IFRS

STAFF PAPER

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Project	**Financial Instruments with Characteristics of Equity (FICE)**
Paper topic	Project update

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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (IASB). This paper does not represent the views of the IASB or any individual IASB member. Any comments in the paper do not purport to set out what would be an acceptable or unacceptable application of IFRS® Accounting Standards. The IASB's technical decisions are made in public and are reported in the IASB® *Update*.

Purpose of this paper

1. This paper provides an update on the FICE project based on the project plan the International Accounting Standards Board (IASB) discussed in October 2019 (Agenda Paper 5). This paper does not ask for decisions from the IASB.

Project objectives

2. As discussed by the IASB in October 2019, the objectives of this project are to:
   (a) address known practice issues that arise when applying IAS 32 *Financial Instruments: Presentation* to classify financial instruments as financial liabilities or equity; and
   (b) improve the information provided in the financial statements about the financial instruments issued by the entity.

3. The IASB noted the following as the important considerations in meeting the project objectives in paragraph 2 of this paper:
   (a) limit changes to classification outcomes to those in which sufficient evidence exists that such a change would provide more useful information to users of financial statements;

(b) clarify interactions between the requirements in IAS 32;

(c) finalise the amendments in a timely manner; and

(d) develop an efficient transition approach that will consider implementation costs.

Project plan and progress update

4. In order to achieve the project objectives, the IASB observed that it was important for the project to have a clear and well-defined scope.

5. In determining which classification issues to address, the IASB considered whether:

   (a) the issues have a widespread effect and have, or are expected to have, a material effect on those affected;

   (b) financial reporting would be improved through a change in the required classification or through the elimination, or reduction, of diverse accounting outcomes that result from a lack of clarity in the IAS 32 requirements or insufficient application guidance; and

   (c) the issues can be resolved efficiently and effectively without fundamentally rewriting IAS 32 and amending other IFRS Accounting Standards (except for consequential amendments).

6. The IASB also noted that improving presentation and disclosure requirements about financial instruments issued by entities would be essential in achieving the project objectives. It would use the proposals included in the 2018 Discussion Paper *Financial Instruments with Characteristics of Equity* (2018 DP) as the starting point for clarifying presentation and disclosure. Those proposals would be further developed taking into account the feedback. In addition, the IASB would explore whether any additional disclosure requirements should be developed to provide information that would not be provided through classification requirements or to complement the classification requirements.

7. Based on the above, the IASB decided on the following project plan. We indicate below the IASB's progress against each topic:

Topic	IASB Progress
Classification	
Financial instruments settled in own equity instruments (including 'fixed-for-fixed' condition in IAS 32)	Tentative decision made April 2020
Obligations that arise only on liquidation (eg perpetual instruments)	Tentative decision made February 2021
Financial instruments with contingent settlement provisions	Tentative decision made December 2021
The effects of laws on the contractual terms	Tentative decision made December 2021
Reclassification between financial liabilities and equity instruments	To be discussed in H1 2022
Obligations to redeem own equity instruments (eg put options on non-controlling interest)	To be discussed in 2022
Overall consistency check and other related matters, eg transition	To be discussed in 2022
Presentation and disclosure	
Refinements of disclosures proposed in the 2018 DP	Tentative decisions made April 2021 and May 2021
Presentation (including presentation for obligations that arise only on liquidation)	To be discussed in 2022
Any further disclosure requirements	To be discussed in 2022

8. Appendix A to this paper provides the summary of IASB tentative decisions to date.

Plan for 2022

9. In 2022, the staff plan to present their analysis on the remaining topics set out in paragraph 7 of this paper for IASB discussion. The staff will then ask the IASB to make tentative decisions with a view to ask for its permission to begin the balloting process of an Exposure Draft.

Appendix A – Summary of IASB tentative decisions

Classification: financial instruments settled in an entity's own equity instruments

A1. In April 2020, the IASB made the following tentative decisions.

(a) for a derivative on own equity to meet the fixed-for-fixed condition in IAS 32, the number of functional currency units to be exchanged with each underlying equity instrument must be fixed or only vary with:

(i) allowable preservation adjustments; or

(ii) allowable passage of time adjustments.

(b) to classify as equity a contract that 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.

(c) an entity would be required to classify derivatives on own equity as equity instruments if preservation adjustments require the entity to preserve the relative economic interests of future shareholders to an equal or a lesser extent than those of the existing shareholders.

(d) an entity would be required to classify derivatives on own equity as equity instruments if passage of time adjustments:

(i) are pre-determined and vary only with the passage of time; and

(ii) fix the number of functional currency units per underlying equity instrument in terms of a present value.

Classification: financial instruments with obligations that arise only on liquidation of the entity

A2. In February 2021, the IASB tentatively decided not to change how such instruments should be classified; but instead to develop presentation and disclosure requirements in relation to them.

Disclosures: terms and conditions

A3. In April 2021, the IASB tentatively decided that, for financial instruments with characteristics of both financial liabilities and equity instruments (except for stand-alone derivatives), an entity would be required to disclose in the notes information about:

(a) 'debt-like features' in financial instruments that are classified as equity instruments;

(b) 'equity-like features' in financial instruments that are classified as financial liabilities; and

(c) debt-like and equity-like features that determine the classification of such financial instruments as financial liabilities, equity instruments or compound financial instruments.

Disclosures: potential dilution

A4. In April 2021, the IASB tentatively decided to require an entity to disclose information about the maximum dilution of ordinary shares in the notes, 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. An entity would:

(i) include the total number of share options outstanding (as required to be disclosed by IFRS 2 *Share-based Payment*) and the number of unvested shares, if known; and

(ii) indicate the possibility for unknown dilution where the maximum number of additional ordinary shares that could be delivered is not yet known.

(b) the minimum number of ordinary shares required to be repurchased.

(c) sources of any significant changes in (a) and (b) from the prior reporting period and how these sources contributed to those changes.

(d) terms and conditions relevant to understanding the likelihood of maximum dilution, including a cross-reference to disclosures required by IFRS 2 for a description of share-based payment arrangements.

(e) a description of any share buy-back programmes or other arrangements that may reduce the number of shares outstanding.

Disclosures: the nature and priority of claims against an entity

A5. In May 2021, the IASB tentatively decided to require:

(a) an entity to disclose and categorise in the notes its claims that are financial instruments in a way that reflects differences in their nature and priority, and at a minimum, to distinguish between:

(i) secured and unsecured financial instruments;

(ii) contractually subordinated and unsubordinated financial instruments; and

(iii) those issued or owed by the parent and those issued or owed by subsidiaries; and

(b) the disclosures to be made for all financial liabilities and equity instruments that are within the scope of IAS 32.

Disclosures: terms and conditions about priority on liquidation for particular financial instruments

A6. In May 2021, the IASB tentatively decided to require:

(a) an entity to disclose in the notes:

(i) terms and conditions that indicate priority on liquidation;

(ii) terms and conditions that could lead to changes in priority on liquidation;

(iii) that a particular type of financial instrument has more than one level of contractual subordination, if applicable (for example, if some subordinated liabilities are contractually subordinated to other subordinated liabilities);

(iv) narrative information when an entity is aware of significant uncertainty about the application of relevant laws or regulations that could affect how priority will be determined on liquidation; and

(v) details of intra-group arrangements such as guarantees that may affect their priority on liquidation (for example, which entities are providing and receiving guarantees); and

(b) the disclosures to be made for all financial instruments with characteristics of both debt and equity, including compound instruments, but excluding stand-alone derivative instruments.

A7. An entity would be required to make the disclosures described in (a) as part of the disclosures about terms and conditions on which the Board tentatively agreed at its April 2021 meeting.

Classification: financial instruments with contingent settlement provisions

A8. In December 2021, the IASB tentatively decided to propose amendments to IAS 32:

(a) to clarify that financial instruments with contingent settlement provisions may be compound instruments;

(b) to clarify that the liability component of a compound financial instrument with contingent settlement provisions, which could require immediate settlement if a contingent event occurs, is measured at the full amount of the conditional obligation;

(c) to clarify that payments at the discretion of the issuer are recognised in equity, even if all the proceeds are initially allocated to the liability component of a compound financial instrument;

(d) to specify that the term 'liquidation' in paragraph 25(b) of IAS 32 refers to when an entity is in the process of permanently ceasing operations; and

(e) to specify that an assessment of whether a contract term is 'not genuine' under paragraph 25(a) of IAS 32 is not made by considering only the probability of the contingent event occurring.

Classification: the effects of applicable laws on contractual terms of financial instruments

A9. In December 2021, the IASB tentatively decided to propose amendments to IAS 32 to require an entity to classify financial instruments as financial liabilities or equity by considering:

(a) terms explicitly stated in the contract that give rise to rights and obligations that are in addition to, or more specific than, those established by applicable law; and

(b) applicable laws that prevent the enforceability of a contractual right or a contractual obligation.