Financial Instruments with Characteristics of Equity
Presentation of equity and financial liabilities

Objective

1 The objective of this agenda paper is to discuss the IASB's latest tentative decisions on:

(a) *The presentation of equity instruments*: how to mitigate the concerns raised by stakeholders about the limited information an entity provides in its financial statements about equity instruments it has issued; and

(b) *The presentation of liability instruments*: how to mitigate the concerns raised by stakeholders relating to a subset of financial liabilities subsequently measured at fair value through profit or loss, applying IFRS 9 *Financial Instruments*. More specifically, whether the changes in the carrying amount of the financial liability should be presented in profit or loss or equity when the financial liability contains a contractual obligation to pay the holder an amount based on the entity's performance or changes in the entity's net assets.

Presentation of equity instruments

What is the issue?

2 Stakeholders, particularly users of financial statements, have raised concerns that the information an entity provides about equity instruments that it has issued is too limited. The absence of specific IFRS requirements to provide more detailed information about various types of equity instruments is one of the reasons why some equity investors and analysts support a narrow definition of equity.

3 Users of financial statements have been asking for better information about the impact of other classes of equity on ordinary shares. That is, a clearer distinction of the distribution of profits amongst holders of different types of equity instruments so that they can understand the impact of other classes of equity instruments have on ordinary shares. In addition, other stakeholders have suggested requiring separate presentation in the statement of financial position of the various equity instruments, including equity components of compound instruments and derivatives over own equity, to help users of financial statements better understand where the different components of complex financial instruments are presented within the equity caption of financial statements.

IASB proposals in the DP

4 In its Discussion Paper, the IASB's preliminary view was that the information required by IAS 1 *Presentation of Financial Instruments* should be improved to require total equity and changes in equity to be disaggregated between ordinary shares and equity instruments other than ordinary shares.

5 The IASB's preliminary view was also that the attribution for non-derivative equity instruments should be based on the existing requirements of IAS 33 *Earnings per Share*. However, the IASB did not form a preliminary view in relation to the attribution approach for derivative equity instruments. It considered only various attribution approaches and asked for feedback.

EFRAG Comment Letter

6 In its comment letter, EFRAG was concerned that the introduction of subclasses of equity and any attribution mechanisms would introduce significant complexity and increased costs for preparers without adding significant value to users. EFRAG also considered that the costs of the information provided by the attribution approaches (i.e., attributing total income and expense to equity instruments other than ordinary shares and updating the carrying amounts of those equity instruments based on that attribution) were likely to exceed the related benefits.

7 EFRAG also provided an alternative approach. To provide additional and relevant information about the effect of equity instruments other than ordinary shares, EFRAG considered that the IASB could combine a number of different improvements:

(a) improve presentation by requiring further disaggregation of equity on the face of the statement of financial position and disclosures related to the different components/classes of equity;

(b) improve current requirements in IAS 33 based on the shortcomings that the IASB identified in the DP; and/or

(c) improve current disclosures in IAS 33 on dilution, including the distribution of returns when there is full dilution.

The IASB discussions and tentative decisions

8 In December 2022, the IASB staff recommended that no changes were made to the presentation requirements in IAS 32 for equity instruments.

9 In the IASB's staff view, the following principles, requirements and tentative decisions provided an adequate basis for entities to present information about equity instruments:

(a) the principles and requirements in IAS 1 (e.g. paragraphs 54, 55, 77, 78, 79(b), 81B, 106(d), 107 and 108);

(b) the principles and requirements in IAS 33 (e.g. paragraphs 12 and 70);

(c) the tentative decisions made as part of the IASB's Primary Financial Statements (PFS) project (e.g. the new aggregation and disaggregation principles); and

(d) the IASB's tentative decisions on requiring disclosures on financial instruments with characteristics of equity, particularly on key terms and conditions and maximum potential dilution, which largely meet the information needs of users.

10 In December 2022, the IASB did not make any decisions on this matter but asked the IASB staff to further explore potential presentation requirements.

11 In February 2023, after discussing the IASB's Staff recommendations and the particular needs of investors in ordinary shares for transparency and clearer distinction of returns to ordinary shareholders, the IASB tentatively decided to amend the requirements in IAS 1 to ensure amounts attributable to ordinary shareholders are clearly visible and separately presented in an entity's statement of

financial position, statement(s) of financial performance and statement of changes in equity. These amendments would require an entity to:

(a) **Statement of financial position**: present line items on issued capital and reserves attributable to ordinary shareholders of the parent separately from issued capital and reserves attributable to other owners of the parent in the statement of financial position (paragraph 54(r) of IAS 1);

(b) **Statement of changes in equity:** Present each class of ordinary share capital separately from each class of other contributed equity in the statement of changes in equity (paragraph 108 of IAS 1);

(c) **Statement of financial performance**: profit or loss and comprehensive income for the period attributable to ordinary shareholders of the parent separately from the respective amounts attributable to other owners of the parent in the statement(s) of financial performance (paragraph 81B of IAS 1); and

(d) **Statement of changes in equity or in the notes**: the amount of dividends recognised as distributions to ordinary shareholders separately from dividends recognised as distributions to other owners during the period, and also present the related amount of dividends per share, either in the statement of changes in equity or in the notes (paragraph 107 of IAS 1).

12 Nonetheless, IASB members asked the IASB staff to consider further how the amounts attributable to ordinary shareholders would be disaggregated.

EFRAG Secretariat analysis/Recommendation

13 In its preliminary impact assessment included in EFRAG draft comment letter to the IASB 2018 DP, EFRAG observed that 16 companies provided different levels of disaggregation of their equity within the statement of financial position.

14 In general, most financial institutions (81%) presented additional equity components other than those required by IAS 1 (issued capital and reserves attributable to owners of the parent; and non-controlling interest).

15 However, the level of disaggregation of different equity components on the face of the statement of financial position varied. For example, two financial institutions provided very detailed information about the composition of their equity (showed more than 20 different line items) while three financial institutions did not provide any additional detail of the different equity components.

16 The following items were included on the face of the statement of financial position by more than one entity:

(a) Issued capital (81%);

(b) Share premium (63%);

(c) Retained earnings (56%);

(d) Other reserves (44%);

(e) Other equity instruments (38%);

(f) Translation differences (19%); and

(g) Treasury shares (13%).

17 When analysing financial institutions, the amounts related to hybrid securities were so significant that many financial institutions have been, even if not required, presenting these instruments separately as ‘other equity instruments’.

18 For vanilla convertible bonds and certain derivatives on own equity, the EFRAG Secretariat noticed that although the IASB often requires separation, for accounting purposes, of the different components of the financial instruments, it is difficult to identify and locate the equity components of these financial instruments which may be presented within different line items such as reserves, share premium and other equity instruments. The same applies to equity-settled share-based payments within the scope of IFRS 2 *Share-based Payments*.

19 Therefore, for these types of instruments, it is often difficult to identify and locate within the primary financial statements and related notes the amounts related to 'quasi-capital' components (i.e. instruments that are classified as equity but are not issued capital; give only third parties the right to buy equity in the future), even when considering the existing disclosure requirements (e.g. paragraph 17 of IFRS 7 Financial Instruments: Disclosures).

20 The EFRAG Secretariat acknowledges that the IASB is currently discussing potential improvements to the disaggregation and aggregation principles within the project Primary Financial Statements, which might alleviate some of the concerns above.

21 Nonetheless, the EFRAG Secretariat considers that improvements to the disaggregation within equity could be included in this project and welcomes the IASB's decision to make more visible (through separate presentation) a distinction between ordinary shareholders of the parent separately and other owners of the parent (fairly aligned with the IASB's preliminary view included in the DP that the information required by IAS 1 should be improved to require total equity and changes in equity to be disaggregated between ordinary shares and equity instruments other than ordinary shares but without updating the carrying amount of related instruments).

22 Still, this would raise the question of how such separation should be done (e.g. use of subtotals within equity or simply more disaggregation through additional line items).

23 In addition, it raises the question of how the attribution between ordinary shareholders of the parent and other owners of the parent should be made (i.e. whether it be in accordance with the alternative approaches included in the DP).

24 Considering this, it would be useful to see some illustrative examples explaining how the IASB's tentative decisions should be applied in practice.

Questions for EFRAG FR TEG

25 Do EFRAG FR TEG members have any comments on the IASB's tentative decisions?

26 Do EFRAG FR TEG members agree with EFRAG Secretariat Analysis?

Presentation of financial liabilities

What is the issue?

27 The IASB discussed the concerns raised by stakeholders relating to an entity's treatment of a subset of financial liabilities if the financial liabilities are measured at fair value through profit or loss in accordance with the requirements in IFRS 9 *Financial Instruments*.

28 Some stakeholders have questioned whether it is appropriate for an entity to recognise changes in the carrying amount of the financial liability in profit or loss when the financial liability contains a contractual obligation to pay the holder an amount based on:

(a) the entity's performance; or

(b) changes in the entity's net assets.

29 Stakeholders considered that it results in counter-intuitive accounting in profit or loss because gains are recognised when an entity performs poorly, and losses are recognised when an entity performs well.

IASB proposals in the DP

30 To address this issue, the Discussion Paper suggested a way of distinguishing financial liabilities with equity-like returns from other financial liabilities by:

(a) presenting these liabilities separately from other financial liabilities as a separate line item in the statement of financial position; and

(b) presenting separately income or expenses resulting from these liabilities in the statement of financial performance - outside the statement of profit or loss (P&L) in other comprehensive income (OCI).

EFRAG Comment Letter

31 EFRAG welcomed the IASB's efforts to address the concerns of some stakeholders that the current accounting requirements lead to counterintuitive outcomes when applied to liabilities with an equity-like return.

32 However, EFRAG was not convinced that expanding the use of Other Comprehensive Income ('OCI') was the most appropriate way to address those concerns and suggested that the IASB instead considered enhanced disclosures.

The IASB discussions and tentative decisions

33 In December 2022, the IASB staff recommended that no changes are made to the presentation requirements in IAS 32 to specifically address financial liabilities containing contractual obligations to pay amounts based on the entity's performance or changes in the entity's net assets. The IASB staff considered that the principles and requirements in IAS 1 (e.g. paragraph 85 of IAS 1), including any decisions to be made as part of the PFS project provided an adequate basis for entities to determine whether to present particular types of financial liabilities and their associated gains or losses separately in the financial statements.

34 However, the IASB staff recommended entities with these types of financial liabilities measured at fair value through profit or loss be required to disclose the total gains or losses recognised in profit or loss in each reporting period that arise from remeasuring such financial liabilities. Therefore, entities would be required to disclose separately the amount of the net gains or losses on financial liabilities designated and/or mandatorily measured at fair value through profit or loss (applying IFRS 7) that relates to these types of financial liabilities. These disclosures, together with the proposed disclosures of key terms and conditions for financial liabilities with equity-like features, will address the information needs of users of financial statements.

35 After discussing the IASB Staff recommendations, the IASB supported the IASB's staff recommendation and tentatively decided against adding to the presentation requirements in IAS 32 for financial liabilities.

36 The IASB also tentatively decided to require an entity with these types of financial liabilities measured at fair value through profit or loss to disclose in each reporting period the total gains or losses that arise from remeasuring such financial liabilities. These disclosures, together with the proposed disclosures of terms and conditions tentatively agreed to by the IASB in April 2021, will help to meet the information needs of users of financial statements.

EFRAG Secretariat analysis/Recommendation

37 The EFRAG Secretariat welcomes the IASB's tentative decisions on presentation of financial liabilities as they seem to be aligned with EFRAG's comment letter.

38 Nonetheless, the EFRAG Secretariat considers that there is a need to test the scope of such disclosures with different financial instruments and believes that this topic should give rise to separate question in the IASB's forthcoming exposure draft.

Questions for EFRAG FR TEG

39 Do EFRAG FR TEG members have any comments on the IASB's tentative decisions?

40 Do EFRAG FR TEG members agree with EFRAG Secretariat Analysis?