สภาวิชาชีพบัญชี ในพระบรมราชูปถัมภ์
FEDERATION OF ACCOUNTING PROFESSIONS
UNDER THE ROYAL PATRONAGE OF HIS MAJESTY THE KING

December 15, 2018

Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board (IASB)
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Mr. Hoogervorst,

Response on IFRS Standards Discussion Paper DP/2018/1 : Financial Instruments with Characteristics of Equity

The Federation of Accounting Professions of Thailand would like to show our appreciation on the opportunity to response on ***IFRS Standards Discussion Paper DP/2018/1 : Financial Instruments with Characteristics of Equity***. Overall, we agree with the revised concept proposed by the Board regarding classification principles of financial instrument. In addition, an illustrative example in practice might be provided by the Board would be helpful for practitioner.

Please find our responses to the specific survey raised in ***IFRS Standards Discussion Paper DP/2018/1 : Financial Instruments with Characteristics of Equity*** in an attachment. We believe that these responses will help the practitioners in the future and that our response will contribute positively to the IASB's due process. Should you need more information, please kindly contact the Federation of Accounting Professions of Thailand.

The Federation of Accounting Professions avails itself of this opportunity to the International Accounting Standards Board the assurances of its highest consideration.

Yours sincerely,

Associate Professor Dr.Somchai Supattarakul
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IFRS Standards Discussion Paper DP/2018/1 Financial Instruments with Characteristics of Equity

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?

FAP : (a) Agree. It is undeniable that financial instruments nowadays have been significantly and continuously changing; especially the growing innovation which combines various features into a single financial instrument. The characteristics of those financial instruments become more complex and challenging to be distinctly classified as liabilities or equity. As a result, the International Accounting Standards Board (IASB) introduces the Financial Instruments with Characteristics of Equity (FICE) project and publishes this discussion paper to articulate the classification principles in order to solve challenges of applying IAS 32.

Certainly, there are challenges on applying IAS 32 which undermine the comparability and understandability of financial information relevant to users of financial statements. The prominent difficulties of IAS 32 application; e.g. unclear rationale, complexity of requirements, inconsistencies, and diversity in practice; have already been captured by IASB in the description of challenges. Additionally, due to the varieties of challenges, it is valid to organize them into two main topics which are conceptual challenges and application challenges; in order that the approach to address them could be effectively and inclusively structured.

(b) Agree that the challenges identified are important to users of financial statements, especially due to their effect on qualitative characteristics of financial information as aforementioned. In order to address those challenges, it is important that the preferred approach captures the key concept of classification and contains an explanation of requirements that are understandable as well as applicable for all circumstances, so that it provides a consistent classification outcome to avoid controversial issues. The challenges would persist and possibly become entangled if they are solved in a piecemeal fashion which could possibly result in a contradictory outcome. Also, the clear classification principles would be beneficial for many stakeholders; e.g. investors, creditors, and users of financial statements in general, to be referred to as a basis for analysis of financial information. As a result, a standard-setting activity is encouraged in order to solve the challenges systematically and yield a consistent outcome for future financial innovations.

Section 2—The Board's 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?

FAP : Agree with the classification concept of the Board's preferred approach which focuses on the information that is relevant to an assessment of liquidity and solvency of an entity. The distinction between liability and equity based on the 'timing feature' and the 'amount feature' provides a clear rationale for classification. In addition, the presentation and disclosure regarding other features would potentially address a conceptual challenge arisen from the fact that the classification solely might not be able to depict all features of a financial instrument.

Overall, the approach effectively captures the key concept of classification with the user-oriented point of view and enhances the articulation of classification rationale by redefining the requirements with new terminology, while the concept and classification outcome are intended to remain the same. Using different terms from IAS 32; for instance, 'economic resources, independent, available economic resources', the concept covers broader scope which makes it applicable for complex financial instruments and future innovations. On the other hand, due to the broadly defined terms, further guidance from the Board on practical issues would be helpful for achievement of consistent application; i.e. alleviate the challenge of diversity in practice. In addition, an assessment on whether the benefit of this articulation to users outweigh the costs incurred from transition would help to reaffirm the necessity of implementing this approach.

Section 3—Classification of non-derivative financial 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?

FAP : Agree with the concept of classification that essentially remains the same as in IAS 32, though it is noted that some classification outcome would be changed due to the new approach of articulation. Regardless of those changes, it is important that the classification outcome be reasonable and clearly depict the underlying rationale. To illustrate, irredeemable cumulative preference shares would become a liability under the Board's preferred approach but they are classified as equity under IAS 32. By classifying them as liability, it precisely depicts the obligation of fixed dividend payment which is relevant to the assessment of the issuer's solvency. Unlike a creditor; however, a holder of cumulative preference shares has the same level of rights and priority of claims with a holder of non-cumulative preference shares classified as equity and this fact should be clarified through presentation and disclosure.

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?

FAP : Definitely, a puttable instrument meets the timing feature of the Board's preferred approach and would be classified as financial liability; due to the fact that the redemption may occur anytime at the option of the holders. Furthermore, as stated in the discussion paper, this approach has already addressed various concerns that may lead to the puttable exception. However; in the Board's view, the need for the exception still persists; particularly for the case of an entity with all claims classified as liability. This implies that the exception is so essential that the consistency of the whole principle have to consequently be undermined. Accordingly, it is worth considering the existence of the case which no claim meets the definition of equity - an illustrative example in practice to be provided by the Board would be appreciated.

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?

FAP: (a) Agree. Classifying a derivative on own equity in its entirety is encouraged, as the cost and complexity of classifying the individual legs would outweigh the benefit; especially, in the aspect of measurement. According to the Board's objection, it is true that the rights and obligations are interdependent and one side of exchange (one leg); e.g. the right to receive a financial asset, to extinguish a financial liability or the obligation to deliver shares; may not be able to fulfill the definition of asset, liability or equity, individually. In addition, it would be consistent with IFRS 9 that does not separate a derivative into components.

(b) It is a good idea that classification of non-derivative and derivative financial instruments are consistently based on the same core principles which alleviate the conceptual and application issues. This classification approach is more inclusive and covers broader scope of financial instruments that might be complicated. Nevertheless, the fixed-for-fixed condition as in IAS 32 is expected to work well in our country since the existing derivatives on own equity in the market are merely common ones.

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?

FAP : We agree with the Board's preliminary views set out in paragraphs 5.48 (a) - (b) because considering contractual rights and obligations in package will represent substance of the contractual arrangement of the transaction. Therefore, evaluating the terms of the package consistent with compound instruments will reflect liability and equity component consistent with substance over form concept.

We also agree with the accounting as described in paragraph 5.30. These illustrated example in paragraphs 5.33-5.34 should be accommodated with the issued standard in order to help user to understand about accounting treatment.

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?

For financial instruments with alternative settlement outcomes as described in paragraph 5.48(c) :

(a) In our view, the Board shouldn't seek to address the issue because the benefits of providing information about the alternative settlement outcomes as described in paragraph 5.43-5.47 does not worth the cost. The separation embedded derivative and fair value measurement could be difficult. Moreover, the issuer has the unconditional right to avoid the liabilities settlement outcome. Therefore the fair value of the alternative settlement outcomes won't give the relevant information to the user. However, we agree that the information regarding the alternative settlement should be disclosed especially terms, condition and nature of the instrument.

(b) Not applicable.

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?

FAP : Agree to the presentation and disclose requirements in paragraph 6.53 because the information could help user to assess balance-sheet solvency and return and agree to paragraphs 6.54 because other IFRS provide sufficient presentation and disclosure requirement.

In our view the separation of embedded derivatives from the host contract should not require to disclose because it would be costly for preparer to apply them and difficult for users of financial statement to understand the information which do not useful for user.

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?

FAP : In our view, although information about the distribution of returns among all equity is useful for user to understand nature and return from equity instrument but the calculation of earnings ratio and price to ratio is quite complex and difficult for users of financial statement to understand the information.

Agree to the attribution for non-derivative equity instruments should be based on the existing requirements of IAS 33, because IAS 33 give sufficient useful information to user and non-derivative equity instrument do not have any right to holder or issuer.

Actually we believe that with the existing requirement of IAS 33 is still an appropriate. However in our view, if user need more information , the average of - period approach is the most appropriate because this approach would treat the derivative equity instruments as common share equivalent based on their relative average fair value during the period that reflect values of instrument for the period.

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?

FAP : Agree to the Board's preliminary view, because those information give useful information to user of financial statements make each of the identified assessment separately. However in case of information about the priority should provide information about terms and conditions of financial instrument to determine each instrument's priority.

In our view for providing useful information to users of the financial statements and developing the preliminary views on disclosures, the guidance on the disclosure in the financial statements should be developed or illustrative example accompanying a standard.

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?

FAP : (a) Agree because economic incentives are not rights or obligations but are factors that impact the likelihood of an entity or holder exercising particular right which may change over time.

(b) Agree because this paragraph does not conflict with general approach and give more understanding to user.

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?

FAP : Agree because the contractual terms of a financial instrument consistently with IAS32 and IFRS 9.