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Submitted to: [www.ifrs.org](http://www.ifrs.org)

Dear Andreas

**IASB/ED/2023/5 Financial Instruments with Characteristics of Equity (Proposed amendments to IAS 32, IFRS 7 and IAS 1) ('the ED')**

Thank you for the opportunity to comment on the ED.

We are broadly supportive of the ED proposals and note the following in this regard:

- The ED proposals, including the proposed clarification of the classification and measurement requirements for obligations to purchase the entity's own shares and for financial instruments with contingent settlement features, are expected to reduce diversity in practice, assist preparers of financial statements to apply the requirements of IAS 32 consistently, and improve comparability in financial statements.
- While the proposed disclosure requirements in the ED appear extensive, we note that financial instruments with characteristics of both debt and equity tend to be bespoke, rather than standardised, and differ from one entity to another – therefore, requiring disclosure of specific information about such instruments (when they are material) would arguably be useful for investors, as they may not be able to infer this information from their experience with other types of financial instruments, etc.

However, we recommend improving the clarity of the proposed requirements relating to the effect of laws and regulations, to encourage entities to reflect the substance of contractual arrangements when classifying financial instruments. Please refer to the Appendix to this letter for more information.

If you have any queries or require clarification of any matters in this letter, please contact Gali Slyuzberg ([gali.slyuzberg@xrb.govt.nz](mailto:gali.slyuzberg@xrb.govt.nz)) or me.

Yours sincerely



Carolyn Cordery  
**Chair – New Zealand Accounting Standards Board**

## Appendix

### 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.

### Response to Question 1

1. The key principle in existing paragraph 15 of IAS 32 is that entities should classify issued financial instruments based on the substance of the contractual arrangement. The proposed new paragraphs relating to the effects of laws and regulations seem to emphasise the distinction between two types of contractual terms – those that mirror laws or regulations, and those that do not – and that these two types of contractual terms affect classification differently. The wording used in the proposed new paragraphs to emphasise this distinction may not be helpful in considering the principle in paragraph 15, and we have concerns that this wording could lead to some confusion and application challenges, as described in paragraphs 3-5 below. In particular, as sub-paragraph 15A(b) appears to repeat sub-paragraph 15A(a) with a further nuance, we believe one sub-paragraph could instead communicate the intended principle.
2. To address the matters described in paragraphs 3-5 below, we recommend that the IASB:
  - (a) Considers explicitly linking the requirements and guidance in proposed new paragraphs 15A and AG24A-B with the principle in existing paragraph 15 in IAS 32, which requires entities to consider the substance of the contractual arrangement;
  - (b) Considers moving the requirement in paragraph AG24B to not disaggregate rights/obligations that arise partially but not solely from laws or regulations into the core text of IAS 32, so that it is either part of or next to paragraph 15A. This should help clarify that despite the wording of paragraph 15A(b), rights and obligations that arise partially from laws/regulations may still need to be taken into account when classifying financial instruments; and

- (c) Considers clarifying in IAS 32 that contractual terms giving rise to rights/obligations that mirror legal requirements do not on their own determine the classification of financial instruments – and clarifying how an entity considers different types of rights/obligations when classifying a financial instrument.
3. The recommendations in paragraph 2 above could help reduce the ambiguity arising from ED paragraphs 15A(b) and AG24B, as to whether rights/obligations arising from laws or regulations are to be considered or disregarded when classifying issued financial instruments. That is:
- (a) Proposed paragraph 15A(b) says that an entity “shall not consider any right or obligation created by relevant laws or regulations that would arise regardless of whether the right or obligation is included in the contractual arrangement”. This could be read as if rights/obligations that are specified in the contract but arise from laws/regulations should never be considered when classifying a financial instrument as a liability or equity.
  - (b) However, paragraph AG24B implies that when a contractual right/obligation arises partially, but not solely, from applicable laws or regulations, the right/obligation is to be considered in its entirety – which implies that rights/obligations created by laws or regulations are not to be completely ignored. Furthermore, existing paragraph 15 requires classification based on the substance of the contractual arrangement.
  - (c) While paragraph 15A(b) should be read in conjunction with existing paragraph 15 and proposed paragraph AG24B, it is potentially confusing that paragraph 15A(b) implies something different to those paragraphs. Also, if the intent of the proposed amendments is that contractual terms that mirror legal requirements *should not, in and of themselves, determine the classification* of the financial instrument, this does not seem to be clear from the proposed paragraphs 15A and AG24A-AG24B. The clarifications in paragraph 2 of this letter could help address this.
4. The recommendations in paragraph 2 above could also help reduce confusion as to whether, in applying new paragraphs 15A and AG24A-AG24B, a right/obligation should be taken into account when classifying a financial instrument in situations where:
- (a) a law imposes a requirement relating to a financial instrument, but provides several options as to how the requirement could be satisfied, or does not specify how the requirement may be satisfied; and
  - (b) the entity’s contractual arrangement refers to that legal requirement and specifies how it is to be satisfied.
5. Furthermore, we note the following about paragraph AG24B:
- (a) Paragraph AG24B acknowledges that some contractual rights/obligations would arise partially from laws/regulations, and partially from the specific contractual terms that are not in laws/regulations – e.g. when the law specifies a minimum dividend payment for a certain type of instrument, but the issuing entity specifies a higher minimum dividend payment for the instrument it issues.

- (b) The paragraph notes that such rights/obligations are not to be disaggregated into their contractual and legal/regulatory parts. In the example in paragraph AG24B, the 'contractual' aspect of the obligation to pay a specific dividend amount (which is higher than the legal minimum) prevails over the legal aspect of the obligation when determining whether the obligation affects the instrument's classification – and the entire obligation to pay a dividend is classified as a financial liability. However, it is not clear whether this would always be the case.
- (c) If the IASB's intention is that contractual terms that are based on, but also build on, legal rights/obligations should always be taken into account when classifying issued financial instruments, it would be useful to clarify this in the proposed requirement in paragraph AG24B leading up to the example – and to elevate this part of the paragraph so that it is part of or near paragraph 15A, as noted in paragraph 2 of this letter.