, foreign currency and coco bond (Korean convertible/hybrid instrument). 2 Singapore staff said that financial institutions often issue financial instruments to meet capital	

	already well understood. (a) Considering the IASB's preferred approach described in the DP, do you expect significant classification changes? If so, please provide examples. Korea has noted classifying irredeemable preference shares as one of the classification changes. b) Have your constituents issued financial instruments with cumulative features? What would be the financial impact of these classification changes as per their assessment? (c) Do you consider that it is relevant to classify financial instruments that are only settled on liquidation (e.g. cumulative preference shares) as financial liabilities? Why or why not.	adequacy requirements for prudential purposes. The DP may have implications over some of those instruments, such as perpetual irredeemable non-cumulative non-convertible instruments that are currently classified as equity. The amount feature will result in a different classification, which may significantly impact financial institutions' reporting financial position and performance.	
6	*This is question 4 in FICE DP* A puttable instruments is a financial instrument	1 Australia is supportive of keeping the puttable exception. However, planning to reach out to Cooperatives and Mutual entities to understand	

	that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on occurrence of an uncertain future event or the death or retirement of the instrument holder. IAS 32 classifies obligations with particular features to transfer economic resources as equity, even though the instruments meet the definition of a financial liability. Refer to IAS 32 paragraph 16A – 16D. (paragraphs 3.29 to 3.36 of the DP) Eg when it entitles the holder to a pro rata share of the entity's net assets in the event of liquidation The 'puttable exception' is retained under the IASB's preferred approach Do you agree with retaining the 'puttable exception'? Why or why not?	how they are impacted. 2 Hong Kong staff said based on previous outreach, the puttable exemption is being used, so Staff thinks the feedback will be to keep the exception. 3 Indian Staff said they think constituents will want to keep it. 4 Korean Staff don't have much concern about keeping the puttable exemption but wonder whether the IASB would consider separating the put option from shares. As per BC54[i] of IAS 32, Board had indicated conducting further research into an approach that splits a puttable share into an equity component and a written put option component. Staff are of the view that this DP would be a good opportunity to explore that. 5 Japanese Staff do not have a view on this matter at this stage but do think it would be better if the IASB could evaluate how DP proposals would classify these puttable instruments in the absence of puttable exception. 6 Singapore staff do not have a view as yet on this matter. However, staff observed that the strict	

		pro-rata condition in the puttable exception will continue not to address the challenges when an entity does not have claims that qualify for classification as equity (e.g. some unit trusts that issue multiple classes of units).	
7	*This question is related to example 9 (slide 24) in the slide pack – Foreign Currency Right Issue Exception* IAS 32 classifies rights, options, or warrants to issue a fixed number of an entity's own equity instruments in exchange for a fixed amount of any currency as equity instruments, if, and only if, the entity offers those instruments pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Under the IASB's preferred approach all derivatives to deliver a fixed number of an entity's own ordinary shares for a fixed amount of foreign currency would be classified as financial assets or financial liabilities with	1 Australia Staff is not supportive of removing this exception. If these instruments are classified as liability, the substance of these transactions may not be appropriately being reflected in the accounting outcome. Many Australian entities issue these instruments to meet regulatory requirements and/or access global markets. 2 Hong Kong Staff was unable to comment as they have not yet reached out to their stake holders. 3 India Staff have concerns about removing this exception. They also commented the volatility in profit or loss will increase if these instruments are classified as liabilities. 4 Japan Staff do not have a view on this question at this stage. 5 Korea consider that the IASB should provide clarification as to why the exception provided in	

	related returns presented in OCI. IAS 32 was amended to include this exception in Oct 2009. The IASB agreed with the IFRIC's 2005 conclusion that a contract with an exercise price denominated in a foreign currency would not result in the entity receiving a fixed amount of cash. However, the IASB also agreed with the IFRIC that classifying rights as derivative liabilities was not consistent with the substance of the transaction. Rights issues are issued only to existing shareholders on the basis of the number of shares they already own. In this respect they partially resemble dividends paid in shares. (Refer BC4F to BC4I of IAS 32) Many issuing entities fix the exercise price of right issues in currencies other than their functional currency because the entities are listed in more than one jurisdiction and might be required to do so by law or regulation. Removing foreign currency rights issue exception will affect entities as these are usually relatively large transactions. In our	IAS 32 is no longer required and how the problems identified when providing this exception in IAS 32 has now been resolved. They said that the IASB had not explained how the issues raised in 2009 have been resolved or how removing this exception would be justified in the light of BC4F to BC4I in IAS 32. 6 Singapore Staff do not have any comments as yet on this matter.	

	opinion, classifying rights as derivative liabilities was not consistent with the substance of the transaction as rights issues are issued only to existing shareholders on the basis of the number of shares they already own and they partially similar to dividends paid in shares AASB is of the view that the foreign currency rights issue is still relevant and should be retained until the IASB is able to find a solution that addresses the issues that gave rise to the amendments in 2009. The DP's proposals would also lead to an additional item presented in OCI and would raise the discussion whether there should be recycling. (a) Do you agree with the IASB removing foreign currency rights issue exception in IAS 32? (b) Do you agree that IASB's preferred approach would solve the concerns that led to this amendments in 2009?		

	(c) Are you aware of any issues with the application of foreign currency right issue exception?		
8	*This is question based on question 05 in FICE DP* NCI puts are Instruments that require an entity to repurchase the non-controlling interest shares in a subsidiary in exchange for an amount of cash equal to their fair value, at the option of the holder (section 4 of the DP). IASB proposes a consistent classification of rights and obligations regardless of structure. For NCI puts, this means: • recognise a liability for the present value of the redemption amount • derecognise the underlying NCI shares • classify the remaining rights and obligations using derivative principles (a) To what extent are written puts on NCI used by the entities in your jurisdiction? (b) Do you think the IASB's proposals for NCI	1 Singapore Staff commented that the practical challenges with NCI puts do not appear to have been addressed in this DP. Singapore staff observed that one of the reasons underlying those challenges is the requirement for written puts to be measured on a gross basis, and that it may be worthwhile to explore gross vs. net measurement for NCI puts. 2 Hong Kong and India Staff said they are yet to do more analysis on this. India Staff said classification seems to be okay but de-recognition needs more analysis. Hong Kong said they would like more explanation on equity side of NCI put, de-recognition of NCI at FV and treatment of premium. 3 Japan and Korea do not have any comments as yet on this matter. 4 Australia agreed with Hong Kong and plans to carry put further outreach to understand specific	

	puts would help address the challenges with the application of IAS 32?	matters that have not been addressed by this DP.	
9	*This is the first part of the question 8 in FICE DP* The Board's preliminary view is that it would be useful to users of financial statements assessing the distribution of returns among equity instruments to expand the attribution of income and expenses to some equity instruments other than ordinary shares. Do you agree? Why, or why not?	The member countries did not have any preliminary views on this matter at this stage.	
10	Is there any other are or question in DP that any of the members feel as important to raise?	1 Japan and Hong Kong questioned the usefulness of attributing total OCI to other equity instruments. Japan also mentioned that they are not clear as to how equity claims should be measured. Japan and Hong Kong questioned whether the benefits of the information provided by the attribution approaches (i.e. attributing total comprehensive income to equity instruments other than ordinary shares and updating the carrying amounts of those equity instruments based on that attribution) would	

		exceed the related costs.	

[i] The Board concluded that conducting further research into an approach that splits a puttable share into an equity component and a written put option component (financial liability) would duplicate efforts of the Board's longer-term project on liabilities and equity. Consequently, the Board decided not to proceed with a project at this stage to determine whether a puttable share should be split into an equity component and a written put option component.