mazars

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La Défense, 29 March 2024

Re: Exposure Draft 2023/5: Financial Instruments with Characteristics of Equity (proposed amendments to IAS 32, IFRS 7 and IAS 1)

Dear Andreas,

Mazars is pleased to comment on the International Accounting Standards Board's Exposure Draft *Financial Instruments with Characteristics of Equity* issued in November 2023.

We welcome and support the Board's objectives and guidelines, which aim to resolve some of the practical problems identified without fundamentally amending IAS 32, as well as the areas identified for clarification.

We agree that most of the Board's proposals will help to reduce the diversity observed in practice. Several proposed amendments will clarify existing requirements in a useful and effective manner.

We have nevertheless identified situations where we believe that the proposals would result in a counter-intuitive or economically inconsistent outcome or would not necessarily provide useful information to users of the financial statements.

We have identified four priority topics that we encourage the Board to reconsider, in order to meet the objectives of clarification and harmonisation of IAS 32 without calling into question the relevance and usefulness of the information provided:

- **the effects of relevant laws or regulations**: we do not support the approach proposed by the Board, which we believe is likely to give rise to concerns given the complexity of the criteria envisaged by the Board, the unexpected consequences on instruments that do not pose interpretation problems in practice, and the operational weight in the implementation of the Exposure Draft analysis criteria;

- **obligations to purchase an entity's own equity instruments**: while we agree on the Board's proposal to apply a 'gross approach' and the initial and subsequent measurement principles based on the full amount of the obligation, we disagree with the Board's proposals regarding the debit entry on the financial liability on initial recognition, and the remeasurement of the financial liability through profit or loss. We believe the outcome of such accounting treatment would not provide users with useful and relevant information and

propose to the Board an alternative view further developed in paragraphs 33 to 47 in appendix to this letter;

- **contingent settlement provisions**: we question the Board's intention to apply to this type of feature the same requirements as for obligations to purchase an entity's own equity instruments, in terms of initial and subsequent measurement. Given the potentially very broad scope of the proposal, questions would arise as to the relationship and consistency of these principles with the measurement requirements in IFRS 9 and IFRS 13.
  We encourage the Board to clarify the scope of this proposal and its practical application in the light of current standards, given the potentially significant and widespread impact it could have.

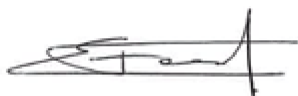
- **reclassification of financial liabilities and equity instruments**: we agree with the proposal to reclassify an instrument when a change of the substance of the contractual arrangement is due to a change in external circumstances, but we disagree with the Board proposal to prohibit reclassification in situations where the contractual arrangement changes because of passage of time only. We consider that requiring a financial instrument to be classified as a financial liability at a reporting date when there is no longer a contractual obligation to deliver cash or another financial asset does not provide relevant and useful information to users of the financial statements;

- **disclosure**: we acknowledge the need to improve the disclosures required in relation to financial instruments with debt or equity characteristics, and the usefulness of the disclosures proposed by the Board.
  However, we believe that the Board should not maintain its disclosure requirements relating to the nature and priority of claims in the event of liquidation and 'equity-like- and 'debt-like' characteristics. We also propose to the Board to move the disclosures relating to potential dilution of ordinary shareholders to IAS 33, because of the operational complexity to provide those disclosures and the limited relevance compared to the potential costs involved.

Our detailed answers are provided in the attached appendix.

We would be pleased to discuss our comments with you and are at your disposal should you require clarification or additional information.

Yours sincerely,



Edouard Fossat

Financial Reporting Technical Support

Appendix

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.

(1) We agree with the practical challenges and inconsistencies identified by the Board in paragraphs BC12 and BC18 of the Basis for Conclusions of the Exposure Draft, when considering the effects of relevant laws or regulations on the classification of financial instruments.

(2) To resolve the inconsistencies identified in practice, consistently with our comment letter on the Discussion Paper in 2018, we are convinced that it is necessary to take into account all the rights and obligations of a contract, including those arising by law, when classifying an issued financial instrument. We do not see any conceptual reason to make a difference between a contractual and a legal obligation. What is relevant is whether there is an obligation to deliver cash, or not. The fact that this obligation stems from a legal or contractual requirement does not change the economic position of the entity.

(3) Whether or not they are replicated in the contract, any legal rights or obligations that may have an impact on the contract are taken into account by investors and contribute to their overall understanding of the instrument issued and the decision to invest or not. We would therefore be in favour of the 'all-inclusive' classification approach as presented in BC14.

(4) Despite our support for an 'all-inclusive' approach, we are aware that this approach would represent a significant departure from the current standard and the current practice, which is largely based on the consideration of contractual rights and obligations alone. An 'all-inclusive' approach could lead to significant classification changes, especially for financial instruments subject to a legal obligation to deliver cash (e.g. ordinary shares with statutory minimum dividends) that would be considered (at least partially) as financial liabilities.

(5) We understand that, given its objectives of clarifying IAS 32 without changing its fundamental principles, the Board has chosen to propose an intermediate approach between an 'all-inclusive' approach and an approach that would only take into account contractual rights and obligations. However, we believe that the approach proposed by the Board raises a number of conceptual and operational problems.

(6) Firstly, we have concerns about the potential unintended consequences this proposal may have on many highly regulated common financial instruments that do not currently raise specific classification issues. For example, we question whether it is the Board's intention to allow some 'puttable' instruments that are currently classified as financial liabilities to meet the definition of an equity instrument (because the obligation for the issuer to redeem the holder is a direct result of the European or local law).

(7) Secondly, we consider that implementing the principles set out by the Board could prove complex from an operational point of view and generate significant costs in terms of legal analysis. Complying with the Board's proposals would require preparers to carry out a detailed analysis in order to identify for each contract the totality of the applicable legal texts, and to draw a clear line between the strict reproduction of legal requirements and the inclusion of rights or obligations additional to those created by relevant laws and regulations.

(8) In addition, the application of the Board's proposal could raise new questions and potential inconsistencies regarding the accounting treatment resulting from the existence or non-existence of rights or obligations over and above the legal provisions of otherwise similar instruments.

(9) Considering the example developed in paragraphs BC23 to BC26 of two ordinary shares subject to a 10% statutory profit distribution obligation, the proposed clarifications would result in:

- a classification of the total amount of the first ordinary share (which merely reflects the strict minimum distribution required by law) as an equity instrument, including the part linked to the legal obligation to pay a dividend of 10%;
- a classification of 15% of the total amount of the second ordinary share as a financial liability, because this instrument creates an additional obligation to distribute 5% of the issuer's profits of the year compared to the obligation established by relevant laws, and because those two elements cannot be considered separately for a classification purpose.

Although the instruments are both subject to the same legal obligation to pay 10% of the issuer's annual profits, we find it counter-intuitive that this same obligation is reflected differently depending on whether an additional contractual right or obligation is attached to it.

(10) If the Board does not wish to consider an all-inclusive approach, we suggest that the Board does not proceed with the proposed amendment because consistent practices and interpretations have nevertheless established in each jurisdiction, and because we are not convinced that the proposal has a favorable cost/benefit ratio.

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.

(11) We welcome and support the Board's proposal to clarify the requirements relating to the fixed-for-fixed condition.

(12) However, we would like to draw the Board's attention to the proposals relating to instruments issued in foreign currencies and the adjustments described as 'passage of time'.

Functional currency denomination

(13) We agree with the Board's analysis expressed in paragraph BC42 of the Basis for Conclusions of the Exposure Draft, that an amount fixed in a foreign currency exposes the entity to a foreign exchange risk and that the instrument would therefore not have a fixed exchange ratio.

(14) However, considering that the mere existence of a foreign exchange risk means that the fixed-for-fixed criterion is not met seems to be too restrictive an approach. Such a strict rule would not take account of the reality and economic environment of the instruments concerned, where many issuers do not have a choice of currency in which they issue. For instance, a private issuance contract might be denominated in the functional currency of the investor, rather than that of the issuer, or an entity that

is listed on a foreign stock exchange might not be able to issue shares at a price denominated in its functional currency.

(15) To reflect this reality in the clarifications of the fixed-for-fixed criterion, we suggest that the Board not limit the currency in which the instrument is denominated to the entity's functional currency.

(16) To this end, we believe it would be appropriate to draw on existing guidance on embedded foreign currency derivatives in a host contract that is an insurance contract or not a financial instrument in IFRS 9.B4.3.8(d). It would seem logical and consistent to us to consider that as long as such a foreign exchange component does not lead to bifurcate it as an embedded derivative, the fixed-for-fixed criterion is not called into question.

(17) In our opinion, such proposition would neither be complex nor costly to implement because it would only align the ‘fixed for fixed’ condition for instruments denominated in foreign currencies with the existing principles in terms of embedded derivative analysis.

Passage of time adjustments

(18) We welcome and agree with the Board's approach on the principle of allowing adjustments linked to the passage of time to meet the fixed-for-fixed criterion.

(19) We understand and agree that passage of time adjustments should be predetermined and vary with the passage of time only. Those criteria would be consistent with generally accepted current practice.

(20) However, we are not sure that we fully understand the Board's objectives regarding the criterion described in paragraph 22C(b)(iii), requiring that such adjustments have the effect of fixing, at initial recognition, the present value of the amount of consideration exchanged for each of the entity's equity instruments. This criterion should be clarified and accompanied by detailed illustrative examples in order to better define the conditions of application of this principle. In particular, the Board could develop examples in which this criterion is validated insofar as the Illustrative Examples provided mainly present cases where the criterion is not met.

(21) We do not understand solely on the basis of the explanations given in BC57 and in Illustrative Example 20, why, if the objective is to allow adjustments reflecting the passage of time, adjustments made on the basis of indexation to a floating benchmark interest rate (such as Euribor) would not meet this criterion. In finance, the passage of time is considered to be reflected by a fixed or variable interest rate.

(22) In our view, this position raises questions given that this type of index, from the perspective of classifying financial assets under IFRS 9, does not call into question the ‘SPPI test’ and is a representation of the time value of money, as stated in IFRS 9.B4.1.13 (instruments B and C) and consistently with IFRS 9.4.1.9A-E.

(23) We suggest that the Board clarifies that, as a matter of principle, the passage of time can be reflected by a fixed interest rate or by a floating interest rate, and once this principle has been established, to specify which specific characteristics of a floating rate could call into question the 'fixed-for-fixed' criterion.

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.

(24) We welcome the Board's objective of bringing consistency to a subject that has seen several practices emerge in the absence of clear guidance in IAS 32, and for which clarifications had already been envisaged but could not be achieved.

(25) A major complication in this type of obligation arises from the cross-analysis and interactions between IAS 32 and IFRS 10 when the entity does not have access to the rights and returns associated with ownership of the equity instruments to which the obligation relates.

(26) While we agree with the ‘gross approach’ proposed by the Board, we strongly disagree with most of the clarifications on the accounting treatment of these obligations. Instead, we propose an alternative view on the treatment of these obligations that we believe is compatible with current standards.

Gross versus net approach

(27) Based on paragraph BC77 and BC78 of the Basis for Conclusions, the Board considers that non-controlling interests (hereafter ‘NCI’) holders hold two separate rights that must be accounted for separately (i.e. two different units of account). We consider this analysis is a possible view and we do not disagree with the Board’s conclusion.

(28) However, we believe that the analysis is only partial and does not take into account the obligations attached to these rights. To be exercised, the right of NCI holders to sell their interests to the entity is indeed accompanied by an obligation to relinquish their rights to the net assets. In the Board's analysis, only the cash outflow relating to this second right is recognised, but not the obligation to give up their claims on the net assets.

(29) By analogy with the recognition of a derivative, the Board's approach would mean recognising only the pay leg of a swap. In our opinion, a strict analysis based on two separate units of accounts would naturally lead to applying a ‘net approach’ (i.e. derivative accounting) when accounting for all the rights and obligations of the instruments held by NCI holders.

(30) However, we are not in favour of a 'net approach’ because it would require a fundamental change to IAS 32.23. The obligation to deliver cash or another financial asset is a higher principle of the standard and provides useful information to users of financial statements about the entity’s exposure to liquidity risk as set out in paragraphs BC69-70 of the Exposure Draft's Basis for Conclusions. We also believe that a ‘gross approach’ avoids structuring opportunities.

Debit to equity on initial recognition of a financial liability

(31) Although we understand and share the objective of the Board to find a solution that would comply both with IAS 32 and IFRS 10 without fundamentally changing IAS 32, we believe that the Board's proposal runs up against several conceptual difficulties.

(32) Notwithstanding the analysis provided in paragraph BC78, we believe the proposal would result in a double counting of the NCI in the statement of financial position, because both existing and potential rights of NCI holders are taken into account at the same time, even though they are mutually exclusive. NCI holders can receive either the profits and net assets to which they are entitled as existing shareholders, or the cash corresponding to the purchase of their interest by the entity as third-party creditors, but not both. This approach would result in a double reduction in equity attributable to owners of the parent and therefore would not give a faithful representation of their claims or relevant information to users of the financial statements.

(33) Alternatively, we suggest that the Board consider an initial recognition of the financial liability by debiting NCI first and parent's equity for the residual value. Contrary to the Board's interpretation detailed in paragraph BC72, we do not consider that debiting the NCI would necessarily mean their derecognition. In our view, this initial debit entry would be only an adjustment of the carrying amount of the NCI without denying their rights as current shareholders of the group (i.e. a matter of presentation of the NCI, not a matter of derecognition).

(34) This solution would be consistent with the clarification provided in question 4 of the Board, i.e. that an equity component of a compound instrument still exists even if it is recognised at a nil value (e.g. voluntary dividends accounted for as a reduction in equity, even if the full value was initially attributed to the liability component).

(35) We believe that this approach is consistent with:

- the requirements of IAS 32.23 and IAS 32.AG27(b) to recognise a financial liability reflecting the obligation for the entity to purchase its own equity instruments;
- IFRS 10.B89-90 specifying that the proportion of profit or loss and changes in equity allocated to the parent and NCI is determined solely on the basis of existing ownership interests and does not reflect the possible exercise or conversion of potential voting rights and other derivatives; and
- IFRS 10.B96 specifying that a change in the relative interests of NCI shall be reflected in the carrying amount of controlling and non-controlling interests, with any difference between the adjustment and the fair value attributed to the owners of the parent.

(36) In order to avoid any confusion as to the fact that NCI would no longer appear in the primary financial statements, we propose to accompany this proposal with specific disclosures in the notes to the financial statements relating to the carrying amount of the NCI based on the principles of IFRS 12.12. These disclosures would make clear to users the amount of the NCI's present ownership interest that has been presented as a liability due to the existence of a put option held by the NCI holders. This liability could appear on a separate line designated as such within NCI (e.g. '*effect of exercising put options*').

Initial and subsequent measurement of the financial liability

(37) We agree with the Board's proposal to consider the same approach for initial and subsequent measurement of the financial liability based on the full amount the entity would be required to deliver to settle the liability. We believe that this approach would make it possible to provide useful information to users of the financial statements in terms of liquidity risk, by presenting in advance the maximum amount that the entity would be required to pay to the NCI holders.

(38) Nevertheless, we encourage the Board to develop specific guidance on the discount rate to be applied in determining the present value of the repurchase obligation, given the characteristics of this type of financial liability.

Gains and losses on remeasurement of the financial liability

(39) In practice, remeasurement issues mainly relate to obligations to purchase own equity instruments in the form of NCI put options whose strike price is set at fair value or depends on a formula designed to approximate the fair value of the instrument.

We acknowledge that the Board's proposal to record gains and losses on remeasurement of the financial liability in profit or loss appears a natural solution in the case of an ordinary financial liability. However, we do not believe that this accounting treatment is appropriate in the specific case of an entity's obligation to repurchase its own equity instruments, which we believe have characteristics justifying a different treatment.

(40) Our first area of concern is that in the case of an NCI put at fair value, applying the Board's proposal would result in a 'double counting' in the net profit attributable to the parent. This is because the profit or loss is impacted by (i) the remeasurement of the put liability and (ii) the normal allocation to the NCI holders in their capacity as current shareholders, whereas they may have (i) or (ii) but not both at the same time.

(41) We also see a counter-intuitive effect of the Board's proposal linked to the fact that an increase in the value of the subsidiary subject to the put results in a reduction in the group's net result (through the remeasurement loss of the put liability) and therefore a reduction in its net book value.

(42) Furthermore, we disagree with the Board's analysis set out in paragraph BC87 that the remeasurement of the financial liability is not a transaction with owners in their capacity as owners. Insofar as NCI holders are always recognised in their rights as current shareholders and always appear in the statement of financial position (even for a potential zero value), we find it difficult to justify a different approach to their right to sell their interest. The decision by NCI holders to exercise their right to sell their interest will be taken in their capacity as current shareholders of the Group. They will make their decision, as any other shareholder thinking about the opportunity to sell its participation, by contemplating the exercise price of the put, their expectations in terms of future dividends and future increase in value of the shares, and their need for cash.

(43) In this regard, we believe that the Board's view of IAS 1.106(d)(iii) and IAS 1.109 explained in paragraph BC87 would be very restrictive. We acknowledge that the remeasurement of a financial liability does not strictly correspond to the cases presented in the two paragraphs considered as reflecting a transaction with owners in their capacity as owners. However, as the financial liability represents the amount at which the share transfer will take place once the instrument is settled or exercised, the purpose of remeasuring the financial liability is only to anticipate the value of this future potential acquisition of interests in the subsidiary. As the remeasurement of the financial liability only bridges the gap between initial and final measurement of a transaction with owners in their capacity as owners, it should also be considered this way even though the transfer of shares is not yet effective.

(44) As such a transaction is in our view a transaction with owners in their capacity as owners, and to be consistent with our proposal on the initial recognition of the financial liability, we propose to apply the same principle to the remeasurement of the financial liability, i.e. to allocate the gains and losses on remeasurement first to NCI and the remainder to parent's equity, in accordance with IFRS 10.B96.

(45) As an exception is already proposed in IAS 32.23 for the initial and subsequent measurement of these obligations compared with conventional financial liabilities, we suggest that the same be done for the recognition of remeasurement gains or losses:

- either by explicitly referring to the provisions of IFRS 10.B96;
- or by describing the proposed principle without referring to IFRS 10, replacing the words *'any gains or losses on remeasurement of the financial liability are recognised in profit or loss'* in the Board's proposal with *'gains or losses on remeasurement of the financial liability are recognised first as an adjustment to the carrying amount of the relevant non-controlling interests, and then directly in equity attributable to the owners of the parent for any residual value after adjustment of the non-controlling interests.'*

(46) We also propose that the Board amend paragraphs IAS 1.106(d)(iii) and IAS 1.109 in a consistent manner so as to explicitly include the remeasurement of the liability (in anticipation of the exercise of the put) as a case of revaluation through equity.

Other clarifications

(47) We agree and support the clarification of the Board that a financial liability must be recognised when the obligation is settled by delivering a variable number of another class of the entity's own equity instruments, for the reasons set out in paragraphs BC63-65.

(48) We also agree with the Board's principle to account for the expiry of a written put option by removing the carrying amount of the financial liability and include it in the same component of equity as that from which it was removed on initial recognition of the financial liability.

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.

(49) We agree with most of the Board's proposals, with the exception of the definition of the term 'liquidation'. In addition, while we agree with the Board's proposal to align the initial and subsequent measurement of financial liabilities arising from contingent settlement provisions in the specific situations of compound instruments and own equity derivatives, we nevertheless draw the Board's attention on the lack of clarity about the scope of such decision that could result in significant unintended consequences related to measurement issues.

Measurement of a financial instrument with a contingent settlement provision

(50) We understand the Board's intention to align initial and subsequent measurement for financial liabilities arising from contingent settlement provisions. We also note this approach is consistent with the Board's proposal related to obligations for an entity to purchase its own equity instruments.

(51) While we agree with the Board's proposal for such obligations for the reasons set out in paragraph 37, we question the implications of extending these measurement requirements to a wider scope which could create problems of practical application in relation to existing standards.

(52) Our first concern relates to the scope of this proposal in relation to the definition of a contingent settlement provision. We believe the scope of paragraphs 25 and 25A should be clarified to specify whether the Board's proposal should apply only to contingent settlement provisions included in compound financial instruments, to all

financial instruments or to any type of contingent settlement feature, including those present in non-financial contracts.

The Board's proposal could have a significant impact regarding the number of instruments containing clauses that would comply with the general definitions in paragraphs 25 and 25A (such as loans with covenants, ESG loans, loans indexed to the issuer's profits, or even contingent consideration in the context of a business combination under IFRS 3).

(53) Beyond the scope of compound instruments and own equity derivatives, ignoring the probability and expected timing of the contingent event may in some situations create practical issues due to conceptual differences with IFRS 9 requirements for the initial and subsequent measurement of financial liabilities.

(54) A first potential problem arises from the requirement to measure a financial liability at fair value on initial recognition under IFRS 9. In practice, applying the definition of fair value leads a market participant to take into account and weight possible events and their outcomes in various scenarios when estimating the price of a financial instrument.

(55) Disregarding the range of possible outcomes in the initial measurement of a financial instrument issued and retaining only the amount corresponding to the worst-case scenario, could result in a mismatch between the fair value in accordance with IFRS 13, and the requirement to recognise the financial liability (or liability component of a compound financial instrument) at its maximum amount, without any clear standard specification on how to deal with this mismatch.

(56) A second issue relates to the subsequent remeasurement methods in relation to the requirements of IFRS 9.B5.4.6. The Board's proposal to subsequently measure a financial liability arising from a contingent settlement provision at the present value of the full redemption amount would be inconsistent with this general measurement principle in IFRS 9, because when revising its estimates of payments or receipts, an entity would take into account the probability and expected timing of the contingent event in the estimated future contractual cash flows.

(57) Given the complexity and number of instruments concerned, we encourage the Board to clarify the scope of the contingent settlement provisions covered by the proposal, as well as how this proposal should relate to the existing initial and subsequent requirements of IFRS 9, IFRS 13 and the other standards concerned by such features (e.g. IFRS 3).

In our view, such clarifications should include practical examples of how to determine the appropriate discount rate to use to calculate the present value of the contingent settlement obligation (based on similar existing guidance in IAS 37 or IAS 19), and the impact on the amortised cost and effective interest rate of eligible financial instruments.

(58) We also suggest that the Board completes the proposed change to IAS 32.31 by also mentioning the exception to the remeasurement requirements for financial liabilities in IFRS 9 set out in paragraph 23 as follows: *'Except as stated in paragraph**s 23** and 25A […]'*

The meaning of 'liquidation'

(59) We would first like to raise a question about the impact of the liquidation of an entity within a consolidated group in which the parent entity issuing consolidated financial statements is not itself in liquidation. At the subsidiary's level, liquidation generates an obligation to pay NCI holders a share of the liquidation surplus. We wonder if this situation should lead the parent reporting entity to recognise a financial liability to NCI holders as soon as the liquidation process is launched or only when the process is completed.

(60) We understand the objectives of clarifying the concept of liquidation, particularly with a view to making a clear distinction between the liquidation process and the processes for resolving a company's difficulties.

(61) Although we approve the Board's desire to propose a harmonised and clear definition of the concept of liquidation, we believe this notion is above all legal and can vary from one jurisdiction to another, as can the process by which it is implemented. The Board's proposal could create an inconsistency or even a contradiction with the already existing legal definitions of liquidation.

(62) For example, in some countries, liquidation begins before or at the time the entity permanently ceases its operations but is not a consequence of the entity permanently ceasing its operations. Most of the time, as a matter of principle, liquidation leads to the cessation of business, not the reverse. It should also be noted that the entity may be authorised to continue its operations temporarily during the liquidation process.

(63) On the basis of our observations and given the absence of significant difficulties in interpreting the concept of liquidation in practice, we suggest that the Board should not attempt to define this term more precisely.

Other clarifications

(64) We welcome and agree with other proposed clarifications. We find it useful and relevant to specify that for a compound instrument, an equity component continues to exist even if for a nil value, and that discretionary payments of the issuer have to be recognised in equity even in this case.

(65) We also support the clarification related to the assessment of whether a contractual term is 'not genuine', that seems aligned with the generally observed practice. Nevertheless, we believe that the proposed example in AG28 about instruments with a 'regulatory change clause' could be open to interpretation and lead to a misinterpretation if the circumstances and wording of this type of clause differs from the general example given. We therefore propose removing this example from the paragraph AG28 and moving it to the illustrative examples to avoid turning a specific case into a general principle regardless of the circumstances.

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.

(66) We welcome and support the Board's proposal on a subject that has hitherto been the subject of no standard-setting guidance. We believe that the Board's proposal represents a useful improvement that is consistent with current practice. We particularly welcome the guidance provided in paragraph AG28B that these criteria do not constitute an exhaustive list and that their relative assessment depends on the facts and circumstances.

(67) In order to help stakeholders understand the methodology presented, we encourage the Board to develop illustrative examples that will provide a concrete understanding of the various criteria proposed and the way in which they may interact with each other.
The Board might for example use the governance examples seen recently in the case of Special Purpose Acquisition Companies, which allow a specific category of shareholders to force the liquidation of the entity if it has not initiated an IPO by a specified date.

(68) Despite such additional guidance, in our opinion such questions will continue to require a significant level of judgement to determine the relevant IFRS accounting treatment. For this reason, we recommend to the Board to perform some field testing to confirm whether such guidance will lead to the expected outcomes.

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.

(69) We agree with the Board's proposal to reclassify an instrument when a change of the substance of the contractual arrangement is due to a change in external circumstances, such as a change in an entity's functional currency or a change in an entity's group structure. We also agree with the accounting and measurement proposal when a reclassification occurs.

(70) We support the Board's principle of reclassifying financial instruments at the date of the change in circumstances without waiting for the reporting date. However, we believe that this requirement could be sometimes difficult to implement in order to define precisely when the change in circumstances occurred, and that the reporting date could in practice be used as a backstop. We encourage the Board to consider allowing this simplification, subject to specific disclosures in the notes explaining why the exact date of the change in circumstances could not be determined.

(72) Beyond the cases of reclassification required by the Board, we strongly disagree with the clarification explained in paragraph BC140(b) to prohibit reclassifications when the substance of a contractual arrangement changes because a contractual feature changes or expires with passage of time only (e.g. expiration of a conversion option that would not meet the fixed-for-fixed condition).

(73) Once a clause in the contract that led to its classification as a financial liability has lapsed, the instrument meets the definition of an equity instrument. Maintaining its classification as a financial liability would not be a faithful representation of the economic reality of the contract at the reporting date and would not provide useful information to the users of financial statements.

(74) Requiring a reclassification of financial instruments whose contractual features cease to be applicable due to the passage of time would also be consistent with:

- the provisions of IAS 32.16E-F related to reclassification of puttable instruments; and
- the proposed transition requirements that do not require the entity to separate the liability and equity components if the liability component of a compound financial instrument with a contingent settlement provision is no longer outstanding at the date of initial application.

(75) We do not agree with the Board's view presented in paragraph BC145 of the Basis for Conclusion to justify the prohibition of reclassification. We do not think that tracking and monitoring instruments to identify contractual terms that become or stop being effective with the passage of time would be onerous. In practice, the financial instruments issued to finance an entity are few in number and are subject to ad hoc negotiation and structuring and are therefore closely monitored. As the Board also proposes to require disclosing such information in question 7, we see no practical obstacle to drawing the same conclusions with regard to balance sheet classification.

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.

(76) We support and agree with the Board's general proposal to expand the objectives of IFRS 7, and the clarifications proposed in paragraphs (a) to (e) for the first set of Board's proposals. We believe that there are no current requirements dedicated to financial instruments with characteristics of equity issued and that the requirements of current general standards such as IAS 1 may not be sufficient to provide enough relevant information even on significant financial instruments issued.

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(77) While we find most information required in the second set of proposals useful and interesting for users of financial statements, we have strong concerns about the cost / benefit ratio of this kind of requirement. Much information required would be complex and difficult to produce in an operational manner, without its relevance justifying such a cost of implementation.

Nature and priority on liquidation (paragraphs 30A, 30B and 30E)

(78) We expect the required disclosures on priority on claims to be very difficult to produce and to present it in an understandable manner. Such information is first and foremost legal. Complying with the proposed amendment would require a complex legal analysis in each relevant jurisdiction to determine the nature and priority of the claims. Such analysis would be all the more difficult to produce when a group operates in several jurisdictions where liquidation rules may significantly differ.

(79) We also believe that most investors in subsidiaries will be first concerned by the nature and priority of claims at the subsidiary's level. Aggregating information at the parent's company level may not provide investors with useful information to understand their particular situation within the group.

Potential dilution of ordinary shares

(80) The principle proposed by the Board to consider the potential dilution of ordinary shares, based on the maximum number of additional ordinary shares the entity might be required to deliver, is clear and supported by relevant examples in IG14F-H.

(81) While we understand the Board's objectives and the rationale behind the information to be disclosed, we do not understand why such disclosures should fall within the scope of IAS 32 when IAS 33 already requires a certain amount of information on dilution of ordinary shareholders, albeit on a different basis.

(82) We would therefore propose to require this information in IAS 33 rather than IAS 32 to reconcile the disclosures related to dilution within one standard and limit the scope of entities that would be required to provide this disclosure to listed entities only, for which this type of information is the most relevant and the least costly to produce compared to other non-listed entities.

Terms and conditions

(83) We welcome and support the proposed disclosures about the terms and conditions of financial instruments that determine their classification as financial liabilities or equity instruments (paragraph 30D(a) of IFRS 7). We think this information will be useful for users to understand the classification of issued financial instruments that are often very complex and require clear, concise explanations to understand their main features.

(84) Although we agree with the principle of providing relevant information on the main contractual features that determine the classification of a financial instrument, we do not support the Board's proposal to also require detailed information on ‘equity-like characteristics’ and ‘debt-like characteristics’ that are not representative of the classification of financial instruments (paragraph 30D(b) of IFRS 7).

(85) In our opinion, information on the contractual characteristics that determine the classification of financial instruments is sufficient to provide the users of the financial statements with useful information. We acknowledge that financial instruments with both liability and equity characteristics are often complex and difficult to understand in their entirety for users of the financial statements, but we do not believe that requiring an extensive set of disclosures for potentially each financial instrument issued to deal with this complexity would significantly improve the relevance of the information if the key features were already disclosed.

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 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.

(86) Although we agree with the Board's objective and acknowledge that an allocation of equity and comprehensive income among the different categories of shareholders of the group would be useful for the users of the financial statements, no practical guidance is provided, and the required disclosures could prove difficult to implement in a consistent and comparable way among issuers.

(87) Guidance and illustrative examples should be given about:

- the meaning of ordinary shareholders, with regards to the general definition provided in IAS 33.5 ('*an equity instrument that is subordinate to all other instruments*') suggesting that only one class of shares can be ordinary shares;
- situations where several classes of ordinary shares exist at the same time with different ranks of subordination / dividend payment depending on the rights attached to them and being considered;
- the allocation key to be used in dividing the amounts between ordinary shareholders and other owners of the parent (e.g. effect of certain equity instruments such as equity derivatives, or preference shares that include special rights in profit or loss or would be paid only under specific circumstances such as the liquidation of the issuer).

(88) We suggest that the Board specifies the basis on which the amounts requested should be allocated, depending on the aggregate that is concerned (share capital and reserves, comprehensive income, etc.).

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. For an entity already applying IFRS Accounting Standards, the IASB proposes: (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.

(89) We agree with the Board's transition requirements and reliefs proposed.

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.

(90) We broadly support the Board's proposal, with the exception of the disclosures relating to the nature and priority of claims in the event of liquidation and those relating to '*equity-like*' and '*debt-like*' characteristics, as explained in our response to question 7.