AASB Exposure Draft

ED 186
August 2009

Classification of Rights Issues (proposed amendment to AASB 132)

Comments to AASB by 24 August 2009

Australian Government

Australian Accounting Standards Board

Commenting on this AASB Exposure Draft

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 24 August 2009. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 7 September 2009. Comments should be addressed to:

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West Victoria 8007
AUSTRALIA
E-mail: standard@aasb.gov.au

Respondents to the IASB are asked to send their comments electronically through the 'Open to Comment' page on the IASB website (www.iasb.org)

All non-confidential submissions to the AASB will be made available to the public on the AASB website: www.aasb.gov.au.

Obtaining a Copy of this AASB Exposure Draft

This AASB Exposure Draft is available on the AASB website: www.aasb.gov.au. Alternatively, printed copies of this AASB Exposure Draft are available by contacting:

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AASB REQUEST FOR COMMENTS

In light of the Australian Accounting Standards Board's (AASB's) policy of incorporating International Financial Reporting Standards (IFRSs) into Australian Accounting Standards, the AASB is inviting comments on:

(a) any of the proposals in the attached International Accounting Standards Board (IASB) Exposure Draft, including the specific questions on the proposals as listed in the Invitation to Comment section of the attached IASB Exposure Draft; and

(b) the 'AASB Specific Matters for Comment' listed below.

The AASB would prefer that respondents supplement their opinions with detailed comments, whether supportive or critical, on the major issues. The AASB regards both critical and supportive comments as essential to a balanced review and will consider all submissions, whether they address all specific matters, additional issues or only one issue.

Due Date for Comments to the AASB

Comments should be submitted to the AASB by 24 August 2009. This will enable the AASB to consider those comments in the process of formulating its own comments to the IASB. Constituents are also strongly encouraged to send their response to the IASB.

AASB Specific Matters for Comment

The AASB would particularly value comments on whether:

(a) there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

  (i) not-for-profit entities; and

  (ii) public sector entities.

(b) overall, the proposals would result in financial statements that would be useful to users; and

(c) the proposals are in the best interests of the Australian economy.

August 2009

Exposure Draft ED/2009/9

Classification of Rights Issues

Proposed amendment to IAS 32

Comments to be received by 7 September 2009

International
Accounting Standards
Board®

Exposure Draft

CLASSIFICATION OF RIGHTS ISSUES (proposed amendment to IAS 32*)*

Comments to be received by 7 September 2009

ED/2009/9

This exposure draft *Classification of Rights Issues* (proposed amendment to IAS 32) is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued as an amendment to IAS 32. Comments on the exposure draft and the Basis for Conclusions should be submitted in writing so as to be received by **7 September 2009.** Respondents are asked to send their comments electronically to the IASB website (www.iasb.org), using the 'Open to Comment' page.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

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International
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Introduction

1 This exposure draft contains a proposal by the International Accounting Standards Board to amend IAS 32 *Financial Instruments: Presentation*. The purpose of the amendment is to clarify the classification of instruments that give the holders the right to acquire an entity's own equity instruments at a fixed price (rights issue) when that price is stated in a currency other than the entity's functional currency.

2 The proposed amendment specifies that a rights issue offered pro rata to all of an entity's existing shareholders on the exercise of which the entity will receive a fixed amount of cash for a fixed number of the entity's own equity instruments is classified as an equity instrument regardless of the currency in which the exercise price is denominated.

3 The proposed amendment is intended to clarify the circumstances in which the currency the entity will receive on the issue of an instrument does not affect its classification as a liability or an equity instrument.

Invitation to comment

The Board invites comments on the amendment proposed in this exposure draft, particularly on the questions set out below. Comments are most helpful if they:

(a) comment on the question as stated;

(b) indicate the paragraph or paragraphs to which they relate;

(c) contain a clear rationale; and

(d) if applicable, include an alternative the Board should consider.

The Board is not seeking comments on matters in IAS 32 other than those set out in this exposure draft.

Respondents should submit comments in writing so as to be received no later than **7 September 2009**.

Question 1 – Specifying the characteristics of the rights issue

The proposed amendment applies to instruments (rights) to be offered pro rata to all existing owners of the same class of equity instruments and the exercise price to be a fixed amount of cash in any currency.

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Do you agree with the proposal to limit the amendment to instruments with these characteristics? If not, why? Are there any other instruments that should be included and why?

Question 2 – Specifying the currency of the exercise price

The proposed amendment specifies that the fixed amount of cash the entity will receive can be denominated in any currency. If that currency is not the entity's functional or reporting currency, the proceeds it receives from the issue of its shares will vary depending on foreign exchange rates.

Do you agree with the proposal to permit an entity to classify rights with the characteristics set out above as equity instruments even when the exercise price is not fixed in its functional or reporting currency? If not, why?

Question 3 – Transition

The proposed change would be required to be applied retrospectively with early adoption permitted.

Is the requirement to apply the proposed change retrospectively appropriate? If not, what do you propose and why?

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Proposed amendment to IAS 32 *Financial Instruments: Presentation*

Paragraphs 11 and 16 are amended (new text is underlined and deleted text is struck through). Paragraph 97E is added.

Definitions

11 **The following terms are used in the Standard with the meaning specified:**

...

A *financial liability* is any liability that is:

(a) ...

(b) a contract that will or may be settled in the entity's own equity instruments and is:

(i) a non-derivative for which the entity may be obliged to deliver a variable number of the entity's own equity instruments; or

(ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose, rights to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also f~~F~~or ~~this~~ these purposes the entity's own equity instruments ...

16 When an issuer applies the definitions in paragraph 11 to determine whether a financial instrument is an equity instrument rather than a financial liability, the instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met.

(a) ...

(b) If the instrument will or may be settled in the issuer's own equity instruments, it is:

(i) a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or

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(ii) a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose, rights to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Also, f~~F~~or ~~this~~ these purposes the issuer's own equity instruments do not include instruments that have all the features and meet the conditions described in paragraphs 16A and 16B or paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the issuer's own equity instruments.

...

Effective date and transition

97E Paragraphs 11 and 16 were amended by *Classification of Rights Issues* issued in [month] 2009. An entity shall apply that amendment for annual periods beginning on or after [90 days after the amendment is issued]. Earlier application is permitted. If an entity applies the [draft] amendment for a period beginning before [date to be inserted after exposure], it shall disclose that fact.

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Approval by the Board of *Classification of Rights Issues* published in August 2009

The exposure draft *Classification of Rights Issues* (proposed amendment to IAS 32) was approved for publication by the fifteen members of the International Accounting Standards Board.

Sir David Tweedie	Chairman
Stephen Cooper	
Philippe Danjou	
Jan Engström	
Patrick Finnegan	
Robert P Garnett	
Gilbert Gélard	
Amaro Luiz de Oliveira Gomes	
Prabhakar Kalavacherla	
James J Leisenring	
Patricia McConnell	
Warren J McGregor	
John T Smith	
Tatsumi Yamada	
Wei-Guo Zhang	

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Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the proposed amendment to IAS 32.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in the exposure draft *Classification of Rights Issues* (proposed amendment to IAS 32). Individual Board members gave greater weight to some factors than to others.

BC2 The International Financial Reporting Interpretations Committee (IFRIC) received requests for guidance on whether a call option entitling the holder to receive a fixed number of the entity's own equity instruments for a fixed amount of a currency other than the entity's functional currency (foreign currency) should be accounted for as a derivative liability.

BC3 In 2005 the IFRIC was asked whether the equity conversion option embedded in a convertible bond denominated in a foreign currency met IAS 32's requirements to be classified as an equity instrument. IAS 32 states that a derivative instrument relating to the purchase or issue of an entity's own equity instruments is classified as equity only if it results in the exchange of a fixed number of equity instruments for a fixed amount of cash or other assets. At that time, the IFRIC concluded that if the conversion option was denominated in a currency other than the entity's functional currency, the amount of cash to be received in the functional currency would be variable. Consequently, the instrument was a derivative liability that should be measured at its fair value with changes in fair value included in profit or loss.

BC4 However, the IFRIC also concluded that this outcome was not consistent with the Board's approach when it introduced the 'fixed for fixed' notion in IAS 32. Therefore, the IFRIC decided to recommend that the Board amend IAS 32 to permit a conversion or stand-alone option to be classified as equity if the exercise price was fixed in any currency. In September 2005 the Board decided not to proceed with the proposed amendment.

BC5 In its discussion of the request for guidance received in 2009, the IFRIC recognised the concerns that led the Board not to proceed with the amendment the IFRIC recommended in 2005. However, the IFRIC

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believed that the Board could and should consider making a narrow targeted amendment to IAS 32 to address this question. The IFRIC recommended that the Board amend IAS 32 as soon as possible.

Characteristics of rights issues

BC6 Rights issues are one method an entity uses to raise capital. The entity issues one or more rights to acquire a fixed number of additional shares pro rata to all existing shareholders of a class of equity instruments. The exercise price is normally below the current market price of the shares. Consequently, a shareholder must exercise its rights if it does not wish its proportionate interest in the entity to be diluted. Issues with these characteristics are discussed in IFRS 2 *Share-based Payment* and IAS 33 *Earnings per Share*.

BC7 The Board agreed with the IFRIC's previous conclusion that a contract with an exercise price denominated in a foreign currency would not result in the entity receiving a fixed amount of cash in its functional currency. However, the Board also agreed with the IFRIC that classifying rights as derivative liabilities was not consistent with the substance of the transaction. Rights are issued only to existing shareholders on the basis of the number of shares they already own. In this respect they resemble dividends paid in shares.

BC8 The *Framework* defines income and expenses as changes in economic benefits that result in changes in equity, other than those relating to contributions by or distributions to equity participants. IFRS 2 (paragraph 4) states:

> ... if an entity grants all holders of a particular class of its equity instruments the right to acquire additional equity instruments of the entity at a price that is less than the fair value of those equity instruments, and an employee receives such a right because he/she is a holder of equity instruments of that particular class, the granting or exercise of that right is not subject to the requirements of this IFRS.

BC9 In excluding grants of rights with these features from the scope of IFRS 2, the Board explicitly recognised that the holder of the right receives it as a holder of equity instruments, ie as an owner. The Board noted that IAS 1 *Presentation of Financial Statements* requires transactions with owners in their capacity as owners to be recognised in the statement of changes in equity rather than in the statement of comprehensive income.

BC10 Consistently with its conclusion in IFRS 2, the Board decided that a pro rata issue of rights to all existing shareholders to acquire additional shares is a transaction with an entity's owners in their capacity as owners.

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Consequently, those transactions should be recognised in equity, not comprehensive income. Because the Board concluded that the rights were equity instruments, it decided to amend the definition of a financial liability to exclude them.

BC11 The Board decided not to extend this conclusion to other instruments that grant the holder the right to purchase the entity's own equity instruments. The fact that the rights are distributed pro rata to existing shareholders is critical to the Board's conclusion that this is a transaction with owners in their capacity as owners. The equal treatment of all owners of the same class of equity instruments was also the basis on which, in IFRIC 17 *Distributions of Non-cash Assets to Owners*, the IFRIC distinguished non-reciprocal distributions to owners from exchange transactions.

Decision to amend IAS 32

BC12 The Board accepted the IFRIC's recommendation to make a narrow targeted amendment to IAS 32 urgently despite its active major project to reconsider the classification of instruments as liabilities or equity. The Board was advised that rights with the characteristics discussed above are being issued frequently in the current economic environment. The Board was also advised that many entities fix the exercise price of the rights in currencies other than their functional currency because the entities are listed in more than one jurisdiction and are required to do so by law or regulation. Therefore, the accounting conclusions affect a significant number of entities in many jurisdictions. In addition, because these are usually relatively large transactions, they can have a substantial effect on entities' financial statement amounts.

Transition

BC13 The Board noted that IAS 32 requires retrospective application in all cases. The Board believes that a requirement to restate comparative information when the proposed amendment is first applied should not entail significant cost or effort. In addition, the Board's conclusions would not require an entity to use hindsight to make estimates to implement the amendment. Consequently, the Board proposes that this amendment to IAS 32 should be applied retrospectively.

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