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7 September 2009

International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH
United Kingdom

Email: CommentLetters@iasb.org

Dear Sir/Madam

SAICA SUBMISSION ON EXPOSURE DRAFT ON *CLASSIFICATION OF RIGHTS ISSUES – PROPOSED AMENDMENT TO IAS 32*

In response to your request for comments on the IASB's exposure draft, *Classification of Rights Issues – Proposed Amendment to IAS 32*, attached is the comment letter prepared by The South African Institute of Chartered Accountants (SAICA). Please note that SAICA is not only a professional body, but also secretariat for the Accounting Practices Board (APB), the official standard-setting body in South Africa. The SAICA comment letter results from deliberations of the Accounting Practices Committee (APC), which is the technical advisory body to the APB.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph
Project Director – Accounting

cc: Moses Kgosana (Chairman of the Accounting Practices Board)
Prof Alex Watson (Chairman of the Accounting Practices Committee)

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SAICA SUBMISSION ON EXPOSURE DRAFT ON *CLASSIFICATION OF RIGHTS ISSUES – PROPOSED AMENDMENTS TO IAS 32*

GENERAL COMMENTS

We support the International Accounting Standard Board's (IASB's) proposed amendment to IAS 32 – *Financial Instruments: Presentation* (IAS 32) and we agree that the instruments addressed by the Exposure Draft should be classified as equity. However, we suggest that the IASB considers expanding the proposed approach to all instruments issued and not only those offered pro rata to all owners of the same class of equity instruments. Our responses to the specific questions raised in the invitation to comment section are provided below.

SPECIFIC COMMENTS

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.
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?

We agree that instruments with these characteristics should be classified as equity. However, we question why this amendment should be limited only to these instruments offered pro rata to all existing owners of the same class of equity instruments.

We acknowledge that the proposal places emphasis on the fact that because the offer is made pro rata to all owners of the same class of equity instruments, the transaction is one with owners in their capacity as owners. Whilst we do not disagree with this, it is noted that the exposure to foreign exchange rate fluctuations inherent in the transaction is not itself a transaction with owners in their capacity as owners. Therefore, if such foreign exchange rate exposure does not violate equity classification for these instruments, it is unclear why it should violate equity classification for otherwise identical instruments not offered pro rata to all owners of the same class of equity instruments.

Currently under IAS 32, if the exercise price is fixed in the entity's functional currency (and the number of instruments is fixed), the instrument is classified as equity and the entity is not required or permitted to recognise changes in fair value of such instruments through profit or loss. However, if the exercise price was fixed in a foreign currency, then *all* the fair value changes (changes in both market price and foreign currency) are required to be recognised. This appears inconsistent. The only difference between the two instruments described is that one is priced in a foreign currency. In substance, this is no different to pricing a transaction in a non-financial instrument in a foreign currency compared to one in the functional currency, for example, a transaction to sell equipment in a foreign currency. The host contract (denominated in the functional currency) is the same in both transactions. Currently, under IAS 39 – *Financial Instruments: Recognition and Measurement*, there is guidance on when such foreign currency embedded derivatives (embedded in financial assets or financial liabilities) are required to be separated out. If they are not required to be separated out (closely related to the host), then such exposures are not accounted for prior to the recognition of the sale of the underlying asset.

Therefore, we believe that the classification of the host contract as either debt or equity should not be affected by the fact that the exercise price is fixed in a foreign currency. The question is whether the foreign currency exposure should be accounted for separately, and if so, should it be recognised in profit or loss.

Paragraph 15 of IAS 32 states that the issuer of a financial instrument should classify the instrument "in accordance with the substance of the contractual arrangement". Based on this requirement, it is our view that the terms of an instrument (rather than the context in which it is issued) should determine its classification as equity or a financial liability.

We therefore believe that the same principle should apply when classifying all instruments involving the entity's own equity instruments such as written call options and compound instruments such as convertible bonds, regardless of whether they are offered pro rata to all owners of the same class of equity instruments. We note that the title of the amendment will need to be updated accordingly if the principle is extended.

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?

We agree with the proposal as we believe that the currency in which the exercise price is denominated should not impact the classification of the instrument as long as the exercise price is a fixed amount.

As noted in our answer to Question 1, the foreign currency exposure is not itself a transaction with owners in their capacity as owners. However, we do not believe that the mere fact that the transaction is denominated in a foreign currency should violate equity classification for at least the host contract, i.e. the issue of a fixed number of shares for a fixed amount. The question is whether the foreign currency exposure should be separated out and accounted for separately. We believe that the IASB should address this issue. One possible approach could be to follow a similar approach to IAS 39, which requires embedded foreign currency derivatives to be separated only if they are not closely related to the host contract. Where it is clear that the entity is not speculating in the foreign currency (for example, the foreign currency is that of the shareholders), the foreign currency embedded derivative could be regarded as being closely related and should not be separated out. We acknowledge that if the IASB were to follow such an approach, guidelines would need to be provided to determine when separation is required.

It is also noted that with regard to instruments not offered pro rata to all owners of the same class of equity instruments, there is a different accounting result depending on whether the entity receives fair value for the granting of such rights. If the entity does receive fair value, IAS 32 currently requires such instruments to be treated as derivatives (and accordingly remeasured to fair value through profit or loss). However, if they were not issued for fair value, then IFRS 2 – *Share-based Payment* (via IFRIC 8 – *Scope of IFRS 2*) would regard them as share-based payment transactions, which would be classified as equity-settled on the basis that the counterparty has the right to receive equity instruments of the entity, even though the exercise price is denominated in a foreign currency. In other words, under IFRS 2 such instruments would not be remeasured to fair value. This accounting inconsistency also highlights whether under IAS 32 it is correct that equity classification is violated simply because the exercise price is in a foreign currency.

As indicated above, we believe that this principle should be extended beyond offers made pro rata to all owners of the same class of equity instruments and should apply to the classification of all issued instruments.

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?

We believe that the requirement to apply the proposed change retrospectively is appropriate. We agree with the IASB's conclusion in BC13 of the Exposure Draft that retrospective application should not require significant cost or effort as the information required for retrospective application should be available to entities impacted by this Exposure Draft.

OTHER COMMENTS

The IASB discussed the classification of contracts settled in own equity denominated in a foreign currency previously at its September 2005 meeting. We understand that it was decided at that meeting not to proceed with an amendment to IAS 32 as a result of various concerns. The Exposure Draft's Basis for Conclusions does not articulate these previous concerns. We suggest that the IASB expand the Basis for Conclusions to outline and address these previous concerns so that it is clear how the current thinking ties in with the previous views or concerns.

We also note that the application of the proposed amendment in respect of rights issues by subsidiaries in the consolidated financial statements could be clarified. The proposed amendment refers to "the entity's own equity instruments". Paragraph 54 of IAS 1 – *Presentation of Financial Statements* states that non-controlling interests should be presented within equity. However, non-controlling interests may not necessarily be regarded as the entity's own equity instruments. As IAS 27 – *Consolidated and Separate Financial Statements* defines a parent as an <u>entity</u> that has one or more subsidiaries and paragraph 54 of IAS 1 makes a distinction between the equity of the parent and non-controlling interests, a strict interpretation of the wording of the proposed amendment could therefore result in rights issues by subsidiaries that are classified as equity in the subsidiaries' financial statements being classified as derivatives in the group's consolidated financial statements. We suggest that the amendment include an additional paragraph clarifying that rights issued by subsidiaries that are classified as equity instruments should also be classified as equity by the group.

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