Mar. 26, 2024

IFRS Foundation
7 West ferry Circus
Canary Wharf
London E14 4HD, United Kingdom

RE: Exposure Draft, *Financial Instruments with Characteristics of Equity- Proposed amendments to IAS 32, IFRS 7 and IAS 1*

Dear Colleagues,

The Saudi Organization for Chartered and Professional Accountants (SOCPA) appreciates the efforts of the IASB and welcomes the opportunity to comment on the ED, ***Financial Instruments with Characteristics of Equity- Proposed amendments to IAS 32, IFRS 7 and IAS 1.***

As highlighted in our comments to the discussion paper on financial instruments with characteristics of equity – DP/2018/1 – June 2018, the classification of Islamic financial instruments as debt or equity under the principles of IAS 32 presents several challenges due to the fundamental differences in their structures compared to conventional interest-based instruments. Islamic finance emphasizes risk-sharing and asset-backed transactions. Consequently, the classification criteria outlined in IAS 32, which primarily rely on contractual terms and cash flow characteristics, may not adequately capture the nature of Sharia-compliant instruments. Instruments such as sukuk, which represent ownership in underlying assets or projects, often blur the lines between debt and equity, as they entail both periodic returns and ownership rights. This ambiguity complicates the application of IAS 32's classification framework, requiring careful consideration of the economic substance and contractual arrangements unique to Islamic finance to ensure accurate and consistent classification of these instruments. As the exposure draft has not considered our comments to the above referred discussion paper, we suggest additional guidance be issued to address these challenges effectively and promote alignment between Islamic finance principles and international financial reporting standards.

Our detailed comments on the questions raised in the Exposure Draft are attached in the appendix to this letter.

Please feel free to contact Dr. Abdulrahman Alrazeen at (razeena@socpa.org.sa) for any clarification or further information.

Sincerely,

Dr. Ahmad Almeghames

SOCPA Chief Executive Officer

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Appendix: SOCPA Comments on Exposure Draft, *Financial Instruments with Characteristics of Equity- Proposed amendments to IAS 32, IFRS 7 and IAS 1*

Question 1 — The effects of relevant laws or regulations (paragraphs 15A and AG24A–AG24B of IAS 32)

The IASB proposes to clarify that:

(a) only contractual rights and obligations that are enforceable by laws or regulations and are in addition to those created by relevant laws or regulations are considered in classifying a financial instrument or its component parts (paragraph 15A); and

(b) a contractual right or obligation that is not solely created by laws or regulations, but is in addition to a right or obligation created by relevant laws or regulations shall be considered in its entirety in classifying the financial instrument or its component parts (paragraph AG24B).

Paragraphs BC12–BC30 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

SOCPA Comments:

SOCPA overall agrees with the IASB's direction. The proposals provide important clarification by focusing on contractual rights and obligations enforceable by laws or regulations. The proposals clarify the classification framework while maintaining practicality. As noted in BC20, contractual terms are subject to negotiation and can be modified, while legal mandates apply universally and are non-negotiable.

We appreciate the emphasis on incremental contractual obligations (BC23). This concept could provide valuable information to users of financial statements. However, BC25 highlights the potential complexity of separating and accounting for such obligations individually. In situations like the variable conversion threshold example, separation becomes impractical.

Therefore, we suggest the IASB consider a middle ground:

- Focus on enforceable contractual rights and obligations as proposed. This ensures clarity and consistency while respecting contractual autonomy.
- Allow separate accounting for incremental contractual obligations in instances where it is feasible and provides meaningful information. This addresses the potential value of disaggregation while acknowledging practical limitations.
- Provide clear guidance on situations where separate accounting isn't practicable. This can help with consistent application and reduce ambiguity.

In addition, we recommend further analysis of specific instrument types and scenarios to assess the practical implications of the proposed approach. This will help identify any potential issues or unintended consequences before finalizing the amendments.

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SOCPA, based on information collected during an outreach carried out by SOCPA noted that certain constituents believed that taking into consideration the overall effects of laws (all-inclusive approach) could represent a significant change to current requirements, which would be beyond the scope of the project, particularly when considering that IFRS 9 is a contractual-based Standard. An all-inclusive classification approach (i.e., requiring the issuer of a financial instrument to consider contractual terms and rights as well as obligations established by relevant laws or regulations) could lead to significant classification changes, such as changes on the classification of ordinary shares with statutory minimum dividends, which would become liabilities (at least in part). They also noted that law and regulation can be changed unilaterally by an authority (without agreement from the counterparties in the contract) and, consequently, this could lead to continuous classification changes when there are frequent changes in the law.

Question 2 — Settlement in an entity's own equity instruments (paragraphs 16, 22, 22B–22D, AG27A and AG29B of IAS 32)

The IASB proposes to clarify when the fixed-for-fixed condition in paragraph 16(b)(ii) of IAS 32 is met by specifying that the amount of consideration to be exchanged for each of an entity's own equity instruments is required to be denominated in the entity's functional currency, and either:

(a) fixed (will not vary under any circumstances); or
(b) variable solely because of:
   (i) preservation adjustments that require the entity to preserve the relative economic interests of future shareholders to an equal or lesser extent than those of current shareholders; and/or
   (ii) passage-of-time adjustments that are predetermined, vary with the passage of time only, and have the effect of fixing on initial recognition the present value of the amount of consideration exchanged for each of the entity's own equity instruments (paragraphs 22B–22C).

The IASB also proposes to clarify that if a derivative gives one party a choice of settlement between two or more classes of an entity's own equity instruments, the entity considers whether the fixed-for-fixed condition is met for each class of its own equity instruments that may be delivered on settlement. Such a derivative is an equity instrument only if all the settlement alternatives meet the fixed-for-fixed condition (paragraph AG27A(b)).

The IASB further proposes to clarify that a contract that will or may be settled by the exchange of a fixed number of one class of an entity's own non-derivative equity instruments for a fixed number of another class of its own non-derivative equity instruments is an equity instrument (paragraph 22D).

Paragraphs BC31–BC61 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

SOCPA Comments:

SOCPA agrees with the proposal of requiring the consideration to be exchanged for each of an entity's own equity instruments being required to be denominated in the entity's functional currency as this aligns with the economic substance of the transaction and eliminates foreign currency risk as a factor in classification. SOCPA also agrees for allowing preservation and passage-of-time adjustments when the exchange is fixed. We believe these adjustments preserve the fixed-for-fixed nature while accommodating reasonable changes that don't alter the fundamental equity characteristics of the instrument. Preservation adjustments would ensure equitable treatment of current and future equity holders. Passage-of-time adjustments would account for the time value of money without introducing uncertainty.

Additionally, SOCPA agrees with the proposals relating to paragraph AG27A(b) as it ensures consistency in classification when a derivative offers a choice of settlement or involves a share-for-share exchange. We believe that this would align with the fixed-for-fixed principle by requiring all settlement alternatives to meet the conditions for equity classification.

In addition, SOCPA believes the clarification in paragraph 22D that a contract settled by the exchange of a fixed number of one class of an entity's own non-derivative equity instruments for a fixed number of another class of its own non-derivative equity instruments qualifies as an equity instrument, adds clarity.

SOCPA, based on information collected during an outreach carried out by SOCPA noted that the majority of the constituents agreed with the aspects highlighted above. However, a specific concern was raised that the economic interests of future shareholders to be equal or lesser than current shareholders was not conceptually clear as a reason. They believe this area may need to be elaborated to facilitate the application. In addition, they also believe that it was not clear how the passage of time adjustments is connected to the accounting periods/fiscal years.

Question 3—Obligations to purchase an entity's own equity instruments (paragraphs 23 and AG27B–AG27D of IAS 32)

The IASB proposes to clarify that:

(a) the requirements in IAS 32 for contracts containing an obligation for an entity to purchase its own equity instruments also apply to contracts that will be settled by delivering a variable number of another class of the entity's own equity instruments (paragraph 23).

(b) on initial recognition of the obligation to redeem an entity's own equity instruments, if the entity does not yet have access to the rights and returns associated with ownership of the equity instruments to which the obligation relates, those equity instruments would continue to be recognised. The initial amount of the financial liability would, therefore, be removed from a component of equity other than non-controlling interests or issued share capital (paragraph AG27B).

(c) an entity is required to use the same approach for initial and subsequent measurement of the financial liability—measure the liability at the present value of the redemption amount and ignore the probability and estimated timing of the counterparty exercising that redemption right (paragraph 23).

(d) any gains or losses on remeasurement of the financial liability are recognised in profit or loss (paragraph 23).

(e) if a contract containing an obligation for an entity to purchase its own equity instruments expires without delivery:
   (a) the carrying amount of the financial liability would be removed from financial liabilities and included in the same component of equity as that from which it was removed on initial recognition of the financial liability.
   (b) any gains or losses previously recognised from remeasuring the financial liability would not be reversed in profit or loss. However, the entity may transfer the cumulative amount of those gains or losses from retained earnings to another component of equity (paragraph AG27C).

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(f) written put options and forward purchase contracts on an entity's own equity instruments that are gross physically settled—consideration is exchanged for own equity instruments—are required to be presented on a gross basis (paragraph AG27D).

Paragraphs BC62–BC93 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

SOCPA Comments:

(a) SOCPA believes some concerns may arise regarding the application of the requirements to contracts settled by delivering a variable number of another class of equity instruments. Stakeholders might question the comparability of such contracts with those settled in cash or another financial asset, potentially leading to challenges in interpretation and implementation.

(b) SOCPA believes one potential concern could be related to the determination of when an entity has "access to the rights and returns associated with ownership". There may be ambiguity in assessing when these rights are legally or substantively transferred, leading to challenges in consistently applying this criterion.

(c) SOCPA has concerns about ignoring the probability and estimated timing of the counterparty exercising the redemption right for subsequent measurements. This could be perceived as a departure from fair value principles, potentially impacting the relevance and reliability of the financial statements.

(d) SOCPA has concerns regarding the consistency of recognizing gains or losses on remeasurement in profit or loss. We believe such gains or losses, particularly in the context of equity instruments, should be recognized directly in equity to better align with the nature of these instruments as ownership interests.

(e) SOCPA believes this approach seems reasonable, as it ensures consistency and clarity in the accounting treatment of expired contracts without causing undue volatility in profit or loss.

(f) SOCPA agrees with this proposal.

SOCPA, based on information collected during an outreach carried out by SOCPA noted that the majority of the constituents agreed with the aspects highlighted above.

Question 4— Contingent settlement provisions (paragraphs 11, 25, 25A, 31, 32A, AG28 and AG37 of IAS 32)

The IASB proposes to clarify that:

(a) some financial instruments with contingent settlement provisions are compound financial instruments with liability and equity components (paragraphs 25 and 32A);

(b) the initial and subsequent measurement of the financial liability (or liability component of a compound financial instrument) arising from a contingent settlement provision would not take into account the probability and estimated timing of occurrence or non-occurrence of the contingent event (paragraph 25A);

(c) payments at the issuer's discretion are recognised in equity even if the equity component of a compound financial instrument has an initial carrying amount of zero (paragraphs 32A and AG37);

(d) the term 'liquidation' refers to the process that begins after an entity has permanently ceased its operations (paragraph 11); and

(e) the assessment of whether a contractual term is 'not genuine' in accordance with paragraph 25(a) of IAS 32 requires judgement based on the specific facts and circumstances and is not based solely on the probability or likelihood of the contingent event occurring (paragraph AG28).

Paragraphs BC94–BC115 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

SOCPA Comments:

(a) The proposed clarification that some financial instruments with contingent settlement provisions are compound financial instruments with liability and equity components seems reasonable. This aligns with the existing framework.

(b) The proposal to exclude the probability and estimated timing of occurrence or non-occurrence of the contingent event in the initial and subsequent measurement of the financial liability appears reasonable. While simplification is beneficial, SOCPA believes careful consideration should be given to the application of this approach in specific scenarios to avoid unintended consequences or inconsistencies.

(c) The proposal to recognize payments at the issuer's discretion in equity, even if the equity component has an initial carrying amount of zero, seems appropriate. While the principle is sound, SOCPA believes additional guidance and examples may be necessary to ensure consistent application and prevent potential misinterpretations, especially in complex scenarios.

(d) The clarification that 'liquidation' refers to the process that begins after an entity has permanently ceased its operations appears reasonable.

(e) The clarification that the assessment of whether a contractual term is 'not genuine' should be based on judgment considering all specific facts and circumstances is reasonable. This recognizes the need for a holistic evaluation rather than a purely probabilistic assessment. However, SOCPA believes challenges may arise in applying judgment consistently. Enhanced guidance detailing the factors to be considered in determining the genuineness of contingent settlement provisions would be beneficial to ensure consistent application.

SOCPA, based on information collected during an outreach carried out by SOCPA noted that the majority of the constituents agreed with the aspects highlighted above.

Question 5— Shareholder discretion (paragraphs AG28A–AG28C of IAS 32)

The IASB proposes:

(a) to clarify that whether an entity has an unconditional right to avoid delivering cash or another financial asset (or otherwise to settle a financial instrument in such a way that it would be a financial liability) depends on the facts and circumstances in which shareholder discretion arises. Judgement is required to assess whether shareholder decisions are treated as entity decisions (paragraph AG28A).

(b) to describe the factors an entity is required to consider in making that assessment, namely whether:

(i) a shareholder decision would be routine in nature—made in the ordinary course of the entity's business activities;

(ii) a shareholder decision relates to an action that would be proposed or a transaction that would be initiated by the entity's management;

(iii) different classes of shareholders would benefit differently from a shareholder decision; and

(iv) the exercise of a shareholder decision-making right would enable a shareholder to require the entity to redeem (or pay a return on) its shares in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) (paragraph AG28A(a)–(d)).

(c) to provide guidance on applying those factors (paragraph AG28B).

Paragraphs BC116–BC125 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

SOCPA Comments:

(a) The clarification proposed by the IASB appears reasonable, as it acknowledges that judgment is necessary to assess whether shareholder decisions should be treated as entity decisions. However, SOCPA believes the use of judgment in this context could introduce subjectivity, and it is crucial to ensure that the criteria for such judgments are clear and consistently applied. The application of judgment may lead to interpretational variations, and it is essential to provide additional guidance or examples to minimize inconsistencies in practice.

(b) SOCPA believes while the proposed factors are comprehensive, there might be scenarios where other factors not explicitly mentioned could be relevant. The IASB should include examples that address specific circumstances to ensure consistency in application.

(c) As highlighted in our comments in (a) and (b) above it is important that the IASB includes examples in the application guidance which address specific circumstances and situations.

SOCPA, based on information collected during an outreach carried out by SOCPA noted that the majority of the constituents agreed with the aspects highlighted above.

Question 6— Reclassification of financial liabilities and equity instruments (paragraphs 32B–32D and AG35A of IAS 32)

The IASB proposes:

(a) to add a general requirement that prohibits the reclassification of a financial instrument after initial recognition, unless paragraph 16E of IAS 32 applies or the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement (paragraphs 32B–32C).

(b) to specify that if the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement, an entity would:

(i) reclassify the instrument prospectively from the date when that change in circumstances occurred.

(ii) measure a financial liability reclassified from equity at the fair value of that financial liability at the date of reclassification. Any difference between the carrying amount of the equity instrument and the fair value of the financial liability at the date of reclassification would be recognised in equity.

(iii) measure an equity instrument reclassified from a financial liability at the carrying amount of the financial liability at the date of reclassification. No gain or loss would be recognised on reclassification (paragraph 32D).

(c) provide examples of changes in circumstances external to the contractual arrangement requiring reclassification (paragraph AG35A).

Paragraphs BC126–BC164 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Would the proposal to reclassify the instrument prospectively from the date when a change in circumstances occurred give rise to any practical difficulties? If so, please describe those practical difficulties and the circumstances in which they would arise.

SOCPA Comments:

(a) SOCPA believes the general prohibition may create complexity when determining whether a change in circumstances qualifies as external to the contractual arrangement. Paragraph BC130(b) notes that changes in the substance of a contractual arrangement might occur when a change in circumstances external to the contractual arrangement arises from events not specified in the contract. This broad criterion could introduce challenges in identifying external changes consistently. Although paragraphs BC131-BC134 provide information about changes in substance resulting from external circumstances and the examples mentioned encompass scenarios like changes in functional currency, these paragraphs provide only a framework and therefore the concern is that the broad nature of external changes may still pose challenges in consistent interpretation.

(b) SOCPA agrees with the proposals regarding accounting for when the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement.

(c) SOCPA believes while examples are useful, there may be concerns about the comprehensiveness and specificity of the provided examples. Entities operate in diverse environments and could have transactions structured in different ways; therefore, additional guidance might be needed to cover a broader range of potential scenarios.

SOCPA, based on information collected during an outreach carried out by SOCPA noted that the majority of the constituents agreed with the aspects highlighted above. Additionally, certain constituents believe that some challenges may arise in determining the fair value of the financial liability reclassified from equity at the date of reclassification, especially if the financial instrument is not traded in an active market or has complex or contingent features. Therefore, suggest that the IASB provide some guidance on how to estimate the fair value of such financial instruments in accordance with IFRS 13 Fair Value Measurement.

Question 7 —Disclosure (paragraphs 1, 3, 12E, 17A, 20, 30A–30J and B5A–B5L of IFRS 7)

The IASB proposes:

(a) to expand the objective of IFRS 7 to enable users of financial statements to understand how an entity is financed and what its ownership structure is, including potential dilution to the ownership structure from financial instruments issued at the reporting date (paragraph 1).

(b) to delete the reference to derivatives that meet the definition of an equity instrument in IAS 32 from paragraph 3(a) of IFRS 7.

(c) to move paragraphs 80A and 136A from IAS 1 to IFRS 7. These paragraphs set out requirements for disclosures relating to financial instruments classified as equity in accordance with paragraphs 16A–16B and/or paragraphs 16C–16D of IAS 32 (paragraphs 12E and 30I). The IASB also proposes to expand paragraph 80A to cover reclassifications if there are changes in the substance of the contractual arrangement from a change in circumstances external to the contractual arrangement.

(d) to amend paragraph 20(a)(i) of IFRS 7 to require an entity to disclose gains or losses on financial liabilities containing contractual obligations to pay amounts based on the entity's performance or changes in its net assets, separately from gains or losses on other financial liabilities in each reporting period.

(e) to include disclosure requirements for compound financial instruments in IFRS 7 (paragraph 17A).

The IASB proposes to require an entity to disclose information about:

(a) the nature and priority of claims against the entity on liquidation arising from financial liabilities and equity instruments (paragraphs 30A–30B);

(b) the terms and conditions of financial instruments with both financial liability and equity characteristics (paragraphs 30C–30E and B5B–B5H);

(c) terms and conditions that become, or stop being, effective with the passage of time (paragraph 30F);

(d) the potential dilution of ordinary shares (paragraphs 30G–30H and B5I–B5L); and

(e) instruments that include obligations to purchase the entity's own equity instruments (paragraph 30J).

Paragraphs BC170–BC245 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with the proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

SOCPA Comments:

(a) Proposal to Expand the Objective of IFRS 7

SOCPA believes a potential concern may be the increased disclosure burden on entities. The detailed breakdown of ownership structure and potential dilution might involve complex calculations and may pose challenges for some entities, especially smaller ones. Striking a balance between enhanced disclosure and practicality for preparers needs careful consideration.

(b) Proposal to Delete Reference to Derivatives in IFRS 7

This appears reasonable, as it aligns with the classification principles of IAS 32 and eliminates redundancy. A potential area of concern could be ensuring that the deletion does not lead to unintended consequences or gaps in disclosure. SOCPA believes entities should still provide adequate information to users regarding derivatives that are economically similar to equity instruments.

(c) Proposal to Move Paragraphs from IAS 1 to IFRS 7

SOCPA agrees to this proposal as this streamlines relevant information within IFRS 7 and enhances the coherence of disclosure requirements.

(d) Proposal to Amend Paragraph 20(a)(i) of IFRS 7

SOCPA believes the proposed disclosure requirements would be very similar to what is required in paragraph 41 of IAS 32. This could lead to some ambiguity. As suggested in the Basis for Conclusions perhaps the language in paragraph 41 of IAS 32 should be amended to avoid this confusion.

(e) Proposal to Include Disclosure Requirements for Compound Financial Instruments

SOCPA agrees with this proposal as it addresses the unique characteristics of such instruments, providing users with a better understanding of their terms and conditions.

Comments on the Proposals for Disclosures

(a) Nature and Priority of Claims Against the Entity on Liquidation (Paragraphs 30A–30B):

SOCPA understands that these proposed disclosures provide valuable information about an entity's financial position in the event of liquidation. However, an entity would need to apply judgement when deciding how to categorise claims for the purposes of the disclosure. SOCPA therefore believes as a result of this, comparability between entities would be impacted. Additionally, ensuring that the disclosed information is meaningful and not overly detailed, especially for users with varying levels of financial expertise would also need to be addressed. SOCPA therefore suggests additional guidance in this regard be made available.

(b) Terms and Conditions of Instruments with Both Financial Liability and Equity Characteristics (Paragraphs 30C–30E and B5B–B5H):

SOCPA believes the proposed disclosures are crucial for understanding the impact of instruments with hybrid characteristics.

Additionally, SOCPA would also like to highlight a matter raised by SOCPA at the Islamic Finance Consultative Group meeting in May 2023 which refers to recognition and presentation of “Profit Equalization Reserve (PER)”. A PER arises in Islamic finance, when a customer places an amount in a Mudarabah account which would be managed by the bank. Profits made through the arrangement would be shared between the account holder and the bank. Any losses should, theoretically, be borne solely by the account holder. However, whether because of regulatory controls or to safeguard their reputation, many banks endeavour to provide consistent returns to accountholders and/or maintain parity between Mudarabah profit-sharing accounts and conventional fixed deposit accounts. The need to provide consistent returns on a profit-sharing arrangement is known in the industry as ‘displaced commercial risk’ (“DCR”).

One of the methods utilized by institutions offering Islamic financial services to manage displaced commercial risk is the creation of a Profit Equalization Reserve. In times of higher profits, some of the funds’ income, representing both the institution offering Islamic financial services and accountholder’s portions, would be set aside in a reserve which would be released in times of lower profitability to give ‘additional’ returns to account holders.

The interpretation of IFRS guidance to recognise and present the PER has seen two main methods of accounting being used by preparers:

1. Recognizing PER as a separate category other than equity or liability

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2. Separating the component relating to the financial institution and investment holder and accounting for them separately under equity and liability.

SOCPA would like to urge the IASB review this matter and to provide guidance within IFRS to avoid this diversity in practice.

(c) Terms and Conditions Changing with Time (Paragraph 30F):

SOCPA agrees with this proposal as disclosing terms and conditions that change with time is important for understanding the dynamic nature of financial liabilities.

(d) Potential Dilution of Ordinary Shares (Paragraphs 30G–30H and B5I–B5L):

SOCPA believes some of the information required by the proposed disclosures will be available with entities that apply IAS 33 – Earnings per share and IFRS 2 – Share based payments. The proposed disclosures as well as the information required to be disclosed by IAS 33 and IFRS 2 are related in some way. Therefore, SOCPA suggests when the proposed disclosures are made, an entity should ensure that the disclosures required by the proposals, IAS 33 and IFRS 2 are presented in such a way not to confuse as well as overwhelm a user. IASB could provide illustrative guidance relating to this to ensure this objective is met.

(e) Instruments with Obligations to Purchase Entity's Own Equity Instruments (Paragraph 30J):

SOCPA believes users of financial statements need information that helps them to understand the accounting treatment for an entity’s obligations to purchase its own equity instruments. While some of the disclosures currently required by IFRS 7 provide this information, the proposed disclosures specifically focus on instruments that contain obligations to purchase own equity instruments and this would be beneficial to users.

SOCPA, based on information collected during an outreach carried out by SOCPA noted that the majority of the constituents agreed with the aspects highlighted above. Additionally, certain constituents believe disclosures should be required to further explain complexities around instruments that have both financial liability and equity characteristics.

Question 8 — Presentation of amounts attributable to ordinary shareholders (paragraphs 54, 81B and 107–108 of IAS 1)

The IASB proposes to amend IAS 1 to require an entity to provide additional information about amounts attributable to ordinary shareholders. The proposed amendments are that:

(a) the statement of financial position shows issued share capital and reserves attributable to ordinary shareholders of the parent separately from issued share capital and reserves attributable to other owners of the parent (paragraph 54);
(b) the statement of comprehensive income shows an allocation of profit or loss and other comprehensive income attributable to owners of the parent between ordinary shareholders and other owners of the parent (paragraph 81B);

(c) the components of equity reconciled in the statement of changes in equity include each class of ordinary share capital and each class of other contributed equity (paragraph 108); and

(d) dividend amounts relating to ordinary shareholders are presented separately from amounts relating to other owners of the entity (paragraph 107).

Paragraphs BC246–BC256 of the Basis for Conclusions explain the IASB’s rationale for these proposals. Do you agree with these proposals?

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Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Would the proposed requirement to allocate issued share capital and reserves between ordinary shareholders and other owners of the parent give rise to any practical difficulties in determining the required amounts? If so, please describe the possible difficulties and specify areas in which further guidance would be helpful.

SOCPA Comments:

Proposal (a) suggests separating issued share capital and reserves attributable to ordinary shareholders from those attributable to other owners of the parent. SOCPA believes while this aims to enhance transparency regarding the composition of equity, consideration should be given to whether this information might be more effectively communicated through disclosure in the notes rather than extensive changes to the primary financial statements. The proposed change could also add another layer of complexity to an already complicated set of financial statements in the eyes of certain users – especially the non-accountants.

While transparency is crucial, it is essential to ensure that the additional information required by the other proposals above enhances user understanding without creating unnecessary complexity. The Board should also carefully consider whether the benefits of the proposed amendments justify the associated costs.

SOCPA also believes these proposals will shift the emphasis towards tracking individual classes instead of understanding the overall changes in equity of an entity.

SOCPA, based on information collected during an outreach carried out by SOCPA noted that the majority of the constituents agreed with the aspects highlighted above.

Question 9 —Transition (paragraphs 97U–97Z of IAS 32)

The IASB proposes to require an entity to apply the proposed amendments retrospectively with the restatement of comparative information (a fully retrospective approach). However, to minimise costs, the IASB proposes not to require the restatement of information for more than one comparative period, even if the entity chooses or is required to present more than one comparative period in its financial statements.

For an entity already applying IFRS Accounting Standards, the IASB proposes:

(a) to require the entity to treat the fair value at the transition date as the amortised cost of the financial liability at that date if it is impracticable (as defined in IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors) for the entity to apply the effective interest method in IFRS 9 Financial Instruments retrospectively (paragraph 97X);

(b) not to require the entity to separate the liability and equity components if the liability component of a compound financial instrument with a contingent settlement provision was no longer outstanding at the date of initial application (paragraph 97W);

(c) to require the entity to disclose, in the reporting period that includes the date of initial application of the amendments, the nature and amount of any changes in classification resulting from initial application of the amendments (paragraph 97Z);

(d) to provide transition relief from the quantitative disclosures in paragraph 28(f) of IAS 8 (paragraph 97Y); and

(e) no specific transition requirements in relation to IAS 34 Interim Financial Reporting for interim financial statements issued within the annual period in which the entity first applies the amendments.

For first-time adopters, the IASB proposes to provide no additional transition requirements. Paragraphs BC262–BC270 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why.

Would the proposal to apply the proposed amendments retrospectively give rise to any other cases in which hindsight would be necessary? If so, please describe those cases and the circumstances in which the need for hindsight would arise.

SOCPA Comments:

(a) SOCPA agrees with the proposal in section (a) to allow entities to treat fair value as the amortized cost if applying the effective interest method retrospectively is impracticable.

(b) SOCPA agrees with the proposal in section (b) not to require separation of components for a compound financial instrument when the liability component is no longer outstanding at the date of initial application. This approach aligns with practicality and avoids unnecessary complexity.

(c) SOCPA agrees with the proposal in section (c) to require disclosure of changes in classification resulting from the initial application of the amendments. This enhances transparency and assists users in understanding the impact of the changes.

(d) SOCPA agrees with the proposal in section (d) to provide transition relief from certain quantitative disclosures, as the cost of providing such information might exceed the benefits, especially given the complexities of applying the requirements to complex financial instruments.

(e) SOCPA agrees with the proposal in section (e) to have no specific transition requirements for interim financial reporting within the annual period of applying the amendments. Allowing entities to apply judgment in determining what to disclose is appropriate.

SOCPA, based on information collected during an outreach carried out by SOCPA noted that the majority of the constituents agreed with the aspects highlighted above. However, certain constituents believe the proposed amendments might require preparers to make changes to their financial reporting processes or systems to comply with the revised standards. This could involve updating accounting policies, enhancing internal controls, and providing additional disclosures as necessary. Therefore, they suggest applying the proposed amendments prospectively with the restatement of comparative information where practical.

Question 10 — Disclosure requirements for eligible subsidiaries (paragraphs 54, 61A–61E and 124 of [IFRS XX])

The IASB proposes amendments to the draft Accounting Standard [IFRS XX Subsidiaries without Public Accountability: Disclosures], which will be issued before the proposals in the Exposure Draft are finalised.

[IFRS XX] will permit eligible subsidiaries to apply the recognition, measurement and presentation requirements in IFRS Accounting Standards with reduced disclosures.

The IASB's proposals select appropriate disclosure requirements from those proposed for IFRS 7, based on the IASB's agreed principles for reducing disclosures.

Paragraphs BC257–BC261 explain the IASB's rationale for the selected disclosures.

Do you agree with these proposals? Why or why not? If you disagree with any of the proposals, please explain what you suggest instead and why, taking into consideration the reduced disclosure principles described in BC258.

SOCPA Comments:

SOCPA concurs with the IASB's proposals to select appropriate disclosure requirements for subsidiaries without public accountability, from those proposed for IFRS 7, based on the IASB's agreed principles for reducing disclosures. SOCPA believes this approach is appropriate as applying the principles for reducing disclosures will meet the particular needs of users of eligible subsidiaries' financial statements without imposing costs on preparers that exceed the benefits of the disclosures.

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