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Mr. Steve Ong
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Hong Kong Institute of Certified Public Accountants
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Wanchai, Hong Kong

Dear Steve,

IASB Exposure Draft on Proposed Amendments to IAS 32 – Classification of Rights Issues ("Exposure Draft")

I refer to your letter dated 11 August 2009 on the above to our Mr. Archie Tsim which has been passed to me for my attention.

We have completed our review of the Exposure Draft and our views are set out in the paragraphs below.

General

Before we comment on the Exposure Draft we would express our concern on the exceptional short time of 17 days allowed to provide comments. It appears that this Exposure Draft is a reaction to a real case and we believe this Exposure Draft may have been avoided if the conceptual aspects of proposals are thoroughly considered before releasing detailed standards.

The Exposure Draft seeks to clarify the accounting treatment when rights issues are denominated in a currency other than the functional currency of the issuer. Under the current requirements, such rights issues are accounted for as derivative liabilities. The amendments suggested in the Exposure Draft proposes that if such rights are issued pro rata to an entity's existing shareholders for a fixed amount of currency, they should be classified as equity regardless of the currency in which the exercise price is denominated.

We believe the subject matter would not be limited to such rights issues and similar issues will arise in other instruments. We believe the IASB should deal with the fundamental issue of whether the current rules in IAS 32 are appropriate. Since the matter involves the concept of functional currency, we also suggest that the IASB re-consider the fundamental issue concerning functional currency which is discussed further below.

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Fixed-for-fixed test

Under the fixed-for-fixed test, a derivative will qualify for equity classification only where 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 IFRIC previously decided in the context of convertible bonds that an amount denominated in a currency other than the entity's functional currency is not considered to be "fixed" for this purpose. Adoption of the proposals in the Exposure Draft would therefore appear to be inconsistent with the IFRIC ruling.

Principles-based standards – Fundamental rethink of right issues and functional currency

Under the Framework: -

(a) "equity" is defined as *"the residual interest in the assets of the entity after deducting all its liabilities"*; and

(b) a "liability" is defined as *"a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits"*.

We believe that a rights issue does not give rise to a liability or "present" obligation but only represents an offer of shares for sale. A present obligation only arises when and if the offer is accepted.

If a rights issue is regarded as a liability because it is made in a currency other than the company's functional currency, it would also appear that initial public offerings could potentially also be regarded as liabilities and similarly treated. This would mean that a listing applicant would need to record a liability and to record gains or losses on changes in the value of the "liability" up until the shares are issued. We believe this does not make sense and does not reflect the substance of the transaction which is an offer to potential old and new shareholders or "equity" which will be entitled to residual interest. As mentioned above we believe a liability only crystallizes when there is a present obligation and this will arise when there is an actual transaction or an exchange.

To illustrate, it is possible to have a dual listing in Hong Kong and the PRC and the functional currency could be determined to be either Renminbi or Hong Kong dollars. Once a choice is made it in effect determines which tranche would be regarded as equity and which would be regarded as a liability. This does not sound logical since the substance of the transaction is the issuance of shares to raise capital from shareholders.

We believe that requiring a company to select one functional currency in a global trading environment is unrealistic. A corporation that trades in many countries will have material transactions denominated in more than one currency and it is possible that transactions denominated in the various currencies could be equally weighted. To choose any one currency as the functional currency is unrealistic. Moreover, under existing accounting standards, a company is able to select any currency to be used for its reporting currency which theoretically may be different from its functional currency or the actual currencies in which the company transacts. We believe the functional currency concept needs re-examination as it is not meaningful and complicates accounting.

As mentioned in our previous letters, we believe that the IASB should revisit the Framework so that consistent principles-based standards are developed.

Conclusion

In summary, the IASB should consider the consistency of accounting treatment of financial instruments denominated in a foreign currency. IAS 32 should not be amended in a piecemeal way as it is likely to create unforeseen consequences and conflicts in the treatment of other components of financial statements. The issue raised in the Exposure Draft is also a fundamental issue concerning functional currency that needs to be resolved.

We hope that the above comments are helpful.

Yours sincerely,
For and on behalf of
The Stock Exchange of Hong Kong Limited

Colin Chau
Senior Vice President
Listing Division

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c.c. Mr. Archie Tsim – Chief Financial Officer
Mr. Mark Dickens – Head of Listing