

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

Financial Instruments with Characteristics of Equity

Cover Note

Objective

- 1 The objective of the session is to:
 - (a) discuss EFRAG Secretariat's assessment of the most recent developments undertaken by the IASB with regards to the FICE project; and
 - (b) provide EFRAG TEG members with a summary of the feedback received from EFRAG User Panel and EFRAG Financial Instruments Working Group.

Introduction

- 2 The objective of the FICE project is to investigate potential improvements to:
 - (a) the classification of liabilities and equity in IAS 32 *Financial Instruments: Presentation*, including investigating potential amendments to the definitions of liabilities and equity in the Conceptual Framework; and
 - (b) the presentation and disclosure requirements for financial instruments with characteristics of equity, irrespective of whether they are classified as liabilities or equity.

Background

- 3 The IASB's discussion on its research project FICE started in May 2015 and EFRAG Secretariat has been regularly providing updates to EFRAG User Panel, EFRAG FIWG and EFRAG TEG. These updates covered the following discussions:
 - (a) **the features of claims** that are relevant for primary users of financial statements in making economic decisions (i.e. type, amount, timing and priority of the claim). This analysis formed the basis for the classification, presentation and disclosures of claims in the IASB's project;
 - (b) **improvements to the classification requirements:** the IASB identified three new approaches (Alpha, Beta and Gamma);
 - (c) **improvements to the presentation of financial instruments classified as liabilities:** the IASB discussed the presentation of liabilities with different features on the face of the statement of financial position and the presentation of income and expenses that arise from different subclasses of liabilities in the statement of financial performance, including the use of other comprehensive income (OCI);
 - (d) **improvements to the presentation of financial instruments classified as equity:** the IASB discussed how subclasses of equity could help in providing

additional information about the features identified as relevant. This included discussions on whether subclasses of equity should include “ordinary shares” and “senior classes of equity”, whether the attribution of profit or loss and OCI should be expanded to senior classes of equity (and if so how) and whether the carrying amount of each subclass of equity should be updated to reflect the attribution of profit or loss and OCI;

- (e) **derivatives on own equity:** the IASB discussed the application of the Gamma approach to different types of derivatives on own equity, the unit of account for accounting for derivatives on own equity and whether derivatives should be split into components for classification purposes. It also discussed the existing puttable instruments exception in IAS 32 *Financial Instruments: Presentation* and how the Gamma approach addresses some issues that arise in practice when applying the fixed-for-fixed condition in IAS 32;
 - (f) **claims with conditional alternative outcomes:** the IASB considered the challenges in accounting for claims with conditional alternative liability and equity settlement outcomes. For example, it considered whether economic incentives that may influence the entity’s decision to exercise its option should be considered for classification purposes;
 - (g) **improvements to the disclosure requirements:** the IASB discussed improvements to disclosure requirements including improvements to disclosures on priority of claims on liquidation and potential dilution of ordinary shares;
 - (h) **the accounting within equity:** the IASB discussed illustrative examples that clarify how its decisions on the Gamma approach apply to accounting within equity, including convertible bonds and put options written on own equity;
 - (i) **the scope of contractual rights and obligations:** the IASB discussed whether the effects of law should be considered for the purposes of classifying financial instruments under the Gamma approach. In particular, whether the Gamma approach should focus only on the contractual terms of a financial instrument (as in IAS 32 and IFRS 9) or whether it should consider both the rights and obligations arising from the contract and the law for classification purposes (as in IFRIC 2 *Members’ Shares in Co-operative Entities and Similar Instruments*);
 - (j) **the classification of derivatives on non-controlling interests with an exercise price denominated in a foreign currency:** the IASB discussed which functional currency should be the reference point in determining whether a derivative is denominated in a foreign currency; and
 - (k) a summary of interactions with other IFRS Standards, IFRIC Interpretations and the Conceptual Framework for Financial Reporting.
- 4 On 24 January 2018 the IASB discussed an issue raised on the pre-ballot draft of the FICE Discussion Paper. Please refer to agenda paper 12-02 in this regard.
- 5 The IASB has finalised its discussions on this project and, as a next step, the IASB is planning to publish a Discussion Paper by June 2018.
- 6 Based on the feedback received on the DP, the IASB will need to decide whether to add a project to its Standards-level programme to amend IAS 32 and whether any further changes are needed to the Conceptual Framework.

Agenda Papers

- 7 In addition to this cover note, agenda papers for this session are:

FICE – Cover Note

- (a) Agenda paper 12-02 – Update; and
- (b) Agenda paper 12-03 – Summary of feedback received from EFRAG User Panel and EFRAG FIWG.