EFRAG'S consultation on its Draft Comment Letter (DCL) in response to the IASB Exposure Draft (ED) on Financial Instruments with Characteristics of Equity

Position paper – Executive summary

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On 29 November 2023, the International Accounting Standards Board (IASB) proposed amendments in an Exposure Draft to tackle challenges in financial reporting for instruments with both debt and equity aspects, focusing on clarifying issues within IAS 32 and enhancing disclosures in IFRS 7 and IAS 1. The amendments target various areas such as financial instrument classification, derivatives settled in the issuer's equity, and disclosures on claims and terms of financial instruments. Additionally, on 15 January, the European Financial Reporting Advisory Group (EFRAG) released a draft comment letter supporting the IASB's efforts and suggesting improvements, with a deadline for comments set for 20 March 2024. EFRAG is also conducting a field-test to evaluate the impact of the proposed changes.

General comments

In general, the WSBI-ESBG welcomes the IASB's efforts to address practical issues in financial reporting concerning IAS 32, aiming to clarify principles and provide application guidance for consistent implementation. However, we have concerns and suggestions for reconsideration, including the need for more clarification and examples regarding the impact of relevant laws or regulations on financial instrument classification. Additionally, we seek further guidance on topics such as the recognition of liabilities for obligations to redeem entity's own equity and the calculation of total comprehensive income attributable to other owners of the parent.

Effects of Relevant Laws or Regulations

WSBI-ESBG acknowledges the necessity of considering both contractual terms and legal regulations for understanding financial instruments. We support EFRAG's concerns regarding practical challenges and unintended consequences, suggesting further clarification and field-testing. We also emphasize the need for guidance on assessing the impact of IASB proposals on various instruments, particularly puttable instruments and compound instruments.

Settlement in an Entity's Own Equity Instruments

The lack of guidance on the fixed-for-fixed condition in IAS 32 has led to diverse interpretations. While the proposed amendments provide clarity on this aspect, WSBI-ESBG seeks further clarification, especially regarding convertible loans with variable interest rates. We also suggest complementing proposed requirements with a reasonability test for passage-of-time adjustments.

Obligations to Purchase an Entity's Own Equity Instruments

While the clarification in the ED is helpful, WSBI-ESBG raises concerns about recognizing liabilities for obligations to redeem entity's own equity, particularly regarding non-controlling interests. We suggest recognizing such liabilities as a separate component of non-controlling interests and offer insights into alternative approaches for remeasurement of financial liabilities.

Contingent Settlement Provisions

WSBI-ESBG finds the proposed clarifications in the ED helpful for initial recognition and measurement of financial instruments with contingent settlement provisions. However, we emphasize the need for further clarity, especially concerning the accounting treatment for instruments where the obligation amount exceeds the consideration received.

Shareholder Discretion

While WSBI-ESBG generally supports the proposed requirements regarding shareholder discretion, it notes diversity in practice regarding treating shareholder decisions as entity decisions. We stress the importance of considering specific circumstances and suggest factors for entities to assess when determining whether shareholder decisions are treated as entity decisions.

Disclosure

WSBI-ESBG acknowledges the significance of increased disclosure requirements but stresses the importance of clarity and practicality. We raise concerns about the usefulness of certain disclosures, particularly regarding priority on liquidation for financial institutions, and suggest cross-referencing to existing regulatory documents.

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