IFRS

STAFF PAPER

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IASB® meeting

Project	**Financial Instruments with Characteristics of Equity (FICE)**
Paper topic	Summary of feedback—The Board's preferred approach

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Objective

1. This paper summarises the feedback on the Discussion Paper *Financial Instruments with Characteristics of Equity* (DP). More specifically, this paper focuses on feedback from comment letters and outreach on the Board's preferred approach to classification of financial instruments, which is based on the timing and amount features.

Structure of paper

2. The remainder of this paper is structured as follows:

   (a) Background—the proposals in the DP (paragraphs 3–5)

   (b) Key messages from the feedback (paragraphs 6–9)

   (c) Feedback in relation to the timing feature (paragraphs 10–13)

   (d) Feedback in relation to the amount feature (paragraphs 14–38)

   (e) Other features of claims that are relevant to classification (paragraphs 39–42)

   (f) Alternative classification approaches suggested (paragraph 43)

Background—the proposals in the DP

3. The Board's preferred approach to classification, described in the DP, would classify a claim as a liability if it contains:

   a) an unavoidable obligation to transfer economic resources at a specified time other than at liquidation (the timing feature); and/or

   b) an unavoidable obligation for an amount independent of the entity's available economic resources (the amount feature).

4. This is because, in the Board's view, information about both features are relevant to assessments of the entity's financial position and financial performance. More specifically:

   (a) *assessments of funding liquidity and cash flows*—whether an entity will have the economic resources required to meet its obligations as and when they fall due. These assessments are driven by information about requirements to transfer economic resources at a specified time other than at liquidation ie the timing feature.

   (b) *assessments of balance-sheet solvency and returns*—whether an entity has sufficient economic resources required to meet its obligations at a point in time, and whether the entity has produced a sufficient return on its economic resources to satisfy the return that its claims oblige it to achieve. These assessments are driven by information about the amount of the obligation ie the amount feature.

5. The DP also proposed that information about other features of claims, such as priority of claims, should be provided through presentation and disclosure.

Key messages

6. **Should the Board retain the binary classification in its preferred approach?** Most respondents supported the Board's decision to continue the binary distinction between liabilities and equity and define equity as the residual interest in the assets of the entity after deducting all of the entity's liabilities. While acknowledging that some financial instruments indeed contain features of both equity and a liability, most respondents including users of financial statements, expressed the view that other

approaches such as introducing a 'mezzanine' class of financial instruments would give rise to increased complexity and reduced understandability for users of financial statements, such as the need for two sets of classification principles to distinguish three classes of claims and determining the accounting for changes in the value of 'mezzanine' financial instruments.

7. **What features of claims are relevant in distinguishing financial liabilities from equity?** Most respondents agreed with the Board that both the *timing* of the required transfer of economic resources and the *amount* of the obligation are the relevant features of financial instruments for the purpose of distinguishing financial liabilities from equity. However, most respondents were not supportive of the amount feature assessment as described in the Board's preferred approach.

8. **Should classification be driven by any other features of claims?** Most respondents agreed with the proposal in the DP that information about other features of claims, such as priority of claims, should be provided through presentation and disclosure.

9. **Do respondents support the use of timing and amount features in classifying financial instruments as proposed in the DP?** Almost all respondents expressed support for the timing feature. However, most respondents disagreed and/or expressed concerns over the amount feature assessment, as described in the Board's preferred approach, in particular, how it applies to obligations for an amount payable only on liquidation. Respondents also highlighted a number of challenges associated with the new terminology used to articulate the amount feature such as the dependency on the entity's available economic resources. Some respondents acknowledged the inherent difficulty in defining 'residual interest', but no specific suggestion was made that could be incorporated into or used instead the current description of the amount feature.

Timing feature

10. Almost all respondents supported the timing feature for one or more of the following reasons:

    (a) The timing feature is largely consistent with the existing requirements in IAS 32 *Financial Instruments: Presentation* and is not expected to lead to implementation challenges because it uses well-established and easily understood terms.

(b) The timing feature is broadly consistent with the definition of liability in the *Conceptual Framework for Financial Reporting* (the Conceptual Framework).[1]

(c) The timing feature provides relevant information for the assessments of funding liquidity and cash flows of an entity.

11. Few respondents noted that it also provides information about assessments of balance-sheet solvency and returns. That is because, information provided about the timing of cash outflows required to settle an entity’s liabilities enables users of financial statements to compare them to the entity's existing resources hence contributing to the assessments about whether the entity has sufficient resources to meet its financial obligations. Some of these respondents suggested that a classification approach that would focus solely on the *timing feature* may be worth exploring it again, acknowledging that the Board had previously discussed and rejected an approach primarily focused on the timing feature (the so-called Alpha approach). See paragraph 43(b) for alternative approaches suggested.

What is meant by ‘liquidation’?

12. However, many respondents, primarily from the banking sector, questioned how to interpret the term ‘liquidation’ as included in the timing feature. This is because, some entities do not necessarily go directly into liquidation but instead may be subject to other processes, for example, some regulated financial institutions are subject to resolution regimes[2]. In particular, in the context of the banking industry, the resolution regimes are generally designed to prevent a bank from going into liquidation. Consequently, under such regime, financial instruments with obligations that require transfer of economic resources upon the resolution event specified by

[1] The Board issued the revised Conceptual Framework for Financial Reporting (the Conceptual Framework) in May 2018.

[2] For example, resolution regime in accordance with Directive 2014/59/EU establishing a framework for the recovery and resolution of credit institutions and investment firms in the European Union.

the regime (which may or may not be specified in the contract), would require such transfer before the liquidation of the entity. More specifically, in this context:

(a) some respondents asked for greater clarity and implementation guidance on how the notion of 'liquidation' should be applied in such situations.

(b) other respondents suggested the Board broaden the description of the timing feature to also take into consideration events similar to liquidation such as resolution described above.

13. Few respondents also questioned why the liquidation in the timing feature does not include contractually specified liquidation.[3] In their view, equity instruments issued by a limited-life entity provide their holders with the same equity risk as those issued by a non-limited-life entity. Accordingly, these respondents consider that these financial instruments should be classified as equity by definition rather than being classified as equity applying the puttable exception. In their view, equity classification would better depict the economic characteristics and risks of these financial instruments. See Agenda Paper 5E for this meeting for further details.

Amount feature

14. Whilst most respondents agreed that information about the *amount* of an obligation is a relevant feature when distinguishing financial liabilities from equity, almost all respondents expressed concerns related to the way it is articulated in the Board's preferred approach in the DP. Such concerns included:

(a) obligation for an independent amount that only arises on liquidation of the entity (paragraphs 15–17).

(b) the interaction with the Conceptual Framework (paragraphs 18–25).

(c) the clarity of articulation of the new terminology (paragraphs 26–31).

(d) measurement challenges (paragraphs 32–38).

[3] Footnote to paragraph 2.22 of the Discussion Paper *Financial Instruments with Characteristics of Equity* (DP) states that if liquidation is contractually specified, such as in a limited-life entity, or occurs in tandem with a particular event or at the option of the holder, information about obligations to transfer economic resources at such dates will also be relevant to assessments of funding liquidity and cash flows. For the purposes of the DP, liquidation does not include contractually specified liquidation. Therefore, references to contracts that require a transfer of economic resources only at liquidation include only perpetual contracts.

Obligation for an independent amount payable on liquidation of the entity

15. One of the primary concerns raised by almost all respondents who did not support the amount feature related to the liability classification resulting from applying the amount feature to financial instruments that contain obligations for an independent amount payable only on liquidation of the entity. Reasons for those concerns included:

    (a) such an application is inconsistent with the going concern assumption, because determining classification for a financial instrument based on '*what happens at liquidation*' whilst the entity is preparing financial statements applying the going concern assumption contradicts such an assumption as defined in the Conceptual Framework.[4] Some also questioned the usefulness of the resulting information to the users of the financial statements. This is because, while the entity is a going concern there will be no contractual requirement for the entity to transfer cash or other financial assets and the liability classification does not provide information about the present obligations of the entity.

    (b) such an application is different from the existing classification requirements in IAS 32 and would result in a change in the classification outcome. This is because applying IAS 32[5] financial instruments that require payment *only on liquidation* are classified as equity.

    (c) overall, respondents questioned the usefulness of the information provided by this approach, because in their view, liquidation would require settlement of all claims, including all financial liabilities and equity instruments. Respondents argued that settlement amount of all claims would be *dependent* on the entity's available economic resources

[4] Paragraph 3.9 of the Conceptual Framework states that financial statements are normally prepared on the assumption that the reporting entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to enter liquidation or to cease trading. If such an intention or need exists, the financial statements may have to be prepared on a different basis. If so, the financial statements should describe the basis used.

[5] The respondents referred to paragraph 25(b) of IAS 32 which requires that if the issuer can be required to settle the obligation in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) only in the event of liquidation of the issuer then such obligation is not classified a financial liability.

at that point in time (ie to the extent that the entity has sufficient economic resources available).

16. Respondents described examples of financial instruments that contain an obligation for an independent amount such as periodic coupon payment based on a specific interest rate but also contain an option for the issuer to defer the payment until liquidation. Further, many of these instruments have a fixed notional amount that is required to be repaid at liquidation with an option for the issuer to redeem the instrument at a specified date or on the occurrence of a specified event. From the contractual perspective, such obligations only arise on liquidation even if in practice the entity would often choose to (and are expected to by the current and potential investors) make payments on a periodic basis and to repay the principal amount at a specified date before liquidation.

17. While acknowledging that using the amount feature in classification could provide information for the assessments of balance-sheet solvency and returns, few respondents questioned whether the liability classification of obligations that only arise on the entity's liquidation would indeed facilitate such assessments. This is because, in their view, the assessment of balance-sheet solvency and returns in the context of classification of a financial instrument is about whether the financial instrument can cause an entity to become insolvent and that is relevant while the entity is a going concern (ie solvent) and not upon its liquidation.

Interaction with the Conceptual Framework

'Practical ability to avoid' vs 'unavoidable obligation'

18. Many respondents commented on what they consider as an inconsistency between the concept of 'unavoidable obligation' (included in both the amount and timing features) in the Board's preferred approach and the 'practical ability to avoid' as described in the Conceptual Framework. For ease of reference, we have reproduced the relevant paragraphs from the Conceptual Framework in Appendix A to this paper.

19. More specifically, many of these respondents suggest the Board clarify how these two concepts interact with each other, and set out the rationale for any deviation, should an inconsistency remain. Few respondents, whilst acknowledging that there

are operational challenges with considering economic incentives in classifying financial instruments, expressed the view that in some circumstances, those incentives may be sufficiently compelling for an entity to choose a settlement outcome that warrants a particular classification (eg excessive increase in interest rate in a step-up bond[6] would suggest the liability classification) and hence those should be considered in classification of such financial instruments in order to reflect their 'substance over form'.

20. Additionally, these respondents referred to paragraphs 4.34–4.36 of the Conceptual Framework (reproduced in Appendix A to this paper), which discuss situations where an entity has an obligation because it has no practical ability to avoid payment or transfer, and raised a question about the proposed liability classification proposed in the DP for a financial instrument that contains an obligation for an independent amount that only arises on liquidation. According to these respondents, if the issuer of a financial instrument has the practical ability to avoid the payment arising from obligations in such financial instrument as long as it is a going concern, then arguably, the financial instrument would not be a liability applying this notion. They highlighted that paragraph 4.34 of the Conceptual Framework also states that neither an intention to make a transfer, nor a high likelihood of a transfer, is sufficient reason for concluding that the entity has no practical ability to avoid a transfer.

'Economic resources' vs 'available economic resources'

21. The Conceptual Framework defines an economic resource as a right that has the potential to produce economic benefits. In addition, it defines an asset as a present economic resource controlled by the entity as a result of past events.

22. Many respondents raised the question on how the definition of an economic resource in the Conceptual Framework interacts with the term 'available economic resources' in the Board's preferred approach, referring to paragraph 3.17 of the DP in particular, which is reproduced below:

[6] Respondents described step-up bonds that are irredeemable and have an interest rate that is fixed initially but resets to a higher rate after a specified period of time.

> 3.17 An entity's available economic resources are the total recognised and unrecognised assets of the entity that remain after deducting all other recognised and unrecognised claims against the entity (except for the financial instrument in question). An entity should not need to determine its available economic resources to assess whether the amount of a financial instrument (that is, the amount of the contractual obligation of a financial instrument) is independent of its available economic resources. Whether the amount of a financial instrument is independent of the entity's available economic resources should be clear from the instrument's contractual terms.

23. These respondents observed that whilst the concept of 'economic resources' in the Conceptual Framework appears to indicate that economic resources represent the assets of the entity, the 'available economic resources' in the DP appears to be more closely related to the net assets of an entity. Some of these respondents asked for further clarity of articulation (see paragraphs 27–30).

24. Few respondents highlighted that, in some cases what would be considered as a liability under the Conceptual Framework differs from the proposals in the DP because of the difference in how an obligation to transfer own shares is treated. The Conceptual Framework states that a liability must include an obligation to *transfer an economic resource*, and it indicates that an *entity's own equity instruments are not its economic resources*. However, applying the proposals in the DP, the entity would classify as a financial liability a financial instrument that requires a *transfer of own shares* for an amount independent of the entity's available economic resources regardless of the fact that the entity has no obligation to transfer economic resources before liquidation.

Other comments

25. Whilst acknowledging that the Conceptual Framework was completed on the basis that specific challenges of distinguishing liabilities from equity for financial instruments would be investigated through the FICE project, few respondents expressed the view that the starting point of any project, including FICE, should be within the principles in the Conceptual Framework, and that the rationale should be clearly articulated, if any deviations are necessary.

Concerns expressed around the clarity of articulation

New terminology

26. Most respondents expressed the view that the Board's preferred approach introduces new terminology which leads to the following concerns:

    (a) *Costs, potential unintended consequences and disruption in practice*. New terminology requires preparers and auditors to familiarise with the new terms, reconsider current classification decisions and document new assessments of all complex financial instruments. This would increase implementation costs, the need for judgment and interpretations and pose conceptual or practical challenges that are not currently present when applying requirements of IAS 32. These respondents recommended that the Board consider how it could articulate its preferred approach using existing terminology, thereby limiting unintended consequences and unnecessary implementation efforts.

    (b) *Lack of clarity on new terms*. Respondents requested further explanation or clearer definition of some terms, in particular those that are required to assess the amount feature of a financial instruments. A lack of clarity might lead to interpretative issues and diversity in practice. Paragraphs 27–30 below provide further information on this.

How to determine whether an obligation amount is independent of the entity's available economic resources?

27. Most respondents suggested the Board should clarify how entities determine whether an obligation amount is independent of the entity's available economic resources. Many of these respondents highlighted that the DP states that whether the amount of a financial instrument is independent of the entity's available economic resources should be clear from the instrument's contractual terms, but in practice, the contractual terms of financial instruments often do not use that terminology.

28. The DP explained that the entity's share price might be used as a proxy for changes in the entity's available economic resources.[7] Many respondents expressed the view

[7] Footnote to paragraph 4.29 of the DP states that when derivatives on own equity are valued, a variable such as the entity's share price might be used as a proxy for changes in the entity's available economic resources.

that the Board should clarify why an entity's share price represents an appropriate proxy for changes in the entity's available economic resources. These respondents commented that it would not always be clear in practice what can and cannot be used as a proxy. More specifically, while it may be straightforward when the amount of an obligation is a fixed amount, that determination would often involve significant judgement for an amount that is also affected by multiple variables.

29. Additionally, some respondents asked what alternative measures could be used as a proxy, for example, for entities that are not listed and therefore do not have quoted price of their shares. Some of these respondents suggested Earnings Before Interest and Tax (EBIT) or other similar measures as an alternative proxy.

30. Furthermore, many respondents posed questions on the meaning of, or described their own understanding of, the following specific terms, which are relevant to assessing the amount feature of a financial instrument:

(a) *the amount of an obligation*—noting that paragraph 3.21 of the DP states that the 'amount' of a particular financial instrument as used in the Board's preferred approach is not the fair value of the financial instrument, respondents suggested the Board clarify what the 'amount' is. For example, whether it represents amount required to be transferred on settlement date.

(b) *unrecognised assets of the entity, unrecognised claims against the entity*—questions on how unrecognised assets and unrecognised liabilities should be incorporated in determining the entity's available economic resources.[8] For example, some preparers said that they often only consider some but not all claims or cash flows in their forecasts and may not consider contingent assets or liabilities explicitly. A question was also raised on what measurement basis should be applied for determining an entity's available economic resources, for example, whether a historical cost or current value measurement should be considered.

[8] See paragraph 22 for a discussion of an entity's available economic resources described using the terms unrecognised assets of the entity and unrecognised claims against the entity.

(c) *degree of independence*—respondents overall requested further clarity on what would be considered independent and suggested the Board specify the degree of independence that would be required to meet this principle. For example, a financial instrument contains a cap on the amount of the obligation such that the amount varies with changes in the entity's available economic resources but does so in a way that the amount could only marginally exceed the entity’s available economic resources. Does the Board consider such an amount to be ‘independent’?

Solvency assessment

31. All respondents who explicitly provided feedback regarding this assessment, agreed that information that enable the assessment of balance-sheet solvency and returns is critical to users of financial statements. However, many of these respondents questioned the understandability and clarity of the articulation of this assessment, as set out in the DP (reproduced in paragraph 4(b) of this paper). Some said that this assessment is most relevant whilst the entity applies the going concern assumption and obligations for amounts payable only on liquidation are not relevant to this assessment. See also paragraphs 15–17 of this paper.

Measurement challenges

32. While acknowledging that the scope of the DP does not includes measurement of financial instruments, many respondents expressed the view that consideration must be given to initial and subsequent measurement, in order to enable a meaningful assessment of the proposed classification approach. The potential measurement challenges that were most frequently raised by respondents are described below. Additionally, Agenda Paper 5B for this meeting further discusses these measurement challenges in the context of specific financial instruments.

Measurement of an obligation for an independent amount payable at liquidation

33. Paragraph 3.24(b) of the DP[9] explains that if the financial instrument contains a fixed amount payable only at liquidation, then such amount is considered

[9] As an example of financial instruments with amounts that are not independent of the entity’s available economic resources paragraph 3.24(b) of the DP describes an irredeemable non-cumulative preference share

independent of the entity's available economic resources. On initial recognition, that fixed amount would be discounted back to nil or an insignificant amount if measured on a going concern basis.

34. In response to this, firstly few respondents questioned whether it is useful to classify a component of a financial instrument as a financial liability based on an obligation for an amount that would be discounted back to nil or an insignificant value (if measured on a going concern basis). In other words, it appeared counterintuitive that the classification depends on an obligation that has no value or insignificant value at initial recognition.

35. Secondly, many respondents noted that this approach gives rise to significant challenges in measurement of the liability component of compound instruments applying IFRS 9 *Financial Instruments.* This is because it would require remeasurement of changes in timing and/or amount of that obligation at each reporting date. According to these respondents, several measurement challenges and questions would arise, notably:

    (a) some respondents asked whether the proposal would require an entity to assess the probability and the timing of the entity going into liquidation or whether it would require a binary assessment (ie assume liquidation will not occur within a definite time period as long as the going concern assumption applies). If the former is required, some raised concerns on the extent of judgement required and practical implications for an entity to estimate, or auditors to audit it. They observed that as liquidation becomes more likely, the increase in the probability for a transfer of economic resources to settle the amount payable at liquidation will result

with a stated coupon or dividend amount that is a specified rate of return or a specified amount of cash, but the coupon or dividend amount is cancelled if the coupon is not paid by the entity. Because the entity has the unconditional right to avoid paying coupons or dividends, this stream of cash flows is not considered to be independent of the available economic resources. The irredeemable non-cumulative preference share may also require a fixed amount to be paid at liquidation, for example in the form of a principal amount. If so, such instruments are compound instruments. The fixed amount payable at liquidation is independent of the entity's available economic resources, however, on initial recognition, that fixed amount would be discounted back to nil or an insignificant amount if measured on a going concern basis.

in losses reported in profit or loss, due to the acceleration of the unwind of the discount for the passage of time.

(b) some respondents asked, whether changes in subsequent measurement of the financial liability component of a compound instrument would be recorded as gain or loss in the statement of profit or loss (as required by IFRS 9), or whether it would necessitate a reallocation of the value between its financial liability and equity component.

(c) if the financial instrument includes an option for the issuer to redeem the financial instrument (issuer call option), in particular, when there are multiple call options (eg issuer call options contingent on trigger events such as a change in regulatory capital treatment, tax treatment, etc.), this would increase the challenges in measurement of the liability component. This is because, it raises the question as to whether entities need to factor the probability that the call option will be exercised in the measurement of the financial liability component.

36. The clarifications required on the meaning of 'liquidation' and whether it includes other insolvency events, as described in paragraph 12, were also raised as part of these comments as they would have measurement implications if entities were required to assess the probability of liquidation in measuring the financial liability component.

Measurement consequences for holders of financial instruments

37. Whilst acknowledging that the DP is focused on distinguishing financial liabilities from equity for the issuer of financial instruments, few respondents expressed concerns over the potential implications of the DP proposals to the holders of financial instruments. This is because, IFRS 9 refers to IAS 32 for the definition of equity instruments.

38. To illustrate the above point, respondents used the example of irredeemable fixed-rate cumulative preference shares that are classified as equity applying IAS 32 but

would be classified as financial liability applying proposals in the DP[10]. Respondents noted that in the holder's financial statements, they may be required to be measured at fair value through profit or loss. Respondents view this as effectively eliminating the option for the holders to elect to present subsequent changes in fair value of these financial instruments in other comprehensive income (OCI), given such an election is only available for financial instruments that are classified as equity under IAS 32.

What other features of claims are relevant to classification—or should they be provided through presentation and disclosure?

39. Most respondents agreed with the Board that information about features of claims, other than the timing and the amount features, should be provided through presentation and disclosure.

40. Nonetheless, a few respondents, expressed the view that other features including priority on liquidation, the extent to which the holders of a financial instrument will absorb losses when required (loss absorption capacity) and voting rights are also relevant features.

41. A respondent representing an association of academics expressed the support for the timing and amount features. While observing that there are many other features of financial instruments that are likely to be relevant to users of financial statements, such as voting rights, form of settlement and priority in liquidation, this respondent highlighted academic research that suggests users of financial statements form their own beliefs about liability or equity status based on criteria that would be difficult to codify in standards. As a result, whatever features or other determinants the Board chooses as classification criteria will be incomplete and, in some sense, arbitrary.

[10] Paragraph 3.15 of the DP states that one classification outcome that would change as a result of the articulation of the amount feature is that of irredeemable fixed-rate cumulative preference shares. IAS 32 classifies such cumulative preference shares as equity instruments because there is no contractual obligation to transfer cash or another financial asset or to deliver a variable number of shares at a specified time other than at liquidation. In contrast, the Board's preferred approach would classify such cumulative preference shares as financial liabilities because the entity has an obligation for an amount independent of the entity's available economic resources. This is because the fixed-rate dividends accumulate over time and changes in the entity's available economic resources will not result in changes in the amount of the obligation for the cumulative preference shares, even though the entity is only required to transfer economic resources at liquidation.

However, the solvency and valuation perspective (which in their view are similar to the timing and amount features) have long been considered fundamental in discussions regarding classifying equities and liabilities, and therefore, the respondent agrees that the Board's preferred approach constitutes a reasonable basis for classification.

42. Few users of financial statements expressed their preference for 'basic ownership' approach under which all financial instruments other than ordinary shares are classified as financial liabilities because of richer information provided for financial liabilities and the simplicity of the approach. On the other hand, few others acknowledge that they often develop their own classification approaches, by making various adjustments to meet their needs for classification of financial instruments as reported by entities, suggesting one set of classification principles cannot meet all needs. Furthermore, they acknowledge that users of financial statements amongst themselves have different focus areas and information needs (for example, credit analysts vs equity analysts). For this reason, they are supportive of improving the disclosures required to allow them to conduct their own assessment.

Suggested classification approaches—alternative to the Board's preferred approach

43. Few respondents suggested the following classification approaches for the Board to consider as an alternative to the Board's preferred approach:

(a) a basic ownership approach under which only ordinary shares are classified as equity;

(b) an approach based solely or primarily on the timing feature. A few variations were suggested, which included:

(i) an approach that would classify a financial instrument as a financial liability if it contains an obligation to transfer cash or another financial asset *or own equity instruments* at a specified time other than at liquidation;

(ii) an approach based on the timing feature but that would classify all derivatives on own equity as financial assets or financial liabilities;

(iii) an approach that would classify a financial instrument as a financial liability if it contains the timing feature and no voting rights. The amount feature would be reflected in the measurement rather than classification of a financial instrument.

(iv) an approach based solely on the timing feature whereas the amount feature would only be used for the purpose of determining presentation of changes in financial liabilities into profit or loss or OCI.

(c) an approach that would:

(i) classify as financial liabilities all financial instruments that contain a present obligation to transfer an economic resource using the definition of liability in the Conceptual Framework; and

(ii) classify claims that do not meet the definition of liability as 'other claims' which would then be further disaggregated into *equity*—claims that have an interest in the future performance of the entity; and '*non-equity*'—all the remaining claims that are neither financial liabilities nor equity. An example of the 'non-equity' type claim would be an obligation to transfer a fixed amount of cash only at liquidation.

Appendix A—Paragraphs extracted from the Conceptual Framework

(emphasis added)

4.26 A liability is a present obligation of the entity to transfer an economic resource as a result of past events.

4.27 For a liability to exist, three criteria must all be satisfied:
(a) the entity has an obligation;
(b) the obligation is to transfer an economic resource; and
(c) the obligation is a present obligation that exists as a result of past events.

4.28 The first criterion for a liability is that the entity has an obligation.

4.29 An obligation is a duty or responsibility that an entity has no **practical ability to avoid**. An obligation is always owed to another party (or parties). The other party (or parties) could be a person or another entity, a group of people or other entities, or society at large. It is not necessary to know the identity of the party (or parties) to whom the obligation is owed.

4.32 In some situations, an entity's duty or responsibility to transfer an economic resource is conditional on a particular future action that the entity itself may take. Such actions could include operating a particular business or operating in a particular market on a specified future date, or exercising particular options within a contract. In such situations, the entity has an obligation if it has no practical ability to avoid taking that action.

4.34 The factors used to assess whether an entity has the practical ability to avoid transferring an economic resource may depend on the nature of the entity's duty or responsibility. For example, in some cases, an entity may have no practical ability to avoid a transfer if any action that it could take to avoid the transfer would have economic consequences significantly more adverse than the transfer itself. However, neither an intention to make a transfer, nor a high likelihood of a transfer, is sufficient reason for concluding that the entity has no practical ability to avoid a transfer.

4.35 In some cases, it is uncertain whether an obligation exists. For example, if another party is seeking compensation for an entity's alleged act of wrongdoing, it might be uncertain whether the act occurred, whether the entity committed it or how the law applies. Until that existence uncertainty is resolved—for example, by a court ruling—it is uncertain whether the entity has an obligation to the party seeking compensation and, consequently, whether a liability exists. (Paragraph 5.14 discusses recognition of liabilities whose existence is uncertain.)

4.36 The second criterion for a liability is that **the obligation is to transfer an economic resource.**