Staff paper

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IASB® meeting

Date	**April 2023**
Project	**Financial Instruments with Characteristics of Equity (FICE)**
Topic	**Project update**
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Purpose of this paper

1. This paper provides an update on the FICE project based on the project plan the International Accounting Standards Board (IASB) discussed in October 2019 (Agenda Paper 5). This paper does not ask for any decisions from the IASB.

Project objectives

2. As discussed by the IASB in October 2019, the objectives of this project are to:

   (a) address known practice issues that arise when applying IAS 32 *Financial Instruments: Presentation* to classify financial instruments as financial liabilities or equity; and

   (b) improve the information provided in the financial statements about the financial instruments issued by the entity.

3. The IASB noted the following as the important considerations in meeting the project objectives in paragraph 2 of this paper:

(a) limit changes to classification outcomes to those in which sufficient evidence exists that such a change would provide more useful information to users of financial statements;

(b) clarify interactions between the requirements in IAS 32;

(c) finalise the amendments in a timely manner; and

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

Project plan and progress update

4. In order to achieve the project objectives, the IASB observed that it was important for the project to have a clear and well-defined scope.

5. In determining which classification issues to address, the IASB considered whether:

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

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

   (c) the issues can be resolved efficiently and effectively without fundamentally rewriting IAS 32 and amending other IFRS Accounting Standards (except for consequential amendments).

6. The IASB also noted that improving presentation and disclosure requirements about financial instruments issued by entities would be essential in achieving the project objectives. It would use the proposals included in the 2018 Discussion Paper *Financial Instruments with Characteristics of Equity* (2018 DP) as the starting point for clarifying presentation and disclosure. Those proposals would be further developed taking into account the feedback. In addition, the IASB would explore

whether any additional disclosure requirements should be developed to provide information that would not have been provided through classification requirements; or to complement the classification requirements.

7. Based on the above, the IASB decided on the following project plan. We indicate below the IASB's progress against each topic:

Topic	IASB Progress
Classification	
Financial instruments settled in own equity instruments (including 'fixed-for-fixed' condition in IAS 32)	Tentative decisions made April 2020 and February 2023
Obligations that arise only on liquidation (eg perpetual instruments)	Tentative decision made February 2021
Financial instruments with contingent settlement provisions	Tentative decisions made December 2021 and February 2023
The effects of applicable laws on the contractual terms of financial instruments	Tentative decision made December 2021 and February 2023
Shareholders' discretion	Tentative decision made February 2022
Reclassification between financial liabilities and equity instruments	Tentative decisions made in June 2022 and February 2023

Topic	IASB Progress
Obligations to redeem own equity instruments (eg put options on non-controlling interests)	Tentative decisions made in September 2022 and February 2023
Transition	To be discussed in April 2023
Presentation	
Financial liabilities containing contractual obligations to pay amounts based on an entity's performance or changes in its net assets	Tentative decisions made in December 2022 and February 2023
Equity instruments	Tentative decisions made in February 2023
Disclosures	
Refinements of disclosures proposed in the 2018 DP	Tentative decisions made April 2021 and May 2021
Any further disclosure requirements	To be discussed in April 2023

8. Appendix A to this paper provides a summary of the IASB tentative decisions to date.

Plan for the remainder of 2023

9. In April 2023, the staff plan to present their analysis and ask the IASB to make tentative decisions on the remaining topics set out in paragraph 7 of this paper. The next step will be to ask the IASB for its permission to begin the balloting process of an Exposure Draft. The goal is to publish the Exposure Draft towards the end of 2023.

Appendix A – Summary of IASB tentative decisions

Classification

Financial instruments settled in an entity's own equity instruments

A1. In April 2020, the IASB made the following tentative decisions:

(a) for a derivative on own equity to meet the fixed-for-fixed condition in IAS 32, the number of functional currency units to be exchanged with each underlying equity instrument must be fixed or only vary with:

(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 the existing shareholders; or

(ii) passage of time adjustments that are predetermined, vary only with the passage of time and fix the present value of the number of functional currency units per underlying equity instrument.

(b) to classify as equity, a contract can be settled by exchanging a fixed number of non-derivative own equity instruments with a fixed number of another type of non-derivative own equity instruments.

A2. In February 2023, the IASB tentatively decided to amend the foundation principle, tentatively agreed in April 2020, which clarifies when the fixed-for-fixed condition is met. The foundation principle, as amended, states the condition is met if the entity knows how many functional currency units it will exchange *per type of* own share if the option is exercised.

Financial instruments with obligations that arise only on liquidation of the entity

A3. In February 2021, the IASB tentatively decided not to change how such instruments should be classified; but instead to develop presentation (see paragraph A18 of this paper) and disclosure requirements (see paragraphs A19 – A23 of this paper) to meet the information needs of investors in ordinary shares.

Financial instruments with contingent settlement provisions

A4. In December 2021, the IASB tentatively decided to propose amendments to IAS 32:

(a) to clarify that financial instruments with contingent settlement provisions may be compound instruments;

(b) to clarify that the liability component of a compound financial instrument with contingent settlement provisions, which could require immediate settlement if a contingent event occurs, is measured at the full amount of the conditional obligation;

(c) to clarify that payments at the discretion of the issuer are recognised in equity, even if all the proceeds are initially allocated to the liability component of a compound financial instrument;

(d) to specify that the term 'liquidation' in paragraph 25(b) of IAS 32 refers to when an entity is in the process of permanently ceasing operations; and

(e) to specify that an assessment of whether a contract term is 'not genuine' under paragraph 25(a) of IAS 32 is not made by considering only the probability of the contingent event occurring.

A5. In February 2023, the IASB tentatively decided to clarify that an entity is required to use the same approach for initial and subsequent measurement of financial liabilities within the scope of paragraph 25 of IAS 32—that is, the entity would ignore the probability and estimated timing of the contingent event in initial and subsequent measurement.

The effects of applicable laws on contractual terms of financial instruments

A6. In December 2021, the IASB tentatively decided to propose amendments to IAS 32 to require an entity to classify financial instruments as financial liabilities or equity by considering:

(a) terms explicitly stated in the contract that give rise to rights and obligations that are in addition to, or more specific than, those established by applicable law; and

(b) applicable laws that prevent the enforceability of a contractual right or a contractual obligation.

A7. In February 2023, The IASB tentatively decided to simplify the proposed principles by requiring an entity to consider, in classifying a financial instrument, only enforceable contractual terms that give rise to rights and obligations in addition to, or more specific than, those established by applicable law.

Shareholders' discretion

A8. In February 2022, the IASB tentatively decided to explore a factors-based approach to help an entity apply its judgement when classifying a financial instrument with a contractual obligation to deliver cash (or to settle it in such a way that it would be a financial liability) at the discretion of the issuer's shareholders. Such an approach would provide examples of potential factors for an entity to consider when assessing whether a decision of shareholders is treated as a decision of the entity. This assessment is needed to determine whether an entity has an unconditional right to avoid delivering cash (or settling a financial instrument in such a way that it would be a financial liability).

Reclassification between financial liabilities and equity instruments

A9. In June 2022, the IASB tentatively decided to add general requirements on reclassification to IAS 32 to prohibit reclassification other than for changes in the substance of the contractual terms arising from changes in circumstances outside the contract. This approach does not affect reclassifications already required in IAS 32.

A10. The IASB also tentatively decided to clarify that when the substance of the contractual terms changes because of changes in circumstances outside the contract:

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

(b) an equity instrument reclassified from a financial liability would be measured at the carrying value of the financial liability at the date of reclassification. No gain or loss would be recognised.

(c) a reclassification would be accounted for in the reporting period in which the change in circumstances occurred.

The IASB also acknowledged the importance of disclosures in helping users of financial statements better understand the change in classification and its effect on measurement, if any.

A11. In February 2023, the IASB tentatively decided:

(a) to replace 'reclassified' and 'reclassification' with alternative wording in paragraph 23 of IAS 32.

(b) to require an entity to make a reclassification at the date of the change in circumstances that necessitated the reclassification. However, the IASB will ask a question in the forthcoming exposure draft to assess the practical considerations of this requirement.

Obligations to redeem own equity instruments

A12. In September 2022, the IASB tentatively decided to propose amendments to IAS 32 to clarify:

(a) that paragraph 23 also applies to an obligation to redeem an entity's own equity instruments that is required to be settled in a variable number of a different type of the entity's own equity instruments.

(b) the accounting on initial recognition of the obligation to redeem an entity's own equity instruments, if the entity does not already have access to the returns associated with an ownership interest. If the obligation involves non-controlling interests, the debit entry is recognised against a component of equity other than non-controlling interests. In the case of an entity's other obligations to purchase its own shares, the debit entry is recognised against a component of equity other than issued share capital.

(c) that on expiry of a written put option on an entity's own equity instruments:

(i) the financial liability is reclassified to the same component of equity as that from which it was reclassified on initial recognition of the put option; and

(ii) the cumulative amount in retained earnings related to remeasuring the financial liability could be reclassified to another component of equity but is not reversed in profit or loss.

A13. The IASB also tentatively decided to clarify that written put options and forward purchase contracts on an entity's own equity instruments are required to be presented gross, instead of net, in order:

(a) to align the accounting for these instruments with the accounting for other obligations that are conditional on events or choices that are beyond the entity's control; and

(b) to assist users of financial statements in assessing the entity's exposure to liquidity risk.

A14. In February 2023, the IASB tentatively decided:

(a) to clarify in paragraph 23 of IAS 32 that, when remeasuring the financial liability, an entity is required to recognise gains or losses in profit or loss;

(b) to clarify that an entity is required to use the same approach for initial and subsequent measurement of financial liabilities within the scope of paragraph 23 of IAS 32—that is, the entity would ignore the probability and estimated timing of the holder exercising the written put option in initial and subsequent measurement; and

(c) to remove from paragraph 23 of IAS 32 the reference to IFRS 9 about subsequent measurement.

Presentation

Financial liabilities containing contractual obligations to pay amounts based on an entity's performance or changes in its net assets

A15. In December 2022, the IASB tentatively decided against adding to the presentation requirements in IAS 32 for financial liabilities.

A16. However, the IASB tentatively decided to require an entity with these types of financial liabilities measured at fair value through profit or loss to disclose in each reporting period the total gains or losses that arise from remeasuring such financial liabilities. These disclosures, together with the proposed disclosures of terms and conditions tentatively agreed to by the IASB in April 2021, will help to meet the information needs of users of financial statements.

A17. In February 2023, after discussing how the proposed disclosure requirement tentatively agreed in December 2022 relates to the presentation requirement in paragraph 41 of IAS 32, the IASB tentatively decided to delete the second sentence of paragraph 41 of IAS 32.

Equity instruments

A18. In February 2023, the IASB tentatively decided to amend the requirements in IAS 1 *Presentation of Financial Statements* to ensure *amounts attributable to ordinary shareholders* are clearly visible on an entity's statement of financial position, statement(s) of financial performance and statement of changes in equity. These amendments would require an entity to present:

(a) line items on issued capital and reserves attributable to *ordinary shareholders of the parent* separately from issued capital and reserves attributable to other owners of the parent in the statement of financial position (paragraph 54(r) of IAS 1);

(b) *each class of ordinary share capital* separately from each class of other contributed equity in the statement of changes in equity (paragraph 108 of IAS 1);

(c) profit or loss and comprehensive income for the period attributable to *ordinary shareholders of the parent* separately from the respective amounts attributable to other owners of the parent in the statement(s) of financial performance (paragraph 81B of IAS 1); and

(d) the amount of dividends recognised as distributions to *ordinary shareholders* separately from dividends recognised as distributions to other owners during the period, and also present the related amount of dividends per share, either in the statement of changes in equity or in the notes (paragraph 107 of IAS 1).

Disclosures

Terms and conditions

A19. In April 2021, the IASB tentatively decided that, for financial instruments with characteristics of both financial liabilities and equity instruments (except for stand-alone derivatives), an entity would be required to disclose in the notes information about:

(a) 'debt-like features' of the financial instruments that are classified as equity instruments;

(b) 'equity-like features' of the financial instruments that are classified as financial liabilities; and

(c) debt-like and equity-like features that determine the classification of such financial instruments as financial liabilities, equity instruments or compound financial instruments.

Potential dilution

A20. In April 2021, the IASB tentatively decided to require an entity to disclose information about the maximum dilution of ordinary shares in the notes, including:

(a) the maximum number of additional ordinary shares that an entity could be required to deliver for each type of potential ordinary share outstanding at the reporting date. An entity would:

(i) include the total number of share options outstanding (as required to be disclosed by IFRS 2 *Share-based Payment*) and the number of unvested shares, if known; and

(ii) indicate the possibility for unknown dilution where the maximum number of additional ordinary shares that could be delivered is not yet known.

(b) the minimum number of ordinary shares required to be repurchased.

(c) sources of any significant changes in (a) and (b) from the prior reporting period and how these sources contributed to those changes.

(d) terms and conditions relevant to understanding the likelihood of maximum dilution, including a cross-reference to disclosures required by IFRS 2 for a description of share-based payment arrangements.

(e) a description of any share buy-back programmes or other arrangements that may reduce the number of shares outstanding.

The nature and priority of claims against an entity

A21. In May 2021, the IASB tentatively decided to require:

(a) an entity to disclose and categorise in the notes its claims that are financial instruments in a way that reflects differences in their nature and priority, and at a minimum, to distinguish between:

(i) secured and unsecured financial instruments;

(ii) contractually subordinated and unsubordinated financial instruments; and

(iii) those issued or owed by the parent and those issued or owed by subsidiaries; and

(b) the disclosures to be made for all financial liabilities and equity instruments that are within the scope of IAS 32.

Terms and conditions about priority on liquidation for particular financial instruments

A22. In May 2021, the IASB tentatively decided to require:

(a) an entity to disclose in the notes:

(i) terms and conditions that indicate priority on liquidation;

(ii) terms and conditions that could lead to changes in priority on liquidation;

(iii) that a particular type of financial instrument has more than one level of contractual subordination, if applicable (for example, if some subordinated liabilities are contractually subordinated to other subordinated liabilities);

(iv) narrative information when an entity is aware of significant uncertainty about the application of relevant laws or regulations that could affect how priority will be determined on liquidation; and

(v) details of intra-group arrangements such as guarantees that may affect their priority on liquidation (for example, which entities are providing and receiving guarantees); and

(b) the disclosures to be made for all financial instruments with characteristics of both debt and equity, including compound instruments, but excluding stand-alone derivative instruments.

A23. An entity would be required to make the disclosures described in A22 (a) as part of the disclosures about terms and conditions on which the IASB tentatively agreed at its April 2021 meeting.