ACCOUNTING AND CORPORATE REGULATORY AUTHORITY

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(By online submission)

Dear Andreas

RESPONSE TO EXPOSURE DRAFT ON FINANCIAL INSTRUMENTS WITH CHARACTERISTICS OF EQUITY

The Singapore Accounting Standards Committee (ASC), under the Accounting and Corporate Regulatory Authority (ACRA), welcomes the opportunity to comment on the Exposure Draft on *Financial Instruments with Characteristics of Equity—Proposed amendments to IAS 32, IFRS 7 and IAS 1* (the ED) issued by the International Accounting Standards Board (the IASB) in November 2023.

The current requirements of IAS 32 *Financial Instruments: Presentation* and the increasing complexity and sophistication of financial instruments being issued have created challenges for the classification of financial instruments with characteristics of equity (FICE). Therefore, we commend the IASB's continued efforts to address those challenges and welcome its focus on this project to provide clarity on the existing requirements such that current classification outcomes would be changed only if such a change would minimise practice diversity and provide more useful information to users of financial statements (users). We consider it important that the IASB continues to improve the presentation and disclosure of financial information provided on financial liabilities and equity instruments, particularly on information that cannot be captured in the binary classification of these instruments.

We are generally supportive of the proposals set out in the ED but have specific comments on certain aspects. Our comments are as follows:

Question 1—The effects of relevant laws or regulations (paragraphs 15A and AG24A–AG24B of IAS 32)
The IASB proposes to clarify that: (a) only contractual rights and obligations that are enforceable by laws or regulations and are in addition to those created by relevant laws or regulations are considered in classifying a financial instrument or its component parts (paragraph 15A); and (b) a contractual right or obligation that is not solely created by laws or regulations, but is in addition to a right or obligation created by relevant laws or regulations shall be considered in its entirety in classifying the financial instrument or its component parts (paragraph AG24B). Paragraphs BC12–BC30 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

We are generally supportive of the proposed clarifications that only legally enforceable contractual rights and obligations that are in addition to those established by relevant laws or regulations are considered in classifying a financial instrument or its component parts.

In our view, while the 'all-inclusive' classification approach in paragraph BC14 of the Basis for Conclusions on the ED (BC) offers certain merits, such as having a classification outcome that fully captures the economic substance of the financial instrument or its component parts (thereby enhancing the comparability of information provided to users), it would result in a fundamental change to the classification requirements in IAS 32 and is also inconsistent with the approach to assessing contractual cash flow characteristics of financial assets in IFRS 9 *Financial Instruments*. We agree that this would go beyond the scope of this project.

Therefore, we are more persuaded by the proposed clarifications in the ED as they build on the fundamental principle that a contractual right or obligation applies only on the specific instrument and can be negotiated or modified by the parties to the contract. This would result in a classification outcome that reflects the substance of the contractual arrangement negotiated by the parties involved and disregards rights or obligations for which the decision-making rights are outside the control of the parties involved, such as those solely created by laws or regulations, since a change in relevant laws or regulations would affect all instruments subject to those laws or regulations. The proposed clarifications would maintain the distinction between financial liabilities and non-financial liabilities, which is important because of the different nature and measurement bases for these two categories of liabilities.

Moreover, as pointed out in paragraph BC18 of the BC, it should not be the case that 'two entities based in the same jurisdiction that issue economically similar financial instruments could classify the instruments differently if one entity reproduces the rights and obligations derived from laws or regulations in the contract and the other entity does not'.

Lastly, parties to a contract would usually consider all relevant legislations or legal precedents that could override contractual terms, and accordingly, the proposed clarifications that require identification of contract terms that are in addition to those created by laws would not place overly onerous burden on preparers such that costs would outweigh benefits.

Nonetheless, we have the following comments for the IASB's consideration:

Clarity in the drafting of the proposed clarifications

We received feedback from our stakeholders that the current wordings of the proposed clarifications could result in different interpretations of the requirements. To better understand the conceptual rationale of the proposed clarifications on how rights and obligations created by relevant laws or regulations should be considered for the classification of financial instruments, a detailed reading of the BC would usually be required. Hence, we suggest that the IASB refines the current wordings of the proposed clarifications to avoid different interpretations that could result in practice diversity.

Interaction with IFRS 9

Paragraph B4.1.13 of IFRS 9 provides an example (Instrument E) in which payments that arise only because of a national resolving authority's power to impose losses on instrument holders are not considered by the holder when assessing the contractual cash flow characteristics of an instrument because that power, and the resulting payments, are not contractual terms of the instrument. In other words, rights or obligations derived from relevant laws or regulations are not considered for classification of financial instruments. However, neither the example nor other requirements in IFRS 9 specify the classification considerations when:

(a) Rights or obligations derived from relevant laws or regulations are included as contractual terms; or

(b) Contractual rights or obligations are *in addition* to those created by relevant laws or regulations.

Should the IASB proceed to finalise the ED proposals, we suggest that the IASB looks into the interaction of the proposed clarifications with the relevant requirements in IFRS 9, and whether there should be consequential amendments made to IFRS 9 to avoid possible asymmetry in the accounting treatment by the issuer and the holder.

Question 2—Settlement in an entity's own equity instruments (paragraphs 16, 22, 22B–22D, AG27A and AG29B of IAS 32)
The IASB proposes to clarify when the fixed-for-fixed condition in paragraph 16(b)(ii) of IAS 32 is met by specifying that the amount of consideration to be exchanged for each of an entity's own equity instruments is required to be denominated in the entity's functional currency, and either: (a) fixed (will not vary under any circumstances); or (b) variable solely because of: (i) preservation adjustments that require the entity to preserve the relative economic interests of future shareholders to an equal or lesser extent than those of current shareholders; and/or (ii) passage-of-time adjustments that are predetermined, vary with the passage of time only, and have the effect of fixing on initial recognition the present value of the amount of consideration exchanged for each of the entity's own equity instruments (paragraphs 22B–22C). The IASB also proposes to clarify that if a derivative gives one party a choice of settlement between two or more classes of an entity's own equity instruments, the entity considers whether the fixed-for-fixed condition is met for each class of its own equity instruments that may be delivered on settlement. Such a derivative is an equity instrument only if all the settlement alternatives meet the fixed-for-fixed condition (paragraph AG27A(b)). The IASB further proposes to clarify that a contract that will or may be settled by the exchange of a fixed number of one class of an entity's own non-derivative equity instruments for a fixed number of another class of its own non-derivative equity instruments is an equity instrument (paragraph 22D). Paragraphs BC31–BC61 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

We are broadly supportive of the proposed clarifications on how the fixed-for-fixed condition would be met when:

(a) There are certain qualifying adjustments;

(b) There is a choice of settlement between two or more classes of an entity's own equity instruments; or

(c) Settlement is achieved by the exchange of a fixed number of one class of an entity's own non-derivative equity instruments for a fixed number of another class of its own non-derivative equity instruments.

In our view, the fixed-for-fixed condition should have a high hurdle that entities need to overcome to limit structuring opportunities to achieve equity treatment. The proposed clarifications continue to uphold this high hurdle and are generally aligned with existing practice.

Nonetheless, we have the following comments on the qualifying adjustments for the IASB's consideration:

<u>Passage-of-time adjustments</u>

We agree with the IASB that passage-of-time adjustments would still meet the fixed-for-fixed condition as there would not be any uncertainty in the variability in exchange ratio arising from passage-of-time adjustments, i.e., the amount of consideration to be received (or paid) or the number of equity instruments to be delivered (or reacquired) on each possible settlement date would be *predetermined at the inception of the contract* and *vary with passage of time only*. This mirrors existing practice.

However, the proposed clarifications also introduce a new criterion for qualifying passage-of-time adjustments. The proposed paragraph 22C(b)(iii) of IAS 32 requires a qualifying passage-of-time adjustment to also *have the effect of fixing on initial recognition the <u>present value</u> of the amount of consideration exchanged for each of the entity's own equity instruments—any difference in the amounts of consideration to be exchanged on each possible settlement date represents compensation proportional to the passage of time*. Paragraph BC54(c) of the BC elaborated that:

(a) This would require the extent of the passage-of-time adjustment to be analysed using a <u>present value calculation</u> to assess whether the difference between the amount of consideration to be paid or received on each settlement date represents only compensation proportional to the passage of time; and

(b) The present value calculation is <u>not intended to assess whether there is compensation for the time value of money</u> or whether the adjustment is reasonable, and is not related to any effective interest method calculation.

This is a new concept introduced by the IASB with the objective of ensuring that any difference in the amount of consideration to be received or paid on each possible settlement date is clearly related to the passage of time (and would therefore limit the risk of structuring opportunities) and be more consistent with the fixed-for-fixed condition.

In our view, the IASB did not intend for the present value calculation to be assessed to ascertain whether there is compensation for the time value of money as mentioned in

(b) above. However, the usage of the terms ‘passage of time’ and ‘present value calculation’, which are similarly used in other IFRS Accounting Standards, may suggest certain contradictions to the IASB’s intention above. For example:

(a) Paragraph B4.1.9A of IFRS 9 states that time value of money is the element of interest that provides consideration for only the passage of time; and

(b) When other IFRS Accounting Standards such as IFRS 9, IFRS 13 *Fair Value Measurement*, IFRS 16 *Leases* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* refer to present value calculations or measurements, they would entail the incorporation of time value of money (discount rates, effective interest rates, etc.) or the entity’s own credit risk.

This could result in practical application challenges when applying the criterion in question. Accordingly, we suggest that the IASB considers clarifying in the proposed requirements under paragraph 22C(b)(iii) of IAS 32 what it means by ‘compensation proportional to the passage of time’ and explicitly stating that such adjustments cannot be contingent on inputs that are available subsequent to contract inception, for example, interest rate benchmark, inflation index or market share price on a future date. While these are currently mentioned in the illustrative examples of the ED, we view that they should be given more prominence and included as part of the proposed requirements given the potential for application challenges as explained above.

Preservation adjustments

The proposed clarifications for preservation adjustments in paragraph 22C(a) include the terms ‘current holders of the entity’s own equity instruments’ (current equity instruments holders) and ‘future holders of the entity’s own equity instruments’ (future equity instruments holders). We suggest the IASB clarifies whether:

(a) The term ‘current equity instrument holders’ refers to ordinary shareholders only or to all equity instrument holders; and

(b) The term ‘future equity instrument holders’ refers to future holders of the equity instrument being assessed, or all future holders who might hold different instruments.

Question 3—Obligations to purchase an entity’s own equity instruments (paragraphs 23 and AG27B–AG27D of IAS 32)
The IASB proposes to clarify that: (a) the requirements in IAS 32 for contracts containing an obligation for an entity to purchase its own equity instruments also apply to contracts that will be settled by delivering a variable number of another class of the entity’s own equity instruments (paragraph 23).

(b) on initial recognition of the obligation to redeem an entity's own equity instruments, if the entity does not yet have access to the rights and returns associated with ownership of the equity instruments to which the obligation relates, those equity instruments would continue to be recognised. The initial amount of the financial liability would, therefore, be removed from a component of equity other than non-controlling interests or issued share capital (paragraph AG27B).

(c) an entity is required to use the same approach for initial and subsequent measurement of the financial liability—measure the liability at the present value of the redemption amount and ignore the probability and estimated timing of the counterparty exercising that redemption right (paragraph 23).

(d) any gains or losses on remeasurement of the financial liability are recognised in profit or loss (paragraph 23).

(e) if a contract containing an obligation for an entity to purchase its own equity instruments expires without delivery:

  (i) the carrying amount of the financial liability would be removed from financial liabilities and included in the same component of equity as that from which it was removed on initial recognition of the financial liability.

  (ii) any gains or losses previously recognised from remeasuring the financial liability would not be reversed in profit or loss. However, the entity may transfer the cumulative amount of those gains or losses from retained earnings to another component of equity (paragraph AG27C).

(f) written put options and forward purchase contracts on an entity's own equity instruments that are gross physically settled—consideration is exchanged for own equity instruments—are required to be presented on a gross basis (paragraph AG27D).

Paragraphs BC62–BC93 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Many entities with financial instruments that contain obligations for the issuing entities to purchase their own equity instruments, particularly written put options to non-controlling interest (NCI) holders, would be affected by the proposed clarifications if they previously recognised such obligations using a different approach (e.g., debiting NCI on initial recognition). Nonetheless, we agree with the IASB's proposal to debit against a component of equity other than NCI based on the rationale offered in the BC as the proposed clarifications would reduce the practice diversity caused by the absence of specific guidance in IFRS Accounting Standards. While the IASB concluded in paragraphs BC81 to BC83 of the BC that practice issues relating to the

measurement of financial liabilities are generally outside the scope of this project, it proposed an approach that would provide greater consistency between the assumptions and inputs used for initial and subsequent measurement and could resolve many questions about subsequent measurement in practice. In our view, this approach presents a pragmatic solution that offers merit in reducing measurement complexity while fostering greater consistency in practice, and is aligned to the rationale in paragraph BC12 of the Basis for Conclusions on IAS 32 that an entity will not be able to avoid bearing the full amount of its obligation should the holder exercise its option. Therefore, we welcome the proposed clarifications which would result in a consistent approach for the recognition and measurement of obligations to purchase an entity's own equity instruments.

Furthermore, we suggest that the IASB considers how to account for financial instruments with an obligation to purchase own equity instruments that might have a range of redemption amounts on the earliest possible redemption date itself (e.g., the redemption amount on the earliest possible date might be contingent on meeting future performance targets). The IASB should provide clarifications on how the financial liability for such obligations should be measured.

Question 4—Contingent settlement provisions (paragraphs 11, 25, 25A, 31, 32A, AG28 and AG37 of IAS 32)

The IASB proposes to clarify that:

(a) some financial instruments with contingent settlement provisions are compound financial instruments with liability and equity components (paragraphs 25 and 32A);

(b) the initial and subsequent measurement of the financial liability (or liability component of a compound financial instrument) arising from a contingent settlement provision would not take into account the probability and estimated timing of occurrence or non-occurrence of the contingent event (paragraph 25A);

(c) payments at the issuer's discretion are recognised in equity even if the equity component of a compound financial instrument has an initial carrying amount of zero (paragraphs 32A and AG37);

(d) the term 'liquidation' refers to the process that begins after an entity has permanently ceased its operations (paragraph 11); and

(e) the assessment of whether a contractual term is 'not genuine' in accordance with paragraph 25(a) of IAS 32 requires judgement based on the specific facts and circumstances and is not based solely on the probability or likelihood of the contingent event occurring (paragraph AG28).

Paragraphs BC94–BC115 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

We generally support the proposed clarifications as it addresses longstanding application ambiguity regarding whether to classify a financial instrument with a contingent settlement provision as a financial liability in its entirety, or as a compound financial instrument with both a liability component and an equity component.

However, the IASB may wish to consider our comments below on other areas:

Measurement of liabilities arising from contingent settlement provisions

Our comment for the initial and subsequent measurement of the financial liability for an obligation to purchase own equity instruments under Question 3 is equally relevant here.

Meaning of 'liquidation'

The IASB may wish to consider revisiting the proposed definition of 'liquidation'. Liquidation is a legal concept with varying definitions and interpretations across different jurisdictions that may not aligned with this proposed definition. Likewise, permanent cessation of operations may have different interpretations in practice. Introducing a single definition in IFRS Accounting Standards would be unnecessarily restrictive and might not reflect how the liquidation clause of a financial instrument will be exercised in accordance with the applicable laws or regulations of the respective local jurisdiction. Hence, we suggest that the IASB considers providing factors that an entity would be required to consider in determining the meaning of liquidation as it relates to the financial instrument and the local jurisdiction, instead of having a conclusive definition of 'liquidation' in the proposed clarifications.

Meaning of 'not genuine'

Under usual circumstances, terms are included in a contract for an economic purpose and would therefore be deemed as genuine. It remains unclear as to when a contractual term could be assessed to be not genuine. We suggest that the IASB includes guidance of such instances to provide clarity on this.

Question 5—Shareholder discretion (paragraphs AG28A–AG28C of IAS 32)
The IASB proposes: (a) to clarify that whether an entity has an unconditional right to avoid delivering cash or another financial asset (or otherwise to settle a financial instrument in such a way that it would be a financial liability) depends on the facts and circumstances in which shareholder discretion arises. Judgement is required to

assess whether shareholder decisions are treated as entity decisions (paragraph AG28A).

(b) to describe the factors an entity is required to consider in making that assessment, namely whether:

   (i) a shareholder decision would be routine in nature—made in the ordinary course of the entity's business activities;

   (ii) a shareholder decision relates to an action that would be proposed or a transaction that would be initiated by the entity's management;

   (iii) different classes of shareholders would benefit differently from a shareholder decision; and

   (iv) the exercise of a shareholder decision-making right would enable a shareholder to require the entity to redeem (or pay a return on) its shares in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) (paragraph AG28A(a)–(d)).

(c) to provide guidance on applying those factors (paragraph AG28B).

Paragraphs BC116–BC125 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree, please explain what you suggest instead and why.

We commend the IASB for its efforts in addressing the practice issues relating to shareholder discretion. This is expected to remain a complex area requiring judgement based on the specific facts and circumstances, especially with corporations continuously evolving their ownership structure to court investors. In the absence of a silver bullet for the practice issues, we welcome the IASB's proposed principles-based approach and the complementing factors that must be considered by an entity during the assessment.

Question 6—Reclassification of financial liabilities and equity instruments (paragraphs 32B–32D and AG35A of IAS 32)

The IASB proposes:

(a) to add a general requirement that prohibits the reclassification of a financial instrument after initial recognition, unless paragraph 16E of IAS 32 applies or the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement (paragraphs 32B–32C).

(b) to specify that if the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement, an entity would:

  (i) reclassify the instrument prospectively from the date when that change in circumstances occurred.

  (ii) measure a financial liability reclassified from equity at the fair value of that financial liability at the date of reclassification. Any difference between the carrying amount of the equity instrument and the fair value of the financial liability at the date of reclassification would be recognised in equity.

  (iii) measure an equity instrument reclassified from a financial liability at the carrying amount of the financial liability at the date of reclassification. No gain or loss would be recognised on reclassification (paragraph 32D).

(c) provide examples of changes in circumstances external to the contractual arrangement requiring reclassification (paragraph AG35A).

Paragraphs BC126–BC164 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Would the proposal to reclassify the instrument prospectively from the date when a change in circumstances occurred give rise to any practical difficulties? If so, please describe those practical difficulties and the circumstances in which they would arise.

We are generally supportive of the IASB's proposal to add a general requirement that prohibits the reclassification of a financial instrument after initial recognition, and that reclassification is required when the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement. We also agree broadly with the proposed measurement approach.

We consider that reclassification under the proposed approach would result in a more faithful representation of the substance of the contractual terms at the reporting date, consistent with paragraph 2.12 of the *Conceptual Framework for Financial Reporting*, and the proposed measurement approach would be consistent with paragraphs 16E and 16F of IAS 32. Additionally, we are not aware of any practical difficulties that could arise from reclassifying the instrument prospectively from the date when a change in circumstances occurs.

Nonetheless, we have the following comments:

<u>Scope of prohibition of reclassification—when a contractual term becomes, or stops being, effective with the passage of time</u>

We suggest that the IASB reconsiders its proposal that prohibits reclassification when the substance of the contractual arrangement changes because of a contractual term that becomes, or stops being, effective with the passage of time during the instrument's life.

Retaining this prohibition may result in an incorrect classification of certain instruments. For example, applying the ED proposal, an instrument would retain its initial classification as a financial liability after expiry of the terms relating to the liability feature, and thus, not faithfully present its true economic substance. In our view, such an approach would also be inconsistent with paragraph 3.3.1 of IFRS 9, which requires a financial liability to be removed from its statement of financial position when it is extinguished—i.e., when the obligation specified in the contract is discharged or cancelled or expires.

We are not persuaded by the IASB's rationale in the BC that the additional disclosures required by the ED about changes in contractual terms relating to the passage of time would compensate for this classification inconsistency and still ensure relevant information is provided to users. In our view, the incremental costs to account for the effects of these changes would *not* outweigh the benefits of faithful representation and comparability for users.

Question 7—Disclosure (paragraphs 1, 3, 12E, 17A, 20, 30A–30J and B5A–B5L of IFRS 7)
The IASB proposes: (a) to expand the objective of IFRS 7 to enable users of financial statements to understand how an entity is financed and what its ownership structure is, including potential dilution to the ownership structure from financial instruments issued at the reporting date (paragraph 1). (b) to delete the reference to derivatives that meet the definition of an equity instrument in IAS 32 from paragraph 3(a) of IFRS 7. (c) to move paragraphs 80A and 136A from IAS 1 to IFRS 7. These paragraphs set out requirements for disclosures relating to financial instruments classified as equity in accordance with paragraphs 16A–16B and/or paragraphs 16C–16D of IAS 32 (paragraphs 12E and 30I). The IASB also proposes to expand paragraph 80A to cover reclassifications if there are changes in the substance of the contractual arrangement from a change in circumstances external to the contractual arrangement. (d) to amend paragraph 20(a)(i) of IFRS 7 to require an entity to disclose gains or losses on financial liabilities containing contractual obligations to pay amounts based on the entity's performance or changes in its net assets, separately from gains or losses on other financial liabilities in each reporting period.

(e) to include disclosure requirements for compound financial instruments in IFRS 7 (paragraph 17A).

The IASB proposes to require an entity to disclose information about:

(a) the nature and priority of claims against the entity on liquidation arising from financial liabilities and equity instruments (paragraphs 30A–30B);

(b) the terms and conditions of financial instruments with both financial liability and equity characteristics (paragraphs 30C–30E and B5B–B5H);

(c) terms and conditions that become, or stop being, effective with the passage of time (paragraph 30F);

(d) the potential dilution of ordinary shares (paragraphs 30G–30H and B5I–B5L); and

(e) instruments that include obligations to purchase the entity's own equity instruments (paragraph 30J).

Paragraphs BC170–BC245 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

We generally support the additional disclosures in the ED, aimed at providing users with better information about features of claims that are not presented by the binary distinction between financial liabilities and equity, and the improved disclosures for equity instruments. While we recognise the extensiveness of the proposed disclosures, these are aimed to meet the needs of users by providing information on an entity's capital structure (i.e., the nature and priority of claims against the entity on liquidation), terms and conditions indicating the priority on liquidation for FICE and potential dilution in the ordinary shares from financial instruments issued at the reporting date.

Nature and priority of claims on liquidation

Our stakeholders have shared that there would be complexities involved, for example, requiring legal specialists to analyse the effects of liquidation rules in the respective jurisdictions on contractual subordination of instruments, particularly entities that operate in multiple jurisdictions, and disclosures on a consolidated basis where claims could depend on the respective jurisdictional liquidation framework of each subsidiary and the parent, and against different pools of assets within the group. While we generally support the ED proposal, we suggest that the IASB performs field testing to assess that the benefits from the disclosure requirements would outweigh the complexity and costs relating to obtaining this information.

In addition, we have the following comments for the IASB's consideration:

Expected timing and uncertainty of cash flows

We note the proposed disclosures illustrated in IG14E of IFRS 7 *Financial Instruments: Disclosures* do not appear to provide information about the *expected* timing and uncertainty of the cash flows. Paragraph B10A of IFRS 7 currently requires an entity to state if the outflows of cash (or another financial asset) included in quantitative liquidity risk disclosures based on contractual terms could occur significantly earlier or be for significantly different amounts from those indicated. Hence, we suggest that the IASB considers expanding the example in IG14E to illustrate the estimated timing and amounts of cash outflows.

For certain instruments, such as perpetual securities that provide the issuer with a right to defer interest payments indefinitely, information about the conditions in which the entity would expect to defer payments or an estimate of the timing of payments would be useful to investors. Similarly, where the probability and estimated timing of uncertain future events are not considered in the initial and subsequent measurement of a financial liability arising from the contingent settlement provisions, such information would help users better determine the nature, amount, timing and uncertainty of cash flows.

Other disclosures

In line with the intent of requiring presentation of amounts attributable to ordinary shareholders (see Question 8), the IASB may wish to consider adding required disclosures of undeclared cumulative dividends or similar distributions to other owners that would affect the ordinary shareholders' residual interest in the entity's assets after deducting all of its liabilities on liquidation. This would provide information to help users understand how the entity distributes its returns to ordinary shareholders and other owners.

Another example where significant judgement would likely be involved is in concluding that a contractual term agreed between contracting parties is 'not genuine' (see Question 4). We suggest that the IASB considers adding specific requirements for an entity to disclose its significant judgements where in accordance with paragraph 25(a) of IAS 32, the entity concluded that part of the contingent settlement provision that could require settlement in cash or another financial asset is not genuine.

Question 8—Presentation of amounts attributable to ordinary shareholders (paragraphs 54, 81B and 107–108 of IAS 1)
The IASB proposes to amend IAS 1 to require an entity to provide additional information about amounts attributable to ordinary shareholders. The proposed amendments are that:

(a) the statement of financial position shows issued share capital and reserves attributable to ordinary shareholders of the parent separately from issued share capital and reserves attributable to other owners of the parent (paragraph 54);

(b) the statement of comprehensive income shows an allocation of profit or loss and other comprehensive income attributable to owners of the parent between ordinary shareholders and other owners of the parent (paragraph 81B);

(c) the components of equity reconciled in the statement of changes in equity include each class of ordinary share capital and each class of other contributed equity (paragraph 108); and

(d) dividend amounts relating to ordinary shareholders are presented separately from amounts relating to other owners of the entity (paragraph 107).

Paragraphs BC246–BC256 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Would the proposed requirement to allocate issued share capital and reserves between ordinary shareholders and other owners of the parent give rise to any practical difficulties in determining the required amounts? If so, please describe the possible difficulties and specify areas in which further guidance would be helpful.

We agree with the IASB that users would benefit from improved information about similarities and differences between claims of an entity's investors on the entity's net assets. The proposed disclosures on terms and conditions, potential dilution and the nature and priority of claims would provide transparency about whether an entity has issued other equity instruments.

Improved information should also include an attribution of amounts attributable to ordinary shareholders separately from other owners of the entity. A meaningful attribution may have to consider the relative amounts due at liquidation, and other features such as restrictions on distributions and priority of claim on liquidation.

However, the challenge lies in determining an attribution approach that could provide useful information, without undue complexity and costs. We have concerns about how the ED proposals could be applied in a practical manner given that there is a lack of principles and/or guidance on the attribution method and the considerations.

Some possible areas which the IASB could consider providing guidance are included below:

<u>No pre-determined distribution or distribution that may vary on liquidation</u>

The attribution method becomes unclear when the equity instrument does not have a pre-determined distribution formula, or has a distribution formula that may vary on liquidation.

Different rights and obligations

Financial instruments classified as equity could have different rights and obligations, despite having an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation. These differences could result in different amounts of the residual return being allocated to the different classes of equity instruments based on features that are not reflected by their equity classification, for example:

(a) Priority of the claim on liquidation;

(b) Extent of participation in the residual interest; and

(c) Rights to receive distributions.

It is unclear how to attribute between ordinary shareholders and other owners when they have different rights and obligations. We suggest that the IASB provides clear principles on the attribution approach. This would also help entities determine:

(a) Whether and how to attribute other comprehensive income, such as hedging gains or losses and exchange differences on translating foreign operations; and

(b) Whether cumulative or non-cumulative dividends should be considered only when declared, or whether any undeclared amounts should be accumulated and included in the attribution. For example, corporate hybrids or AT1 capital instruments that are equity-classified under IAS 32 principles (because the issuer has the right to defer payment until its liquidation) often have fixed-rate coupons payable on specified dates that accumulate if undeclared.

Attribution of total comprehensive income to derivative equity instruments

In our view, the benefits of attributing total comprehensive income to derivative equity instruments are unlikely to be justified by the costs of providing the information. The amount attributable to the derivatives may not have significant predictive value for the returns that the holders would receive over the life of those instruments.

Paragraph BC256 of the BC states that, 'The presentation of equity attributable to ordinary shareholders and other equity holders in the draft illustrative example is *based on the contractual terms applicable at the reporting date*…'. In our view, the IASB should clarify whether, for the purpose of separately presenting amounts attributable to ordinary shareholders and other owners, they have intended to mean the wordings in italics, i.e., that contractual terms that are contingent on future events are not considered. If this is indeed the IASB's intention, these wordings should be included in

IAS 1 amendments, rather than residing in the BC. This would avoid potential confusion in practice.

Question 9—Transition (paragraphs 97U–97Z of IAS 32)
The IASB proposes to require an entity to apply the proposed amendments retrospectively with the restatement of comparative information (a fully retrospective approach). However, to minimise costs, the IASB proposes not to require the restatement of information for more than one comparative period, even if the entity chooses or is required to present more than one comparative period in its financial statements. For an entity already applying IFRS Accounting Standards, the IASB proposes: (a) to require the entity to treat the fair value at the transition date as the amortised cost of the financial liability at that date if it is impracticable (as defined in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*) for the entity to apply the effective interest method in IFRS 9 *Financial Instruments* retrospectively (paragraph 97X); (b) not to require the entity to separate the liability and equity components if the liability component of a compound financial instrument with a contingent settlement provision was no longer outstanding at the date of initial application (paragraph 97W); (c) to require the entity to disclose, in the reporting period that includes the date of initial application of the amendments, the nature and amount of any changes in classification resulting from initial application of the amendments (paragraph 97Z); (d) to provide transition relief from the quantitative disclosures in paragraph 28(f) of IAS 8 (paragraph 97Y); and (e) no specific transition requirements in relation to IAS 34 *Interim Financial Reporting* for interim financial statements issued within the annual period in which the entity first applies the amendments. For first-time adopters, the IASB proposes to provide no additional transition requirements. Paragraphs BC262–BC270 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why. Would the proposal to apply the proposed amendments retrospectively give rise to any other cases in which hindsight would be necessary? If so, please describe those cases and the circumstances in which the need for hindsight would arise.

Subject to our comments below, we are generally supportive of the transition requirements on the basis of the IASB's rationale.

We recognise that the fully retrospective approach would generally facilitate year-on-year comparability and help users identify and assess changes and trends in an entity's financing and ownership structure, liquidity and solvency.

Although the fundamental classification principles in IAS 32 are not changed, the proposed amendments to IAS 32 which aimed to address accounting diversity by clarifying relevant classification principles would necessarily mean that some entities might need to change their accounting policies when initially applying the proposed amendments. Accordingly, the IASB may wish to consider providing additional transition reliefs in the following areas to help mitigate the costs to preparers, while ensuring that the impact on the information needs of users remains reasonably minimal.

Hedging relationships impacted by classification changes

For entities that need to change the classification of financial liabilities either at initial recognition or when reclassification requirements were met, for which hedge accounting was applied, their assessments of the qualifying criteria and hedge effectiveness of existing hedging relationships would be impacted. For example, if a financial liability, previously designated in a hedging relationship, is reclassified as an equity instrument (which is not an eligible hedged item), the entity would be forced to retrospectively discontinue the hedging relationships. As the hedge accounting in previous periods was based on previously designated hedging relationships that were aligned with its risk management activities and previously assessed to be effective, a fully retrospective approach might lead to significant costs to preparers in quantifying the impact, and complexities in presenting and disclosing the impact on hedge accounting on initial adoption of the amendments—which could be confusing to users.

Hence, we suggest that the IASB considers providing additional transition relief, such as allowing entities to cease the impacted hedging relationship retrospectively from inception of the hedging relationship (i.e., effectively, hedge accounting has never been applied for that hedged item).

Financial instruments that ceased to exist at the date of initial application

We suggest that the IASB considers a practical expedient of not requiring an entity to change the classification of a financial instrument retrospectively for which the financial instrument had been extinguished in the previous period. Similar to the arguments in paragraph BC266 of the BC, where the financial liability or liability component was no longer outstanding at the date of initial application, retrospective application would be of little benefit because it would involve changing the amounts of retained earnings and another component of equity.

Question 10—Disclosure requirements for eligible subsidiaries (paragraphs 54, 61A–61E and 124 of [IFRS XX])
The IASB proposes amendments to the draft Accounting Standard [IFRS XX *Subsidiaries without Public Accountability: Disclosures*], which will be issued before the proposals in the Exposure Draft are finalised. [IFRS XX] will permit eligible subsidiaries to apply the recognition, measurement and presentation requirements in IFRS Accounting Standards with reduced disclosures. The IASB's proposals select appropriate disclosure requirements from those proposed for IFRS 7, based on the IASB's agreed principles for reducing disclosures. Paragraphs BC257–BC261 explain the IASB's rationale for the selected disclosures. Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why, taking into consideration the reduced disclosure principles described in BC258.

We generally agree with the IASB's proposals for selecting appropriate disclosure requirements from those proposed for IFRS 7 (subject to our comments in Question 7), based on the IASB's agreed principles for reducing disclosures for eligible subsidiaries as described in paragraph BC258 of the BC.

We hope that our comments will contribute to the IASB's deliberation on the ED. Should you require any further clarification, please contact our project managers Yun Leng Chua at chua_yun_leng@acra.gov.sg or Eddie Lim at eddie_lim@acra.gov.sg.

Yours sincerely

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Technical Director
Accounting Standards Committee
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