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Comments on the Exposure Draft *Financial Instruments with Characteristics of Equity (Proposed amendments to IAS 32, IFRS 7 and IAS 1)*

To the IASB Board Members:

The Japanese Institute of Certified Public Accountants (JICPA) appreciates the continued efforts of the International Accounting Standards Board (IASB) to develop high quality accounting standards and welcomes the opportunity to comment on the Exposure Draft *Financial Instruments with Characteristics of Equity (Proposed amendments to IAS 32, IFRS 7 and IAS 1)* (Exposure Draft).

IAS 32 *Financial Instruments: Presentation* (IAS 32) sets out requirements for classifying and presenting financial instruments as financial liabilities or equity instruments in the financial statements of the entity that issues those instruments. A growing number of complex financial instruments with both financial liability and equity characteristics has posed challenges in applying IAS 32 and resulted in diversity in practice regarding classification. That diversity reduces the comparability and understandability of financial statements, making it difficult for users of financial statements to assess the effects of financial instruments on the issuer's financial position and operating results. Against this backdrop, JICPA supports the IASB's decision to focus on clarifying the classification requirements in IAS 32 and associated requirements, as they shall improve the comparability and understandability of financial statements.

On the other hand, although we understand the purpose of amending IAS 32 is to solve practical issues without making fundamental changes to the standard, we recommend certain proposed amendments to be reconsidered or clarified as they do not seem to be consistent with the current practices that are reasonably accepted under IAS 32 or practically aligning with other requirements.

For example, the requirement for passage-of-time adjustments is proposed in paragraph 22C(b)(iii) of IAS 32 for the purpose of clarifying the fixed-for-fixed condition; however, the rationale behind the IASB's decision is not clear enough. We recommend the Board to reconsider and clarify the proposal. Also, paragraph 23 of IAS 32 stipulates the measurement of a contractual obligation of an entity to purchase its own equity instruments; however, it is not clear enough as to how the requirement in IAS 32 is related to IFRS 9 *Financial Instruments* (IFRS 9), IFRS 7 *Financial Instruments: Disclosures* (IFRS 7), and IFRS 13 *Fair Value Measurement* (IFRS 13). Likewise, paragraph 25A of IAS 32 stipulates the measurement of financial liabilities arising from contingent settlement provisions; however, it is not clear enough as to how the requirement in IAS 32 is related to IFRS 9, IFRS 7, and IFRS 13.

Please see our comments to each Question in the following pages.

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

Comment:

We agree with the proposal.

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.

Comment:

(1) The concept of the amount of consideration exchanged for an entity's own equity instruments to be denominated in the entity's functional currency

According to paragraph 22B of IAS 32, 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. When the functional currency of a subsidiary is different from that of a parent company, for example, and when the subsidiary issues foreign currency convertible bonds that are convertible to the parent's shares, the concept of functional currency could be interpreted in several ways under the current requirements as described below. We suggest the IASB clarify as to which entity's functional currency should be referred to for classification purposes:

- According to paragraph 22B of IAS 32, the amount of consideration exchanged for an entity's own equity instruments is required 'to be denominated in the entity's functional currency,' indicating the entity is simply referring to the issuer of the financial instrument. Thus, in this paragraph, it seems to be clear that classification is based on the subsidiary's functional currency.
- Whereas in the latter half of paragraph AG29B of IAS 32, it is stated that 'an entity classifies a financial instrument as equity if the consideration amount is in the functional currency of the entity within the group whose equity instruments will be delivered on settlement.' In this paragraph, the entity is represented as the issuer of the equity instruments to be delivered. Therefore, it could be interpreted that the paragraph is referring to the parent company, meaning that classification can be based on the parent's functional currency. That said, uncertainty remains as to whether or not it is clearly referring to the parent, given that it is explicitly stated in the paragraph that it is 'the entity within the group whose equity instruments will be delivered,' not 'the entity whose equity instruments will be delivered on settlement.'

(2) Requirement in paragraph 22C(a)(ii)

For the purpose of meeting the 'preservation adjustment' requirement in paragraph 22B(b) of IAS 32, the adjustment should 'preserve the economic interests of the future holders of the entity's own equity instruments (the future equity instrument holders) to an equal or lesser extent, relative to the economic interests of the current equity instrument holders' in accordance with paragraph 22C(a)(ii). However, it is not clearly indicated in the paragraph as to how such condition should be assessed. Although five illustrative examples (Example 16–20) are presented in paragraphs IE64–86 in the Exposure Draft with regard to fixed-for-fixed conditions, none of them illustrates preservation adjustment cases that meet the requirement. As having no guidance for assessing the type of adjustments that would meet the preservation adjustment requirement may cause inconsistency in interpretations, we highly recommend additional guidance be introduced to supplement paragraph 22C(a)(ii).

(3) Requirement in paragraph 22C(b)(iii)

① Reconsidering the necessity of introducing paragraph 22C(b)(iii)

We understand the purpose of amending IAS 32 is to solve practical issues without making fundamental changes to the standard. However, the introduction of paragraph 22C(b)(iii) may result in different accounting treatments compared to current practices, which could interfere with the IASB's original purpose of the IAS 32 amendment. In detail, the fixed-for-fixed condition is fulfilled under the current practice as long as both of the following are met: exchanges to equity instruments are allowed at different point in times; and the variable amount is predetermined as fixed adjustments at the inception of the contract even when the consideration amount fluctuates. As the introduction of paragraph 22C(b)(iii) may cause a change in the current practice, we highly recommend the IASB to revisit the necessity of implementing the new requirement.

> Paragraph 22C(b)(iii):
> An adjustment that 'has 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—any difference in the amounts of consideration to be exchanged on each possible settlement date represents compensation proportional to the passage of time.'

② Clarification of paragraph 22C(b)(iii)

Paragraph BC56 describes the reason why the Board decided to introduce the requirement in paragraph 22C(b)(iii) of 'having the effect of fixing the present value of the amount of consideration exchanged for each of the entity's own equity instruments.' According to paragraph BC56, it seems no rationale behind the decision is given other than saying it is 'more consistent with the fixed-for-fixed condition' compared to the approach in paragraph BC54(a), under which only paragraphs 22C(b)(i) and (ii) are required to be followed. As the requirement in paragraph 22C(b)(iii) could be interpreted differently, we highly recommend the Board to provide a rationale behind the proposal and clarify whether or not the requirement in paragraph 22C(b)(iii) is considered to be met in the following specific circumstances:

- When an adjustment is made to the contractually-determined fixed interest rate in proportion to the passage of time as consideration for the time value of money, credit risk and other basic lending risks and costs.

  We suggest the element of interest having an effect of fixing present value be clarified. If the element of interest is following paragraph B4.1.7A of IFRS 9, as referred to in paragraph BC57, it should be clarified whether the element is meeting the following two conditions: the effect of fixing the amount of consideration to be paid or received in terms of present value; and compensation proportional to the passage of time.

- When an adjustment is made in proportion to the passage of time based on the forward price on each possible settlement date. Note that estimations generally used to calculate forward prices, including future interest rates and expected dividends at the inception of the contract, are predetermined as fixed adjustment amounts (or adjustment rates) at the time of entering into the contract.

  We believe clarification is needed whether adjustments based on forward price elements fulfill the fixed-for-fixed condition. When settlement can be made at different point in times or over different periods, the amount of consideration on each possible settlement date could be adjusted based on estimations used for the above-mentioned forward prices. In general, forward prices for equity instruments are calculated using a spot price of an equity instrument, adding interest-equivalent amount from the spot date to the future forward delivery date, and subtracting dividend payment expected to be received from the equity instrument over the period. No leverage element is included in the calculation formula, and thus, it should not contradict the concept of 'having the effect of fixing the present value of the amount of consideration exchanged for each of the entity's own equity instruments.' Further, according to the Exposure Draft—Snapshot issued on November 2023, the example for passage-of-time adjustments illustrated in *1. Classification of financial instrument: B—Fixed-for-fixed condition for derivatives* indicates that the adjustment to compensate the bondholder for the loss of time value in the option is 'considered to introduce variability based solely on the passage of time, and therefore meets the fixed-for-fixed condition.' Accordingly, we believe adjustments for forward price estimations on each possible settlement date that are predetermined at the inception of the contract fulfill the fixed-for-fixed condition. We request the Board's clarification in this area, too.

- When an adjustment is made in proportion to the passage of time based on a fixed adjustment rate determined under a contract in order to correspond to changes in the future value of equity instruments on each possible settlement date. Note that the fixed adjustment rate is predetermined as a fixed value under the contract on the basis of future inflation rates and growth rate forecasts at the inception of the contract.

When the amount of consideration is adjusted proportional to the passage of time based on inflation rates and growth rates, which are predetermined under the contract as fixed values, the consideration amount would not change when inflation rates and growth rates subsequently change in the future. Even when future elements, such as inflation rates and growth rates, are incorporated into adjustments, we can argue that such adjustments fulfill the fixed-for-fixed condition as long as they are fixed in values or rates. The IASB's clarification is needed in this area, too.

③ Additional guidance with numeric examples

At the IASB meeting in April 2020, passage-of-time adjustments were discussed and numeric examples were provided in paragraph 21 of the staff paper. （AP5B: Financial instruments settled in own equity instruments: adjustment principle (ifrs.org)） The IASB can resume the example and create additional guidance to illustrate what kind of elements should be adjusted as passage-of-time adjustments.

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:

   (i) 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.

   (ii) 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).

(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.

Comment:

(1) Relation between the proposed paragraph 23 of IAS 32 and IFRS 9

The objective of IAS 32 is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities (paragraph 2 of IAS 32). The principles in IAS 32 complement the principles for recognising and measuring financial assets and financial liabilities in IFRS 9, and for disclosing information about them in IFRS 7 (paragraph 3 of IAS 32).

In accordance with paragraph 23 of IAS 32 per the Exposure Draft, when measuring a contractual obligation to purchase an entity's own equity instruments, the entity, on initial recognition, disregards the probability and estimated timing of the counterparty's exercise of its redemption right and discounts the redemption amount to its present value assuming that the redemption will occur at the earliest possible redemption date. Subsequently, the present value of the redemption amount is subject to remeasurement with any gains or losses recognised in profit or loss. Further, the term ‘in accordance with IFRS 9’ is deleted from the subsequent measurement requirement in paragraph 23 of IAS 32.

As the obligation represents a financial liability, the amount should be recognised at fair value upon initial recognition, and subsequently measured at either amortised cost or fair value under the two measurement categories in accordance with IFRS 9. However, financial liabilities under the proposal do not seem to be measured at fair value because none of the fair value measurement requirements are reflected in the Exposure Draft, nor do they appear to be measured at amortised cost as liabilities under the Exposure Draft are required to be measured at the present value of the settlement amount. In other words, it is uncertain as to how the contractual obligations should be accounted for in accordance with the classification and measurement requirements (initial and subsequent) under IFRS 9. Therefore, we recommend the IASB to amend IFRS 9, which stipulates requirements for recognition and measurement of financial instruments, so as to clarify the accounting treatment for the contractual obligations and align with the proposed amendments in paragraph 23 of IAS 32.

Furthermore, paragraph 23 of IAS 32 in the Exposure Draft proposes that an obligation for an entity to purchase its own equity instruments for cash or another financial asset should be discounted to the present value of the redemption amount assuming that the redemption will occur at the earliest possible redemption date. We suggest the Board clarify when and how to measure the present value of settlement amounts in cases where not only settlement dates but also settlement amounts could fluctuate under a contract. This is because when a contractual term of an entity allows not only settlement dates but also settlement amounts to fluctuate, and the entity measures liability at the present value of the redemption amount at the earliest possible redemption date without considering probability of occurrence, the liability amount recognised could be understated by not considering other possible scenarios. In such cases, we doubt whether the amount of financial liabilities measured under the proposed approach would truly depict the amount of obligation the entity owes.

(2) Relation between the proposed paragraph 23 of IAS 32 and IFRS 7/ IFRS 13

According to paragraph 23 of IAS 32, the probability and estimated timing of the counterparty exercising their right to redeem have no effect on the initial or subsequent measurement of the financial liability. On the other hand, fair value measurement in accordance with IFRS 7 and IFRS 13 generally requires entities to consider such probability and timing elements. We wonder whether or not such difference in accounting treatments is indicating that a separate disclosure of fair value is required, because the book value of a financial liability recognised in accordance with the proposed paragraph 23 of IAS 32 could be different from that recognised under IFRS 7 and/or IFRS 13. Also, it is uncertain as to how the financial liability should be accounted for in accordance with paragraph 8 of IFRS 7 for the purpose of categorising financial liabilities as well as paragraph 20 of IFRS 7 for disclosing associated items of income, expense, gains or losses. Therefore, we recommend the IASB to amend IFRS 7 and IFRS 13 to clarify accounting treatments for such financial liabilities so that they align with the proposed amendments in paragraph 23 of IAS 32.

(3) Paragraph AG27D of IAS 32

In accordance with the first half of paragraph AG27D of IAS 32 in the Exposure Draft, if an entity's contractual obligation to purchase its own equity instruments is to be gross physically settled—consideration is to be exchanged for own equity instruments—the entity is required to present its contractual obligation on a gross basis even if the obligation arises from a written put option or a forward purchase contract.

On the other hand, it is proposed in the latter half of the same paragraph of AG27D, saying that if the obligation was to be net settled (in cash or in shares) or could be net settled (at the election of either the issuer or the holder), derivative accounting would apply.

If a counterparty can elect net settlement, there is a chance the counterparty would pick gross settlement. In such cases, the issuer may have no choice but to settle its contractual obligation in gross amount. When derivative accounting is required in such cases, it will contradict the first half of paragraph AG27D of IAS 32, which requires an entity to present its contractual obligation on a gross basis if it is to be gross physically settled. Therefore, we recommend the IASB to amend the latter half of paragraph AG27D to explicitly state that derivative accounting is applicable only when the obligation was to be net settled.

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.

Comment:

(1) Relation between the proposed paragraph 25A of IAS 32 and IFRS 9

The objective of IAS 32 is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities (paragraph 2 of IAS 32). The principles in IAS 32 complement the principles for recognising and measuring financial assets and financial liabilities in IFRS 9, and for disclosing information about them in IFRS 7 (paragraph 3 of IAS 32).

In accordance with paragraph 25A of IAS 32 per the Exposure Draft, when an entity measures a financial liability arising from a contingent settlement provision on initial recognition and subsequently, the entity should disregard the probability and estimated timing of occurrence or non-occurrence of uncertain future events (or the outcome of uncertain circumstances) and discount the settlement amount to its present value, assuming settlement will occur at the earliest possible settlement date specified in the contract. In accordance with IFRS 9, though, a financial liability arising from a contingent settlement provision should be recognised at fair value upon initial recognition, and subsequently measured at either amortised cost or fair value under the two measurement categories. That being said, financial liabilities under the Exposure Draft do not seem to be measured at fair value because none of the fair value measurement requirements are reflected in the proposal, nor do they appear to be measured at amortised cost as liabilities are required to be measured at the present value of the settlement amount. In other words, it is uncertain as to how the measurement of a financial liability arising from a contingent settlement provision should be accounted for in accordance with the classification and measurement requirements (initial and subsequent) under IFRS 9. Therefore, we recommend the IASB to amend IFRS 9, which stipulates requirements for recognition and measurement of financial instruments, so as to clarify the accounting treatment for the obligation and align with the proposed amendments in paragraph 25A of IAS 32.

Furthermore, paragraph 25A of IAS 32 per the Exposure Draft proposes that the initial or subsequent measurement of the financial liability arising from the contingent settlement provision should be discounted to the present value of the settlement amount assuming settlement will occur at the earliest possible settlement date specified in the contract. We suggest the Board clarify when and how to measure the present value of settlement amounts in cases where not only settlement dates but also settlement amounts could fluctuate under a contract. For example, when an entity measures the liability at the present value of the settlement amount at the earliest possible settlement date without considering probability of occurrence, the liability amount recognised could be understated by not considering other possible scenarios. In such cases, we doubt whether the amount of financial liabilities measured under the proposed approach would truly depict the amount of obligation the entity owes.

(2) Relation between the proposed paragraph 25A of IAS 32 and IFRS 7/ IFRS 13

Paragraph 25A of IAS 32 insists that the probability and estimated timing of occurrence or non-occurrence of uncertain future events (or the outcome of uncertain circumstances) have no effect on the initial or subsequent measurement of the financial liability arising from the contingent settlement provision. On the other hand, fair value measurement in accordance with IFRS 7 and IFRS 13 generally requires entities to consider such probability and timing elements. We wonder whether or not such difference in accounting treatments is indicating that a separate disclosure for fair value is required, because the book value of a financial liability recognised in accordance with the proposed paragraph 25A of IAS 32 could be different from that recognised under IFRS 7 and/or IFRS 13. Also, it is uncertain as to how the financial liability arising from the contingent settlement provision should be accounted for in accordance with paragraph 8 of IFRS 7 for the purpose of categorising financial liabilities as well as paragraph 20 of IFRS 7 for disclosing associated items of income, expense, gains or losses. Therefore, we recommend the IASB to amend IFRS 7 and IFRS 13 to clarify accounting treatments for financial liabilities arising from the contingent settlement provision so that they align with the proposed amendments in paragraph 25A of IAS 32.

(3) Application of paragraph 25A of IAS 32

It is unclear whether paragraph 25A of IAS 32 in the Exposure Draft should be applied only to non-derivatives classified as financial liabilities due to contingent settlement provisions, and not to derivatives with contingent settlement provisions, which are to be measured at fair value. We therefore recommend that it should be explicitly stated in paragraph 25A of IAS 32 that the paragraph is not applicable to derivative liabilities with contingent settlement provisions.

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.

Comment:

(1) Factors to consider when treating a shareholder decision as an entity decision under corporate governance

The assessment of whether to treat a shareholder decision as an entity decision should be determined by looking into whether the shareholder decision is made as part of the decision-making process under the entity's corporate governance.

Particularly, according to paragraph AG28A(b) of IAS 32, when a shareholder decision relates to an action proposed or a transaction initiated by the entity's management for shareholder approval, the shareholder decision is likely to be treated as an entity decision. In contrast, if a shareholder decision relates to an action proposed or a transaction initiated by a third party, the shareholder decision is unlikely to be treated as an entity decision. However, we do not think the assessment of whether or not it is as an entity decision should be dependent on the party that made the proposal or action. Instead, if the shareholder decision is made in accordance with the decision-making process under the entity's corporate governance, the decision should be treated as an entity decision.

Further, paragraph AG28A(d) of IAS 32 provides a case where the exercise of a shareholder decision-making right enables 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). Such decision-making rights, according to the paragraph, indicate that the shareholders would make their individual decisions as investors in the shares, and the shareholder decision is unlikely to be treated as an entity decision. However, if a shareholder exercises its redemption right and an entity approves the redemption as part of its decision-making process, we believe the shareholder decision should be treated as an entity decision.

(2) Additional examples in paragraphs AG28A(a)–(d)

In addition to factors set out in paragraphs AG28A(a)–(d) for an entity to consider when assessing whether shareholder decisions should be treated as entity decisions, we suggest specific examples be illustrated for each factor, as they would be useful in practice when exercising judgement for individual cases.

(3) Application guidance for paragraph AG28A of IAS 32 for contracts including a change of control clause

According to paragraphs IE76–81 of Example 19 *Change of control provisions* in the Exposure Draft, it is concluded that in the event of a change of control, when an adjustment is made to a conversion ratio that does not meet the fixed-for-fixed condition, the conversion option should be classified as a financial liability. Example 19 is based on an assumption that an adjustment to the conversion ratio that could infringe the fixed-for-fixed condition will not be triggered unless a change of control occurs. That said, as a change of control occurs as a result of shareholder decisions, it appears Example 19 is indicating that a change of control cannot be avoided by the entity once the decision is made by shareholders. However, the Exposure Draft does not provide a clear enough rationale as to why such shareholder decision for a change of control is unavoidable by the entity. On the other hand, we see diversity in practice about whether a shareholder decision for a change of control should be treated as an entity decision or investors decision.

Therefore, we recommend additional guidance be introduced for the application of paragraph AG28A for the assessment of whether a shareholder decision for a change of control should be treated as an entity decision or investors decision.

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.

Comment:

(1) Reclassifications to be made when the substance of the contractual arrangement changes due to a change in circumstances external to the contractual arrangement

① When the substance of the contractual arrangement changes due to contract modifications

Reclassification is required in the Exposure Draft only when the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement. On the other hand, no clear explanation is provided for the accounting treatment for contract modifications. Therefore, we recommend clarification be made for the following:

- When a financial instrument is classified as a financial liability based on original contractual terms, but later meets the definition of equity in accordance with subsequent changes made to the original contractual terms, would the instrument meet the 'substantial modification' requirement in paragraph 3.3.2 of IFRS 9, under which the instrument is accounted for as an extinguishment of the original financial liability and the recognition of a new equity? Or would the original classification of the financial liability be maintained because the liability does not meet the 'substantial modification' requirement, resulting in no derecognition of financial liability and no reclassification to equity on the basis that the substance of the contractual arrangement has changed for reasons other than a change in circumstances external to the contractual arrangement?
- When a financial instrument is classified as equity based on original terms and conditions under a contractual arrangement, but later meets the definition of a financial liability in accordance with subsequent changes made to the original contractual terms and conditions, how should it be accounted for? Currently, there is no IFRS Standards stipulating the accounting for derecognition of equity as a result of contract modifications.

As there have been no general guidance for reclassifications when the classification of liability and equity results in different conclusions in accordance with new terms and conditions due to contract modifications, we acknowledge there is diversity in practice where certain companies are applying reclassification accounting in such circumstances. Therefore, we suggest clarification is required on the accounting for reclassification when the substance of contractual arrangements changes due to contract modifications.

② A contractual term that becomes, or stops being, effective during the financial instrument's life

Reclassification is required in the Exposure Draft only when the substance of the contractual arrangement changes because of a change in circumstances external to the contractual arrangement. Therefore, according to paragraph BC143 of IAS 32, reclassification would be prohibited if the substance of the contractual arrangement changes because of a contractual term that becomes, or stops being, effective during the instrument's life. This could be a case where a financial instrument is originally classified as a financial liability upon issuance due to contractual terms not fulfilling the fixed-for-fixed condition, but later meeting the definition of equity from the point when the contractual term expires at a specific date. The Board provides the following rationale behind the conclusion: it would increase costs and complexity for preparers of financial statements because entities would have to assess at each reporting date whether an instrument would be reclassified (paragraph BC145 of IAS 32); a requirement to reclassify all types of changes in the substance of the contractual arrangement would go beyond the clarification of IAS 32 requirements with an understanding that it should have been the original intent of the IASB to prohibit subsequent reclassifications of financial instruments, in principle, when IAS 32 was initially issued (paragraph BC146 of IAS 32); and the measurement of financial liabilities would be updated to reflect changes in the substance of the contractual arrangement, thereby continuing to provide useful information to users of the financial statements even when no reclassifications are made (paragraph BC143 of IAS 32).

However, as we do not expect such expirations of contractual terms requiring classifications to happen frequently, we doubt the Board's argument on the entity's burden of reassessment costs. In fact, there are already practices in place where entities reclassify instruments to equity to reflect the change in the substance of the contractual arrangement. Rather, as pointed out in paragraph BC144, we are more concerned about the downside of not making reclassifications to equity appropriately, as such accounting treatment may not provide useful information to users of financial statements by not aligning with the definition of financial liability and equity under IAS 32 and the definition of liability under the Conceptual Framework. Therefore, we do not think reclassifications should be prohibited if the substance of the contractual arrangement changes due to the passage of time and other circumstances.

Based on above, we recommend the Board to revisit the proposal, which allows reclassifications only when the substance of the contractual arrangement changes due to a change in circumstances external to the contractual arrangement.

(2) Accounting for the holder of a financial instrument upon reclassifications

Currently, the holder of a financial instrument is required to account for classification depending on how the issuer accounts for the instrument, either as a financial liability or an equity instrument, under IAS 32. Based on the classification, the holder is further required to follow IFRS 9 to determine the classification in accordance with the subsequent measurement of a financial asset. The requirement becomes particularly important when the holder designates the investment in a financial instrument as a financial asset that is measured at fair value through other comprehensive income. That being said, paragraph 32B of IAS 32 proposes a requirement for the reclassification of financial liabilities and equity instruments, but it does not stipulate how it would affect the accounting treatment for the holder of the instrument when such reclassification occurs on the issuer side. Although we understand that our comment goes beyond the scope of the Financial Instruments with Characteristics of Equity project (the FICE project), we suggest the Board consider clarifying the accounting treatment for the holder side upon reclassifications.

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.

Comment:

(1) Disclosing information on terms and conditions of a compound financial instrument with characteristics of both a liability and an equity

According to paragraph 17A(a) of IFRS 7, for compound financial instruments, with both a liability and an equity component, an entity shall disclose the terms and conditions of the instrument that determine its classification on initial recognition. Further, paragraph 30D of IFRS 7 requires that an entity should explain how the terms and conditions of financial instruments with both financial liability and equity characteristics (excluding all standalone derivatives) relate to their classification as financial liabilities or equity instruments, including the following disclosures:

(a) the terms and conditions of financial instruments that determine their classification as financial liabilities or equity instrument; and

(b) cash flow characteristics that are not representative of the classification of financial instruments as financial liabilities or equity instruments, but that are relevant to an understanding of the nature of those financial instruments (i.e., 'debt-like characteristics' and 'equity-like characteristics').

We suggest the Board provide further clarification regarding the scope and the level of detail of the terms and conditions required to be disclosed under the Exposure Draft.

(2) Disclosing information on potential dilution of ordinary shares

To inform potential dilution of ordinary shares, paragraph 30G(a) of IFRS 7 requires entities to disclose information on the maximum number of additional ordinary shares the entity might be required to deliver for each class of potential ordinary shares outstanding at the end of the reporting period. Further, according to paragraphs B5I(a), BC221 and BC228 of IFRS 7, entities should include anti-dilutive instruments that could become dilutive in the future even if they are not dilutive at the reporting date, explicitly stating that these requirements differ from requirements in IAS 33 *Earnings per Share*, the standard setting out requirements for the calculation of diluted earnings per share (EPS).

Paragraph IG14G(iii) in IFRS 7 illustrates Convertible Bond C as an example for potential dilution of ordinary shares, which is anti-dilutive because the conversion option is out-of-the-money at the reporting date, indicating that even in such cases, an entity is required to disclose the maximum dilution for the bond. However, according to the disclosure example in Table 1 *Maximum dilution of ordinary shares and related terms and conditions* per paragraph IG14H of IFRS 7, no such description is noted in the paragraph. Therefore, we recommend descriptions should be consistent within IFRS 7 examples regarding the disclosure information on potential dilution of ordinary shares. Also, we propose adding the following underlined sentence in Table 1 in order to avoid potential confusion in practice by clarifying differences in disclosure requirements between IFRS 7 (per paragraph 30G(a) of IFRS 7) and IAS 33. We understand the disclosure meets the requirement in paragraph 30G(d) of IFRS 7, representing a description of the terms and conditions of contracts that are relevant in understanding the likelihood of the maximum dilution of ordinary shares.

Table 1 Maximum dilution of ordinary shares and related terms and conditions

Instruments	*Maximum number of additional ordinary shares*	*Terms and conditions relating to the instrument or transaction*
Convertible Bonds A and C	600	Holder has an option to convert the bond at a specified conversion date using a specified conversion ratio of CU15 per share and CU12 per share for Convertible Bonds A and C respectively. <u>Even when Convertible Bond C is anti-dilutive because the conversion option is out-of-the-</u>

		money at the reporting date, 250 shares are included in the maximum dilution of ordinary shares.

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? 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.

Comment:

(1) We believe allocating issued share capital and reserves as well as profit or loss and other comprehensive income between ordinary shareholders and other owners of the parent will give rise to practical difficulties, given that the calculation method for the allocation is not clear enough.

Rights held by ordinary shareholders and other owners of the parent, such as the rights to receive dividends and distribution of residual assets, could be different not just between ordinary shareholders and other owners, but also among other owners. Thus, it is uncertain as to how the allocation of reserves and the other components of equity between ordinary shareholders and other owners can be made based on contractual terms. Further, it is uncertain as to how an assessment can be made on whether changes in equity attributable to other owners of the parent should be derived from comprehensive income or reclassified from equity attributable to ordinary shareholders. There are also cases where equity instruments other than ordinary shares are entitled to certain rights to receive distribution of residual assets under contractual terms. In such cases, we understand separate disclosures of the amount of equity and profit attributable to other owners would meet the information needs of the users of financial statements, as proposed by the Board in the Exposure Draft. However, inconsistency in disclosure information may arise among entities without having a clear calculation method for attribution, which could result in failing to provide useful information to users, thus not being able to meet the objective of the proposal. Accordingly, we suggest the Board develop application guidance on the calculation method for attribution.

(2) When equity instruments other than ordinary shares are issued through subsidiaries, it could have a significant impact beyond the presentation issue.

Even if clarification is made on the calculation method for the attribution of financial instruments to ordinary shareholders and other owners of the parent, additional issues could arise when the financial instrument is issued through a subsidiary. Currently, there are no explicit requirements under IFRS, stating how amounts attributable to other owners of the subsidiary should be calculated. Accordingly, we expect diversity in practice exists as to how amounts are calculated and classified as non-controlling interests. Once clarification is made on the calculation method for the attribution of financial instruments to ordinary shareholders and other owners of the parent, the amount of equity and profit attributable to other owners of the subsidiary that are not offset upon consolidation (i.e., amount contributed from outside the group) may not reconcile with the amount of equity and profit attributable non-controlling interests calculated under the current practice.

Based on above, the proposal could substantially have a significant impact beyond the presentation issue, such as EPS calculation and the accounting for changes in equity. As we understand it is not the intention of the FICE project to change current practices fundamentally, we highly recommend the IASB to carefully consider the cost-benefit of introducing such an amendment.

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.

Comment:

(1) Introducing a transition requirement to review classifications based on contractual terms at the date of transition

We believe a transition requirement should be introduced to review classifications based on contractual terms at the date of transition, not at the date when each financial instrument is issued. For example, when contractual terms at the original issue date are precluding the entity from meeting the fixed-for-fixed condition, and when those contractual terms expire before the transition date, it is possible that, under the current practice, the instrument is already reclassified from a financial liability to equity based on terms and conditions after the expiration. As reclassification is not allowed for such instrument in accordance with the proposed Exposure Draft, the instrument would need to be adjusted at the transition date back to the original classification as of the issuance date of the instrument. In such cases, as contractual terms used for the basis for the original classification are no longer effective due to expiration at the transition date, the classification made as the transition date would not represent the economic substance of the instrument as of the date of transition. Further, given that an assessment of whether or not a financial instrument is an equity often involves a lot of judgement, the Board should carefully consider any hindsight risks for going back to the original issuance date for reassessment purposes. Therefore, we suggest introducing a transition requirement, allowing entities to review classifications based on contractual terms at the date of transition.

(2) Introducing transition relief for first-time IFRS adopters

When entities are in the process of transitioning to IFRS or plan to transition to IFRS in the future based on current IAS 32, financial instruments issued before the finalisation or the application of the Exposure Draft are required to be assessed retrospectively as of the original issuance date of the instrument. For example, if contractual terms have partly or entirely expired during the period of the original issuance date to the transition date, the classification would be based on contractual terms that no longer exist at the transition date, which certainly would not represent the economic substance of the instrument as of the date of transition. Further, given that an assessment of whether or not a financial instrument is an equity often involves a lot of judgement, the Board should carefully consider any hindsight risks for going back to the original issuance date of the instrument for reassessment purposes. Therefore, we suggest introducing transition relief for first-time IFRS adopters to apply the proposed amendments retrospectively.

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.

Comment:

JICPA agrees with the proposal.

Yours faithfully,

Eriko Otokozawa
Executive Board Member－Business Accounting Standards and Practice/Corporate Disclosure
The Japanese Institute of Certified Public Accountants