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