To IFRS Foundation (e-mail: commentletters@ifrs.org)

Comments on the IASB's Discussion Paper of 28 June 2018 on the FICE project – IFRS Standards Discussion Paper DP/2018/1

In DP/2018/1 of 28 June 2018 the International Accounting Standards Board (IASB) invites comments on all matters in that Discussion Paper. We, Mr. Greger Bolin and Mr. Björn Forssén, are responding by giving some suggestions on the topic of way of application of the ideas in the Discussion Paper.

IAS 32 *Financial Instruments: Presentation* establishes principles for distinguishing financial liabilities from equity instruments (**IN2**). Various challenges have arisen from the application of IAS 32 to a growing number of financial instruments with characteristics of equity (**IN4** and **IN5**). Therefore, the International Accounting Standards Board (Board) decided to add the Financial Instruments with Characteristics of Equity research project (FICE project) to its research agenda to investigate the challenges with applying IAS 32 to financial instruments with characteristics of equity (**IN5**).

The focus of the FICE project is on the classification of financial liabilities and equity instruments from the perspective of the issuer (the entity) – **IN2**. To address the challenges it identified, the Board has developed preliminary views on the classification, presentation and disclosure of financial instruments with characteristics of equity (**IN5**). With regard of classification principles the Board's preferred approach would classify a financial instrument 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 (**IN10**). Under these presuppositions a financial instrument issued by the entity would be deemed a financial liability and not an equity instrument.

Our main criticism of the Board's preferred approach is that its distinction between financial liabilities and equity instruments begins with the classification of a financial instrument as a financial liability by such an instrument fulfilling certain prerequisites as above-mentioned, where another financial instrument consequently is deemed having the characteristics of equity. In our opinion, it should be expressly stated that it is the other way around, i.e. first you determine whether a financial instrument is an entity's own equity instrument (derivates on own equity) and if it is not you may examine if it should be defined as a financial liability. Without this suggested order of application there is a risk that the numerous examples given in the Discussion Paper regarding the classification issue (see e.g. IN18 and IN19) may lead to interpretations based on the assumption that it is only a matter of the wording of casuistic definitions of the two categories of financial instruments labelling various types of such instruments as belonging to one of them. That would be contrary to the ambition with the Board's preferred approach, which inter alia is to ”improve the consistency, completeness and clarity of the requirements for classification, in particular for contractual rights and/or obligations to exchange financial instruments, in which at least one of the financial instruments to be exchanged is an entity's own equity instrument (derivatives on own equity)” – **IN9**.

Thus, where clarity is concerned, we suggest a procedural approach completing the Board's preferred approach at large for the purpose of making the distinction between financial liabilities and equity instruments. The present categories of financial instruments are necessary for the entity issuing the instruments obtaining additional financing besides its return on the entity's economic resources (its assets). A user of the entity's information about its assets and the claims against the entity (its liabilities and equity) shall be able to assess the entity's financial strengths and weaknessess (**2.15**). The Board has identified two broad assessments in that sense depending on information about different sets of features of claims, namely, respectively, the timing feature and the amount feature (**2.17**). Regarding the amount feature the assessment includes whether an entity has sufficient economic resources required to meet its obligations at a point in time, and whether the entity has produced a sufficient return on its economic resources to satisfy the return that its claims oblige it to achieve (**2.17 b**). In the latter respect, we argue for a completing procedural approach to the Board's preferred approach, where the entity – or rather its owner – shall be able to rely on an assessment, showing that the claims represented by the instruments issued by it are likely to be satisfied by its economic resurces, as useful evidence in various courts to prove that the entity's assests and liabilities and equity are giving the user a correct information about the entity's value as a whole. A conception that only the wording of casuistic definitions of the two categories of financial instruments rules, concerning the issue of classifying them, would, as above-mentioned, work against the Board's preferred approach, where it is aiming to improve the consistency, completeness and clarity of the requirements for classification of them. The fact that the two assessments regarding, respectively, the timing feature and the amount feature are considered separately in the Discussion Paper, because they are driven by different features of claims (**2.18**), increases the emergence of such a conception by interpreters of the Board's preferred approach, if it will not be completed with our suggested procedural approach, i.e. a way of application of the ideas in the Discussion Paper meaning that a determination is made first whether a financial instrument is an entity's own equity instrument and – if it is not – examining in a next step if it should be defined as a financial liability. Thereby it would be made clear that the interpretation result could be that it is a case of neither one of the two categories, i.e. the instrument may not be a financial one at all, but e.g. representing a dividend or a gift reducing the entity's equity. The Board's preferred approach should also contain something to show an awareness of the importance of delimiting the issuing of financial instruments from the supply of a market for such instruments.

Best regards,

Greger Bolin
Bachelor of Science in Business Administration and Economics
E-mail: greger@rasundaconsulting.com

Björn Forssén
Member of the Swedish Bar Association and Doctor of Laws
E-mail: bjorn.forssen@telia.com