30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410   Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org   Website: www.iasb.org

International Accounting Standards Board

This observer note is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. Views expressed in this document are identified by the staff as a basis for the discussion at the IFRIC meeting. This document does not represent an official position of the IFRIC. Decisions of the IFRIC are determined only after extensive deliberation and due process. IFRIC positions are set out in Interpretations.

Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting:	**2 November 2006, London**
Project:	**Review of published tentative agenda decisions**
Subject:	**IAS 32 *Financial Instruments: Presentation* - Foreign currency instruments exchangeable into equity instruments of the parent entity of the issuer (Agenda Paper 7(vi))**

Tentative agenda decision published in July-2006 IFRIC Update

At its meeting in April 2005, the IFRIC concluded that derivative contracts that may be settled by an entity by delivering a fixed number of its own equity instruments in exchange for a fixed amount of foreign currency are financial liabilities. At the same time, the IFRIC recommended that the issue should be referred to the Board. However, the Board, in September 2005, decided not to proceed with any amendments to IAS 32 *Financial Instruments: Presentation* in connection with convertible instruments issued by an entity in a currency other than the functional currency of the entity.

Subsequently, the IFRIC was asked to consider an issue relating to the issuance by a subsidiary of financial liabilities that provide holders with the rights to exchange the liability instruments into a fixed number of equity instruments of the parent at a fixed amount of currency. Variants considered were that the amount of currency is fixed if it is denominated in (i) the functional currency of the issuer of the exchangeable financial instruments or (ii) the functional currency of the issuer of the equity instruments. The issue was whether the conversion options embedded in the exchangeable financial instruments should be classified as equity in the consolidated financial statements of the parent in accordance with IAS 32 *Financial Instruments: Presentation*.

The IFRIC noted that a group does not have a functional currency. It therefore discussed whether it should add a project to its agenda to address which currency should be the reference point in determining whether the embedded conversion options are denominated in a foreign currency.

The IFRIC believed that the issue is sufficiently narrow that it is not expected to have widespread relevance in practice. [The IFRIC, therefore, decided] not to take the issue onto the agenda.

Deloitte.

Deloitte Touche Tohmatsu
Hill House
1 Little New Street
London EC4A 3TR
United Kingdom

Tel: National +44 20 7936 3000
Direct Telephone: +44 20 7007 0907
Direct Fax: +44 20 7007 0158
www.deloitte.com
www.iasplus.com

25 September 2006

Robert Garnett, Chairman
International Financial Reporting Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Email: ifric@iasb.org

Dear Bob,

Proposed rejection wording: IAS 32 *Financial Instruments: Presentation – Foreign currency instruments exchangeable into equity investments of the parent entity of the issuer*

Deloitte Touche Tohmatsu is pleased to respond to IFRIC's publication in the July 2006 IFRIC Update of the tentative decision not to take onto the IFRIC's agenda a request for an interpretation of foreign currency instruments exchangeable into equity investments of the parent entity of the issuer.

We are not supportive of the proposed rejection wording which states that the issue is sufficiently narrow and is not expected to have widespread relevance in practice.

This issue does have widespread relevance. The issue of convertible bonds is increasingly common. In June 2004, the market value of outstanding liquid European convertible securities that matured after 1/1/05 amounted to $143.8bn[1]. It is improbable that groups will only issue convertible debt out of the ultimate parent or a subsidiary that happens to have the same functional currency as the ultimate parent. Groups operate in multiple countries with multiple operations that have different functional currencies. Groups purposely issue convertible bonds out of certain jurisdictions to access local investors. Another common scenario is where a group acquires an entity that already has a convertible bond in issue to local investors, and following acquisition, the group amends the conversion option such that it will convert into the

[1] Nomura International plc, London. Convertible Research Group, "The Impact of New Accounting – IAS 32 and how it affects European Convertibles"

ultimate parent's shares as opposed to the acquired subsidiary's shares. The change to the conversion right ensures that the group's interest in the subsidiary will not be subsequently diluted by the convertible bond. The issuer remains unchanged, but is now a subsidiary of the group and the instrument is convertible into the ultimate parent's shares. This rejection notice is equally valid for groups that issue convertible bonds that are convertible into a subsidiary's shares where the instrument is issued by the ultimate parent or a different subsidiary. Interpreting whether a group needs to assess the functional currency of the issuer of the instrument or the issuer of the shares that will be delivered if the instrument is converted is vital in order for groups to determine whether they have issued a compound or hybrid instrument.

We find it unsatisfactory that in June 2005 the IFRIC concluded that the functional currency of the issuer was relevant in determining whether a conversion option was considered "a fixed amount of cash". This conclusion was later endorsed by the Board in September 2005, yet in July 2006, the IFRIC is unable to reach a conclusion on a fact pattern that is an elaboration on this original discussion. The IFRIC must have considered the issue of foreign denominated convertible bonds to be sufficiently widespread in practice or it would not have previously dealt with the issue and referred it to the Board for a proposed amendment to IAS 32. The IFRIC has already provided an answer on one aspect of the accounting for foreign currency convertible bonds. To not consider the other aspects will create uncertainty and diversity in practice.

The previous conclusion by the IFRIC and the IASB that derivatives over own equity must require an exchange of a fixed amount of functional currency cash for a fixed number of equity instruments to be classified as equity is relevant not solely for convertible bonds, but also for standalone derivatives on own equity. It is a basic requirement that entities have a robust interpretation on how "a fixed amount of cash" should be interpreted both for compound instruments and standalone derivatives. We urge the IFRIC to complete the work it has started in this area and provide a definitive conclusion on how to account for these instruments.

If you have any questions concerning our comments, please contact Ken Wild in London at +44 (0) 207 007 0907.

Sincerely,

Ken Wild
Global IFRS Leader

cc: Allan Cook, IFRIC