STAFF PAPER

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IASB Meeting

Project	**Financial Instruments with Characteristics of Equity research project**
Paper topic	Features of claims

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Introduction

1. This paper discusses the various characteristics (or features) of claims for which information about them might be useful to existing and potential investors, lenders and other creditors (the primary users) in making decisions about providing economic resources to the entity. [1]

2. The objective of this paper is to set the foundations that will help the IASB:

   (a) identify, confirm (or change) and reinforce the underlying rationale of the distinction between liabilities and equity used in IAS 32 *Financial Instruments: Presentation*, and

   (b) identify other ways of distinguishing between claims, including for any additional sub-classifications within liabilities or within equity that may be required to provide useful information.

3. At this meeting, we are seeking directional input, including whether we have adequately defined the various characteristics (or features) that might be relevant for classification purposes. We are not, <u>at this stage</u>, asking the IASB to form a

[1] In this paper:

(a) the terms characteristics and features are used interchangeably

(b) the term 'useful' refers to information that has both of the fundamental qualitative characteristics of relevance and faithful representation (QC4) and

(c) the term 'users' refers to existing and potential investors, lenders and other creditors (OB5) and thus the term 'users' also refers to those holding claims against the entity.

preliminary view as to which characteristic(s) (or feature(s)) should distinguish liabilities from equity and which should distinguish sub-classes within liabilities and within equity.

4. This paper is structured as follows:

   (a) Background (paragraphs 5–8)

   (b) Scope of this paper (paragraphs 9–10)

   (c) What is a feature of a claim? (paragraphs 11–14)

   (d) What makes a feature relevant? (paragraphs 15–16)

   (e) How do financial statements provide information about relevant features? (paragraphs 17–22)

   (f) What features have we identified and why are they relevant? (paragraphs 23–67)

   (g) Questions for the IASB (after paragraph 67)

   (h) How would we analyse some simple instruments based on the identified features? (paragraphs 68–85)

Background

5. In Agenda Paper 5A of May 2015 we discussed:

   (a) the main challenges with distinguishing between liabilities and equity under IAS 32*;* and

   (b) how we intend to approach addressing those challenges.

6. At that meeting we distinguished between two different sets of challenges in IAS 32:

   (a) **Conceptual**—These are challenges with the underlying rationale of, and approach to, the distinction between liability and equity in IAS 32 and in the *Conceptual Framework for Financial Reporting (the*

Conceptual Framework)[2]. Addressing these challenges requires identifying, confirming (or correcting) and reinforcing the underlying rationale of IAS 32.

(b) **Application**—These are challenges with the application of the requirements in IAS 32 to particular types of transactions in practice. Addressing these challenges requires improving the consistency, completeness, and clarity of those requirements and the reassessing the appropriateness of any cost/benefit trade–offs, practical expedients and exceptions.

7. We suggested that it is important that we think about the underlying rationale before we think about improving how that underlying rationale is implemented by the requirements of IAS 32.

8. In addition, the IASB has already indicated that it would like to explore other ways of addressing the challenges such as through potential improvements to the presentation and disclosure requirements for financial instruments with characteristics of equity, irrespective of whether they are classified as liabilities or equity.

Scope of this paper

9. To avoid complicating matters at this stage of our analysis, this paper does not include a discussion of:

(a) Derivatives on own equity—We will discuss the consequences of such contracts at a future meeting.

(b) Existence uncertainty, or feature uncertainty—In this paper, we assume that the claim exists and the features of the claim are completely specified.

[2] The IASB recently published the Exposure Draft *Conceptual Framework for Financial Reporting* (ED/2015/3). References in this paper to the *Conceptual Framework* are references to the existing *Conceptual Framework for Financial Reporting* unless otherwise stated.

10. Extending the scope of our analysis to include the consequences of the above may require revisiting some of the analysis in this paper. This is another reason why we are not asking for preliminary views at this stage.

What is a feature of a claim?

11. A claim against the entity is a present obligation of the entity to transfer economic resources in some possible scenario in the future, including at liquidation.[3] It need not be certain or even probable that such a transfer will be required. However, the obligation must already exist, and there must be at least one circumstance in which the entity will be required to transfer economic resources.

12. The features of a claim refer to how the claim specifies the required transfer of economic resources (or in other words, how it specifies the circumstances under which the entity's obligation will be settled). Each claim will differ in the way that it specifies the future transfer of economic resources required to settle the claim and the priority of that transfer in relation to other claims.

13. Instead of fulfilling the obligation as specified in the claim, the entity may:

    (a) settle or extinguish the claim by:

        (i) transferring economic resources to the holder by repurchasing the claim on the market or negotiating a release from the claim (eg when buying back its own debt and equity instruments);

        (ii) transferring economic resources to a third party in exchange for the third party undertaking/assuming the obligation in the claim (with the consent of the holder of the claim); or

    (b) replace the existing claim with a new claim with different features (eg when refinancing loans, or offering shares in exchange for debt).

14. The value of economic resources transferred to settle or extinguish the claim (or the value of the new claim(s) required to replace the existing claim) will depend

[3] While claims are not economic resources of the entity, claims include present obligations to transfer items that are themselves claims against the entity because those items are also obligations of the entity to transfer economic resources.

on the features of the existing claim including those features that might affect the probability that a transfer will be required. Even though a claim derives its value from those features, the claim is the *existing obligation* to transfer economic resources, not the future transfer of economic resources itself, regardless of the probability that such a transfer will be required.[4]

What makes a feature relevant?

15. The objective of financial reporting is to provide financial information about the entity that is useful to users (existing and potential holders of claims) in making decisions about buying, selling or holding equity and debt instruments (ie claims).[5] Those decisions depend on the returns that users expect from those instruments, for example dividends, principal and interest payments or market price increases. Those expectations depend on their assessment of the prospects for future cash inflows to the entity and their assessment of management's stewardship of the entity's resources. Consequently, users need information to help them make those assessments.[6] Information about the priorities and payment requirements (ie about the features) of existing claims, helps users to predict how future cash flows will be distributed among those with a claim against the reporting entity.[7]

16. Based on the above, the staff consider that features are relevant if they have the potential to affect the prospects for future cash flows.

How do financial statements provide information about relevant features?

17. Financial information can be communicated by various means; the principal methods are through:

[4] Hence, an entity may settle a claim even before the claim requires a transfer of economic resources and the value of economic resources transferred on settlement may differ from the amount specified.

[5] *Conceptual Framework* paragraph OB2

[6] *Conceptual Framework* paragraph OB3

[7] *Conceptual Framework* paragraph OB13

(a) the process of recognition and measurement of the elements in the statement of financial position and the statement of financial performance; and

(b) presentation and disclosure.

18. However, the process of recognition and measurement is limited because:

(a) not all assets and liabilities are recognised; and

(b) the amounts for assets and liabilities that are recognised are measured using different measurement bases.

19. Those limitations are significant to the classification of claims. This is because, unless all elements are recognised and measured at a current value[8], there needs to be at least one claim for which the amounts recognised in the financial statements is determined as a result of the recognition and measurement of (including changes in) the entity's economic resources and other claims (ie as a residual).

20. In order to provide useful information about a claim that contains features that could affect the prospects for future cash flows, it must be measured (be that through recognition or disclosure). Thus, **our first step** is to identify the types of features that affect the prospects for future cash flows (ie relevant features).

21. Of course, different features affect the prospects for future cash flows in different ways, and information about those effects may influence different types of assessments that users need to make. Those differences may require:

(a) different recognition requirements or measurement bases;

(b) the inclusion of the amounts measured in different totals and sub-totals in the statement of financial position and statements of performance;

(c) additional information about those features to be disclosed in the notes to the financial statements.

22. **At a future meeting**, we will discuss the relevance of the features we identify to:

[8] However, general purpose financial statements are not designed to show the value of the entity as a whole (*Conceptual Framework* paragraph OB7).

(a) assessments users make with the **statement of financial position** (for example, those mentioned in paragraph OB13 of the *Conceptual Framework*).

(b) assessments users make with the **statement of financial performance** (for example, those mentioned in paragraph OB15–OB19 of the *Conceptual Framework*).

What features have we identified and why are they relevant?

23. This section discusses various features that we identified by analysing existing classification requirements in IFRS, and other features that have been explored in the past.

24. We have analysed the features separately in order to isolate their effect on the prospects for future cash flows. However, in reality they would appear in combination and interact with each other. In the last section of this paper we analyse some simple instruments based on the features identified.

25. For each feature:

    (a) we describe the feature;

    (b) discuss how the feature might affect the prospects for future cash flows (**and therefore when it is relevant**); and

    (c) discuss how the feature is depicted in the financial statements under existing IFRSs.

26. We have grouped the features into the following categories:

    (a) The **type** of economic resource required to be transferred to settle the claim (paragraphs 29–35)

    (b) The **timing** of the transfer of economic resources required to settle the claim (paragraphs 36–43)

    (c) The **amount (or quantity)** of economic resources required to be transferred to settle the claim (paragraphs 44–49)

(d) The **priority (or seniority/rank)** of the claim relative to other claims (paragraphs 50–54)

27. A claim may also include **conditions or contingencies** that modify the type or amount of economic resources required to be transferred, or the timing of the required transfer, based on the occurrence of future events (paragraphs 55–58).

28. We also discuss other features that we considered but do not think are relevant in paragraph 59–67.

Type of economic resource required to settle the claim

29. The claim could specify **the type of economic resource** required to be transferred to the claim holder when the claim is settled, for example:

    (a) cash

    (b) a financial asset

    (c) goods or services

    (d) any economic resources under the control of the entity.

30. An obligation to transfer a **specified type** of economic resource:

    (a) allocates different types of the entity's economic resources to different claims; and

    (b) introduces the risk that the entity will not have the type of economic resources required to settle the claim. Its ability to meet the obligation to transfer the specified type of economic resource will also depend on the amount required and the time of the required transfer.

31. To the extent that the entity has to produce/ convert existing economic resources, or obtain the specific type of resource by issuing other claims, the marginal cost (or marginal benefits) (for example, transaction costs) of obtaining the right type of economic resource will flow to other claim holders. The extent of the marginal costs and benefits will also depend on the specified timing and amount.

32. Alternatively, the claim could contain **no obligation** of the entity to transfer a specific type of economic resource (for example, ordinary shares). Such a claim would allow the entity to transfer any type of economic resource in settlement of

the claim. In this case, the type of economic resources required to settle the claim does not affect the prospects for future cash flows independently of the economic resources of the entity, or the other claims of the entity. However the claim may have other features that affect the prospects for future cash flows (such as the timing of the required settlement or the amount of economic resources to transfer when the claim is settled).

33. A claim could also specify that it may be settled by issuing other claims against the entity to the claim holder, such as own debt or own shares. These claims could themselves specify different features, including specifying the type of resource required to settle the claim. If a claim is settled by transferring another claim, you have to follow the chain of claims to determine the type of economic resource that is ultimately specified.

34. Under existing IFRSs, some requirements, in particular different recognition and measurement requirements, are specific to the type of economic resource to be transferred. For example:

    (a) the requirements of IFRS 9 *Financial Instruments* and IAS 32 apply to "contractual obligations to deliver **cash or another financial asset** to another entity".[9]

    (b) the requirements of IAS 18 *Revenue* apply to the sale of goods and the rendering of services.[10]

35. There are no requirements under IFRSs to distinguish between liabilities and equity if the claim obliges the entity to transfer different types of economic resources of the entity (ie cash, goods, services etc).

Timing of required settlement of the claim

36. The claim could specify **the timing of required full or part settlement** of the claim, for example:

    (a) calendar dates prior to liquidation for part settlement (eg coupon payment dates) or

[9] IAS 32 paragraph 11 definition of a financial liability

[10] IAS 18 has been superseded by IFRS 15 *Revenue from Contracts with Customers*

(b) calendar dates prior to liquidation for full settlement (eg maturity dates).

37. An obligation to transfer an economic resource at a specified time:

(a) allocates the entity's economic resources to claim holders at different times (one claim holder may receive resources before another), and thus affects the prospects for future cash flows through the time value of money; and

(b) introduces the risk that the entity will be unable to settle the obligation at the time required. Its ability to settle the obligation at the time required will also depend on the specified type and amount of the required transfer.

38. To the extent that the entity has to produce/ convert existing economic resources, or obtain the economic resources by issuing other claims, the marginal cost (or marginal benefits) (for example, transaction costs) of obtaining the required economic resources at the time required will flow to those claims **which** oblige the entity to transfer economic resources at a later time. The extent of the marginal costs and benefits will also depend on the specified timing and amount.

39. Alternatively, the claim could contain **no obligation** of the entity to transfer economic resources prior to liquidation (for example, ordinary shares). Such a claim may allow the entity to delay transferring any economic resource until liquidation. In this case, the timing of settlement of the claim does not affect the prospects for future cash flows independently of the economic resources of the entity, or the other claims of the entity. However the claim may have other features that affect the prospects for future cash flows (such as the amount of economic resources to transfer or the type of economic resource to transfer when the claim is settled).

40. Under existing IFRSs, **the timing of the required settlement of the claim** is typically included in the definitions of liabilities implicitly:

(a) obligations to transfer economic resources [prior to liquidation of the entity] are liabilities under the proposed *Conceptual Framework for Financial Reporting*[11].

(b) obligations to transfer cash or other financial assets [prior to liquidation] are liabilities under existing IAS 32[12]

(c) obligations to transfer cash or other assets [prior to liquidation] are liabilities under existing IFRS 2 *Share-based Payments*[13].

(d) liabilities are also distinguished between current and non-current on the statement of financial position (or, if elected, in the order of liquidity if that is most relevant) under existing IAS 1 *Presentation of Financial Statements*. [14]

41. The claim could also specify the timing of other changes to the features of the claim such as the following:

(a) changes in the **amount** of the claim over time (eg interest, resets etc)

(b) exercise or expiration dates **of other features**

(c) dates when claims convert to, or are replaced by, **new claims with different features**.

42. The timing of changes to other features of the claim may also affect the prospects for future cash flows, however they do not require the entity to settle the claim at a particular point in time prior to liquidation. This effect is considered in relation to the features that they modify (such as the amount).

43. However, we note that both IFRS 2 and the *Conceptual Framework* classify a claim that obliges the entity to deliver equity instruments prior to liquidation as equity, regardless of any other features such as the amount of equity instruments to be transferred, or the timing of the required transfer.[15]

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[11] ED/2015/3 paragraph 4.24

[12] IAS 32 paragraph 11 definition of a financial liability

[13] IFRS 2 Appendix A definition of cash-settled share-based payment transaction

[14] IAS 1 paragraph 60

[15] ED/2015/3 paragraph 4.30

Amount or quantity of economic resources required to settle the claim

44. The claim could **specify the amount or quantity of economic resources** required to be transferred to the claim holder when the claim is settled, for example:

    (a) face values, coupons, floors and/or ceilings denominated in units of a selected currency, commodity, financial asset or a basket or index of assets.

    (b) rates of change of an amount over time, set by reference to market interest rates, fixed rates, or changes in prices of a reference economic resource denominated in units of a selected currency, commodity, financial asset or a basket or index of assets, including formulas that magnify (or supress) changes in the underlying reference economic resource.

45. Typically, the quantity of the resources required to settle a claim will be specified using the same units as the type of resource required to be transferred, however this is not necessarily always the case. For example, many derivatives are required to be settled with cash, but the amount of cash required to settle the claim may be determined by references to commodities or share prices.

46. An obligation to transfer a specified amount of economic resources:

    (a) allocates different quantities or amounts of economic resources to different claims. How the amount is specified will be the primary source of how the allocation of economic resources amongst claims changes over time;

    (b) introduces the risk that the entity will not have the amount of economic resources required to settle the claim. Its ability to meet the obligation to transfer the specified amount of economic resources will also depend on the type required and the time of the required transfer.

47. To the extent the entity has an insufficient amount or quantity of economic resources to satisfy a claim, the claim holder bears the shortfall of economic

resources (due to the limited liability of claims). The extent of the shortfall will also depend on the claim's priority relative to other claims.[16]

48. Alternatively, the claim could contain **no obligation** of the entity to transfer a specified amount or quantity of economic resources other than a pro-rata share of the entity's remaining economic resources, less those required to settle higher priority claims, on liquidation. In this case, the amount of resources required to settle the claim does not affect the prospects for future cash flows independently of the economic resources of the entity, or the other claims of the entity. However the claim may have other features that affect the prospects for future cash flows (such as the timing of the required settlement or the type of economic resources to transfer when the claim is settled).

49. Under existing IFRSs, the amount of economic resources required to settle a claim is used in the following places:

    (a) obligations to transfer a variable number of equity instruments [equal to a specified amount] are financial liabilities under IAS 32.[17]

    (b) "the amount of the preference dividends for cumulative preference shares required for the period… is deducted from profit or loss" for the purpose of calculating earnings-per-share under IAS 33 *Earnings-per-share*.[18]

    (c) one of the conditions under the puttable exception in IAS 32, is that the total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised and unrecognised net assets of the entity over the life of the instrument.[19] However, features of other instruments that have the effect of substantially restricting or fixing the residual return to the puttable instrument holders, result in puttable instruments being

[16] See more details under the priority feature

[17] IAS 32 paragraph 11 definition of a financial liability

[18] IAS 33 paragraph 14(b)

[19] IAS 32 paragraph 16A(e). Also, note that the entity's net assets are those assets that remain after deducting all other claims on its assets (16A(a)).

classified as a liability even if it is the most residual claim and would have the other features that would meet the exception for puttable instruments under IAS 32.[20]

Priority

50. As noted previously, the economic benefits derived from a claim will be limited by the future economic benefits that the entity can derive from its existing economic resources. To counteract this limitation, some claims specify the **priority of the claim relative to other claims**[21], for example:

    (a) Senior secured bonds

    (b) Junior bonds

    (c) Preference shares

    (d) Common shares

    (e) Warrants

51. Specifying the priority of claims modifies the prospects for future cash flows depending on relative ranking of the claims. This is commonly referred to as the 'pecking order' or 'waterfall'. This is a result of the limited liability of claims (ie that the only source of economic resources to meet claims against the entity is the entity's present economic resources and the future economic benefits produced from them).

52. If two claims against an entity have equal priority and other features, then they will participate equally in the prospects for future cash flows on its economic resources. If they have different priorities but all other features are equal, then they will not participate equally in the prospects for future cash flows.

53. Under existing IAS 32 puttable financial instruments that include an obligation to transfer cash or other financial assets prior to liquidation are classified as equity (even if it meets the definition of a liability) "if it has all of the following features:

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[20] IAS 32 paragraph 16A(e) and 16B(b)

[21] The priority of the claim at a group level can also be implemented by structuring various entities in a consolidated group.

(a) it entitles the holder to a pro-rata share of the entity's net assets in the event of the entity's liquidation. The entity's net asset are those assets that remain after deducting all other claims on its assets….

(b) the instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:

(i) Has no priority over other claims to the assets of the entity on liquidation; and

(ii) Does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments;

(c) all financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features….

(d) …

(e) the total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the profit or loss, the change in the recognised net assets or the change in the fair value of the recognised an unrecognised net assets of the entity over the life of the instrument (excluding any effects of the instrument)." [22]

54. Under existing IAS 33 ordinary shares (for which earnings-per-share is calculated) are defined as an equity instrument that is subordinate to all other classes of equity instruments.[23]

Conditionality and contingencies

55. The claim could specify conditions attached to another particular feature (ie type, timing or amount), or to the claim as a whole. Any of the main features could be:

(a) Unconditional

(b) Conditional on events within the control of the entity

(c) Conditional on events within the control of the claim holder

[22] IAS 32 paragraph 16A

[23] IAS 33 paragraph 5 definition of ordinary shares

(d) Conditional on events beyond the control of both

56. The transfer of economic resources can also be conditional on future events. That is, in some scenarios in the future, the obligation may cease to exist, or it may be converted into a different type of obligation on the occurrence or non-occurrence of a specified event (eg as occurs for written or purchased options to issue claims). The possibility of these events occurring will also affect the distribution of returns among claims.

57. Under existing IFRSs, some requirements, in particular different recognition and measurement requirements, are specific to the type of event the claim is contingent on.

58. We will discuss contingencies and conditionality in more detail when we discuss derivatives at a future meeting.

Features that we do not think are relevant

59. Some of the other features suggested over the years include:

(a) rights included in claims that may affect the entity's economic resources (such as voting or protective rights)

(b) the risk of returns on the claim

(c) the perspective of financial reporting.

60. In the staff's view, these are either not features that affect the prospects for future cash flows on the claim, or a result of other features that do affect the prospects for future cash flows on the claim. Furthermore, none of these are used in current IFRSs for classification purposes.

Rights that may affect the entity's economic resources

61. The claim may specify voting rights or restrictive rights over the entity's activities, including rights to vote at shareholder meetings, debt covenants, or other restrictions over the types of activities that the entity may undertake.

62. Specifying voting and restrictive rights allocates different levels of power over the entity's activities to different claim holders. Those rights may affect the entity's economic resources and the prospects for future cash flows of those resources,

however they do not affect how those prospects are allocated amongst claims. Information about the nature and amount of economic resources is provided through recognition and measurement requirements of the entity's assets. Furthermore, if a claim holder has control over the entity, then they have the power to demand information about the entity and are not the primary users of financial statements.

63. Disclosure of voting and restrictive rights may help users understand how power over the entity's activities and economic resources is distributed amongst claims.

The risk of returns

64. We think the risk of returns is a measure of the uncertainty of the prospects for future cash flows on a claim. It is an important measure, however, the risk of a particular claim is not a specified feature of a claim.[24] Rather the risk of returns is a product of all of the features of the claim itself, the features of the economic resources of the entity and any the features of any other claims against the entity that might have an effect.

65. The effect of a particular feature on the risk of returns may influence different types of assessments that users need to make, and therefore a desired *outcome* of classification may be to depict claims that have similar risk together. However risk is the result of features which will have to be specified to achieve that outcome.

The perspective of financial reporting

66. In its recent Exposure Draft *Conceptual Framework for Financial Reporting*, the IASB is proposing that, consistently with the objective for financial reporting, financial statements should be presented from the perspective of the entity and should provide information that is useful to existing and potential investors, lenders and other creditors, and the information provided should focus on their common information needs.

[24] This should be differentiated from the risk of returns introduced by specifying, for example, an amount of economic resources to be transferred that varies in response to some underlying, or by specifying the priority of the claim. That is risk resulting from the 'amount' or 'priority' features.

67. The separation of the entity from its capital providers implies that financial statements should report economic phenomena that affect the entity and not those that affect its capital providers. This means that transactions and contracts of capital providers that are entered into independent of the entity should not be reported in the entity's financial statements. In contrast, the entity's buying, selling and contracting on its own claims affects the entity and its capital providers because such actions affect the economic resources and outstanding claims of the entity, thus the prospects for future cash flows.

Questions for the IASB

Questions
1) Do you have any comments on how we have described the features we have identified?
2) Do you think that some of the features we have identified are not relevant?
3) Are there other features that we have not considered?

How would we analyse some simple claims based on the identified features?

68. We illustrate some examples of the following below:

    (a) Claims that contain no relevant features (paragraphs 71–73)

    (b) Claims that contain all relevant features (paragraphs 74–76)

    (c) Claims that contain some relevant features (paragraphs 77–85)

69. We have included a table summarising the examples after paragraph 85.

70. As a reminder, **features of claims are relevant if they affect the prospects for future cash flows**. For simplicity, we have ignored priority and uncertainty features.

No relevant features

71. If a claim does not contain features that affect the prospects for future cash flows independently of other claims, then the prospects for future cash flows on the claim will depend on other factors.

72. An example of this type of claim would be an ordinary share which contains no obligation of the entity other than the obligation to transfer to the holder of the claim, at the end of the entity's life (ie at liquidation), whatever type and amount of economic resources remain under the entity's control after meeting all other claims.

73. For the existing and potential investors in entities with such claims, information about the entity's economic resources and about any relevant features of **other claims** against the entity will be relevant. Hence, recognition and measurement of the entity's economic resources and of its other claims should be sufficient to satisfy the information needs of existing and potential investors in the entity with regards to these types of claims.

All relevant features

74. If a claim contains all relevant features that might affect the prospects for future cash flows, then, information about the type, timing, amount and uncertainty of future cash flows on the claim be relevant.

75. An example of this type of claim would be an ordinary bond that contains an obligation of the entity to transfer an amount of cash, equal to an amount specified in a particular currency, at a specified time prior to liquidation and senior to all other claims.

76. For the existing and potential investors in entities with such claims, information about the entity’s economic resources and about the nature and amounts related to **this claim, as well as other claims**, will be relevant. The timing, amount and uncertainty of the claim is typically captured by using an appropriate measurement basis, say amortised cost, and the claim would be described as a financial liability given the requirement to transfer cash. The changes in the measurement of the claim from, period to period, would show how the distribution of future cash flows changes over time through the accrual of interest. Additional information might also be provided about the timing of payment by classifying the claim as either current or non-current on the statement of financial position.

Some relevant features

77. Some claims may contain some features that affect prospects for future cash flows, and other that do not.

78. Examples include:

    (a) Shares redeemable for their fair value

    (b) Share-settled debt

    (c) Cumulative preference shares

Shares redeemable for their fair value

79. A claim might share the same features as ordinary shares, except that the entity has the obligation to settle the claim, at fair value, at a specified time prior to liquidation (or perhaps on demand of the holder) with cash.

80. For this type of claim, the timing of settlement and the type of resource required to settle the claim has been specified. If the entity does not have sufficient cash on hand to transfer at the required time, the costs of obtaining cash, or converting existing economic resources to cash, will be borne by the entity and other claim holders, including any costs of potential financial distress.

81. However, all other features would be similar to ordinary shares, and those other features will have no effect on the prospects for future cash flows. For example, the amount of cash required to settle the claim (and changes in that amount over time) will be the same as the amount of cash required to settle an ordinary shares.

Share-settled debt

82. A claim might share the same features as an ordinary bond, except that the entity has the obligation to settle the claim using a variable number of its own ordinary shares instead of cash.

83. For this type of claim the amount of the claim changes over time, until settlement, similar to the ordinary bond, however the entity does not need to convert its existing economic resources to cash, or obtain additional cash by issuing other claims. Thus the effect on the prospects for future cash flows is similar to an ordinary bond (for example, interest accretion), except for the marginal cost or benefit of exchanging shares for the cash required to settle the ordinary bond. If the entity has the ability to issue additional shares, then the other shareholders' interest in the entity will be diluted by the specified amount.

Cumulative preference shares

84. A claim might share the same features as an ordinary bond, except that the entity does not have the obligation to settle the claim in whole, or in part, prior to liquidation.

85. For this type of claim the amount of the claim changes over time, until settlement, similar to the ordinary bond, however the entity does not need to convert its

existing economic resources to cash, or obtain additional cash by issuing other claims. Thus the effect on the prospects for future cash flows is similar to an ordinary bond, except for the marginal cost or benefit of delaying the timing of settlement until liquidation.

Summary analysis of instruments

Does the claim specify the following feature such that it affects the prospects for future cash flows?			
	Type	**Timing**	**Amount**
Ordinary share	No	No	No
Ordinary bond	Yes (cash)	Yes (prior to liquidation)	Yes (amount of currency, or rate of change specified)
Shares redeemable at fair value	Yes (cash)	Yes (prior to liquidation)	No (amount dependent on economic resources and claims)[25]
Share-settled debt	No (type of economic resource not specified)	No (not required to be settled with economic resources prior to liquidation, however conversion to a claim with different features required prior to liquidation)	Yes (amount of currency, or rate of change specified)
Cumulative preference shares	No (type of economic resource not specified)	No (not required to be settled with economic resources prior to liquidation)	Yes (amount of rate of change specified)

[25] The fair value of the ordinary shares reflects the total amount of recognised and unrecognised economic resources and other claims.