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International Accounting Standards Board
7 Westferry Circus
Canary Wharf
London E14 4HD
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Dear Board Members,

RESPONSE TO EXPOSURE DRAFT *Financial Instruments with Characteristics of Equity (Proposed amendments to IAS 32, IFRS 7 and IAS 1)* ("ED")

ISCA sought views from its members through a 10-week public consultation and from the ISCA Financial Reporting Committee which comprises experienced technical professionals from audit firms, preparers of financial statements and other stakeholders.

We appreciate and support the IASB's efforts to address practice issues arising from the application of IAS 32 through clarification of the relevant key principles. Except for ED Questions 1 and 6, we are generally supportive of the rest of the proposals made in the ED and have highlighted areas where further clarification(s) could be made to enhance the understandability / scope / applicability of the requirements.

As mentioned, we have reservations regarding the IASB's proposals in the following areas:

- The effects of relevant laws or regulations (ED Question 1).

  Our key concerns are:
  - Paragraph 15A(a) of IAS 32 appears to require the consideration of rights and obligations created by laws and regulations as the baseline, but this seems to contradict paragraph 15A(b) of IAS 32.
  - The interpretation of paragraph 15A(a) to consider rights and obligations created by laws and regulations goes beyond the remit of IAS 32 and IFRS 9 which focuses on the assessment of contractual terms. This can lead to practical challenges and inconsistent application, particularly where the laws and regulations of other jurisdictions apply.

  In view of the above concerns, we urge the IASB not to proceed with its proposals in this area.

- Reclassification of financial liabilities and equity instruments (ED Question 6)

  Our key concern is that prohibiting the reclassification of a financial liability to equity due to changes in contractual terms that become, or stop being, effective with the passage of time would not be a faithful representation of the condition of an entity at its reporting date. This would lead to reduced understandability and comparability of the financial statements.

  Hence, we urge the IASB to require reclassification from financial liabilities to equity when the liability feature, or a component of an instrument has expired.

Our detailed comments to specific questions in the ED are set out below.

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.

Proposed paragraph 15A of IAS 32

The IASB has proposed the following clarifications in the proposed paragraph 15A of IAS 32 which states that "*In classifying a financial instrument…an entity (a) shall consider only contractual rights and obligations that are enforceable… and are in addition to those created by relevant laws or regulations…; 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.*"

From reading of paragraph 15A(a) of IAS 32, an entity may interpret the proposal as requiring the consideration of contractual rights and obligations, in addition to those established by laws and regulations. This suggests that rights and obligations created by laws and regulations appear to be the baseline that must be considered before evaluating any additional rights and obligations established by the contract. However, this will seem to contradict paragraph 15A(b) of IAS 32 which prohibits the consideration of any rights and obligations created by relevant laws or regulations.

Notwithstanding the above, if the IASB's intention is to consider the rights and obligations created by laws and regulations as the baseline, this can be complex and require in-depth legal analysis as it can extend to consideration of case laws as well as laws and regulations in multiple jurisdictions. In addition, this interpretation of the proposed clarifications appears to go beyond the remit of IAS 32 and IFRS 9 which focus on the assessment of contractual terms and may lead to potentially significant disruptions to current practice(s).

It is also unclear how the requirements in the said paragraph could be applied in certain common situations:

- Ordinary shares issued with no contractual terms that are additional to the rights and obligations based on laws and regulations (e.g. no redemption right, dividend entitlement based on profits declared by company) – it is unclear how such ordinary shares would be assessed since the requirement in paragraph 15A(b) requires that the entity shall not consider any right or obligation created by relevant laws or regulations.
- Related party advances or loans without contractual agreements and whose rights and obligations are based solely on laws and regulations – it is similarly unclear how such advances and loans would be assessed in accordance with the requirements of paragraph 15A(b).

In view of the above concerns, we urge the IASB not to proceed with its proposals in this area.

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.

(a) Proposed amendments to paragraph 16(b)(ii) and 22 of IAS 32

The IASB has proposed the inclusion of "… settling a fixed amount of its financial liability…" as a situation where the entity issues a fixed number of its own equity instruments in paragraph 16(b)(ii) and 22 of IAS 32.

We wish to highlight that the use of the phrase "fixed amount of financial liability" is inconsistent with the example in paragraph 22 which refers to "fixed stated principal amount". A liability with a fixed "principal amount" could have varying "financial liability" recorded at amortised cost due to the application of the effective interest rate method. This may result in instruments such as convertible loans that are currently accounted for as compound instruments (with conversion feature treated as equity) failing the fixed-for-fixed test, especially for instruments that are convertible at any point in time.

The proposed example in paragraph IE60 and IE61 also illustrates the lack of clarity in using the term "financial liability". In paragraph IE61, it is explained that even if the "principal amount" varies over time due to the accrual of interest which can be added to the principal, the conversion feature would still qualify as an equity instrument. The rationale for this is that "…Although the total amount outstanding of the financial liability might vary depending on the amount of interest accrued over the life of the bond, the conversion ratio is fixed from inception of the bond…"

In view of the above, we suggest for the IASB to clarify the following:

- whether the "financial liability" refers to principal, amount at amortised cost or another amount; and
- whether changes in a financial liability due to computation of the effective interest rate will affect the fixed-for-fixed test, or are such changes deemed to be "passage-of-time adjustments" and thus, can be disregarded.

(b) Proposed paragraph 22C(a)(i) of IAS 32

In relation to preservation adjustments, the IASB has proposed in paragraph 22C(a)(i) of IAS 32 to require the adjustment to be made upon the occurrence of a contractually specified event(s) that affects the economic interests of the current holders of the entity's own equity instruments (current equity instrument holders).

We wish to share that it is common for convertible instruments to include a general “catch all” clause that allows for adjustments to be made upon the occurrence of events that are not contractually specified provided that the adjustments put the holders of the instrument in question into the same economic position relative to ordinary shareholders post the event. As such, the resulting effect of the adjustment is to preserve the economic position of the equity derivative or convertible instrument holders relative to the ordinary shareholders (equity instrument holders).

In view of the above, we suggest for the IASB to clarify whether such “catch all” adjustment clause could still meet the requirements in paragraph 22C(a)(i) of IAS 32 and qualify as “preservation adjustments”.

(c) Proposed paragraph 22C(a)(ii) of IAS 32

In relation to preservation adjustments, the IASB has proposed in paragraph 22C(a)(ii) of IAS 32 to require the adjustment to preserve the economic interests of the future holders of the entity’s own equity instruments (the future equity instrument holders) to an equal or lesser extent, relative to the economic interests of the current equity instrument holders.

We wish to highlight that the reference to “future holders” is not clear if:

- it is referring to collectively all future holders of different instruments such as convertible bonds, options, warrants, equity-classified share-based payments that can be settled in the entity’s own equity instruments; or
- it is referring to the future holders of each type/class of instrument being assessed (e.g. convertible bonds with the same terms would have one assessment, options with same terms on standalone basis would have one assessment).

We also wish to highlight that the reference to “current equity instrument holders” is unclear if it is referring to ordinary shareholders or all equity instrument holders such as those holding preference shares and equity-classified derivatives.

We suggest for the IASB to provide clarification on the above.

(d) Proposed paragraph 22C(b)(iii) of IAS 32

In relation to passage-of-time adjustments, the IASB has proposed in paragraph 22C(b)(iii) of IAS 32 to require the adjustment to 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 – any difference in the amounts of consideration to be exchanged on each possible settlement date represents compensation proportional to the passage of time.

We wish to highlight that it is unclear how the “proportion to the passage of time” should be computed (e.g. should the risk-free discount rate be used or with risk adjustments to the discount rate). Hence, we suggest for the IASB to provide clarification on this.

(e) Proposed paragraph AG29B of IAS 32

Paragraph AG29B states that “Paragraph 22B specifies requirements for classifying an equity instrument a contract that will be settled by an entity exchanging a fixed number of its own equity instruments for a fixed amount of consideration. One of these requirements is that the amount of consideration to be exchanged for each of the entity’s own equity instruments be in the entity’s functional currency. In consolidated financial statements…an entity classifies a financial instrument as equity if the consideration amount is in the functional currency of the entity within the group whose equity instruments will be delivered on settlement…”

As equity is a non-monetary item, we challenge the relevance of the functional currency to the classification of a financial instrument. Applying the requirements in the above paragraph could result in a subsidiary which issues a convertible bond, denominated in its own functional currency (e.g. Singapore Dollar) and convertible into a fixed number of its parent’s shares (whose functional currency is United States Dollar), to fail the fixed-for-fixed condition. This would be a change from current practice.

We suggest for the IASB to amend paragraph AG29B such that the reference to the functional currency for the assessment may be the functional currency of either the issuer of the instrument or the issuer of the underlying shares.

We also wish to highlight that paragraph AG29B is unclear on whether it could address one common anti-dilution provision (i.e. an adjustment compensating for the dilutive effect of a below-market issuance, which may not be offered on a pro-rata basis to all existing shareholders). We suggest for the IASB to clarify whether the preservation adjustment test could be applied for such situations, and whether "current shareholders" would include the beneficiaries of the below-market issuance.

(f) Proposed Example 13B (paragraphs IE55 to IE59) of the Illustrative Examples accompanying IAS 32

The proposed example in paragraphs IE55 to IE59 contains the fact pattern that both Parent Y and Subsidiary X have the same functional currency. We suggest that the illustration also show the impact on the analysis if the functional currencies are different.

We wish to highlight that based on the proposed paragraph 22D and paragraphs BC58 to BC61, foreign currency is not a consideration when the number of shares to be exchanged is fixed in a share-for-share exchange. Hence, we suggest for the IASB to clarify/illustrate that even if the parent and the subsidiary have different functional currencies, the accounting outcome remains unchanged.

(g) Proposed Example 19 (paragraphs IE76 to IE81) of the Illustrative Examples accompanying IAS 32

Paragraph IE79 states that in determining the appropriate classification of the conversion option, Entity X assesses whether the conversion ratios have the effect of fixing on initial recognition the present value of the amount of consideration exchanged for each of its own shares; and if the different conversion ratios represent compensation proportional to the passage of time. If so, the adjustment to the conversion ratio in this example would be a passage-of-time adjustment and Entity X would classify the conversion option as an equity instrument.

We suggest for the IASB to provide more details in the above example on how to determine if the conversion adjustment is compensating for time value in the conversion option that the ED envisages. The example can also clarify:

- (i) whether the time value of the conversion option is calculated only at inception and reduced on a straight line basis or another basis (to specify);
- (ii) whether it is also acceptable for the time value of the conversion option to be valued as of the date of change of control based on certain formula, as this would be the most accurate reflection of the time value to be compensated;
- (iii) whether there are other acceptable methods.

Accepting (ii) could mean that share price as at the date of change of control would have to be an input to the said formula, but paragraph IE80 appears to suggest that share price is not an allowable input for the passage-of-time adjustment.

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:

  (a) 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.

  (b) 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.

(a) Proposed amendments to paragraph 23 of IAS 32

Measurement basis/model

The IASB has proposed amendments to paragraph 23 of IAS 32 to clarify the following measurement basis/model for the entity's obligation to purchase its own equity instruments:

- A financial liability is recognised initially at the present value of the redemption amount;
- The initial amount of the financial liability is removed from a component of equity;
- On subsequent measurement, the entity is to measure the financial liability at present value of the redemption amount and recognise any gains or losses on remeasurement of the financial liability in profit or loss; and
- If the contract expires without delivery, the carrying amount of the financial liability is removed from financial liabilities and included in equity.

We wish to highlight the following concerns regarding the proposed measurement basis/model:

Concern 1 – Apparent contradiction with paragraph B96 of IFRS 10 on the proposal to record remeasurement gains and losses in profit or loss

In relation to the proposal to record gains and losses on remeasurement of the financial liability in profit or loss, we note the IASB's explanation in paragraph BC87 that this achieves an internally consistent principle within IAS 32 and IFRS 9. However, this appears to contradict paragraph B96 of IFRS 10 which requires the recognition directly in equity of any differences between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent. Hence, we urge the IASB to address this apparent conflict.

Concern 2 – Apparent inconsistency with paragraph 47 of IFRS 13 on the proposal to measure the financial liability at present value of the redemption amount

We note that there is a fundamental difference between contingent obligations and those that are solely controlled by the holder, and we hold the view that this difference should be reflected in the proposed measurement basis/model.

For those obligations that are solely controlled by the holder, the proposal to measure the obligation at present value of the redemption amount (ignoring expected timing and probability of the redemption) is inconsistent with paragraph 47 of IFRS 13 – which requires that the fair value of the financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

The proposed measurement basis/model could result in entities presenting the obligation at a significantly undervalued amount when the terms of the contract provide a significant incentive to redeem at a later date. Hence, we urge the IASB to address this concern.

We also suggest for the IASB to provide further guidance on the following areas:

Area 1 – Measurement of the financial liability if the redemption amount is contingent on meeting future performance targets or based on a formula linked to future performance metrics

We suggest for the IASB to provide guidance on how redemption amount that is contingent on meeting future performance targets or based on a formula linked to future performance metric such as EBITDA should be measured (e.g. based on maximum potential obligation, expected obligation by projecting future performance, most likely obligation, obligation determined based on current performance levels, or another measure).

Area 2 – Accounting treatment when the instrument is exercised

We note that paragraph 23 of IAS 32 covers initial recognition, subsequent measurement and expiry of an obligation to purchase an entity's own equity instruments. We suggest for the IASB to complete the scenarios by providing guidance on exercise of the instrument – whether the put liability is treated similar to expiration of the instrument, and the purchase of non-controlling interests (NCI) is accounted for as a typical transaction with NCI. In practice, it is not unusual for a call option to be issued together with a put option over a subsidiary's shares. There is diversity in views on whether the call and put options should be seen as one instrument – a synthetic forward. We suggest for the IASB to consider covering this in the amendments to IAS 32.

Contracts with obligations to settle in a variable number of shares to the value of the contractual obligation

The IASB has also amended paragraph 23 of IAS 32 to cover contracts that contain obligations to "settle in a variable number of shares to the value of the contractual obligation". We suggest for the IASB to clarify the accounting (i) if the settlement value is not the contractual value of the obligation; and (ii) where there is a choice of gross or net settlement.

We would like to highlight that there are general observations that such contracts or terms should be accounted for as derivatives rather than on a gross basis, which is similar to the alternative view of Mr Robert Uhl presented in paragraphs AV1 to AV3 of the Basis for Conclusions. Doing so would reflect the true economic gain/loss from such contracts, which would have been captured under fair value changes of the derivative if derivative accounting were to be applied. The presentation of a liability at gross redemption amount does not provide useful information to users of the financial statements. We have included an example below to illustrate this.

For instance, a parent that issues put options to NCI of a subsidiary where the exercise price is based on a formula – say a multiple of EBITDA which is intended to approximate the fair value of the shares. Applying the proposed accounting treatment in paragraph 23 of IAS 32 would lead to losses from remeasurement of the redemption amount if the subsidiary performs well (i.e. having increasing EBITDA). However, economically, the price being paid is a proxy of "fair value" and there is no true economic loss. We urge the IASB to consider how to address this concern.

With respect to gross presentation, we wish to highlight that there are also general observations that the gain or loss from remeasurement of the redemption liability can distort operating performance.

Continuing from the above example on NCI put exercise price based on a multiple EBITDA and assuming that the subsidiary is performing better than the previous year, the resulting profit or loss statement would not be reflective of the consolidated operating performance because the loss from remeasurement of the redemption liability masks the improved operating profit of the subsidiary. The opposite effect would happen if the subsidiary performs worse in a subsequent year – the gain from remeasurement of the liability would mask the poor performance of the subsidiary. We urge the IASB to consider how to address this concern.

There are also views that changes in the liability should not affect profit or loss, to be consistent with transactions with NCI which do not lead to gain or loss in the profit or loss.

(b) Proposed paragraph AG27B of IAS 32

The IASB has proposed to clarify that the initial amount of the financial liability is to be removed from a component of equity other than non-controlling interests or issued share capital 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.

We wish to highlight that the paragraph AG27B does not explicitly cover the accounting treatment if an entity "has access to the rights and returns" over its own equity instruments. It is not clear if the paragraph AG27B should be interpreted to mean that in the converse situation, the equity instruments should be derecognised.

We also suggest for the IASB to provide further guidance on how to assess "access to the rights and returns associated with ownership of the equity instruments".

In relation to the proposal to recognise the initial amount of the financial liability against the parent's ownership interests instead of non-controlling interests, we share similar concerns about the potential double-counting of the NCI subject to the contract as shared in paragraph BC77. However, we also note the IASB's view and explanation in paragraph BC78 on this. Therefore, we suggest for the IASB to distinguish the NCI that is subject to the put option from other NCI in the financial statements.

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.

(a) Proposed amendment to paragraph 11 of IAS 32

The IASB has proposed to define the term 'liquidation'" as "the process that begins after an entity has permanently ceased its operations".

In practice, operations may continue while an entity is being liquidated. Hence, the proposed definition which is based on the cessation of operations would appear to be narrower than current practice because it would not include such scenarios even when the process is irreversible and the only outcome is the ultimate liquidation of the entity.

We suggest the following revised definition for the IASB's consideration:
"Liquidation is the irreversible process by which an entity converts its assets to cash or other assets and settles its obligations with creditors in anticipation of the entity ceasing all operations".

(b) Proposed paragraph 25A of IAS 32

The IASB has proposed paragraph 25A of IAS 32 to clarify that the initial and subsequent measurement of the financial liability arising from the contingent settlement provision would be the present value of the settlement amount and would not take into account the probability and estimated timing of occurrence or non-occurrence of the contingent event.

We suggest for the IASB to provide guidance on how redemption amount that is contingent on meeting future performance targets or based on a formula linked to future performance metric such as EBITDA should be measured (e.g. based on maximum potential obligation, expected obligation by projecting future performance, most likely obligation, obligation determined based on current performance levels, or another measure).

Observation regarding the interaction of contingent settlement provisions with the amendments to IAS 1

We wish to highlight that it is unclear whether non-current liabilities with covenants should be presented as current or non-current as of reporting date, and this is illustrated in the example below:

Example

Entity A has a loan with a covenant whereby the loan is immediately repayable on change in control of the entity. This loan liability is classified as non-current based on paragraph 72B of IAS 1[1] if the covenant is not breached as at reporting date.

Entity B has a preferred share that has a contingent settlement provision relating to change in control, and there is a liability for the settlement amount (but would otherwise have been equity as there is no obligation to redeem, no required distributions, etc). It is unclear if this liability should be classified as current or non-current.

Proponents of current classification argue that paragraph 72B of IAS 1 is only for loan arrangements and this contingent settlement liability should be a current liability to reflect its impact on liquidity of an entity. However, proponents of non-current classification argue that it is unusual that the preferred share is classified as current while the loan (in Entity A's case) is classified as non-current despite the uncertain event of change in control being exactly the same in both instruments.

We urge the IASB to provide clarity on the current/non-current classification of such liabilities given that the measurement does not take into account the probability of the contingent event occurring.

[1] Paragraph 72B of IAS 1 states:

An entity's right to defer settlement of a liability arising from a loan arrangement for at least twelve months after the reporting period may be subject to the entity complying with conditions specified in that loan arrangement (hereafter referred to as 'covenants'). For the purposes of applying paragraph 69(d), such covenants:

- *(a) affect whether that right exists at the end of the reporting period—as illustrated in paragraphs 74–75—if an entity is required to comply with the covenant on or before the end of the reporting period. Such a covenant affects whether the right exists at the end of the reporting period even if compliance with the covenant is assessed only after the reporting period (for example, a covenant based on the entity's financial position at the end of the reporting period but assessed for compliance only after the reporting period).*
- *(b) do not affect whether that right exists at the end of the reporting period if an entity is required to comply with the covenant only after the reporting period (for example, a covenant based on the entity's financial position six months after the end of the reporting period).*

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 with any of the proposals, please explain what you suggest instead and why.

(a) Proposed paragraph AG28A of IAS 32

The IASB had proposed a list of factors in paragraph AG28A of IAS 32 that an entity would be required to consider in assessing whether shareholder decisions were treated as entity decisions. In particular, the factor set out in paragraph AG28A(d) relates to considering whether the shareholder decision-making right enable a shareholder to require the company to redeem or pay a return on its shares in such a way that the instrument would be a financial liability. The said paragraph further states that "…such decision-making rights indicate that the shareholders would make their individual decisions as investors in the shares, and the shareholder decision is unlikely to be treated as an entity decision."

We are concerned that reading paragraph AG28A(d) in isolation suggests that a shareholders' vote over ordinary or special dividends is not an entity decision. However, in our view, such a decision can be an entity decision because it is a collective decision made as part of the entity's governance structure that generally benefits the shareholder group as a whole.

(b) Proposed paragraph AG28B of IAS 32

The IASB has proposed paragraph AG28B to require that "an entity shall consider relevant factors in assessing whether a particular shareholder decision is treated as an entity decision. The factors set out in paragraph AG28A(a)-(d) are not exhaustive; other factors might be relevant…. The weightings applied to each factor in making that assessment depend on the specific facts and circumstances…"

We wish to highlight that the application of the above requirements in paragraph AG28B in practice could be challenging as it would involve significant judgement to be made. We suggest for the IASB to provide illustrative examples on how to apply the requirements set out in paragraph AG28B to ensure consistency in application.

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.

(a) Proposed paragraph 32B of IAS 32

The IASB has proposed to clarify in paragraph 32B of IAS 32 that an entity shall not reclassify a financial liability or an equity instrument after initial recognition unless the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement.

We are concerned that prohibiting the reclassification of a financial liability or an equity instrument due to changes in contractual terms that become, or stop being, effective with the passage of time could lead to reduced understandability and comparability of financial statements. As explained in paragraph BC131 of the Basis for Conclusions, there could be some liabilities that could have otherwise qualified as equity but would be prohibited to be reclassified as equity. We are of the view that this would not faithfully represent the condition of an entity at its reporting date.

In paragraph BC145 of the Basis for Conclusions, it is explained that the approach to require reclassification of the instrument for all changes in the substance of the contractual arrangement would increase costs of tracking contractual terms. However, the IASB has also proposed to require terms and conditions of instruments that become, or stop being, effective with the passage of time, to be disclosed under paragraph 30F of IFRS 7. The costs to track such terms and conditions would be incurred in any case.

Hence, we urge the IASB to require reclassification from financial liabilities to equity when the liability feature, or a component of an instrument has expired. This will also be consistent with paragraph 3.3.1 of IFRS 9 and paragraph 16E of IAS 32.

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

(a) Proposed paragraphs 30A and 30B of IFRS 7

The IASB has proposed to require an entity to group claims arising from financial liabilities and equity instruments within the scope of IAS 32 into classes of claims based on their contractual nature and priority on liquidation and to provide certain minimum disclosures.

We are concerned that the required disclosures on priority on liquidation will be challenging to apply for an entity that operates in multiple jurisdictions subject to different liquidation rules. Complexities could also arise from intra-group financing arrangements that will not be "visible" in the consolidated financial statements but could affect the priorities of the external creditors. We urge the IASB to address these concerns.

(b) Proposed paragraph 30E of IFRS 7

The IASB has proposed to require certain disclosures about the priority of financial instruments with both financial liability and equity characteristics in the event of the issuing entity's liquidation.

We are concerned that assessing priority of claims against entity on liquidation could be complex for certain entities and may require involvement of legal specialists in preparing and auditing the required disclosures. We suggest for the IASB to provide guidance and/or practical expedients for this disclosure requirement.

(c) Proposed paragraph 30F of IFRS 7

The IASB has proposed to require disclosure of the terms and conditions of financial liabilities (including all stand-out derivatives) that become, or stop being, effective with the passage of time before the end of the instrument's contractual term.

We are concerned that for entities which hold many of such financial instruments which become, or stop being, effective with the passage of time before the end of the instruments' contractual terms, the information in the financial statements may be cluttered. We suggest for the IASB to consider if an aggregated way of disclosure is possible.

(d) Proposed paragraphs 30G and 30H of IFRS 7

The IASB is proposing to require an entity to disclose information about the maximum dilution of ordinary shares and to set out the information in a table (to the extent possible) for each class of ordinary shares.

We are concerned that the calculation of maximum dilution of ordinary shares as proposed in paragraphs 30G and 30H of IFRS 7 is based on different principles than those in IAS 33, and we are unsure how this information will reconcile to the disclosures required by IAS 33. We urge the IASB to address this concern.

(e) Other comments

In line with the presentation of amounts attributable to ordinary shareholders as proposed in ED Question 8, IASB could consider adding a required disclosure of unpaid cumulative dividends or similar distributions to other owners that will affect ordinary shareholders share of equity on liquidation (if not already reflected in the allocation between ordinary shareholders and other owners of the parent).

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.

(a) Proposed paragraph 54 of IAS 1

The IASB has proposed to require an entity to present separately issued capital and reserves attributable to ordinary shareholders of the parent and other owners of the parent.

We suggest for the IASB to provide more details on how an entity should calculate the allocation of equity between ordinary and other owners (for instance, based on hypothetical liquidation at the reporting date or on another basis).

In addition, we suggest for the IASB to provide further guidance on the following areas:

- how to consider dividends (cumulative/non-cumulative) or similar amounts distributable to other owners;
- how reserves will be allocated to other owners (for instance, calculate the percentage of total reserves attributable to other owners and apply this constant percentage across all types of reserves); and
- accounting treatment for buyback of other owners' interest (treatment for the reserves allocated to the acquired other owners).

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.

We note that some of the proposed amendments could lead to significant changes in accounting for financial instruments that are issued in the past. It may be onerous for entities to retrace the accounting for these financial instruments retrospectively. We suggest for the IASB to consider allowing an alternative transition approach to ease the impact, such as assessing treatment of instruments at the date of initial application based on the terms and conditions effective on that date.

We also suggest for the IASB to consider providing a transition relief for entities that will need to reclassify financial liabilities for which hedge accounting is applied. One possible solution could be to allow entities to cease the hedging relationship retrospectively from inception of the hedging relationship (so that effectively, hedge accounting has never been applied for that hedged item).

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.

In practice, creditors and lenders generally look to the parent entity before extending credit to its subsidiaries and may rely largely on the parent's ability to pay or provide financial guarantees. The additional proposed disclosures by the subsidiaries may be less relevant to the users of their financial statements. We suggest for the IASB to consider the following:

- Providing a practical expedient whereby the disclosures would only be required if a subsidiary has indication of liquidity or going concern risk (or similar).
- For nature and priority of claims on liquidation arising from financial instruments, similar to our comment (b) to ED Question 7 above, we suggest for the IASB to provide guidance or practical expedients on how the disclosure can be prepared.

Should you require any further clarification, please feel free to contact Ms Felicia Tay at felicia.tay@isca.org.sg or Ms Jezz Chew at jezz.chew@isca.org.sg.

Yours faithfully,
Mr Wai Geat, KANG
Divisional Director
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