INSTITUT DER WIRTSCHAFTSPRÜFER

Institut der Wirtschaftsprüfer
in Deutschland e. V.

Wirtschaftsprüferhaus
Tersteegenstraße 14
40474 Düsseldorf
Postfach 32 05 80
40420 Düsseldorf

TELEFONZENTRALE:
+49 (0) 211 / 45 61 - 0

FAX GESCHÄFTSLEITUNG:
+49 (0) 211 / 4 54 10 97

INTERNET:
www.idw.de

E-MAIL:
info@idw.de

BANKVERBINDUNG:
Deutsche Bank AG Düsseldorf
IBAN: DE53 3007 0010 0748 0213 00
BIC: DEUTDEDDXXX
USt-ID Nummer: DE119353203

Mr Andreas Barckow, Chair
International Accounting Standards Board
Columbus Building 7
Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

28 March 2024

602/579

Dear Mr Barckow

Re.: IASB Exposure Draft – Financial Instruments with Characteristics of Equity – Proposed amendments to IAS 32, IFRS 7 and IAS 1

The IDW (Institut der Wirtschaftsprüfer in Deutschland e.V.)[1] would like to thank you for the opportunity to comment on the IASB's Exposure Draft (ED) *"Financial Instruments with Characteristics of Equity (FICE) - Proposed amendments to IAS 32, IFRS 7 and IAS 1".*

We welcome the IASB's project on FICE and have followed it closely from the outset. The outcome of the project may have a significant impact on the presentation of equity and liabilities, and corresponding disclosures. Hence, it is of considerable importance for entities of every size and in every sector reporting under IFRS. We see the developments, i.e. the progress that has been made over time, but also the challenges that the project continues to pose.

As described in our Comment Letter of 7 January 2019 on Discussion Paper 2018/1 "Financial Instruments with Characteristics of Equity", we believe that there are only two sensible approaches to overcome the current application problems and other challenges in connection with IAS 32:

[1] The IDW is a voluntary membership organisation representing the interests of the profession of public auditors in Germany and counts over 83 % of this profession as members.

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann, WP StB, Sprecher des Vorstands;
Melanie Sack, WP StB, stv. Sprecherin des Vorstands;
Dr. Torsten Moser, WP

Amtsgericht Düsseldorf
Vereinsregister VR 3850

1) developing a completely new and comprehensive approach to distinguishing (financial) liabilities from equity – applicable to all financial instruments, with no significant exceptions; or
2) focussing on the resolution of practical problems with the existing guidance in IAS 32.

Approach 1 would certainly have been preferable in the long term. With the current requirements for the classification and recognition of financial instruments as financial liabilities or equity instruments, practice is already reaching the boundaries of IAS 32 (we refer in this context to the requests to the IFRS Interpretations Committee (IC)). Financial innovations, market forces and changes to the regulations, in particular for the financial industry, will also lead to new and more complex financial instruments in the future. This will undoubtedly lead to further application issues for IAS 32.

For reasons that we can appreciate, the IASB has decided in favour of the second approach, which attempts to solve selected application problems pragmatically without fundamentally questioning the current classification of financial instruments in accordance with IAS 32.

With regard to the proposals in the ED, we believe that there are a number of sensible approaches and ideas that we welcome in principle, but also see a need for further clarification and improvement. This includes, in particular, the proposals on the effects of relevant laws or regulations (Q1), settlement in an entity's own equity instruments (Q2), contingent settlement provisions (Q4), shareholder discretion (Q5), the reclassification of financial liabilities and equity instruments (Q6) and disclosures (Q7).

Moreover, from our point of view, the proposals in this ED to improve the presentation of financial instruments should be better addressed in a separate project on IAS 1 or IFRS 18 *General Presentation and Disclosures* and not as part of the FICE project (we refer to our answer to Q8).

Further, we would like to comment on the specific questions of the ED as follows:

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.

The IDW welcomes the fact that the IASB has focused on this topic. In our opinion, the largely unresolved question of whether, and if so to what extent, relevant laws or regulations could create rights and obligations that affect the classification of a financial instrument as a financial liability or as an equity instrument results in considerable diversity in practice. Over the years, however, a largely uniform best practice has emerged within individual jurisdictions.

We fully agree with the Board's conclusion in paragraph 19 of the Basis for Conclusions of the ED that approaches resulting in classification outcomes that depend on whether and how rights and obligations arising from laws or regulations are included in the contractual terms would not meet the objective of consistent classification for economically similar instruments. Instead, these approaches could increase the risk of structuring opportunities because the classification outcome would be inappropriately influenced by whether and how entities choose to include rights and obligations arising from laws or regulations in the terms of the contract.

In our view, however, the proposed approach, according to which 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, would lead to the same (unsatisfactory) result. With this approach, the classification outcomes depend on the jurisdiction to which the entities or contracting parties belong. Instruments with the same rights and obligations are classified differently if the agreements made between the contracting parties are already contained in the laws and regulations of country A (with the consequence that these may not be taken into account in the classification of the instrument in accordance with IAS 32) – in contrast to country B, in which the agreements made must first be contractually fixed by the contracting parties, with the consequence that in country B the agreements would the taken into account when classifying the instrument in accordance with IAS 32. We note that what constitutes laws and, in particular, regulations is not well defined in the proposal. We do not believe that this is a sensible or appropriate approach.

Moreover, we have the following specific questions about the approach proposed in the ED and its consequences:

- If any repayment obligations of a plain vanilla instrument are enshrined in law in a jurisdiction, would the instrument then have been classified as equity?
- As shareholders' put options are enshrined in law for German partnerships, are these options no longer to be taken into account in the future for classification purposes in accordance with IAS 32? In this case, would the implication be that the definition of equity is met, and the presentation exemption established in paragraphs 16A-16D of IAS 32 in 2008 would become obsolete for such instruments?

  We would like to point out that in many jurisdictions, comprehensive statutory regulations in civil law (including company law and debt law) determine large parts of the rights and obligations of financial instruments. For example, in Germany, termination rights, compensation claims and the distribution of profits for German partnerships are regulated by law. If these regulations are indispensable, they do not need to be “repeated” in contracts. Individual contractual agreements or provisions in the articles of association, specifications or concretisations are only possible or necessary if a statutory provision is allowed to be modified by contract or absent. If contractual agreements violate mandatory statutory provisions, they are nullified and hence, irrelevant for accounting purposes. In our opinion, legal requirements inevitably have an impact on contractual agreements. The economic substance of the financial instrument is therefore affected by all rights and obligations – regardless of the basis (law, articles of association, individual contractual agreement).

- We are concerned that the formulation “contractual rights and obligations that ... exist *in addition to* the rights and obligations created by relevant laws or regulations” will lead to numerous discussions in practice. In future, the question will arise anew in every jurisdiction as to whether certain contractual provisions are fully or only partially covered by the legislation, which may have a significant impact on the classification decision. The question arises as to whether *in addition to* refers to absolutely every contractual clause or only material clauses. Where is the boundary?

Finally, from the IDW's perspective, while the underlying rationale might be understandable, the proposals are not convincing. They do not provide a clear and unambiguous principle. On the contrary, the proposals give rise to new ambiguities and also harbour the risk of unintended accounting consequences. As long as the IASB does not introduce a clear principle with regard to the (non-)consideration of laws or regulations, we do not see any advantage over the status quo that would justify the cost of changing the guidance. Hence, we suggest that the IASB either provides more clarity on the proposals or keeps the status quo for the time being.

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.

The IDW generally agrees with the IASB's proposal. Firstly, we concur that the clarifications to the fixed-for-fixed condition in paragraph 16(b)(ii) of IAS 32 are consistent with the underlying principle for classifying derivatives as equity instruments and, furthermore, we believe that the clarifications are useful as they codify some of the current accounting practice.

We also consider the introduction of two types of adjustments to the fixed exchange ratio (i.e. *preservation adjustments* and *passage-of-time adjustments*) to be sensible. However, in our view, there are still some ambiguities in the application of the requirements to specific instruments, so we would be grateful to the IASB for additional explanations or further application guidance. Therefore, additional guidance and examples on the determination of and differentiation between preservation adjustments and passage-of-time adjustments would be helpful.

Regarding passage-of-time adjustments, we generally question whether, and if so, under what conditions, a variable interest rate can be regarded as a passage-of-time adjustment. In this context, we would also like to know:

- <u>With reference to Illustrative Example 14:</u> Is the fixed-for-fixed condition met for a variable rate convertible loan where both the principal amount and accrued interest are added to the amount to be converted? From our point of view, such a case would be comparable to a fixed-rate loan that meets the fixed-for-fixed criterion.

- <u>With reference to Illustrative Example 20</u>: Is the fixed-for-fixed condition met for derivatives where the strike price varies either (a) with an interest rate benchmark that only represents the time value of money relevant to the derivative or (b) with an inflation index that is not leveraged and relates to inflation in the issuer's own economic environment? In both cases, the adjustment is based on a predetermined formula where the inputs to the formula vary only with time (i.e., time is the only input).

With regard to implementation of the new requirements in practice, further application guidance and examples would be helpful, in particular on determining the present value and considering the implicit influence of change of control clauses.

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:*

> *(i) 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.*
>
> *(ii) 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.*

The IDW appreciates the IASB's discussion on accounting for contracts that oblige an entity to purchase its own equity instruments, in particular, derivatives such as written put options on non-controlling interests (NCI puts) as there is much diversity and regulatory scrutiny in practice.

The specific requirements for recognising and presenting obligations to repurchase own equity in accordance with paragraph 23 of IAS 32, i.e., recognising a financial liability for the present value of the redemption amount by removing the amount from equity, lead to numerous uncertainties and discussions in practice. In our view, many of these application issues could easily be eliminated if derivative accounting were applied. However, abolishing the gross recognition of financial liabilities (and thus paragraph 23 of IAS 32) for this type of contract would represent a fundamental change both conceptually and in terms of existing practice. As rightly stated in paragraph 69 of the Basis for Conclusions, reconsidering the gross presentation requirement in paragraph 23 of IAS 32 would go beyond the scope of the project and is therefore not in line with the IASB's current objective, i.e. focusing on practical issues that can be resolved efficiently and effectively without fundamentally changing IAS 32.

With this in mind, we comment on the proposed clarifications as follows:

a) We agree that the requirements in IAS 32 for contracts containing an obligation for an entity to purchase its own equity instruments should 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) Despite the clarifications, the inconsistency between IFRS 10 and IAS 32 remains. From our point of view, it still appears counterintuitive to recognise a potential redemption amount as a liability (reflecting a claim from NCI) while continuing to recognise the related NCI in equity 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.

   With reference to these proposals, we request further explanation or application guidance on the IASB's view of when an entity has or does not have access to the rights and returns associated with ownership of the equity instruments to which the obligation relates.

c) First of all, we can confirm that there is much diversity in practice relating to the initial measurement (in particular, how the present value of the redemption amount is determined) and the subsequent measurement of the financial liability. The IASB now proposes a comparatively simple and pragmatic approach, which could solve a number of application problems, namely initial recognition and subsequent measurement of the financial liability at the present value of the redemption amount.

   The IASB is thereby essentially proposing a third measurement approach for financial liabilities under IFRS for subsequent measurement in accordance with paragraph 23 of IAS 32. Irrespective of the fact that we continue to see neither the reason nor the need to treat a financial liability differently under IAS 32 than under IFRS 9, we believe it is imperative that the IASB also deal with issues relating to the measurement of the financial liability as part of this project and provide further application guidance or illustrative examples for determining the present value of the redemption amount (for situations including those in which the amount payable on redemption is variable).

   Furthermore, with regard to the measurement of the financial liability, we also question whether the approach from paragraph 47 of IFRS 13 should be taken into account, i.e. *"The fair value of a financial liability … is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid"*.

d) We recognise that the proposed clarifications will reduce current diversity in practice and thus improve comparability.

However, from a conceptual perspective, the proposal is unclear. This is a consequence of the continuing inconsistencies between the requirements for recognising and measuring financial liabilities in line with paragraph 23 of IAS 32 and certain requirements in IFRS 9 and IFRS 10.

On the one hand, we agree that the proposal, as set out in paragraph 87 of the Basis for Conclusions, is consistent with some of the requirements in IAS 32, IFRS 9 and IAS 1. On the other hand, the proposal is inconsistent with the current accounting treatment of transactions with owners in their capacity as owners, which have to be accounted in equity. Presenting subsequent measurement changes in profit or loss would, therefore, be counterintuitive.

In addition, the Board's reasoning that, in transactions with owners in their capacity as owners that include a right to acquire shares, it should make a difference whether the right is granted to *all* existing holders of a particular class of equity instruments or only to a subset of them (we refer to paragraph 88 onwards in the Basis for Conclusions) is not convincing. The shareholders (all or some of them) are acting in their capacity as owners. In our opinion, this is the only decisive factor.

e) We consider the proposal to be logical and therefore agree with it.

f) Most of the questions that arise in connection with accounting for the expiry of a written put option are related to its initial recognition and measurement. We therefore refer to our comments above.

With regard to the transitional requirements, we believe the proposed clarifications relating paragraph 23 of IAS 32 should be applied prospectively. Retrospective application would mean a considerable effort for the preparers. Careful consideration should be given to whether the benefits for users outweigh the costs associated with that effort.

Finally, we would like to kindly request that any future amendments to IAS 32 be formulated as clearly and consistently as possible and that, for example, interactions between the proposed amendments presented here and under Question 1 be considered. These amendments may have a significant impact on a large number of German partnerships whose shares must be puttable by law and which currently utilise the exemptions in paragraphs 16A-16D in order to be able to present equity.

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.

The IDW agrees with the proposed amendments to paragraph 25 of IAS 32. This includes the clarification that some financial instruments with contingent settlement provisions may be compound financial instruments with liability and equity components that have to be separated. We believe that these changes can contribute to the harmonisation of accounting practice.

However, we do not agree with introducing paragraph 25A of IAS 32 for the following reasons:

- Firstly, we believe that there is an inconsistency between the scope of application of paragraphs 25 and 25A of the ED. While paragraph 25 of

IAS 32 addresses instruments with settlement provisions that are contingent on the occurrence or non-occurrence of uncertain future events (or the outcome of uncertain circumstances) that are beyond the control of both the issuer and the holder of the instrument, paragraph 25A of the ED addresses instruments with settlement provisions that are contingent on the occurrence or non-occurrence of uncertain future events (or the outcome of uncertain circumstances) that are only beyond the control of the issuer.

- Secondly, we are concerned about the introduction of requirements for the initial and subsequent measurement of the liability component of a compound financial instrument with contingent settlement provisions (and, as a result, the disregarding of the probability and estimated timing of the occurrence or non-occurrence of uncertain future events). This would be consistent with certain requirements of IAS 32 (in particular paragraph 23). On the other hand, such requirements are again in direct conflict with the requirements for the measurement of financial liabilities in accordance with IFRS 9. If the IASB pursues the proposed approach, we believe a scope paragraph would need to be added to IFRS 9 to clarify when the measurement approach in IAS 32 supersedes the general measurement requirements in IFRS 9.
- Furthermore, in our opinion, the proposed requirements for a “gross presentation” of the liability component does not always lead to meaningful results and raises further questions. For example, discounting the settlement amount at the earliest possible settlement date does not seem to be appropriate for start-up companies. We also question how to deal with any differences between the present value of the settlement amount and the fair value at initial recognition.

Overall, we therefore see no additional benefit from the introduction of the paragraph 25A as proposed in the ED compared to the status quo.

In the context of the proposed definition of the term “liquidation”, we believe that a more harmonised and clear definition of the concept of liquidation is necessary. This is particularly due to the fact that a legal definition can vary from one jurisdiction to another.

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.

The IDW appreciates that the IASB has addressed the issue of shareholder discretion, as IAS 32 does not yet contain any requirements in this regard and questions of application regularly arise in practice.

In particular, we agree with the Board's decision to present several factors that an entity must consider when assessing whether shareholder decisions are to be treated as entity decisions, rather than a general principle or specific factor (which we believe is difficult to identify). We believe that these factors will be helpful in practice and support the decision-making process. A case-by-case analysis, however, is still essential for each type of financial instrument issued.

We only have some concerns about the factor (d) of paragraph AG28A. In this context, we consider that the question of how the shareholders' decision-making right at the Annual General Meeting regarding the distribution of the entity's profits to its shareholders should be assessed. In our view, it is unclear whether factor (d) applies in this case, so it would be unlikely that this shareholder decision is treated as an entity decision.

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.

The IDW welcomes the proposed introduction of requirements for the reclassification of financial liabilities and equity in IAS 32.

In our view, the examples in paragraph 32C and paragraph 35A of Application Guidance in the ED are useful and appropriate. However, we are not convinced that the wording in the proposed paragraph 32C of IAS 32 is adequate and precise enough to describe the type of events that lead to changes in circumstances external to the contractual arrangement that require reclassification.

For example, we question whether:

- the reasons the substance of the contractual agreement changes matter. For example, are only changes to the law or regulation meant or, more generally, all events that are beyond the control of one or both parties to the contractual arrangement?
- it is appropriate to prohibit reclassification except in the cases provided for. What about changes that only become so substantial over time that the reason for classifying them as financial liabilities, for example, no longer applies? What about contractual agreements whose substance simply changes because a contractual term changes or options expire due to the passage of time?

In summary, in our view, the proposed wording of paragraph 32C of IAS 32 of the ED does not adequately reflect the examples of reclassifications presented. We therefore propose at least the following amendment: *„Changes in circumstances external to the contractual arrangement arise from events not specified in the contract ~~that have not been considered in classifying the financial instrument on initial recognition.~~"*).

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.

In general, the IDW supports the IASB's efforts to improve transparency and understandability of financial instruments, including the addition of disclosure requirements about equity instruments or equity components of compound instruments that are in the scope of IAS 32 or about the terms and conditions of financial liabilities and equity instruments issued by an entity. We also welcome the IASB's intention to locate such disclosure requirements in one place and not spread them across several standards. However, we have concerns that some of the additional disclosures proposed in IFRS 7

(i) overlap with the disclosures required by other IFRSs, and

(ii) are not appropriate in their level of detail, i.e. the cost of providing the information for preparers seem to outweigh the benefit to users.

(a)-(c): Firstly, we agree with both the proposed extended objective and scope of IFRS 7 and the transfer of paragraphs 80A and 136A from IAS 1 to IFRS 7. In connection with the scope of IFRS 7, however, the question arises as to whether and, if so, which disclosure requirements are relevant for payment obligations that do not fall within the scope of IAS 32, i.e. for payment obligations that do not arise from a financial instrument.

(d): We have significant concerns about the proposed additional disclosure requirements in paragraph 20(a)(i) of the ED due to cost-benefit considerations. In this context, we recommend that the IASB undertake further outreach activities to verify the need for these disclosures.

(e): We agree with the proposed disclosure requirements for compound financial instruments in the new paragraph 17A of IFRS 7.

Our comments on the proposed paragraphs 30A-30J and B5A-B5 in Application Guidance for IFRS 7 in the ED are as follows:

(a): In general, we agree that additional information about the nature and priority of financial liabilities and equity instruments on liquidation would be useful to users of financial instruments. However, there are concerns on whether providing such detailed information, in particular at group level, could be operationalised in practice.

In our view, distinguishing between subordinated and non-subordinated claims will pose considerable challenges in practice, as it is often difficult to determine whether the priority of a claim arises from the contract or from the relevant laws or regulations. The jurisdiction in which the entity is domiciled or operates plays a decisive role here. For example, in many jurisdictions payments to the government have precedence, which means that all other liabilities are subordinated regardless of the terms of the contract.

(d): Further, we appreciate the necessity to provide information about dilution that could arise from any potential increase in the number of issued ordinary shares. However, having consistency within and between the standards in mind, we prefer addressing the shortcomings of information in IAS 33 by amending or replacing that standard rather than supplementing the disclosure requirements of IAS 32.[2]

Overall, the Board must strike a balance between aggregation of information and potential loss of informational value. In this context, we renew our recommendation that the IASB carry out further outreach activities to verify the need for, and the level of detail of, the proposed new disclosure requirements in IFRS 7. In this respect, it is important to understand how users process the information.

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

[2] In this context, we would like to refer to the earlier project "Tax Arising from Payments on Participating Equity Instruments" on IAS 33, in which critical issues have already been identified and the IASB gained valuable initial insights.

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.

In general, we support the idea of providing additional information on amounts attributable to ordinary shareholders. In our view, a further disaggregation of amounts or components of equity can increase the informational value of the financial statements.

However, we consider the practical implementation of the proposals to be challenging in many cases. For example, a number of questions arise with regard to the allocation of the issued capital and the reserves to ordinary shareholders of the parent and other owners of the parent in the statement of financial position and statement of comprehensive income, particularly if the issued capital (consisting of multiple classes of shares) or the reserves have several subcategories.

We also question to whom the reserve is attributable if an entity – in the case of an obligation to redeem an entity's own equity instruments – does not yet have access to the rights and returns associated with ownership of the equity instruments to which the obligation relates and therefore continues to recognise those equity instruments.

From our point of view, further questions arise regarding

- the presentation of certain items within equity, such as share premiums, retained earnings, dividend pushers and translation differences; and
- the treatment of specific instruments, such as those that pay a fixed rate coupon, where the issuer has the right to defer payment until its liquidation (for example, whether or not profit or loss and comprehensive income should be attributed to other owners of equity only when dividends or coupons are declared, or whether any unpaid amounts are required to be accumulated and attributed).

Additional application guidance and illustrative examples would be very helpful and could facilitate the implementation of the final requirements. Further, the interaction between the proposed requirements and IAS 33 is also unclear from our point of view. A definition of the term "ordinary shareholders of the parent" would be helpful, including a clarification of whether, and if so what, differences exist to the definition of "ordinary shares" under IAS 33.

We certainly agree that, in addition to the classification of financial instruments, improved presentation and disclosure can also contribute to increasing the informational value. However, in view of the considerable need for improvement and clarification we are of the opinion that the entire complex of issues should be better addressed in a separate project on IAS 1 or IFRS 18 *General Presentation and Disclosures*, and not as a part of the FICE-project.

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.

(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 agree that full retrospective application of the proposed amendments will provide users of financial statements with the best possible information, thereby improving consistency and facilitating the analysis of financial information.

We believe that the proposed amendments are largely clarifying amendments and additions to the existing requirements of IAS 32. Nevertheless, we believe that these amendments presented in the ED will potentially lead to more changes in the classification of financial instruments in practice than originally envisaged. We also believe that the proposed additional disclosure requirements under IFRS 7 will lead to considerable efforts for the preparers. Therefore, the impact of the fully retrospective approach should be carefully considered in terms of timing and cost-benefit analysis.

We recommend that the Board consider, among other things, whether "grandfathering" should be permitted for existing instruments or a subgroup thereof, for example with regard to the proposed amendments or additions to obligations to purchase an entity's own equity instruments and reclassifications of financial liabilities and equity instruments. In our view, this could provide significant relief to preparers.

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 the IDW's opinion, amending IFRS 19 *Subsidiaries without Public Accountability: Disclosures* is necessary and sensible due to the proposed amendments to IFRS Accounting Standards in this ED. However, in this context, we would like to refer once again to our comments on questions 7 and 8 of the ED.

We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely

Bernd Stibi
Technical Director
Financial & Sustainability Reporting

Kerstin Klinner
Senior Technical Manager
Financial & Sustainability Reporting