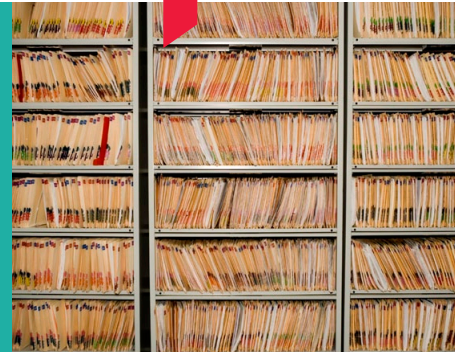


INTERNATIONAL FINANCIAL REPORTING BULLETIN 2009/10

AMENDMENT TO IAS 32

CLASSIFICATION OF RIGHTS ISSUES



Background

The International Accounting Standards Board (IASB) has published an amendment to International Accounting Standard (IAS) 32 *Financial Instruments: Presentation*.

The amendments change the accounting treatment when a rights issue is denominated in a currency other than the functional currency of the issuer. They require that if such rights are exercisable for a fixed amount of currency and are issued pro rata to all of the existing owners of the same class of an entity's own non-derivative equity instruments, they should be classified as equity regardless of the currency in which the exercise price is denominated.

The IASB has noted in the basis of conclusions to the exposure draft of the amendment that IAS 32 currently requires such rights issues to be accounted for as derivative financial liabilities, and that this outcome is not consistent with the substance of the transaction.

The principles underlying the amendment are set out below.

Rights issues

A rights issue is where shares are offered to existing shareholders in proportion to their current shareholding. The exercise price is often below the current market price of the shares, which gives investors an incentive to buy the new shares. If a shareholder does not exercise its rights and others do exercise them, that shareholder's proportionate interest in an entity is diluted.

As a result of the global financial crisis, an increased number of entities, including banks and financial institutions have either undertaken, or are considering undertaking a rights issue in order to raise capital. The amounts involved can be significant.

The exercise price of a rights issue may be in a currency which is different from the functional currency of the issuer. This may be because the issuer is listed in more than one jurisdiction, and may also be due to legal requirements.

Accounting for a rights issue under the existing IAS 32 where the exercise price is denominated in a currency other than the issuer's functional currency

In accordance with IAS 32.11(b)(ii), a financial liability includes a derivative financial liability that will or may be settled by delivering a fixed number of an entity's own equity instruments for a variable amount of cash.

In a rights issue, where the exercise price is a fixed price in a currency other than the functional currency of the entity, such an issue would meet the definition of a derivative financial liability. This is because the amount of cash received in functional currency will vary due to exchange rate fluctuations, meaning that the 'fixed' for 'fixed' criterion in IAS 32.11(b) would not be met. The rights issue would therefore give rise to a financial instrument which meets the definition of a derivative under paragraph 9 of IAS 39 *Financial Instruments: Recognition and Measurement*.

A consequence of accounting for such a rights issue as a derivative financial liability is that changes in the fair value of that liability will be recorded in profit or loss from the date of grant of the rights to their exercise date. Changes in value will arise from variations in an entity's own share price, and fluctuations in foreign exchange rates.

STATUS

Final

EFFECTIVE DATE

Annual periods beginning on/after 1 February 2010

ACCOUNTING IMPACT

Classification of rights issue at a fixed price per share when that price is stated in a currency other than an entity's functional currency

Rationale for, and scope of, the amendments

In its basis for conclusions the IASB acknowledges that accounting for such rights issues as derivative financial liabilities is not consistent with the substance of a rights issue which is a transaction with the owners of an entity in their capacity as owners.

In particular, it was considered that such accounting would not be consistent with the following:

- the exclusion of rights issues from the scope of IFRS 2 '*Share-Based Payment*', where it is recognised that the holder of the right receives it as a holder of equity instruments (ie as an owner); and
- the requirement in IAS 1 '*Presentation of Financial Statements*' to report transactions with owners in their capacity as owners outside of comprehensive income.

The IASB therefore considered it necessary to make narrow targeted amendments to IAS 32. Due to the nature of the amendments there are no consequential amendments to other standards.

The scope of the amendments is limited to rights issues and does not extend to cover other instruments that grant the holder the right to purchase the entity's own equity instruments, such as the conversion feature in convertible bonds. It is noted that the exercise of such a conversion feature does not primarily represent a transaction with owners in their capacity as such.

The amendments

Amendments have been made to paragraphs 11(b)(ii) and 16(b)(ii) of IAS 32 (the paragraphs which define a financial liability and an equity instrument) to include the following for the purpose of determining equity/liability classification:

"For this purpose, rights, options or warrants 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, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments."

Effective date

The effective date of the amendment to IAS 32 is annual accounting periods commencing on or after 1 February 2010. Earlier application is permitted. However, entities that report in accordance with EU-endorsed IFRS will need to wait until the amendment has been endorsed (at the time of publication of this IFRB, this is expected to be in the fourth quarter of 2009). Similarly, in other jurisdictions which have adopted IFRS as national GAAP, there may be a period of time before the amendments are legally effective.

BDO International is a world wide network of public accounting firms, called BDO Member Firms, serving international clients. Each BDO Member Firm is an independent legal entity in its own country. The network is coordinated by BDO Global Coordination B.V. incorporated in the Netherlands, with an office in Brussels, Belgium, where the International Executive Office is located.

The information in this bulletin is for general guidance only and is not a substitute for professional advice. The BDO Member Firms accept no responsibility for any actions taken or not taken on the basis of the information in this bulletin. © BDO Global Coordination B.V. 2009.

www.bdointernational.com