Applying IFRS

FICE project progresses

December 2023

Building a better working world

Contents

What you need to know

- The IASB's FICE project seeks to address the practice issues that arise in applying IAS 32 *Financial Instruments: Presentation* and to expand the disclosure requirements relating to issued financial instruments.
- The IASB has published an Exposure Draft (ED) Financial Instruments with Characteristics of Equity – proposed amendments to IAS 32 *Financial Instruments: Presentation*, IFRS 7: *Financial Instruments: Disclosures*, IAS 1 *Presentation of Financial Statements* on 29 November 2023 reflecting the tentative decisions reached to date. The 120-day comment period closes on 29 March 2024.
- In addition to clarifying the classification requirements in IAS 32, including their underlying principles, the ED proposes enhanced presentation and disclosure requirements for financial liabilities and equity instruments, aiming to improve the information provided about features of financial liabilities and equity instruments that would not otherwise be apparent from their classification.

Introduction

The International Accounting Standards Board (the IASB or the Board) published on 29 November 2023 an exposure draft, Financial Instruments with Characteristics of Equity - proposed amendments to IAS 32 *Financial Instruments: Presentation*, IFRS 7: *Financial Instruments:* Disclosures, IAS 1 *Presentation of Financial Statements* (the ED).[1] The comment period lasts for 120-days and closes on 29 March 2024.

Previously, the IASB issued two Discussion Papers,[2] seeking to improve IAS 32, which considered the classification of issued financial instruments, as equity or liabilities. In both cases, this involved seeking to establish new principles. However, based on feedback received, the Board resolved not to rewrite the standard fundamentally, but only to:

- Address known practice issues that arise when applying IAS 32

  And

- Improve the information provided in the financial statements about the financial instruments issued by the entity.

The current FICE project progressed from a research programme to standard setting in December 2020.[3] The ED reflects the tentative decisions reached since then by the IASB in response to the practice issues identified.

This publication summarises the amendments proposed in the ED and includes some preliminary views on the scope and impact of the amendments as drafted.

How we see it

We support the IASB in seeking to clarify IAS 32 and providing more guidance for classifying and presenting financial instruments as financial liabilities or equity, which generally aligns with current practice and should lead to greater consistency of application. The overall requirements of IAS 32 are well understood and work well and the IASB is focusing on those practice issues that have proven to be problematic.

In developing the proposed amendments, the IASB seems to have followed an approach, that emphasises that equity should represent the most junior class of ownership interest issued by an entity, normally identified with ordinary shares or equivalent instruments. However, the classification principles of IAS 32 remain unchanged.

Whilst the amendments are described as clarifications, since they revise the existing requirements, they represent changes to the corresponding accounting standards. Therefore, if, on first application of the amendments, entities have to change their accounting retrospectively, this will not represent the correction of a prior period error.

[1] Exposure Draft, Financial Instruments with Characteristics of Equity. Proposed amendments to IAS 32, IFRS 7 and IAS 1, (the ED) November 2023. LINK

[2] Financial Instruments with Characteristics of Equity, February 2008. LINK. Financial Instruments with Characteristics of Equity, June 2018. LINK

[3] IASB Staff paper 5, December 2020, Financial Instruments with Characteristics of Equity, Project proposal – moving the project to the standard-setting program. LINK

1.The effects of relevant laws or regulations

In assessing whether a financial instrument or its component parts should be classified as a financial liability or equity under IAS 32, it is necessary to consider the effect of laws or regulations that apply in the jurisdiction in which it has been issued as well as the specific contractual terms of the instrument. [4]

The ED proposes to clarify that to classify a financial instrument or its component parts as equity or a financial liability, an issuer should consider:[5]

- Only contractual rights and obligations that are enforceable by laws or regulations and are in addition to those created by relevant laws or regulations; rights and obligations created by relevant laws or regulations that would arise regardless of whether the right or obligation is included in the contractual arrangement should be ignored (so, for instance, if the terms set out in the applicable law required a minimum dividend to be paid, this should be ignored and would not lead to the instrument being classified as a liability, even if the same term was included in the contractual agreement)

  And

- Such contractual rights and obligations must be considered in their entirety in classifying the financial instrument or its component parts, and must not be disaggregated into contractual and non-contractual parts (so, if the applicable law required a minimum dividend to be paid but the entity chose to specify a higher minimum dividend, the entire contractual obligation to pay dividends would be classified as a financial liability or a liability component).

The ED also proposes to clarify that relevant laws or regulations that prevent the enforceability of a contractual right or a contractual obligation must be considered. This is consistent with the principle in IFRIC 2 *Members' shares in co-operative entities and similar instruments* that, if redemption of an instrument is unconditionally prohibited by local law, regulation or an entity's governing charter, the instrument is classified as equity, despite the holder having a right to request redemption.

How we see it

The combined effect of these proposed amendments is expected to be generally consistent with current practice and they provide helpful clarification of the interaction between IAS 32 and IFRIC 2.

Entities should carefully consider the potential effect of the proposals on their issued financial instruments, including terms that are in addition to those required by laws or regulation, which would result in the combined terms being considered in their entirety for the purpose of classification.

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[4] The ED, BC 12, which identifies existing IAS 32 paragraph 11 that refers to contracts and contractual rights and contractual obligations.

[5] The ED, paragraphs 15A and AG24A to AG24B.

2. Fixed for fixed

It is an underlying principle of IAS 32 that an obligation to settle a transaction in an entity's own equity instruments, must be classified as equity and not as a financial liability, only when the obligation is to exchange a fixed amount of equity instruments in return for a fixed amount of consideration. This is known as the fixed-for-fixed condition.

The ED proposes to clarify that:[6]

- 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 (since denomination in a foreign currency would result in variability in the functional currency value of the amount at settlement).
- For a derivative on own equity to meet the fixed-for-fixed condition in IAS 32 and hence qualify to be classified as equity, the number of functional currency units to be exchanged with each underlying equity instrument must be fixed (will not vary in any circumstances), or vary only with:
  - "Preservation adjustments"

    And / or
  - "Passage of time adjustments"
- A contract must be classified as equity when it can be settled by exchanging a fixed number of non-derivative own equity instruments, with a fixed number of another type of non-derivative own equity instruments. This is relevant if an instrument gives the holder a choice of settlement between two or more classes or an entity's own equity instruments.

Preservation adjustments are those that require the entity to preserve the relative economic interests of the holders of the right to be future shareholders, to an equal or lesser extent than those of the existing shareholders. This would include adjustments to the terms of the derivative, to reflect, for example, stock splits, bonus issues of shares and abnormal dividends paid on the existing shares. An adjustment which is more favourable to the derivative holder than changes in the interests of existing shareholders would prevent the obligation being classified as equity.

Passage of time adjustments are those that:

- Are pre-determined and vary only with the passage of time

  And
- Fix on initial recognition the present value in the entity's functional currency of the amount of consideration exchanged for each of the entity's own equity instruments. Any difference to the amount of consideration to be exchanged on each possible settlement date represents compensation proportional to the passage of time.

How we see it

The proposed clarifications are largely consistent with developed practice and should provide a more robust framework to support it. Entities will need to apply judgement to determine whether the adjustments support an equity classification, including how to assess what is proportional to the passage of time.

[6] The ED, IAS 32, paragraphs 16, 22, 22B to 22D, AG27A and AG29B.

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

Obligations for an entity to purchase its own equity instruments exist in various forms. A reasonably common example, in addition to a forward contract to purchase its own shares, is a contract that provides the holder of a minority interest with the right (but not the obligation) to require the entity to purchase its own shares. This might arise in the context of a business combination, where the original owners retain a minority equity stake that they can sell to the purchaser sometime after the acquisition. The purchase price may be fixed, or it may be set by reference to a factor such as multiple of revenue, profit or the quoted share price of the entity.

For obligations such as these, IAS 32 requires an entity to recognise a financial liability for the present value of the redemption amount, which is removed from equity and included in financial liabilities. Practice issues have arisen with respect to which component of equity the amount is removed from and how to measure the liability for the redemption amount. To address this, the IASB proposes to clarify that:[7]

- 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.
- At initial recognition of the liability to redeem an entity's own equity instruments, if the entity does not yet have access to the rights and returns associated with the instruments, they continue to be recognised. The initial amount of the financial liability is therefore removed from a component of equity other than non-controlling interests or issued share capital.
- The same approach must be used for initial and subsequent measurement of the financial liability. That is, it must be measured at the present value of the redemption amount at the earliest possible redemption date, ignoring the probability and estimated timing of the counterparty exercising its redemption right.
- Gains and losses on remeasuring the financial liability are recognised in profit and loss.
- If a contract containing an obligation to purchase own equity expires without delivery:

    - The carrying amount of the financial liability is derecognised and included in the same component of equity from which it was removed on initial recognition.

    And

    - Any gains or losses previously recognised from measuring the financial liability are not reversed, but the cumulative gain or loss may be transferred from retained earnings to another component of equity.

[7] The ED, IAS 32, paragraphs 23, AG27B to AG27D.

- Written put options and forward purchase contracts on an entity's own equity instruments that are gross physically settled must be presented on a gross basis.

How we see it

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 scope of IAS 32 beyond classification and presentation, by creating a new measurement approach. It is a current requirement of IAS 32 that, at initial recognition, the liability must be recognised at the present value of the redemption amount. However, the proposed amendments clarify that both the initial and subsequent measurement should consider the earliest possible redemption date, ignoring the probability and estimated timing of the counterparty exercising their right to redeem. They also indicate that at each reporting date, as the value of the liability changes, due to the unwinding of the discount and changes to the forecast settlement amount, any such changes would be recognised in profit and loss. The final amendments would benefit from a worked example illustrating this calculation.

For the purpose of determining the classification of financial instruments, the effect of laws and regulations should be ignored, as discussed in section 1 above. By contrast, for the initial and subsequent measurement of a financial liability arising from an entity's contractual obligation to purchase its own equity, the potential effect of such laws and regulations must be considered (such as if bank bail-in regulations were triggered). For example, entities should assess the impact of the proposed requirements on the measurement of a financial liability component embedded into a host equity contract, which currently may have an immaterial fair value due to the expected remote likelihood of the obligation to purchase own equity as a result of the bank bail-in regulations being triggered.

Many entities with written put options over non-controlling interests will be affected by the proposals, as there is presently diversity in practice on how entities account for them. Since the proposed amendments will apply retrospectively, entities should consider the impact on their existing instruments. Entities contemplating new transactions should take into consideration the potential effect of the proposals in this area.

4.Contingent settlement provisions

Financial instruments may contain a requirement for settlement in cash upon the occurrence of an uncertain future event that is beyond the control of both the issuer and the holder of the instrument.

A practice issue has arisen in IAS 32 regarding whether a financial instrument with such a contingent settlement provision should be classified as a financial liability in its entirety, or as a compound instrument, comprising separate equity and liability components. Another area identified by the IASB as potentially benefitting from clarification, is whether the measurement of a contingent settlement provision should reflect the probability and estimated timing of the contingent event on and after initial recognition. In addition, practice questions have arisen in determining when a contractual feature should be considered 'not genuine' and what is meant by the term 'liquidation'.

To address these points, the ED proposes to amend IAS 32:[8]

- To clarify that financial instruments with contingent settlement provisions may be compound instruments.
- To clarify that the probability and estimated timing of occurrence or non-occurrence of uncertain future events (or the outcome of uncertain circumstances) have no effect on the initial or subsequent measurement of the financial liability arising from the contingent settlement provision. An entity measures the financial liability on initial recognition and subsequently at the present value of the settlement amount.
- To clarify that payments at the discretion of the issuer (such as dividends) are recognised in equity, even if all the proceeds are initially allocated to the liability component of a compound financial instrument.
- To specify that the term 'liquidation' in paragraph 25(b) of IAS 32 refers to the process that begins after an entity has permanently ceased operations.
- To specify that an assessment of whether a contract term that is 'not genuine' under paragraph 25(a) of IAS 32 is not made by considering only the probability of the contingent event occurring but requires judgement based on the specific facts and circumstances.

How we see it

It is important that entities carefully review the wording of the ED and consider the implications of the proposals for financial liabilities and equity instruments they have issued.

Entities for which the clarification that payments at the discretion of the issuer are recognised in equity represents a potential change, should consider how any hedge accounting relationships could be affected (since the charge is no longer recognised as an expense and equity is ineligible for hedge accounting).

For entities that plan to use the IASB's proposed new Dynamic Risk Management model to account for portfolios of risk,[9] any potential change in the classification of issued financial instruments arising from the proposed amendments, should be considered.

5. Shareholders' discretion

For an issued financial instrument to be equity, the entity must have an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation. Where issued financial instruments are subject to discretionary payments, to demonstrate this right, the decision whether to make the payment must reside with the entity. A practice question arises when such payments are subject to shareholder approval and whether the shareholder decision affects an entities unconditional right to avoid making a payment.

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[8] The ED, IAS 32, paragraphs 11, 25, 25A, 31, 32A, AG28 and AG37.

[9] See Applying IFRS, IASB continues to develop its DRM accounting model, December 2023. LINK

The ED provides examples of potential factors for an entity to consider when assessing whether a decision of shareholders is treated as a decision of the entity and, therefore, to support the classification of an instrument as equity.[10] Each of the factors listed for consideration would not be determinative on its own nor is the list intended to be exhaustive:

- Whether a shareholder decision is routine in nature, i.e., made in the ordinary course of the entity's business activities, which is more likely to be treated as a decision of the entity. This could include whether it is part of the operating and corporate governance process, e.g., the approval of dividends at an annual general meeting.
- Whether the decision relates to an action proposed or a transaction initiated by the entity's management, so that shareholders merely approve or reject management's proposals. If management can avoid an outflow by not proposing an action requiring shareholder approval, the shareholder discretion has no bearing on classification (so it remains a decision of the entity). Alternatively, if a shareholder decision relates to an action proposed or a transaction initiated by a third party for shareholder approval (such as if an entity that wants to take control of the group and shareholders are offered to sell their shares to that entity), the shareholder decision is unlikely to be treated as an entity decision (i.e., the entity cannot prevent the decision being required, indicating a financial liability).
- Whether the issue affects different classes of shareholders differently, e.g., discretion by preference shareholders would be treated as indicative of a liability and separate voting by class would suggest independent decisions as investors in a particular class of shares and not as an entity decision.
- A shareholder decision-making right may enable a shareholder to require the entity to redeem or pay a return on its shares in cash. Such decision-making rights indicate that the shareholders would make their decisions as investors in the shares and is unlikely to be an entity decision.

How we see it

This is an area that is currently unclear and where practice is varied. The factors are broadly consistent with how practice has developed, and the additional guidance is therefore welcome. However, the approach proposed could be more restrictive than some current practice.

By providing examples of factors to consider (which are not determinative or exhaustive), judgement will continue to be required. This will allow for a principles-based approach to be applied as new corporate governance practices emerge.

Entities with different categories of shareholders should pay particular attention to the potential consequences of this additional guidance.

6. Reclassifications of financial liabilities and equity instruments

IAS 32 does not currently provide any general guidance for reclassifications. The existing requirements relate to the classification of a financial instrument or its component parts, only on initial recognition. Some specific guidance exists

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[10] The ED, IAS 32, paragraphs AG28A to AG28C.

for reclassifying puttable instruments and obligations arising on liquidation, but this applies in only limited circumstances.[11] As a result, diversity in practice has arisen.

The ED proposes to clarify that financial liabilities and equity instruments cannot be reclassified after initial recognition unless certain conditions are met:[12]

- The specific guidance for puttable instruments and obligations arising on liquidation applies (this is an existing IAS 32 requirement as noted above)
- The substance of the contractual relationship changes because of a change in circumstances external to the contractual arrangement.

Changes that are external to the contractual arrangement arise from events not specified in the contract that have not been considered in classifying the financial instrument on initial recognition. The ED provides an example of the type of change as being one that would affect an entity's business activities and operations, such as a change in an entity's functional currency or a change in its group structure (such as a non-group entity becoming a subsidiary). Such events do not modify the contractual terms but change the substance of the contractual terms.

Reclassification is notably different to the derecognition of one instrument and recognition of another. Derecognition is outside the scope of the proposed amendments. A modification of a financial liability would lead to derecognition if the change is considered 'substantial'.[13]

The ED proposes that if an instrument is reclassified, it is applied prospectively from the date the change in circumstances occurs. An entity must not reverse in profit or loss any previously recognised income, expense, gains or losses.

- If an equity instrument is reclassified as a financial liability, any difference between the fair value of the liability and the carrying amount of the equity instrument at the date of reclassification, is recognised in equity.
- If a financial liability is reclassified as an equity instrument, the equity instrument is recognised at the carrying value of the financial liability at the date of reclassification, with no gain or loss recognised.

How we see it

We welcome the proposed amendments as IAS 32 is currently silent on the subject of reclassifications and there is diversity in practice.

The type of change required to support the reclassification of a financial liability or equity instrument has some similarity to the existing guidance in IFRS 9 for the reclassification of a financial asset.[14] In both cases, a reclassification would not arise due to changes to the contractual terms of the instrument, but only as a result of a change in circumstance which is external to the contractual arrangements of the financial instrument (such as a change to the business model for financial assets or a change in the

[11] IAS 32, paragraph 16E.
[12] The ED, IAS 32, paragraphs 32B to 32D and AG35A.
[13] IFRS 9, section 3.3, in particular paragraphs 3.3.2 and B3.3.6.
[14]

functional currency or the group structure of the issuing entity for an issued equity or liability instrument).

A modification of the contractual terms would either result in no change to the classification or in the derecognition of the original instrument, if the modification is substantial. A change in contractual terms as a result of the passage of time (e.g., a variable conversion ratio which becomes fixed after a period of time), would not result in a reclassification. However, the ED proposes additional disclosures in relation to such instruments that are affected by the passage of time.

7. Disclosures

A key objective of the amendments is to improve the information provided about the financial instruments issued by the entity. The ED therefore proposes to amend the objective of IFRS 7 to provide information on how the entity is financed, its capital resources and its ownership structure, including potential dilution of the ownership structure from financial instruments issued at the reporting date.[15]

The proposed amendments result in some significant additions to the existing IFRS 7 disclosure requirements.

How we see it

The disclosure proposals will, collectively, add significantly to an issuer's disclosure obligations. It is important that constituents examine the proposals carefully, so that the cost of compliance can be adequately assessed and compared against the perceived benefits for users.

Entities should check that the disclosure requirements are operable, and that the disclosures objectives are sufficiently clear that they can make appropriate materiality assessments and determine the right level of granularity for the disclosures.

7.1. The nature and priority of claims against the entity on liquidation

The ED proposes to require an entity to disclose information on the nature and priority of claims against the equity on liquidation.[16] This is because the way an entity may be financed could include complex financial instruments that combine characteristics of financial liabilities and equity instruments and have different levels of subordination. The enhanced disclosure is intended to enable users of financial statements to assess the nature of the claims against the entity arising from its issued financial instruments and how the claims affect the entity's liquidity and solvency.

The proposed amendments would require the entity to disclose the carrying amount of each class of claims arising from these financial instruments and the line item in the statement of financial position where the claim is included. An entity must group the claims into classes based on their contractual nature and priority on liquidation and therefore at a minimum:

[15] The ED, IFRS 7, new paragraph 1(c).
[16] The ED, IFRS 7, new paragraph 30A and 30B.

- In its separate and consolidated financial statements, distinguish between
    i. Secured and unsecured claims; and
    ii. Subordinated and unsubordinated claims;

And

- In its consolidated financial statements, distinguish between:
    i. Financial liabilities and equity instruments that the parent has issued;

       And

    ii. Financial liabilities that subsidiaries have issued and non-controlling interests in those subsidiaries (not separately for each subsidiary).
- These disclosures are to be made for all financial liabilities as well as equity instruments that are within the scope of IAS 32.
- In contrast with the disclosures covered in section 7.3 below, the objective of this disclosure is not to provide information about the priority of individual financial instruments on liquidation, but rather a categorisation of the capital structure to show differences in the quality of capital within the structure to help users assess the nature of the claims and how they affect the entity's liquidity and solvency. As a result, the information can be provided on a consolidated and aggregated basis.

How we see it

The IASB chose, rather than developing a definition for what comprises an entity's capital structure, to require an explanation of each of the financial instruments that, in effect, comprise the entity's capital structure. Entities will need to apply judgement in deciding what information to provide, how it should be categorised and aggregated (for example, subordination, collateralisation and loss-absorbing capacity), whilst meeting the minimum disclosure requirements.

7.2. Terms and conditions of financial instruments with both financial liability and equity characteristics

Key cash flow characteristics of 'typical' financial liabilities are specified timing and fixed or determinable amounts whereas the key cash flow characteristics of 'typical' equity instruments are unspecified timing and unspecified amounts.

The ED proposes that, for financial instruments with both financial liability and equity characteristics (except for stand-alone derivatives), an entity would be required to disclose in the notes to the financial statements, information about:[17]

- 'Debt-like features' in financial instruments that are classified as equity instruments (for example, fixed coupons payable on a preference share, but only if dividends are paid on ordinary shares.
- 'Equity-like features' in financial instruments that are classified as financial liabilities (for example, embedded derivatives on own equity that do not

[17] The ED, IFRS 7, new paragraphs 30C and 30D.

meet the fixed for fixed criterion, or-'write-down bonds', where the principal is reduced if the issuer's capital falls below a trigger level).

- The terms and conditions that determine the classification of such financial instruments as financial liabilities, equity instruments or compound financial instruments.

How we see it

The IASB has previously considered how to account for contractual terms that create economic compulsion for an entity to make a discretionary payment. Such financial instruments may be classified as equity but have debt-like features. Providing additional information on financial instruments with such characteristics, is an example of what the disclosures are intended to do.

The proposed application guidance provides some helpful indicators to distinguish between debt and equity-like features, including in the event of liquidation.[18] The amendments seek to establish broad principles to assist in identifying relevant financial instruments not covered in the application guidance. This is necessary given the level of innovation in capital markets and, hence, the likelihood of the emergence of new features in the future.

7.3 Priority on liquidation of financial instruments with characteristics of both financial liabilities and equity

The ED proposes to require an entity to disclose more granular information about priority on liquidation for financial instruments with characteristics of both debt and equity, including compound instruments, but excluding stand-alone derivative instruments. This priority information should be provided as part of the terms and conditions disclosures mentioned in section 7.2. above and should include the following:[19]

- Terms and conditions that indicate priority on liquidation, including those which could lead to a change in priority on liquidation
- Information about the level of contractual subordination, if it differs from the contractual subordination of other instruments in that class (for example, if some subordinated notes rank junior to other subordinated notes, or in securitisations where instruments are issued in multiple tranches, each having a subordination ranking)
- Information about any significant uncertainty about how relevant laws or regulations applicable to financial instruments could affect their priority on liquidation
- A description of any intra-group arrangements, such as guarantees, that might affect the priority on liquidation (for example, which entities are providing and receiving guarantees)

In this way, investors would be alerted to terms that they think might be important and can decide whether to perform further analysis by reviewing the underlying documents.

[18] The ED, IFRS 7, new paragraphs B5B to B5G.
[19] The ED, IFRS 7, new paragraph 30E.

How we see it

The disclosures about priority on liquidation refer to an instrument's contractual terms and not to the effect of laws and regulations (unless there is significant uncertainty about how they would be applied). Therefore, there may be a risk that the information that would be required to be disclosed would provide an incomplete picture of the priorities of financial instruments in the event of liquidation, especially for international groups with operations governed by a variety of laws and regulations.

The disclosure of priority on liquidation does not explicitly require information on regulatory resolution, about which the provision of further information may be beneficial.

7.4 Passage of time

The ED proposes to require an entity to disclose information about the terms and conditions of financial liabilities (including standalone derivatives) that either become, or stop being effective with the passage of time before the instrument's contractual term.[20] This disclosure is a consequence of the decision that passage-of-time changes do not result in the financial liability being reclassified.

7.5 Potential dilution of ordinary shares

The ED proposes to require additional disclosure, to enable users of financial statements to understand the potential dilution of ordinary shares arising from financial instruments that could be settled by delivering ordinary shares.[21] This could include, for example, convertible bonds and derivatives on own equity. The disclosure requirement also applies to share-based payment transactions to which IFRS 2 *Share-based Payment* applies. This disclosure would be in addition to the normal IAS 33 *Earnings per share* diluted earnings per share disclosure.

The ED proposes that the entity would be required to disclose information about the maximum dilution of ordinary shares, in a tabular format (to the extent possible), including:

(a) The maximum number of additional ordinary shares that an entity could be required to deliver for each type of potential ordinary share outstanding at the reporting date

(b) A description of contracts or other commitments to repurchase ordinary shares and the minimum number of each class

(c) A description of the causes for any significant changes in (a) and (b) from the prior reporting period and how these causes contributed to the changes

(d) A description of the terms and conditions that are relevant to understanding the likelihood of maximum dilution of ordinary shares for each class of potential ordinary shares outstanding at the end of the reporting period

(e) The information required in points (a) to (d) above would be set out in a table, which would also include:

[20] The ED, IFRS 7, new paragraph 30F.
[21] The ED, IFRS 7, new paragraph 30G and 30H.

i. The total maximum number of additional ordinary shares the entity might be required to deliver, being the sum of the amounts disclosed by (a) above

And

ii. The net maximum number of additional ordinary shares the entity may be required to deliver calculated by subtracting (b) above, from (e) i. above.

Such information would help users to understand how an entity distributes its returns to ordinary shareholders, how the entity has financed its operations in the past, and how the entity's capital structure might change in the future based on the instruments issued at the reporting date.

How we see it

Entities that apply IAS 33 will already provide information on the potential dilution of ordinary shares. The disclosures proposed in the ED are not intended to duplicate or replace the information already provided and some of the existing information could be used to meet the new requirements. However, the proposed requirements would serve a different purpose and would set-out different calculations to IAS 33. Entities should, therefore, carefully assess the impact of these additional requirements (including share-based payments to which IFRS 2 applies).

7.6 Puttable financial instruments classified as equity instruments

The ED proposes to require entities to disclose information to enable users to evaluate the nature, amount, timing and uncertainty of cash flows arising from puttable financial instruments classified as equity that it issues.[22] This includes:

- Summary quantitative information about the amount classified as equity instruments
- Its objectives, policies and processes for managing its obligation under the put option, including any changes from the prior reporting period
- The expected cash outflow on redemption or repurchase of that class of financial instruments and how the entity determined the expected outflow

7.7 Financial instruments that include an obligation for an entity to purchase its own equity instruments

The ED proposes to require entities to disclose information to enable users to understand the accounting for financial instruments that include an obligation for an entity to purchase its own equity instruments (such as those described in section 3 above) as follows:[23]

- The amount removed from equity and included in financial liabilities on initial recognition of the obligation as a financial liability, and the component of equity from which it was removed
- Any remeasurement gain or loss recognised in profit and loss in the reporting period

[22] The ED, IFRS 7, new paragraph 30I.
[23] The ED, IFRS 7, paragraph 30J.

- Any gain or loss on settlement if the obligation was settled in the reporting period
- The amount removed from financial liabilities and included in equity if the obligation expired unexercised in the reporting period
- Any transfers within equity of amounts related to the obligation during the reporting period and the components of equity affected by the transfer

8. Presentation

The ED proposes to amend IAS 1 to require an entity to provide additional information about amounts attributable to ordinary shareholders.[24] This will be presented separately from amounts attributable to other holders of the entity's own equity instruments. The change is intended to improve the information provided about an entity's financial instruments, particularly with respect to similarities and differences between claims of an entity's investors on the entity's net assets.

The proposed amendments are for:

- The statement of financial position to show 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.
- The statement of comprehensive income to show 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.
- The components of equity to be reconciled in the statement of changes in equity to include each class of ordinary share capital and each class of other contributed equity.
- Dividend amounts relating to ordinary shareholders to be presented separately from amounts relating to other owners of the entity.

9. Transition

The ED proposes that the transition to the amendments follows a fully retrospective approach. This requires the restatement of comparative information, but to reduce the burden of initial application, the IASB has limited it to one prior period, even if the entity presents more than one prior period in its financial statements.

The IASB chose to propose a fully retrospective approach on initial application to maximise the consistency of financial information between periods and facilitate analysis and understanding of comparative information.

Whilst the detailed restatement information is only required for one comparative period, in applying the fully retrospective approach, entities will need to make an adjustment to opening retained earnings at the beginning of the comparative period, to reflect any change in classification that applies at the start of that period. The opening adjustment would need to reflect as if the amendments had always been applied by the entity to any financial instruments outstanding for which the classification changes due to the amendments.

[24] The ED, IAS 1, paragraphs 54, 81B, 107 and 108.

The Board proposes to allow a relief, for equity instruments required to be classified as financial liabilities, from applying the effective interest method in IFRS 9 retrospectively, if it is impracticable. In this case, the fair value at the transition date would be treated as the amortised cost of the financial liability at that date.

A further relief is proposed for compound instruments, which is if the liability component is no longer outstanding at the date of initial application, it will not be necessary to separate the compound financial instrument.

The ED proposes an exemption, from the requirement to disclose for the first period in which the amendments are applied and the comparative period, the amount of the adjustment:

i) For each line item affected

And

ii) For entities that apply IAS 33, for basic and diluted earnings per share

For a change in the classification of a financial instrument on initial application of the amendments, the ED proposes that entities must disclose at the transition date or, if the financial instrument was issued during a comparative period, as at the beginning of the first reporting period after the financial instrument was issued:

i) The previous classification and carrying amount of the financial instrument determined immediately before applying the amendments

And

ii) The new classification and carrying amount of the financial instrument determined after applying the amendments

How we see it

The requirement for fully retrospective application may give rise to some further practicability challenges where the potential effect of the change in classification took place in prior periods for which sufficiently detailed information is not available.

For financial instruments in hedging relationships, if their classification were to change under the proposed amendments, the entity may be forced to retrospectively discontinue these hedging relationships when the amendments become effective. One example could be 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). Another example could be a compound financial instrument presently classified as a liability, for which the remuneration is reclassified from expense to equity. Entities should identify which existing hedging relationships could be at risk of this outcome and assess the potential consequences.

In assessing the implications of the proposals (and when planning to implement the amendments once they have been finalised), entities should also identify any new hedging relationships they intend to designate when the amendments take effect, as there are no exemptions from prospective hedge accounting designation.

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