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Director General  
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1049 Brussels

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Dear Mr Holmquist

**Adoption of the Amendment to IAS 32 *Classification of Rights Issues***

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards we are pleased to provide our opinion on the adoption of the Amendment to IAS 32 *Classification of Rights Issues* ('the Amendment'). The Amendment was issued as an Exposure Draft in August 2009 and EFRAG commented on that draft.

The Amendment clarifies that a rights issue offered pro rata to all of an entity's existing shareholders on the exercise of which the entity will receive a fixed amount of cash for a fixed number of the entity's own equity instruments is classified as an equity instrument regardless of the currency in which the exercise price is denominated.

The Amendment shall be applicable for annual periods beginning on or after 1 February 2010. Earlier application is permitted.

EFRAG has carried out an evaluation of the Amendment. As part of that process, EFRAG issued an evaluation of the Amendment against the EU endorsement criteria for public comment and, when finalising its advice and the content of this letter, it took the comments received in response into account. EFRAG's evaluation is based on input from standard-setters, market participants and other interested parties, and its discussions of technical matters are open to the public.

EFRAG supports the Amendment and has concluded that it meets the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards, in that:

- it is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

- it meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

For the reasons given above, EFRAG believes that it is in the European interest to adopt the Amendment and, accordingly, EFRAG recommends its adoption. EFRAG's reasoning is explained in the attached 'Appendix - Basis for Conclusions'.

On behalf of the members of EFRAG, I should be happy to discuss our advice with you, other officials of the EU Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely

Stig Enevoldsen  
**EFRAG, Chairman**

## **Appendix Basis for Conclusions**

*This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on the Amendment.*

*In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity as a contributor to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as adviser to the European Commission on endorsement of the final IFRS or Interpretation on the issue.*

*In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the European endorsement criteria, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.*

### **Does the accounting that results from the application of the Amendment meet the criteria for EU endorsement?**

- 1 EFRAG has considered whether it believes that the Amendment meets the requirements of the European Parliament and of the Council on the application of international accounting standards, in other words that the Amendment:
  - (a) is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and
  - (b) meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG has also considered whether it is in the European interest to adopt the Amendment.

- 2 Having formed tentative views on these issues and prepared a draft assessment, EFRAG issued that draft assessment on 8 October 2009 and asked for comments on it by 4 November 2009. EFRAG has considered all the comments received, and all were supportive of EFRAG's tentative conclusion that the Amendment meets the EU endorsement criteria and EFRAG should recommend its endorsement.

#### *Relevance*

- 3 According to the Framework, information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.

- 4 EFRAG considered whether the Amendment would result in the provision of relevant information—in other words, information that has predictive value, confirmatory value or both—or whether it would result in the omission of relevant information.
- 5 Under existing IFRS, the transactions falling within the scope of the Amendment would result in the foreign currency exposure (arising from the difference between the currency in which the transactions are to be settled and the entity's functional currency) and the equity price risk exposure being marked-to-market with gains and losses reported in profit or loss. Under the Amendment, these gains and losses will not be reported in profit or loss. EFRAG has therefore considered whether the 'non-reporting' of these gains and losses as they arise means that relevant information is no longer being provided in the financial statements.
- 6 The nature of transactions carried out by a reporting entity with its equity holders as equity holders is that they are fundamentally different transactions from other transactions ('ordinary transactions') carried out by the entity and that aspects of the transactions that would be relevant to report in the financial statements were they to arise in the context of ordinary transactions are not relevant. EFRAG's assessment is that this is the position in this case. For that reason, EFRAG's overall assessment is that the Amendment meets the relevance criterion.

#### *Reliability*

- 7 EFRAG also considered the reliability of the information that will be provided by applying the Amendment. The Framework explains that information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.
- 8 There are a number of aspects to the notion of reliability: freedom from material error and bias, representationally faithful, and complete. In EFRAG's view, the Amendment does not raise any issues concerning freedom from material error and bias or completeness. Furthermore, it believes that the key issue to be considered in the context of faithful representation is whether the Amendment correctly differentiates between transactions that are transactions carried out by a reporting entity with its equity holders as equity holders and other transactions.
- 9 The Amendment applies only to rights issues, options or warrants to acquire a fixed number of the reporting entity's own equity instruments for a fixed amount of any currency that are offered pro rata to all of the entity's existing owners of the same class of its own non-derivative equity instruments. EFRAG has no concerns about such transactions when they embody the terms and conditions that usually relate to such transactions. However, some EFRAG members have some concerns about two types of transaction:
  - (a) long-dated rights issues; in other words, rights issues where the period between issue and exercise is much longer than the normal period; and

- (b) rights issues that are disproportionately large compared to the amount of shares outstanding in that particular class.

In both cases, the concern is that the transaction has the potential to involve more than just a transaction carried out by a reporting entity with its equity holders as equity holders.

- 10 EFRAG notes however that, were such transactions to be carried out, they would be highly visible and, as a result, are likely to be both apparent to and understood by users of the financial statements. Furthermore, EFRAG believes that the Amendment will result in a significant improvement in the representational faithfulness of the accounting treatment of the vast majority of transactions falling within the scope of the Amendment. As a result, EFRAG's assessment is that overall the Amendment will not give rise to reliability concerns.

#### *Comparability*

- 11 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.
- 12 EFRAG has considered whether the Amendment has been scoped in a way that results in transactions that are economically similar being accounted for differently, or transactions that are economically different being accounted for as if they are similar. EFRAG's assessment is that that is not the case with the Amendment. As a result, its assessment is that the Amendment meets the comparability criterion.

#### *Understandability*

- 13 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence. Although there are a number of aspects to the notion of 'understandability', EFRAG believes that most aspects are covered by the discussion above about relevance, reliability and comparability (because, for example, information that represents something as similar when it is in fact dissimilar is not comparable, and that lack of comparability will mean it is also not understandable). As a result, EFRAG believes that the main additional issue it needs to consider in assessing whether the information resulting from the application of the Amendment is understandable is whether that information will be unduly complex. In EFRAG's view the Amendment does not introduce any new complexities.
- 14 EFRAG's assessment is therefore that the Amendment meets the understandability criterion.

#### *True and fair view*

- 15 EFRAG has also concluded that there is no reason to believe that the information resulting from the application of the Amendment would be contrary to the true and fair view principle.

*European interest*

- 16 EFRAG is not aware of any reason to believe that it is in the European interest not to adopt the Amendment.

*Conclusion*

- 17 Having considered the various arguments described in this Appendix, EFRAG has concluded that the Amendment satisfies the criteria for endorsement in the EU.