January 7, 2019

Mr. Hans Hoogervorst, Chairman
International Accounting Standards Board
Columbus Building,7 Westferry Circus,Canary Wharf
London E14 4HD
United Kingdom

Dear Mr. Hoogervorst,

Discussion Paper DP/2018/6 Financial Instruments with Characteristics of Equity

The Financial Accounting Issues Task Force of the Taiwan Financial Reporting Standards Committee (TFRSC) of Accounting Research and Development Foundation in Taiwan appreciates the opportunity to respond to the above discussion paper.

The attachments (Attachment 1) are our comments to this discussion paper. The comments are those of the Financial Accounting Issues Task Force and do not necessarily represent official opinions of the TFRSC.

If you have any question about our comments, please contact me (via my email: ccliu@management.ntu.edu.tw) or Ms. Margaret Tsui (via her email:margaret@ardf.org.tw).

Sincerely Yours,

Chi-Chun Liu, Ph.D.
Chairman,
Taiwan Financial Reporting Standards Committee,
Accounting Research and Development Foundation, Taiwan

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Attachment 1
Discussion Paper DP/2018/6 Financial Instruments with Characteristics of Equity

Financial Instruments with Characteristics of Equity

General remarks on the Discussion Paper of the FICE

Challenges identified in the Discussion Paper

We agree with the description of the conceptual challenges and application challenges in paragraph 1.23－1.37 of this Discussion Paper. In our view, the lack of clear rationale for the classification of financial instruments in IAS32 may lead to the users of financial statements difficult to interpret the information provided to them when analyzing the solvency and return of the entity. In addition, the inconsistency between the definition of a financial liability in IAS 32 and the definition of a liability in the Conceptual Framework for Financial Reporting (the 2018 Conceptual Framework) and other IFRS Standards is confusing if a financial instrument meets the definition of a financial liability while not meeting the definition of a liability, and vice versa.

Challenges we have encountered in Taiwan when applying IAS 32

In Taiwan, we have encountered similar challenges identified in this Discussion Paper in practice, such as conversion options embedded in convertible bonds with an anti-dilution provision when applying the fixed-for-fixed condition as described in paragraph 1.36(a) and obligations arising from non-contractual terms as described in paragraph 1.36(e). More specifically, an entity issues a financial instrument which is wholly held by its wholly-controlled parent. The contract specifies that the decision of whether to make distributions of the instrument solely depends on the entity. However, the parent (which is also the holder of the instrument) of the entity may direct the operating and financial policies of the entity through the presence of control. Under the circumstances, when it comes to the presentation of the entity's individual financial statements, can we interpret that the entity does not have an unconditional right to avoid delivering cash or another financial asset and therefore, a financial liability should be recognized even if it seems no contractual obligation exist? As another example of the challenges we encountered in Taiwan, the trustees of Real Estate Investment Trusts (REITs), in accordance with the law, are required to distribute 90% or more of distributable income to beneficial owners of REITs each year to gain tax credit. Besides, the law requires that the distribution proportion should be specified in the contract. However, the beneficial owners theoretically can vote to waive the distribution. When the REITs liquidate, the surplus will be distributed to the beneficial owners. Hence, it is highly

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debatable whether the distribution obligation imposed by law, but allowed to be cancelled by the beneficial owners, meets the definition of contractual obligation.

Our response to the FICE project

We express our support to the intention of the FICE project to articulate the principles for the classification of financial instruments as either financial liabilities or equity instruments. However, we suggest that the Board review the concept of the liabilities and equity comprehensively, and in the current stage, we believe that the Board should focus on making improvements to IAS 32 to respond those challenges identified in applying IAS 32, rather than introducing a new way of distinguishing financial liabilities and equity while not addressing the inconsistency between different IFRS Standards.

The reasons for our dissenting opinion relating to the Board's preferred approach

We think the Board's preferred approach lacks connection and consistency with the definition of a liability and equity and related supporting guidance in the 2018 Conceptual Framework. For example, as an obligation is a duty or responsibility that an entity has no practical ability to avoid in accordance with paragraph 4.29 of the 2018 Conceptual Framework, we questioned the inconsistent use of the term 'unavoidable' obligation in the preferred approach. On the other hand, we are concerned about whether the criteria for classifying an item as a liability described in paragraph 2.33 of the Discussion Paper within the preferred approach also apply to the claims other than financial instruments applicable to other IFRS Standards, such as the obligations applicable to IAS 37 and the instruments applicable to IFRS 2. If not doing so, how would the preferred approach address the inconsistency among different IFRS Standards? Regarding to amount feature, it is unclear that using the 'available economic resource' within the preferred approach would achieve the intended objective since the definition of 'available economic resource' in the paragraph 3.17 of the Discussion Paper is difficult to link to the definition of 'economic resource' in the 2018 Conceptual Framework. As a result, it is highly likely to lead to much confusion to the users of the financial statements. Furthermore, we believe that the Board's preferred approach will introduce more complexities. Applying the amount feature to the derivatives on own equity would introduce new concept, such as independent and partly independent variables as the discussion in the paragraph 4.49－4.66 of the Discussion Paper. It might be difficult to determine whether a variable is independent of the entity's available economic resource, especially for some

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complex derivatives. In addition, for similar derivatives with similar variables, there is a possibility that entities might reach different conclusions and create inconsistencies.

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