IFRS® Accounting

Staff paper

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Topic	**Feedback analysis—disclosures**
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Purpose of the paper

1. In this paper the staff analyse the detailed feedback from comment letters and outreach on some of the disclosure proposals in the Exposure Draft *Financial Instruments with Characteristics of Equity* (the ED) issued in November 2023. Agenda Paper 5C for this meeting contains the staff's summary of the detailed feedback.

2. At this meeting, the staff will seek input from IASB members on potential changes to the proposed amendments related to some of the disclosure proposals in response to the feedback and on the timing of finalising these amendments. This paper does not ask for any decisions from the IASB. The other disclosure proposals will be discussed at a future meeting.

3. This paper is structured as follows:

   (a) staff's preliminary views and next steps;

   (b) question for the IASB; and

   (c) staff analysis.

Staff's preliminary views and next steps

4. Considering feedback on the ED, the staff think the proposed disclosure requirements could be further refined to reduce the burden on preparers while still meeting the needs of users of financial statements. Some of the potential refinements that could be made include areas such as:

   (a) the scope and objective of IFRS 7 *Financial Instruments: Disclosures,* for example:

      (i) including 'puttable instruments and obligations arising on liquidation' classified as equity instruments applying paragraphs 16A–16D of IAS 32 *Financial Instruments: Presentation* in the scope of the 'nature and priority of claims' and 'terms and conditions' disclosures;

      (ii) allowing cross-referencing by including the references to the proposed disclosure requirements within paragraph B6 of IFRS 7;

   (b) the terms and conditions about compound financial instruments and financial instruments with both financial liability and equity characteristics, for example:

      (i) including compound financial instruments in the scope of draft paragraphs 30C–30E of IFRS 7 and deleting draft paragraph 17A(a) of IFRS 7 about the terms and conditions of the compound instrument that determine its classification;

      (ii) deleting draft paragraph 17A(b) of IFRS 7 about the amounts allocated on initial recognition to the liability and equity components;

      (iii) scoping out particular equity-like characteristics in financial liabilities from the disclosure requirements, such as subordination features (draft paragraph B5F(a)(iii) of IFRS 7) and settling the instrument by delivering own equity instruments (draft paragraph B5F(b) of IFRS 7);

      (iv) deleting the proposed disclosure requirements for terms and conditions about priority in draft paragraphs 30E(a)–30E(c) of IFRS 7 and only

requiring the information in draft paragraph 30E(d) of IFRS 7 about any intra-group arrangements; and

(v) providing application guidance to explain that debt and equity-like characteristics are the shared characteristics that would cause instruments to be aggregated into classes and an illustrative example of the terms and conditions of a financial liability with equity-like characteristics;

(c) the nature and priority of claims on liquidation, for example:

(i) changing the scope to include financial liabilities in the scope of IAS 32 that arise from transactions that involve only the raising of finance applying the principles in IFRS 18 *Presentation and Disclosure in Financial Statements* and equity instruments issued to raise finance;

(d) the potential dilution of ordinary shares, for example:

(i) renaming the title of the proposed disclosure to 'maximum dilution of ordinary shares';

(ii) clarifying that off-balance sheet commitments should be considered;

(iii) including examples of information that could be provided in the description of the terms and conditions that are relevant in understanding the likelihood of the maximum dilution of ordinary shares (eg exercise prices and whether anti-dilutive at reporting date); and

(iv) clarifying that in some cases, the number of shares in share buy-back arrangements may be unknown.

5. The staff will discuss the potential changes to the disclosure proposals with consultative groups and seek their input on the timing of finalising these amendments before bringing them back to the IASB for further discussion and decision-making at a future meeting.

Question for the IASB

Question for the IASB
Do you have any questions or comments about the staff's preliminary views, analysis and next steps?

Staff analysis

Scope and objective of IFRS 7 including the overall proposals

Scope and objective of IFRS 7

6. As noted in paragraph 15 of Agenda Paper 5C for this meeting, most respondents that commented on the expanded scope and objective of IFRS 7 agreed with the proposal because it would improve transparency by requiring disclosures for both financial liabilities and equity instruments. However, to address the concerns about potential disclosure overload, the staff think the scope of the disclosures for 'terms and conditions' (see paragraphs 25–36 of this paper) and 'nature and priority of claims on liquidation' (see paragraph 64–77 of this paper) could be further refined.

7. In response to feedback noted in paragraph 16(d) of Agenda Paper 5C for this meeting, the staff considered the applicability of the proposed disclosures to members' shares in cooperative entities classified as equity applying IFRIC 2 *Members' Shares in Co-operative Entities and Similar Instruments* (IFRIC 2 instruments).

8. Paragraphs 7–8 of IFRIC 2 state that members' shares are equity if the entity has an unconditional right to refuse redemption or redemption is unconditionally prohibited by local law, regulation, or the entity's governing charter. Therefore, in the staff's view, IFRIC 2 instruments would be subject to the relevant proposed disclosure requirements. There is no reason to exclude them from the scope of the proposed disclosure requirements related to terms and conditions and nature and priority of

claims. Including them within the scope of the proposals would achieve the objectives of the proposals (see paragraph 4 of Agenda Paper 5C of this meeting).

9. The staff note that classifying puttable instruments and obligations arising on liquidation as equity instruments (applying paragraphs 16A–16D of IAS 32) is an exception to the principles in IAS 32 which require instruments containing contractual obligations for the issuer to repurchase or redeem to be classified as financial liabilities. For this reason, paragraph 3(f) of IFRS 7 excludes these types of instruments from the scope of the disclosures in IFRS 7 related to financial liabilities. The IASB decided to maintain this scope exception for puttable instruments and obligations arising on liquidation and merely include them in the scope of IFRS 7 for the paragraphs proposed to be relocated from IAS 1 *Presentation of Financial Statements* relating to disclosures about reclassification and puttable instruments.

10. However, puttable instruments and obligations arising on liquidation, similar to IFRIC 2 instruments, are part of the entity's capital structure. Therefore, the staff are of the view that such instruments should also be included within the scope of the proposed disclosure requirements related to terms and conditions and nature and priority of claims (see paragraph 4 of Agenda Paper 5C of this meeting).

Cross-referencing

11. To reduce the volume of disclosures and avoid duplications, a few respondents suggested the IASB allow cross-referencing to other documents (eg Basel III Pillar 3 *Disclosure Requirements*), similar to the requirements for cross-referencing in paragraph B6 of IFRS 7 related to financial instrument risk disclosures.[1]

12. Based on the ED feedback and the staff's research findings on regulatory disclosures discussed in the February 2021 IASB meeting, the staff think regulatory reports might

[1] B6 The disclosures required by paragraphs 31–42 shall be either given in the financial statements or incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.

contain some information that would be required by the proposals despite their different objectives. Thus, the staff think allowing cross-referencing could alleviate the potential burden on preparers but only if those regulatory reports are available to users of the financial statements on the same terms as the financial statements and at the same time. In the staff's view, the reference to the relevant paragraphs such as draft paragraphs 30A–30E and 30G–30H of IFRS 7 could be added to paragraph B6 of IFRS 7 if the IASB decides to allow further cross-referencing.

Field-testing or further outreach

13. Some respondents suggested that the IASB perform field-testing or further outreach before finalising the disclosure proposals so that the right balance between costs to preparers and benefits for users of financial statements is achieved.

14. As discussed in Agenda Paper 5B for the July 2024 IASB meeting, the staff continue to believe that it is not necessary to conduct further field tests and outreach. The staff has already conducted extensive outreach on the ED proposals with stakeholders prior to the end of the consultation period. In addition, the ED proposals were developed after conducting extensive outreach on refinements to the proposals in the 2018 Discussion Paper *Financial Instruments with Characteristics of Equity*. Due to the number of instruments affected by the proposals, it is also not feasible to test the disclosure proposals on every instrument. The IASB's intention is to develop principles that are robust and able to be applied to new instruments that might arise in the future.

Aggregation/disaggregation and materiality judgements

15. The staff note that some respondents believe the overall reporting burden may be reduced if the IASB provides clarity and application guidance on how disclosures may be aggregated. Similarly, a few respondents mentioned that applying the materiality framework would be challenging because they believe the proposals, especially the 'terms and conditions' and 'potential dilution of ordinary shares' disclosures, require information to be provided on an instrument-by-instrument basis.

16. The staff believe that it is not the IASB's intention to require any proposed disclosures on an instrument-by-instrument basis; this is why the proposed disclosures explicitly refer to 'each class of financial instruments' or 'each class of potential ordinary shares'. In addition, the general principles in paragraphs 41–42 and B110 of IFRS 18 for aggregating and disaggregating information in financial statements would continue to apply, specifically:

> 41(d) aggregate or disaggregate items to disclose information in the notes that fulfils the role of the notes in providing material information […]
>
> 42 Applying the principles in paragraph 41, an entity shall disaggregate items whenever the resulting information is material. […]
>
> B110 Paragraphs 20 and 41(d) require an entity to disaggregate items to disclose material information in the notes. An entity uses its judgement to do this based on an assessment of whether the items have characteristics that are shared (similar characteristics) or characteristics that are not shared (dissimilar characteristics). […]

17. Furthermore, paragraph B3 of IFRS 7 includes guidance on how to determine the appropriate level of disclosures:

> An entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of this IFRS, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics. It is necessary to strike a balance between overburdening financial statements with excessive detail that may not assist users of financial statements and obscuring important information as a result of too much aggregation. For example, an entity shall not obscure important information by including it among a large amount of insignificant detail. Similarly, an entity shall not disclose information that is so aggregated that it obscures important differences between individual transactions or associated risks.

18. Regarding materiality judgements, paragraphs B1–B5 of IFRS 18 provide the overarching principles to help entities make materiality judgements, in particular:[2]

> B1 Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

19. In the staff's view, an entity needs to apply the principles mentioned above for aggregation/disaggregation, including the requirement in paragraph B3 of IFRS 7, when preparing the financial statements. This includes assessing whether information, whether qualitative or quantitative, is material for the purposes of the financial statements. The staff believe IFRS Accounting Standards provide an adequate basis to determine how to apply those principles, thus further clarification of the principles would not be necessary. A cross reference to paragraph B3 of IFRS 7 could be added, where relevant and the staff will consider this when drafting the final amendments.

20. However, the staff acknowledge that entities with large volumes of contracts may encounter operational challenges in determining the appropriate level of disclosures. The staff think it would be helpful if all the proposed disclosure requirements clearly refer to classes of financial instruments. Although paragraph 6 of IFRS 7 states how to group financial instruments into classes, the staff also think the IASB could provide some application guidance on what is meant by 'class', particularly for the proposed terms and conditions disclosures (see paragraphs 38–42 of this paper).[3]

[2] Similar guidance is provided in IFRS Practice Statement 2 *Making Materiality Judgements*

[3] Paragraph 6 of IFRS 7 states: "When this IFRS requires disclosures by class of financial instrument, an entity shall group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. An entity shall provide sufficient information to permit reconciliation to the line items presented in the statement of financial position."

Terms and conditions (draft paragraphs 30C–30E of IFRS 7)

21. The main concern raised by respondents was that the volume of disclosures would significantly increase, especially if information would be required on an instrument-by-instrument basis when the terms were not exactly the same.

22. The staff note that the IASB's intention with the proposed disclosure was neither to require disclosure on an individual instrument level nor to require disclosure of all the terms and conditions of particular instruments. The IASB only proposed to require disclosure of those terms and conditions that are needed to understand the nature, timing, amount and uncertainty of future cash flows.

23. Feedback from current and past consultations on this topic indicated that the focus should be on 'complex' financial instruments, although there does not appear to be a consistent description of what stakeholders consider to be complex instruments. We therefore continue to be of the view that the focus should remain on financial instruments with both financial liability and equity characteristics. Without such focus, it would be very subjective to provide the disclosures based on what entities regard as complex instruments.

24. However, the staff considered whether the scope of the financial instruments to which the proposed requirements would apply, could be further refined to respond to concerns about potential disclosure overload while still satisfying the information needs of users of financial statements. In addition, the staff explored whether, or to what extent, the proposed disclosures are already covered by other requirements.

Scope of terms and conditions disclosure

25. As discussed in paragraphs 7–10 of this paper, the staff think puttable instruments and obligations arising on liquidation and IFRIC 2 instruments which are classified as equity instruments would be included in the scope of the proposals because they contain 'debt-like' characteristics.

Which debt-like characteristics and equity-like characteristics?

26. As explained in paragraph BC203 of the Basis for Conclusions of the ED, the IASB proposed to require more information about financial instruments with both financial liability and equity characteristics in response to the needs from users of financial statements to better understand the nature and characteristics of these instruments.

27. Draft paragraphs B5B–B5F of IFRS 7 proposed application guidance and examples on the meaning of 'equity instruments with debt-like characteristics' and 'financial liabilities with equity-like characteristics'. To reduce the potential burden on entities, the staff considered whether some of these particular debt-like or equity-like characteristics could be excluded from the scope of the proposed requirements.

28. In doing so, we considered whether the information would be provided as part of other disclosure proposals and if the characteristics are needed to achieve the objectives of the disclosure.

Debt-like characteristics in equity instruments	**Staff consideration**
Fixed or determinable amounts	
Perpetual instruments and irredeemable preferred shares with **fixed cumulative coupons and specified coupon dates** and a fixed principal amount	Entities are expected to be exposed to the specified cash outflows on specified dates from issuing these instruments and information about these characteristics is necessary for investors to understand the nature, amount, timing and uncertainty of their cash flows.
Reverse convertible instruments that include a right for the issuer to choose whether to settle in **a fixed amount cash** or a fixed number of shares **at a specified date**	
Perpetual instruments that can be redeemed by the issuer after a specified number of years for **a fixed amount** of a specified currency.	

<table>
<tr><td colspan="2">Incentives to make payments of fixed or determinable amounts</td></tr>
<tr><td>Perpetual instrument with cumulative coupon payments at an increasing rate if it is not redeemed</td><td rowspan="2">Entities are reasonably expected to be exposed to the specified cash outflows from issuing these instruments and this information is necessary for investors to understand the nature, amount, timing and uncertainty of their cash flows.</td></tr>
<tr><td>Perpetual instrument with contractual features that may create preference to pay a specified amount of coupons
(eg dividend stopper)</td></tr>
</table>

Equity-like characteristics in financial liabilities	**Staff consideration**
Variable or indeterminable amounts	
Payments based on the entity's financial performance, position or share price (eg based on a specified % of **profit or** the entity's **share price** at settlement date)	Entities are exposed to uncertain cash outflows and this information is necessary for investors to understand the nature, amount, timing and uncertainty of their cash flows.
Loss-absorption or subordination	
Reduction in principal amount upon the occurrence of a specified decline in the issuer's capital ratio	Entities are exposed to uncertain cash outflows and this information is necessary for investors to understand the nature, amount, timing and uncertainty of their cash flows.
Payments are made only after settling other obligations (eg subordinated debt instrument)	Users of financial statements are likely to get this information from the proposed nature and priority of claims disclosures in draft paragraphs 30A–30B of IFRS 7
Avoid transferring cash for a specified period of time	
Redeemable instrument with **the right to defer** coupon payments for a specified period of time	Entities are exposed to uncertain cash outflows and this information is necessary for investors to understand the nature, amount, timing and uncertainty of their cash flows.

Settle by transferring own equity instruments instead of cash	
Settling instruments by delivering a variable number of own equity instruments	Users of financial statements are likely to get this information from the proposed potential dilution disclosures in draft paragraphs 30G–30H of IFRS 7
Indirect obligations where the issuer has the choice to settle in cash or shares whose value substantially exceeds the cash value	Users of financial statements are likely to get this information from the proposed potential dilution disclosures in draft paragraphs 30G–30H of IFRS 7

29. Considering these debt-like and equity-like characteristics, the staff are of the view that some of the equity-like characteristics in financial liabilities such as subordination or settling instruments by delivering entities' own equity instruments could be excluded from the terms and conditions disclosures. This information would not be lost because it would be provided by 'nature and priority of claims on liquidation' and/or 'potential dilution' disclosures that would be required by draft paragraphs 30A–30B and 30G–30H of IFRS 7, respectively.

30. Therefore, an entity would not be required to provide the proposed disclosures for any instruments with these characteristics only. In the staff's view, scoping out those characteristics would help to reduce the potential burden on preparers while still meeting the information needs of users of financial statements.

Compound financial instruments

31. The staff note that some respondents thought the information required by draft paragraph 17A of IFRS 7 would be captured by the proposed requirements in draft paragraphs 30C–30D of IFRS 7. This is due to a perceived confusion that 'financial instruments with both financial liability and equity characteristics' would include compound financial instruments as well as the fact that both sets of requirements would require disclosure of the terms and conditions of the instrument that determine its classification.

32. In the staff's view, the requirements in draft paragraph 17A of IFRS 7 were meant to apply to compound financial instruments, which consist of both financial liability and equity *components*. Paragraph 28 of IAS 32 requires the issuer of a non-derivative financial instrument to evaluate the terms of the financial instrument to determine whether it contains both a liability and an equity component and classify such components separately as financial liabilities, financial assets or equity instruments.

33. On the other hand, '*financial instruments with both financial liability and equity characteristics'* were meant to apply to a financial instrument recognised in its entirety as either a financial liability with equity-like characteristics or an equity instrument with debt-like characteristics.

34. Therefore, unless either the financial liability or equity component of a compound instrument has cash flow characteristics that are not representative of their classification, those components would not have been in the scope of draft paragraphs 30C–30E of IFRS 7.

35. However, the staff acknowledge respondents' view that compound financial instruments could be considered as financial instruments with both financial liability and equity characteristics because prior to separation, the instrument has characteristics of both financial liability and equity. We also note that draft paragraph 30E(a) of IFRS 7 require disclosure of terms and conditions that could lead to a change in priority on liquidation and the example of conversion features could arise in a compound financial instrument (eg convertible bonds) if conversion is into a fixed number of own shares.

36. To simplify the disclosures and reduce the perceived confusion about duplication, the staff suggest including compound instruments in the scope of draft paragraphs 30C–30E of IFRS 7.

37. The staff also think that draft paragraph 17A(b) of IFRS 7 should be deleted based on feedback that the amounts allocated on initial recognition to the liability and equity

components were already presented in the statement of financial position and the benefits of providing that disclosure on an ongoing basis may not outweigh the costs.

Aggregation

38. As noted in paragraph 20 of this paper, the staff think it would be helpful to clarify that the information would be provided based on classes of financial instruments and provide additional application guidance on what is meant by ‘class’ of financial instrument for the purpose of the proposed terms and conditions disclosures.[4]

39. The objective of the proposed requirements is to enable users of financial statements to understand how the terms and conditions of financial instruments with both financial liability and equity characteristics relate to their classification and affect the nature, amount, timing and uncertainty of their cash flows. In addition, information is typically required to be aggregated based on the types of financial instruments that share similar characteristics.

40. In the staff’s view, for the purposes of the terms and conditions disclosures, the ‘shared characteristics’ are the debt and equity-like characteristics that would cause instruments to be aggregated. In the illustrative example in draft paragraph IG14E of the Guidance on implementing IFRS 7, the subordinated notes all have fixed rate coupons which reset after initial call date, the issuer has discretion to defer coupon payments and the option to redeem the instrument.

41. These shared ‘debt-like characteristics’ make the subordinated notes a class of instruments even though the terms of each instrument may differ in terms of coupon rates, reset rates, currency, call dates or notional amounts. Entities would need to apply judgement as to how much quantitative and qualitative information to disclose and whether any further disaggregation is necessary so that material information is not obscured.

[4] Draft paragraph 30E of IFRS 7 states that an entity should provide information that enables users of financial statements to understand the priority on liquidation of each class of financial instruments. In contrasts, draft paragraphs 30C–30D of IFRS 7 do not specify the information should be disclosed based on classes.

42. The staff think it would be useful to add application guidance to explain that debt and equity-like characteristics are the shared characteristics that would cause instruments to be aggregated into a 'class' of financial instruments in the context of the terms and conditions disclosures. In addition, the staff think it would be useful, as requested by respondents, to add an illustrative example of the terms and conditions of a financial liability with equity-like characteristics when finalising the amendments.

Potential overlap with other requirements or within the proposals

43. A few respondents pointed out that there is potential overlap between existing and proposed disclosures, or even within the proposed disclosure requirements and asked the IASB to consider addressing this issue to avoid any duplicative information. Examples cited by respondents included:

    (a) equity-like characteristics such as payments of amounts that are variable or indeterminable, or that might not occur on specified dates (in draft paragraph B5F(a) of IFRS 7) might also be captured by the liquidity risk disclosures in IFRS 7; and

    (b) equity-like characteristics such as payments that are directionally consistent with changes in the issuer's financial performance, financial position or share price (in draft paragraph B5F(a)(i) of IFRS 7) might be captured by the requirement in draft paragraph 20(a) of IFRS 7—disclosure of gains or losses on financial liabilities that include contractual obligations to pay amounts that vary with the entity's performance or changes in its net assets.

44. The staff do not think there is a duplication of requirements because the objective of each of these disclosures is different. As explained in paragraph BC204 of the Basis for Conclusions on the ED, the existing disclosure requirements in IFRS 7 are not specifically focussed on financial instruments with both financial liability and equity characteristics and do not capture all relevant aspects of those instruments' terms and conditions.

45. The staff acknowledge that liquidity risk disclosures in paragraph B10A(b) of IFRS 7 about the outflow of cash that could be for significantly different amounts could include some information about 'equity-like characteristics' that might affect the amount of the cash flows the issuer has an obligation to deliver. However, paragraph B10A(b) of IFRS 7 could also provide disclosures about changes in amounts due to interest rate risk or net vs gross settlement.

46. In addition, the information that would be required by draft paragraph 20(a) of IFRS 7 is to help users of financial statements understand the impact on profit or loss recognised for the period of changes relating to the issuing entity's performance or changes in its net assets. The information provided by draft paragraphs B5F(a)(i) of IFRS 7 explains the 'equity-like' characteristics that are not representative of the financial liability's classification.

47. The staff think it could be helpful to clarify that an entity need not duplicate information already presented elsewhere, provided the information is incorporated by cross reference, similar to the wording in paragraph 35C of IFRS 7 (relating to credit risk disclosures provided outside the financial statements). However, in our view, because the objectives of the proposed disclosures are clear, clarification by the IASB would not be necessary.

Priority on liquidation (draft paragraph 30E of IFRS 7)

48. These proposed disclosures were in response to the needs of users of financial statements to understand the risks and returns, and the priority on liquidation of financial instruments with both financial liability and equity characteristics.

49. The staff note that respondents raised significant concerns about disclosing the terms and conditions about priority on liquidation as proposed in the ED. As noted in paragraph 25 of Agenda Paper 5C for this meeting, a few respondents suggested the proposed requirements should be removed because they do not consider it to be useful to the decision-making of users of financial statements. The staff therefore considered

the feasibility and usefulness of each of the proposed disclosures in the light of the feedback.

Indication of and possible changes to priority and contractual subordination of instruments (draft paragraphs 30E(a)–30E(b) of IFRS 7)

50. Respondents raised concerns about the operational complexity of preparing and providing this information when there are multiple subsidiaries in a consolidated group from different jurisdictions or extensive intra-group financing arrangements. Respondents also noted that information about priority on liquidation would be of limited relevance for entities in the financial services sector because the resolution process is intended to prevent liquidation of entities in most cases. In their view, disclosing this information would be impracticable in most situations.

51. The staff acknowledge that disclosing this information at a consolidated level would be complex and subject to operational challenges because liquidation occurs at the individual legal entity level (see paragraph 81 of this paper). This fact is illustrated in IE14E of the Guidance on implementing IFRS 7 where the disclosure refers to the indication of priority relevant to the 'respective issuing companies'.

52. The staff also acknowledge feedback questioning the relevance of the information when the entity is a going concern or a financial institution subject to regulatory resolution measures aimed at preventing liquidation from occurring. The staff note that users of financial statements asked for information about the actual order of priority of instruments so may not find disclosure of the fact that there are multiple levels of subordination in a class of instruments to be useful to their needs.

Significant uncertainty from laws or regulation (draft paragraph 30E(c) of IFRS 7)

53. Respondents raised multiple concerns about this requirement, including:

    (a) how entities might assess whether there is 'significant uncertainty';

(b) significant costs and efforts that would be incurred to analyse all relevant laws or regulations that could affect priority on liquidation and to obtain legal advice to provide meaningful information; and

(c) disclosing information that might be sensitive or prejudiced.

54. During the initial outreach on the 2018 Discussion Paper, stakeholders raised concerns about the cost and complexity if entities were required to obtain legal opinions and disclose information covering different scenarios where there is uncertainty over legal outcomes. In developing the proposals in the ED, the IASB proposed requiring a narrative disclosure to provide users of financial statements with relevant information or at least a starting point from which they could perform further assessments. The IASB hoped that this would allow entities to provide the information without having to obtain legal opinions or predict the likely outcomes of bankruptcy court ruling.

55. As explained in paragraph BC218 of the Basis for Conclusions on the ED, contracts commonly include a caveat about laws or regulations that might affect the priority of financial instruments on liquidation of an entity. Therefore, the contractual priority was intended to be in line with the applicable laws and the legal framework that the contract is subject to, and the disclosure should reflect such priority.

56. As acknowledged in the ED, the application of relevant laws or regulations may result in uncertainty in how the priority will be determined at liquidation. We think the IASB's intention was not to require entities to predict what legal outcomes at liquidation may be in providing this disclosure.

57. However, we acknowledge stakeholders' concerns about providing this narrative disclosure because laws or regulations could affect the priority of financial instruments in many ways and it would be challenging to consider all the relevant aspects of their implications. We also agree that a generic statement about the existence of caveats such as those discussed in paragraph 55 of this paper, is unlikely to be useful to users of financial statements.

A description of any intra-group arrangements (draft paragraph 30E(d) of IFRS 7)

58. As explained in Agenda Paper 5B for the July 2024 IASB meeting, some users of financial statements mentioned the limitations of the disclosures on nature and priority of claims on liquidation due to its focus on contractual subordination. They said that structural subordination should be considered in addition to contractual subordination.

59. The staff are of the view that users of financial statements would obtain some information about structural subordination through the proposed requirement to distinguish between financial instruments issued by the parent and those issued by subsidiaries in draft paragraph 30B(b) of IFRS 7. In addition, the staff believe that the disclosure about intra-group arrangements continues to be needed to provide users of financial statements with some information about structural subordination because intra-group arrangements (eg guarantees from the parent to the subsidiary's creditors) might affect the priority of these financial instruments on liquidation of the entity that issued them.

Conclusion

60. Therefore, considering the feedback and the intended benefits to users of financial statements compared to the potential costs to preparers, the staff are of the view that the IASB could remove the proposed disclosure requirements in draft paragraphs 30E(a)–30E(c) of IFRS 7.

61. The staff also note that the proposed disclosure on the nature and priority of claims on liquidation (discussed in the next section of this paper) would provide users of financial statements with an overall picture of an entity's ownership structure and categorise claims based on their level of security and subordination. The staff also think users of financial statements can obtain some information about terms and conditions that could lead to a change in priority on liquidation from the proposed potential dilution disclosures. For example, if a financial instrument includes a conversion feature, this information would be disclosed as part of the 'potential dilution disclosures'.

Nature and priority of claims on liquidation (draft paragraphs 30A–30B of IFRS 7)

62. The IASB proposed disclosures about an entity's financing structure in response to the request from users of financial instruments for information to help them assess the nature of these claims against the entity and understand how the claims affect the entity's liquidity and solvency. The IASB specifically considered the scope of the proposed disclosures and decided for simplicity and comparability purposes that the disclosures would apply to all financial liabilities and equity instruments in the scope of IAS 32 rather than developing a definition of 'capital structure'.

63. Although some respondents agreed with the proposed disclosure requirements, most were concerned about the scope of the disclosures, potential practical difficulties of providing the information and the usefulness of the information to users of financial statements.

Scope

64. Respondents expressed mixed views on the scope of the proposed disclosure requirements. A few mentioned that the disclosure would not provide a complete view of what would happen on liquidation because the scope of the disclosure is limited to financial liabilities and equity instruments in the scope of IAS 32. In contrast, a few respondents suggested further limiting the scope of this disclosure to material financial instruments or issued financial securities only.

65. In the staff's view, it would not be appropriate to include all of an entity's liabilities and equity instruments (including those outside the scope of IAS 32). Such a requirement would extend beyond the scope of this project and could require entities to make speculative judgements about the circumstances of a hypothetical liquidation situation. Instead, the staff think it would be more appropriate to explore other alternatives to the scope of this proposed disclosure while ensuring that the users of financial statements are still provided with useful information.

66. Firstly, the staff considered the suggestion to limit the scope of this requirements to instruments in the scope of IFRS 7 because these disclosure requirements would be located in that Standard. The staff note that the scope of IAS 32 and IFRS 7 is largely consistent except for:

(a) the exclusion of puttable instruments and obligations arising on liquidation from IFRS 7; and

(b) the inclusion of unrecognised financial instruments in the scope IFRS 7.

67. Given that the proposed disclosure requirements in draft paragraphs 30A–30B of IFRS 7 are intended to be required for all of an entity's financial liabilities and equity in the scope of IAS 32, the staff understand the IASB's intention was to include all 'recognised financial instruments' that are part of the entity's financing structure at the reporting date. IFRS 7 includes unrecognised financial instruments in its scope and therefore, the staff think it would not be appropriate to align the scope of the proposed disclosure requirements with the scope of IFRS 7.

68. The staff note that the following financial instruments are already scoped out of the proposed disclosure requirements:

(a) employers' obligations arising from employee benefit plans, to which IAS 19 *Employee Benefits* applies;

(b) insurance contracts as defined in IFRS 17 *Insurance Contracts* or investment contracts with discretionary participation features within the scope of IFRS 17 (other than those specified in paragraph 4(d)(i)–(v) of IAS 32);

(c) financial instruments, contracts and obligations under share-based payment transactions to which IFRS 2 *Share-based Payment* applies (other than those specified in paragraph 4(f)(i)–(ii) of IAS 32 as well as the proposed disclosure requirements in draft paragraphs 30G–30H of IFRS 7); and

(d) lease liabilities[5] arising from leases, to which IFRS 16 *Leases* applies.

69. To further reduce the scope of financial instruments required by the proposed disclosures, the staff considered the suggestion from respondents to limit the requirement to 'financial securities' that are issued. The staff note that 'financial securities' is not defined or referred to in IFRS Accounting Standards. We understand that it is meant to refer to a subset of financial instruments that are issued. These issued securities would usually have a term sheet or prospectus but the staff think it is not possible to conclude that other contracts and agreements do not result in issued securities. The staff further understand that issued financial securities would exclude items like loans payable, trade payables (whether as part of a supplier chain financing transaction or not), other accruals, deposits, lease liabilities and equity reserves. However, some of these items like loans payable and supplier financing arrangements might be an important part of an entity's financing structure. As such, we do not intend to explore this alternative further.

70. The staff also considered the definition of financing activities in IAS 7 *Statement of Cash Flows* as activities that result in changes in the size and composition of the contributed equity and borrowings of the entity. Paragraph 17 of IAS 7 includes as examples of cash flows from financing activities:

(a) cash proceeds from issuing shares or other equity instruments;

(b) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings; and

(c) cash payments by a lessee for the reduction of the outstanding liability relating to a lease.

71. Following the principles in IAS 7 would result in expanding the scope of the proposed disclosures to lease liabilities. On the other hand, paragraph B53 of IFRS 18 includes

[5] Paragraph AG9 of IAS32 clarifies that a lessor regards a finance lease as a financial instrument, while the lessee's obligation is not specified. Furthermore, lease liabilities are not subject to disclosures required by IFRS 7. A maturity analysis of lease liabilities is required by paragraph 58 of IFRS 16. However, the proposed illustrative example (paragraph IG14C of the Guidance on implementing IFRS 7) erroneously includes 'lease liabilities' and this will be fixed in the final amendments.

lease liabilities as 'liabilities arising from transactions that do not involve only the raising of finance'.

72. The staff therefore considered 'liabilities that arise from transactions that involve only the raising of finance' in paragraph 59(a) of IFRS 18 that are used to determine which income and expenses to classify in the financing category. Paragraph B50 of IFRS 18 explains that in such transactions, an entity:

(a) receives finance in the form of cash, or an extinguishment of a financial liability, or receipt of the entity's own equity instruments; and

(b) at a later date, will return in exchange cash or its own equity instruments.

73. Paragraph B51 of IFRS 18 provides examples of liabilities arising from transactions that involve only the raising of finance such as:

> B51 […] (a) a debt instrument that will be settled in cash, such as debentures, loans, notes, bonds and mortgages […]
>
> (b) a liability under a supplier finance arrangement when the payable for goods or services is derecognised […]
>
> (c) a bond that will be settled through delivery of an entity's shares […]
>
> (d) an obligation for an entity to purchase its own equity instruments […]

74. Paragraph B53 of IFRS 18 provides examples of liabilities arising from transactions that do not involve only the raising of finance such as:

> B53 […] (a) payables for goods or services that will be settled in cash […]
>
> (c) lease liabilities—an entity receives a right-of-use asset, not finance in the form described in paragraph B50(a)
>
> (d) defined benefit pension liabilities—an entity receives employee services, not finance in the form described in paragraph B50(a) […]

75. The staff think this category ('liabilities that arise from transactions that involve only the raising of finance') provides a good boundary to limit the scope of the disclosures

without compromising the information needs of users of financial statements. In addition, it does not require the IASB to define any specific concept such as 'complex financial instruments', 'capital' or 'issued financial securities'. Thus, the staff are of the view that aligning the scope of financial liabilities that would be subject to the disclosures with 'liabilities that arise from transactions that involve only the raising of finance' in IFRS 18 would provide a proper basis for the refinement. Therefore, the proposal would apply to all financial liabilities in the scope of IAS 32 that 'arise from transactions that involve only the raising of finance' applying the principles in IFRS 18.

76. Similarly, equity instruments issued for the raising of finance would still be included in the table. Therefore, equity reserves and equity derivatives would be scoped out. Derivatives by definition have little or no initial net investment and information about derivatives on own equity would be included in the potential dilution disclosures.

77. As discussed in paragraphs 7–10 of this paper, the staff think puttable instruments and obligations arising on liquidation which are classified as equity instruments would be within the scope of the proposals and IFRIC 2 instruments would also be included because IFRIC 2 applies to financial instruments in the scope of IAS 32.

Practical difficulties and usefulness of the information

78. Most respondents who commented on this proposal expressed concerns about:

(a) the impact of local legislation and liquidation rules for entities operating in multiple jurisdictions and the difficulty to differentiate between claims based on contractual rights and those based on relevant laws or regulations.

(b) the difficulty to collect information and rank the instruments in order of priority at a consolidated entity level because information about liquidation is available for each individual entity rather than at a consolidated entity level.

(c) the potential need for significant judgements to be made to categorise claims.

79. In addition, the staff noted respondents' feedback that information on the priority of claims on liquidation may be of limited relevance in regulated financial institutions, in which regulatory resolution may be a more likely outcome than liquidation.

80. As explained in BC200 of the Basis for Conclusions on the ED, the proposed disclosures are meant to provide information about how the entity is financed, its capital resources and its ownership structure by *categorising* claims based on their contractual features with regards to priority on liquidation. This is not intended to require disclosing the relative ranking of individual financial instruments at an individual entity level.

81. The staff believe that to some extent, the concerns mentioned in paragraph 78 of this paper, arise from a misunderstanding that these disclosures are meant to show the actual order of priority on liquidation of financial instruments. The staff acknowledge that the actual claims on liquidation would be impacted by different factors such as relevant laws or regulations. It is the legal entity information and not information about the consolidated group that would be most useful to the users of financial statements. In addition, some items in the legal ranking are not recognised on the consolidated balance sheet eg investors' costs relating to their claims and there may be internal transfers between consolidated entities in the liquidation process. Therefore, the intention of these disclosures is not to show the order of priority on liquidation.

82. In the staff's view, the objectives of these disclosures are different from those of terms and conditions about priority on liquidation in draft paragraph 30E(a)–30E(c) of IFRS which the staff propose deleting (see paragraphs 50–57 of this paper). As stated in paragraph 80 of this paper, the purpose of this proposed disclosure is to enable users of financial statements to understand how the entity is financed and its ownership structure without having to consider relevant laws or regulations and the assumption that all legal entities within the group are liquidated simultaneously.

83. Some respondents noted that disclosure of this information would bring greater transparency for markets and policymakers and might deter the structuring of

transactions simply to achieve particular reporting outcomes. They noted research on recent market developments, indicating increasing numbers of companies that are employing aggressive strategies to manage their debts and raise finance such as manipulating asset collateral or altering the hierarchy of creditor repayment. [6]

84. The staff therefore remains of the view that it is important for transparent and timely information to be provided to users of financial statements about the nature and priority of contractual claims on liquidation. We therefore do not agree with those respondents that suggested that this proposed requirement be deleted.

Contradicting a going concern view

85. Some respondents commented that providing the information about nature and priority of claims on liquidation would be contrary to the going concern principle and should be required only when there are significant concerns about going concern.

86. As discussed in Agenda Paper 5B for the April 2021 IASB meeting, the staff believe that it is important to provide this information in a timely manner even if there are no significant concerns about going concern. Providing the disclosure only when there are significant concerns about the entity's ability to continue as a going concern would be too late for such information to be decision-useful for investors and/or potential investors.

Potential dilution of ordinary shares (draft paragraphs 30G–30H of IFRS 7)

87. Although some respondents agreed with the proposals, most respondents were concerned about the practical difficulties of providing the required information and the potential burden on preparers because of a perceived overlap with the information provided by IAS 33 *Earnings per Share* for diluted earnings per share (EPS). Some respondents suggested the IASB require reconciliation between the two sets of

[6] Bloomberg UK 3.9.2024 by Eliza Ronalds-Hannon 'The new Rules of Debt are totally cutthroat'

information, while others said the proposed disclosure requirements should be included in IAS 33 rather than IFRS 7.

88. As described in paragraph BC220 of the Basis for Conclusions on the ED, the IASB proposed the disclosure to enable users of financial statements to assess the maximum potential dilution of ordinary shares arising from financial instruments that could be settled in ordinary shares, such as convertible bonds and derivatives on own equity instruments. Such information would enable investors to understand how an entity distributes its returns to ordinary shareholders, how the entity has financed its operations in the past, and how the entity's ownership structure might change in the future.

89. In addition, paragraph BC221 of the Basis for Conclusions on the ED clarified that the IASB does not intend to duplicate or replace information already required by IAS 33. Although entities applying IAS 33 currently provide some information about the potential dilution of ordinary shares when disclosing diluted EPS, the proposed disclosure requirements serve a different purpose and use different assumptions and calculations. Therefore, the staff are of the view that providing a reconciliation between diluted EPS and maximum potential dilution would not be feasible and could lead to further confusion.

90. However, the staff think it would be useful to require entities to provide a qualitative disclosure to explain the link or the difference between maximum potential dilution and diluted EPS as part of the transition disclosures, so that users of financial statements can better understand the objective of the disclosures.

91. As noted in Agenda Paper 5C for the February 2021 IASB meeting, the staff continue to think the disclosures would not be too onerous for entities that currently do not provide IAS 33 disclosures because the disclosure would not require determining the market price of ordinary shares at the reporting date or the average market price over a reporting period. It also does not require any assumptions or judgements to be made about the likelihood of the maximum potential number of shares to be issued.

92. This proposed disclosure is focusing only on the maximum contractual number of shares that could be issued. Considering the needs of users of financial statements, the staff are of the view that the proposal should be applied by both listed and unlisted entities and IFRS 7 is the right place to require the information. Amending IAS 33 is outside the scope of the FICE project.

93. The staff considered feedback that the information could be misleading, such as:

Feedback	**Staff consideration**
Including shares from anti-dilutive instruments could be misleading	The purpose of this disclosure is to inform 'maximum dilution of ordinary shares' regardless of whether instruments are dilutive or anti-dilutive because anti-dilutive instruments could become dilutive in the future. In addition, users of financial statements consider this information to be useful. However, they noted that it would be helpful if anti-dilutive instruments are clearly highlighted in the table. Whether an instrument is anti-dilutive, could be included as an example of the requirement in draft paragraph 30G(d) of IFRS 7 to disclose a description of the terms and conditions of contracts that are relevant in understanding the likelihood of the maximum dilution of ordinary shares.
Having data for maximum dilution would not be useful without information about the probability that this maximum dilution will occur and the other financial effects (ie proceeds) of issuing additional shares	The proposals already include a requirement in draft paragraph 30G(d) of IFRS 7 to disclose a description of the terms and conditions of contracts that are relevant in understanding the likelihood of the maximum dilution of ordinary shares. We think it would be helpful to provide examples of the information that entities could disclose (eg exercise prices of written call

	options). However, disclosing fair value information of derivatives on own equity, or the amount by which an option is out of or in the money, might be an operational burden on preparers. In addition, the information regarding the other financial effects (eg proceeds) could be derived from the terms and conditions. The objective of this disclosure is to focus on the maximum number of additional ordinary shares as a starting point for further analysis.
Maximising potential dilution does not take into account the interaction between different instruments	The increase in the ordinary shares due to the settlement of a particular type of instrument could impact the probability of exercise or number of additional ordinary shares on another type of instrument. However, the purpose of this disclosure is to provide the maximum dilution without considering probabilities as a starting point in user analyses.

94. A few respondents expressed concerns about the granularity of the information. They said providing information on an instrument-by-instrument basis would obscure important information and also would present practical challenges for preparers. On the other hand, users of financial statements said that seeing the maximum dilution for each instrument along with information about the key terms and conditions and the diluting event is useful because the breakdown would enable them to make their own judgements (as noted in paragraph 37 of Agenda Paper 5C of this meeting).

95. However, the staff note that the proposed information is required to be disclosed for each class of potential ordinary shares. Instruments with similar terms can thus be grouped together although if the instrument has dissimilar terms from other instruments, the disclosure may then be on an instrument-by-instrument basis in that each instrument would then be a class on its own.

96. Regarding the use of ‘unknown dilution’ in the disclosures, the staff heard feedback from users of financial statements both in favour of and against disclosing ‘unknown number of shares’ at the reporting date where the number of shares to be delivered depends on the value at settlement date. The IASB had previously discussed this topic and agreed that it would be more accurate to state that the number is unknown and would also be less burdensome for unlisted entities as explained in paragraph BC229 of the Basis for Conclusions on the ED.

97. However, the staff acknowledge that for ‘share buy-backs’ it could be impractical to provide the number of shares the entity is required to repurchase in some cases. As portrayed in draft paragraph IG14G(viii) of the Guidance on implementing IFRS 7, in some cases, the number of shares entities plan to repurchase could vary within a range. However, a few respondents said that share buy-back transactions are often conducted with a cap on the maximum amount expected to be spent rather than on the number of shares. The staff are of the view that it would be reasonable to disclose ‘unknown’ in such cases.

98. In addition, the staff noted feedback that ‘off-balance sheet’ commitments (ie standby facility agreements where an entity can sell shares to investors up to a specified amount) should be included in the proposed disclosure requirements. The staff are of the view that any contract an entity has entered into by the end of the reporting period which could result in the issue of ordinary shares, regardless of whether it is recognised or not, should be included in the disclosure of potential dilution of ordinary shares. Thus, the staff think the IASB could clarify that these off-balance sheet commitments should also be considered when calculating potential dilution of ordinary shares.

99. Finally, the staff think the wording ‘*potential* dilution of ordinary shares’ could cause unintended confusion because ‘potential’ could imply the probability of the dilution should be considered. As the IASB’s intention is to provide users of financial statements with an indication of the maximum dilution ie worst case scenario that

could arise, without considering the probability or likelihood, the staff think it would be more reasonable to label the disclosure as '*maximum* dilution of ordinary shares'.

Transition (draft paragraph 44LL of IFRS 7)

100. A few respondents mentioned that they would need a sufficient transition period considering the expanded disclosure requirements. The staff will further consider feedback on transition including whether any transition relief or transitional disclosures is necessary and present the staff's analysis at a future meeting.