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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: **September 2008, London**
Project: **Transaction Costs Deducted from Equity (Agenda Paper 4C)**

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1. In July 2008 the IFRIC published a tentative agenda decision not to add an item to its agenda to provide guidance on the extent of transaction costs to be accounted for as a deduction from equity in accordance with IAS 32 paragraph 37. IAS 32.37 includes the following requirement: "The transaction costs of an equity transaction are accounted for as a deduction from equity (net of any related income tax benefit) to the extent they are incremental costs directly attributable to the equity transaction that otherwise would have been avoided."

2. Two comment letters were received.

3. Both comment letters agree with the IFRIC's recommendation that the Board develop common definitions for the terms "incremental" and "directly attributable" as different interpretations of these terms are creating divergence in practice – not only in relation to equity transaction costs.

4. Both comments letters also suggest that the IFRIC respond to the request for guidance on the allocation of joint costs which was not addressed in the tentative agenda decision.

5. One comment letter agrees with the IFRIC's decision not to add the issue to its agenda and with the IFRIC's conclusion that costs of becoming a public entity or acquiring an exchange listing are not related to issuing or acquiring an entity's own equity instruments.

6. The other comment letter disagrees with the tentative agenda decision because it does not provide sufficiently specific guidance to address the issue identified in the submission. In particular, the agenda decision's wording does not clarify whether the costs identified in IAS 32 paragraph 37 relate to an equity transaction or to becoming a public company or how to separate costs relating to two transactions when they occur at the same time, such as an issue of new equity instruments as part of an initial public offering.

Staff Analysis

7. In the staff's view, the guidance being sought by the second comment letter is how to implement a specific provision of IAS 32. The staff believes that the principle underlying that requirement is clear and that its application in practice requires judgement. The staff does not believe that the IFRIC should provide guidance on the specific cost that may or may not be deducted from equity transactions.

8. As noted in the agenda paper for the July meeting and in the tentative agenda decision, the costs IAS 32.37 permits to be deducted from equity are those an entity incurs in issuing or acquiring its own equity instruments. In the staff's view, if the costs would not have been incurred if the entity were not at the same time becoming a public company, they should not be considered to be part of the equity transaction.

9. Therefore, an entity could identify which cost relate to the equity issuance by determining whether they would have been incurred if it was already a public company. This approach would clearly address some of the questions raised in both the submission and the comment letter with respect to costs such as 'success bonuses' paid to management on the completion of an IPO

10. In addition, the staff does not believe that the Board would have identified the costs listed as examples in IAS 32.37 if it did not believe that in many circumstances those costs would relate to the equity transaction. Consequently the staff does not believe that additional guidance is required on this issue.

11. The staff agrees with one of the comment letters that 'any transaction costs relating jointly to both transactions must be allocated to those transactions using a basis of allocation that is rational and consistent with similar transactions'. However, we are not convinced that adding this wording to the agenda decision would provide much useful insight for constituents. In general, all IFRSs that require allocations specify that the basis must be rational and used consistently.

Staff recommendations

12. The staff continues to recommend that the IFRIC should not add this issue to its agenda.

13. The staff recommends that guidance on the method of allocation not be added to the agenda decision. However, the staff agrees that the issue is identified but not discussed. Therefore the staff proposes amending the agenda decision to delete reference to this issue.

14. The staff has set out wording for the final agenda decision in Appendix A.

Question for the IFRIC

15. Does the IFRIC agree with the staff recommendations?