

IAS 39: Classification of Exchanged Shares

Extract, IFRS Discussion Group Report on Meeting – May 14, 2015

Some entities in the exploration stage in the mining industry are facing challenges in raising capital through issuing common shares for cash. As a result, certain of these entities have turned to using alternative financing transactions. A form of financing transaction that has been used by a number of entities in the exploration stage (exploration entity) is the issuance of common shares in exchange for shares of another entity (financing entity).

Fact Pattern

The financing entity is a closed-end investment company. Concurrently with the exchange of shares, the financing entity lists its shares on a stock exchange. This fact pattern assumes that the purpose of the transaction is to provide the exploration entity with the ability to generate cash for its operations through the subsequent sale of the financing entity's shares. The financing entity's shares are initially subject to resale restrictions that are in place for approximately six months. These restrictions include a requirement that any share sales are approved by the financing entity.

Issue: Do the financing entity's shares meet the criteria in IAS 39 to be classified as held for trading and, therefore, at fair value through profit or loss?

IAS 39 *Financial Instruments: Recognition and Measurement* requires financial assets to be classified into one of four categories at initial recognition: financial assets at fair value through profit or loss; held-to-maturity investments; loans and receivables; and available-for-sale.

From the perspective of the exploration entity, the financing entity's shares clearly do not meet the criteria for classification as held-to-maturity investments, or loans and receivables. In determining whether the financing entity's shares should be recognized at fair value through profit or loss, it depends if they meet certain conditions in paragraph 9 of IAS 39, one of which is whether the shares are classified as held for trading.

View A – Yes, the financing entity's shares meet the criteria for being classified as held for trading.

This view considers that the exploration entity's main purpose to enter into such transaction is to raise cash in the short term. Since the intention is to sell the shares in the near term, the investment should be classified as held for trading and, therefore, at fair value through profit or loss.

View B – No, the financing entity's shares do not meet the criteria for being classified as held for trading.

Paragraph AG14 in IAS 39 states that "trading generally reflects active and frequent buying and selling, and financial instruments held for trading generally are used with the objective of generating a profit from short-term fluctuations in price or dealer's margins." This view considers that the intention to acquire the financing entity's shares is to raise cash to support ongoing operations as opposed to generating profits from short-term fluctuations.

Furthermore, the shares are subject to resale restrictions and, thus, the exploration entity's ability to sell these shares is limited in some manner. Paragraph 9 of IAS 39 indicates that if investments in equity instruments do not have a quoted market price in an active market, and the fair value cannot be reliably measured, the investment cannot be designated at fair value through profit or loss.

The Group's Discussion

Most Group members supported the view that the financing entity's shares do not meet the criteria for being classified as held for trading because the resale restriction affects the ability to sell the shares in the near term (View B). The Group also clarified that in the fact pattern being considered, there is no requirement to sell the financing entity's shares. The possibility of View A was discussed given there is no definition on what constitutes "near term" in IAS 39. While Group members noted that professional judgment is required to determine whether the shares were acquired for the purpose of selling in the near term, some members thought that the six month resale restriction posed some difficulty in this fact pattern. Group members observed that although the specific facts and circumstances may vary, there are limited instances of this type of transaction in the market.

The Group's discussion raises awareness about this item. No further action was recommended to the AcSB.

(For a full understanding of the discussions and views expressed, listen to the [audio clip](#)).