

Appendix 1

FAR SRS' response to the questions raised in the Exposure Draft

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?

In the Basis for Conclusion, BC11, it is stated that the fact that the rights are distributed *pro rata* to existing shareholders is critical to the Board's conclusion. FAR SRS questions why the characteristic *pro rata* is a prerequisite for the instrument to be classified as equity instrument. From the entity perspective it is an owner transaction regardless if all the owners are treated the same or not. The issue of equal treatment of all the owners is not an accounting issue. This means that directed share issues and disproportionate rights issues should be treated in the same way as *pro rata* rights issues, i.e. as equity instruments. If the characteristic *pro rata* is to be a critical factor that determines the classification of the instrument as an equity instrument further explanation of the factors behind this judgment should be presented.

FAR SRS sympathizes with the Board's objective to present a temporary solution pending the outcome of the long-term project concerning the classification of an instrument as equity instrument or liability. However, it is important to present a consistent and principle-based solution in the short-term also. The proposal in the Exposure Draft is too rule-based. If the Exposure Draft amendment is to be the short-term solution to solve parts of the current urgent issues in the finance market it is of utmost importance to present a principle-based approach in the long-term. Another problem with this proposal is that not all transactions, which in substance are the same, are treated the same way, i.e. the proposal presented in the Exposure Draft is not consistent.

In the Framework paragraph 39 the following is stated; "*Users must also be able to compare the financial statements of different entities in order to evaluate their relative financial position, performance and changes in financial position. Hence, the measurement and display of the financial effect of like transactions and other events must be carried out in a consistent way throughout an entity and over time for that entity and in a consistent way for different entities*". Like transactions must be carried out in a consistent way, i.e. also foreign currency convertible bonds and written call options on shares should be in the scope of this amendment. Even though the proposal in the Exposure Draft is an exception of the fixed-for-fixed requirement in IAS 32 it is essential to apply the principle of comparability.

Foreign currency convertible bonds are in substance the same as right issues denominated in foreign currency. There is no difference economically if the instrument consists of two components; a convertible with an embedded warrant, or two separate instruments; one debenture and one warrant. FAR SRS does not see the logic to why they should be accounted for differently. FAR SRS cannot see why fluctuations in the form of currency and measurement effects have to be recognized in profit or loss in one case. The proposal in the Exposure Draft is too bound by the form of the transaction and not by the economic substance.

There is furthermore a risk of abuse if the proposed amendment is approved. By structuring the transaction as two separate instruments instead of one instrument with two components and by insuring no linkage between the instruments exists the same effect can be achieved as the one presented in the proposed Exposure Draft. In other words it is important to address the issue of foreign currency convertible bonds already in the short-term project.

The same applies to written call options on treasury shares as with foreign currency convertible bonds. In substance the transaction is similar to right issues except that the shares already exist. There is no difference economically and hence should be treated in the same way as other similar transactions. In FAR SRS' view, it is important that the exception is formulated in an as principle-based manner as possible which would also contribute to prevent abuse, as presented above.

FAR SRS is also concerned that the proposed amendment would remove the possibility to apply hedge accounting on the transactions within the scope of the amendments. It will no longer be possible to apply hedge accounting. Even though the problem probably is of remote importance because of limited use in practice FAR SRS suggests that the Board performs an analysis of the potential effects including transitional effects on retrospective application on the hedging instruments, see our comments to Question 3 below.

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?

FAR SRS agrees with the proposal.

However, FAR SRS notes that the questions are formulated in an inappropriate manner. Firstly, the question should not be if we agree with to proposal to *permit*, rather if we agree with the proposal to *obligate* an entity to classify rights with the characteristics set out as equity instruments regardless of the denomination currency. Secondly, there is no

reason to explicitly mentioning the reporting currency. These formulations have no impact on the proposed amendment.

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?

FAR SRS thinks retrospective application is appropriate to facilitate comparability over time and between companies. Also, we see no major costs or complexity in retrospective application unless the transaction was hedged and hedge accounting was applied. Retrospective application of existing hedge accounting would prevent the entity from applying hedge accounting retrospectively which would affect the presentation of performance in profit or loss.