Appendix
Exposure Draft Financial Instruments with Characteristics of Equity - ANC Comment Letter

Question 1 - The effects of relevant laws or regulations

1. The ANC welcomes the IASB's efforts to propose an approach for determining how the effects of relevant laws or regulations should be taken into account in the classification of a financial instrument (or its component parts) as a financial liability, financial asset or equity instrument. This clarification effort is all the more welcome as it aims to reduce the diversity that has developed in practice.

2. Some practices exclude the effects of relevant laws and regulations, e.g. the obligation to pay dividends in certain jurisdictions such as Brazil or Greece, or in certain legal types of entities. In the case of Mandatory Tender Offers (MTO), when the law requires an acquirer exceeding a certain interest threshold (for example 30% of an acquiree) to launch an offer on the remaining shares, such an obligation is generally ignored in the first place and only gives rise to the recognition of a financial liability on the date when the tender is launched.

3. Conversely, other practices immediately consider the effects of relevant laws and regulations. E.g. paragraph BC5.21 of the Basis for Conclusions on IFRS 9 confirms that a mutual fund that is puttable at the option of the holder does not qualify as an equity instrument because of the put feature, while in many jurisdictions, including in Europe, the existence of the put option arises from legal requirements. Similarly, IFRIC 2, Members' Shares in Co-operative Entities and Similar Instruments, considers the effects of relevant laws or regulations to determine if members' shares should be classified as equity instruments or as financial liabilities.

4. To reduce this diversity, the IASB decided to clarify, in draft paragraph 15A(b) of the Exposure Draft, that if a right or obligation is created by relevant laws or regulations, and would arise regardless of whether it is included in the contractual arrangement, an entity would not consider that right or obligation in classifying the instrument (or its component parts) as a financial liability, financial asset or equity instrument.

5. Within the ANC's jurisdiction, the *Code Monétaire et Financier* (Monetary and Financial Code or CMF) forms the basis of French banking and financial law. The CMF provides the legal and regulatory framework applicable to many loans, borrowings or deposits issued by banking and financial institutions, for which there is little or no room for contractual negotiation. As the rights and obligations applicable to these instruments are defined by the legal and regulatory provisions of the CMF, the IASB's proposal could lead to these rights and obligations being ignored, leading to a potential equity classification of these instruments. The ANC would be pleased to provide the IASB with examples of instruments identified in its jurisdiction. The ANC understands that similar issues also prevail in other jurisdictions, and that it is not the IASB's intention to change the classification of such financial instruments.

6. The ANC understands the IASB's objective of not expanding beyond the contractual perimeter, the rights and obligations to be considered in analysing the classification of a financial instrument, and in particular supports its concern to keep certain assets and liabilities created by statute, such as income taxes or levies, outside the scope of IAS 32.

7. In the course of its work, the ANC considered the possibility that the effects described in paragraph 5 could be caused by an imperfection in the drafting of the proposal. However, none of the drafting changes examined by the ANC were able to reach a satisfactory result. These unsuccessful attempts highlight that the root of the difficulties is not a simple question of drafting, but rather the principle itself. For this reason, the ANC is in favour of seeking an approach that allows the contract to be considered in the broader context of its legal and regulatory environment.

8. The ANC supports the "all-inclusive" approach described in paragraph BC14 of the Basis for Conclusions on the Exposure Draft.

9. The "all-inclusive" approach is consistent with the overarching scope of management's responsibilities as defined by paragraph 1.23 of the Conceptual Framework, i.e. "ensuring that the entity complies with applicable laws, regulations and contractual provisions".

10. The ANC observes that paragraph 5 of IFRIC 2 states that an entity "must consider all of the terms and conditions of the financial instrument in determining its classification as a financial liability or equity. Those terms and conditions include relevant local laws, regulations and the entity's governing charter". However, the ANC notes that the IFRIC 2 Consensus interpreting the current requirements in IAS 32 seems to conflict with the proposed paragraph 15A(b) in the Exposure Draft, and is concerned about this conflict, given that one of the objectives of the project that led to the Exposure Draft is not to fundamentally change the requirements in IAS 32, as explained in draft paragraphs BC6 and BC16.

11. The ANC also notes that the "all-inclusive" approach was successfully applied by the IASB in drafting recent standards such as IFRS 15, IFRS 16 and IFRS 17. For example, the educational material on the application of IFRS 16, Leases published by the IFRS Foundation on 10 April 2020 explains that "in applying IFRS 16 an entity treats a change in lease payments in the same way, regardless of whether the change results from a change in the contract itself or, for example, from a change in applicable law or regulation".

12. Also, the "all inclusive" approach results in instruments presenting the same cash-flows characteristics, but arising from potentially different contractual or legal sources, to be classified identically. Such a result cannot be reached when the classification depends on the legal framework in which the instrument was created and is unlikely to result in distinctions that will be useful to users of the financial statements.

13. The ANC recognises though, that practice has developed and suggests that the IASB considers limited exceptions that would not disrupt practices, e.g. for bail-in requirements giving the power for the regulator to require some instruments that have characteristics of equity instruments to convert into a variable number of other shares or other equity instruments.

14. However, if the IASB were not endorsing the principles of the "all-inclusive" approach, the ANC would highly recommend to withdraw its current proposal, while requiring transparency on the approaches and judgements applied by an entity.

Question 2 - Settlement in an entity's own equity instruments

15. The application of the fixed-for-fixed condition introduced in IAS 32 has opened a large number of interpretative questions and has led to diversity in the accounting treatments applied. Although welcoming the efforts made to clarify the guidance in that area, the ANC remains of the view that a better solution would be to classify as equity both: (a) non-derivative financial liabilities that will be settled in the issuer's own shares subject to a cap where the entity has the possibility to issue new shares within the limit of the cap; and (b) derivatives that will be settled by the receipt of: (i) a variable amount of cash for the delivery of a fixed number of shares; or (ii) a fixed amount of cash for the delivery of a variable number of shares; or (iii) a variable amount of cash for the delivery of a variable number of shares. The ANC does not believe that such changes would contradict the principles of the Conceptual Framework. In addition, the ANC considers that these changes would reduce the complexity in applying IAS 32 and improve the relevance of information for users of financial statements. Nevertheless, the proposals developed hereafter remain within the existing confines of IAS 32 and do not consider the possibility of such changes.

The effect of foreign currency

16. The ANC examined the IASB's analysis to identify when the effect of foreign currency disrupts the fixed-for-fixed condition in draft paragraph 16(b)(ii) of IAS 32 and agrees with the observation expressed in draft paragraph BC42 of the Basis for Conclusions on the Exposure Draft, that a foreign exchange risk arises if "the amount of cash (...) an entity would exchange on settlement is not fixed in its functional currency". However the ANC fails to understand how this observation resulted in the IASB's proposal in draft paragraph AG29B of the Application Guidance, that "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". The ANC considers that this approach could be problematic for a consolidated group whose subsidiaries have different functional currencies.

17. The ANC rather considers that the appropriate reference point in draft paragraph AG29B of the Application Guidance should be the functional currency of the entity where the amount of cash is exchanged on settlement.

Adjustments that are consistent with the fixed-for-fixed condition

18. The ANC welcomes the general approach defined by the IASB to determine when the fixed-for-fixed condition in draft paragraph 16(b)(ii) of IAS 32 is met, including in situations where the variability solely results from preservation and passage-of-time adjustments. However, the ANC disagrees with the conclusions reached on the analysis of passage-of-time adjustments in Illustrative Examples 19 (paragraphs 19-20) and 20 (paragraphs 21-22).

19. Illustrative Example 19 proposes the fact pattern of a bond convertible at maturity into ordinary shares of the issuer, with a clause that enhances the conversion ratio in the event of a change of control, to compensate the bondholder for the loss of time value in the option. Draft paragraph I80 considers the situation where the conversion ratio is calculated on the basis a formula whose inputs include the entity's share price and the time remaining until the original conversion date. The conclusion states that such an adjustment is not a passage-of-time adjustment, since the conversion ratio incorporates the entity's share price.

20. Current practice analyses the time value of an option as an adjustment representative of both the passage of time and preservation adjustments. In practice, the time value of an option includes the entity's share price, as in the fact pattern proposed in Illustrative Example 19. The conclusion of Example 19 would therefore prevent such clauses from qualifying as passage-of-time or preservation adjustments, and lead to their measurement at fair value through profit or loss, which seems to contradict the intention of the proposed principle on passage-of-time and preservation adjustments. The ANC therefore invites the IASB to revise the conclusion of Illustrative Example 19.

21. The fact pattern proposed by Illustrative Example 20 figures a call option granted to a third party on the entity's shares, the strike price of which depends on the option exercise date and the rate of a specified interest rate benchmark on that date. Draft paragraph IE85 observes that the formula's inputs vary not only with the passage of time, but also with an interest rate benchmark. As a consequence, the clause defining the strike price does not qualify as a passage-of-time adjustment.

22. The ANC does not consider that an interest rate benchmark such as Euribor or inflation would alter the passage-of-time nature of the adjustment and therefore suggests that the IASB identifies more precisely which characteristics of a benchmark interest rate are likely to interfere with the notion of passage of time.

Question 3 - Obligations to purchase an entity's own equity instruments

23. The ANC understands that the proposals made by the IASB in this Exposure Draft, and in particular those relating to the accounting for obligations to purchase an entity's own equity instruments, fall within a specific narrow-scope mandate: to clarify the reading of the existing requirements of IAS 32, without fundamentally revising its principles. As a consequence, when examining the proposals of the Exposure Draft, the ANC was careful to bear in mind the boundaries of this mandate, in order to avoid any misunderstanding of the solutions proposed and to assess the extent to which the objective set by this mandate had been achieved.

Assessment of the relevance of the IASB's proposal

Description of the fact pattern

24. To assess the relevance of the proposed model, the ANC considered the fact pattern of an entity held by a controlling interest of 80% and a non-controlling interest of 20%. The entity's net assets initially amount to CU1,000, allocated between controlling and non-controlling interest holders at CU800 and CU200 respectively. The entity issues a put exercisable at the fair value of the shares held by non-controlling interest holders. Upon issuance of the put, the present value of the exercice price equals the fair value of the shares at CU300.

25. Over the period, the entity's net assets, excluding the liability arising from the put option, increase by CU120, of which 80%, i.e. CU96 is attributable to equity holders of the parent and 20%, i.e. CU24 to non-controlling interest holders. The financial liability increases by CU50, representing the change in fair value of non-controlling interest holders. That change in fair value of CU50 may be broken-down into a component A of CU24, corresponding to the change in the carrying amount of the net assets, excluding the liability arising from the put option, attributable to non-controlling interest holders; and a component B of CU26, hereafter referred to as the "measurement mismatch", equal to the total of: (i) the change in the fair value of *unrecognised* assets and liabilities; and (ii) the difference between the fair value and the carrying amount of *recognised* assets and liabilities.

Statement of financial position

26. In the statement of financial position, the IASB's proposal leads actually to recognise twice the rights of non-controlling interest holders: on the one hand, a share in equity measured in accordance with applicable accounting standards; on the other hand, a financial liability measured at fair value.

27. The rights of non-controlling interests holders on these equity and liability items are mutually exclusive. Non-controlling interests holders will not receive both the benefits and net assets they are entitled to as shareholders *and* the cash associated with the put option. They will receive either one, *or* the other, but not both. As a consequence of this double recognition, the equity attributable to the owners of the parent does not faithfully represent their claims, since the claims of non-controlling interest holders were deducted twice.

Statement of profit or loss

28. The double presentation in the statement of financial position of the rights of non-controlling interest holders in the form of a share in equity and a financial liability has consequences in the statement of profit or loss as well. Each time the entity generates CU100 of net income, the 80% share attributable to equity holders of the parent will be reduced twice by the 20% attributable to non-controlling interest holders: firstly through the allocation of the net income between equity holders of the parent and non-controlling interest holders (CU20), and secondly through the increase in the value of the financial liability (CU20). As a consequence, while users of financial statements would expect an amount of CU80 to be attributed to the parent, the IASB's proposal attributes only CU60. The table below allocates the net income described in the fact pattern (CU120) between equity holders of the parent and non-controlling interest holders. The ANC understands that the remeasurement entry of the financial liability (CU50) is fully allocated to the share of net income attributable to equity holders of the parent, consistently with the rationale of the initial recognition entry. The circled amounts evidence that the share of net income attributable to equity holders of the parent is impacted twice by the interests attributable to non-controlling interest holders: through the allocation of net income between entity's shareholders (CU24), and through the portion of the remeasurement of the financial liability corresponding to the net income attributable to non-controlling interest holders (component A - CU24).

	Net income		
	Parent	Non-controlling	Total
Net income of the period	120		120
Allocation of net income between entity's shareholders	(24)	24	0
Remeasurement of the financial liability			
. Of which change measured in accordance with applicable accounting standards (component A)	(24)		(24)
. Of which gap to fair value, or mismatch component (component B)	(26)		(26)
Total	**46**	**24**	**70**

29. Besides, the share in net income attributable to equity holders of the parent is distorted by the measurement mismatch between the net income attributable to non-controlling interest holders, and the carrying amount of the financial liablity, whose measurement is based on the fair value of non controlling interests' shares, i.e. component B. If all of the entity's assets and liabilities were recognised and measured at fair value, the entity's net income and the remeasurement of the financial liability would be measured identically at fair value. The distortion caused by component B would disappear, but the double recognition of non-controlling interests would remain. Conversely, the distortion represented by component B will increase if the entity creates value that is not recognised in the statement of financial position, e.g. through internally generated goodwill or intangibles, and the share of the net income attributable to equity holders of the parent will be reduced through the increase in the financial liability.

Counter-intuitive effects on cash transactions

30. The inconsistencies generated by the proposed model on non-cash impacts in the statement of financial position and in the statement of profit or loss are also present in transations involving a cash impact, in two different ways. First, when a dividend is distributed, the reduction in equity attributable to non-controlling interest holders will generate a gain in profit or loss corresponding to the downward revaluation of the financial liability, since all other things being equal, the fair value of non-controlling interests' shares will decrease by an equivalent amount. Second, whereas the users of the financial statements would normally expect that the effect of the exercise of the put option would be limited to the settlement of the financial liability by the delivery of cash or another financial asset, the users will also observe, under the IASB's proposal, an increase in the equity attributable to equity holders of the parent, to the extent of the reclassification of the equity attributable to non-controlling interest holders, which seems counter-intuitive.

31. As a conclusion, the double recognition of the rights of non-controlling interest holders in the statement of financial position and in the statement of profit or loss, the measurement mismatch in the statement of profit or loss and the counter-intuitive effects on cash transactions are blurring the representation of obligations to purchase an entity's own equity instruments and do not provide relevant information to users of financial statements.

Technical analysis of the IASB's proposal

Gross presentation

32. The ANC concurs with the IASB's analysis outlined in paragraphs BC69-70 of the Basis for Conclusions on the Exposure Draft that an entity's obligation to purchase its own shares is settled by an outflow of cash or another asset against an inflow of its own shares, which do not meet the definition of an asset. As a consequence, the ANC agrees with the IASB's view to maintain the gross presentation requirement in paragraph 23 of IAS 32, consistently with the boundaries of the project.

Debit to equity on initial recognition of a financial liability

33. The ANC examined the IASB's proposal to debit, on initial recognition of the obligation, 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, thus maintaining the corresponding non-controlling interests within equity. In support of this proposal, the IASB considered two main arguments: on the one hand, non-controlling interests represent existing ownership interests that have not yet been extinguished – the existing interest argument (paragraphs 34-35); on the other hand, the put option granted to non-controlling interest holders is an additional right that should be represented separately from the existing ownership interest – the double unit of account argument (paragraphs 36-38).

34. The existing interest argument, based on paragraphs B89, B90 and B96 of the Application Guidance of IFRS 10, emphasises that the financial statements should continue to present the share of non-controlling interests in the statement of financial position, profit or loss and other changes in equity, for as long as non-controlling shareholders will retain their rights to the returns associated with their ownership interests.

35. The ANC observes that under this reading of the IFRS 10 Application Guidance, the share of interests attributable to non-controlling shareholders is maintained within equity, although in the ANC's view, these ceased to meet, since the grant of the put option, the "non-controlling interests" definition in Appendix A of IFRS 10, i.e. "equity in a subsidiary not attributable, directly or indirectly, to a parent" (paragraphs 37-38). Indeed since that date, the interests held by non-controlling shareholders ceased to meet the definition of equity instruments and as such, should no longer be presented within equity, as further discussed in the following paragraphs.

36. The double unit of account argument, described in paragraph BC78 of the Basis for Conclusions on the Exposure Draft, is based on the observation that the put option granted to non-controlling interest holders is an additional right that does not replace their current rights or ownership interests. To this extent, it would be appropriate for the financial statements to present these two rights separately, on the one hand the share attributable to non-controling shareholders within equity, and on the other hand the financial liability arising from their right to exercise the option.

37. How should the put feature be considered in classifying the shares of non-controlling interest holders? Paragraph BC11 of IAS 32 answers that "an entity's obligation to purchase its own shares establishes a maturity date for the shares that are subject to the contract. Therefore, to the extent of the obligation, those shares cease to be equity instruments when the entity assumes the obligation". In other words, paragraph BC11 observes that the put option operated a fundamental change in the nature of the equity instrument when the entity assumed the obligation, regardless of whether the put option is a feature of the share, or an agreement between the signatory parties. The same paragraph further notes that the way the obligation was structured, either as a redemption clause embedded within the equity instrument, or as a free-standing derivative contract, has no impact on the conclusion.

38. Two other paragraphs in IAS 32 confirm that the rights held by non-controlling interest holders within a consolidated group are presented as a single financial liability and not separately as an equity instrument and a financial liability. Paragraph BC68 confirms that a puttable financial instrument is classified as a financial liability in consolidated financial statements, even if the instrument is classified as an equity instrument in separate financial statements. In the Application Guidance, paragraph AG29 explains that the principles of paragraphs BC11 and BC68 apply, irrespective of the entity issuing the obligation within the consolidated group and of the way the instrument is classified its separate financial statements.

39. The ANC encourages the IASB to reconcile its proposal with paragraphs BC11, BC68 and AG29 of IAS 32.

40. The ANC also observes that a large part of the difficulties related to the recognition of obligations to purchase an entity's own equity instruments arises from the apparent conflict between paragraphs B89 of IFRS 10 and BC11 of IAS 32, and encourages the IASB to clarify how these two paragraphs should be read.

41. On the one hand, paragraph B89 of IFRS 10 states that "the proportion of profit or loss and changes in equity allocated to the parent and non-controlling interests in preparing consolidated financial statements is determined solely on the basis of existing ownership interests and does not reflect the possible exercise or conversion of potential voting rights and other derivatives". On the other hand, paragraph BC11 of IAS 32 analyses that shares including a put option feature "cease to be equity instruments when the entity assumes the obligation".

42. Some readers of paragraph B89 of IFRS 10 may conclude that put options should be ignored when calculating the percentage of interest held by non-controlling interest holders, which indeed, creates a conflict with paragraph BC11 of IAS 32. However, others read paragraph B89 of IFRS 10 in the light of paragraph BC11 of IAS 32, which resolves the conflict, since shares including a put option feature already ceased to qualify as equity instruments and as such, should be classified as liabilities. As a consequence, no share of net income should be allocated to such interests in profit or loss.

Initial and subsequent measurement of the financial liability

43. The ANC agrees with IASB's proposal to measure the financial liablity at the present value of the redemption amount and ignore the probability and estimated timing of the counterparty exercising that redemption right. Regarding the expected timing issue, the ANC encourages the IASB to consider the merits of a drafting inpired from paragraph 47 of IFRS 13, e.g. "the fair value of a financial liability with a demand feature should not be less than the amount repayable on demand discounted from the first date that the amount could be required to be paid". Such a drafting would better address situations in which different exercise dates with different exercise prices exist.

44. Whichever solution the IASB chooses, the ANC believes that further guidance would be needed on how to apply its measurement proposals, since these make it clear that IFRS 9 does not apply. In particular, further clarification would be necessary to enable consistent application on issues such as whether a discount rate is set at initial recognition, similar to amortised cost measurement, or updated at each reporting date, similar to fair value measurement. It would also be helpful to provide guidance on determining the discount rate, which is a source of diversity in practice.

45. The ANC acknowledges that the proposal to remeasure the financial liablity against profit or loss qualifies as a technically available solution within the boundaries of the IASB's mandate. However, the ANC has more reservations about the relevance of this solution for users of financial statements, as it introduces a mismatch between the measurement of the entity's assets and liabilities and the measurement of the financial liability. The ANC cannot support a solution in which the share of net income attributable to equity holders of the parent is impacted by such a measurement mismatch.

Alternative proposal

46. As part of its work, the ANC examined alternatives to the IASB's proposal that: (i) recognise a gross financial liability against equity attributable to non-controlling interest holders (paragraphs 26-29) so as to avoid double recognition issues and be consistent with the principles of IAS 32 (paragraphs 37-38); (ii) avoid any profit or loss mismatch (paragraphs 28-29); and (iii) ensure, within the confines of the existing standard-setting framework, a consistent and useful presentation for the users of financial statements.

47. The "ANC Preferred Approach" allocates the entire net income of the period (CU120) to the equity holders of the parent and recognises component A (CU24) of the change in fair value of the financial liability (CU50) as a debit in the share of profit or loss attributable to the equity holders of the parent.

	Net asset		Equity, parent		Equity, NCI		OCI, parent		Net income, parent		Net income, NCI		Financial liability	
	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Initial situation	1 000			800		200								
Emission of the put option			100		200									300
Net income of the period	120									120				
Financial liability remeasurement			26						24					50

48. The "ANC Preferred Approach" allocates component B (CU26), which is at the origin of the mismatch in the statement of profit or loss, as a debit from the share of equity attributable to the equity holders of the parent, by analogy with the requirements of paragraph 13 of IFRIC 17, applicable to the remeasurement of a financial liability corresponding to a distribution of non-cash assets to owners. Some might also consider that paragraph B96 of IFRS 10 could also support such a split.

49. The "ANC Preferred Approach" may not correspond to the dominant practice within its jurisdiction and within Europe. However the "ANC Preferred Approach" is compatible with the existing standard-setting framework and achieves a consistent and useful presentation for the users of financial statements. The ANC therefore invites the IASB to examine its merits. The ANC will be supportive of any solution that avoids, on the one hand, recognising the rights attributable to non-controlling interest holders twice in the statement of financial position and the statement of profit or loss and, on the other hand, distorting the parent entity's share in the net income of the period for the difference between fair value and accounting valuation requirements in the measurement of the share of net assets attributable to non-controlling interest holders.

Question 4 - Contingent settlement provisions

Measurement of the liability component of a compound financial instrument with a contingent settlement provision

50. The IASB is proposing to measure the liability component of a compound financial instrument with a contingent settlement provision at the full amount payable to settle the liability component upon occurrence of the uncertain future event, discounted from the earliest date that the amount could be required to be paid, i.e. without considering the probability of the uncertain future event occurring, or its estimated timing.

51. The ANC observes that the IASB' proposal is generally consistent with the way practice has developed in the ANC's jurisdiction. The ANC is aware that other jurisdictions may have considered the probability of the contingency in the measurement of the liability component. However, certain compound financial instruments provide different settlement outcomes over different dates, such different outcomes being either pre-defined by the contract, or subject to the entity's future performance. To assess the way the IASB's proposal is working on such instruments, the ANC considered the fact pattern of an entity issuing a compound financial instrument with discretionary interest payments (equity component) and two different cash settlement outcomes (liability component), one at CU40 shortly after the issuance date, and one at CU100 at a later date, contingent on a specific event. Upon initial recognition of the financial instrument, the entity would recognise a liability component measured at CU40 and an equity component measured at CU60. The possible settlement outcome at CU100 subject to the occurrence of the contingent settlement event would trigger a debit remeasurement of CU60 in profit or loss, once the first contingency has lapsed, which in our view does not result in relevant information for users of financial statements.

52. To address the measurement of compound financial instruments with different settlement outcomes over different dates, the ANC notes that it would be necessary to explore measurement bases involving the probability and estimated timing of different uncertain future events occurring. For example, the liability component could be measured at the greater of the probability weighted amount of the different settlement outcomes, or the maximum settlement outcome.

53. The IASB could explore another alternative where the maximum settlement outcome is greater than the initial fair value of the financial instrument. Applying the IASB's proposal to such a situation would result in a negative equity component, which might be counter-intuitive. To overcome this difficulty, the ANC suggests that the initial measurement of the liability component be capped at the initial fair value of the financial instrument, and integrates the effect of timing and probability only to the extent of the potential excess of the amounts that could be required to be repaid, beyond the initial measurement of the liability component.

54. The objective of IAS 32 is to state the presentation rules applicable to financial instruments, while IFRS 9 deals with the measurement of financial assets and financial liabilities. As evidenced by the two fact patterns examined in paragraphs 51-53, an attempt to provide an answer to such complex measurement issues within a narrow-scope amendments project presents a risk of proposing a solution that addresses only part of the issues. The ANC thus encourages the IASB to consider measurement issues as part of a separate standard-setting project to amend IFRS 9.

Accounting for discretionary payments

55. The ANC agrees with the IASB's proposal to clarify that a discretionary payment made on a compound financial instrument is debited from equity, consistently with the existence of that equity component.

56. In the particular case of perpetual instruments with discretionary payments, convertible into a variable number of an issuer's own shares, the ANC notes that some preparers have been analysing such discretionary payments as interest expenses debited from profit or loss. Among these, some may additionally have entered into derivative contracts to hedge such interest expenses within a cash flow hedge. For these preparers, the IASB's analysis changes the accounting nature of the hedged item and the derivative instrument ceases to qualify as a hedging instrument within a hedging relationship. The ANC thus invites the IASB to propose a transition provision to avoid any unintended mismatch in profit or loss.

The meaning of "not genuine"

57. The ANC has no comment on the IASB's proposals relating to the identification of a non-genuine clause. However, the ANC encourages the IASB to outline further, in the Basis for Conclusions, the situations that presented practical application difficulties and justified this amendment.

Question 5 - Shareholder discretion

58. The ANC welcomes the IASB's approach of proposing a methodology for identifying, by means of a judgement based on a non-limitative list of factors outlined in draft paragraph AG28A of the Application Guidance of IAS 32, whether a shareholder's decision is made in its capacity as an investor or by the entity. The ANC would nevertheless like to draw the IASB's attention on factors (c) and (d) of draft paragraph AG28A.

59. Factor (c) of draft paragraph AG28A requires an entity to consider whether different classes of shareholders benefit differently from a shareholder decision. The ANC invites the IASB to develop further the drafting of this factor, so as to better illustrate the situations concerned in practice.

60. Factor (d) of draft paragraph AG28A requires an entity to consider whether exercise of a shareholder decision-making right enables a shareholder to require the entity to redeem its shares in cash or another financial asset. The ANC is concerned that the current drafting of this factor may unintentionally lead an entity to conclude that shares that may be repurchased following a decision agreed by the General Shareholders' Meeting qualify as a financial liability, while such shares should meet the definition of an equity instrument as long as the General Shareholders' Meeting is the entity's general governing body, which is the case in France.

Question 6 - Reclassification of financial liabilities and equity instruments

61. Draft paragraph BC128 of the Basis for Conclusions on the Exposure Draft explains the difference between derecognition and reclassification.

62. The ANC suggests that the IASB provides an example within this draft paragraph to illustrate the difference between derecognition and reclassification.

63. The IASB's proposals address the classification of a financial instrument in situations where the substance of the contractual arrangement changes without modification to the contractual terms. The ANC suggests that the IASB should consider incorporating into IAS 32 the November 2006 IFRIC Agenda Decision clarifying the situation in which an amendment to the contractual terms of an equity instrument results in the instrument being classified as a financial liability of the issuer.

64. The ANC also suggests that the IASB considers providing guidance on how to account for modifications of compound financial instruments.

Types of changes in the substance of a contractual arrangement

65. Draft paragraph 32B of the Exposure Draft requires an entity to reclassify a financial liability or equity instrument if the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement. Draft paragraphs 32C and AG35A indicate further that a change in an entity's functional currency or a change in an entity's group structure qualify as changes in circumstances external to the contractual arrangement.

66. The ANC suggests the IASB to clarify, in relation to two other sections of the Exposure Draft, if a change in relevant laws or regulations, or a shareholder's decision qualify as changes in circumstances external to the contractual arrangement.

67. Draft paragraph BC132 of the Basis for Conclusions on the Exposure Draft explains that a financial instrument cannot qualify as an equity instrument if, at any point over the contractual life of the instrument, an obligation to transfer cash or another financial asset has existed. Drawing from this principle stated by paragraph 16 of IAS 32, the IASB considers that a financial instrument that includes a contractual term that initially results in its classification as a financial liability, but that ceases to be effective at a specified point in time, may not be reclassified as an equity instrument, even though the instrument would be classified as an equity instrument if it were initially recognised at that point in time.

68. The ANC observes that the rationale followed by the IASB maintains a financial instrument classified as a financial liability, although that financial instrument will never be settled in cash or another financial asset. Besides, the IASB's proposal continues to classify as a financial liability a financial instrument that qualifies as an equity instrument in substance. For these reasons, the ANC disagrees with the IASB's proposal to prohibit reclassification as a result of the passage of time.

Reclassification approaches

69. The reclassification situations addressed in the Exposure Draft provide useful clarification on the impacts of the IASB's proposals on instruments qualifying as liability or equity instruments in their entirety.

70. The ANC encourages the IASB to develop further its proposals to illustrate how the IASB's proposals apply to compound financial instruments.

Timing of reclassification

71. In its proposals, the IASB decided that an entity should reclassify a financial instrument as a financial liability or an equity instrument from the date of the change in circumstances that affects the classification of that instrument.

72. The ANC agrees with the principle, but considers that illustrative examples would be helpful to determine that date in practice.

Question 7 - Disclosure

73. The ANC agrees with the IASB's proposal to expand the objective of IFRS 7 to equity instruments, to enable users of financial statements to understand the diversity of financial instruments that exist within the spectrum ranging from liability to equity. The IASB's general approach of placing the disclosures' objectives into perspective, rather than requiring a checklist, is particularly welcome. More specifically, the ANC approves the proposals to require additional information relating to the description of the terms and conditions of financial instruments with both financial liability and equity characteristics, and to reclassifications.

Nature and priority of claims on liquidation, arising from financial instruments

74. Feedback collected on the IASB's proposals to disclose information on the nature and priority of claims on liquidation indicates that to be relevant, especially within a multi-jurisdiction consolidated group with a wide variety of instruments, the information should be much more granular than what is indicated in the proposal, potentially in electronic format on a line-by-line basis. However, the ANC shares the IASB's view that to be useful, the notes should present a reasonable level of aggregation. For these reasons, the ANC did not identify any middle-ground approach and suggests that this proposal be withdrawn.

Potential dilution of ordinary shares

75. The ANC observes that the principles applied in draft paragraphs 30G and 30H of IFRS 7 differ from the existing principles in IAS 33, Earnings per Share. To that extent, the IASB should explain both the objectives and usefulness of these new requirements, and how these reconcile with the existing requirements in IAS 33. Provided that evidence can be put forward to support the proposed disclosures, the ANC also suggests that these new requirements be added to IAS 33 instead of IAS 32, which would appropriately and consistently limit the scope of such additional disclosures to those entities that are required to disclose information in accordance with IAS 33.

Question 8 - Presentation of amounts attributable to ordinary shareholders

76. The IASB proposes to require that 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. The ANC would like to express two observations with respect to this proposal.

77. The ANC considers that the objectives of the IASB's proposals on the presentation of amounts attributable to ordinary shareholders as well as the related Application Guidance are insufficiently clear, which is likely to undermine the usefulness of disclosures and lead to inconsistencies in practice. In particular, the ANC observes that no guidance is provided to determine how an entity should take into account the effects of several equity instruments other than ordinary shares, such as equity derivatives, or preference shares with cumulative effects, when determining the amounts attributable to ordinary shareholders. The absence of guidance may give rise to practical application questions. The ANC is therefore unable to assess whether the IASB's proposal results in relevant information for users of financial statements.

78. The ANC understands from draft paragraph BC251 of the Basis for Conclusions on the Exposure Draft, that the IASB decided to require the information to be presented in the primary financial statements, to avoid that users would have "to go through multiple notes to the financial statements to piece together the information". The ANC considers that the IASB's proposal tends to depart from the objective of synthetic financial statements, by overloading them with information that would be more appropriately located in the notes. Such information could be disclosed in the form of one single note, so as to make it easier for the readers of financial statements to identify the information.

Question 9 - Transition

79. As outlined in paragraph 56 with respect to the specific issue of discretionary payments, some proposals of the Exposure Draft are changing the accounting nature of certain items that may have been designated as hedged items before the transition date. Since the derivative previously designated as a hedging instrument ceases to qualify as such within a hedging relationship, the ANC invites the IASB to propose a transition provision to avoid any unintended mismatch in profit or loss.

Question 10 - Disclosure requirements for eligible subsidiaries

80. The ANC is not commenting this issue.