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Date

Mr Hans Hoogervorst

Chairman

International Accounting Standards Board

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Dear Hans,

IASB DP/2018/1 *Financial Instruments with Characteristics of Equity*

The Australian Accounting Standards Board (AASB) is pleased to provide comments on Discussion Paper DP/2018/1 *Financial Instruments with Characteristics of Equity* (DP). In formulating these comments, the views of the Australian Constituents were sought and considered.

The DP was issued in Australia by the AASB as Invitation to Comment ITC 40 *Financial Instruments with Characteristics of Equity* in July 2018. The AASB received xx submissions, which are available on the AASB's website.[1]

The AASB acknowledges the efforts of the International Accounting Standards Board (IASB) to:

- Address conceptual challenges and practical application issues in applying IAS 32 *Financial Instruments: Presentation* to financial instruments with characteristics of equity; and
- Provide better presentation and disclosure information about these instruments for users.

However, the AASB questions whether the proposals in the DP adequately address some of the current practical challenges faced by constituents in applying IAS 32 *Financial Instruments: Presentation*, as identified by the IFRS Interpretation Committee and the IASB, without giving rise to new practical issues and challenges. The AASB is not convinced that the purported benefits of the proposals outweigh the costs and disruption that entities would incur in understanding and applying the proposed principles and new terminology in the DP. The AASB suggests that the IASB introduces a robust, transparent and comprehensive set of disclosures, for example disclosures on liquidity, financial instruments with anti-dilutive provisions and NCI puts, to resolve the majority of practical challenges, without changing the classification outcomes, the well understood terminology and requirements in IAS 32.

Please refer to Appendix A of this submission for AASB's detailed responses.

The AASB's submission focusses on whether the proposals in the DP help address the practical issues that are of particular relevance to Australian stakeholders and provides responses to Questions 1, 2, 4 and 8 in the DP.

1 Refer to http://www.aasb.gov.au/Work-In-Progress/Open-for-comment.aspx?id=2118 for submissions received on ITC 40.

If you have any questions regarding this letter, please do not hesitate to contact Shachini Dassanayake, Project Manager (sdassanayake@aasb.gov.au).

Yours sincerely,

Kris Peach

Chair

APPENDIX A – AASB's responses to Questions 1, 2, 4 and 8 in DP/2018/1

Question 1:

Paragraphs 1.23–1.37 describe the challenges identified and provide an explanation of their causes.

(a) **Do you agree with this description of the challenges and their causes? Why or why not? Do you think there are other factors contributing to the challenges?**

(b) **Do you agree that the challenges identified are important to users of financial statements and are pervasive enough to require standard-setting activity? Why or why not?**

AASB's response to Question 1

The AASB recognises the IASB's effort to address current application issues and practical challenges in applying IAS 32 to complex financial instruments with characteristics of equity.

The AASB also understands that one of the objectives of this project is to develop clear classification principles to ensure consistent application and to future proof the accounting requirements for instruments that have not been designed yet.

However, the AASB does not consider that proposals in DP/2018/1 have adequately addressed some of the key practical challenges (see below for details). Furthermore, the AASB is concerned that some of the IASB's proposals might create new practical challenges and change current classifications for some financial instruments that have not raised any practical concerns and are well understood by users of financial statements.

Summary of feedback on application issues and practical challenges

The AASB recognises the IASB's effort to address current application issues and practical challenges in applying IAS 32 to complex financial instruments with characteristics of equity.

The AASB also understands that one of the objectives of this project is to develop clear classification principles to ensure consistent application and to future proof the accounting requirements for instruments that have not been designed yet.

However, the AASB does not consider that proposals in DP/2018/1 have adequately addressed some of the key practical challenges highlighted to IFRS Interpretations Committee and to the IASB; and considers that some of the IASB's proposals create new practical challenges (refer below for details).

The AASB is of the view that the IASB's preferred approach would result in classification changes for certain financial instruments that currently do not raise concerns in practice (see examples below). IAS 32 works well for the majority of the financial instruments and results in classification outcomes which are well understood by preparers and users of financial statements. Therefore changes to IAS 32 classification outcomes should be clearly rationalised as to how new outcomes not only alleviate practical challenges, but are also more useful for users of financial statements.

The AASB would recommend the IASB introduces a robust, transparent and comprehensive set of disclosures, for example disclosures on liquidity, financial instruments with anti-dilutive provisions and NCI puts, to resolve the majority of practical challenges, without fundamentally changing classification outcomes.

Examples of practical challenges <u>that remain unaddressed</u> in the IASB's preferred approach proposed in DP/2018/1

1. Accounting challenges for non-controlling interest written put options (NCI puts)

What is the issue?	Extent of the issue	Proposed solution and recommendation

The following practical challenges in IAS 32 with NCI puts do not appear to have been addressed in DP/2018/1:
• Neither IAS 32 nor DP/2018/1 articulate whether the contra entry to the liability should be recognised for the put option as a derecognition of NCI or a general reduction in equity (alongside NCI). Noting that many Australian constituents are of the view that is not appropriate to reduce NCI while the voting rights and dividend rights of the minority shareholders are intact.
• The AASB considers that the derecognition of NCI and the recognition of a gross liability for the redemption amount of the shares on exercise of the put and subsequent attribution of profit or loss and other equity to a 'derecognised' NCI would be quite confusing to users of financial statements.
• The AASB notes that the DP also does not deal with certain conceptual issues that have been raised in the past or certain related application issues like:
  ◦ why changes to the redemption amount (especially for written puts at fair value) should be recognised in profit or loss in accordance with IFRS 9 rather treated as transactions between equity holders in accordance with IFRS 10 and IAS 1;
  ◦ The treatment of profit allocation and dividends paid to NCI under IFRS 10 when NCI has been derecognised;
  ◦ The impact of the changes on other topics such as earnings per share; and
  ◦ how to account for the uncertainty around how many shareholders would exercise the put option.
	NCI puts are relatively common in Australia as they create a mechanism for minority shareholders to exit from their investments at a future date, particularly in instances when the entity's shares are not traded in an active market.	The AASB recommends that the IASB should address, by way of further analysis and outreach, accounting issues for NCI puts regarding initial recognition and subsequent measurement that have not been considered in the DP. Specifically, the AASB have noted two issues resulting in disparity in practice:
		• How the contra entry to the liability should be recognised for the put option?
		• How a parent entity should account for the NCI put as a liability?
		To overcome the second practical issue noted above, the AASB suggests that NCI puts and NCI forwards should be accounted for in the same way as other derivatives written on an entity's own equity.
		The AASB would prefer that the IASB should explore enhanced disclosure opportunities to better represent the information required by users of the financial statements on NCI puts.

What is the issue?	Extent of the issue	Proposed solution and recommendation
The AASB questions why NCI puts and NCI forwards should be accounted for differently from other derivatives written on an entity's own equity (for example share options and warrants). The AASB notes that the NCI put might result in an outflow of cash to redeem own equity. However this might also be the case with other derivatives on an entity's own equity and the AASB is not convinced that the treatment of NCI put should be different from other derivatives on own shares. The DP also suggests including separate presentation of fair value changes in OCI for certain NCI puts (e.g. fair value puts). The AASB does not support the IASB's proposals of presenting income and expenses that arise from fair value NCI puts in OCI. Whilst we agree it would reduce the impact and related volatility of fair value changes in profit or loss, conceptually we don't agree with this approach and suggest it would: • result in an additional item presented in OCI, increasing the complexity of OCI, with a practical question as to whether or not to recycle these returns to profit or loss; • appear to be at odds with the IASB's intention detailed in paragraph 7.17 of the revised *Conceptual Framework for Financial Reporting* (referred to throughout this comment letter as revised Conceptual Framework), where the IASB have stated that only in exceptional circumstances would income or expenses arising from a change in the current value of an asset or liability be included in OCI (ie only when doing so would result in the statement of profit or loss providing more relevant information, or providing a more faithful representation of the entity's financial performance).		

2. Accounting challenges for instruments with anti-dilutive provisions

What is the issue?	**Extent of the issue**	**Proposed solution and recommendation**
IAS 32 does not provide a clear guidance around instruments with anti-dilutive provisions. Specifically, it does not provide guidance as to how to apply the fixed-for-fixed condition to a written call option to deliver a fixed number of an entity's own shares in exchange for a fixed amount of cash when the number of shares changes only as a result of an instrument's anti-dilution provision. Therefore there are several interpretations available on this topic where the principles in IAS 32 are interpreted in different ways. Anti-dilution provisions are often built into convertible instruments (usually referred to as "conversion price adjustments") in order to protect the holders of the instrument against a dilution of interest arising from such events. IAS 32 does not specifically deal with conversion price adjustments. If these adjustments meet the fixed-for-fixed criterion, then the conversion component will be classified as equity. Otherwise it will be classified as liability. The key question is – should an instrument that has an anti-dilutive provision that only kicks in to protect existing shareholders really fail an equity classification? DP/2018/1 does not appear to address the above practical challenges or provide guidance around these instruments either.	Many large corporates in Australia issue instruments with anti-dilution provisions as a mechanism to mitigate the dilutive effect of future share issuances on certain shareholders. The most common protections prevalent in Australia are designed to apply in situations in which share is sold to new investors at a price lower than that paid by earlier investors (which is also known as 'down rounds').	In our opinion, instruments with anti-dilutive provisions that result in changes to the conversion ratio that are purely "anti-dilutive" do not in substance breach the fixed-for-fixed requirement and should be classified as equity. The narrow focus of the fixed-for-fixed requirement in IAS 32 and the principles in DP/2018/1 mean that some instruments with conversion price adjustments fail to meet the definition of equity. In practice, this results in very few convertible bonds being treated as compound instruments (because anti-dilution provisions are included in most convertible bonds). We consider that the DP should address this issue in applying the proposed principles, taking account of the economic substance of the arrangement, which would mean that in most instances these instruments should be considered as equity. We strongly recommend that the IASB to consider addressing this issue in progressing this project.

3. Accounting challenges for convertible bonds issued in a foreign currency

What is the issue?	Extent of the issue	Proposed solution and recommendation
Under IAS 32 and DP/2018/1, mandatorily convertible bonds at a fixed for fixed ratio issued in a foreign currency would be classified as a liability due to the foreign currency being an independent variable. Similar to foreign currency rights (refer to Example 6), many entities operating in Australia and other countries in the Asia-Pacific region issue these instruments in a foreign currency to access the deep markets in the United States of America, United Kingdom and Europe. We are of the view that these instruments should be allowed an equity classification to reflect their true nature and economic characteristics. The counter argument is that these instruments are exposed to foreign currency fluctuations, which users of the financial statements would be interested in understanding – by classifying these as liabilities, foreign currency gains and losses can be observed through movements through profit or loss. However, the AASB suggests a more practical outcome would be for the IASB to consider classifying such instruments as equity based on the criteria in paragraph 6.34 in the DP as the only independent variable in these types of convertible bonds is the foreign currency fluctuation.	These instruments are common in Australia. They are issued by Australian financial institutions and large corporates.	The AASB strongly recommends that the IASB should consider classifying such instruments as equity based on the criteria in paragraph 6.34 in the DP as, in most cases, the only independent variable in these types of convertible bonds is the foreign currency fluctuation. The AASB considers that this would provide more useful information to users if coupled with disclosures about the risks and volatility resulting from these instruments.

4. Accounting challenges for Contingent Convertible Capital Instruments (CoCo bonds)

What is the issue?	**Extent of the issue**	**Proposed solution and recommendation**
CoCo bonds are financial instruments that convert into a variable number of the issuer's own equity instruments contingent on the occurrence of an uncertain future event, which is beyond the control of both the issuer and the holder of the instrument. The key issue for these instruments is whether they should be classified as equity, financial liabilities or a combination of both. In addition, the conversion feature may be an embedded derivative that requires separate accounting. As a result, the leading question is how to measure these instruments and components of these instruments. Neither IAS 32 nor DP/2018/1 have adequately addressed this matter. We are aware of at least five alternative accounting treatments being applied in practice (please see below): • The entire instrument is classified as a liability because the issuer has a contractual obligation to deliver a variable number of its own equity instruments should a contingent non-viability event occur. • The instrument is treated as a compound instrument, whereby a liability component is recognised reflecting the issuer's obligation (discussed above) and an equity component reflecting the discretionary interest payments. • The instrument is treated as a compound instrument, whereby a liability component is recognised reflecting the issuer's obligation (discussed above) and an equity component reflecting the discretionary interest payments – but the equity component is measured at zero initially. • The instrument is treated as a compound instrument, whereby a liability component is recognised and an embedded derivative for the	In the wake of the financial crisis, Australian regulators imposed new regulatory requirements in Australia to strengthen the capital base of financial institutions, particularly the banking sector. To comply with these new regulatory requirements financial institutions may issue financial instruments that convert into a variable number of the issuer's own ordinary shares in the event the institution breached minimum regulatory requirements (this type of contingent event is called a 'non-viability' event). The AASB understands that these instruments are widely used by Australian banks to meet regulatory requirements.	The AASB recommends the IASB performs more research into this topic to address practical challenges associated with CoCo bonds and to better explain conclusions in the DP for accounting for such instruments. The AASB's preliminary view for Coco bonds is that the entire instrument should be accounted as equity, because the instrument has no stated or pre-determined maturity date and represents a residual interest in the entity's net assets. However, the AASB would welcome further discussion on the topic to flesh out alternative views.

What is the issue?	Extent of the issue	Proposed solution and recommendation
conversion feature that obliges the issuer to settle in a variable number of its own shares. • The entire instrument is classified as equity as the instrument has no stated or pre-determined maturity date and represents a residual interest in the entity's net assets. The AASB does not consider that the IASB's preferred approach has reached a conclusion on the above alternative approaches used in practice, and is of the view that this matter should be addressed by the IASB as part of this project.		

Examples of <u>new practical challenges</u> as a result of the IASB's preferred approach proposed in DP/2018/1

5. The classification outcome for cumulative irredeemable preference shares and perpetual bonds

What is the issue?	Extent of the issue	Proposed solution and recommendation
Under IAS 32, irredeemable cumulative preference shares and perpetual bonds are classified as equity. Under DP/2018/1, these instruments would be classified as financial liabilities because the fixed-rate dividends/interests accumulate over time and changes in the entity's available economic resources will not result in changes in the amount to be settled on these instruments, even though the entity has a right to indefinitely defer the payments on these instruments until upon liquidation. The AASB considers that this creates a situation where the classification does not reflect the substance of these transactions as the entity has a right to defer payment indefinitely as long as the entity is a going concern. In addition, the classification of these instruments as liability based on the proposals in the DP would also result in measurement challenges as outlined. In particular, the AASB questions how such instruments would be valued given they only fall due on liquidation. Liquidation – under the going concern assumption, is not expected in the shorter or longer term. The AASB has identified the following practical challenges may arise from the IASB's preferred approach: • Classifying perpetual instruments as liabilities may affect the amount of capital an entity is required to have under capital regulatory regulations. • Classifying perpetual instruments as liabilities could impact leveraging ratios resulting entities not meeting debt covenants. • Measuring perpetual instrument as liabilities would be difficult given the entity is a going concern. The IASB would also need to provide a view on whether they should be measured at amortised cost or fair value and how to factor in discretionary dividends. • If such liabilities are measured at fair value – entities would face difficulties in determining the fair value of such instruments as most are	These instruments are commonly used by Australian financial institutions and large corporates.	The AASB is of the view that classifying irredeemable cumulative preference shares and perpetual bonds as liabilities does not represent the substance of these transactions. The current classification of these instruments under IAS 32 has not resulted in any practical issues and as such, the AASB is not convinced that the classification outcomes for these instruments should be changed under the new classification principles developed by the IASB. The AASB recommends that the IASB considers including 'other than liquidation' into its 'amount feature', which would result in these instruments not being classified as liabilities (see response to Question 2 for more details). The AASB notes that the IASB has not limited the principles to only consider events other than liquidation to help address the question of whether economic compulsion should considered in classification. The AASB considers that economic compulsion on its own is not enough to establish a contractual obligation. The obligation must be established through the terms and conditions of the financial instrument. The AASB refers to the principles articulated in paragraphs 4.34 – 4.36 of the IASB's revised Conceptual Framework, which discuss situations where an

What is the issue?	Extent of the issue	Proposed solution and recommendation
not actively traded and therefore do not have readily determinable fair values. There is also likely to be increased subjectivity and volatility in reported earnings.		entity has an obligation because it has no practical ability to avoid payment or transfer. In these situations, the assumption is that an entity is a going concern and if the entity can avoid a payment as long as it is a going concern, then there is no obligation or liability. The IASB's revised Conceptual Framework also states that neither an intention to make a transfer, nor a high likelihood of a transfer, is sufficient reason for concluding that the entity has no practical ability to avoid a transfer. Thus, based on the above, the AASB recommends that the 'amount feature' leg of the principles to apply to situations other than liquidation to prevent changes in unwarranted changes in classification for instruments that are well understood and have no practical application challenges.

6. The removal of the foreign currency rights issue exemption

What is the issue?	**Extent of the issue**	**Proposed solution and recommendation**
Currently, an entity can apply the foreign currency rights issue exemption in IAS 32 and classify rights to shares issued for a fixed amount of foreign currency as equity, if such rights are issued pro-rata to all of an entity's existing shareholders in the same class for a fixed amount of currency, regardless of the currency in which the exercise price is denominated. The IASB is proposing removing this exemption in DP/2018/1, meaning that such instruments would be classified as a liability due to the foreign currency being an independent variable. To mitigate the impact of this, the IASB has proposed that related returns can be presented in Other Comprehensive Income (OCI), if certain criteria are met. This is a significant issue in Australia because these transactions are commonly issued only to existing shareholders on the basis of the number of shares they already own, and are therefore similar in nature to dividends paid in shares – meaning the IASB's proposed classification would not reflect the substance of these transactions (a similar conclusion was reached by the IASB in the Basis for Conclusions (BC) paragraph BC4F[2] of IAS 32). The IASB has not provided sufficient explanation as to how the issues that warranted the foreign currency rights issue exemption in IAS 32 have been resolved to warrant the removal of the exemption. Therefore the AASB, does not support the proposal to remove the exemption. The AASB also does not support the IASB's proposals of presenting income and expenses that arise from such liabilities in OCI for the similar reasons as articulated in Example 1 above.	These instruments are widely used by Australian financial institutions and large corporates who enter into large transactions. Therefore the impact of this issue is significant. Many entities issue these rights in currencies other than their functional currency because they are listed in more than one jurisdiction; are required to do so by law or regulation; and/or need access global markets as the local market does not meet their needs.	Similar to the AASB's comments in relation to Example 3, The AASB recommends that the IASB considers classifying these instruments as equity based on the criteria in paragraph 6.34 in the DP as the only independent variable in these instruments is the foreign currency. The AASB considers that this would provide more useful information to users if coupled with disclosures about the volatility resulting from these instruments being issued in a foreign currency rather than the presentation exception proposed in the DP of presenting the income and expenses arising from these types of instruments in OCI.

2 BC4F states 'The Board agreed with the IFRIC's 2005 conclusion that a contract with an exercise price denominated in a foreign currency would not result in the entity receiving a fixed amount of cash. However, the Board also agreed with the IFRIC that classifying rights as derivative liabilities was not consistent with the substance of the transaction. Rights issues are issued only to existing shareholders on the basis of the number of shares they already own. In this respect they partially resemble dividends paid in shares.

7. Classification outcome of certain instruments with obligations to deliver entity's own shares

What is the issue?	Extent of the issue	Proposed solution and recommendation
Different classification outcomes arise when applying IASB's preferred approach and the principles in the revised Conceptual Framework. For example under DP/2018/1 irredeemable cumulative preference shares and instruments with obligations to deliver a variable number of shares equal to a fixed amount of cash results in a liabilities classification, whereas these two instruments would be classified as equity under the IASB's revised Conceptual Framework. This conflict may lead to contracts that are economically similar being classified differently. There is an inherent inconsistency between the IASB's preferred approach, which appears to have principles to classify instruments from the perspective of a 'proprietor', whilst the revised Conceptual Framework appears to take the view that general purpose financial statements are prepared from an 'economic entity' perspective. If the IASB takes a conceptually different approach to the revised Conceptual Framework, the IASB should explain why it is necessary for it to do so for this project and articulate the rationale for its different approach.	Instruments with obligations to deliver a variable number of shares equal to a fixed amount of cash are widely used by Australian financial instruments and large corporates.	The AASB recommends the IASB considers the conceptual differences between what is proposed in DP/2018/1 and the revised Conceptual Framework to ensure the overall objective of the general purpose financial statements is consistently applied.

Question 2:

The Board's preferred approach to classification would classify a claim as a liability if it contains:

(a) an unavoidable obligation to transfer economic resources at a specified time other than at liquidation; and/or

(b) an unavoidable obligation for an amount independent of the entity's available economic resources.

This is because, in the Board's view, information about both of these features is relevant to assessments of the entity's financial position and financial performance, as summarised in paragraph 2.50. The Board's preliminary view is that information about other features of claims should be provided through presentation and disclosure.

Do you agree? Why, or why not?

AASB's response to Question 2

The AASB agrees that information provided in the financial statements about claims on an entity should help users to assess the entity's liquidity and solvency. However the IASB's proposed principles of timing and amount features to address liquidity and solvency assessments result in new practical challenges when applying them and do not address some of the current practical challenges.

The AASB notes that solvency and liquidity are closely interrelated and the timing leg of the proposed principles in the DP, in most cases, addresses both of these. The AASB has concerns with the amount leg of the proposed principles specifically as it does not limit the principles to events 'other than at liquidation'. The AASB notes that this leg of the principles would result in certain instruments that are currently classified as equity (as articulated in Q1 Example 5) to be liabilities. The AASB considers such changes in classifications to be unwarranted as the current classifications for these instruments are not causing any issues in practice and are well understood by users.

The AASB is concerned that similar to above, there may be other unwarranted changes in classification that are counter-intuitive to the real substance of the transaction.

The AASB is also concerned that the IASB's preferred approach in the DP introduces completely new terminology that would require preparers and auditors to reconsider some past classification decisions, resulting in disruption, additional costs for preparers and emergence of new issues and uncertainties. The AASB questions whether the effort required is worthwhile, if the effect is marginal.

Furthermore, the AASB is not supportive of the IASB amending the revised Conceptual Framework based on the outcome of a research or standard-setting project, such as this. Determining the conceptual principles for distinguishing liabilities from equity seems a logical and essential first step before addressing specific issues in practice. Therefore, we recommend completion of the relevant components of the revised Conceptual Framework first, rather than amending IAS 32 and reverse-engineering the revised Conceptual Framework.

In the AASB's view, a careful weighing of the potential benefits of these principles against the potential risks of unnecessary disruption and unintended consequences is crucial.

Concerns with the 'amount features'

The AASB agrees that information provided in the financial statements about claims on an entity should help users to assess the entity's liquidity and solvency. The AASB notes that solvency and liquidity are closely interrelated and the timing leg of the proposed principles in the DP, in most cases, addresses both of these concepts.

The AASB has concerns with the amount leg of the proposed principles specifically as it does not limit the principles to events 'other than at liquidation'. The AASB notes that this leg of the principles would result in certain instruments that are currently classified as equity (as articulated in Q1 Example 5) to be liabilities. The AASB considers such changes in classifications to be unwarranted as the current classifications for these instruments are not causing any issues in practice and are well understood by users.

The AASB notes that the IASB has not limited the principles to only consider events other than liquidation to help address the question of whether economic compulsion should considered in classification. The AASB considers that economic compulsion on its own is not enough to establish a contractual obligation. The obligation must be established through the terms and conditions of the financial instrument. The AASB refers to the principles articulated in paragraphs 4.34 – 4.36 of the IASB's revised Conceptual Framework, which discuss situations where an entity has an obligation because it has no practical ability to avoid payment or transfer. In these situations, the assumption is that an entity is a going concern and if the entity can avoid a payment as long as it is a going concern, then there is no obligation or liability. The IASB's revised Conceptual Framework also states that neither an intention to make a transfer, nor a high likelihood of a transfer, is sufficient reason for concluding that the entity has no practical ability to avoid a transfer. Furthermore, The AASB considers that it is conceptually inconsistent to determine classification of an instrument (ie liability or equity) based on how claims are prioritised and amounts distributed on liquidation, when financial statements are prepared on a going concern basis.

Thus, the AASB recommends that the IASB limits the amount leg of its principles to events other than at liquidation. This would result in classification outcomes that are more in line with the economic substance of the transactions and consistent with the current classifications outcomes that are well accepted and understood. This would also help avoid unnecessary costs and disruption with no or limited benefits. The AASB is also of the view that the terms 'entity's available economic resources' and 'amounts independent of the entity's available economic resources' could be more clearly articulated as they appear to be circular in nature.

***Concerns with the lack of linkage with the* revised Conceptual Framework**

The IASB mentioned in the DP, that it would consider possible implications of what was being proposed for the revised Conceptual Framework. The AASB recommends that conceptual principles for distinguishing liabilities from equity should be determined first, prior to addressing specific issues in practice. In the AASB's view, this would be a better approach to future proof the requirements.

The AASB notes that the liability definition in DP/2018/1 is broader than the definition of a liability in the revised Conceptual Framework as it classifies claims as liabilities where:

- there is no obligation to transfer economic resources before liquidation, even though the entity continues to operate as a going concern; and
- there is no transfer of economic resources but there is transfer of shares to an amount independent of the entity's available economic resources

It is not clear from the DP why the IASB's approach in the DP has to be different from the principles in the revised Conceptual Framework for a liability. The AASB recommends that the IASB to start with the revised Conceptual Framework prior to revising the Standard, if the objective is to develop robust principles to distinguish liabilities from equity and to future proof the accounting.

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?

AASB's response to Question 4

The AASB agrees with the IASB's preliminary view that the puttable exception should be retained as was suggested in the IASB's preferred approach.

However, we recommend that the IASB should further explore:

- the extent to which the exception is used in practice;
- implementation challenges arising from it; and
- whether the requirements of paragraphs 16A to 16F of IAS 32 should be improved.

Additional feedback on the IASB's puttable exemption

The AASB agrees with the IASB's preliminary view is that the puttable exception should be retained. The AASB considers that it is important that the puttable exception continues to be available to avoid counter-intuitive outcomes in classification.

However, The AASB suggests that the IASB provides examples and guidance on how this the puttable exception would be applied. Feedback has been that it is difficult to understand the requirements in IAS 32 on when the exception would apply.

Notes for the Board's information only:
Staff is expecting a submission from Business Council of Co-operatives and Mutuals after which the above views will be further fleshed out.

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?

AASB's response to Question 8

For the reasons set out below, the AASB disagrees with:

- the IASB's preliminary view 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; and
- presenting equity like returns of financial liabilities in the OCI for some particular NCI puts.

However, the AASB recommends providing following disclosures in the financial statements:

- Maximum number of potential ordinary shares;
- Priority of claims on liquidation; and
- Terms and conditions that affect the timing and the amount of cash flows.

Feedback on attribution of income and expenses to some equity instruments other than ordinary shares

The AASB is not convinced of the usefulness of attribution approaches suggested in the DP for investors. We are of the view that cost of providing these information would significantly exceed the intended benefits. We do not believe it is appropriate to allocate total comprehensive income to certain derivatives when they are not entitled to dividends or income of the entity. As noted in our comment letter on DP/2013/1 *A Review of the Conceptual Framework for Financial Reporting* (Response to Question 10 that DP), we do not support attribution of income and expenses to each class of equity instruments other than ordinary shares[3].The AASB is also of the view, that the approach suggested in the DP does not cover other forms of equity outside IAS 32 for example employee share options. Thus provides incomplete information.

However, the AASB recommends providing disclosures on the expected maximum number of potential ordinary shares, priority of claims on liquidation and terms and conditions affecting timing and amount of cash flows, which would be useful to users.

Feedback on presenting equity-like returns of financial liabilities in the OCI for certain financial instruments

As noted in Examples 1 and 6, the AASB does not support the IASB's proposals of presenting income and expenses that arise from certain liabilities in OCI for the following reasons:

- it would result in an additional item presented in OCI, increasing the complexity of OCI, with a practical question as to whether or not to recycle these returns to profit or loss;
- it would lead to an exception in presentation– replacing one rule with another rather than a principle-based outcome; and
- appears to be at odds with the IASB's intention detailed in paragraph 7.17 of the revised Conceptual Framework.

Refer to Examples 1 and 6, within the AASB's response to Question 1 for further details.

3 For the Board's information only: Refer to AASB comment letter of DP/2013/1 page 39-46