IFRS Foundation

2023

World Standard-setters Conference

#WSS2023

Better information for better decisions

Update on financial instruments projects

Breakout session 1

Presenters

Zach Gast
IASB Member

Riana Wiesner
IASB Technical Director

Jaco Jordaan
IASB Technical Staff

Angie Ah Kun
IASB Technical Staff

Alev Halit Ongen
IASB Technical Staff

Agenda

1 **Amendments to the Classification and Measurement of Financial Instruments**

2 **Financial Instruments with Characteristics of Equity**

IFRS Accounting

Amendments to the Classification and Measurement of Financial Instruments

The views expressed in this presentation are those of the presenter, not necessarily those of the IFRS Foundation, International Accounting Standards Board or the International Sustainability Standards Board.

Objective and timeline

To address matters arising from

- the Post-Implementation Review (PIR) of the classification and measurement requirements of IFRS 9; and
- the IFRS Interpretations Committee

Q1 2022	Q2-Q4 2022	Q1 2023	Q3 2023	Q4 2023 – TBD
Feedback received on PIR of IFRS 9 C&M	IASB decisions on standard-setting	Exposure Draft issued	Feedback received on Exposure Draft	Redeliberation

Preliminary feedback on Exposure Draft

Topic	Further clarification needed
Derecognition of financial liabilities	
Classification of financial assets	
General (incl. ESG-linked features)	
Non-recourse features	
Contractually linked instruments	
Disclosure	
Equity instruments designated at fair value through OCI	
Changes in cash flows due to contingent events	
Transition	

Derecognition of financial liabilities

Proposals	Feedback
Clarifying that settlement date accounting applies to both financial assets and financial liabilities	Mostly supportive, with calls for further clarification
Permitting a financial liability that is settled using an electronic payment system to be deemed to be discharged before settlement date if criteria are met	Mostly supportive, but some calls to make option available to financial assets and concerns that the criteria are too restrictive

Classification of financial assets—general

Proposals	Feedback
Clarification of a ‘basic lending arrangement’	Support for intention, but questions around the interaction of amendments and reference to ‘magnitude’ of changes in cash flows
Changes to contractual cash flows are SPPI compliant if the contingent events is specific to the borrower	Concerns about financial assets with terms linked to increased lending costs or group-wide ESG targets
Examples to apply the general principles to financial assets with ESG-linked features	Requests for expanded analysis of the proposed examples and for additional examples

Classification of financial assets—non-recourse features and CLIs

Proposals	Feedback
Clarification of ‘non-recourse features’ and examples of applying look-through test	Mostly supportive, with some questioning the more restrictive description and others asking for more guidance
Clarification of the scope of contractually linked instruments (CLI) and contrasting with secured lending arrangements	Mostly supportive, but many asking for clarification on the distinction between secured lending arrangements and CLIs
Clarification of the eligibility of lease receivables with SPPI cash flows in the underlying pool	Supportive, but some asking for further clarification on residual values

Disclosure

Proposals	Feedback
Amended disclosure requirements for equity instruments designated at fair value through other comprehensive income	Mostly supportive
Qualitative and quantitative disclosure requirements for contractual terms that could change the timing or amount of contractual cash flows based on a contingent event specific to the borrower	Strong objections to the scope of the requirements, particularly from banks

Next steps

The IASB will consider the feedback received in finalising the amendments to IFRS 9 and IFRS 7

IFRS®
Accounting

Financial Instruments with Characteristics of Equity

Topics for today

1. Project overview
2. Proposed amendments to classification
3. Proposed amendments to presentation and disclosures
4. Proposed transition requirements

Objective and timeline

- **Improve information** provided in financial statements about financial instruments issued
- **Address known practice issues** applying IAS 32 *Financial Instruments: Presentation* by clarifying underlying principles and not fundamentally rewriting IAS 32

Q4 2019	Q2 2020 – Q2 2021	Q4 2021	Q1-Q2 2022	Q3 2022	Q4 2022 – Q2 2023	Q4 2023
Project plan agreed	Fixed-for-fixed condition	Contingent settlement provisions	Shareholders' discretion	Obligations to repurchase own equity instruments	Presentation	Exposure Draft
	Perpetual instruments	Effects of laws/regulations on contractual terms	Reclassifications		Sweep Issues	
	Disclosures				Disclosures	
					Transition	

For tentative decisions on these topics see Agenda Paper 5A and IASB update for the April 2023 IASB meeting.

Proposed amendments to classification

Fixed-for-fixed condition

For a contract to be classified as an equity instrument, the amount of consideration to be exchanged for each of an entity's own equity instruments shall be in the entity's **functional currency** and be either:

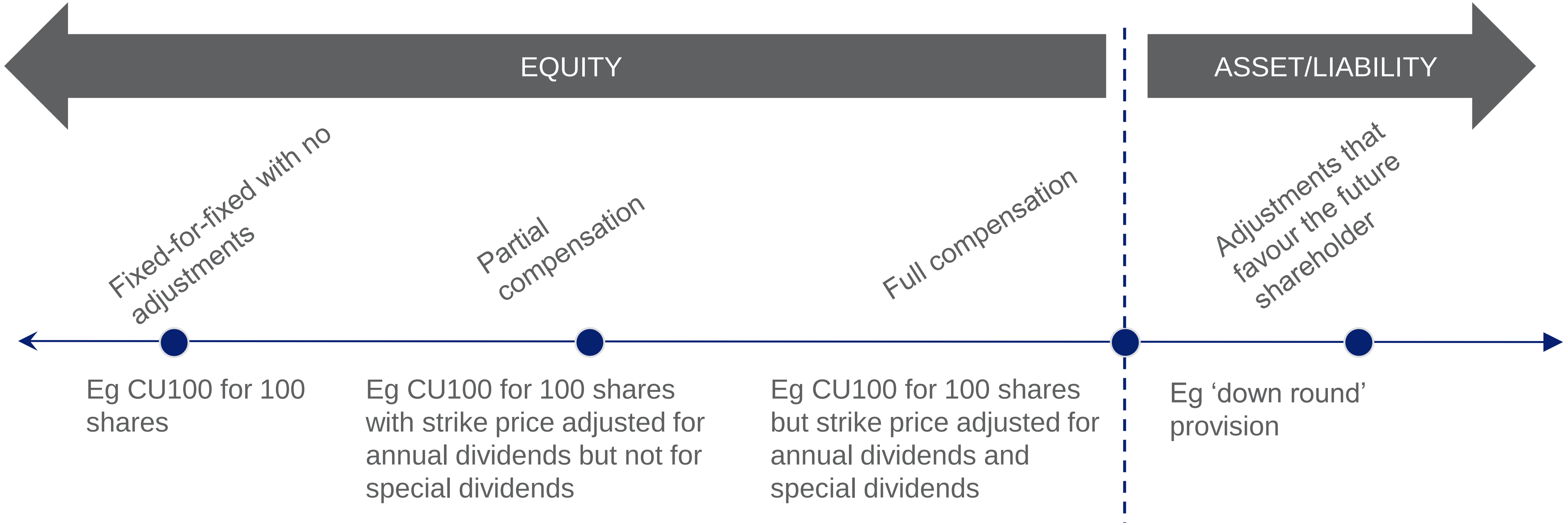
- fixed (that is, will not vary under any circumstances); or
- variable solely as a result of either a preservation adjustment or passage-of-time adjustment or both.

Examples	Classification
Fixed number of shares for fixed amount A written call option gives the holder a right to buy 100 of the company's own shares for CU100 in cash in five years	**Equity** The amount of cash the entity will receive for each share is fixed, ie CU1 per share
Variable number of shares to a fixed value A written call option gives the holder a right to buy as many of the company's own shares as are worth CU100 in exchange for CU95 in cash	**Financial liability** The amount of cash the entity will receive for each share is not fixed

IFRS Accounting

Preservation adjustments

Classify as equity if adjustments preserve economic interests of future shareholders **to an equal or a lesser extent** relative to economic interests of current shareholders.



Passage-of-time adjustments

Classify as equity if adjustments:

- are pre-determined at inception of the contract;
- vary only with the passage of time; and
- has the effect of fixing the present value (PV) at initial recognition of the amount of consideration exchanged for each of the entity's own equity instruments.

Examples	Classification
Company A issues an option that can be exercised for predetermined amounts at predetermined dates: • 10 shares for CU100 at end of Year 1 • 10 shares for CU150 at end of Year 2 • 10 shares for CU500 at end of Year 3	**Likely to be a financial liability** Not likely to be a passage-of-time adjustment because the contract does not fix the PV of the consideration amount per share (PV at inception of CU150 in Year 2 is unlikely to be the same as PV at inception of CU500 in Year 3 applying the same discount rate).

Reclassification between financial liabilities and equity instruments

IAS 32 requirements

- Paragraph 15 requires an issuer of a financial instrument to classify the instrument, or its component parts, on initial recognition.
- No general reclassification requirements.
- Paragraphs 16E-16F contain specific requirements for reclassifying puttable instruments and obligations arising on liquidation.

Diversity in practice when there is a change in the substance of the contractual arrangement without a modification of the contract

Change in circumstances external to the contractual arrangement

Reclassification required prospectively from the date the change in circumstances occurs.

Changes when an existing contractual term becomes or stops being effective **with the passage of time**

Reclassification prohibited, disclosure required.

Contingent settlement provisions

Paragraph 25 of IAS 32

Example	Contingent convertible instrument
Key Features	• Issued at par • Convertible into variable number of shares to the value of fixed par amount if CET 1 ratio breached • No maturity date • Contingent event outside the control of both parties, could occur immediately • Discretionary dividends
Liability component	Settlement in variable number of shares upon contingent event
Equity component	Discretionary dividends

Practice questions

- Is there a required order of applying requirements in IAS 32?
- What is the impact of probability on measurement?
- How are subsequent discretionary distributions recognised?

Proposed amendments

Order of applying requirements in IAS 32	Financial instruments with contingent settlement provisions could be compound instruments.
Impact of probability on measurement	Same approach for initial and subsequent measurement of a financial liability (or liability component) ie ignore probability and estimated timing of the contingent event. Therefore, a liability component of a compound financial instrument with a contingent settlement provision, which could require immediate settlement if a contingent event occurs, is measured at the full undiscounted amount of the conditional obligation.
Discretionary payments	Discretionary payments recognised in equity, even if all the proceeds are initially allocated to the liability component of a compound financial instrument.

Other proposed amendments

Liquidation

Stages of a business

Going concern

Financial Difficulty

Permanent Ceasing of Operations

Liquidation Process

Strike Off

Proposed amendment

'Liquidation' refers to when an entity is in the process of permanently ceasing operations

Non-genuine

Extremely rare

Highly abnormal

Very unlikely

Proposed amendment

'Not genuine' assessment requires judgement and is not based solely on the probability or likelihood of the contingent event occurring

Paragraph 23 of IAS 32

Obligations to redeem own equity instruments

For a contract containing an obligation for an entity to purchase own equity instruments for **cash or another financial asset**:

- a financial liability is recognised initially at the **present value of the redemption amount**, reclassified from **equity**;
- the financial liability is subsequently measured in accordance with **IFRS 9**; and
- the financial liability is reclassified to equity if the contract expires without delivery.

- Written put options on non-controlling interests (NCI puts) and forward contracts to buy own equity
- Evidence of accounting diversity in practice
- Several Committee and IASB discussions since 2006, all ultimately referring the issues to be considered comprehensively as part of the FICE project

Practice question 1

What is the question?

What is the debit entry on initial recognition of the obligation to redeem an entity's own equity instruments in the consolidated financial statements?

- Diversity in practice whether NCI or parent equity should be debited.
- Affects accounting for dividends subsequently paid to NCI shareholders and accounting on expiry/settlement of the NCI put.
- Similar issues arise for other obligations to redeem own equity instruments.

What is the IASB proposing?

If the entity does not yet have access to the rights and returns associated with ownership, initial amount removed from a component of equity **other than non-controlling interests or issued share capital.**

Practice question 2

What is the question?

Where are changes in the carrying amount of the financial liability recognised when the NCI put is subsequently measured?

- Perceived conflict between IAS 32 (refers to IFRS 9 for subsequent measurement of financial liability) and IFRS 10 (refers to equity transactions with owners in their capacity as owners).

What is the IASB proposing?

Gains or losses from remeasurement are recognised in **profit or loss**.

Practice question 3

What is the question?

How would the financial liability be measured subsequently?

- Would an entity subsequently apply the IFRS 9 requirements for amortised cost or fair value accounting and take into account probabilities and estimates of the amount and timing of contractual cash flows?

What is the IASB proposing?

- Use the **same approach for initial and subsequent measurement**—ignore the probability and estimated timing of the holder exercising the written put option in initial and subsequent measurement; and
- **Remove the reference to IFRS 9** from paragraph 23 of IAS 32.

Practice question 4

What is the question?

What if a company settles an NCI put with a variable number of parent shares instead of cash?

- Does paragraph 23 of IAS 32 apply because it only refers to settlement in cash or another financial asset?

What is the IASB proposing?

Paragraph 23 applies also to obligations to redeem own equity that could be settled in a **variable number of another class** of own equity.

Practice question 5

What is the question?

Should obligations arising from gross physically settled forward purchase contracts and written put options be presented on a gross or net basis?

- Gross presentation consistent with accounting for puttable shares and obligations that are conditional on events beyond the entity's control.
- Net presentation consistent with accounting for derivatives.

What is the IASB proposing?

- Not to reconsider gross vs net but clarify **rationale for gross basis**.
- Written put options and forward purchase contracts on an entity's own equity instruments are required to be presented gross to:
  - align the accounting with other obligations that are conditional on events or choices beyond the entity's control; and
  - assist users of financial statements in assessing the entity's exposure to liquidity risk.

Practice question 6

What is the question?

What is the accounting on expiry of a written put option on an entity's own equity instruments?

- IAS 32 requires the carrying amount of the financial liability to be removed from financial liabilities and included in equity but does not specify where to recognise the credit to equity.
- Can gains or losses previously recognised in profit or loss from remeasuring the financial liability be reversed upon expiry of the put option?

What is the IASB proposing?

On expiry of a written put option on an entity's own equity instruments:

- the financial liability is included in the same component of equity as that from which it was removed on initial recognition of the put option; and
- the cumulative amount in retained earnings related to remeasuring the financial liability could be transferred to another component of equity but is **not reversed in profit or loss**.

Proposed amendments to presentation and disclosures

Presentation—Proposed amendments to IAS 1

To ensure amounts attributable to ordinary shareholders are clearly visible on an entity's statement of financial position, statement(s) of financial performance and statement of changes in equity, an entity will be required to present:

Equity

- Ordinary shareholders of parent
- Other owners of the parent

Balance sheet

Line items on issued capital and reserves shown separately

Statement of financial performance

Results attributable shown separately

SOCIE

Each class of contributed equity shown separately

Distributions shown separately

Not applicable to stand-alone derivatives

Disclosures

Terms & Conditions

- **Debt-like characteristics**
- **Equity-like characteristics**
- Characteristics that determine the classification

Priority on liquidation

- **Nature and priority of claims against an entity**
- **T&Cs about priority on liquidation for particular instruments**

Potential dilution

- Maximum number of additional ordinary shares
- Reduced by minimum number of shares for repurchase

Additional disclosures

- Reclassifications
- Remeasurement gains or losses on liabilities based on entity's performance/net assets
- Obligations to redeem own equity instruments

Other T&Cs

- Significant judgements
- Terms that become/stop being effective with passage of time
- Compound instruments – initial allocation between components

Scope of IFRS 7

Equity instruments issued

Debt-like characteristics in equity instruments

Even though the entity has no contractual obligation to deliver cash, contractual terms:

- give rise to cash flows that have similar characteristics of nature, timing or amount to those of a financial liability; or
- may cause an entity to deliver debt-like cash flows.

- For example, preference shares not redeemable by the holder, classified as equity because the entity has the contractual right to avoid/defer payment until liquidation.
- Debt-like characteristics—fixed cumulative coupon amounts, specified coupon payment dates and fixed principal amount.

Equity-like characteristics in financial liabilities

- Contractual terms that give rise to cash flows that have similar characteristics of nature, timing or amount to those of ordinary shares.
- Do not negate any contractual obligation on the issuer to deliver cash but may affect the amount or timing of the cash flows an entity has a contractual obligation to deliver.
- May result in an entity delivering its own equity instruments to settle an obligation or not paying the full amount of the obligation.

For example, a financial liability that requires an entity to settle the instrument by delivering a variable number of own shares to the holder.

Disclosures – Priority on liquidation: claims against entity

Objective

Provide information about nature and priority of claims against the entity that arise from financial instruments

Scope

All financial liabilities and equity instruments within the scope of IAS 32

Requirements

Categorise financial instruments by differences in nature and priority, distinguishing between:

- secured and unsecured
- contractually subordinated and unsubordinated
- issued/owed by parent and issued/owed by subsidiaries

Priority on liquidation illustrative disclosure

Nature and priority of claims (Company Y)

	As of 31 Dec 2020 (CU million)		
		Issued/owed by	
	Consolidated	parent	subsidiaries
Secured and unsubordinated			
Senior secured debt (a)	1,200	-	1,200
Lease liabilities (a)	920	780	140
Unsecured and unsubordinated			
Trade and other payables	1,450	320	1,130
Senior unsecured debt (a)	450	-	450
Unsecured and subordinated			
Subordinated liabilities (see note 15)	590	480	110
Classified as financial liabilities	*4,610*	*1,580*	*3,030*
Unsecured and subordinated			
Perpetual notes (see note 18)	200	200	-
Irredeemable preference shares (See note 19)	400	400	-
Non-controlling interest	1,350	-	1,350
Other reserves	15,000	10,000	5,000
Ordinary share capital	8,500	8,500	-
Classified as equity	*25,450*	*19,100*	*6,350*
Total	***30,060***	***20,680***	***9,380***

(a) Included in the “Borrowings” line item in the statement of financial position.

Disclosures – Priority on liquidation: contractual terms about priority

Objective

Provide information about the risks and returns of financial instruments on liquidation of the entity

Scope

- Financial instruments with characteristics of both debt and equity
- Includes compound instruments
- Excludes standalone derivatives

Requirements

Disclose terms and conditions about priority of financial instruments on liquidation, including:

- terms that indicate priority
- terms that could lead to changes in priority
- details of intragroup arrangements such as guarantees

Proposed transition requirements

Transition

Fully retrospective with restatement of comparative information

1. Transition relief from some requirements
2. Disclosure of nature and amount of any changes in classification resulting from initial application
3. No specific relief from IAS 34 requirements for interim financial statements
4. No additional transition relief for first-time adopters

IFRS
Accounting

Follow us online

ifrs.org

@IFRSFoundation

IFRS Foundation

International Accounting
Standards Board