

14 December 2018

Mr Hans Hoogervorst
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Submitted to: www.ifrs.org

Dear Hans

DP/2018/1 Financial Instruments with Characteristics of Equity

Thank you for the opportunity to comment on DP/2018/1 *Financial Instruments with Characteristics of Equity* (the DP). The DP has been exposed in New Zealand and some New Zealand constituents may comment directly to you.

We acknowledge the importance of this project and support your efforts to look at ways of addressing the challenges in applying IAS 32 *Financial Instruments: Presentation* to financial instruments with characteristics of equity and providing better information about equity instruments.

In responding to the DP, we have limited our response to some specific issues, covered by Questions 4, 8 and 9.

If you have any queries or require clarification of any matters in this letter, please contact Joanne Scott (Joanne.Scott@xrb.govt.nz) or me.

Yours sincerely



Kimberley Crook
Chair – New Zealand Accounting Standards Board

Appendix

Section 3—Classification of non-derivative financial instruments

Question 4
The Board's preliminary view is that the puttable exception would be required under the Board's preferred approach. Do you agree? Why, or why not?

We agree that the puttable exception in IAS 32 *Financial Instruments: Presentation* would continue to be required under the Board's preferred approach to classification of non-derivative financial instruments.

As previously identified by constituents, application of the classification requirements in IAS 32 to certain puttable instruments can give rise to counter intuitive outcomes in the financial statements.

We note the acknowledgement in the DP (paragraphs 3.32 and 3.33) that application of the Board's preferred approach to classification would lead to puttable instruments, including those that are currently classified as equity instruments in accordance with paragraphs 16A and 16B of IAS 32, being classified as liabilities.

The issues originally raised by constituents, as outlined in paragraph BC50 of the Basis for Conclusions on IAS 32, would therefore still exist under the proposals.

Given the emphasis placed by the IASB on setting standards that are useful for decision making by users of general purpose financial statements, we think that it is important that the puttable exception continues to be available.

Section 6—Presentation

Question 8

The Board's preliminary view is that it would be useful to users of financial statements assessing the distribution of returns among equity instruments to expand the attribution of income and expenses to some equity instruments other than ordinary shares. Do you agree? Why, or why not?

The Board's preliminary view is that the attribution for non-derivative equity instruments should be based on the existing requirements of IAS 33. Do you agree? Why, or why not?

The Board did not form a preliminary view in relation to the attribution approach for derivative equity instruments. However, the Board considered various approaches, including:

- (a) a full fair value approach (paragraphs 6.74–6.78);
- (b) the average-of-period approach (paragraphs 6.79–6.82);
- (c) the end-of-period approach (paragraphs 6.83–6.86); and
- (d) not requiring attribution, but using disclosure as introduced in paragraphs 6.87–6.90 and developed in paragraphs 7.13–7.25.

Which approach do you think would best balance the costs and benefits of improving information provided to users of financial statements?

We do not support the Board's preliminary views about the attribution of income and expenses to some equity instruments other than ordinary shares. The proposals appear to reflect the views of some investors that would prefer a narrow equity approach to the distinction between liabilities and equity, even though the Board has decided against that approach in developing the classification proposals in the DP.

The attribution proposals involve the allocation of income and expenses to some instruments (for example, derivative instruments) that might have no entitlement to net income. For derivatives, there is no obvious way to make the allocation, as demonstrated by the fact that the Board considered three approaches and was unable to provide a preliminary view. We consider that any such allocation would be arbitrary.

We have previously indicated that we do not support updating the allocation of total equity amongst different classes of equity holders (see our response to Question 10 of DP/2013/1 *A Review of the Conceptual Framework for Financial Reporting*).

We are not convinced of the usefulness of this information for investors. Because we are unconvinced of the information's usefulness we also have reservations about the cost:benefit aspects of the proposal. We think that some of the other presentation and disclosure proposals in the DP are more likely to lead to better information about equity instruments and suggest that the IASB focus on those other proposals.

Section 7—Disclosure

Question 9

The Board's preliminary view is that providing the following information in the notes 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 (see paragraphs 7.7–7.8). 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 (see paragraphs 6.8–6.9).
- (b) information about potential dilution of ordinary shares. These disclosures would include potential dilution for all potential issuance of ordinary shares (see paragraphs 7.21–7.22).
- (c) information about terms and conditions should be provided for both financial liabilities and equity instruments in the notes to the financial statements (see paragraphs 7.26–7.29).

Do you agree with the Board's preliminary view? Why, or why not?

How would you improve the Board's suggestions in order to provide useful information to users of financial statements that will overcome the challenges identified in paragraphs 7.10 and 7.29?

Are there other challenges that you think the Board should consider when developing its preliminary views on disclosures?

We generally support the proposals listed in Question 9. However, we have provided comments on each of the proposals below.

Disclosure of priority on liquidation

We believe that the proposal to require disclosure of priority of financial liabilities and equity instruments on liquidation would provide users with useful information.

Although we support this proposal, we acknowledge that such disclosure requirements could give rise to practical issues, particularly where an entity has a number of different types of equity instruments. These issues could be addressed by permitting aggregation of instruments with similar characteristics or by establishing objective-based disclosure requirements rather than being prescriptive or requiring quantification.

We note that parties other than those that hold financial instruments may also have claims on liquidation. In order to be useful, we think the proposed disclosure should encompass other claims on liquidation, such as preferential creditors.

We acknowledge that a requirement to disclose a comprehensive analysis of priority of instruments and claims, including quantitative information, could give rise to practical issues. One way of dealing with such issues would be to provide guidance about alternative presentation methods. The Board might wish to explore requiring the disclosure of instruments and claims in order of priority, but without requiring quantitative information for each type of instruments or claims.

We also consider that it might be necessary to provide guidance on determining the priority of claims for the *reporting entity*, as the claims themselves might be against an individual entity within a group.

Information about the potential dilution of ordinary shares

We believe that the proposal to require disclosure of information about the potential dilution of ordinary shares would provide users with useful information. Some of the proposed information is already available in the notes, but the proposals would provide more information than diluted earnings per share disclosures prepared in accordance with IAS 33 *Earnings per Share*. In addition, the presentation of information in tables (as per the illustrative example in the DP) can make information more accessible to users.

Information about terms and conditions

Consistent with our comment letter on DP/2013/1, we support the proposal to require more information about the terms and conditions of financial liabilities and equity instruments. We agree that it would be appropriate to update the disclosure requirements for equity instruments, including enhancing disclosure requirements about the rights associated with different types of equity instruments.

Entities that have a number of classes of equity instruments might require guidance to assist them in complying with disclosures about the rights associated with those instruments and, in particular, ways in which they could aggregate information about classes of equity instruments. For example, guidance could explain that classes of equity instruments could be grouped based on the similarity of their rights to dividends, net assets on liquidation or other entitlements.

We are aware of the Board's ongoing work as part of its Disclosure Initiative project, particularly its work to develop guidance to assist the Board in developing and drafting disclosure objectives and requirements. We recommend that the Board consider developing a specific disclosure objective for information about terms and conditions and identify ways in which an entity could satisfy that disclosure objective, as opposed to prescriptive disclosure requirements. One possible disclosure objective could be: 'An entity shall disclose information about the rights/entitlements for each class of equity instrument, to enable primary users of the financial statements to understand the potential impact of those rights/entitlements on the claims of other types of equity instrument holders.'