Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Our Ref.: C/FRSC

**Sent electronically through the IASB Website (www.iasb.org)**

4 September 2009

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

Dear Sirs,

**IASB Exposure Draft on Proposed Amendments to IAS 32 – *Classification of Rights Issues***

The Hong Kong Institute of Certified Public Accountants is the only body authorised by law to promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. We welcome the opportunity to provide you with our comments on the captioned Exposure Draft. Our responses to the questions raised in your Exposure Draft are set out in the Appendix for your consideration.

We agree that applying the current "fixed for fixed" requirements in IAS 32.16(b)(ii) in a number of situations does not result in a faithful representation of the economic characteristics of equity-linked instruments in the financial statements. However, we do not consider that the proposed limited scope amendment provides a satisfactory solution, as we consider it represents a narrow rule-based exception to the principles in IAS 32 that will benefit a small number of preparers, rather than an amendment founded on a coherent conceptual principle that would be of benefit to the wider population of IFRS users. We also have concerns about the IASB making this kind of amendment in order to provide a quick fix to a practical problem.

In particular, while we agree with the explanation in BC7 that granting rights pro rata to existing shareholders at below fair value resembles dividends paid in shares, we consider that this is only relevant to the question of the initial recognition of the grant (i.e. that if a liability is to be recognised on initial recognition, then the double entry would be a debit to equity, with recognition in the statement of changes in equity as a transaction with shareholders). We do not consider that this aspect is relevant to the question of whether or not the instruments granted to the shareholders should themselves be classified as derivative liabilities or equity instruments and therefore whether or not post initial recognition these instruments should be subject to fair value remeasurement through profit or loss.

We therefore consider that the amendment should consider the broader implications of the fixed for fixed rule rather than creating an exception for one specific transaction type. For example, many businesses operating in China, and listed overseas, would have Renmimbi as their functional currency. However, since the Renmimbi is not a freely convertible currency, it cannot typically be used as the issuing currency for convertible debt to international investors, resulting in the use of a foreign currency (typically USD). In such cases, under the current "fixed for fixed" rule, the conversion options are required to be classified as derivatives, with the result that the full movement in their fair

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value is recognised in profit or loss on remeasurement, even though the vast majority of that movement is attributable to movements in the underlying equity price, rather than being due to changes in foreign exchange rates.

We believe that the same accounting treatment should be applied to all economically similar instruments regardless of legal form or functional currency of the issuer. That could be achieved by allowing that a predetermined amount of cash, denominated in any currency, can be regarded as a "fixed amount" for the purposes of applying IAS 32.16(b)(ii). Alternatively the amendment could consider a predetermined amount of cash in the functional currency or a transaction-related currency as a fixed amount for the purposes of applying IAS 32.16(b)(ii). In this regard, the IASB could use the guidance within IAS 39 as to when an embedded derivative is closely related to the host in identifying transaction related currencies, hence the guidance potentially already exists within issued standards.

If you have any questions on our comments, please do not hesitate to contact me at ong@hkicpa.org.hk.

Yours faithfully,

Steve Ong

Steve Ong, FCA, FCPA
Director, Standard Setting Department

SO/WC/ac

## Hong Kong Institute of CPAs

**Comments on the IASB Exposure Draft of Proposed Amendments to IAS 32 – *Classification of Rights Issues***

**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?**

As noted in our cover letter, we accept that the issue of share options to shareholders in a rights issue is a transaction with equity-holders. Accordingly, if given initial recognition at fair value, this transaction would be initially recognised as a distribution with a debit to equity under existing standards. However, after initial recognition, the holder of a right under a rights issue is economically in the same position as the holder of any other fixed price call option over the equity of the entity, in that movements in the fair value of such call options will be primarily determined by movements in the fair value of the underlying equity. It is irrelevant to that economic position whether or not that holder of the option is also the holder of the underlying equity instruments in the entity (and in fact, even with options granted under a rights issue, the option is often transferred by the shareholder to another party who may, or may not, already be a shareholder in the entity). Accordingly, the credit entry arising from options granted under a rights issue (i.e. if recognised initially at fair value) should be classified in the same manner as any other share options issued by the entity.

We therefore do not agree with the proposal to limit the amendment to instruments with the characteristics of the rights issue. We do not believe that there is a conceptual rationale to treat options granted under rights issues differently from other share options issued by the entity.

Rather than creating an exception for any specific transaction, the issue should be addressed by establishing a principle that the term 'fixed amount of cash' in IAS 32 includes situations where the cash is fixed in any currency, or in a transaction-related currency as discussed earlier in the letter. In this way, equity conversion features that are not denominated in the functional currency of the entity – often for purely practical reasons – could be classified as equity.

**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 to permit an entity to classify instruments convertible into a fixed number of shares upon payment of a fixed amount of cash as equity instruments when the exercise price is not fixed in its functional or presentational currency.

However, as noted above, we do not believe that this should be restricted to rights issues but should apply to all derivatives over own equity.

**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?**

If the IASB decides to proceed with the proposed amendments, we would agree with the transitional arrangement as proposed.