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Submitted electronically via www.ifrs.org

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Dear Sirs,

Re: Financial Instruments with Characteristics of Equity (DP/2018/1)

This letter is the response of the Canadian Accounting Standards Board (AcSB) to the International Accounting Standards Board's (IASB) Discussion Paper, "Financial Instruments with Characteristics of Equity" issued in June 2018.

Our process

As part of our due process for this Discussion Paper, we consulted with over 100 stakeholders across Canada through discussions with our IFRS® Discussion Group, User Advisory Council, Academic Advisory Council, CPA Canada Mining Task Force, CPA Canada Oil and Gas Task Force, CPA Canada Investment Funds Advisory Group, the Canadian Banking Association, the Office of the Superintendent of Financial Institutions, the Canadian Life and Health Insurance Association and user groups. In addition, we held outreach sessions across Canada with preparers, practitioners, regulators and users of financial statements. We considered the results of these discussions when developing this letter.

Our view

We commend the IASB for striving to address the current application challenges with IAS 32 *Financial Instruments: Presentation* through its Financial Instruments with Characteristics of Equity Project. We agree that standard setting activity is required to address issues that currently arise with the application of IFRS 32.

Classification principles

We acknowledge the need to refine the classification principles to address the challenges identified in IAS 32. However, we are of the view that the IASB's preferred approach is not robust enough to address all the challenges identified in practice. The new terminology introduces very complex concepts that are likely to create additional application challenges. This element of complexity is exacerbated by the difference in the definition of a financial liability between the IASB's proposed approach and that of the recently issued Conceptual Framework and IFRS 2, *Share-Based Payments*.

More specifically, we think the challenges are associated with the amount feature. We think the IASB should reconsider whether the amount feature should be triggered if it only arises on liquidation, as the amount feature as defined contradicts the going concern concept. For example, the proposals assume that the classification of cumulative preferred shares is a liability, as the amount feature is met, due to payment of the principal that would trigger upon liquidation and the requirement to pay dividends on these instruments, regardless of dividend declaration. We think that the IASB needs to better articulate the nature, terms and characteristics of the type of cumulative preferred share which should be classified as a liability, because there could be substantive differences among the features of certain types of cumulative preferred shares, which may result in a different classification outcome.

In Canada the cumulative dividend on cumulative preferred shares is considered legally payable only upon unilateral declaration of the dividend by the issuer. That is, such dividends are never payable unless they are declared by the issuer, who has complete discretion as to whether to do so. In our view, the current classification of cumulative preferred shares in Canada as equity instruments is warranted based on the terms and conditions of the instruments. The nature of the principal element and the ability to not pay dividends on a Canadian cumulative preferred share results in a risk profile more closely related to that of an ordinary equity instrument than that of a perpetual debt instrument. The IASB's proposal would cause these cumulative preferred shares to effectively be measured on a split basis, which introduces an additional element of complexity that does not exist today.

Based on the instruments discussed during our outreach, we agree that the classification of most traditional financial instruments would be unaffected. However, we are concerned with the comprehensive work effort that will be required by an entity to consider the proposed principles. We also think field testing is needed as application difficulties may arise when these principles are applied to instruments currently issued in Canada and other jurisdictions around the world.

We welcome the proposal that an anti-dilution feature that does not introduce an independent variable resulting in a liability classification, as this will help reduce application challenges and inconsistent treatment for instruments which are broadly the same in the Canadian market.

Puttable exception

We agree with the retention of the puttable exception though we request the IASB to reconsider elements within the requirements of the puttable exception, as there have been application issues allowing ambiguous interpretation in practice of the current criteria. This has been further detailed in the Appendix 1 to this letter.

Compound instruments and redemption obligation arrangements

We agree that the introduction of definitive guidance in this area will help eliminate diversity in practice for the accounting for redemption obligation arrangements and non-controlling interest (NCI).

Presentation

We disagree with the IASB's view to separately identify liabilities whose amount depends on own performance and are concerned with the proposed use of other comprehensive income (OCI). In our view, OCI is not fully understood and the presentation of gains and losses within OCI would add a further element of complexity. We also suggest that the IASB take this opportunity to more thoroughly consider issues with performance reporting and the economic impact on the entity, before expanding the use of OCI.

We appreciate the IASB's effort to expand the disclosures for equity instruments. However, we do not agree with the proposal to expand the attribution of income and expenses to equity instruments other than ordinary shares. We think that this proposal will not provide useful and relevant information to users and will only add to the complexity and costs to disclose such information. Consider the attribution of income and expenses to

warrants that are deeply out of the money and that will most likely never participate in the resources of the entity. Users are unlikely to find this information useful and relevant to their needs. As such, we think the IASB should explore the disclosure option in the proposals together with a comprehensive relook at the current requirements of IAS 33, *Earnings Per Share*.

Disclosure

We strongly support the proposed disclosure of the terms and conditions of financial instruments, especially as it relates to equity instruments. Users are generally interested in understanding the future cash flows of the entity as they evaluate investment alternatives. Their evaluation can be assisted by quality disclosures of contractual terms of equity instruments. These disclosures are currently lacking in the financial statements.

Our responses to your questions

Appendix 1 to this letter responds to the questions posed in the Discussion Paper and expands on the points raised above. Appendix 2 outlines alternative views not shared by the AcSB, that were provided by some stakeholders during our outreach.

We would be pleased to elaborate on our comments in more detail if you desire. If so, please contact me or, alternatively, Katharine Christopoulos, Senior Principal, Accounting Standards (+1 416 204-3270 or email kchristopoulos@acsbcanada.ca) or Jayshal Daya, Principal, Accounting Standards (+1 416 204-3501 or email jrdaya@acsbcanada.ca).

Yours truly,

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About the Canadian Accounting Standards Board

We are an independent body with the legal authority to establish accounting standards for use by all Canadian publicly accountable enterprises, private enterprises, not-for-profit organizations and pension plans in the private sector. We are comprised of a full-time Chair and volunteer members from a variety of backgrounds, including financial statement users, preparers, auditors and academics; a full-time staff complement supports our work.

Our standards

We have adopted IFRS® Standards as issued by the IASB for publicly accountable enterprises. Canadian securities legislation permits the use of U.S. GAAP in place of IFRS Standards in certain circumstances. We support a shared goal among global standard setters of high-quality accounting standards that result in comparable financial reporting outcomes regardless of the GAAP framework applied.

We developed separate sets of accounting standards for private enterprises, not-for-profit organizations and pension plans. Pension plans are required to use the applicable set of standards. Private enterprises and not-for-profit organizations can elect to apply either the set of standards developed for them, or IFRS Standards as applied by publicly accountable enterprises.

Our role vis-à-vis IFRS Standards

Our responsibility to establish Canadian GAAP necessitates an endorsement process for IFRS Standards. We evaluate and rely on the integrity of the IASB's due process as a whole, and monitor its application in practice. In addition, we perform our own due process activities for each new or amended IFRS Standard to ensure that the standard is appropriate for application in Canada. We reach out to Canadians on the IASB's proposals to understand and consider their views before deciding whether to endorse a final IFRS Standard. A final standard is available for use in Canada only after we have endorsed it as Canadian GAAP.

APPENDIX 1

Section 1 – Objective, scope and challenges

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?

1. We agree with the challenges identified but think there are additional challenges with the current application of IAS 32 that should also be considered. We are of the view that the proposals as they currently stand are not robust enough to address other important application issues identified in practice, which we elaborate on throughout this response letter. We acknowledge that IAS 32 resulted in reasonable classification outcomes in most cases, however standard setting activity is required to:
   a) address the changes in the evolving market place and the introduction of more complex instruments with both debt and equity features;
   b) solve application issues with the fixed-for-fixed condition, non-controlling interest (NCI) puts and contingent settlement provisions; and
   c) provide users with adequate disclosure of contractual terms and conditions to allow the analysis of future cash flow implications of equity instruments.
2. Some stakeholders noted that the use of more complex instruments with debt and equity features typically impacts smaller and emerging companies primarily in the energy, utilities and mining sectors more than larger entities, as these entities have less access to traditional financing sources. However, we think that the use of complex financial instruments with characteristics of debt and equity may become more widespread as interest rates rise and traditional financing sources start to lose their appeal in the market.
3. We are also of the view that IAS 32 does not include adequate guidance to address the classification implications on day 2 accounting should there be no change to the contractual terms of the instrument, but a subsequent change in a factor relevant to the initial classification of the instrument, such as the functional currency of the issuer.
4. We also note that there are application challenges when accounting for the “net asset value attributed to unit holders” when an entity has no contributed equity, such as some mutual funds and unit trusts. Currently, Illustrative Example 7 in IAS 32 provides no guidance for the measurement basis of this residual asset presentation. While IAS 32 deals with the classification of financial instruments, we think if IAS 32 is going to be revised, the IASB could consider where a stakeholder should be directed to, in order to measure the residual asset.

Section 2- The Boards preferred approach

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?

5. We are of the view that the IASB's preferred approach is not robust enough to address all the challenges identified in practice and places a focus on liquidation that may not be warranted. We think the IASB should reconsider whether the amount feature should be triggered if it only arises on liquidation as the proposal would contradict the going concern concept.
6. However, we welcome standard setting activity to address the challenges identified with IAS 32 and the IASB's proposals to:
   a) retain the binary classification approach;
   b) retain equity as the residual interest;
   c) address issues in the current model, though we think the proposals do not address all the issues in practice; and
   d) provide information of other features through presentation and disclosure.
7. We understand the IASB's approach is to address the definition of a liability within the Financial Instruments with Characteristics of Equity project and then revisit the definition in the recently issued Conceptual Framework. We think there is a fundamental flaw to this approach as a consistent definition of a financial liability between the IASB's proposed approach and the Conceptual Framework is essential in developing the core principles for this project. For example, the Conceptual Framework defines a liability as "a present obligation to transfer an economic resource as a result of past events". This definition creates an inconsistency with the IASB's preferred approach to classify an obligation to deliver a variable number of the entity's own shares with a total value equal to a fixed amount of currency as a financial liability.
8. A similar discrepancy exists between IFRS 2, *Share-Based Payments* and the IASB's proposed approach as IFRS 2 requires obligations to deliver equity instruments prior to liquidation that meet certain criteria to be classified as equity.
9. We also note that the proposed principles are not simple concepts and are challenging to comprehend without the provision of examples. This questions whether the IASB should reconsider the terminology being introduced, which we discuss in our response to question 3.

Section 3 – Classification of non-derivative instruments

Question 3
The Board's preliminary view is that a non-derivative financial instrument should be classified as a financial liability if it contains: (a) an unavoidable contractual obligation to transfer cash or another financial asset at a specified time other than at liquidation; and/or (b) an unavoidable contractual obligation for an amount independent of the entity's available economic resources. This will also be the case if the financial instrument has at least one settlement outcome that has the features of a non-derivative financial liability. Do you agree? Why, or why not?

10. While we agree with the timing feature in (a), we disagree with the amount classification principle proposed in (b). The new terminology introduces very complex concepts that are likely to create additional application challenges that may not be warranted.
11. Terms such as the issuer's own performance and how an entity should look at its performance are terms subject to different interpretations. During our outreach sessions, respondents also questioned the amount feature more generally as the terminology introduced is very complex.
12. The following terms in the amount feature were identified as difficult to interpret:

a) **Available economic resources (AER)** – The IASB has defined this concept as a being the residual after deducting the total recognized and unrecognized claims against the entity from its total recognized and unrecognized assets. The application of this concept to some financial instruments tied to the returns from a project of the entity may prove challenging. For example, a financial instrument with returns tied to returns from a project of an entity, that has no other projects or assets, could potentially be considered dependent on the entity's AER and not trigger the amount feature. The complexity of this concept is further increased in instances in which the entity has unrecognized assets that are not captured in the returns of the entity or within the entity's financial statements as a whole.

b) **Independent** – The IASB needs to better articulate what would be considered independent and define the degree of independence that would be required to meet this principle. We also think that further consideration should be given to the application of the independence requirement when applied to private enterprises who do not have a publicly quoted equity price.[1]

Cumulative preferred shares:

13. We think that the IASB needs to better articulate the nature and characteristics of a cumulative preferred share which must be classified as a liability, as these instruments may have different terms and characteristics across jurisdictions and therefore not all cumulative preferred shares may necessarily result in a similar classification outcome. Further, a better articulation of how declared and unpaid dividends should be classified would be welcome, as the IASB's proposed approach could result in different classification outcomes depending on the unique characteristics of the instrument.
14. The IASB should also consider the potential negative implications that a change in classification of cumulative preferred shares will have on the methodology debt agencies use to evaluate entities.
15. Some stakeholders questioned the relevance and usefulness of information provided should cumulative preferred shares be classified as a liability. They noted that in the normal course of business, when an entity is considered a going concern, the liability would be negligible, but as an entity's prospects change and the entity fails to be a going concern, a meaningful amount will show up as a liability. This change only arises once the entity experiences financial difficulty, rather than prior to those events. Therefore, this information would only be communicated to users when there are already problems. We think that this issue is further complicated during the stages prior to final liquidation, such as when an entity remains a going concern and/or has a bankruptcy filing, neither of which may definitively indicate when liquidation might occur.

Instruments unique to the Canadian market

Cumulative preferred shares in Canada

16. A large number of Canadian companies issue preferred shares, particularly in the financial, utilities and pipeline industries. Cumulative preferred shares in Canada hold a different meaning, in that the cumulative dividend on preferred shares is considered legally payable only upon unilateral declaration of the dividend by the issuer. That is, such dividends are never payable unless they are declared by the issuer, who has complete discretion as to whether to do so.
17. The discussion paper assumes that the classification of cumulative preferred shares when payment of the principal is triggered on liquidation is a liability. However, the present value of such instruments when no cumulative preferred share dividends are declared is nil (or negligible) since the amount is projected out so far into the future. A compound instrument may result because there is a still a discretionary feature for the undeclared cumulative dividends, which would be recorded in equity and would be equal to the full proceeds. In our view, the current classification of cumulative preferred shares as equity instruments in Canada is warranted based on the terms and conditions of the instruments. The nature of the principle element and the ability to not pay dividends on a cumulative preferred share results in a risk profile more closely related to that of an ordinary equity instrument than that of a perpetual debt instrument.

[1] There are a large number of Canadian private enterprises that apply IFRS as their financial reporting framework.

Non-viable Contingent Capital (NVCC)

18. The discussion paper refers to contingent convertible bonds which in Canada come in the form of NVCC instruments.
19. NVCC instruments are:
    - part of the regulatory capital that must be able to absorb losses in a failed financial institution;
    - these instruments can be issued as debt or preferred shares; and
    - they must have in their contractual terms and conditions a clause requiring a full and permanent conversion into common shares upon a trigger event.
20. NVCC instruments are prevalent in the Canadian banking industry and are used by the industry to gain favorable capital treatment. NVCC instruments represent a significant portion of the capital structure for Canadian financial institutions, which account for a large percentage of the Canadian market capitalization. These instruments are similar to perpetual preferred shares but have a contingent feature that converts the instrument into a variable number of common shares upon a non-viable event as determined by a regulator. Under the proposals, these instruments would be classified as liabilities as a triggering event can occur that is not within the control of the entity. Under IAS 32, these instruments are treated as equity in Canada, the classification of these instruments as accounting equity is widely accepted by users of financial statements and is currently consistent with the regulatory equity classification for capital purposes. However, if classified as a liability, they would be deemed to be a liability for regulatory purposes and would not be eligible for favorable capital treatment. We are therefore of the view that a change in classification of these instruments would negatively impact the industry without enhancing the relevance and usefulness of information provided to users of financial statements.

Other issues

21. We express concern regarding the transition requirements and request the IASB to take into consideration the implied cost implications if it decides to move forward with some of these proposals. Retrospective application to all open contracts at transition could result in some entities having to evaluate a large volume of contracts, which would result in significant costs for preparers for what the IASB intends will result in minimal change.

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?

22. The puttable exception is applied frequently in Canada by real estate investment trusts, private equity limited life vehicles and partnerships. We agree with the retention of the puttable exception, however, we request the IASB reconsider the requirements of the puttable exception as there have been application issues in the Canadian market. More specifically, the criteria in paragraph IAS 32.16A(c), 16B, 16C(c) and 16D, allows for ambiguous interpretation depending on how each entity evaluates the implications that its other financial instruments may have on the puttable instrument and whether it meets the puttable exception in the presence of these other financial instruments. For example, many partnerships with general partnership managers have contracts with the entity which stipulate that the management fees are based on the change in the recognized net assets or the change in the fair value of recognized net assets of the partnership. The complexity created is whether this management contract results in a breach of the criteria in paragraph IAS 32.16B and 16D.
23. Challenges adhering to the requirement in IAS 32.16A(c) are also experienced in the Canadian market to determine whether puttable instruments have identical features. In some cases, there may be different voting rights for two series of otherwise identical puttable instruments or different fee structures depending on whether the instrument is issued to a wholesale or a retail investor; however, all other terms impacting the payouts and future cash flows of the instrument are identical. We question whether this criterion should be narrowed to only require identical features for those characteristics which have a direct impact on the future cash flows due to the puttable instrument holder.

Section 4 – Classification of derivative financial instruments

Question 5
The Board's preliminary view for classifying derivatives on own equity—other than derivatives that include an obligation to extinguish an entity's own equity instruments—are as follows: (a) a derivative on own equity would be classified in its entirety as an equity instrument, a financial asset or a financial liability; the individual legs of the exchange would not be separately classified; and (b) a derivative on own equity is classified as a financial asset or a financial liability if: (i) it is net-cash settled—the derivative requires the entity to deliver cash or another financial asset, and/or contains a right to receive cash for the net amount, at a specified time other than at liquidation; and/or (ii) the net amount of the derivative is affected by a variable that is independent of the entity's available economic resources. Do you agree? Why, or why not?

24. In theory, we are supportive of replacing exceptions, such as the fixed-for-fixed criteria, with new classification criteria for derivatives on own equity to address the challenges currently faced. We also agree with the proposal to classify derivatives on own equity in their entirety as an equity instrument. However, similar to the challenges noted above for non-derivative instruments, we think that significant challenges may be faced applying the proposed amount feature. We are therefore not supportive of the classification criteria proposed for derivative instruments on own equity.
25. We are of the view that the IASB's preferred approach does not address all the challenges identified. For example, it is not clear from the IASB's preferred approach how to classify convertible debt instruments with a conversion feature that results in the number of shares into which it is converted being dependent on the five-day moving average price prior to conversion. Further to this point, it is also not clear whether this instrument contains an embedded derivative, as there is no clear accounting guidance on how this should be treated.
26. While the use of the foreign currency rights exception is not widely applied in Canada, we think there is no significant difference between rights issues and convertible bonds or warrants denominated in a foreign currency. We think that consistency among financial instruments with a similar nature is critical to the retention or removal of the foreign currency rights issue exception. We are therefore indifferent to the removal or retention of this exception, provided consistency is ensured across all instruments with a similar nature, i.e. should the IASB decide to retain this exception, consideration should be given to extending this requirement to other similar instruments beyond rights issues to preserve the consistency of classification for similar instruments. Removal of the foreign currency rights exception will result in consistent accounting treatment with current U.S. GAAP requirements.
27. We also request the IASB consider whether liability classification would be appropriate in instances where the foreign currency component represents an immaterial component of the overall change in the fair value of an equity option instrument; or under instances in which financing cannot be raised in the entity's functional currency. For example, a Canadian entity might have a U.S. dollar functional currency, but the market for a particular type of financial instrument in Canada is only denominated in Canadian dollars.

Anti-dilution features

28. We agree with the proposal within the discussion paper that an anti-dilution feature in itself will not trigger the amount feature. This proposal will help reduce application challenges and provide much relief in the Canadian market. This proposal is also consistent with the recent U.S. GAAP amendment made by the FASB pertaining to down-round features, which was well received by most Canadian stakeholders.

Section 5 – Compound instruments and redemption obligation arrangements

Question 6
Do you agree with the Board's preliminary views set out in paragraphs 5.48(a)–(b)? Why, or why not? Applying these preliminary views to a derivative that could result in the extinguishment of an entity's own equity instruments, such as a written put option on own shares, would result in the accounting as described in paragraph 5.30 and as illustrated in paragraphs 5.33–5.34. For financial instruments with alternative settlement outcomes that do not contain an unavoidable contractual obligation that has the feature(s) of a financial liability as described in paragraph 5.48(c), the Board considered possible ways to provide information about the alternative settlement outcomes as described in paragraphs 5.43–5.47. (a) Do you think the Board should seek to address the issue? Why, or why not? (b) If so what approach do you think would be most effective in providing the information, and why?

29. We agree that the introduction of definitive guidance in this area will help eliminate diversity in practice when accounting for redemption obligation arrangements and the treatment of NCI puts.
30. We agree with the proposal to have changes in the NCI put liability portion go through OCI as remeasurement of the put liability to P&L would be inappropriate.
31. However, we do not agree with the proposal to gross up the liability upon derecognition of the NCI component and we are of the view that net accounting for this liability would be a better reflection of the economics.
32. For financial instruments with alternative settlement options that do not contain an unavoidable contractual obligation that have the feature of a financial liability, we think that enhanced disclosure of such instruments, such as its characteristics and terms and conditions, may be preferable.

Section 6 – Presentation

Question 7
Do you agree with the Board's preliminary views stated in paragraphs 6.53–6.54? Why, or why not? The Board also considered whether or not it should require separation of embedded derivatives from the host contract for the purposes of the presentation requirements as discussed in paragraphs 6.37–6.41. Which alternative in paragraph 6.38 do you think strikes the right balance between the benefits of providing useful information and the costs of application, and why?

33. We disagree with the IASB's view to separately identify liabilities whose amount depends on own performance.
34. We are concerned about the effect that the use of OCI for financial liabilities where the amount of the obligation is dependent on the entity's AER and the effect of this change on Earnings Per Share (EPS). We are also concerned that the use of OCI is not fully understood and that the presentation of gains and losses within OCI adds an additional element of complexity.
35. In addition, the example provided in the discussion paper on counterintuitive accounting provides a very simplistic instrument. In practice, many instruments are complex and involve different types of features and flowing the fair value changes of such an instrument through OCI can be challenging.
36. We also suggest that this is a good opportunity for the IASB to more thoroughly consider issues with performance reporting and the economic impact on the entity, before expanding the use of OCI.
37. We agree with the proposal to require separation of embedded derivatives from the host contract for the purposes of presentation requirements. This proposed presentation would better reflect to users of the financial statements what component of the financial instrument is associated with the related OCI income or expense presented.

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? The Board's preliminary view is that the attribution for non-derivative equity instruments should be based on the existing requirements of IAS 33. Do you agree? Why, or why not? The Board did not form a preliminary view in relation to the attribution approach for derivative equity instruments. However, the Board considered various approaches, including: (a) a full fair value approach (paragraphs 6.74–6.78); (b) the average-of-period approach (paragraphs 6.79–6.82); (c) the end-of-period approach (paragraphs 6.83–6.86); and (d) not requiring attribution, but using disclosure as introduced in paragraphs 6.87–6.90 and developed in paragraphs 7.13–7.25. Which approach do you think would best balance the costs and benefits of improving information provided to users of financial statements?

38. We do not agree with the proposal to expand the attribution of income and expenses to equity instruments other than ordinary shares. We are of the view that the provision of such information will not provide useful and relevant information to users. For example, a warrant holder does not currently have any legal entitlement to any comprehensive income and attribution of income to these warrant holders distorts the income to which current equity holders are entitled. This would also be applicable to derivative financial instruments that are deeply out of the money that will most likely never participate in the resources of the entity.
39. We are also of the view that the attribution approaches (a)-(c) may result in additional complexity and costs that outweigh the benefits of such presentation, when in fact all that users may need is the additional disclosure.
40. We do agree that disclosures of some equity instruments today can be improved. As such, we think the IASB should explore the disclosure option in the proposals together with a comprehensive relook at the current requirements of IAS 33, *Earnings Per Share.*

Section 7 – Disclosure

Question 9
The Board's preliminary view is that providing the following information in the notes to the financial statements would be useful to users of financial instruments: (a) information about the priority of financial liabilities and equity instruments on liquidation (see paragraphs 7.7–7.8). Entities could choose to present financial liabilities and equity instruments in order of priority, either on the statement of financial position, or in the notes (see paragraphs 6.8–6.9). (b) information about potential dilution of ordinary shares. These disclosures would include potential dilution for all potential issuance of ordinary shares (see paragraphs 7.21–7.22). (c) information about terms and conditions should be provided for both financial liabilities and equity instruments in the notes to the financial statements (see paragraphs 7.26–7.29). Do you agree with the Board's preliminary view? Why, or why not? How would you improve the Board's suggestions in order to provide useful information to users of financial statements that will overcome the challenges identified in paragraphs 7.10 and 7.29? Are there other challenges that you think the Board should consider when developing its preliminary views on disclosures?

41. We strongly support the proposal for additional disclosure of the terms and conditions for financial liabilities and equity instruments as this information would be helpful to users. Current disclosures for equity instruments are limited and we think these proposals will be well received by most stakeholders.

During outreach activities, user and academic stakeholders appreciated the additional disclosures proposed and noted that the most important disclosure for them would be the terms and conditions.

42. However, further consideration should be given to what information would be helpful to users as it relates to the maximum dilution of shares and the priority of claims upon liquidation. During our outreach activities, we heard from users that they are primarily interested in understanding the future cash flows of the entity to make sound investment decisions. Additional disclosures would help users identify the nature and type of cash flows and allow the users to draw the link to the type of financial instrument. Cash flows associated with debt instruments compared to equity instruments are not considered equal and providing this information to draw the distinction would be most helpful to users.

Section 8 – Contractual terms

Question 10
Do you agree with the Board's preliminary view that: (a) economic incentives that might influence the issuer's decision to exercise its rights should not be considered when classifying a financial instrument as a financial liability or an equity instrument? (b) the requirements in paragraph 20 of IAS 32 for indirect obligations should be retained? Why, or why not?

43. We agree with the IASB's view and note that the consideration of economic compulsion would complicate the classification of financial instruments and result in several other challenges.

Question 11
The Board's preliminary view is that an entity shall apply the Board's preferred approach to the contractual terms of a financial instrument consistently with the existing scope of IAS 32. Do you agree? Why, or why not?

44. We agree with the IASB's view and note that the consistency with IAS 32 will be well received.
45. However, we also think that more clarification is required from the IASB to specifically indicate what should be considered a contractual term. For example, in some instances it is difficult to ascertain whether law is part of the contractual terms or whether it overlays the contractual terms of the arrangement. There are also circumstances when legislation mandates a certain outcome, but the entity's contractual terms do not reflect this, despite the contract still being subject to that law.
46. We also note that further complexity may arise in determining whether there is a change to the terms of the contract in instances in which the contract references existing legislation and there is a subsequent change to this legislation. Additionally, we have been made aware that in some foreign jurisdictions, some of the terms of the contract have already been included in the local legislation.

Appendix 2

Alternative Stakeholder Views

As noted in our cover letter, we received diverse views in some of our outreach activities. Appendix 2 outlines these alternative views not shared by the AcSB, that were provided by some stakeholders during our outreach. These alternative views have been provided to ensure that the IASB has a more complete understanding of the diverse range of views that we received. These views may be relevant for the IASB to consider in relation to other global views that have been communicated to the IASB.

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?

47. Some stakeholders noted that the issues faced under IAS 32 are not significant enough to require the introduction of new principles. These stakeholders are of the view that most of the current challenges faced with IAS 32 can be solved with disclosures and are concerned with the magnitude of effort that will be required for minimal change in classification to most straight-forward traditional financial instruments. Stakeholders are also concerned about the application difficulties that may arise as a result of the complexity of the proposed principles, when applied to instruments currently issued in the Canadian market.

Question 6
Do you agree with the Board's preliminary views set out in paragraphs 5.48(a)–(b)? Why, or why not? Applying these preliminary views to a derivative that could result in the extinguishment of an entity's own equity instruments, such as a written put option on own shares, would result in the accounting as described in paragraph 5.30 and as illustrated in paragraphs 5.33–5.34. For financial instruments with alternative settlement outcomes that do not contain an unavoidable contractual obligation that has the feature(s) of a financial liability as described in paragraph 5.48(c), the Board considered possible ways to provide information about the alternative settlement outcomes as described in paragraphs 5.43–5.47. (a) Do you think the Board should seek to address the issue? Why, or why not? (b) If so what approach do you think would be most effective in providing the information, and why?

48. During outreach conducted, some preparers questioned whether it is appropriate to derecognize the equity or NCI component prior to settlement. Derecognition of the NCI component is viewed as awkward as a result of the NCI still existing at the time and continuing to share in the earnings of the entity until conditional settlement.
49. Some stakeholders also called for a risk and rewards model to be applied to the derecognition of the NCI equity component, as well as additional guidance on the treatment of how earnings should be allocated after its derecognition. In their view the risk and rewards model would be considered a more robust basis for derecognizing the related NCI component.

Question 7
Do you agree with the Board's preliminary views stated in paragraphs 6.53–6.54? Why, or why not? The Board also considered whether or not it should require separation of embedded derivatives from the host contract for the purposes of the presentation requirements as discussed in paragraphs 6.37–6.41. Which alternative in paragraph 6.38 do you think strikes the right balance between the benefits of providing useful information and the costs of application, and why?

50. The feedback received from users was mixed on this proposal with some users preferring the presentation of such gains and losses within OCI, as this would result in less noise in profit and loss. Other users preferred retaining current practice with changes flowing through the P&L. The users that preferred the OCI approach do not view these gains and losses as core to the operations of the entity and wanted them removed. To support this view, some academic stakeholders indicated that these gains and losses should go through OCI because OCI serves as a flag that the instrument has both debt and equity features that are not easily captured by a debt or equity label. In their view, this would alert analysts and other users to conduct additional analysis to better understand the features and their implications for pricing the instrument.

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? The Board's preliminary view is that the attribution for non-derivative equity instruments should be based on the existing requirements of IAS 33. Do you agree? Why, or why not? The Board did not form a preliminary view in relation to the attribution approach for derivative equity instruments. However, the Board considered various approaches, including: (a) a full fair value approach (paragraphs 6.74–6.78); (b) the average-of-period approach (paragraphs 6.79–6.82); (c) the end-of-period approach (paragraphs 6.83–6.86); and (d) not requiring attribution, but using disclosure as introduced in paragraphs 6.87–6.90 and developed in paragraphs 7.13–7.25. Which approach do you think would best balance the costs and benefits of improving information provided to users of financial statements?

51. Some user stakeholders appreciated the IASB's proposed approach to present separately the different types of equity in the statement of changes in equity, as this provided them with better insight into what resides within equity.

Question 9
The Board's preliminary view is that providing the following information in the notes to the financial statements would be useful to users of financial instruments: (a) information about the priority of financial liabilities and equity instruments on liquidation (see paragraphs 7.7–7.8). Entities could choose to present financial liabilities and equity instruments in order of priority, either on the statement of financial position, or in the notes (see paragraphs 6.8–6.9). (b) information about potential dilution of ordinary shares. These disclosures would include potential dilution for all potential issuance of ordinary shares (see paragraphs 7.21–7.22). (c) information about terms and conditions should be provided for both financial liabilities and equity instruments in the notes to the financial statements (see paragraphs 7.26–7.29). Do you agree with the Board's preliminary view? Why, or why not? How would you improve the Board's suggestions in order to provide useful information to users of financial statements that will overcome the challenges identified in paragraphs 7.10 and 7.29?

Are there other challenges that you think the Board should consider when developing its preliminary views on disclosures?

52. Preparers raised concerns about the presentation of claims based on order of priority and that this may prove challenging in instances in which the entity has subsidiaries and multiple instruments. They think the IASB should reconsider the rigidity of this requirement so that the costs to do not exceed the benefits.