SUMMARY OF MEETING WITH SMPC TECHNICAL ISSUES WORKING GROUP
IASB Discussion Paper on Financial Instruments with Characteristics of Equity

Date: 13 September 2018
Time: 9:30 am – 11:30 am
Venue: HKICPA Conference Room, 37/F Wu Chung House, Wanchai

Present: Gary Poon, Poon & Co
Chan Yuk Sim, Grant Thornton
Philip Fung, Lak & Associates CPA
Lau Kwok Hung, Crowe Horwath
Basilia Wong, HLB Hodgson Impey Cheng
Yip Ngai Shing, Mazars
Eky Liu, Standard Setting, HKICPA

Challenges in applying IAS 32

- Common financial instruments issued by clients include:
  - Convertible bonds with anti-dilution clauses / adjustments to conversion ratio / contingent settlement provisions
  - Convertible bonds denominated in foreign currency
  - Irredeemable preference shares with fixed dividend
  - Preference shares with step-up dividend clauses
  - NCI puts
- SMPs faced the following challenges when applying IAS 32:
  - Assessing whether anti-dilution provisions and adjustments to conversion ratio in convertible bonds meet the fixed-for-fixed condition.
  - Contingent settlement provisions - It is difficult to consider whether some events/circumstances occur within or beyond the control of the issuer, e.g. public listing of the company.
  - The accounting treatment on the equity side of a NCI put is not clear under IAS 32.

Classification of non-derivative financial instruments

- Some SMPs clients issue cumulative fixed rate irredeemable preference shares. The holders of such preference shares usually inject funds to the issuer through subscribing such preference shares and do not expect the issuer to repay until liquidation. Therefore, such preference shares are often viewed as 'equity', which is inconsistent with the classification outcome under the IASB's preferred approach.

- One SMP commented that the IASB's preferred approach changes the classification outcome of cumulative fixed rate irredeemable preference shares but it is not clear why such change is needed and how the new classification outcome would be better.
- Another SMP commented that it may be difficult to rationalise the classification of a claim that is only settled at liquidation as 'liability' just because the interests/dividends are fixed amounts. But he admitted that such claim is not equity, which represents the residual interest of the entity.
- The Discussion Paper introduces new classification principles and new terminology which are currently not in IAS 32. Therefore having more guidance on the new principles, in particular, the notion of amount independent of the entity's available economic resources, would be helpful,

Classification of derivatives on own equity

- SMPs are not aware of clients applying the 'puttable exception' or 'foreign currency rights issue exception' under IAS 32. Therefore, they do not have any comments on retaining / removing those exceptions under the IASB's preferred approach.
- SMPs commented that the Discussion Paper does not resolve the practical application issues on anti-dilution provisions. Because the notion of amount independent of the entity's available economic resources is new but unclear at the moment, there could be more challenges in assessing the impact of anti-dilution provisions under the IASB's preferred classification approach.

Compound financial instruments and redemption obligation arrangements

- SMPs considered that the Discussion Paper provides a clear accounting treatment on the equity side of a NCI put at its initial recognition. However, they would like to have more explanation on the following:
  - The rationale of derecognising the NCI at fair value.
  - The meaning of the remaining rights and obligations after recognising the redemption amount and derecognising the NCI.

Presentation of financial liabilities

- SMPs considered that presenting income or expenses resulting from financial liabilities with equity-like returns in other comprehensive income (OCI) would reduce the volatility of profit or loss.
- However, they expressed the concern of expanding the use of OCI. They also

considered that the IASB should explain further whether such presentation is consistent with the presentation principles on income and expenses in the *Conceptual Framework for Financial Reporting 2018*.

Presentation of equity instruments

- SMPs expressed the following concerns regarding attribution of income and expenses to equity instruments other than ordinary shares:
    - Entities would need to incur additional costs to measure the fair values of the equity instruments and perform the attribution.
    - Financial statements would become more complicated as income and expenses arising from different financial instruments would be presented in different areas of the financial statements. SMPs questioned whether such presentation would be relevant and useful to users of financial statements.
    - One SMP questioned the meaning of profit or loss and total comprehensive income when IASB is proposing more income and expenses to be presented outside profit or loss.
- One SMP considered that the disclosures of the contractual terms of equity instruments would be more useful and relevant to users of financial statements.

Disclosures

- SMPs supported the proposals of disclosing potential dilution of ordinary shares and the contractual terms and conditions of financial instruments.
- In respect of the proposed disclosure of priority of claims on liquidation, SMPs expressed the following views:
    - The proposal seems to contradict with the going-concern basis of preparing financial statements.
    - The disclosure of maturity analysis of financial liabilities under IFRS 7 already provides sufficient information about the timing and amount of settlement.
    - It is questionable whether such disclosure, which covers only financial instruments but ignores non-financial liabilities, is useful.
    - It is not certain whether insolvency laws should be taken into account when preparing such disclosure.