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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London
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Email: commentletters@iasb.org

11 September, 2009

Dear Sir David,

Re: Exposure Draft, *Classification of Rights Issues*

Deloitte Touche Tohmatsu is pleased to comment on the IASB Exposure Draft, *Classification of Rights Issues* (the "Exposure Draft").

We appreciate the IASB's efforts to address a specific issue related to the equity classification for derivative contracts on an entity's own equity. IAS 32 *Financial Instruments: Presentation* (paragraph 16) provides that a derivative is an equity instrument only if it will be settled by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments (the "fixed for fixed" criterion). We believe that the "fixed for fixed" criterion is a bright line rule that lacks a clear conceptual basis. Additionally, the application of the "fixed for fixed" criterion has caused numerous issues in practice which are not limited to the application of the "fixed-for-fixed" criterion to rights issues with an exercise price denominated in a foreign currency (i.e., not the reporting entity's functional currency).

As such, we are concerned that the IASB is dealing with rights issues in isolation. Modifying the "fixed for fixed" criterion only for rights issued pro rata to all existing owners of the same class of equity instruments to acquire a fixed number of an entity's own equity instruments for a fixed amount of any foreign currency would create inconsistencies with other derivatives that do not meet the "fixed for fixed" criterion when their exercise price or forward price is denominated in a foreign currency. Common examples include warrants, conversion options embedded in convertible bonds, and agreements to issue a fixed number of ordinary shares for a fixed amount of cash in foreign currency. Moreover, because we believe the wider "fixed for fixed" criterion is conceptually flawed and results in a number of practice issues that are not limited to derivative contracts with an exercise price denominated in a foreign currency, the IASB should take this opportunity to address the "fixed for fixed" criterion in its entirety on an accelerated basis. More specifically, the IASB should develop a model that has a clear principle for when a derivative contract that will or may be settled through the delivery of the issuers own equity instruments can qualify for equity classification.

If, however, the IASB proceeds to address the classification of certain pro rata rights issues denominated in a foreign currency in isolation from the wider “fixed for fixed” criterion, we believe that the scope of the project should be limited to only pro rata rights issues denominated in a foreign currency[1] that are exercisable in a very short period normally necessary to complete the transaction in the relevant jurisdiction (e.g., 30 days). For such contracts, movements in the value of the contract in the period shortly after the issuance of the rights may be viewed as a re-estimation of the initial distribution (i.e., remeasurement of the dividend granted to all shareholders in their capacity as owners at issuance of the right).

In providing a rationale for its proposal, we note that the IASB, in the Basis for Conclusions to the Exposure Draft, focuses only on the initial recognition of the distribution of certain rights issues to owners in the statement of changes in equity. We agree that the issuance of these instruments is an equity transaction. However, this line of reasoning does not clearly explain why the rights issues should be considered equity instruments after issuance and subsequent changes in value of the instrument should not be recognised. For example, a pro rata issuance of an entity’s note to its shareholders may be considered a dividend, but that does not change the note from a liability to an equity instrument. However, we acknowledge that after the pro rata distribution of a rights issue, some subsequent changes in the value of the stock may be due to that very same rights issue making it impracticable to determine whether near term changes in the value of the rights issue are part of the issuance or subsequent changes in the value of the right. Thus, for pro rata rights issues denominated in a foreign currency with very short maturities, it is reasonable to conclude that subsequent changes in value are part of the dividend to shareholders, in effect accounting for these instruments as equity instruments.

We also note that the Exposure Draft, if finalised as currently drafted, would create a difference with U.S. GAAP. Under FASB Accounting Standards Codification 815-40-15-7I (previously paragraph 19 of EITF Issue No. 07-5, Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity’s Own Stock), derivative contracts on an entity’s own equity instruments are not classified in equity if the strike price is denominated in a foreign currency. The EITF reached this conclusion in part to converge with the requirements in IAS 32. As stated in prior comment letters, we believe it is very important to have one set of high-quality global standards in order to create a truly level playing field for companies around the globe, and thus we strongly encourage the IASB to deal with the classification of derivative contracts on an entity’s own equity as part of the current joint project with the FASB, *Financial Instruments with Characteristics of Equity.*

Our detailed responses to the questions for respondents are included in Appendix A.

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

[1] We believe the Board also should consider parameters around the foreign currencies that may be used in denominating the strike price to avoid permitting embedding of inappropriate foreign currency derivatives into equity instruments that may not be related to the markets in which the entity’s equity instruments are regularly bought and sold.

Appendix A: Questions for Respondents

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?

Response 1

As discussed in the cover letter, we believe that the IASB should reconsider the current "fixed-for-fixed" criterion for equity classification in IAS 32 as a matter of urgency. However, we have concerns that the IASB is dealing with rights issued pro rata to all existing owners of the same class of equity instruments to acquire a fixed number of an entity's own equity instruments for a fixed amount of any foreign currency in isolation from the wider "fixed for fixed" criterion in IAS 32. We believe the wider "fixed for fixed" criterion is conceptually flawed and results in a number of practice issues that are not limited to rights issues with an exercise price denominated in a foreign currency. As such, the IASB should take this opportunity to address the "fixed for fixed" criterion in its entirety as a matter of urgency on an accelerated timescale. Further, we strongly encourage the IASB to address the classification of derivative contracts on an entity's own equity as part of the current joint project with the FASB, *Financial Instruments with Characteristics of Equity*.

If the IASB proceeds to address the classification of certain rights issues denominated in a foreign currency in isolation from the wider "fixed for fixed" criterion, we believe that the scope of the project should be limited to rights issues denominated in a foreign currency that are exercisable in a reasonable short period normally necessary to complete the transaction in the relevant jurisdiction.

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?

See our response to Question 1.

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?

We agree that it is appropriate to require retrospective application and permit early adoption.