UK Endorsement Board

Feedback Statement

Financial Instruments with Characteristics of Equity: Amendments to IAS 32, IFRS 7 and IAS 1

Final Comment Letter (FCL)

April 2024

The UK Endorsement Board (UKEB) is responsible for endorsement and adoption of IFRS for use in the UK and therefore is the UK's National Standard Setter for IFRS. The UKEB also leads the UK's engagement with the IFRS Foundation on the development of new standards, amendments and interpretations.

The comment letter to which this feedback statement relates forms part of those influencing activities and is intended to contribute to the IFRS Foundation's due process.

The views expressed by the UKEB in its comment letter are separate from, and will not necessarily affect the conclusions in, any endorsement and adoption assessment on new or amended international accounting standards undertaken by the UKEB.

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Purpose of this Feedback Statement

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This feedback statement presents the views of UK stakeholders received during the UKEB's outreach activities on the IASB's Exposure Draft (ED) *Financial Instruments with Characteristics of Equity* and explains how the UKEB's Final Comment Letter addressed those views.

The IASB's Exposure Draft

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The IASB issued the Exposure Draft (ED) *Financial Instruments with Characteristics of Equity (Amendments to IAS 32, IFRS 7 and IAS 1)* (the Amendments) in November 2023. The Amendments propose:

- Requirements on **the effects of laws and regulations** to be considered when classifying financial instruments as liabilities or equity.

- Principles for assessing whether financial instruments meet the **fixed-for-fixed condition -** to meet the criteria for equity classification, the amount of consideration exchanged for a company's own equity instruments is required to be in the company's functional currency and either fixed or variable only with specified adjustments.

- Further requirements on the scope, classification, measurement and presentation of **obligations to redeem own equity instruments and contingent settlement provisions**. An entity should use the same approach for initial and subsequent measurement of the financial liability, i.e. 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.

- A factor-based approach to assess whether decisions are taken by the entity, in relation to instruments that include a contractual obligation to deliver cash at the discretion of the issuer's **shareholders.**

The IASB's Exposure Draft (continued)

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The Amendments also propose:

- Prohibition of **reclassification** other than for changes in the substance of the contractual terms arising from changes in circumstances outside the contract.

- **Additional disclosure requirements** for issued financial instruments, including in relation to potential dilution and priority of claims on liquidation.

- New **presentation** requirements, including presenting issued share capital and reserves, profit or loss, other comprehensive income and dividends attributable to ordinary owners of the entity separately from those attributable to other owners. The statement of changes in equity should include each class of ordinary share capital and other equity.

- Full retrospective application on **transition** with limited exceptions.

- Reduced disclosures to be included within the forthcoming *Subsidiaries without Public Accountability* standard.

Outreach approach

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The UKEB's outreach activities took place between September 2023 and March 2024 and were conducted to develop the UKEB Comment Letter.

Due to the project timeline, most of our outreach activities were performed in the early stages of the project and these stakeholder views were reflected in the UKEB Draft Comment Letter (DCL).

All comments and views were considered in reaching the UKEB's final assessment of the Amendments.

Outreach activities included:

- Discussions with the UKEB Financial Instruments Working Group, the UKEB Accounting Firms and Institutes Advisory Group, the UKEB Investor Advisory Group and the UKEB Preparer Advisory Group.
- Meetings with preparers, users, accounting firms, industry bodies and regulators.
- Public consultation on the UKEB's DCL.

The DCL was shared with our outreach participants via subscriber alerts as well as being made available on the UKEB website.

Three written responses to the DCL were received, two from accounting firms and one from a preparer. These are included in the stakeholder outreach statistics shown in the table and are summarised in the next pages, together with advisory group and informal feedback received during the comment period.

One accounting firm wrote to observe that it did not have fundamental concerns on the main observations and recommendations in the DCL. We therefore do not refer to its response in the next pages.

Where stakeholders agreed with the UKEB draft position and where there has been no substantive change in drafting from the DCL, this has not been included in the summary of detailed feedback.

Stakeholder type	Organisations represented
Preparers	15
Users	13
Accounting firms and institutes	12
Industry bodies*	3
Regulators	2
Total	**45**

*The industry bodies have multiple members, often representing a variety of stakeholder types.

UKEB and stakeholder views
Reclassification

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IASB proposals	UKEB draft position	Further stakeholder views	UKEB final position
• Requires that an instrument would continue to be recognised as a liability if a contractual clause becomes, or stops being, effective with the passage of time.	• Recommended that the IASB consider requiring reclassification of instruments where contractual terms become, or stop being, effective with the passage of time. • Recommended additional application guidance on the distinction between reclassification and derecognition, if the IASB proceeds with the ED proposals.	• Stakeholders agreed with the UKEB's position. • One stakeholder considered the UKEB recommendation an insufficient corrective. Instead, they recommended the IASB develops illustrative examples.	• Consistent with draft position but added that guidance in this significant area should be incorporated within the main body and application guidance of the Standard, rather than in non-mandatory illustrative examples (not endorsed by the UKEB). • Recommended additional application guidance on the distinction between reclassification and derecognition, whether or not the IASB proceeds with the ED proposals.

UKEB and stakeholder views
Obligations to redeem own equity

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IASB proposals	UKEB draft position	Further stakeholder views	UKEB final position
• An entity is required to use the same approach for initial and subsequent measurement of the financial liability, i.e. to 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.	• Expressed concern that using the same approach for initial and subsequent measurement of the financial liability, i.e. measuring the liability at the present value of the redemption amount and ignoring the probability and estimated timing of the counterparty exercising that redemption right, goes beyond clarification of classification outcomes, and may have unintended consequences. • Recommended discounting liabilities from the expected settlement date.	• Stakeholders shared the UKEB's concerns on the approach adopted. • Some stakeholders considered that the UKEB proposed recommendation needed further development, as potential related application questions (such as whether the redemption amount should be based on the most likely outcome or a probability weighted outcome and how the expected settlement date should be determined when there are various settlement date options) remained unanswered. They considered that measurement requirements should be included within IFRS 9 *Financial Instruments*.	• Proposed retaining the existing reference to IFRS 9 measurement requirements and removing the final two sentences of paragraph 23, as stakeholder feedback has highlighted the difficulties of introducing a new measurement basis. • Removed recommendation proposing an alternative new measurement basis in the light of feedback on the difficulties presented by such an approach. • Requested the IASB consider measurement issues within its *Amortised Cost Measurement* project.

UKEB and stakeholder views
Obligations to redeem own equity (continued)

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IASB proposals	UKEB draft position	Further stakeholder views	UKEB final position
• Where a contract contains an obligation for an entity to purchase its own equity instruments, the entity initially should recognise a financial liability at the present value of the redemption amount by removing that amount from equity and including it in financial liabilities.	• Supported the IASB proposal.	• Stakeholders largely agreed with the UKEB's position. • One stakeholder considered that under the IASB proposal, the claim of non-controlling interest (NCI) shareholders would be recognised twice in substance. They proposed recognising the financial liability as proposed but offsetting the redemption amount against NCI and only the remainder removed from parent equity.	• Retained draft position, as the requirement is consistent with the treatment of mandatorily redeemable shares and other obligations conditional on events or choices beyond the entity's control.

UKEB and stakeholder views
Obligations to redeem own equity (continued)

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IASB proposals	UKEB draft position	Further stakeholder views	UKEB final position
• Changes in the present value of the redemption amount should be recognised in profit or loss.	• Supported the IASB proposal.	• Most stakeholders agreed with the UKEB's position. • One stakeholder disagreed with the UKEB's position. They considered that changes in the present value of the redemption amount should be presented in equity. They considered that the requirements in IFRS 10 *Consolidated Financial Statements* should take precedence, as the liability reflects amounts that could be paid to acquire NCI, and changes in the proportion held by NCI shareholders should be recognised in equity.	• Retained draft position, as it provides consistency with IFRS 9, which requires gains or losses on remeasurement of financial liabilities to be recognised in profit or loss.

UKEB and stakeholder views
Contingent settlement provisions

IASB proposals	UKEB draft position	Further stakeholder views	UKEB final position
• An entity is required to use the same approach for initial and subsequent measurement of the financial liability, i.e. to 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.	• Expressed concern that using the same approach for initial and subsequent measurement of the financial liability, i.e. to measure the liability at the present value of the redemption amount, ignoring the probability and estimated timing of the counterparty exercising that redemption right, goes beyond clarification of classification outcomes, and may have unintended consequences. • Recommended discounting liabilities from the expected settlement date.	• Some stakeholders agreed with the UKEB's position. • Other stakeholders considered that the UKEB draft recommendation needed further development as it too introduced a new measurement basis. They further considered that new measurement requirements should be included within IFRS 9 *Financial Instruments*.	• Proposed retaining the existing reference to IFRS 9 measurement requirements and removing paragraph 25A, as stakeholder feedback has highlighted the difficulties of introducing a new measurement basis. • Removed recommendation proposing an alternative new measurement basis in the light of feedback on the difficulties presented by such an approach. • Requested the IASB consider measurement issues within its *Amortised Cost Measurement* project.

UKEB and stakeholder views
Contingent settlement provisions (continued)

IASB proposals	UKEB draft position	Further stakeholder views	UKEB final position
• Liquidation is defined as the process that begins after an entity has permanently ceased its operations.	• Supported the IASB's proposal.	• Most stakeholders agreed with the UKEB's position. • One stakeholder observed that liquidation is governed by laws and regulations, which differ between jurisdictions, and may start before an entity ceases operations. They were concerned that introducing a definition may have unintended consequences, and preferred not introducing a definition.	• Retained draft position, because the IASB's proposed wording was considered sufficiently broad to apply across jurisdictions and should reduce inconsistency.

UKEB and stakeholder views
Fixed-for-fixed condition

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IASB proposals	UKEB draft position	Further stakeholder views	UKEB final position
• Any difference in the amounts of consideration to be exchanged on each possible settlement date represents compensation proportional to the passage of time.	• Recommended providing additional explanation of the meaning of 'proportional' in relation to the fixed-for-fixed condition, together with illustrative examples.	• Stakeholders agreed with the UKEB's draft position. • In addition, one stakeholder requested confirmation that rounding provisions, which avoid shares being issued in fractions, do not breach the fixed-for-fixed condition. • That stakeholder also suggested the IASB should explore whether paragraph 22B should be expanded to include the functional currency of the holder, not just the issuer.	• Consistent with draft position. • Considered that rounding provision clauses were unlikely to be material. • Did not include a recommendation to explore whether paragraph 22B should be expanded to include the functional currency of the holder, as this would not provide useful information in relation to the issuer's financial statements.

UKEB and stakeholder views

Disclosures

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IASB proposals	UKEB draft position	Further stakeholder views	UKEB final position
• Entities should disclose information about the nature and priority of claims against them on liquidation arising from financial liabilities and equity instruments.	• Observed that ED IFRS 7 paragraphs 30A and 30B may be difficult to apply in groups, where establishing the priority of instruments on liquidation may not be possible when the instruments are held in different legal entities. Further, as claims within one legal entity are not subordinated to those in any other, a consolidated disclosure could be misleading. • Recommended removing ED IFRS 7 paragraphs 30A and 30B.	• Stakeholders agreed with the UKEB's position. They considered that the consolidation position could be misleading because claims are made against individual legal entities, and hence the group itself cannot be liquidated. • One stakeholder agreed with the UKEB's draft position but queried why we had proposed removing paragraph 30A when elsewhere we suggested that other disclosures meet the disclosure objective expressed within that paragraph.	• Made observation on difficulty of applying 30B in groups. • Clarified recommendation to remove ED IFRS 7 paragraphs 30A and 30B, by replacing cross-reference to the disclosure objective contained in ED paragraph 30A with reference to the overall disclosure objectives set out in IFRS 7 paragraph 1.

UKEB and stakeholder views
Disclosures (continued)

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IASB proposals	UKEB draft position	Further stakeholder views	UKEB final position
• Entities should disclose potential dilution to the ownership structure from issued financial instruments.	• Noted field testing carried out by EFRAG and requested the IASB consider further field testing of disclosures.	• Stakeholders agreed with the UKEB's position. • One of those stakeholders further considered that the IASB should explore whether such disclosures should be included in IAS 33 *Earnings per Share* and whether they should be aligned with existing requirements on dilution to avoid confusion among users.	• Broadly consistent with draft position but removed reference to EFRAG field testing. • There is no apparent conflict between these proposals and the disclosures required by IAS 33.
• Entities should disclose information about the terms and conditions of financial instruments with both financial liability and equity characteristics.	• Noted field testing carried out by EFRAG and requested the IASB consider further field testing of disclosures.	• Stakeholders agreed with the UKEB's position. • One of those stakeholders suggested that the IASB should specify that disclosures required by paragraphs 30C to 30E only apply to those financial instruments that are individually material to the reporting entity.	• Broadly consistent with draft position but removed reference to EFRAG field testing. • Did not include proposal to restrict recommendation to those financial instruments that are individually material, as this departs from usual IFRS practice.

UKEB and stakeholder views
Transition

IASB proposals	UKEB draft position	Further stakeholder views	UKEB final position
• Entities should apply full retrospective application on transition.	• Noted that if instruments were required to be retrospectively reclassified from equity to a financial liability on transition, entities would have to measure their fair value at inception, which could prove onerous. • Recommended that the IASB consider providing transitional relief from full retrospective application where this would require undue cost or effort.	• Stakeholders agreed with the UKEB's position. • Some stakeholders considered that full retrospective application could require consequential remeasurement of acquisition-date goodwill arising. • One stakeholder, who agreed with the UKEB draft position, observed that restating comparatives relating to extinguished financial instruments has limited value and this exemption would reduce the cost of implementation.	• Broadly consistent with draft position. • Recommended that if financial instruments have been extinguished at the date of initial application, they should not be required to be restated. Observed that full retrospective application could require consequential remeasurement of acquisition-date goodwill arising. • Recommended that the IASB consider transition relief to assess classification at the date of initial application, on the basis of the facts and circumstances at that date, including assessing only features unexpired at that date. • Included reference to the transition provisions of the Exposure Draft *Amendments to Classification and Measurement* as a relevant point of comparison.

UKEB and stakeholder views
Effects of laws

IASB proposals	UKEB draft position	Further stakeholder views	UKEB final position
• In classifying a financial instrument (or its component parts) as a financial liability, a financial asset or an equity instrument, an entity: (a) shall consider only contractual rights and obligations that are enforceable by laws or regulations and are in addition to those created by relevant laws or regulations (such as statutory or regulatory requirements applicable to the instrument); and (b) shall not consider any right or obligation created by relevant laws or regulations that would arise regardless of whether the right or obligation is included in the contractual arrangement.	• Recommended that the IASB clarify how paragraph 15A(b) differ from paragraph 15A(a) or considers removing it.	• Stakeholders agreed with the UKEB's position. • One stakeholder considered that paragraph 15A(a) rather than 15A(b) should be removed, as they considered that contractual provisions that are knowingly unenforceable would be disregarded as non-genuine. They also considered that 15A(b) could result in counter-intuitive outcomes. However, they noted that this was not likely to cause issues in the UK. They suggested that IFRS 17 *Insurance Contracts* paragraph 2 offers an alternative approach.	• Retained recommendation, as paragraph 15A(a) states the requirement for consideration of rights and obligations that are in addition to those created by laws without ambiguity on features, the form of which is not specified in law. • An approach that requires the issuer of a financial instrument to consider contractual terms and rights and obligations established by relevant laws or regulations, similar to that proposed by IFRS 17 paragraph 2, would be outside the scope of this clarificatory project.

UKEB and stakeholder views
Effects of laws (continued)

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IASB proposals	UKEB draft position	Further stakeholder views	UKEB final position
• The IASB described how the proposals would affect financial instruments with ‘bail-in’ provisions, including Additional Tier 1 capital instruments issued by banks to meet regulatory capital requirements.	• Recommended the inclusion of an illustrative example based on paragraph BC13 with some suggested enhancements to reflect regulatory requirements better. • Further recommended that guidance on accounting for AT1 instruments currently in the Basis for Conclusions be moved to the IAS 32 *Financial Instruments: Presentation* Application Guidance.	• Stakeholders agreed with the UKEB’s position. • One stakeholder considered that in the light of their views on 15A(a) described above, the illustrative examples and guidance proposed would not resolve the practical issues.	• Retained draft position in accordance with retention of draft recommendation on paragraph 15A. • Removed paragraph suggesting enhancements to reflect regulatory requirements to enhance clarity of recommendations.

Disclaimer

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This Feedback Statement has been produced in order to set out the UKEB's response to stakeholder comments received on the UKEB's Draft Comment Letter on the IASB's exposure draft *Financial Instruments with Characteristics of Equity (Amendments to IAS 32, IFRS 7 and IAS 1)* and should not be relied upon for any other purpose.

The views expressed in this Feedback Statement are those of the UK Endorsement Board at the point of publication.

Any sentiment or opinion expressed within this Feedback Statement will not necessarily bind the conclusions, decisions, endorsement or adoption of any new or amended IFRS by the UKEB.

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