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Sir David Tweedie
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Our ref MT/288
Contact Mary Tokar

7 September 2009

Dear Sir David

Comment letter on Exposure Draft *Classification of Rights Issues*

We appreciate the opportunity to comment on the International Accounting Standards Board's (IASB or Board) Exposure Draft (ED) *Classification of Rights Issues*. This letter expresses the views of the international network of KPMG member firms.

We support the Board's proposal to make a focused amendment to IAS 32 *Financial Instruments: Presentation* to clarify that rights denominated in a fixed amount of foreign currency should be accounted for as equity instruments.

We agree that the amendment should be made as soon as possible, consistent with the Board's commitment to due process, given that the global financial crisis has led a number of companies to undertake rights issues in recent months and this matter may be material to those companies' 2009 financial statements.

Appendix 1 contains our detailed responses to the specific questions asked by the Board.

Please contact Mary Tokar or Chris Spall at +44 (0)20 7694 8871 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

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Appendix 1

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 with the proposal to limit the amendment to rights offered *pro rata* to existing shareholders of the same class whose exercise price is a fixed amount of cash in any currency.

We agree that accounting for such rights issues as derivative liabilities is not consistent with the substance of the transaction and does not meet the objective of providing useful information for users of financial statements. As noted in paragraph BC9, IAS 1 *Presentation of Financial Statements* requires transactions with owners in their capacity as owners to be presented in equity and not profit or loss. We agree that a *pro rata* rights issue is a transaction with an entity's owners in their capacity as owners and it is appropriate for the Board to resolve this conflict with the general requirements of IAS 32 as proposed. The proposal is consistent with the substance of a rights issue, being a fund-raising exercise that is a transaction with shareholders.

Given the Board's active project on *Financial Instruments with Characteristics of Equity* ("debt/equity project"), we support the Board's proposal to make a narrow targeted amendment to IAS 32 to address rights issues only. Recent economic conditions have caused more entities to undertake rights issues to raise additional equity capital. These transactions could have a significant impact on those entities' 2009 financial statements and therefore warrant addressing this issue on an accelerated basis.

However, we believe that the condition that the offering be to "all" existing shareholders of the same class should be clarified such that this criterion is not failed merely as a result of laws or regulations that limit the entity's ability to offer the rights to certain individual shareholders. Companies that undertake rights issues may have shareholders that are located in many countries, including jurisdictions other than those in which they have stock market listings. Securities laws or regulations in some countries may prevent a company from offering the rights to acquire new shares to shareholders in those countries. In these circumstances, the new shares that underlie the rights that otherwise would have been offered to the excluded shareholder typically are sold at fair value to a third party and any surplus of the proceeds generated over the fixed rights issue price, net of costs, is paid to the excluded shareholder. This ensures that shareholders who are technically excluded from the offering by the laws that apply in their jurisdiction retain the economic benefit of the rights that they otherwise would have received and are treated equally with shareholders in other jurisdictions who are offered rights but choose not to take them up. We understand that most, if not all, rights issues contain as a result of the operation of law "excluded shareholder" arrangements and therefore to deny the proposed amendment in such circumstances would seem to defeat its purpose.

To deal appropriately with these situations, we therefore suggest that the Board consider adopting either of the following approaches to clarifying the issue:

1. Amend the proposed wording changes to paragraphs 11(b)(ii) and 16(b)(ii) of IAS 32 to refer to:

   "… rights to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, or the benefits thereof, pro rata to all ~~of its~~ existing owners of the same class of its own non-derivative equity instruments."

2. Make no amendment to the proposed wording in the body of the standard, but state in the basis of conclusions that it had considered circumstances in which there are excluded shareholders that are compensated economically in lieu of receiving their rights due to statutory or regulatory reasons and that such exclusions do not change the substance that the rights are offered *pro rata* to all shareholders, and such rights issues therefore would qualify for equity classification under the proposed amendment.

Whilst we believe that the proposal could be extended to other types of instruments issued by entities that are denominated in a fixed amount of foreign currency and that may involve the raising of additional equity capital, e.g., warrants and other options on own shares, we believe that these should be addressed on a less urgent basis as part of the debt/equity project.

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 currency? If not, why?

We 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 currency.

As explained in the basis for conclusions, rights issues are one method an entity uses to raise capital, and are issued only to existing shareholders on the basis of the number of shares they already own at an exercise price which is normally below the current market price of the shares. Even if the proceeds from the rights issues are variable in the entity's functional currency, this should not give rise to any gain or loss in profit or loss as it relates to contributions by equity holders. Further, we do not believe that rights issued in the entity's functional currency and those issued in a foreign currency should be accounted for differently, when all the other terms and conditions of the rights are identical.

As discussed in Question 1, whilst we believe that the proposal could be extended to other types of instruments issued by entities that are denominated in a fixed amount of foreign currency and that may involve the raising of additional equity capital, e.g., warrants and other options on own shares, we believe that these should be addressed on a less urgent basis as part of the debt/equity project.

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 proposed and why?

We agree that the proposed change should be applied retrospectively and that early adoption should be permitted.

Retrospective application ensures that financial information is presented on a consistent basis for all periods presented. As noted by the Board, retrospective application should not involve significant cost or effort since any gains or losses previously recognised in profit or loss for qualifying rights issues should be easily identifiable.

Early adoption should be permitted so that entities that have undertaken rights issues during the current year can ensure that their 2009 financial statements reflect the substance of those transactions.