Australian Government
Australian Accounting Standards Board

Level 7, 600 Bourke Street
MELBOURNE VIC 3000
Postal Address
PO Box 204
Collins Street West VIC 8007
Telephone: (03) 9617 7600
Facsimile: (03) 9617 7608

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Sir David Tweedie
Chairman
International Accounting Standards Board
1st Floor
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear David

IASB Exposure Draft ED/2009/9 *Classification of Rights Issues*

The Australian Accounting Standards Board (AASB) is pleased to submit its comments on the abovenamed Exposure Draft. In formulating these comments, the AASB sought and considered the views of Australian constituents. The comment letters received are published on the AASB's website.

The AASB agrees that the currency in which the exercise price of a rights issue is denominated should not affect the classification decision. While acknowledging that the foreign currency amount is not fixed in the functional currency of the entity, the AASB agrees that rights to shares issued pro rata to all existing shareholders are transactions with owners in their capacity as owners. On this basis, the AASB supports this amendment to ensure that the accounting outcomes reflect the equity nature of the transaction.

However, the AASB has some concerns about the scope of this amendment which may imply particular treatments in related but different circumstances. The proposals relate to a limited fact pattern and the AASB would prefer that the IASB focus on developing principles. The AASB finds that the nature of the issue being addressed is not adequately explained in the ED. It is not clear whether the proposals are intended to address issues relating to currency, proportionality or only circumstances involving both. In addition, the 'fixed for fixed' criterion in paragraph 16 of IAS 32 *Financial Instruments: Presentation* is a bright line rule that appears to lack a clear conceptual basis and its application causes issues in practice which are not limited to the situation being addressed specifically by the proposals. Accordingly, the AASB thinks that this matter should be addressed at a conceptual level in the context of the IASB's project on financial instruments with characteristics of equity.

In the meantime, the AASB urges the IASB to reconsider the need to limit the proposals to 'pro rata' rights issues. There is no clear rationale for requiring that all existing owners of the same class participate proportionately in order for there to be an equity classification. While rights may be issued pro rata in many jurisdictions, the AASB notes that it is common for instruments, which are in substance share rights, to be issued on other than a pro rata basis.

Furthermore, the IASB's recourse to IFRS 2 *Share-based Payment* on pro rata rights issues (as noted in paragraph BC10) appears questionable. A distinction is needed in IFRS 2 because of the dual capacity of employees and the need to decide which accounting applies. The proportionality of the receipt of rights by parties who are only equity holders is a different context.

The AASB's specific comments on the questions in the Invitation to Comment are in the attached submission.

If you require further information regarding any matters in this submission, please contact Siva Sivanantham (ssivanantham@aasb.gov.au) or me.

Yours sincerely

K M Stevenson

Kevin M. Stevenson
Chairman

AASB's Specific Comments on IASB Exposure Draft ED/2009/9 *Classification of Rights Issues*

The AASB's views on the questions in the Invitation to Comments are as follows:

> <u>Question 1 – Specifying the characteristics of the rights issue</u>
>
> 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.
>
> 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?

Consistent with its general comments in the covering letter, the AASB broadly supports this proposal.

Paragraph BC11 of the ED explains that "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 AASB understands that the IASB has deliberately limited the scope of the amendments to help avoid unintended consequences, for example to avoid a foreign currency denominated conversion option embedded in a convertible bond being classified as equity. Nevertheless, the AASB cannot understand the need to restrict the amendment to rights offered on a pro rata basis. The Basis for Conclusions does not provide an explanation as to why it is necessary that all existing owners of the same class participate proportionately to obtain an equity classification. In the absence of this explanation, entities may presume that rights issued to existing shareholders, on other than a pro rata basis, are financial liabilities. For example, if share rights are issued to a large institutional shareholder rather than to all existing owners within the same class, it appears that such a rights issue would not attract equity classification under the proposals. Furthermore, even when rights are issued pro rata to all existing shareholders within a class, if some shareholders are unable to accept the offer because they reside in a particular jurisdiction, then it appears that such a rights issue would not in substance attract equity classification. The AASB thinks that if the term 'pro rata' is included to ensure equal treatment of all existing shareholders, then the proposal should require pro rata rights to be offered on an entity level as opposed to a class level. If it is accepted that not all equity holders of the entity are treated on a pro rata basis, there is no reason to restrict equity classification only to situations where share rights are issued in a foreign currency pro rata within the same class.

Given that the proposed amendment can be considered to be an exception to the current 'fixed for fixed' notion in IAS 32, this should be explicitly acknowledged in the Basis for Conclusions.

The ED uses the word 'offer' in paragraphs 11 and 16, while the Basis for Conclusions includes words such as 'issue', 'grant' and 'distribute'. The AASB is unsure as to whether all of these terms are intended by the IASB to have the same meaning.

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?

While acknowledging that the foreign currency amount is not fixed in the functional currency of the entity, the AASB supports the proposed amendment as it enables the accounting outcome to reflect the underlying nature of the transaction.

However, the AASB is unsure as to why question 2 asks "Do you agree with the proposal to permit …", which implies that entities would be able to choose to classify rights issued in a foreign currency as equity or liability. The AASB presumes, based on a reading of the ED, that the proposal is to require equity classification in the circumstances outlined.

Question 3 – Transition

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

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

The AASB agrees with the proposal transitional requirements.