

7 January 2019

International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London
E14 4HD
UK

Dear Sir/Madam

Discussion Paper: Financial Instruments with Characteristics of Equity

Norsk RegnskapsStiftelse (the Norwegian Accounting Standards Board – the NASB) is pleased to respond to your invitation to comment on the *Discussion Paper – Financial Instruments with Characteristics of Equity*.

We agree with the description of the challenges and their causes laid out in the discussion paper. We also agree that the challenges are pervasive enough to require standard-setting activity and support the IASBs effort to clarify the fundamental principles and to improve the presentation and disclosure requirements in IAS 32.

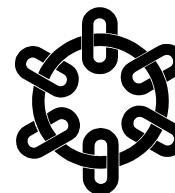
Scope of the classification approach

We do not object to the preliminary view that an entity should apply the classification approach to the contractual terms of a financial instrument (that per definition follow from contract). However, we strongly believe that IFRS should reflect substance over form and that the accounting for similar facts and circumstances should be consistent. Hence, we would encourage the IASB to consider a research project on whether it would be possible to closer harmonise the accounting principles for financial instruments with the principles for accounting for claims that originates from law.

Classification approach

We agree with the main direction of the proposed classification approach and welcomes the following decisions by the IASB:

- To retain the binary split between liabilities and equity.
- To define equity as a residual amount.
- To carry forward the requirements in IAS 32 relating to compound instruments.
- Not to consider economic compulsion/economic incentives when classifying a financial instrument as a financial liability or an equity instrument.



- To develop classification criteria focused on both funding liquidity and cash flows (timing) and solvency (amount), and that information about other features of claims could be provided through presentation and disclosures.
- The decision to classify the derivatives over own equity (other than derivatives that include an obligation to extinguish own equity) in its entirety (unit of account), and that the same classification criteria as for non-derivative financial instruments should be applied to the net amount from such instruments.
- The decision to remove the foreign currency rights issue exemption.

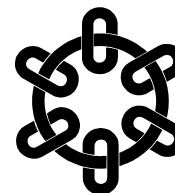
However, we would like to draw your attention to our following reservations and/or comments to the proposed classification approach:

- We concur with the proposed timing feature as a classification criteria. However, we believe the Board will have to clarify and/or define the notion of “liquidation”.
- We support the amount feature as classification criteria in going concern. However, we conceptually disagree that the amounts due at liquidation are financial liabilities prior to liquidation (a change compared to IAS 32). Further, we believe the measurement complexity that arise from having to remeasure the timing and amount due at liquidation, reinforce our view that the amount criteria should not apply at liquidation. Hence, we suggest to amend the amount criteria accordingly.
- We do not object to the direction suggested for redemption obligation arrangements. However, we are somewhat concerned with the proposed guidance for how to account for these instruments within equity and especially the suggestion to derecognise equity instruments as if they were transferred or expired even though they clearly are not. We therefore urge the Board to clarify some of the knock on effects of this preliminary view.
- We disagree with the decision to retain the puttable exemption and believe that the same classification principles should be applied consistently to all instruments without exemptions.

In general, we want to stress the importance of not underestimating the value and benefit of clarifying the fundamental principles of the standard. We acknowledge that any new standard will introduce new terminology that will require reassessment of some past classification decisions. However, we are not particularly concerned with the cost of implementing the proposed clarifications to the classification principles in IAS 32. Based on our experience, the number of entities with contracts that will be challenging to classify under the proposed guidance is low, and for the entities that do have contracts that will have to be reassessed for classification, the number of different types of contracts is normally low. Hence, we would strongly encourage the board to stay the course in this regard and not limit this project to a presentation and disclosure project only.

Presentation of financial liabilities

We agree that additional information about financial instruments that contain no obligation for an amount that is independent of the entity’s available economic resources would be useful. However, we have not yet reached a view on whether this information is best provided through presentation, disclosures or a combination of presentation and disclosure. That said, we would not support a requirement for embedded derivatives to be separated from a host contact measured at fair value for presentation purposes only (complexity and cost benefit).



We are also reluctant towards the suggestion to present income and expenses from these instruments in OCI without subsequent reclassification, and find the approach suggested for a subset of partially independent derivatives to be arbitrary, complex and rules based. Hence, we are inclined to believe that new and additional disclosure requirements might be a preferred solution over the suggested presentation alternatives laid out by the Board.

Presentation of equity instruments

We do not support the average-of-period approach and the end-of-period approach as we find those approaches to be far too complex and costly. We would probably not object to the fair value approach, but tend to believe that a disclosure approach would be preferable over the fair value approach.

Disclosure

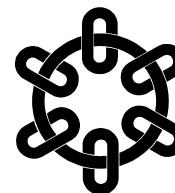
We support extended disclosures about potential dilution of ordinary shares, terms and conditions of financial liabilities and equity instruments and priority of financial liabilities and equity instruments at liquidation. However, we are concerned with the proposed requirement to disclose information about priority of claims on liquidation in consolidated financial statements. In our jurisdiction, only legal entities have the capacity to enter into contracts and to assume obligations and incur debt. Hence, it can be challenging (or impossible) to prepare and disclose complete information about priority of claims on liquidation for consolidated financial statements as it might be inconsistent with the individual entities of the group. The IASB will therefore have to consider the interaction between the individual and consolidated financial statements in its development of disclosures of priority of claims and to consider whether it would (at all) be practicable to provide this type of information in consolidated financial statements.

Please refer to the appendix for our detailed comments and responses to the questions raised in the discussion paper.

You are welcome to contact us if you would like to discuss any specific issues addressed in our response further.

Yours faithfully,

Karina Vasstveit Hestås
Chair of the Technical Committee on IFRS of Norsk RegnskapsStiftelse



Appendix

Question 1

Paragraphs 1.23–1.37 describe the challenges identified and provide an explanation of their causes.

- a) *Do you agree with this description of the challenges and their causes? Why or why not? Do you think there are other factors contributing to the challenges?*
- b) *Do you agree that the challenges identified are important to users of financial statements and are pervasive enough to require standard-setting activity? Why or why not?*

We agree with the description of the challenges and their causes laid out in the discussion paper.

We also agree that the challenges are important to users and pervasive enough to require standard-setting activity.

Question 2

The Board's preferred approach to classification would classify a claim as a liability if it contains:

- a) *an unavoidable obligation to transfer economic resources at a specified time other than at liquidation; and/or*
- b) *an unavoidable obligation for an amount independent of the entity's available economic resources.*

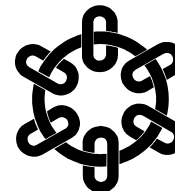
This is because, in the Board's view, information about both of these features is relevant to assessments of the entity's financial position and financial performance, as summarised in paragraph 2.50.

The Board's preliminary view is that information about other features of claims should be provided through presentation and disclosure.

Do you agree? Why, or why not?

Timing criteria

We agree with the timing criteria. However, we would urge the board to elaborate and clarify on the notion of "liquidation". For example, there are circumstances where the legal structure is not "liquidated", but where investors suffer the same amount of losses as if the legal structure was "liquidated" (typical resolutions or where the creditor take control over the entity or the assets of an incorporated company, but where the legal entity survive). Further, we suggest that the board explicitly clarify that the notion of "liquidation" (the exemption from the timing criteria) does not comprise liquidations that are certain to occur and outside the control of the entity. Otherwise, this would constitute a substantial change (compared to IAS 32) and leave the exemption in IAS 32.16C-D redundant. Hence, the future standard must be explicit in this regard.



Amount criteria

We also agree with the fundamental principle and the basis for the amount criteria (second criteria), which we read as a clarification and operationalisation of the fixed-for-fixed criteria in IAS 32. However, we generally disagree that distribution of assets between holders of different classes of equity instruments at liquidation is relevant as classification criteria before liquidation. Firstly, financial statements are prepared on a going concern basis and not on break-up basis. Hence, we believe (like in IAS 32) that such amounts should not be presented as liabilities prior to liquidation. For example, we disagree that liability classification of instruments that do not require transfer of economic resources before liquidation (due at liquidation), such as certain cumulative non-redeemable preference shares and cumulative undated bonds, provide relevant and useful information (a change compared to IAS 32) on a going concern basis. Secondly, this change will introduce complexity in remeasuring the timing and amount due at liquidation under IFRS 9. Take for example a perpetual instrument with cumulative discretionary interest. If this instrument requires repayment of the principal in case of liquidation, the issuer should recognise a liability for this obligation. The liability should be measured in accordance with IFRS 9, i.e. based on expected contractual cash flows. This will require the entity to estimate the time and amount at liquidation. Further, these instruments often contain closely related call options providing the issuer with a contractual right to repay the instrument at certain points in time. In that case, the liability will be measured at the present value of the expected redemption amount, an amount that might be very different (typically binary) depending on whether the entity expect to exercise the call option or not:

- The issuer expects to exercise the call option: measure the financial liability at the present value of the expected redemption amount which typically might be 1-10 years into the future.
- The issuer does not expect to exercise the call option: measure the financial liability at the present value of the expected redemption amount at liquidation, which might or might not be far into the future (year 10?, year 50?, year 100?, year 200?).
- Change in expectations: recognised remeasurement to profit or loss.

Thus, we suggest, both for practical and conceptual reasons, that the IASB amend the amount criteria as follows:

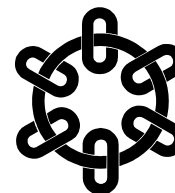
*The Board's preferred approach to classification would classify a claim as a liability if it contains, **other than at liquidation**:*

- a) an unavoidable obligation to transfer economic resources at a specified time ~~other than at liquidation~~; and/or*
- b) an unavoidable obligation for an amount independent of the entity's available economic resources.*

We agree that information about other features and claims should be provided through presentation and disclosure.

Question 3

The Board's preliminary view is that a non-derivative financial instrument should be classified as a financial liability if it contains:



- a) *an unavoidable contractual obligation to transfer cash or another financial asset at a specified time other than at liquidation; and/or*
- b) *an unavoidable contractual obligation for an amount independent of the entity's available economic resources.*

This will also be the case if the financial instrument has at least one settlement outcome that has the features of a non-derivative financial liability.

Do you agree? Why, or why not?

Please refer to our comments to question 2 (general comments to the classification criteria) and question 11 (on whether the criteria should be restricted to “contractual” terms).

Question 4

The Board's preliminary view is that the puttable exception would be required under the Board's preferred approach. Do you agree? Why, or why not?

We do not agree that the arguments in DP 3.37 provide sufficient basis for exempting certain instruments from the classification principles in the standard. We believe the same principles should be applied to all contracts. The consequence of applying the principles (no equity or negative equity) is irrelevant as long as it reflects the actual terms of the contracts entered into by the entity and a correct application of the fundamental principles of the standard. Further, we do not agree that this exemption contribute to more useful information. Rather contrary, we believe an exemption from the main principles in the standard contribute to increased complexity and reduced usefulness. The board should focus on developing clearly articulated principles for classification and stick to those principles. Consistent application of clearly articulated principles provides useful and meaningful information. Hence, we disagree with the decision to retain the puttable exemption in IAS 32.16A-B and IAS 32.16C-D.

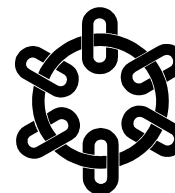
We agree, for the same reason, with the proposal to remove the foreign currency rights issue exemption.

That said, based on our experience, very few Norwegian entities (with puttable instruments and financial statements prepared according to IFRS) qualify for the puttable exemption. The exemption is mainly applied by various investment trusts in standalone financial statements. Those entities normally measure most (or all) assets at fair value. Entities with mixed measurement of assets typically seems to disqualify for the exemption as the puttable instrument is typically not the most subordinated instrument or does not entitle the holder to a pro-rata share of the entity's net assets in the event of the entity's liquidation.

Question 5

The Board's preliminary view for classifying derivatives on own equity—other than derivatives that include an obligation to extinguish an entity's own equity instruments—are as follows:

- a) *a derivative on own equity would be classified in its entirety as an equity instrument, a financial asset or a financial liability; the individual legs of the exchange would not be separately classified; and*
- b) *a derivative on own equity is classified as a financial asset or a financial liability if:*



- i. *it is net-cash settled—the derivative requires the entity to deliver cash or another financial asset, and/or contains a right to receive cash for the net amount, at a specified time other than at liquidation; and/or*
- ii. *the net amount of the derivative is affected by a variable that is independent of the entity's available economic resources.*

Do you agree? Why, or why not?

Unit of account

We agree that derivatives over own equity should be classified in its entirety for the reasons laid out in the discussion paper, i.e. the unit of account is the total instrument and not each leg of the derivative.

Classification principle for derivatives over own equity

We agree that the net amount of the derivative should be analysed by applying the same principles (i.e. the timing and amount criteria) as for non-derivative instruments. Refer to question 2 for our general comments to the classification principles.

We welcome the additional guidance on whether the net amount of a derivative is affected by a variable that is independent of the entity's available economic resources. However, we would like to encourage the IASB to provide further guidance on how contingencies should be considered as within the control of the entity or not. This is an issue that is raised frequently in practice and can be complex to assess.

Question 6

Do you agree with the Board's preliminary views set out in paragraphs 5.48(a)–(b)? Why, or why not? Applying these preliminary views to a derivative that could result in the extinguishment of an entity's own equity instruments, such as a written put option on own shares, would result in the accounting as described in paragraph 5.30 and as illustrated in paragraphs 5.33–5.34.

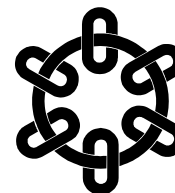
For financial instruments with alternative settlement outcomes that do not contain an unavoidable contractual obligation that has the feature(s) of a financial liability as described in paragraph 5.48(c), the Board considered possible ways to provide information about the alternative settlement outcomes as described in paragraphs 5.43–5.47.

- a) *Do you think the Board should seek to address the issue? Why, or why not?*
- b) *If so what approach do you think would be most effective in providing the information, and why?*

Stand-alone derivative to extinguish an equity instrument (5.48a)

We tend to agree that there are similarities in the substance of compound instrument and of a stand-alone derivative to extinguish an equity instrument. We have observed in practice that at least financial investors with no control or significant influence over the investment seems indifferent between a convertible loan and buying shares with a put over the same shares. Hence, we do not object to an approach (consistent with IAS 32) that aim to reflect that the substance of these instruments is similar to compound instruments.

However, we are somewhat concerned with the proposed accounting for these instruments within equity and especially the suggestion to derecognise equity instruments as if they were



transferred or expired even though they clearly are not. The approach raises several questions that the Board should clarify and elaborate on, such as the treatment of profit allocation and dividends paid when the appurtenant equity component has been derecognised, and the impact on changes in other topics such as earnings per share.

We would also stress the importance of using this opportunity to explicitly clarify whether:

- the accounting for these instruments should differ based on whether the written put forms part of a business combination or whether it is entered into separately and
- whether and why changes in the redemption amount are to be accounted for under IFRS 9 (through profit or loss) and not IFRS 10 and IAS 1 (as transactions between equity holders).

Convertible bonds (5.48b)

We agree with the suggested approach.

Reverse convertible bonds (5.48c)

This type of instruments is not common in Norway. However, we would still encourage the Board to explicitly clarify (for example through providing an example) that reverse convertibles with an option for the issuer to settle the instrument by issuing a fixed number of own shares are to be classified as equity instruments in its entirety. Further, we agree that additional information about these instruments is needed (the alternative settlement method could be affected by variables that are independent of the entity's available economic resources). Hence, we would support an amendment that introduce new requirements to ensure better information on these instruments (disclosures end potentially presentation in equity).

Question 7

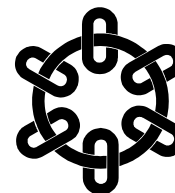
Do you agree with the Board's preliminary views stated in paragraphs 6.53–6.54? Why, or why not? The Board also considered whether or not it should require separation of embedded derivatives from the host contract for the purposes of the presentation requirements as discussed in paragraphs 6.37–6.41. Which alternative in paragraph 6.38 do you think strikes the right balance between the benefits of providing useful information and the costs of application, and why?

Timing feature

We agree that information about the timing features is sufficiently covered by presentation and disclosure requirements in existing IFRS standards. Hence, we see no need to develop new presentation requirements to provide information about the timing feature.

Amount feature - Statement of financial position

We agree that additional information about financial instruments that contain no obligation for an amount that is independent of the entity's available economic resources would be useful. However, we have not reached a view on whether this information is best provided through presentation, through additional disclosures or a combination of presentation and disclosure requirements. That said, we would not support a requirement for embedded derivatives to be separated from a host contract measured at fair value for presentation purposes only. We are



also reluctant towards the suggestion to present income and expenses from these instruments in OCI without subsequent reclassification, and find the approach suggested for a subset of partially independent derivatives to be arbitrary, complex and rules based. Hence, we tend to believe that new and additional disclosure requirements might be a preferred solution over the suggested presentation alternatives laid out in paragraph 6-53.

Question 8

The Board's preliminary view is that it would be useful to users of financial statements assessing the distribution of returns among equity instruments to expand the attribution of income and expenses to some equity instruments other than ordinary shares. Do you agree? Why, or why not?

The Board's preliminary view is that the attribution for non-derivative equity instruments should be based on the existing requirements of IAS 33. Do you agree? Why, or why not?

The Board did not form a preliminary view in relation to the attribution approach for derivative equity instruments. However, the Board considered various approaches, including:

- a) a full fair value approach (paragraphs 6.74–6.78);*
- b) the average-of-period approach (paragraphs 6.79–6.82);*
- c) the end-of-period approach (paragraphs 6.83–6.86); and*
- d) not requiring attribution, but using disclosure as introduced in paragraphs 6.87–6.90 and developed in paragraphs 7.13–7.25.*

Which approach do you think would best balance the costs and benefits of improving information provided to users of financial statements?

Non-derivative equity instruments

We agree that the attribution for non-derivative equity instruments should be based on the existing requirements of IAS 33.

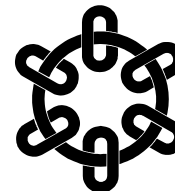
Derivative equity instruments

We do not support the average-of-period approach and the end-of-period approach as we find those approaches to be far too complex and costly. We would probably not object to the fair value approach (a), but tend to believe that a disclosure approach (d) would be preferable over the fair value approach.

Question 9

The Board's preliminary view is that providing the following information in the notes to the financial statements would be useful to users of financial instruments:

- a) information about the priority of financial liabilities and equity instruments on liquidation (see paragraphs 7.7–7.8). Entities could choose to present financial liabilities and equity instruments in order of priority, either on the statement of financial position, or in the notes (see paragraphs 6.8–6.9).*
- b) information about potential dilution of ordinary shares. These disclosures would include potential dilution for all potential issuance of ordinary shares (see paragraphs 7.21–7.22).*



- c) *information about terms and conditions should be provided for both financial liabilities and equity instruments in the notes to the financial statements (see paragraphs 7.26–7.29).*

Do you agree with the Board’s preliminary view? Why, or why not? How would you improve the Board’s suggestions in order to provide useful information to users of financial statements that will overcome the challenges identified in paragraphs 7.10 and 7.29? Are there other challenges that you think the Board should consider when developing its preliminary views on disclosures?

We support more disclosure requirements about potential dilution of ordinary shares, terms and conditions of financial liabilities and equity instruments and the priority of financial liabilities and equity instruments at liquidation. Hence, we broadly support the proposed disclosure requirements. However, we have concerns regarding the requirement to present information about priority on liquidation in consolidated financial statements. In our jurisdiction, only legal entities have the capacity to enter into contracts and to assume obligations and incur and pay debt. Hence, it can be challenging to prepare and disclose information about priority of claims on liquidation for consolidated financial statements as it might be inconsistent with the individual entities of the group. The IASB will therefore have to consider the interaction between the individual and consolidated financial statements in its development of disclosures of priority of claims and to consider whether it would (at all) be practicable to provide this type of information in consolidated financial statements.

Question 10

Do you agree with the Board’s preliminary view that:

- a) *economic incentives that might influence the issuer’s decision to exercise its rights should not be considered when classifying a financial instrument as a financial liability or an equity instrument?*
- b) *the requirements in paragraph 20 of IAS 32 for indirect obligations should be retained? Why, or why not?*

We agree.

Question 11

The Board’s preliminary view is that an entity shall apply the Board’s preferred approach to the contractual terms of a financial instrument consistently with the existing scope of IAS 32. Do you agree? Why, or why not?

We acknowledge that it is challenging to comprehend all consequences of extending the preferred approach to non-contractual terms (including terms that follow from law only). Thus, we do not object to the conclusion at this stage. However, the NASB is a great believer in substance over form and that similar principles should be applied to similar arrangements and similar facts and circumstances. Hence, we would encourage the IASB to consider a research project on whether it would be possible to closer harmonise the accounting principles for financial liabilities (that per definition follow from contract) with the principles for accounting for claims that originates from law, *ceteris paribus*.

In the near term, we would encourage the IASB to provide further guidance on how to draw the distinction between terms that follow by law and terms that follow by contract, where the contract refers to law and/or is enforced by law, an issue that frequently arise in practice.