IFRS Accounting

Staff paper

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Project	**Financial Instruments with Characteristics of Equity (FICE)**
Topic	**Subsidiaries without public accountability: disclosures**
Contacts	Helen Lloyd (hlloyd@ifrs.org) Angie Ah Kun (aahkun@ifrs.org) Riana Wiesner (rwiesner@ifrs.org)

Introduction

1. The IASB expects to publish the Exposure Draft *Financial Instruments with Characteristics of Equity* ("the FICE ED") in the last quarter of 2023, before the issue of the new IFRS Accounting Standard *Subsidiaries without Public Accountability* ("the Subsidiaries Standard").

2. The Subsidiaries Standard will be part of IFRS Accounting Standards and will permit eligible subsidiaries to apply IFRS Accounting Standards with reduced disclosure requirements. An eligible subsidiary that applies the Subsidiaries Standard will apply the recognition, measurement and presentation requirements in IFRS Accounting Standards and the disclosure requirements in the Subsidiaries Standard. The disclosure requirements are to be grouped by the IFRS Accounting Standard to which they relate. As soon as a new or amended IFRS Accounting Standard becomes effective, eligible subsidiaries will need to apply its recognition, measurement and presentation requirements so it is necessary to have the subsidiary-specific disclosures available at the same time.

3. The Exposure Draft *Subsidiaries without Public Accountability: Disclosures* ("the Subsidiaries ED") included IFRS Accounting Standards issued up to February 2021

and it was decided that after the Subsidiaries Standard is issued, the IASB will separately consider amendments to the disclosure requirements in IFRS Accounting Standards issued after 28 February 2021[1]. On an ongoing basis, each new or amended IFRS Accounting Standard will include amendments to the Subsidiaries Standard as a type of consequential amendment so that the Subsidiaries Standard remains up to date with IFRS Accounting Standards, and eligible subsidiaries will always have appropriate disclosure requirements available to them by the time they are required to apply a new or amended IFRS Accounting Standard.[2]

4. The FICE ED will be the first exposure draft to include proposed consequential amendments to the Subsidiaries Standard. It is expected that a similar process will be followed, applying the agreed principles set out in paragraph 5 of this paper as part of the drafting process, for future exposure drafts.

Principles for maintaining the Subsidiaries Standard

5. In April 2023 the IASB discussed feedback received on the Subsidiaries ED, reviewing proposed disclosures based on the principles that were used in the development of the Subsidiaries ED. As described in the staff paper[3]:

> The principles for reducing disclosure requirements applied by the IASB consider the information needs of users of non-publicly accountable entities and that these users find the following information useful:
>
> (a) short-term cash flows, obligations, commitments and contingencies [whether or not recognised as liabilities];

[1] See IASB *Update* of the January 2023 IASB meeting.

[2] See IASB *Update* of the June 2022 IASB meeting.

[3] See Agenda Paper 31A *Feedback on proposed disclosure requirements* of the April 2023 IASB meeting.

(b) liquidity and solvency[4];

(c) measurement uncertainty;

(d) accounting policy choices [ie information about accounting policies chosen by the entity]; and

(e) disaggregation of amounts.

6. Of these principles, most will have at least some relevance when considering which of the proposed FICE disclosures are necessary for eligible subsidiaries. Table A in paragraph 10 of this paper shows which of the principles drove the staff recommendation to include each disclosure in the forthcoming Subsidiaries Standard, though in many cases more than one principle will apply.

7. The IASB also tentatively decided in April 2023 not to include disclosure objectives or guidance on how to apply the disclosure requirements in the forthcoming Subsidiaries Standard.

Purpose and structure

8. This paper considers each of the disclosures which the IASB has tentatively decided to propose in the FICE ED and reviews them against the principles for disclosures in the Subsidiaries ED which will also be applied in the Subsidiaries Standard, concluding with staff recommendations on which disclosures should be proposed in the FICE ED as consequential amendments to the Subsidiaries Standard. The potential amendments are described as relating to the Subsidiaries Standard even though it will not have been published when the FICE ED is issued.

9. The paper is structured as follows:

(a) Summary of staff recommendation;

[4] For the purposes of the Subsidiaries ED these terms are used to emphasise an entity's ability to access resources, particularly cash, rather than to refer to defined solvency ratios. The principle is closely related to that in paragraph 5(a) of this paper.

(b) New disclosures recommended for inclusion in the FICE ED as proposed consequential amendments to the Subsidiaries Standard;

(c) New disclosures not recommended for inclusion in the FICE ED as proposed consequential amendments to the Subsidiaries Standard; and

(d) Staff recommendation and question for the IASB

Summary of staff recommendation

10. The staff recommends that the FICE ED includes consequential amendments to the Subsidiaries Standard to add disclosure requirements consistent with those proposed in the FICE ED in the following areas:

Table A: Topics that should give rise to proposed consequential amendments to the Subsidiaries Standard

Disclosure topic	Tentatively agreed for FICE ED	Paragraph reference in this paper	Relevant principles
Terms and conditions—debt-like and equity-like features	April 2021	12-17	Short-term cash flows
Passage-of-time changes	April 2023	19	Short-term cash flows
Instruments containing obligations to redeem own equity instruments	April 2023	20	Disaggregation, accounting policy information
Financial liabilities with contractual obligations	April 2023	21	Disaggregation

Disclosure topic	Tentatively agreed for FICE ED	Paragraph reference in this paper	Relevant principles
to pay amounts based on the entity's performance or net assets			
Significant judgements	April 2023	22	Accounting policy information

11. The staff recommends that the FICE ED does not include consequential amendments to the Subsidiaries Standard to add disclosure requirements consistent with those proposed in the FICE ED in the following areas:

Table B: Topics that should not give rise to proposed consequential amendments to the Subsidiaries Standard

Disclosure topic	Tentatively agreed for FICE ED	Paragraph reference in this paper
Potential dilution	April 2021	24-27
Nature and priority of claims against an entity	May 2021	28-31
Terms and conditions about priority on liquidation	May 2021	32-34
Disclosure objectives	April 2023	35-37

Disclosure topic	Tentatively agreed for FICE ED	Paragraph reference in this paper
Other disclosures—initial allocation to debt and equity components; reclassifications on change in circumstances	April 2023	38-41

New disclosures recommended for inclusion in the FICE ED as proposed consequential amendments to the Subsidiaries Standard

Terms and conditions

12. In April 2021[5], 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.

[5] See Agenda Paper 5A *Terms and conditions disclosures* of the April 2021 IASB meeting.

13. The IASB's tentative decision at this stage was based on discussions about the needs of investors that included the observation that where investors can receive more information about financial instruments with complex or difficult-to-understand classifications, these users of financial statements will be able to better forecast future cash flows. Other discussions on terms and conditions disclosures took place in April 2023 and are discussed separately in this paper.

14. The April 2021 discussion considered the possibility of aligning the proposed disclosures with the requirements in paragraph 122 of IAS 1 *Presentation of Financial Statements* pertaining to disclosure of judgements made in applying accounting policies that have the most significant effect on amounts recognised in the financial statements. However, this approach would limit the scope of the disclosures on terms and conditions to financial instruments for which classification requires significant judgement and was considered to be too subjective.

15. The principles for subsidiary disclosures in paragraph 5 of this paper include user interest in information about short term cash flows and obligations whether or not they are recognised as liabilities. In the case of instruments that are classified as equity but have debt-like features, there are potential cash flows which would be known to the investors in those instruments but not to other users of financial statements unless these additional disclosures were provided. For those instruments classified as financial liabilities but have equity-like features, there may be uncertainty over future cash flows that is not reflected if the instrument is simply described and presented as a financial liability without further information. Although the potential cash flows that would be disclosed here will not all be short term, the fact that some will be satisfies one of the principles for developing subsidiary disclosures.

16. The proposed disclosures in paragraph 12(c) of this paper, giving more detailed information to users about how the debt-like or equity-like features were considered in concluding on the instrument's classification, appear less relevant to eligible subsidiaries. In addition, the information provided to users of eligible subsidiaries'

accounts through the disclosures in paragraph 12(a) and 12(b) of this paper should be sufficient to meet their needs as set out in paragraph 5.

17. Accordingly, the staff recommend that the terms and conditions disclosures based on paragraphs 12(a) and 12(b) of this paper are included in the FICE ED as consequential amendments to the Subsidiaries Standard but not those in paragraph 12(c) of this paper.

Disclosures—other

18. In April 2023[6], the IASB tentatively decided to include further disclosure requirements in the FICE ED. The requirements described in this paragraph are those that the staff recommends for inclusion in the Subsidiaries Standard; the tentative decisions from April 2023 not recommended for inclusion are discussed in paragraphs 38-41 of this paper. The IASB tentative decided to require:

(a) an entity to disclose, if applicable, information about terms and conditions that become, or stop being, effective with the passage of time before the end of the contractual term of the instrument;

(b) an entity to disclose, for instruments containing obligations to redeem its own equity instruments:

(i) the amount removed from equity and included in financial liabilities when the obligation was initially recognised and the component of equity from which it was removed;

(ii) the amount of remeasurement gain or loss recognised in profit or loss during the reporting period;

(iii) the amount of gain or loss, if any, that was recognised on settlement if the obligation is settled during the reporting period;

[6] See IASB Update of the April 2023 IASB meeting.

(iv) the amount removed from financial liabilities and included in equity if the written put option has expired unexercised; and

(v) the cumulative amount transferred within equity and the component of equity to which it was transferred, if any cumulative amount in retained earnings was transferred;

(c) the separate disclosure of the total gains or losses in each reporting period that arise from remeasuring financial liabilities containing contractual obligations to pay amounts based on an entity's performance or changes in the entity's net assets (that are measured at fair value through profit or loss); and

(d) an entity to disclose significant judgements made in determining the classification of a financial instrument, or its component parts, as a financial liability or as equity.

19. The proposed passage of time disclosures in paragraph 18(a) of this paper provide information that, as set out in the April 2023 staff paper AP5B[7], 'will help users of the financial statements better understand the nature, amount, timing, and uncertainty of cashflows and other features arising from these types of financial instruments'. Since the disclosures have been clearly identified as providing information on cash flows, even though these will not all be short term, this satisfies one of the principles for developing subsidiary disclosures. The staff recommends that this requirement is proposed in the FICE ED as a consequential amendment to the Subsidiaries Standard.

20. The proposed new disclosure requirements on instruments containing obligations to redeem own equity instruments in paragraph 18(b) of this paper give more information to users of financial statements so that they can understand the accounting treatment of these financial instruments. The additions provide disaggregation of amounts that are already included in financial statements (for example, the requirement to show separately gains or losses on settlement which might otherwise have been absorbed into a different line item) and in other cases accounting policy

[7] See Agenda Paper 5B *Scope of IFRS 7 and additional disclosures* of the April 2023 IASB meeting.

information (for example, where in equity amounts are transferred to). These new disclosure requirements therefore satisfy the principles in paragraph 5 of this paper and the staff recommend they are included in the FICE ED as proposed consequential amendments to the Subsidiaries Standard.

21. The proposed requirement in paragraph 18(c) of this paper to show separately any gains or losses on remeasuring financial liabilities containing contractual obligations to pay amounts based on an entity's performance or changes in net assets is another example of providing disaggregated information, and therefore meets one of the principles in paragraph 5 of this paper. The staff recommends that this requirement is included in the FICE ED as a proposed consequential amendment to the Subsidiaries Standard.

22. The disclosure of significant judgements in paragraph 18(d) of this paper emphasises to preparers the need to apply the more general requirement in IAS 1, which appears in paragraph 124 of the Subsidiaries ED. Paragraph 124 gives examples of judgements that an entity may be required to disclose. In the staff's view, adding the judgements on classification of financial instruments as financial liabilities or equity will comply with the principle of providing accounting policy information to users in paragraph 5(d) of this paper, and will help to emphasise the relevance of this matter in a similar way to the tentative decision relating to IFRS 7 *Financial Instruments: Disclosures*. Therefore, the staff recommends that this requirement is included in the FICE ED as a consequential amendment to paragraph 124 of the Subsidiaries Standard (rather than within the IFRS 7 section of the Subsidiaries Standard).

Cost-benefit assessment

23. In some cases the disclosure requirements recommended in paragraphs 17 and 19–22 of this paper may appear onerous for subsidiaries. The staff are of the view that those recommended here have identifiable benefits and should not give rise to disproportionate costs in their preparation. As for all disclosure requirements in the

Subsidiaries Standard, as set out in paragraph 16 of the Subsidiaries ED, disclosures need not be provided if the information resulting from the disclosures is not material.

New disclosures not recommended for inclusion in the FICE ED as proposed consequential amendments to the Subsidiaries Standard

Potential dilution

24. In April 2021[8], 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.

[8] See Agenda Paper 5C *Disclosures—Potential dilution* of the April 2021 IASB meeting.

25. The purpose of the proposed disclosures is to help existing and potential investors to understand how an entity distributes its returns to ordinary shareholders, how it has financed its operations in the past, and how its capital structure might change in the future based on the instruments issued at the reporting date. The proposed disclosures would show maximum dilution which is not a replacement for the diluted EPS disclosures in IAS 33 *Earnings per Share*.

26. Providing detailed information on potential dilution does not satisfy any of the user needs identified in paragraph 5 of this paper. As paragraph BC34(f) of the Basis for Conclusions on the Subsidiaries ED states, 'some disclosures in full IFRS [Accounting Standards] are more relevant to investment decisions in public capital markets than to the transactions and events encountered by typical [eligible subsidiaries]': this applies to the dilution disclosures discussed here.

27. The staff do not recommend that the proposed disclosures relating to potential dilution are required for eligible subsidiaries.

Disclosures—nature and priority of claims against an entity

28. In May 2021[9], 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

[9] See Agenda Paper 5 *Disclosures – priority on liquidation* of the May 2021 IASB meeting.

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

29. The tentative decision covers all financial liabilities and equity instruments in the scope of IAS 32. The disclosures were originally recommended to respond to stakeholder requests for information that focuses on financial instruments used as long-term sources of funding. However, it may not always be clear which sources of funding should be considered as long-term, as summarised in the staff paper:

> Introducing a bright line threshold, eg funding sources repayable after 12 months, may not adequately capture the nature of the funding sources because instruments repayable on demand or within 12 months may also be a recurring source of funding. A good example to consider is supply chain financing which is becoming increasingly common, illustrating that the boundary of what was traditionally considered as funding sources, is becoming less clear.

30. Considering this for eligible subsidiaries, it is still relevant that the driver of these requirements was the effects on long-term financing, because paragraph 5 of this paper identifies that user interests is primarily in short term cash flows. On the other hand, users of the financial statements of eligible subsidiaries are also described as interested in information about liquidity and solvency, and as noted in paragraph 29 of this paper entities may use even short term or on demand financing as part of their planned funding sources.

31. The existence of claims against an entity, and their timing, may affect short or long term cash flows as well as liquidity and solvency, but for the users of eligible subsidiary financial statements, supplementing this with further information about the priorities within those instruments does not sufficiently enhance the basic information to justify the additional cost of preparing and presenting the breakdown of information set out in paragraph 28(a) of this paper. Therefore, the staff recommend that they are not included as proposed consequential amendments to the Subsidiaries Standard.

Terms and conditions about priority on liquidation for particular financial instruments

32. In May 2021[10], 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.

33. An entity would be required to make the disclosures described in paragraph 32(a) of this paper as part of the disclosures about terms and conditions on which the Board tentatively agreed at its April 2021 meeting. The objective of these disclosures is to

[10] See Agenda Paper 5 *Disclosures – priority on liquidation* of the May 2021 IASB meeting.

enable users of the financial statements to understand the risks and returns of particular instruments in the event the entity issuing the instruments is liquidated.

34. For users of the financial statements of eligible subsidiaries, information about what could or will occur on liquidation is not a priority and is not in the list of principles for developing disclosure objectives in paragraph 5 of this paper. Therefore, the staff do not recommend that these disclosures are proposed as consequential amendments to the Subsidiaries Standard.

Disclosure objectives

35. In April 2023[11], the IASB tentatively decided to expand the objective of IFRS 7 to enable users of financial statements to understand how an entity is financed and what its current and potential ownership structures are, and to delete the reference to derivatives that meet the definition of an equity instrument in IAS 32 from paragraph 3(a) of IFRS 7.

36. The Subsidiaries ED does not in general include disclosure objectives, although the IASB tentatively decided in April 2023 that the first sentence in paragraph 44 of the Subsidiaries ED requiring that ‘an entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance’, which is from paragraph 7 of IFRS 7, would remain.

37. The amendment to the objectives section of IFRS 7 is not a disclosure requirement and therefore by default will apply to eligible subsidiaries applying the Subsidiaries Standard. This means that no amendment to the Subsidiaries Standard is needed in respect of this change.

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[11] See Agenda Paper 5B *Scope of IFRS 7 and additional disclosures* of the April 2023 IASB meeting.

Disclosures—other

38. In April 2023[12], the IASB tentatively decided to include further disclosure requirements in the FICE ED. The requirements described in this paragraph are those that the staff does not recommend for inclusion in the Subsidiaries Standard; the tentative decisions from April 2023 recommended for inclusion are discussed in paragraphs 18-22 of this paper. The requirements the IASB tentatively decided to include in the FICE ED that are not being recommended are as follows:

    (a) to include explanations and examples of 'debt-like' and 'equity-like' features in the sections containing application guidance and illustrative examples, to clarify that the disclosures of 'debt-like' and 'equity-like' features would include both quantitative and qualitative information, and to require an entity to disclose the amounts allocated initially to the financial liability and equity components of compound financial instruments; and

    (b) to relocate the disclosure requirement in paragraph 80A of IAS 1 to IFRS 7 and expand it to cover reclassifications when changes in the substance of the contractual terms arise from changes in circumstances outside the contract.

39. The refinements to the terms and conditions disclosures in paragraph 38(a) of this paper mainly relate to augmenting the Application Guidance and Illustrative Examples, and these will be available to eligible subsidiaries applying the Subsidiaries Standard, but do not require new disclosures and therefore will not directly affect the Subsidiaries Standard. The tentative decision on the Subsidiaries project in April 2023 about not adding guidance, described in paragraph 7 of this paper, is also relevant here.

40. The specific requirement in paragraph 38(a) of this paper to disclose the initial allocation between financial liability and equity components of a compound instrument gives further information and relates to the requirement discussed in paragraph 16 of this paper where the staff recommendation was not to add the

[12] See Agenda Paper 5B *Scope of IFRS 7 and additional disclosures* of the April 2023 IASB meeting.

requirement for terms and conditions disclosures (paragraph 12(c) of this paper) to the Subsidiaries Standard. The extra requirement does not relate to short term cash flows, nor does it directly provide disaggregation or accounting policy information. On these grounds it does not appear to meet the reduced disclosure principles for subsidiaries and the staff do not recommend it is included in the Subsidiaries Standard.

41. The disclosure requirement in paragraph 80A of IAS 1 (see paragraph 38(b) of this paper) was not included in the Subsidiaries ED as part of the IAS 1 disclosures because it was not considered to satisfy the principles in paragraph 5 of this paper. It has not been revisited as part of the discussions for the Subsidiaries Standard because no comments were received on the Subsidiaries ED suggesting it be added. In the staff's view, relocation and expansion of this disclosure requirement would not change that assessment.

Staff recommendation and question for the IASB

42. The staff recommend that the IASB proposes in the FICE ED consequential amendments to the Subsidiaries Standard for the topics listed in Table A in paragraph 10 of this paper, but not for the topics listed in Table B in paragraph 11 of this paper.

Question for the IASB
1. Does the IASB agree with the staff's recommendation for consequential amendments to the disclosure requirements for eligible subsidiaries?