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.

VISUALISING FICE

A CLOSER LOOK AT PRESENTATION AND DISCLOSURE

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This Bulletin is issued by the European Financial Reporting Advisory Group (EFRAG). The publication of Bulletins is part of EFRAG's strategy to stimulate debate within Europe and clarify the IASB discussions to the presentation and disclosure requirements for financial liabilities and equity. Any views expressed are tentative. EFRAG will develop its final views after considering the feedback received from its constituents.

Due to the nature of the bulletin, EFRAG has not included questions to constituents. However, constituents may provide their comments by 3 December 2018 through EFRAG's website <here> or by post to:

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All comments received will be placed on the public record unless confidentiality is requested.

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Executive Summary

ES1 In June 2018 the IASB issued the Discussion Paper DP/2018/1 *Financial Instruments with Characteristics of Equity* ('the DP') which proposes the creation of subclasses of equity, subclasses of liabilities and specific presentation requirements for them.

ES2 For **financial liabilities** that provide equity-like returns, the DP proposes:

a) In regard to the statement of financial performance, that income or expenses should be presented in other comprehensive income ('OCI') with no recycling; and

b) For the statement of financial position, presentation of these liabilities as a separate line item.

ES3 Other presentation proposals include:

a) attribution of total comprehensive income to **equity instruments** other than ordinary shares, including instruments such as preference shares, warrants and any derivatives of own equity that are classified as equity.

b) updating of the carrying amount of equity instruments other than ordinary shares, based on the attribution developed for the statement of financial performance. For example, the attribution will lead to an update of the carrying amount of preference shares, warrants and equity instruments other than ordinary shares.

ES4 Finally, the IASB suggests additional disclosures on priority on liquidation, potential dilution of ordinary shares and contractual terms and conditions.

ES5 Although the IASB's preferred approach would not fundamentally change the classification outcomes from IAS 32, the IASB's presentation proposals represent a significant change to current presentation requirements in IAS 1 and current practice.

ES6 Currently entities are not required to separately present information about different subclasses of liabilities and equity. In addition, the IASB's proposals are expected to raise many questions on the use of OCI and whether the update of the carrying amount of subclasses of equity represent the remeasurement of equity. Such significant changes are most likely to affect companies which use complex financial instruments such as derivatives on own shares and puttable instruments.

ES7 The proposed disclosures, as a whole, represent a significant extension of disclosures on financial instruments on own equity. They would provide a greater level of detail about financial instruments classified as equity, making the level of disclosure more similar to financial instruments that are classified as liabilities.

Chapter 1: Background

Purpose of this bulletin

1.1 The IASB DP describes the IASB's preferred approach to the presentation and disclosure of financial liabilities and equity. In order to help constituents to understand the proposed approach and accordingly to help constituents participating in the debate around the DP, EFRAG has issued this bulletin which explains the relevant presentation and disclosure requirements included in the DP.

Why the IASB published a DP

1.2 The IASB has considered how to distinguish liabilities and equity as respondents to the IASB's 2015 Agenda Consultation said that the requirements in IAS 32 *Financial Instruments: Presentation*:

a) are, in some cases, complex, poorly understood and difficult to apply;

b) lead to classification outcomes that do not reflect the economic substance of particular financial instruments common in some jurisdictions;

c) have, over the years, been amended in a piecemeal fashion that has raised practical issues, introduced exceptions and resulted in diversity in practice; and

d) are not robust enough to address the increasing complexity and sophistication of some financial instruments being issued.

1.3 In addition, submissions to the IFRS Interpretations Committee ('IFRS IC') have revealed challenges in distinguishing financial liabilities from equity instruments in IAS 32 for more complex financial instruments. Such challenges include:

a) application of the fixed-for-fixed condition to derivatives on own equity;

b) application of the requirements in IAS 32 to recognise a 'gross' liability for derivatives that include an obligation for the entity to purchase its own ordinary shares, including the repurchase the non-controlling interest shares in a subsidiary (e.g. put options written on non-controlling interests); and

c) bonds that pay interest at the discretion of the issuer and mandatorily converts to a variable number of the issuer's own shares if the issuer breaches a certain threshold.

1.4 The DP states that while the objective of the project is to respond to challenges in distinguishing financial liabilities from equity instruments when applying IAS 32, any potential solution should limit unnecessary changes to classification outcomes that are already well understood. These requirements are explained in the EFRAG bulletin *Demystifying FICE, a clearer picture on classification*.

1.5 The IASB notes that the changes to the classification principles might not be sufficient to resolve all the challenges the IASB has identified. Enhancing presentation and disclosure requirements could, according to the IASB, help address some of those challenges. The

IASB is therefore also providing some views on presentation and disclosures in the DP. When assessing how useful the information resulting from the approach described in the DP would be, it would therefore also be relevant to take the information provided by the proposed presentation and disclosures into account.

Scope of the discussion paper

1.6 While the application of the IASB's preferred approach might change the presentation and disclosures of a financial instrument as a financial asset, financial liability or an equity instrument, the scope of IAS 32 would remain unchanged.

Chapter 2: Presentation of financial liabilities

2.1 In the DP the IASB proposes the creation of subclasses of financial liabilities to distinguish financial liabilities that provide equity-like returns from other financial liabilities. Accordingly, the IASB's preferred approach suggests that entities should separately present financial liabilities that provide equity-like returns. That is, separately present financial liabilities for which the amount is dependent on the entity's available economic resources, including related returns. This would mean that:

a) For the **statement of financial performance** entities would be required to separately present income or expenses resulting from financial liabilities that provide equity-like returns in **OCI with no recycling**.

b) For the **statement of financial position** entities would be required to present this type of liabilities separately from other financial liabilities as a **separate line item**.

2.2 Finally, to help users of financial statements assess in more detail how any potential shortfall or surplus in economic resources is allocated among claims, the IASB suggests requiring the presentation of financial liabilities in **order of priority** on the face of the statement of financial position or in the notes.

2.3 Let us consider a simple example. Under the IASB's preferred approach **shares redeemable at fair value** would be classified as financial liabilities as the entity may be required to redeem its own ordinary shares and transfer cash before liquidation. However, as the amount of the liability is linked to the value of the entity's shares, it provides equity-like returns. Therefore, if an entity performs well, the value of the share price will increase, the amount of the liability will increase and the entity will recognise a loss in OCI.

2.4 The IASB explains that many consider that the recognition of such a loss(gain) in profit or loss (as in IAS 32) is **counter-intuitive**. The IASB also explains that separate presentation requirements would **provide additional information to users of financial statements about financial instruments that are classified as financial liabilities but have characteristics of equity**. That is, the entity is required to deliver economic resources before liquidation but the amount of the liability depends on the entity's available economic resources and it provides an equity-like return. The IASB details that providing information about the dependency of the amount of the liability on the entity's available economic resources (amount feature) through presentation would help users to assess balance-sheet solvency and returns.

2.5 In terms of the scope of the presentation requirements, the DP states that separate presentation requirements would apply to the following instruments:

a) financial liabilities that contain an obligation for an amount that is dependent on the entity's available economic resources (e.g. shares redeemable at fair value);

b) derivative financial assets and derivative financial liabilities that have net amounts unaffected by an independent variable (e.g. written put option on own equity in the entity's functional currency); and

c) partly independent derivatives that meet a certain criteria (e.g. written call option on own equity in foreign currency).

2.6 Certain financial instruments are very complex in nature and contains both a host contract and an embedded derivative, often referred to as hybrid instruments. For such instruments the DP considered the approaches in paragraph 2.14 below.

2.7 For an illustration of how the presentation of the statement of financial position and statement of financial performance will change under the IASB's preferred approach, please see Appendix 1 and 2.

Financial liabilities that contain an obligation for an amount that is dependent on the entity's available economic resources

2.8 For non-derivative financial instruments classified as financial liabilities, entities first need to consider whether the financial liability is for an amount which is dependent on the entity's available economic resources (e.g. shares redeemable at fair value depend on the value of the ordinary shares) to determine whether it should present:

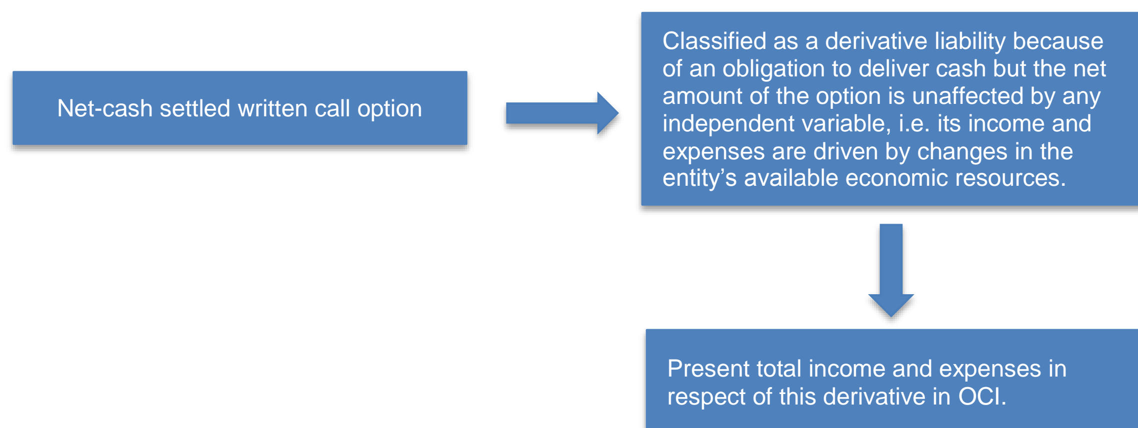
a) this liability separately from other financial liabilities as a **separate line item in the statement of financial position;** and

b) their related income or expenses will be separately present in OCI without recycling to profit or loss.

Derivative financial assets and derivative financial liabilities that have net amounts unaffected by an independent variable

2.9 For derivative or embedded derivative, entities first need to consider whether the net amount of the derivative is affected by an independent variable.

2.10 The presentation of derivatives and embedded derivatives for which the net amount is not affected by independent variables (e.g. written put option on own equity in the entity's functional currency) can be summarised as below.



Partly independent derivatives

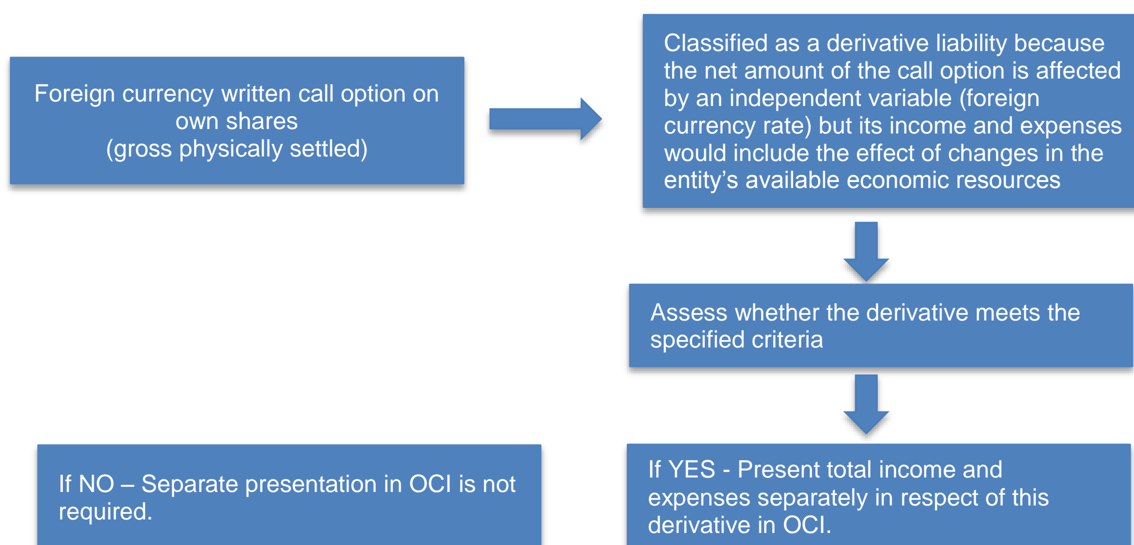
2.11 Certain derivatives on own equity are classified as a derivative liability because the net amount of the instrument is partly affected by an independent variable (e.g. foreign currency rate) and partly affected by the entity's available economic resources (e.g. share price). For example, the net amount of a foreign currency written call option (a

contract to deliver a fixed number of the entity's own shares in exchange for a fixed amount of foreign currency) is partly affected by foreign currency and partly affected by the entity's share price. For partly independent derivatives, the IASB discusses two approaches:

a) **disaggregation approach**: an entity would split the income and expenses that result from the effect of the independent variables (that arise from changes in foreign currency) from those that result from the effect of dependent variables (that arise from changes in the value of the shares). Those that arise from independent variables would be presented in OCI.

b) **the criteria-based approach** (IASB's preferred approach): the separate presentation requirements would only apply to partly independent derivatives that meet particular criteria. This would mean that if the derivative meets a certain criteria, then the entity would present in OCI the income and expenses that arise from the foreign currency and share price.

2.12 Accordingly, under the IASB's preferred approach, if the derivative meets the specified criteria as per paragraph 2.13, then the total income and expenses of such derivatives are presented in OCI. This can be illustrated as follows:



2.13 Applying the criteria-based approach, an entity would present the total income and expenses arising from a partly independent derivative in OCI (including the portion that results from the effect of independent variables) if it meets the following criteria:

Criteria-based approach	
Partly independent derivatives	Meets all the following criteria: • The only independent variable affecting the net amount is a currency other than the entity's functional currency. • The foreign currency exposure (FX) is not leveraged. • The FX exposure does not contain an option feature. • The FX denomination is imposed by an external factor.

2.14 For instruments that contain a non-derivative financial liability and an embedded derivative (e.g. convertible bond), the DP have considered two alternatives with regards to separate presentation:

a) *Alternative A* - presentation requirements would apply only to embedded derivatives that are separated from the host and hybrid instruments that, as a whole, depend on the entity's available economic resources (e.g. shares redeemable at fair value); or

b) *Alternative B* - apply the separate presentation requirements to all embedded derivatives. This approach would require entities to separate all embedded derivatives for the purpose of applying the presentation requirements even if the hybrid contract as a whole is measured at fair value through profit or loss.

Chapter 3: Presentation of equity instruments

3.1 In the DP the IASB discusses the creation of two subclasses of equity: ‘Ordinary Shares’ and ‘Other than ordinary shares’. For the latter, the IASB suggests:

a) expanding the existing requirements on attribution of total comprehensive income (i.e. profit or loss and OCI for the reporting period) to encompass different subclasses of equity instruments. Thus, under the IASB’s preferred approach an entity would, in the statement of financial performance, attribute total comprehensive income to ordinary shares, non-cumulative preference shares, NCI, warrants and any derivatives of own equity that are classified as equity; and

b) updating the instrument’s carrying amount directly through an attribution mechanism. This together with the statement of changes in equity would help users in assessing the allocation of residual returns among those equity instruments.

3.2 The DP explores different methods of attributing total comprehensive income to derivative (e.g. warrants) and non-derivatives (e.g. non-cumulative preference shares) classified as equity.

3.3 When attributing total comprehensive income, the entity would:

a) first attribute total comprehensive income to non-controlling interest as is required at present under IAS 1 *Presentation of Financial Statements*.

b) second, attribute the remaining amount of total comprehensive income to non-derivative equity instruments based on the calculation of basic earnings per share in accordance with IAS 33 *Earnings per Share.*

c) attribute the remaining amount of total comprehensive income to derivative equity instruments which could be based on one of three possible methods (described below).

d) finally, the entity would attribute the remaining income expenses to ordinary shares.

Allocation to non-derivative instruments

3.4 In the case of non-derivative equity instruments other than ordinary shares, the attribution should follow the existing calculation for basic earnings per share in IAS 33 and these amounts would be presented on the face of the statement of financial performance.

Allocation to derivative instruments

3.5 In the case of derivative equity instruments, the IASB provides four alternatives. The IASB does not have a preliminary view about which of the following four approaches would best balance the costs and benefits of improving information provided to users of financial statements. The first approach is to maintain current requirements on attribution and improve disclosure requirements. The remaining approaches are the following:

	Full fair value approach	Average-of-period approach	End-of-period approach
Method	Attribute total comprehensive income to derivative equity instruments equal to change in their fair value.	Use the average-of-period fair value ratio to apportion the entity's total comprehensive income for the period.	Reallocate the end-of-period fair value amount of equity among the various derivative equity instruments and ordinary shares so as to reflect the end-of-period ratio of fair values.
Key Advantages	Similar information about changes in fair value of all derivatives on own equity regardless of their classification.	The amount attributed to the derivative equity instruments and ordinary shares proportionate to their fair value. Similar to IAS 33 diluted EPS approach but uses the fair value instead of the strike price as a basis and takes into account both dilutive and anti-dilutive effects.	Might better depict the relative carrying amounts of the total of the different components of equity at the end of the period than other approaches.
Key Disadvantages	Changes in fair value could exceed total comprehensive income, resulting in a negative amount being attributed to ordinary shares even when the entity made a profit.	Might not provide useful information about the end-of-period carrying amounts.	May not accurately depict distribution of returns during the period because changes in the carrying amounts of derivative equity instruments would include catch-up and other adjustments.

3.6 Under the full fair value approach, the total comprehensive income attributed to the warrants and forward contracts are represented by the change in their respective fair values.

3.7 Under the end of period approach, the fair value at the end of the year of the ordinary shares, warrants and the forward contracts are weighed and the ratio is applied to the *carrying amount of net assets at year end*.

3.8 Under the average of period approach, the average fair value of the ordinary shares, warrants and the forward contracts are weighed and the ratio is applied to the *total comprehensive income for the period*.

3.9 An Illustrative example is included in Appendix 3.

Chapter 4: Disclosure of financial instruments

4.1 The DP states that providing the following information 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. 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.

Illustrative example on priority of claims

	201x
Senior secured loan	2 500
Junior secured loan	1 500
Subordinated note(s)	1 000
Finance leases	450
Pension plan deficit	500
Other financial liabilities	500
Liabilities	**6 450**
Non-cumulative preference shares	1 000
Non-controlling interest	415
Shareholders' equity	1 350
Total group equity	**2 765**
Total Capitalisation	**9 125**

b) information about potential dilution of ordinary shares. These disclosures would include potential dilution for all potential issuance of ordinary shares. The following table illustrates a reconciliation of changes in the number of ordinary shares outstanding and in the maximum number of additional potential ordinary shares that could be issued during the period:

	Ordinary shares outstanding	Maximum additional number of potential ordinary shares
1 January 20x1	5,000,000	900,000
1 January 20x1 - Issue of warrants	-	600,000
1 March 20x1 – Issue of ordinary shares	200,000	-
1 June 20x1 – Conversion of bonds	20,000	(20,000)
1 September 20x1 - Exercise of warrants	400,000	(400,000)

	Ordinary shares outstanding	Maximum additional number of potential ordinary shares
31 December 20x1	5,620,000	1,080,000

c) information about terms and conditions should be provided for both financial liabilities and equity instruments in the notes to the financial statements.

Appendix 1 – Illustrative example for a statement of financial performance

4.2 Below you may find an illustrative example developed by EFRAG for the statement of financial performance. The objective it is just to illustrate the presentation requirements and not on how the entity's performance would change.

IAS 32

Statement of profit or loss

	20x2	20x1
Sales	10 000	10 000
Cost of sales	(9 000)	(9 000)
Interest on bonds	(233)	(233)
Shares redeemable at fair value	(80)	-
Forward to sell shares (net-share settlement)	(50)	-
Commodity indexed forward contract	(50)	-
Profit for the year	**588**	**768**
Profit for the year attributable to:		
Owners of the company - ordinary shares	564	737
Non-controlling interest	23	31

Statement of profit or loss and other comprehensive income

	20x2	20x1
Profit for the year	588	768
Total other comprehensive income	**588**	**768**
Total comprehensive income	**588**	**768**
Total comprehensive income for the year attributable to:		
Owners of the company - ordinary shares	565	738
Non-controlling interest	23	30

IASB's preferred approach

Statement of profit or loss

	20x2	20x1
Sales	10 000	10 000
Cost of sales	(9 000)	(9 000)
Interest on bonds	(233)	(233)
Dividends on cumulative preference shares	(60)	-
Commodity indexed forward contract	(50)	-
Profit for the year	**658**	**768**
Profit for the year attributable to:		
Owners of the company - ordinary shares	631	737
Non-controlling interest	26	31

Statement of profit or loss and other comprehensive income

	20x2	20x1
Profit for the year	658	768
Shares redeemable at fair value (fully dependent:new OCI)	(80)	-
Foreign currency written call option (partially dependent:new OCI)	(50)	-
Total other comprehensive income	**528**	**768**
Total comprehensive income	**528**	**768**
Total comprehensive income for the year attributable to:		
Owners of the company - ordinary shares	350	656
Non-Derivative Senior Class of Equity	56	81
Derivative Senior Class of Equity	101	-
Non-controlling interest	21	31

Appendix 2 – Illustrative example for a statement of financial position

4.3 Below you may find an illustrative example developed by EFRAG for the statement of financial position for an entity presenting more than the two minimum line items required by IAS 1. The objective it is just to illustrate the presentation requirements and not on how the entity's financial position would change.

IAS 32

Statement of financial position

	20x2	20x1
Property, Plant and Equipment	44 000	44 000
Cash	1 768	1 000
Total Assets	**45 768**	**45 000**
Non-current liabilities		
Ordinary bonds	9 000	9 000
Forward sell shares (net-share settlement)	2 050	2 000
Share-settled bonds	3 000	3 000
Commodity indexed forward contract	4 050	4 000
Current liabilities		
Shares redeemable for their fair value	1 080	1 000
Total Liabilities	**19 180**	**19 000**
Ordinary shareholders equity	15 000	15 000
Retained earnings	3 564	3 000
Cumulative preference shares	2 000	2 000
Foreign currency denominated written call option (rights issue)	1 000	1 000
Warrants (fixed-for-fixed)	2 000	2 000
Non-cumulative preference shares	2 000	2 000
Non-controlling interest	1 024	1 000
Total Equity	**26 588**	**26 000**

IASB's preferred approach

Statement of financial position

	20x2	20x1
Property, Plant and Equipment	44 000	44 000
Cash	1 778	1 010
Total Assets	**45 778**	**45 010**
Non-current liabilities		
Ordinary bonds	9 000	9 000
Share-settled bonds (*new rational for classification*)	3 000	3 000
Commodity indexed forward contract	4 050	4 000
Cumulative preference shares (*new classification*)	2 060	2 000
Foreign currency written call option (*separate presentation:PD*)	1 050	1 000
Current liabilities		
Shares redeemable for their fair value (*separate presentation:D*)	1 080	1 000
Total Liabilities	**20 240**	**20 000**
Ordinary shares	15 000	15 000
Retained earnings	3 380	2 900
Other comprehensive income (*from ordinary shares and other*)	(30)	100
Other than ordinary shares		
Derivative Senior Class of Equity (*attribution 3 methods*)		
. Warrants (fixed-for-fixed)	2 050	2 000
. Net-share settled Forward sell shares (new classification)	2 050	2 000
. Embedded derivative in compound instrument	11	10
Non-Derivative Senior Class of Equity (*attribution IAS 33*)		
. Non-cumulative preference shares	2 056	2 000
Non-controlling interest	1 021	1 000
Total Equity	**25 538**	**25 010**

4.4

Appendix 3 – Illustrative example on attribution requirements

4.5 Below you may find an illustrative example developed by EFRAG for the statement of financial position for an entity presenting more than the two minimum line items required by IAS 1. The objective it is just to illustrate the presentation requirements and not on how the entity's financial position would change

Statement of profit or loss

In monetary units	IAS 32	Full fair value	Average of period	End of period
Income	20,000	20,000	20,000	20,000
Expenses	(5,000)	(5,000)	(5,000)	(5,000)
Net result	**15,000**	**15,000**	**15,000**	**15,000**
Attributed to:				
Warrants	-	5,000	2,692	957
Ordinary shares	15,000	10,000	12,300	14,043
EPS (Basic)	15	10	12.3	14
Number of ordinary shares	1,000	1,000	1,000	1,000
Warrants: number of shares to be issued	1,000	1,000	1,000	1,000
Full fair value				
Changes in fair value of warrants		5,000		
End of period approach				
Fair value of ordinary shares at year end			120,000	*92.31%*
Fair value of warrants at year end			10,000	*7.69%*
Carrying amount of net assets at year end			100,000	
Net assets attributable to warrants based on their relative fair value at year end			7,692	
Carrying amount of warrants at beginning of the year			5,000	
Amount attributed to warrants (100 000 x 7.69% - 5 000)			2,692	
Average of the period approach				
Average fair value of ordinary shares over the year				110,000
Average fair value of warrants over the year				7,500
Total				117,500
Weight of warrants				6.38%
Net result at year end				15,000
Amount attributed to warrants (15 000 x 6.38%)				957

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