UK Endorsement Board

Invitation to Comment

Call for comments on the Exposure Draft *Financial Instruments with Characteristics of Equity: Proposed amendments to IAS 32, IFRS 7 and IAS 1*

Deadline for completion of this Invitation to Comment:

Midday, Friday 8 March 2024

Please submit to:

UKEndorsementBoard@endorsement-board.uk

Introduction

The objective of this Invitation to Comment is to obtain input from stakeholders on the Exposure Draft (ED) *Financial Instruments with Characteristics of Equity: Proposed amendments to IAS 32, IFRS 7 and IAS 1* (the Amendments), published by the International Accounting Standards Board (IASB) on 28 November 2023. The IASB's comment period ends on 29 March 2024.

UK endorsement and adoption process

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 (Foundation) on the development of new standards, amendments and interpretations. This letter is intended to contribute to the IASB's due process. The views expressed by the UKEB in this 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.

Who should respond to this Invitation to Comment?

Stakeholders with an interest in the quality of accounts prepared in accordance with international accounting standards.

How to respond to this Invitation to Comment

Please download this document, answer any questions on which you would like to provide views, and return it together with the 'Your Details' form to UKEndorsementBoard@endorsement-board.uk by midday on Friday 8 March 2024.

Brief responses providing views on individual questions are welcome, as well as comprehensive responses to all questions.

Privacy and other policies

The data collected through responses to this document will be stored and processed by the UKEB. By submitting this document, you consent to the UKEB processing your data for the purposes of influencing the development of and adopting IFRS for use in the UK. For further information, please see our Privacy Statements and Notices and other Policies (e.g. Consultation Responses Policy and Data Protection Policy)[1].

The UKEB's policy is to publish on its website all responses to formal consultations issued by the UKEB unless the respondent explicitly requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure. If you do not wish your signature to be published, please provide the UKEB with an unsigned version of your submission. The UKEB prefers to publish responses that do not include a personal signature. Other than the name of the organisation/individual responding, information contained in the "Your Details" document will not be published. The UKEB does not edit personal information (such as telephone numbers, postal or e-mail addresses) from any other response document submitted; therefore, only information that you wish to be published should be submitted in such responses.

[1] These policies can be accessed from the footer in the UKEB website here: https://www.endorsement-board.uk

Questions

Reclassification

1. How common is reclassification in your experience?

Contractual terms in financial instruments that could become or stop being effective pending passage of time or the occurrence or non-occurrence of certain events are not uncommon in practice. We are supportive of further clarification by the IASB on the accounting for financial instruments subject to these types of contractual terms.

2. The UKEB's draft comment letter recommends the IASB considers requiring reclassification for contractual terms that become, or stop being, effective with the passage of time. Do you agree with this recommendation? Please explain why or why not.

Yes	☒	No	☐
We concur with the UKEB's recommendation for the IASB to reconsider whether, as currently proposed, reclassification for contractual terms that become, or stop being, effective with the passage of time, should be prohibited. In our view prohibition of reclassification in this situation results in less relevant information because the required accounting would fail to reflect the economic substance of the instruments at the reporting date.			

3. The UKEB's draft comment letter recommends that the requirements set out in the Basis for Conclusions in relation to this topic should be moved to the Application Guidance and that ED paragraphs BC128, BC129 and BC143 should be redrafted. Do you agree with this recommendation? Please explain why or why not.

Yes	☒	No	☐
We concur that there is tension between the requirements for derecognition and the proposed guidance in relation to reclassification. However, lifting paragraphs BC128 and BC 129 into the Application Guidance and making the changes proposed by the UKEB alone, would in our view not resolve that problem. We recommend that the IASB develops illustrative examples which demonstrate when reclassification or derecognition is appropriate, to aid practical application of the requirements and avoid diversity in practice.			

Obligations to purchase an entity's own equity instruments

4. The UKEB's draft comment letter welcomes the proposals listed at questions 3(a), 3(b), 3(d), 3(e) and 3(f). Do you agree with this support? Please explain why or why not.

Yes	☐	No	☒
We have reservations with the IASB's proposals in 3(b) and 3(d). We are in process of developing our final position and recommendations to the IASB on these proposals, but nevertheless present our preliminary views below. Proposals in 3(b): Under the IASB's proposal in paragraph 27B an entity would recognise non-controlling interest (NCI) presented in equity as well as recognise a liability for the entity's obligation to redeem the equity instruments held by the NCI shareholders, with the corresponding debit recognised in equity. In our view this accounting does not provide relevant information, as in substance it recognises the same claim of NCI shareholders on the entity's assets twice. As an alternative approach we recommend that the financial liability is recognised as proposed in paragraph 27B, but that the redemption amount is first offset against NCI and only the remainder is removed from equity of the owners of the parent. Under this approach NCI is not derecognised, but the debit is an adjustment to the carrying value of NCI. Profit or loss and each component of other comprehensive income would continue to be allocated to NCI. Proposals in 3(d): In contrast to the proposals in paragraph 23, but consistent with the requirements in paragraph B96 of IFRS 10 *Consolidated Financial Statements*, changes in the present value of the redemption amount should be recognised in equity, rather than as proposed by the IASB, in profit and loss. We acknowledge this measurement basis is inconsistent with IFRS 9 *Financial Instruments,* but we believe the requirements in IFRS 10 should take precedence, as the liability reflects the amounts that ultimately could be paid to acquire the NCI, and changes in the proportion held by NCI shareholders should be recorded in equity. We have no further observations regarding the proposals in 3(a), (e) and (f).			

5. The UKEB's draft comment letter recommends that the IASB reconsiders its approach because the introduction of a new measurement basis for financial instruments within IAS 32 is outside the remit of the project and may give rise to unexpected outcomes. We propose discounting liabilities arising from obligations to redeem own equity from the expected settlement date as an alternative worthy of consideration. Do you agree with this recommendation? Please explain why or why not.

Yes	☒	No	☐
The IASB's proposal in paragraph 23 that measurement of the redemption amounts should be based on redemption occurring at the earliest possible date has the benefits of being simple and straightforward to apply. Nevertheless, we share the UKEB's concerns that measurement on this basis could potentially result in misleading information about the entity's obligation.			

We note that the alternative measurement proposal by the UKEB goes beyond changing how the settlement amount should be discounted, as implied in Question 5 above. The UKEB proposes that the measurement of the settlement amount should take into account the probability of all possible settlement options. Although the alternative proposal has merits, it would need to be developed further in order to be capable of being implemented by the IASB. Important aspects are missing or unclear, for example, whether the redemption amount should be based on the most likely outcome or a probability weighted expected outcome, whether the most likely outcome is intended as a minimum measurement threshold, how the discount rate that should be applied to calculate the present value and how the expected settlement date should be determined, when there are various settlement date options. We do not agree with the UKEB that clarifying the measurement requirements for instruments included in these proposals is outside the scope of the IASB's project. Our preference would, however, be that such measurement requirements are included in IFRS 9, rather than IAS 32. If the former is not a suitable alternative for the IASB, we believe the IASB needs to include scope exclusions in IFRS 9 for instruments that should be measured under IAS 32. Please also see our response to Question 9 below.

6. The UKEB's draft comment letter recommends that paragraph AG27D should require gross presentation unless the issuer has the discretion to settle the instrument net, in which case derivative accounting would apply. Do you agree with this recommendation? Please explain why or why not.

Yes	☒	**No**	☐
We concur that the UKEB's proposal has merit and should be explored further by the IASB. We point out a minor drafting point. The second sentence of AG27D begins "If the obligation *was* to be net settled…". Instead consistent with the first sentence of paragraph AG 27D, the second sentence should read "If the obligation *is* to be net settled…"			

Contingent settlement provisions

7. The UKEB's draft comment letter supports the proposals listed at questions 4(a), 4(c), 4(d) and 4(e). Do you agree with the support for these proposals? Please explain why or why not.

Yes	☐	**No**	☒
We agree with the proposals in 4(a), 4(c) and 4(e), but have reservations against proposals in 4(d), which introduces a new definition for "liquidation".			

Liquidation is often a process governed by laws and regulations and hence varies between jurisdictions. The definition proposed by the IASB, is in our view unsuitable to address these differences and can have unintended consequences. The IASB proposes that liquidation is a process that begins after operations have ceased permanently, however, frequently the process of liquidation starts prior to an entity permanently ceasing all its operations. We disagree that an instrument is classified as a financial liability rather than equity, when the obligation to pay crystalises during a process which is intended to end with the permanent cessation of an entity's operations. In our view, given that finding a definition for liquidation could become protracted for the IASB, the status quo, i.e. no definition, is preferable.

8. The UKEB's draft comment letter recommends restricting the scope of these proposals to the debt components of compound financial instruments only. Do you agree with this recommendation? Please explain why or why not.

Yes	☒	**No**	☐
We concur with the UKEB that the scope of the proposals related to contingent settlement options needs to be defined by the IASB. As noted above in our response to Question 5, our preferred approach is that measurement requirements are included in IFRS 9, however, failing that, the instruments in scope of the measurement requirements in IAS 32 need to be scoped out of IFRS 9. Otherwise arrangements such as contingent consideration arising in a business combination or loans that have settlement options which are beyond the control of the lender and the borrower, could fall into the scope of IFRS 9 and IAS 32, but the measurement requirements are different. We believe this is an unintended consequence of the proposals in paragraph 25A, which should be addressed by the IASB.			

9. The UKEB's draft comment letter recommends that the IASB reconsiders its approach because the introduction of a new measurement basis is outside the remit of the project and may give rise to unexpected outcomes. We propose discounting liabilities arising from contingent settlement provisions from the expected settlement date as an alternative worthy of consideration. Do you agree with this recommendation? Please explain why or why not.

Yes	☒	**No**	☐
The proposed measurement requirements in paragraph 25A could give rise to Day 1 gains or losses where the transaction price is different to the settlement amount determined under paragraph 25A, but there is no clarity about how these gains or losses should be accounted for. The IASB needs to develop either separate requirements or refer to those in IFRS 9 on Day 1 gains/losses.			

In addition the measurement requirements when applied to compound instruments could result in a negative equity component. This would occur should the fair value of the instrument be less than the settlement amount for the liability component, determined in accordance with paragraph 25A. The IASB needs to clarify the accounting in this situation. We share the UKEB's concerns regarding measuring of the financial liability at the present value of the settlement amount assuming settlement at the earliest possible settlement date. We have commented on the UKEB's proposals in more detail in Question 5 above. We also reiterate that in our view measurement requirements should be included in IFRS 9, rather than IAS 32. See above our responses to Questions 5 and 8.

Fixed-for-fixed condition

10. The UKEB draft comment letter welcomes the proposals in this area. Do you agree with this view? Please explain why or why not.

Yes	☒	No	☐
We are generally supportive of the IASB's proposals summarised in Question 2 of the IASB's ED. We note however, that there could be practical application issues when deciding whether the adjustments to the consideration exchanged are a preservation or passage of time adjustment or indeed neither of the two. We recommend that the IASB produces more application guidance and other practical examples to demonstrate how the conditions in proposed paragraph 22C should be applied in practice. The examples should cover different scenarios when the conditions are met and when they are failed. In particular we would welcome affirmative guidance from the IASB that rounding provisions, to avoid fractions of shares being issued, do not breach the fixed-for-fixed conditions. We also believe that the IASB should explore whether paragraph 22B could be expanded to include the functional currency of the holder and not just the functional currency of the issuer.			

11. The UKEB draft comment letter recommends rewording the requirement at paragraph 22C(a)(ii). Do you agree with this recommendation? Please explain why or why not.

Yes	☒	No	☐

We note that paragraph A11 of the UKEB's draft comment letter which sets out the UKEB's view on the preservation adjustment does not contain drafting proposals, we therefore cannot comment on the proposed rewording of paragraph 22C(a)(ii). Nevertheless we concur with the UKEB's call for more practical guidance from the IASB around the application of the conditions in proposed paragraph 22C.

12. The UKEB draft comment letter recommends that additional explanation of the meaning of 'proportional' be provided along with additional illustrative examples. Do you agree with this recommendation? Please explain why or why not.

Yes	☒	No	☐
As noted above, the conditions set out in paragraph 22C would benefit from application guidance by the IASB, not just relating to the meaning of "proportional". We note that none of the proposed illustrative examples by the IASB include a scenario where the passage of time conditions are met and we recommend that such an example is developed by the IASB.			

13. The UKEB draft comment letter recommends that the IASB includes specific acknowledgement in the Standard that financial instruments that are linked to determinable benchmark rates, such as interest or inflation meet the fixed-for-fixed condition. Do you agree with this recommendation? Please explain why or why not.

Yes	☒	No	☐
We share the reservations expressed in paragraph A14 of the UKEB's draft comment letter on the proposed restrictions in relation to benchmark interest rates and inflation. In our view links to benchmarks that are based on risk free interest rates and simple inflation linked benchmarks should be permitted.			

Disclosures

14. The UKEB's draft comment letter broadly supports the IASB's proposals on disclosure. Do you agree with that support? Please explain why or why not.

Yes	☒	No	☐
We concur with the IASB's proposals to include equity instruments into the disclosure requirements of IFRS 7 *Financial Instruments: Disclosures* and expand disclosure requirements in relation to newly proposed accounting requirements in IAS 32. However, we also have concerns about the costs and benefits of the disclosure proposals. In addition to the concerns noted by the UKEB in relation to disclosures in paragraphs 30B on priority of claims in liquidation and paragraph 30E(c) about the			

impact of laws and regulations, we disagree with the IASB's approach to disclosures in relation to potential dilution in paragraphs 30G to 30H. We believe the IASB should explore whether such disclosures should be included in IAS 33 *Earnings Per Share* instead and could be aligned with existing requirements on dilution, to avoid confusion by users. We also suggests that the IASB clarifies that disclosures required by paragraphs 30C to 30E about the terms and conditions of financial instruments with both financial liability and equity characteristics, should only apply to those financial instruments that are individually material to the reporting entity.

15. The UKEB's draft comment letter recommends that in the light of the results of the EFRAG field testing, the IASB may wish to consider undertaking further field testing before finalising the disclosures. Do you agree with that recommendation? Please explain why or why not.

Yes	☒	**No**	☐
We concur that field testing of the proposals is necessary, which should cover users and preparers, to assess costs and benefits of the proposed disclosures. The IASB field testing should be expanded to jurisdictions outside the EU, which is the focus of the EFRAG field test.			

16. The UKEB's draft comment letter recommends the IASB considers removing the requirement at ED paragraph 30A and 30B because it is impracticable. Do you agree with that recommendation? Please explain why or why not.

Yes	☒	**No**	☐
We concur that the disclosures proposed in paragraph 30B, requiring that claims should be grouped based on order of their priority on liquidation, could be impracticable in consolidated financial statements. However, it is not clear why the UKEB recommends to remove the disclosure objective in paragraph 30A, when also making reference in paragraph A52 of the UKEB draft comment letter, that an entity can meet that objective by making the disclosures about the terms and conditions of a financial instrument.			

17. The UKEB's draft comment letter recommends removing ED paragraph 30E(c). Do you agree with that recommendation? Please explain why or why not.

Yes	☒	**No**	☐
IAS 1 *Presentation of Financial Statements* requires disclosures of sources of estimation uncertainty that have a risk of resulting in a material adjustment to the carrying amounts of assets and liabilities and management judgements that have the most significant effect on the amounts recognised in the financial statements. On that			

basis we concur that specific disclosures about significant uncertainties on how laws and regulations could affect the priority, may be redundant.

Transition

18. The UKEB's draft comment letter recommends that consideration should be given to providing transitional relief from full retrospective application where this would involve undue cost or effort, similar to that provided by IFRS 9 paragraph 7.2.18 in relation to impairment. Do you agree with this recommendation? Please explain why or why not.

Yes	☒	No	☐
The IASB has provided limited transition reliefs. The field testing by the IASB should include an assessment of whether these provisions enable cost effective transition. In addition the IASB should explore whether a transitional relief based on the impracticability of full retrospective application, should be granted. In paragraph A57 of the UKEB's draft comment letter, the UKEB has identified private equity investors as a stakeholder group that could incur significant costs on transition. The amendments apply to issuers of financial instruments, whilst private equity investors would usually be the holders of these instruments. For clarity, the UKEB may wish to expand on how private equity investors would be affected and the nature of the instruments they tend to issue that give rise to the practical application issues on transition. Based on our experience instruments issued by Limited Liability Partnership can be more complex to assess and possibly the UKEB is referring to instruments issued by these types of entities.			

19. The UKEB's draft comment letter recommends that if financial instruments had been extinguished in the prior year period, they should not be required to be restated. Do you agree with this recommendation? Please explain why or why not.

Yes	☒	No	☐
We concur that the IASB should explore a relief from retrospective application where the financial instrument is no longer outstanding at the date of initial application, similar to the relief granted in proposed paragraph 97W for the liability component of a compound instrument.			

20. The UKEB's draft comment letter recommends 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 an assessment only of features that have not expired at that date. Do you agree with this recommendation? Please explain why or why not.

Yes	☒	No	☐
We concur that the relief proposed by the UKEB should be explored by the IASB as part of its field testing.			

Effects of relevant laws or regulations

21. The UKEB's draft comment letter welcomes the proposals as a pragmatic solution. Do you agree with this view? Please explain why or why not.

Yes	☐		No	☒
We disagree with the proposals in paragraph 15A in relation to the application of laws and regulation. We also do not concur with the UKEB's analysis in paragraph A2 of the draft comment letter. In our view it is paragraph 15A(a) that is redundant, as we would expect that contractual provisions that are knowingly unenforceable would be disregarded in the classification assessment as non-genuine. The proposed requirements in paragraph 15A(b) on the other hand imply that an entity would ignore rights and obligations included in law and regulations, which in our view could result in counter-intuitive outcomes. We are not aware of specific examples in the UK context where this could create problems, since the UK's legal framework is less prescriptive, but could have adverse consequences in jurisdictions where laws and regulations govern the arrangements between issuers and holders of financial instruments. As an alternative, we recommend that the IASB considers whether law and regulations should perhaps be considered as described in paragraph 2 of IFRS 17 *Insurance Contracts,* which would require an issuer to consider the enforceability of contractual terms and conditions as well as implied contractual terms that are imposed by laws and regulations.				

22. The UKEB's draft comment letter recommends the introduction of a further illustrative example on this topic. Do you agree with this recommendation? Please explain why or why not.

Yes	☐	No	☒
As noted above, we believe the IASB should reconsider the proposed requirements. Illustrative examples alone would not resolve the practical application issues.			

23. The UKEB draft comment letter recommends that the guidance in paragraph BC13 should be moved to the Application Guidance to IAS 32 *Financial Instruments: Presentation.* Furthermore, it recommends that paragraph BC13(a) refers to 'loss absorption provisions' rather than 'bail in provisions' and that the language is modified to reflect regulatory requirements. Do you agree with these recommendations? Please explain why or why not.

Yes	☐	No	☒
We believe the clarifications proposed by the UKEB are better provided through illustrative examples, rather than in the Application Guidance to IAS 32.			

Other topics

24. The UKEB's draft comment letter supports the proposals on shareholder discretion and presentation. It also notes that the identification of consequential amendments to the forthcoming standard *Subsidiaries without Public Accountability: Disclosures* is an efficient approach, supports the application of the principles of reducing disclosures proposed in this ED for eligible subsidiaries, but expresses concern that the cost-benefit considerations are not clearly laid out in the ED. Do you agree with these views? Please explain why or why not.

Yes	☐	No	☐
Generally we are supportive of reduced disclosures for subsidiaries without public accountability. However, given the IASB has not yet finalised the new accounting standard and the standard has not yet been endorsed for application in the UK, we believe it is premature to provide specific comments on the proposed reliefs.			

Costs and benefits

We encourage you to participate in the EFRAG field testing by contacting fice@efrag.org.

25. What benefits would these proposals provide you with?

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26. What costs would be associated with these proposals? Please share any qualitative or quantitative information on the cost of implementing the proposals you may be aware of.

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27. What estimated lead time (transition period) would you require to implement these proposals?

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Thank you for completing this Invitation to Comment

Please submit this document by

midday on Friday 8 March 2024 to UKEndorsementBoard@endorsement-board.uk