Joint Outreach Event on the IASB project *Financial Instruments with Characteristics of Equity* (ED/2023/5) ASCG, AFRAC, EFRAG – 4 March 2024 – Report

I. Welcome/Introduction

Prof Morich (DRSC) welcomed the approximately 60 participants and thanked on behalf of all participating organisations for their interest. This was followed by an introduction of the representatives of AFRAC and EFRAG as well as the IASB Chairman, Prof Barckow. Mr Morich briefly explained the course of the event.

II. Presentation of the project (IASB Chair)

The IASB Chairman started with general comments on the project's focus and objective. The IASB's earlier proposal for a fundamentally new classification (see DP 2018) was not accepted at the time; therefore, the objective of this exposure draft is merely to resolve narrow application problems and to clarify or amend specific IAS 32 requirements.

The current consultation primarily aims at obtaining feedback on the proposals and questions raised. Nevertheless, comments can also be made - secondarily - on the extent to which the (narrow) objective of the exposure draft and the project is welcomed. In this respect, a distinction should be made between these two routes as part of the feedback.

In a short survey, the participants confirmed that neither a fundamental review of IAS 32 nor reiterating the proposals from the 2018 DP is desired. Rather, the majority agreed with the request for clarification through limited amendments to the capital distinction in individual cases.

III. Discussion of the proposals/questions in the ED/2023/5

1. Effects of laws and regulations

ED/2023/5 proposes that (a) contractual rights/obligations should only be considered to the extent that they are enforceable by laws and (b) legal rights/obligations should not be considered if they would arise regardless of whether they are included in the contract.

During discussion, it was mentioned that this proposal could be understood to mean that stocks and co-operative shares are not equity. It was incomprehensible why legal/regulatory and contractual provisions should be considered differently. The IASB Chairman clarified and referred to the BC, which explicitly state that both should lead to the same classification. This means that primarily the existence of a contract is crucial, and this leads to a classification based on contractual rights/obligations, regardless of whether these rights are based solely on contractual or regal requirements (then being the basis for the contract).

The example of puttable instruments in partnerships was mentioned as still controversial, and it appear to be still unclear how these would be classified based on the clarifications proposed in the ED. The IASB Chairman explained: If a contract is not puttable, whereas there is a legal redemption right, redemption should always be considered. It was unanimously noted that this is not clear from the wording of the exposure draft and should be clarified by the IASB upon finalisation.

2. Settlement in own equity instruments

ED/2023/5 specifies the fixed-for-fixed condition and clarifies details as regards the right to choose between classes of own equity instruments and in the case of an exchange between classes of shares.

Participants explicitly agreed with, or did not object to, these IASB proposals.

In a brief survey, a large majority of participants stated that index-based variable interest should also be permitted as a passage-of-time adjustment. In addition, it was expressed that the consideration of passage-of-time adjustments is generally appropriate, although this slightly changes the understanding of the fixed-for-fixed condition (in particular due to the variable interest rate).

The IASB Chairman also referred to BC54 with regard to variable interest and suggested that the IASB could take up this detail again and clarify it if deemed necessary.

The aspect of the functional currency (in the context of the fixed-for-fixed condition) was also raised as still deserving discussion. In addition, continuous development of new contract characteristics, partly due to regulatory developments, was pointed out. Therefore, any clarification is unlikely to be permanently helpful. The IASB Chairman replied that the principles in IAS 32 cannot, and should not, follow economic (contractual) practice, but should provide systematic and reliable principles for accounting.

3. Obligations to purchase own equity instruments

ED/2023/5 proposes various clarifications, including on the recognition of the liability for NCI puts and their offsetting against the equity components as well as on the recognition of any effects on subsequent measurement.

In a short survey, around half of the participants agreed with the IASB proposals regarding the gross presentation of NCI puts and the P&L-effective recognition of subsequent measurement effects. EFRAG, on the other hand, emphasised that in its discussion to date (and the resulting DCL) the two aforementioned IASB proposals were not agreed on.

For clarification purposes, the IASB Chairman referred to the reasons behind the proposals (BC68 et seqq., 78, 86 et seqq.). He mentioned that these proposals were adopted by a majority of the

IASB members, but not unanimously. It is obvious that counter-arguments are possible for each proposal, but should also be accepted.

4. Contingent settlement provisions

ED/2023/5 proposes several clarifications on the classification of contingent settlement provisions.

The issue of whether taking into account the probability and timing of occurrence in the assessment was primarily discussed. The participants were divided on this. The same mixed views are also reflected in EFRAG's DCL. The IASB Chairman noted that the IASB was also divided, but the majority decided in favour of the proposal in the ED.

5. Shareholder discretion

ED/2023/5 clarifies whether/to what extent shareholder discretion should be treated as a entity decision and identifies some factors that may be relevant.

The respondents confirmed the relevance of these factors. It was also expressed that the clarifications are in line with the widely used principle of “control” and, therefore, appear generally appropriate. It was also confirmed that these clarifications appear to be in line with current practice. In this respect, few effects for accounting practice are expected. Legal structures in which “entity level” and “owner level” are less distinct are more likely to be affected.

6. Reclassifications

ED/2023/5 clarifies that reclassification is required in two exceptional cases, while otherwise prhibited. These exceptions, and further details regarding the assessment and timing of reclassification, are described explicitly in the ED.

After a brief discussion, these proposals were agreed on or not objected to. For the specific case of AT1, it is deemed questionable whether no reclassification would take place in the event of a change to the contract (cancellation) without changes external to the contracts – I.e. these would continue to be classified as equity.

8. Presentation/Disaggregation

ED/2023/5 proposes that certain amounts in the financial statements should be aggregated more deeply in future – ie. be allocated to three (instead of two) parts.

On this proposal too, there was only a brief discussion.

Miscellaneous

The other IASB proposals (7. Disclosures, 9. Transition, 10. Disclosures for SwoPA) were not presented or discussed due to time constraints.

IV. Summary

The participants summarised the relevance and significance of the individual IASB proposals as portrayed in the box.

Prof Morich gave thanks to all participants for their active role in the discussion, and to the other organisations for contributing to the event.