

IAS Plus Update.

Classification of Rights Issues

On 8 October 2009, the International Accounting Standards Board (IASB) issued an amendment to IAS 32 *Financial Instruments: Presentation*, entitled *Classification of Rights Issues*. This amendment was exposed in August 2009 with a shortened 30-day comment period.

Under the amendments rights, options and warrants otherwise meeting the definition of equity instruments in IAS 32.11 issued to acquire a fixed number of an entity's own non-derivative equity instruments for a fixed amount in any currency are classified as equity instruments provided the offer is made pro-rata to all existing owners of the same class of the entity's own non-derivative equity instruments.

The amendment is effective for annual periods beginning on or after 1 February 2010 with earlier application permitted.

Background to the amendment

Under the requirements of IAS 32.11, a derivative instrument relating to the purchase or issue of an entity's own equity instruments is classified as equity only if it results in the exchange of a fixed number of equity instruments for a fixed amount of cash or other financial assets (the 'fixed for fixed' notion).

In 2005, the International Financial Reporting Interpretations Committee (IFRIC) concluded that in the case of an equity conversion option embedded in a convertible bond denominated in a foreign currency, the amount of cash to be received in the functional currency of the issuer was variable and consequently the instrument should be classified as a liability, rather than as equity.

At that time the IFRIC proposed broader amendments to IAS 32 which would have extended the fixed for fixed notion to all instruments denominated in a currency other than the entity's functional currency. However, the Board did not proceed with the amendment at that time.

Partly as a result of the global financial crisis, in the current market, entities are frequently using the rights-issue mechanism to raise additional capital. Many rights issues are denominated in a currency other than the entity's functional currency because the entity is listed in one or more jurisdictions where the local currency is not its functional currency.

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Because rights, warrants and options are issued only to existing shareholders on the basis of the number of shares they already own, the Board considered they resemble a dividend paid in shares, and as such represent a transaction with equity owners in their capacity as owners. As a result, the Board concluded that rights issues, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if they are offered pro-rata to all of the existing owners of the same class of the entity's own non-derivative equity instruments.

Scope of amendment

During its re-deliberations following the comment period, the Board decided to extend the scope of the amendment to warrants and options that capture the same economic reality as right issues.

The Board decided not to extend this conclusion to other instruments that grant the holder the right to purchase the entity's own equity instruments; the fact that the rights, warrants and options are distributed pro-rata to all existing shareholders was critical in the conclusion that they represent a transaction with equity owners in their capacity as owners.

Effective date and transition

The amendment is effective for annual periods beginning on or after 1 February 2010, with earlier application permitted.

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