

Scope of IFRS 7 and Additional disclosures

Issues Paper

Introduction and Objective

- 1 The objective of this paper is to discuss the IASB's tentative decisions on:
 - (a) the scope and objective of IFRS 7 *Financial Instruments: Disclosures* to cover the proposed disclosure requirements in relation to an entity's issued equity instruments; and
 - (b) additional disclosure proposals identified as a result of the IASB's deliberations on the classification and presentation topics in the FICE project.
- 2 The proposed disclosures tentatively agreed by the IASB in April 2023 will be in addition to the proposed disclosures that were tentatively agreed in the April and May 2021 IASB meetings regarding the terms and conditions, priority on liquidation and potential dilution.
- 3 The table below reflects the April IASB's tentative decisions and the relevant IASB Staff analysis included in its [Agenda Paper 5B](#).

Topic	IASB's tentative decisions	IASB Staff analysis
Scope of IFRS 7	<p>The IASB tentatively decided:</p> <p>(a) to expand the objective of IFRS 7 to enable users of financial statements to understand how an entity is financed and what its current and potential ownership structures are; and</p> <p>(b) to delete the reference to derivatives that meet the definition of an equity instrument in IAS 32 <i>Financial Instruments: Presentation</i> from paragraph 3(a) of IFRS 7, which excludes such derivatives from the scope of the latter Standard.</p>	<p>There are no specific disclosure requirements in IFRS 7 in regard to an entity's issued equity instruments or equity components of compound instruments as equity instruments are not remeasured and disclosures are not needed to meet the current IFRS 7 objectives¹.</p> <p>Both users and preparers acknowledged that this information was lacking.</p> <p>The overall objective will cover the more specific objectives, for example to require entities to provide disclosures that enable users to understand:</p> <ul style="list-style-type: none"> (a) the nature, amount, timing and uncertainty of cash flows from issued financial instruments; (b) dilution that could arise from any potential increase in the number of issued ordinary shares; and (c) the nature and priority of claims and the risks and returns of financial instruments on liquidation of the entity. <p>Regarding deleting the reference to derivatives that meet the definition of an equity instrument in IAS 32 from paragraph 3(a) of IFRS 7², if the objectives in IFRS 7 are expanded, then there would no longer be a need for this exclusion.</p>

¹ Paragraph 1 of IFRS 7 reflects the objectives and states: *'The objective of this IFRS is to require entities to provide disclosures in their financial statements that enable users to evaluate:*

(a) the significance of financial instruments for the entity's financial position and performance; and

(b) the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.'

² Paragraph 3(a) of IFRS 7 states *'Entities shall also apply this IFRS to all derivatives linked to interests in subsidiaries, associates or joint ventures unless the derivative meets the definition of an equity instrument in IAS 32'*.

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Terms and conditions disclosures		
<p>Further refinement of disclosures from April 2021 tentative decision</p>	<p>The IASB tentatively decided:</p> <p>(a) to include explanations and examples of 'debt-like' and 'equity-like' features in the sections of the forthcoming exposure draft containing application guidance and illustrative examples;</p> <p>(b) to clarify that the disclosures of 'debt-like' and 'equity-like' features would include both quantitative and qualitative information;</p> <p>(c) to require an entity to disclose the amounts allocated initially to the financial liability and equity components of compound financial instruments;</p>	<p>In April 2021, the IASB tentatively decided that, for financial instruments with characteristics of both financial liabilities and equity instruments (except for stand-alone derivatives), an entity would be required to disclose in the notes information about:</p> <ul style="list-style-type: none"> (a) 'debt-like features' in financial instruments that are classified as equity instruments; (b) 'equity-like features' in financial instruments that are classified as financial liabilities; and (c) debt-like and equity-like features that determine the classification of such financial instruments as financial liabilities, equity instruments or compound financial instruments. <p>Regarding tentative decision (a), The IASB Staff received feedback from stakeholders that it would be key for the IASB to define debt-like features or equity-like features or to provide additional guidance. Therefore, the IASB Staff will include explanations and examples of debt-like and equity-like features from Agenda Paper 5A of the April 2021 meeting in the Application Guidance and Illustrative Examples to the forthcoming Exposure Draft.</p> <p>Regarding tentative decision (b), providing both quantitative and qualitative information will help the users understand the impact of these features on the nature, amount, timing and uncertainty of the entity's cash flows.</p> <p>Regarding tentative decision (c), providing information on the amounts allocated initially to the financial liability and equity components of compound financial instruments would be useful to users of financial</p>

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		instruments because after separation, it is not always clear that the components were part of a compound instrument.
Other terms and conditions disclosures	<p>The IASB tentatively also decided:</p> <p>(d) to require an entity to disclose the significant judgements it made in classifying the financial instrument, or its component parts, as a financial liability or as equity; and</p> <p>(e) to require an entity to disclose, if applicable, information about terms and conditions that become, or stop being, effective with the passage of time before the end of the contractual term of the instrument.</p>	<p>Regarding tentative decision (d):</p> <p>(a) Paragraph 15 of IAS 32 requires an issuer of a financial instrument to classify the financial instrument, or its component parts, as a financial liability or as equity in accordance with the substance of the contractual arrangement and the definitions of a financial liability and an equity instrument. However, in some cases, significant judgment would be required in determining the classification, e.g., fixed-for-fixed condition whereby an entity may be required to apply judgement in determining whether an adjustment is a preservation adjustment or a passage-of-time adjustment and whether it is an allowable adjustment.</p> <p>(b) An explicit requirement to disclose significant judgements in classifying a financial instrument would help users of financial statements understand why specified instruments are classified as financial liabilities or equity.</p> <p>Regarding tentative decision (e):</p> <p>(a) in June 2022, the IASB tentatively agreed that reclassifications between financial liabilities or equity instruments are generally prohibited other than for changes in the substance of the contractual terms arising from changes in circumstances outside the contract. This means reclassification is prohibited if there are changes in the substance of the contractual terms as</p>

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		<p>a result of the passage of time that are known or anticipated at inception of the contract.</p> <p>(b) The IASB Staff consider that disclosure, if applicable, of terms and conditions that become effective or cease to be effective with the passage-of-time before the end of the contractual term of the instrument, will help users better understand the nature, amount, timing, and uncertainty of cashflows and other features arising from these types of financial instruments.</p>
Additional disclosure requirements		
Reclassifications	<p>The IASB tentatively decided:</p> <p>(a) to relocate the disclosure requirement in paragraph 80A of IAS 1 <i>Presentation of Financial Statements</i> to IFRS 7 and expand it to cover reclassifications when changes in the substance of the contractual terms arise from changes in circumstances outside the contract. An entity would be required to disclose the amounts reclassified into and out of financial liabilities or equity, and the timing and reason for that reclassification.</p>	<p>In June 2022, the IASB tentatively agreed to add general requirements in IAS 32 to prohibit reclassifications other than for changes in the substance of the contractual terms arising from changes in circumstances outside the contract. This does not affect reclassifications that are already required in IAS 32, e.g., specific reclassification requirements on puttable instruments and obligations arising on liquidation.</p> <p>In order to help users to understand the change in classification and its effect on measurement, if any, the IASB Staff recommended that the disclosure requirement in paragraph 80A of IAS 1 for a reclassification of puttable instruments and obligations arising on liquidation is relocated to IFRS 7 and expanded to cover reclassifications when changes in the substance of the contractual terms arise from changes in circumstances outside the contract.</p>
Obligations to redeem own equity instruments	<p>The IASB tentatively decided:</p>	<p>The IASB Staff proposed more comprehensive disclosures in order for users to understand the accounting treatment for obligations to redeem own equity instruments (whereby a financial liability is recognised with a corresponding debit to equity).</p>

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	<p>(b) to require an entity to disclose, for instruments containing obligations to redeem its own equity instruments:</p> <ul style="list-style-type: none"> (i) the amount removed from equity and included in financial liabilities when the obligation was initially recognised and the component of equity from which it was removed; (ii) the amount of remeasurement gain or loss recognised in profit or loss during the reporting period; (iii) the amount of gain or loss, if any, that was recognised on settlement if the obligation is settled during the reporting period; (iv) the amount removed from financial liabilities and included in equity if the written put option has expired unexercised; and (v) the cumulative amount transferred within equity and the component of equity to which it was transferred, if any cumulative amount in retained earnings was transferred. 	<p>There are some disclosures in IFRS 7 on the entity's exposure to and management of liquidity risk and IAS 1 on disclosure, for each class of share capital, the rights, preferences and restrictions attaching to that class including restrictions on the repayment of capital. However, these are not specific to instruments containing obligations to redeem own equity instruments.</p>
Financial liabilities	The IASB tentatively decided:	In December 2022, the IASB tentatively decided to require an entity to disclose the total gains or losses during a reporting period that arise from

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<p>containing contractual obligations to pay amounts based on an entity's performance or changes in the entity's net assets</p>	<p>(c) to amend paragraph 20(a)(i) of IFRS 7 to require the separate disclosure of the total gains or losses in each reporting period that arise from remeasuring financial liabilities containing contractual obligations to pay amounts based on an entity's performance or changes in the entity's net assets.</p>	<p>remeasuring financial liabilities containing contractual obligations to pay amounts based on an entity's performance or changes in its net assets and that are measured at fair value through profit or loss. Applying paragraph 20(a)(i) of IFRS 7, the net gain or net loss on financial liabilities designated as at fair value through profit or loss would be presented or disclosed separately from the net gain or net loss on financial liabilities mandatorily measured at fair value through profit or loss.</p> <p>In April 2023, the IASB Staff recommended a further disaggregation for both financial liabilities designated and mandatorily measured at fair value through profit or loss.</p>

- 4 The IASB Staff did not propose additional disclosures for the following:
- (a) Economic compulsion and indirect obligations:
 - (i) Some financial instruments that are classified as equity instruments may contain economic incentives. For example, some perpetual instruments include a contractual feature that resets the coupon rate to a higher rate if not called on the first call date. Applying IAS 32, economic incentives that might influence the issuer's decision to exercise its rights are not considered when classifying a financial instrument as a financial liability or an equity instrument. Many respondents to the 2018 Discussion Paper *Financial Instruments with Characteristics of Equity* (the DP) suggested that the IASB develop disclosure requirements about the contractual terms and the associated economic incentives.
 - (ii) The IASB Staff indicated that this information is already covered by the proposed requirements to disclose debt-like features and equity-like features in financial instruments with characteristics of debt and equity. Therefore, the IASB Staff did not recommend additional disclosure requirements.
 - (b) Restriction to transfer funds:
 - (i) In response to the DP, a few stakeholders indicated that users of financial statements often look for information about the nature and extent of any significant restrictions on the entity's ability to transfer funds to its shareholders in the form of cash dividends or on the entity's ability to repay its debt.
 - (ii) The IASB Staff did not recommend further disclosures on this because there are specific disclosure requirements in IAS 7³, IFRS 7⁴ and if these disclosures are not sufficient, the entity would be required to provide additional information to enable users of financial statements to understand the impact of the restrictions on the entity's financial position. This was confirmed by the IFRS Interpretations Committee in the March 2022 update for the topic on Demand Deposits with Restrictions on Use arising from a Contract with a Third Party.
 - (c) Compound financial instruments containing contingent settlement provisions:
 - (i) In December 2021, the IASB tentatively decided to clarify that financial instruments with contingent settlement provisions may be compound instruments and that payments at the discretion of the issuer are recognised in equity, even if all the proceeds are initially allocated to the liability component of a compound financial instrument. Some users of financial statements would prefer dividends on such financial instruments to be recognised in profit or loss because they believe

³ Paragraph 48 of IAS 7 *Statement of Cashflows* requires an entity to disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the entity that are not available for use.

⁴ In IFRS 7, an entity would be required to provide disclosures about liquidity risk arising from financial instruments and how an entity manages that risk. Furthermore, paragraph 14 of IFRS 7 requires an entity to disclose information about financial assets pledged as collateral and are no longer available for the use of the entity.

there is less transparency about the returns to ordinary shareholders if they are recognised in equity.

- (ii) The IASB Staff did not recommend any additional disclosure requirements because in February 2023, the IASB decided to amend paragraph 107 of IAS 1 and require an entity to present dividends recognised as distributions to ordinary shareholders separately from dividends recognised as distributions to other owners during the period. This would address the users' concerns on transparency. Also, the IASB's tentative decisions on proposed disclosures of terms and conditions (debt-like and equity-like features) would provide additional information about these compound instruments.
- (d) The effects of laws on the contractual terms:
- (i) As a result of the February 2023 IASB tentative decision, an entity would consider only enforceable contractual terms that give rise to rights and obligations in addition to, or more specific than, those established by applicable law in classifying a financial instrument as a financial liability or equity instrument.
 - (ii) The IASB Staff did not recommend any additional disclosures in regard to:
 - laws and regulations that prevent the enforceability of a contractual term, given that such disclosure would not provide any additional benefit to users of financial statements.
 - legal requirements that could affect the timing and amount of future cash flows of issued financial instruments as this would result in disclosure overload given the broad scope of information that could be captured and consequently not be useful to users of financial statements.

EFRAG Secretariat analysis

- 5 The EFRAG Secretariat welcomes the additional disclosures proposed by the IASB. In [EFRAG's comment letter](#) on the DP, EFRAG highlighted the importance of improving the disclosure requirements for financial instruments with characteristics of equity. EFRAG's comment letter indicated that the IASB should give high priority to additional disclosures on the terms and conditions of financial instruments with characteristics of equity.
- 6 The EFRAG Secretariat notes that in EFRAG's comment letter, EFRAG stated some points to consider, e.g., (a) information about early redemptions and incentives to pay and (b) information about the nature and extent of any significant restrictions of the entity's ability to transfer funds to its shareholders in the form of cash dividends or any significant restrictions of the entity's ability to repay debt. The IASB Staff considered these two topics but did not propose additional disclosures. Their reasoning is stated in paragraph 4(a) and 4(b) above.

Questions for EFRAG FR TEG

- 7 Does EFRAG FR TEG agree with the expansion of the scope in IFRS 7? Please explain.
- 8 Does EFRAG FR TEG agree with the proposed disclosures? Please explain.