

## **Financial Instruments with Characteristics of Equity Subsidiaries without Public Accountability**

### **Objective**

- 1 The objective of the session is to discuss the due process and which disclosures should be proposed in the Financial Instruments with Characteristics of Equity Exposure Draft (FICE ED) as consequential amendments to the forthcoming and new IFRS Standard *Subsidiaries without Public Accountability* (IFRS SWPA)

### **Due process**

#### *Due process related to subsidiaries without Public Accountability*

- 2 In developing the proposed disclosure requirements included in the Exposure Draft *Subsidiaries without Public Accountability: Disclosures* (ED SWPA), the IASB considered:
  - (a) issued IFRS Accounting Standards as at 28 February 2021; and
  - (b) exposure drafts published as at 1 January 2021.
- 3 The IASB also stated in its ED SWPA that if the IASB's proposals proceeded to a final IFRS Standard, the IASB would need to consider updating the forthcoming and new IFRS SWPA for any new or amended disclosure requirements arising from new IFRS Standards or amendments to IFRS Standards.
- 4 In addition, the IASB stated that it would propose amendments to update the IFRS SWPA in exposure drafts that propose new or amended disclosure requirements for IFRS Standards. This would facilitate consideration of the amendments to the Standard at the same time as the related amendments to IFRS Accounting Standards are being discussed.
- 5 At its June 2022 meeting, the IASB discussed how to consider amendments to IFRS Accounting Standards that were not considered when the ED SWPA was developed. At that meeting, the IASB tentatively decided to:
  - (a) include in the ED SWPA disclosure requirements in IFRS Accounting Standards issued as at 28 February 2021;
  - (b) consider amendments to the disclosure requirements in IFRS Accounting Standards issued after 28 February 2021 after the IFRS SWPA is issued (i.e. in a catch-up ED).
- 6 Finally, at its May 2023 meeting, the IASB tentatively decided that until the IASB issues an amendment to the prospective IFRS SWPA, eligible subsidiaries would be required to comply with disclosure requirements in amendments to IFRS Accounting Standards that have been issued after the publication of the ED SWPA.

#### *Proposed due process within the FICE*

- 7 In its project on FICE, the IASB expects to publish a FICE ED in the last quarter of 2023.
- 8 The FICE ED is expected to be published before the issue of the new IFRS SWPA.

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- 9 In its meeting in May 2023, the IASB staff noted that the FICE ED would be the first exposure draft to include proposed consequential amendments to the IFRS SWPA. It was also noted that it was expected that a similar process will be followed for future exposure drafts.

### *EFRAG Secretariat analysis*

- 10 The EFRAG Secretariat acknowledges the benefit discussing amendments to the forthcoming IFRS SWPA at the same time as the related amendments to IFRS Accounting Standards (i.e., IAS 32) are being discussed.
- 11 However, the EFRAG Secretariat expresses concerns that the IASB is planning to include amendments to IFRS SWPA in the forthcoming FICE ED as:
- (a) this would mean discussing potential amendments to a IFRS Standard that does not exist at the date of publication of the FICE ED;
  - (b) such an approach means that the EFRAG Secretariat will have to engage with and get input from subsidiaries without public accountability, who are likely to not be aware of the forthcoming IFRS SWPA and its content.
  - (c) such an approach will require additional effort from the EFRAG Secretariat to inform EFRAG's stakeholders on this project (overview of the project), who might not be yet prompted to provide input since there is still no IFRS SWPA issued; and
  - (d) the first consequential amendments to IFRS SWPA would be discussed within a complex project such as FICE.
- 12 However, the EFRAG Secretariat acknowledges that this approach would be an exception and that an alternative would be including the proposals on disclosures related to FICE in the catch-up ED to IFRS SWPA (however, the catch-up ED would have to wait for the IASB's tentative decisions on the disclosures in its FICE project during the redeliberation period). Another alternative is to issue an ED on SWPA after the amendments to IAS 32 are issued. However, this would significantly delay the process of adding FICE disclosures into the IFRS SWPA.

### **Questions for EFRAG FR TEG members**

- 13 Do EFRAG FR TEG members agree with the IASB's tentative decision to include in the forthcoming FICE ED consequential amendments to the forthcoming IFRS SWPA?
- 14 If not, do EFRAG FR TEG members have any suggestions on how the IASB should proceed?

### **Proposed disclosures for forthcoming IFRS Standard *Subsidiaries without Public Accountability***

- 15 In its May 2023 meeting, the IASB considered each of the disclosures tentatively decided in the FICE ED and assessed them against the principles for disclosures in the ED SWPA.
- 16 In developing the disclosure requirements in the IFRS for SMEs Standard, the IASB was guided by five principles in considering users' information needs (which are in paragraph BC157 of the Basis for Conclusions to the IFRS for SMEs Standard). These principles identify the information that users find important:
- (a) *"Users of the financial statements of SMEs are particularly interested in information about short-term cash flows and about obligations,*

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*commitments or contingencies, whether or not recognised as liabilities. Disclosures in full IFRSs that provide this sort of information are necessary for SMEs as well.*

- (b) *Users of the financial statements of SMEs are particularly interested in information about liquidity and solvency. Disclosures in full IFRSs that provide this sort of information are necessary for SMEs as well.*
- (c) *Information on measurement uncertainties is important for SMEs.*
- (d) *Information about an entity’s accounting policy choices is important for SMEs.*
- (e) *Disaggregations of amounts presented in SMEs’ financial statements are important for an understanding of those statements.*
- (f) *Some disclosures in full IFRSs are more relevant to investment decisions in public capital markets than to the transactions and other events and conditions encountered by typical SMEs.”*

- 17 Considering these principles, the IASB staff recommended that the FICE ED includes consequential amendments to the IFRS SWPA consistent with those proposed in the FICE ED in the following areas:

Disclosures	Reasoning
Terms and conditions - debt-like and equity-like features	Such disclosures would provide useful information for users to better forecast future cash flows, including short-term cash flows
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;	Such disclosures provide useful information about future cash flows
Instruments containing obligations to redeem own equity instruments	Such disclosures provide useful information about disaggregation of amounts and accounting policy choices
Information 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	Such disclosures provide useful information about disaggregation of amounts
Significant judgements made in determining the classification of a financial instrument	Such disclosures provide useful information about accounting policy choices

- 18 In addition, the IASB Staff recommend that the FICE ED does not include the following disclosures for the SWPA:

Disclosures	Reasoning
Potential dilution	This type of disclosure is more relevant to investments decisions in public capital markets than to transactions and events encountered by eligible subsidiaries
Nature and priority of claims against an entity	This information impacts liquidity and solvency and may impact future cash flows, however this additional information does not justify the additional cost of preparing and presenting this information
Terms and conditions about priority on liquidation	This information is not a priority for eligible subsidiaries and does not meet the list of principles in BC157
Disclosure objectives	The ED SWPA does not include disclosure objectives in general
Other disclosures such as explanations and examples of 'debt-like' and 'equity-like' features in the sections containing application guidance and illustrative and disclosures on reclassifications when changes in the substance of the contractual terms arise from changes in circumstances outside the contract.	This information does not seem to meet the list of principles in BC157

- 19 After a comprehensive discussion of the IASB staff proposals, the IASB agreed with the IASB's staff proposal to include consequential amendments to the IFRS SWPA to include the disclosures referred in paragraph 15 (except, for Instruments containing obligations to redeem own equity instruments, disclosing 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).
- 20 In addition, the IASB tentatively decided to include consequential amendments to the IFRS SWPA to include disclosures on nature and priority of claims against the entity.
- 21 More specifically, the IASB tentatively decided to propose consequential amendments to be made to the IFRS SWPA after it has been issued. The amendments would add to the Standard the following disclosure requirements that are to be proposed in the FICE exposure draft:
- (a) for all financial liabilities and equity instruments within the scope of IAS 32 Financial Instruments: Presentation, an entity would disclose and categorise claims against its assets in a way that reflects differences in their nature and priority, and at a minimum, distinguishes between:
    - (i) secured and unsecured financial instruments; and

- (ii) contractually subordinated and unsubordinated financial instruments;
- (b) for financial instruments with characteristics of both financial liabilities and equity instruments (except for stand-alone derivatives), an entity would disclose information about:
  - (i) debt-like features in financial instruments that are classified as equity instruments;
  - (ii) equity-like features in financial instruments that are classified as financial liabilities;
  - (iii) debt-like and equity-like features that determine the classification of such financial instruments as financial liabilities, equity instruments or compound financial instruments;
  - (iv) terms and conditions that indicate priority on liquidation;
  - (v) terms and conditions that could lead to changes in priority on liquidation;
  - (vi) more than one level of contractual subordination, if applicable (for example, if some subordinated liabilities are contractually subordinated to other subordinated liabilities);
  - (vii) any significant uncertainty regarding the application of relevant laws or regulations that could affect how priority will be determined on liquidation; and
  - (viii) intra-group arrangements such as guarantees that may affect their priority on liquidation (for example, which entities are providing and receiving guarantees);
- (c) an entity would disclose 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 financial instrument;
- (d) for instruments containing obligations to redeem own equity instruments, an entity would disclose:
  - (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; and
  - (iv) the amount removed from financial liabilities and included in equity if the written put option has expired unexercised;
- (e) an entity would separately disclose the total gains or losses in each reporting period that arise from remeasuring financial liabilities containing contractual obligations to pay amounts based on the entity's performance or changes in the entity's net assets (that are measured at fair value through profit or loss); and
- (f) an entity would disclose the significant judgements it made in determining the classification of a financial instrument, or its component parts, as a financial liability or as equity.

*EFRAG Secretariat analysis*

- 22 The EFRAG Secretariat highlights that the assessment of users' needs in terms of disclosures (i.e., whether the IASB's proposed disclosures are sufficient) is difficult and subjective.
- 23 In general, subsidiaries without public accountability that are under the scope of the ED SWPA are not expected to issue complex financial instruments that are typically under the scope of the project on FICE. Still, the EFRAG Secretariat agrees with the IASB's tentative decision which seems to be fair balance between costs and benefits related to providing disclosures.
- 24 Nonetheless, the EFRAG Secretariat considers that the entities that would apply the IFRS SWPA would benefit from examples/guidance of 'debt-like' and 'equity-like' features as this is a key concept and these would be included in the FICE ED. Also, the EFRAG Secretariat considers that the IFRS SWPA should be independent as much as possible from the IFRS Accounting Standards, therefore, we suggest minimising cross references to the IFRS Accounting Standards (including any cross references to examples/guidance in the FICE ED/future amendments).
- 25 Also, the EFRAG Secretariat highlights providing disclosures on the nature and priority of claims against an entity may involve some costs as it covers all financial liabilities and equity instruments in the scope of IAS 32. The EFRAG Secretariat will need to engage with eligible subsidiaries to make a cost and benefits analysis.

**Questions for EFRAG FR TEG members**

- 26 Do EFRAG FR TEG members agree with the IASB's tentative decision?
- 27 If not, do EFRAG FR TEG members have any suggestions on how the IASB should proceed in terms of disclosures to be added to IFRS SWPA?