STAFF PAPER

September 2019

IASB® meeting

Project	Financial Instruments with Characteristics of Equity (FICE)		
Paper topic	Project Direction		
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This paper will be discussed at the Board meeting in September 2019.

Introduction

1. At the June and July 2019 Board meetings, the Board discussed feedback received on the Discussion Paper *Financial Instruments with Characteristics of Equity* (DP). At this meeting, the staff set out alternatives the Board could choose for the direction of the FICE project, and explains what each alternative would entail, advantages and disadvantages of these alternatives and indicative timelines.

2. At this meeting, the staff will ask the Board to make a decision on:

    (a) the direction of the project, which will set the direction for the Board's redeliberations; and

    (b) if the Board decides on the project direction recommended by the staff, whether the Board agrees with the objectives and criteria set out in this paper to determine the scope of the project.

3. At a future Board meeting, the staff plan to bring a detailed project proposal based on the decisions made at this meeting. The project proposal will set out the specific areas for redeliberation and the Board will be asked to make a decision on whether to add the project to its standard-setting agenda.[1] See appendix A of this paper for the flow chart that summarises the decision points for the Board.

4. This paper is structured as follows:

   (a) Project direction alternatives and the staff's analysis (paragraphs 5–43);

   (b) Staff's recommendation (paragraph 44);

   (c) Questions for the Board (paragraph 45); and

   (d) Decision points for the Board (Appendix A).

Project direction alternatives and the staff's analysis

5. As the Board was already aware prior to the publication of the DP, accounting diversity and application challenges exist when applying IAS 32 *Financial Instruments: Presentation*. A clear message heard from respondents to the DP is that they are in favour of the Board undertaking some form of standard setting to address the accounting diversity and application challenges—even though the preferred direction of standard-setting varied amongst respondents. Based on the staff analysis of the feedback received, the staff identified the following alternatives for the direction of the FICE project (arranged in the descending order of the likely extent of changes from IAS 32):

   (a) **Alternative A—fundamental review to develop a new approach** to distinguish financial liabilities from equity instruments. The Board would have the flexibility in deciding what the starting point should be.

   (b) **Alternative B—the Board's preferred approach** set out in the DP with some modifications and refinements. Under this alternative, the classification principles would be articulated using the timing and the

[1] The FICE project is currently on the Board's research agenda.

amount features proposed in the DP subject to some clarifications or modifications.

(c) **Alternative C—clarifying amendments to IAS 32**, which would focus on addressing practice issues by clarifying particular underlying principles in IAS 32.

(d) **Alternative D—narrow-scope amendments to IAS 32** such as adding or modifying requirements for specific fact patterns or specific features of financial instruments. The staff expect this alternative would add application guidance to IAS 32 and introduce exceptions if necessary but would not clarify the underlying principles.

(e) **Alternative E—a disclosure-only project** as a separate project. This alternative would involve refining the disclosure proposals in the DP[2] assuming classification requirements remain unchanged from IAS 32.

6. Consistent with the Board's view expressed in the DP, feedback on the DP generally acknowledged that a binary classification model cannot convey all the features of financial instruments. It has also been acknowledged by the Board and respondents that existing IFRS 7 disclosures can be improved, especially disclosures for equity instruments. For this reason, all of the above alternatives (except a disclosure-only project) would include consideration of improvements related to both presentation and disclosure. Feedback received on the DP with respect to presentation and disclosure will be considered when developing any presentation and disclosure proposals.

7. Furthermore, the staff note that Alternatives A-D above would also consider:

(a) matters submitted to the IFRS Interpretations Committee (the Committee) which the Committee decided not to add to its agenda because they would be considered in the FICE project;

(b) relevant Committee discussions and agenda decisions; and

[2] In the context of this alternative, disclosure is not limited to providing information in the notes to the financial statements. For example, the Board may decide that disclosure should be provided either in the notes or on the face of the financial statements.

(c) additional application and/or conceptual matters that were highlighted by respondents to the DP.

8. The staff are of the view that unless the Board wants to proceed with a fundamental review under Alternative A, the project should focus on addressing issues that are currently within the scope of IAS 32 to avoid scope creep with other IFRS standards and to ensure the project proceeds in an efficient manner.

9. Paragraphs 10–**Error! Reference source not found.** below set out the staff's analysis on the possible objectives, relative advantages and disadvantages and expected timing of each alternative.

Alternative A: Fundamental review to develop a new approach

10. Some respondents to the DP said that the Board should undertake a fundamental review of an approach to distinguishing liabilities from equity with the aim of achieving alignment with other IFRS Standards as well as the Conceptual Framework. The staff note that the Board had a previous project to address liability and equity issues in IAS 32, which was a joint project with the US Financial Accounting Standards Board (FASB). In February 2008, the Board published a discussion paper which set out three approaches for identifying equity instruments. Over next two years, the boards discussed the project regularly and further developed their approach which was set out in a staff draft of an exposure draft. The boards circulated the staff draft of the proposals to a small group of external reviewers in the second quarter of 2010 and received over 600 comments. The two most significant concerns related to the overall approach were that the proposals lacked a clear principle and, in some cases provided inconsistent or illogical results. The project was subsequently suspended in October 2010 when the boards acknowledged that the project was a lower priority and they did not have the capacity to devote the time necessary to deliberate it.

11. Under our alternative A, the Board would start over and develop an approach to distinguish financial liabilities from equity instruments without being limited by the current requirements in IAS 32. This approach would involve a fundamental rethinking that results in the development of a comprehensive classification model which considers principles in the Conceptual Framework and, where relevant,

principles in other IFRS Standards with an aim to achieve alignment to the extent possible. The objective of this alternative would be to focus on classifying financial instruments and developing clear principles to distinguish financial liabilities from equity instruments that would:

(a) be consistent with principles applied in the classification of other types of liabilities in other IFRS Standards; and

(b) eliminate the need for exceptions or limit the number of exceptions to a minimum.

12. The main advantages of this alternative are as follows:

(a) it gives the Board an opportunity to develop an approach to distinguish financial liabilities from equity instruments that would potentially be more consistent with the treatment of other types of liabilities.

(b) there is an opportunity to address a wider range of challenges that arise from applying IAS 32 compared to some other alternatives described in this paper because the Board would not be working within the confines of IAS 32. Given that this alternative would allow the Board to fundamentally change its thinking, the Board will have more flexibility to eliminate some sources of application challenges. For example, application questions that relate to the classification of derivatives on own equity could fundamentally be eliminated by classifying all derivatives on own equity as financial assets or financial liabilities. The Board will also be able to explore developing a potential simplification of existing requirements in IAS 32 under this alternative, unlike other alternatives which do not allow for much simplification.

(c) if application questions and challenges could be fundamentally eliminated as described in paragraph (b) above, the classification principles developed under this option would arguably be better at ‘future-proofing’ the Standard ie be applicable to new instruments issued in the future and therefore have a longer expected life compared to other alternatives.

13. The main disadvantages of this alternative include:

(a) the classification principles developed under this alternative are more likely to result in fundamental changes from IAS 32 in terms of classification outcomes, the principles applied to determine the classification outcomes and may involve new terminology. Since the objective of this alternative would be to align the definition of a liability across all types of liabilities to the extent possible, and given the existing differences in IFRS Standards on liabilities, IAS 32 would likely be replaced and there could be changes to other IFRS Standards such as IFRS 2 or IAS 37. In addition, if IAS 32 were to be significantly changed by a fundamentally new classification model, there would also be more significant consequences on other IFRS Standards that rely on the financial instrument definitions in IAS 32 such as IFRS 9 and IFRS 7.

(b) this alternative is likely to require the most time and resources from the staff and the Board compared with other alternatives as it involves a fundamental rethinking of principles. Stakeholders would need more implementation time and effort to apply the new requirements resulting from this alternative. Fundamental changes in classification outcomes would also impact financial ratios and loan covenants. In the meantime, the existing challenges and accounting diversity relating to IAS 32 will remain unresolved until the new Standard is effective.

(c) it is difficult to develop one single set of principles that will (i) solve all conceptual and application challenges related to classifying financial liabilities and equity instruments (ii) be operational and applied in a consistent manner and (iii) provide useful information to the users of financial statements. As part of the previous project, the Board has considered a wide range of potential approaches to distinguish financial liabilities from equity instruments, many of which represented a fundamentally different thinking from IAS 32. However, the Board was not able to find an approach that satisfied all the needs as listed earlier in this paragraph. New application issues or concerns over the usefulness of the resulting information may arise as a result of applying fundamentally new requirements. This will largely depend on what the new fundamentally different approach is. For example, if an approach similar to the basic ownership approach were to be considered[3], the staff expect that there would be fewer application questions and accounting diversity in classification because of its simplicity. However, there may be concerns over the usefulness of the resulting information and implementation challenges relating to measurement of some financial instrument classified as financial liabilities for example, instruments that entitle the holder only to discretionary payments or represent a residual interest in the issuer entity.

14. If the Board pursues this alternative, it could rethink a number of aspects of distinguishing financial liabilities from equity instruments that it would not rethink under other alternatives. Examples include:

(a) an approach to distinguishing financial liabilities from equity instruments based on the definition of a liability in the Conceptual Framework, for example considering ‘no practical ability to avoid’ the obligation. As part of this approach, it:

(i) could consider the role of economic compulsion and economic incentives and the effects of laws and regulation in the classification of financial instruments as financial liabilities or equity instruments; and

(ii) may improve alignment with other IFRS standards, eg IFRS 2 *Share-based Payment;*

(b) whether all contracts to receive or deliver own shares at a future date should be classified as financial assets or financial liabilities until they are settled;

(c) the entity vs proprietary perspective including considering whether the transfer of own shares should be regarded as a transfer of economic resources; and

(d) an approach other than a binary distinction between equity and liability.

[3] Under the basic ownership approach, only the most subordinated instrument issued would be classified as equity instruments.

Alternative B: Board's preferred approach in the DP with modification and refinement

15. Alternative B would involve proceeding with the proposals in the DP taking into account the feedback received. Alternative B would therefore involve articulating the classification principles using the timing and amount features proposed in the DP subject to clarifications or modifications. These classification principles would essentially replace existing classification principles in IAS 32.

16. Consistent with the DP, the objective of Alternative B would be to improve the information companies provide in their financial statements about financial instruments that they have issued, by:

    (a) articulating principles for classifying financial instruments as financial liabilities or equity instruments with a clear rationale while limiting unnecessary changes to classification outcomes of IAS 32 that are already well understood and considered to provide useful information;

    (b) improving the consistency, completeness and clarity of the classification requirements, in particular, for financial instruments that present accounting challenges in practice; and

    (c) improving the information provided through presentation and disclosure about features of financial liabilities and equity instruments not captured by classification alone.

17. In addition, the Board would consider ways to address the main concerns raised by respondents about the Board's preferred approach by:

    (a) improving the clarity of articulation of terms and principles used to describe the classification principles;

    (b) reconsidering particular aspects of the DP proposals based on feedback from respondents.

18. The main advantages of this alternative include the following:

    (a) compared to Alternative A, it is likely to take less time and resources because the Board would have a clear starting point, ie the DP and the feedback received on those proposals.

(b) compared to Alternative D, it has a greater potential for addressing future challenges as well as existing ones because this alternative would provide a principles-based solution.

(c) significant time and resources have gone into developing the DP and for stakeholders to provide feedback. Alternative B will allow the Board to build on the DP approach directly and further develop it as appropriate.

19. The main disadvantages of this alternative include the following:

(a) as highlighted by feedback on the DP, some concerns are likely to remain if the existing classification principles in IAS 32 are replaced with new classification principles. Many may perceive such new principles as a fundamental change from IAS 32. This will especially be the case if there are changes to classification outcomes.

(b) the concerns are likely to remain about whether it is worth requiring all entities to reassess classification outcomes of all of their existing financial instruments if the classification outcomes are similar in many cases to IAS 32. In addition, the Board may be able to address some of the most significant concerns about classification changes by reconsidering particular aspects of the DP proposals, for example classification of perpetual instruments with obligations that only arise on liquidation. However, doing so may increase the concern over whether the benefits resulting from the DP proposals would outweigh the cost of transition especially if this results in less changes to classification outcomes.

(c) concerns are also likely to remain with respect to potential new interpretation issues that could arise from applying new terminology and concepts. Many respondents to the DP raised significant concerns especially about the clarity of the principle in relation to assessing whether the amount of the obligation or a variable in a derivative on own equity is independent of the entity's available economic resources. In addition, by replacing IAS 32 with newly articulated principles, there is a risk that it could create application challenges for financial instruments for which no problem exists applying IAS 32.

(d) Given that there were no specific suggestions or consensus from respondents on how to improve the clarity of terminology used to articulate the Board's preferred approach, the staff expect it would be difficult to achieve significant improvement in the clarity of articulation.

(e) In comparison to Alternatives C–E, it is likely to require more time for the Board to develop modifications and refinements to the proposals in the DP that would address the concerns expressed by respondents. It is also likely to require more time for stakeholders to implement due to new principles and new terminology. Overall, changes resulting from Alternative B are likely to require a later effective date than those resulting from Alternatives C–E.

20. If the Board pursues this alternative, it could, for example redeliberate the following areas of the DP:

(a) whether or how the amount feature assessment should apply to obligations that arise only on the issuer's liquidation and ensure the classification approach is consistent with the going concern assumption;

(b) the clarity of articulation where new terms are introduced, eg available economic resources and the notion of independence, possibly by providing illustrative examples;

(c) the proposals for redemption obligation arrangements including when separate contracts should be treated as if they are a single instrument and the consequences of derecognising underlying own equity;

(d) presentation proposals for equity (in particular, the attribution of total comprehensive income to non-derivative equity instruments) and financial liabilities;

(e) disclosure proposals including how to provide the disclosures on instruments' priority on liquidation and the scope of potential/maximum dilution disclosures;

(f) whether to retain the foreign currency rights issue exception in IAS 32; and

(g) when to take into account the effects of laws and regulations on contractual rights and obligations for classification purposes.

21. In addition, the Board could seek to address additional challenges highlighted by respondents such as whether instruments should be reclassified between financial liabilities and equity after initial recognition and the treatment of shareholder discretion (ie differentiating the entity from its owners) in the classification of financial instruments. If so, the Board would need to consider matters that were not covered in the DP.

Alternative C: Clarifying amendments to IAS 32

22. Alternative C would focus on addressing known practice issues by clarifying underlying principles in IAS 32. For example, underlying principles in IAS 32 may be clarified by adding an explanation of what the current requirements in IAS 32 are designed to achieve and by adding application guidance that facilitates the application of the existing requirements and clarified principles of IAS 32. Also, it would involve clarifying the interactions between different requirements in IAS 32. Similar to Alternative B, Alternative C would also seek to provide a principles-based solution and would have similar end-goals such as clarified principles and improved completeness of classification requirements as explained in paragraph 16. Unlike Alternative B however, the starting point for Alternative C would be the current requirements in IAS 32 and Alternative C would not involve a complete rewrite of IAS 32.

23. When developing the DP, the Board was aware that although IAS 32 presents challenges for some types of financial instruments, it works well for most financial instruments. In recognition of this, the Board sought to limit unnecessary changes to classification outcomes of IAS 32 as stated in paragraph 16 of this agenda paper. However, many respondents said the proposals in the DP would be a fundamental change from IAS 32. The primary concerns raised by respondents related to changes in classification outcomes for perpetual instruments that contain an obligation that arises only on liquidation of the issuer and new terminology used in the DP. Respondents were concerned that the new terminology could lead to new sets of interpretative questions and new accounting

diversity. Another concern raised was that the proposed principles in the DP would not resolve all existing practice issues. Many respondents therefore were doubtful that the new principles in the DP would in fact represent significant improvements to the requirements in IAS 32 that would justify the implementation cost and effort especially when the classification outcomes were largely similar to those of IAS 32. Although Alternative B would aim to mitigate the concerns by adding further clarity, some of these concerns are likely to remain, especially because Alternative B would use new principles and new terminology.

24. The staff—and many respondents to the DP—are of the view that the objectives of the DP (see paragraph 16 of this paper) remain appropriate, but the Board could consider another approach to achieve those objectives, that is by clarifying underlying principles in IAS 32 to address the ‘problem areas without causing unintended consequences or new diversity. making clarifying amendments to IAS 32. Developing such amendments to IAS 32 would involve a bottom-up approach in which the Board would start by considering which accounting challenges need to be addressed and then focus on clarifying the underlying principles in IAS 32 that are necessary to address those accounting challenges (see paragraphs 28–34).

25. In the staff’s view, Alternative C would appeal to a large portion of those respondents who supported so-called ‘targeted improvements to IAS 32’ as many expressed the view that IAS 32 is not broken beyond repair and clarification of the underlying principles in IAS 32, along with guidance that explains the application of these principles, would improve consistent application of the existing requirements in IAS 32.

26. The main advantages of this alternative include the following:

(a) compared to Alternative A, it is likely to take less time and resources because the Board would have a clear starting point, ie the known application issues and accounting challenges raised by respondents over time as well as the requirements in IAS 32 (including existing and familiar terminology).

(b) compared to Alternative B, it would address respondents’ concerns about introducing new terminology and related implementation cost, while it is aimed at achieving similar objectives. The timescale involved in developing an Exposure Draft is likely to be shorter under Alternative C than Alternative B.

(c) compared to Alternative D, it has greater potential for addressing future as well as existing challenges because this alternative would be a principles-based solution.

(d) it will minimise transition effort for stakeholders who do not have complex financial instruments that pose classification challenges when applying IAS 32.

27. The main disadvantages of this alternative include the following:

(a) in comparison to Alternative A, it has limitations as it cannot address as wide a range of challenges because the Board would largely be working within the confines of IAS 32 instead of developing a fundamentally new approach. The staff recognise that Alternative C would not address all issues that arise when applying IAS 32 and some stakeholders may still question whether a fundamental review of IAS 32 is required.

(b) the staff acknowledge that it may be difficult to change some stakeholders' views on what IAS 32 is meant to require or to determine what the underlying principles in IAS 32 are in some cases.

(c) it is likely to require more time to develop clarifications than under Alternatives D and E. It is also likely to require a longer implementation time by stakeholders than under those two alternatives.

What challenges to address

28. The staff are of the view that the Board should prioritise addressing known practice issues and challenges that arise when applying IAS 32, which have resulted in accounting diversity in classifying financial instruments as financial liabilities or equity instruments. The staff consider that it would be helpful for the Board to decide on a set of criteria that will help the Board determine which issues to address in the scope of the project.

29. Considering that some of the most prevalent accounting challenges relating to classification of financial instruments have been submitted to the Committee, the

staff considered the Committee's agenda criteria as set out in paragraph 5.16 of the Due Process Handbook in developing the criteria to be used in this alternative. However, the staff are of the view that the Committee's agenda criteria would need to be modified for the purposes of identifying the issues to address in this project. For example, one of the agenda criteria is that an issue can be resolved efficiently within the confines of existing IFRSs and the Conceptual Framework. However, some matters referred to the Committee were not added to the agenda because they could not be resolved efficiently within the confines of existing IAS 32 or the scope of the issues raised was too broad to be addressed in an efficient manner. In fact, some accounting diversity has continued as a result of the Committee being unable to identify a clear and consistent classification principle based on the words in IAS 32 to conclude on the issues submitted. If this criterion was expanded, more issues could then be identified for possible inclusion in the scope of this project. The Staff are therefore of the view the Board could apply the following criteria to assess which issues to address:

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

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

(c) that can be resolved efficiently and effectively within IAS 32 *and its underlying principles* (ie not confined to the existing classification requirements as written in IAS 32).

30. An issue may be resolved efficiently and effectively within IAS 32 and its underlying principles if the issue can be resolved without:

(a) fundamental changes to the current requirements of IAS 32; and

(b) major amendments to other IFRS Standards (except for consequential amendments).

For example, a change that would classify all derivatives as financial assets or financial liabilities would be an example of a fundamental change to the current IAS 32 requirements. In contrast, clarifying the underlying principle for the fixed-for-fixed requirement and providing additional application guidance would not be.

31. Once the scope of the project has been determined ie which known practice challenges should be addressed, the underlying principles of IAS 32 could be clarified and application guidance could be provided to help achieve consistent application of the principles. Efficient resolution would involve limited rewrite of IAS 32 wherever possible, ie explanations and guidance which is principles-based would be added rather than replacing the current terms used in IAS 32. Where necessary, and particularly in the absence of explicit or implicit principles in IAS 32, the Board will also draw on the feedback received on the DP and consider whether the principles in the Conceptual Framework or other IFRS Standards can help address these accounting challenges.

32. In the staff's view, the Board has sufficient information from the feedback received on the DP and previous consultations to assess the first and second criteria listed in paragraph 29 of this paper. The third criterion, on the other hand, would require reassessment as the project progresses. In particular, the Board would assess whether a solution can be developed within a timeframe that would not significantly delay the finalisation of the other matters within the scope of the project that can be resolved efficiently and effectively. For the purpose of developing a project proposal, the working assumption will be that an issue meets the third criterion unless the Staff is already aware of a reason that the issue cannot be resolved efficiently and effectively, in which case it would not be included in the project proposal.

33. The staff performed a preliminary analysis by applying the criteria in paragraph 29 of this paper to the known practice issues, including the unresolved issues submitted to the Committee as well as the feedback received on the DP and on the Board's previous consultations. Based on the preliminary analysis, the following issues are likely to meet all three of the criteria and be considered in the scope of the project:

   (a) classification of derivatives on own equity, including the application of the fixed-for-fixed condition to anti-dilution provisions in particular.

(b) classification of a contract that contains an obligation to purchase own equity instruments, in particular, NCI puts. This includes considering the:

   (i) accounting within equity (that is, to derecognise equity or not) and associated consequences considering the requirements in IFRS 10, IFRS 3, etc;

   (ii) recognition of the obligation to repurchase own equity instruments on a gross vs net basis;

   (iii) NCI puts settled by a variable number of the parent shares; and

   (iv) presentation of changes in the value of NCI puts.

(c) classification of financial instruments that contain contingent settlement provisions. This includes considering the:

   (i) order of identification of liability and equity components;

   (ii) effect of any conditionality in settlement alternatives;

   (iii) presentation of interest, dividends, gains and losses on a compound instrument;

   (iv) the effects of laws and regulations on the contractual rights and obligations; and

   (v) the effects of shareholder discretion on determining whether an entity has an unavoidable contractual obligation or whether a contingent settlement provision is within the control of the entity.

34. In addition, the Board may decide to include other issues that have been highlighted through feedback received on the DP as part of Alternative C even if the classification requirements in IAS 32 may be clear. For example, the Board could consider whether the liability classification (at least in part) of perpetual instruments with obligations arising only on liquidation would improve the usefulness of information provided to the users of financial statements by undertaking a more focused research and outreach to analyse costs and benefits of any change in classification.

Additional objectives that are aimed at addressing the DP respondents' concerns

35. As mentioned in paragraph 24 of this paper, the objectives of the DP would remain relevant to Alternative C although the approach differs. To ensure the concerns respondents raised about the Board's approach to classification in the DP are addressed and mitigated under this alternative and taking into account the criteria in paragraph 29 of this paper, the staff propose the following additional objectives for Alternative C:

(a) limit the changes to the classification requirements to those that are necessary because there is:

  (i) widespread accounting diversity in practice which reduces comparability across entities. Accounting diversity may arise from 'liberal' interpretation of the IAS 32 classification requirements or from a lack of clarity in IAS 32 requirements;

  or

  (ii) sufficient evidence that a change in the classification outcome would lead to more useful information to users of financial statements ie relevant information that is a faithful representation of the economic substance; and there is a clear classification alternative that would provide more useful information.

(b) ensure the clarifying amendments do not create new internal consistencies in IAS 32. For example, an entity should not arrive at different classification outcomes by applying different classification requirements within IAS 32 to the same instrument or by applying classification requirements in IAS 32 in a different order.

(c) finalise the amendments in a timely manner—the staff think that timely finalisation should be an important consideration in identifying which challenges to address as part of this project because the accounting diversity from these issues has persisted for a long period of time. As the project progresses, the Board would reassess whether a solution can be developed within a timeframe that would not significantly delay the finalisation of the other matters within the scope of the project that can be resolved efficiently and effectively. As a result of this reassessment, the Board may decide a particular issue should not be addressed as part of this project.

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

Alternative D: Narrow-scope amendments to IAS 32

36. This approach would involve adding or modifying requirements in IAS 32 for a specific fact pattern or a specific feature of financial instruments without clarifying existing principles or underlying rationales. The staff expect this alternative would involve adding application guidance or introducing exceptions to IAS 32 requirements, where necessary.

37. The main advantages of this alternative would be that quick solutions could be provided for some existing practice issues, for example what types of prevalent anti-dilution clauses would cause a contract to meet or not meet the fixed-for-fixed condition. However, as this alternative is more likely to involve introducing exception-type requirements, it would require stringent gating criteria in order to specify the scope of any such requirement. In addition, depending on the volume of narrow-scope amendments, it could be less time-consuming for the Board and for stakeholders to implement (compared to Alternatives A-C), and involve less transition effort and limited classification changes.

38. The main disadvantage of this alternative is that it has the potential to further exacerbate inconsistencies within IAS 32 and would have limited ability to address potential classification challenges that may arise in the future because it would not clarify underlying principles. Also, arguably some of the most critical open issues on IAS 32 are unlikely to be solved by looking at a narrow fact pattern. Based on the feedback on the DP, a limited number of stakeholders called for this alternative because stakeholders generally acknowledged these shortcomings.

Alternative E: Disclosure-only

39. A few respondents to the DP supported a disclosure-only project because in their view IAS 32 works well for most financial instruments and does not present significant challenges. In addition, some users of financial statements encouraged the Board to consider moving forward with a disclosure-only project so that additional information can be made available as soon as possible. Under this alternative, the Board would undertake a separate project on disclosures which would involve proceeding with the disclosure proposals in the DP (which were generally widely supported by stakeholders), with refinements to those proposals to reflect the feedback received on the DP. Having the disclosure project as a separate project would not necessarily prevent the Board from undertaking a classification project and it would not prejudge the direction the Board takes for the classification project, ie it can be any one of Alternatives A-D.

40. The main advantage of this option is that the Board will be able to make the improved disclosure information available to users of financial statements in a shorter timeframe than would be required by Alternatives A-D. The main areas requiring further work are addressing operational challenges relating to the priority disclosures, determining the scope of the dilution disclosures and finding the right balance on the level of aggregation for terms and conditions disclosures.[4]

41. The disadvantages of this alternative are that:

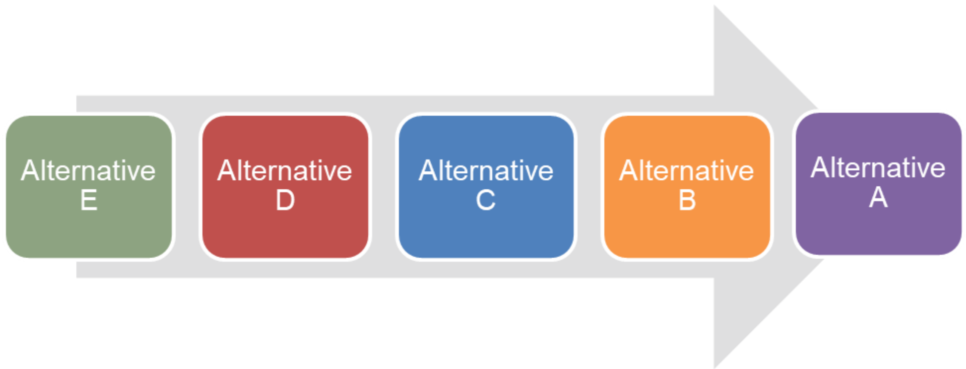
    (a) the disclosure-only project in itself will not address classification issues. Without addressing classification issues, the usefulness of information provided in the financial statements can be improved only to a limited extent.

    (b) it may not be the most efficient option. Depending on the Board's future decisions on classification, these disclosure requirements may change. That may mean the Board may need to make further amendments to disclosures or add disclosure requirements in phases.

[4] Please see Agenda Paper 5B of the July 2019 meeting for the summary of the disclosure proposals (pages 3-5) and the summary of feedback on them.

Expected timeline of the project alternatives

42. Assuming the Board agrees at a future meeting to add the FICE project to its standard-setting agenda, the relevant due process steps will be followed, including the publication of an Exposure Draft. It is therefore not possible to give exact dates as numerous factors play a part in a project timeline. The staff provide an indicative 'timeline' below which compares the project alternatives discussed in this paper, based on the expected relative timing (in order from shortest to longest) to finalise the project:



43. The staff envisage the following resource commitments would be required for the Board to develop each alternative based on the staff's preliminary thinking:

   (a) Alternative A would require the longest time to develop as it would be an entirely new approach to classification and the required timeframe would largely be dependent on the approach the Board takes. There may be a need for another Discussion Paper.

   (b) Alternative B would require a shorter time to be developed than Alternative A but longer than Alternatives C-E because it would be developing new classification principles based on the DP that would replace existing classification principles in IAS 32.

   (c) Alternative C would require a shorter time to be developed than Alternatives A and B because it would focus on addressing known practice issues by clarifying the underlying principles in IAS 32 but longer than Alternatives D and E.

   (d) Alternative D would generally require a shorter time to be developed than Alternatives A-C (because it would add to or modify the requirements in IAS 32 without clarifying the underlying principles) but this would depend on the volume of narrow-scope amendments. The timing can quickly expand if the Board wants to address a wider range of issues. Alternative D would however require a longer time to be developed than Alternative E.

(e) Alternative E would require the shortest time to be developed. However, as highlighted in paragraph 41(b), there may be a need for considering another set of disclosure requirements at a later stage depending on the outcome of any classification project.

Staff's recommendation

44. The staff recommend the Board pursue Alternative C, making clarifying amendments to IAS 32 as described in paragraphs 22–35. Stakeholders confirmed that IAS 32 is not broken and works well for most financial instruments. They also confirmed that there are a number of areas of practice challenges that have persisted and led to accounting diversity. The Committee has not been able to address some of those practice challenges based on the current requirements in IAS 32. Considering the relative advantages and disadvantages of all the alternatives discussed in this paper, on balance, the staff consider that making improvements to the main areas that have given rise to accounting diversity and practice challenges (and which can be resolved efficiently and effectively within IAS 32 and its underlying principles) while limiting the impact to other areas of IAS 32 is the best way forward. It is important to note that improvements made are to be based on principles rather than introducing rules or exceptions. As explained in paragraph 8 of this agenda paper, the staff are of the view that the Board should address only those issues that are currently within the scope of IAS 32 to avoid scope creep with other IFRS standards and to ensure the project proceeds in an efficient manner.

Questions for the Board

45. The staff would like to ask the Board the following questions at this meeting.

Questions for the Board
1. Does the Board agree with the staff's recommendation on the direction of the project ie, Alternative C—clarifying amendments to IAS 32?
2. If the Board agrees with the recommended direction, does the Board agree with the objectives and criteria to determine the scope of the project as described in paragraphs 28—35 of this agenda paper?

Appendix A – Decision points for the Board

A1. The decision points for the Board to make are shown in the chart below. We are asking the Board to make a decision on Decisions 1 and 2 at this meeting. The Board will be asked at a future meeting to decide on Decisions 3 and 4.