STAFF PAPER

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IASB® meeting

Project	**Financial Instruments with Characteristics of Equity (FICE)**
Paper topic	The effects of laws on contractual terms

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Purpose of this paper

1. This paper asks the International Accounting Standards Board (IASB) for a tentative decision on proposed amendments to IAS 32 *Financial Instruments: Presentation* relating to the effects of laws on the classification of financial instruments. More specifically, this paper considers the question as to whether and if so, to what extent, an entity would be required to consider the effect of applicable laws in classifying financial instruments as financial liabilities or equity instruments.

2. This paper includes the staff analysis and the staff's recommended amendments to IAS 32. This paper is a follow-up paper to the discussion the IASB had in September 2021 (Agenda Papers 5E and 5F).

Structure of the paper

3. This paper provides:

   (a) Staff recommendation;

(b) Staff analysis:

(i) Refinements to the principles discussed in September 2021;

(ii) Updated principles;

(iii) Usefulness of the resulting classification and the operationality of the principles;

(iv) Disclosures; and

(c) Question for the IASB.

Staff recommendation

4. The staff recommend that the IASB proposes amendments to IAS 32 to require an entity to consider the following effects of applicable laws when classifying financial instruments as financial liabilities or equity:

(a) for terms that are explicitly stated in the contract, only the terms that give rise to rights and obligations that are in addition to, or more specific than, those established by applicable law would be considered. In other words, if a legal obligation exists irrespective of whether it is explicitly included in the contract, an entity would not consider such an obligation-when classifying financial instruments; and

(b) the effects of applicable laws that prohibit the enforceability of a contractual right or a contractual obligation.

5. The staff recommend the Board require an entity not to separate a single obligation into two liabilities ie a financial and a non-financial liability in applying paragraph 4 of this paper.

Staff analysis

Refinements to the principles discussed in September 2021

6. At the September 2021 IASB meeting, the staff presented a set of potential guiding principles that could be used to determine whether and how to consider

the effects of applicable laws in classifying a financial instrument as a financial liability or equity. These proposed principles required an entity to consider in the classification assessment:

(a) Guiding Principle A: the terms of the financial instrument derived from law that are subject to negotiation and agreement between contracting parties; and

(b) Guiding Principles B and C: laws that limit, modify or prohibit the exercise of an existing right and obligation in a contract and those that are sufficiently specific to allow reasonable determination of contractual rights and obligations.

7. Since the September 2021 meeting, the staff have carried out further research and analysis to refine the guiding principles discussed at that meeting, taking into account suggestions from IASB members. In this section, the staff set out proposed refinements to the principles.

Legal view vs accounting view

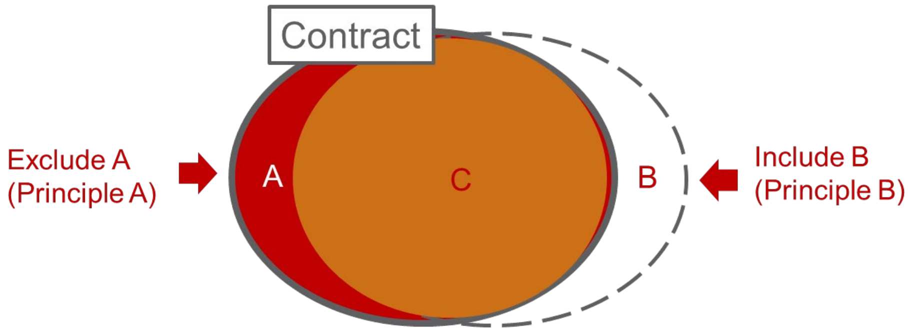
8. The staff acknowledge that the proposed principles may not be completely aligned with the legal view. Applying the legal view, both explicitly stated (ie express) terms and implied terms form part of the contractual terms and are relevant to understanding the rights and obligations arising from a contract. In essence, this would mean that any and all laws in a particular jurisdiction would need to be considered in determining the classification of a financial instrument as a financial liability or equity. Such an approach would be a fundamental change to the current classification basis applied in IAS 32 and would blur the lines between financial liabilities and other obligations to the extent that nearly all obligations might be classified as financial liabilities.

9. The staff believe that a complete alignment of the accounting classification with the legal view would not achieve the IASB's objectives of this project, which include addressing practice issues without fundamentally changing IAS 32.

10. The IASB's objectives for this project would be best achieved by providing a practical boundary for classification purposes. That is, in classifying financial instruments, an entity would need to exclude some legal requirements even if they

are stated in the contract. In contrast, an entity would need to include some other legal requirements even if they are not stated in the contract.

11. The aim of the principles discussed in this paper is to provide clarity on which legal requirements to exclude and which to include in determining the classification of financial liabilities or equity. The diagram below illustrates how Principles A and B are designed to provide that clarity.



A+C: all terms that are explicitly stated in the contract
B+C: what needs to be considered in classifying financial instruments
A: legal requirements explicitly stated in the contract that should be excluded from classification
B: legal requirements not stated in the contract that should be included in classification
C: legal requirements explicitly stated in the contract that should be included in classification and other contractual terms

12. The staff would like to highlight that the legal rights and obligations that an entity does not take into account for classification purposes (for example Area A in the diagram in paragraph 11 of this paper) would still need to be accounted for. IFRS Accounting Standards (Accounting Standards) other than IAS 32 may be applicable.

The meaning of being part of the contractual terms

13. Based on the definition of financial liabilities and equity instruments and the requirements in IAS 32, the staff think it is clear that the classification of financial instruments as financial liabilities or equity instruments is based solely on the contractual terms. In Agenda paper 5E for the September 2021 meeting, the staff stated that the IASB should develop principles that would help entities assess whether a legal requirement is 'part of the contractual terms'. In the context of this project, it means that an entity needs to take into account the rights and

obligations arising from such a legal requirement in classifying financial instruments as financial liabilities or equity.

14. The staff are of the view that there is scope to read the references in IAS 32 to ‘contractual rights and obligations’ as wider in some circumstances, or narrower in others, than explicit terms stated in the contract. The staff believe doing so would be consistent with the underlying principle in IAS 32 to classify a financial instrument in accordance with the ‘substance of the contractual arrangement’.

The scope of ‘law’

15. At the September 2021 IASB meeting, a suggestion was made to clarify what is meant by ‘the law’ in describing the principles. The staff considered how other Accounting Standards refer to laws:

   (a) the *Conceptual Framework for Financial Reporting* refers to ‘legislation or similar means’;

   (b) IFRS 15 *Revenue from Contracts with Customers* refers to ‘legislation or legal precedent that could supplement or override those contractual terms’;

   (c) IFRS 17 *Insurance Contracts* refers to substantive rights and obligations that arise from ‘law or regulation’;

   (d) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* defines a legal obligation as ‘an obligation that derives from a contract (through its explicit or implicit terms), legislation or other operation of law’; and

   (e) IFRIC 2 *Members’ Shares in Co-operative Entities and Similar Instruments* refers to ‘relevant local laws, regulations and the entity’s governing charter in effect at the date of classification’.

16. Many jurisdictions have their own legal system and use different terminology to describe applicable laws such as statutes, legislation, regulation, orders and rules. For example, in the UK, most of the law is made not via Acts passed through Parliament but instead via delegated legislation, the most common form of which

is a Statutory Instrument. There is no limit imposed on the descriptions that may be given to Statutory Instruments.[1]

17. In the context of applying the refined principles, the staff do not intend to limit the scope of laws to exclude particular types of laws or regulations. An entity needs to consider all legal instruments that are relevant to a financial instrument and that are legally enforceable at initial recognition of the instrument. For ease of reference, the staff collectively refer to them as ‘laws’ or ‘legal requirements’ in this paper.

Principle A: the notion of choice

18. In Agenda paper 5F for the September 2021 meeting, the staff described Principle A as considering whether the terms that are derived from or required by law are subject to negotiation and included by choice between the contracting parties. This principle is aimed at answering the question as to whether all the terms explicitly stated in the contract should be treated as part of the contractual terms.

19. Applying Principle A, only those terms that go beyond, or are in addition to, the legal requirements and are therefore subject to negotiation and agreement between the contracting parties are treated as part of the contractual terms. Therefore, an entity would not consider the terms that are not negotiable and neither counterparty has a choice but to accept, when classifying a financial instrument as a financial liability or equity instrument.

20. A question arose about the meaning of having a choice. For example, suppose the local law in a jurisdiction requires all companies in that jurisdiction to distribute a minimum 10% of the entity’s profit as dividends to ordinary shareholders. Some IASB members observed that a company in that jurisdiction can choose to specify in the contract to distribute a particular % of its profits as long as it is above 10%. They asked whether this ability to choose a % higher than the legal minimum, means a contract specifying any % is a result of the choice of the parties to the contract even if a company specifies in the contract that it is required to distribute

[1] https://www.legislation.gov.uk/understanding-legislation

10% of its profit as dividends. It could be seen as the result of the entity choosing not to specify that it will distribute a higher %.

21. In the staff's view, although contracting parties having a choice is important, what is more important is that an entity needs to consider what that choice results in when applying Principle A. The important question is whether the term in the contract creates rights or obligations that are in addition to, or more specific than, the relevant legal requirement. In the example described in paragraph 20 of this paper, the terms in the contract stating that the company is required to distribute the legal minimum of 10% of profits does not create any additional obligation for the entity than what is required by law. Applying Principle A, an entity would therefore not consider such obligation in classifying the financial instrument as a financial liability or equity because the obligation would exist regardless of whether it is included in the contract or not. The revised principle will therefore remove reference to 'choice' and focus on whether the terms create rights and obligations that are beyond those established by law.

Principle A: incremental obligation

22. A question was raised about the situation in which an entity agrees in the contract to deliver cash or another financial asset beyond what is required by law. The question asked whether an entity should treat the entire obligation, or only the incremental portion, as a financial liability. For example, suppose the company in the example in paragraph 20 of this paper specifies in its shareholders agreement to distribute 15% of its profits as dividends. The staff think that the IASB can take one of two possible views. It may view the entire 15% as a financial liability or only the incremental portion of 5% as such. Whichever view it takes, it would be helpful to make that clear in describing Principle A.

23. Arguments could be made for both views. On the one hand, users of the financial statements may benefit from understanding the incremental obligation an entity has created beyond the legal requirement. Separating the minimum legal obligation and the incremental obligation into a non-financial and a financial liability would then be useful. The staff also note that it might be conceptually better to treat only the incremental portion (5% in the example) as a financial

liability given the obligation to distribute the legal minimum of 10% in other instruments would not be classified as a financial liability.

24. On the other hand, separating a single obligation into a financial and a non-financial liability component and applying different Accounting Standards may create complexity and could obscure information about the obligation an entity has. This would especially be the case if different Accounting Standards have different recognition requirements. Also, in some circumstances, it would be difficult to distinguish between the legal obligation and the incremental financial obligation. For example, a law may specify the minimum capital ratio that triggers a conversion into a variable number of ordinary shares. An entity could choose a higher capital ratio as the trigger point. It would be difficult for the entity to identify how much of the obligation is derived from the legal minimum and how much is the incremental portion. In addition, classifying the entire obligation as a financial liability would result in more comprehensive disclosure of the entity's exposure to liquidity risk and the future cash outflows required to settle the obligation.

25. On balance, the staff prefer treating the entire obligation as a financial liability. The staff think it is more useful for users of the financial statements, and simpler for preparers to treat the entire obligation as a financial liability. The staff's view would be the same even if the contract specifies the obligation as 5% distribution of profit plus the legal minimum because the substance of the obligation is the same as the obligation to distribute 15% of profits as dividends.

26. The staff therefore recommend the Board clarify that in applying the proposed principles, an entity would not separate a single obligation into two liabilities ie a financial and non-financial liability. A single obligation in this context would result in a single set of cash flows. For example, the obligation to distribute the legal minimum plus 5% of profit is a single obligation because the entity will pay 15% of profits when it distributes the dividends rather than 10% and 5% of profits separately.

Principle B: modification of the contractual rights and obligations

27. In Agenda paper 5F for the September 2021 meeting, the staff described Principle B as requiring entities, in classifying financial instruments, to consider

whether legal requirements limit, modify or prohibit an existing right or obligation in a contract. This principle is aimed at answering the question of whether particular legal requirements, that may or may not be explicitly stated in the contract, are part of the contractual terms. Therefore, if a legal requirement limits, modifies or prohibits specific contractual rights or obligations in a way that affects their enforceability, including such effects would reflect the substance of the contractual arrangement in the classification of the instrument.

28. Some IASB members were concerned about the ambiguity of 'modifying contractual rights and obligations' and the potential for confusion with other requirements in IFRS 9 *Financial Instruments* applying to the modification of contractual terms. A similar concern was raised about the meaning of 'limiting contractual rights and obligations'. For example, when applicable laws add an obligation to a contract, it may not always be clear whether there is a new obligation or there is a modification or limiting of an existing obligation. In addition, some may argue that a prohibition may be seen as a modification although the opposite is not necessarily true.

29. After further consideration, the staff believe that the ambiguity described in paragraph 28 can be avoided by solely focusing on whether a legal requirement *prohibits* the enforceability of any right or obligation specified in the contract. In the staff's view, the focus on prohibitions also ensures that this principle remains closer to the description of 'contractual' in IAS 32 and would help limit unintended consequences. Paragraph 13 of IAS 32 states that:

> In this Standard, 'contract' and 'contractual' refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing.

By focusing on whether the effects of laws prohibit the enforceability of contractual rights or obligations, an entity would be considering whether the contractual rights and obligations are enforceable after considering the effects of the relevant laws. Doing so would also be more consistent with the principle in

IFRIC 2 that explains how the principles in IAS 32 apply to members' shares in co-operative entities and similar instruments.

Principle B: unconditional vs conditional prohibition

30. At the September 2021 meeting, some IASB members asked us to provide further explanation as to why the staff's preliminary view is that for a law to negate a contractual obligation for classification purposes, the law must unconditionally prohibit the contractual obligation in all circumstances.

31. In our view, this is consistent with the requirements in IAS 32 that an entity needs to have an unconditional right to avoid delivering cash (or another financial asset) to conclude that the obligation meets the definition of an equity instrument and therefore is not a financial liability.[2]

32. Therefore, if a law unconditionally prohibits a contractual obligation of a financial instrument to be enforceable, the law effectively cancels the contractual obligation and the issuer would not consider the contractual obligation in determining the classification. However, if a law only prohibits a contractual obligation when specified conditions are met (eg prohibition on redemption only in the event of liquidity constraints), the law does not cancel the contractual obligation and the entity would be required to consider the contractual obligation in determining the classification. The staff notes that such a conclusion is also consistent with the conclusion in IFRIC 2 that explains how the principles in IAS 32 apply to members' shares in co-operative entities and similar instruments.

33. A single contract might include multiple contractual rights and obligations. If a law prohibits any one or more contractual rights or obligations, the entity is required to consider the effects of such law in classifying the financial instruments. For example, if a law unconditionally prohibits a particular contractual obligation of a financial instrument, the issuer would not consider that particular obligation—but would consider other obligations that are not prohibited by the law—in classifying the financial instrument.

[2] Paragraph 19 of IAS 32

Principle C: is there a need for this principle?

34. In Agenda paper 5F for the September 2021 meeting, the staff proposed a third principle (Principle C) to supplement Principle B. This principle would require an entity to consider the effects of laws in classifying financial instruments only if the effects were sufficiently specific to allow reasonable determination of contractual rights and obligations. It would apply only in one direction, ie only to those rights and obligations that have been determined to be part of the contractual terms applying Principle B. This is because when a legal requirement external to the contract might be regarded as part of the contractual terms, the need arises to consider the usefulness of information resulting from classifying those additional obligations as a financial liability.

35. If Principle B were to be simplified as discussed in paragraph 29 of this paper to require entities to consider the effects of laws only if they *prohibit* specified contractual rights and obligations, this principle would no longer be necessary. Principle C was necessary when Principle B included the notion of *modifying* or *limiting* contractual rights and obligations so that a financial liability is recognised only when the law modifies or limits those rights and obligations in a sufficiently specific manner. Unlike modifications, prohibitions are expected to be more specific so it should be clear to entities which contractual rights or obligations are legally prohibited.

Incorporating the principles into IAS 32

36. The staff prefer incorporating the principles into IAS 32 itself rather than Illustrative Examples which accompany but are not part of IAS 32. We think the principles could be drafted as requirements for an entity to take into account the effects of applicable laws in classifying financial instruments as financial liabilities or equity. By incorporating the principles into IAS 32, they would be more visible to stakeholders and can be more closely linked to the relevant requirements such as paragraph 13 of IAS 32, which describes what ‘contract’ and ‘contractual’ refer to in IAS 32.

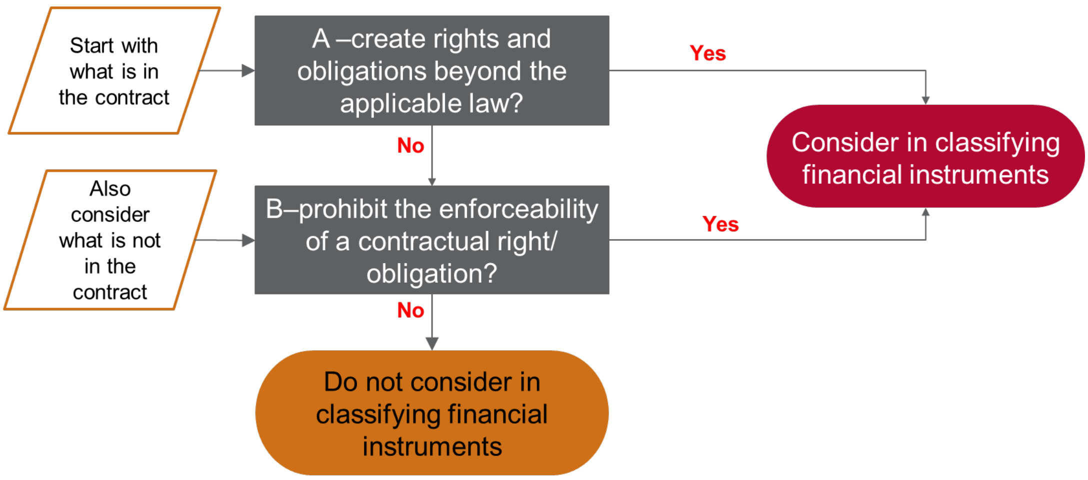
Updated principles

37. The staff updated the proposed principles taking into account the refinements set out in paragraphs 7–36 of this paper. The updated principles would require an entity to consider the following effects of applicable laws when classifying a financial instrument as a financial liability or equity:

    (a) for terms that are explicitly stated in the contract, only the terms that give rise to rights and obligations that are in addition to, or more specific than, those established by applicable law would be considered. In other words, if a legal obligation exists irrespective of whether it is explicitly included in the contract, an entity shall not consider such an obligation when classifying financial instruments; and

    (b) the effects of applicable laws that prohibit the enforceability of a contractual right or a contractual obligation.

38. The following flow chart shows how the updated principles would work. Consistent with the discussion in September 2021, the staff envisage the principles would be applied as a package and in the following order:



Application of the updated principles to examples discussed in September 2021

39. In this section, the staff illustrate the application of the updated principles to the following example financial instruments that were discussed at the September 2021 IASB meeting:

    (a) bail-in instruments where the contract specifies that they:

        (i) are automatically converted into a fixed number of ordinary shares upon the issuer breaching a specified capital ratio (specific loss absorption feature);

        (ii) are subject to the general bail-in power of the relevant regulator. By exercising such power, the regulator can require a broad range of actions including converting the instruments into an unspecified number of equity instruments (general bail-in power);[3] and

        (iii) do not contain any other contractual obligations except to redeem the instrument at par on liquidation of the entity;

    (b) ordinary shares on which the law requires the issuer to pay a minimum 10% of its profit as dividends; and

    (c) puttable financial instruments where the contract states that redemption is unconditionally prohibited by local law. These instruments are currently in the scope of IFRIC 2 and subsequently referred to as 'IFRIC 2-type instruments' in this paper.[4]

[3] For further detail, please see paragraphs 50–51 of Agenda Paper 5E of September 2021 Board meeting.

[4] As noted in Agenda Paper 5F for the September 2021 meeting, the reason why we illustrate how the principles would apply to IFRIC 2 instruments is not because stakeholders are questioning the conclusions in IFRIC 2. It is rather because stakeholders often refer to IFRIC 2 instruments as an example of a situation in which classification of financial instruments considers the effects of relevant laws. The staff's intention is to see how theoretically the proposed principles would apply to these types of instruments.

40. The following table summarises the results of applying the proposed principles and the classification outcomes:

Example instrument	**Application of Principle A**	**Application of Principle B**	**Classification outcome**
Bail-in instrument − Specific loss absorption feature (converting a fixed amount into a fixed number of shares)	Consider in classification—Contractual rights and obligations extend beyond the legal requirements	Not applicable (N/a)—the feature has been determined as relevant to classification applying Principle A	Equity—The specific loss absorption feature is considered but the general bail-in power is not
Bail-in instrument − General bail-in power	N/a—does not give rise to contractual rights and obligations beyond the legal requirements	Do not consider in classification—the law does not prohibit the enforceability of contractual rights and obligations	
Ordinary shares with statutory minimum dividends	N/a—does not give rise to contractual rights and obligations beyond the legal requirements	Do not consider in classification—the law does not prohibit the enforceability of contractual rights and obligations	Equity—no contractual obligation to deliver cash or another financial asset
IFRIC 2-type instruments	N/a—does not give rise to contractual rights and obligations beyond the legal requirements	Consider in classification—the law prohibits the enforceability of the redemption feature in the contract	Equity—the legal requirement effectively nullified the contractual obligation to redeem the instrument

41. Although the staff proposed updating the description of Principle A, the nature of the principle has not changed. The result of applying the principle therefore remains unchanged from the discussion in September 2021.

42. Applying the simplified Principle B, as proposed in paragraph 29 of this paper, the general bail-in power in the instrument does not prohibit an existing contractual right or obligation. Similarly, the statutory minimum dividend requirement does not prohibit any contractual obligation.

43. The classification outcomes applying the proposed Principles A and B remain unchanged from the discussion in September 2021.

Usefulness of the resulting classification and the operationality of the principles

Consistent classification outcomes

44. As discussed at the September 2021 meeting, the staff continue to believe it is important for economically similar financial instruments to be classified the same regardless of whether a legal requirement is reproduced in a contract. The staff believe that applying the principles discussed in this paper would result in a consistent approach to classifying similar financial instruments irrespective of the legal environment the entity operates in.

45. For the purpose of applying both principles, whether an entity needs to consider the effects of laws in classifying a financial instrument, depends on the substance of the effect rather than the way a law is referenced in the contract. For example whether the reference considers future changes in the law or not (referred to as 'dynamic' or 'static' referencing in Agenda paper 5F for the September 2021meeting). A consistent classification approach would result in consistent classification outcomes among financial instruments and improve the comparability of financial statements across entities. This would result in useful information for users of the financial statements about the nature of the obligations an entity is exposed to from its financial instruments.

Usefulness of resulting classification

46. In the staff's view, if a term does not create a right and obligation beyond those established by laws (applying Principle A), excluding it from the contractual terms that determine the classification of a financial instrument applying IAS 32, does not result in a loss of information to investors. This is because knowledgeable investors would be aware of such general legal requirements that are relevant for a type of financial instrument in a particular jurisdiction. Those legal requirements apply regardless of whether they are explicitly included in the contract or not. In addition, the staff will consider whether such information should be disclosed when it discusses additional disclosure requirements at a future meeting.

47. The staff further think the effects of laws should be reflected in the classification to the extent they make any contractual terms unenforceable. Reflecting such effects in determining what are contractual rights and obligations that determine classification (by applying Principle B) would reflect the substance of the contractual arrangement.

48. Rights and obligations that are not considered when classifying financial instruments as financial liabilities or equity, may be recognised and measured by applying other Accounting Standards, for example IAS 37. Information about such rights and obligations will therefore continue to be provided in the financial statements through applying other Accounting Standards.

The extent of classification changes in practice

49. One of the Board's main objectives for this project is to address specific practice issues without fundamentally changing the requirements in IAS 32. Although addressing practice issues and associated accounting diversity might require some classification changes for some entities, the IASB is committed to clarify the underlying principles in IAS 32 that do not result in significant classification changes between financial liabilities and equity.

50. If the proposed principles were expected to result in significant changes to how financial instruments are classified, it would be important for the ASB to consider the potential costs to preparers in comparison to the potential benefits to users of financial statements of such changes. Based on the results of applying the

proposed principles as shown in paragraph 40 of this paper and initial feedback from some stakeholders, the staff do not expect that applying the principles discussed in this paper would result in significant changes in how financial instruments are classified.

Consistency with the classification of financial assets applying IFRS 9

51. The staff believe applying the principles discussed in this paper would not create an inconsistency with how applicable laws are considered for the classification of financial assets in IFRS 9.

52. Paragraph B4.1.13 of IFRS 9 provides examples of financial assets with contractual cash flows that are solely payments of principal and interest on the principal amount outstanding (SPPI). One of the examples in this paragraph is Instrument E, which is:

> […] issued by a regulated bank and has a stated maturity date. The instrument pays a fixed interest rate and all contractual cash flows are non-discretionary.
>
> However, the issuer is subject to legislation that permits or requires a national resolving authority to impose losses on holders of particular instruments, including Instrument E, in particular circumstances. For example, the national resolving authority has the power to write down the par amount of Instrument E or to convert it into a fixed number of the issuer's ordinary shares if the national resolving authority determines that the issuer is having severe financial difficulties, needs additional regulatory capital or is 'failing'.

53. Paragraph B4.1.13 states that:

> That analysis would not consider the payments that arise only as a result of the national resolving authority's power to impose losses on the holders of Instrument E. That is because that power, and the resulting payments, are **not contractual terms** of the financial instrument.
>
> In contrast, the contractual cash flows would not be solely payments of principal and interest on the principal amount outstanding if **the contractual terms** of the financial instrument

permit or require the issuer or another entity to impose losses on the holder (eg by writing down the par amount or by converting the instrument into a fixed number of the issuer's ordinary shares) as long as those contractual terms are genuine, even if the probability is remote that such a loss will be imposed.

54. As discussed in paragraph 42 of this paper, applying Principle B, an entity would not consider the general bail-in power (which is similar to the regulatory powers described in Instrument E) in classifying financial instruments as financial liabilities or equity, ie the general bail-in power is not part of the contractual terms. Under the proposed Principle B, this conclusion would apply regardless of whether the contract is silent on the general bail-power, or reproduced or referred to the general bail-in power. We note that IFRS 9 does not explain what is meant by 'the contractual terms' and does not explicitly distinguish between specific loss absorption features and general bail-in powers.

Consistency with the requirements in IFRIC 2

55. As discussed in paragraphs 29 and 32 of this paper, taking into account the effects of laws that prohibit contractual rights or obligations is consistent with the conclusions in IFRIC 2.

Changes in law subsequent to initial recognition

56. Consistent with the current requirements in IAS 32, an entity determines the classification of a financial instrument as a financial liability or equity at initial recognition. This means that the classification of a financial instrument is determined based on the laws in effect at that date. An entity would not be required to predict possible future changes in the relevant law. We believe this approach will reduce the costs and effort of considering the effects of laws in particular circumstances (ie when required by applying Principle B).

57. The staff recognise there might be a question about whether a future change in the relevant law subsequent to initial recognition could require a reclassification of the financial instrument between financial liabilities and equity. Reclassification is one of the topics the Board decided to explore as part of this project and the staff

will bring an analysis on reclassification relating to changes in law as part of the reclassification discussion at a future meeting.

Disclosures

58. The staff plan to analyse the need for any additional disclosures once the Board completes its deliberations on the classification topics so that we can consider the relevant interactions in developing the disclosure proposals.

59. The staff note that the nature of any additional disclosures would be affected by the principle(s) the Board decides on and the usefulness of the information to users of financial statements. Potential disclosures in this area could include for example, disclosures of legal requirements that could affect the timing and amount of future cash flows of financial instruments issued by an entity even if they do not affect their classification. Another example could be disclosure of legal requirements that prohibit the enforceability of contractual obligations so that users of financial statements can understand their impact on a contract. The staff plan to analyse further whether additional disclosures would be beneficial and present this analysis at a future meeting.

Question for the IASB

60. The staff would like to ask the following question.

Question for IASB members
Do the IASB members agree with the staff recommendations described in paragraphs 4–5 of this paper?