Project **IFRIC Interpretation X *Extinguishing Financial Liabilities with Equity Instruments***

Topic **Cover note**

Purpose of this paper

1. The purpose of this paper is to ask the Board to ratify an Interpretation on extinguishing financial liabilities with equity instruments. The IFRIC voted and confirmed the consensus in the Interpretation, subject to its final review of drafting changes, in its November 2009 meeting.
2. The following agenda papers are provided:
   (a) Agenda paper 14 — Cover note (this agenda paper) which includes:
      (i) background information on the Interpretation.
      (ii) a summary of the scope of the Interpretation.
      (iii) an outline of the issues that are addressed in the Interpretation.
      (iv) An overview of the consensus reached by the IFRIC.
      (v) details of the IFRIC's conclusions relating to re-exposure of the Interpretation.
      (vi) the effective date of the Interpretation and transition guidance.
      (vii) the IFRIC's recommendation for an amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

(b) Agenda paper 14A — IFRIC Interpretation X Extinguishing Financial Liabilities with Equity Instruments (Near Final Draft).

(c) Agenda paper 14B — IFRIC Interpretation X Extinguishing Financial Liabilities with Equity Instruments (marked up to reflect changes from the draft that was distributed to the Board on 4 November 2009).

Background information

3. In June 2009 the IFRIC received a request for guidance on the application of IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 32 *Financial Instruments: Presentation* when an entity issues its own equity instruments to extinguish all or part of a financial liability. The request specifically asked for guidance on how the entity should measure the equity instruments issued.

4. Divergence has arisen in practice, with some entities recording a gain or a loss on these transactions, based on the fair value of either the equity instrument issued (FV of equity) or the financial liability extinguished (FV of the liability). Other entities recognise no gain or loss on these transactions, with the equity instruments issued being recorded at the carrying amount of the financial liability extinguished.

5. The IFRIC decided to develop an Interpretation in response to this divergence in practice as a matter of urgency given the current economic environment.

6. In August 2009, the IFRIC published for public comment the draft Interpretation D25 *Extinguishing Financial Liabilities with Equity Instruments* (D25). In response to the proposals in D25, the IFRIC received 33 comment letters. The IFRIC redeliberated the issues, voted, and confirmed the consensus in the Interpretation, at its meeting in November 2009. The Near Final Draft Interpretation IFRIC X *Transfers of Assets from Customers* was published on the IASB Website after the IFRIC meeting.

Scope

7. The Interpretation addresses only the accounting by an entity when the terms of its financial liability are renegotiated and result in it issuing equity instruments to extinguish part or all of the liability (see paragraph 2 and BC6 of agenda paper 14A).

8. In its deliberations, the IFRIC clarified that an entity shall not apply this Interpretation to transactions in situations where:

    (a) the creditor is also a direct or indirect shareholder and is acting in its capacity as a direct or indirect existing shareholder.

    (b) the creditor and the entity are controlled by the same party or parties before and after the transaction and the substance of the transaction includes an equity distribution by, or contribution to, the entity.

    (c) extinguishing the financial liability by issuing equity shares is in accordance with the original terms of the liability.

Issues addressed in the Interpretation

9. The Interpretation addresses the following issues:

    (a) Are an entity's equity instruments issued to extinguish all or part of a financial liability 'consideration paid' in accordance with paragraph 41 of IAS 39?

    (b) How should an entity initially measure the equity instruments issued to extinguish such a financial liability?

    (c) How should an entity account for any difference between the carrying amount of the financial liability extinguished and the initial measurement amount of the equity instruments issued?

Consensus

10. The staff has summarised below the conclusions reached in the IFRIC's consensus, to assist the Board in reviewing the Interpretation.

Are an entity's equity instruments 'consideration paid'?

11. The IFRIC concluded that the issue of equity instruments to extinguish a financial liability are 'consideration paid' in accordance with paragraph 41 of IAS 39.

How should the equity instruments be measured?

12. In the draft Interpretation, the IFRIC decided that equity instruments issued to extinguish a financial liability should be measured initially at the fair value of the equity instruments issued or the fair value of the liability extinguished, whichever is more reliably determinable (see BC17 of agenda paper 14A).

13. However, many respondents proposed that a preferred measurement basis should be determined to avoid an 'accounting choice' developing in practice.

14. The IFRIC noted that respondents had mixed views on whether the preferred measurement basis should be the fair value of the equity instruments issued or the fair value of the financial liability extinguished. The IFRIC concluded that the fair value of the equity issued should be the proposed measurement basis. If the fair value of the equity instruments issued is not reliably determinable then measurement should reflect the fair value of the liability extinguished (see paragraphs 6, 7 and BC21 of agenda paper 14A).

15. Following redeliberations and in response to comment letters received, the IFRIC also clarified:

    (a) that paragraph 49 of IAS 39 is not applied in measuring the fair value of all or part of a financial liability extinguished that includes a demand feature that is no longer substantive.

    (b) when the equity instruments issued shall be initially measured.

How should a difference between the carrying amount of the financial liability and the consideration paid be accounted for?

16. The Interpretation requires an entity to recognise a gain or loss in profit or loss for any difference between the carrying amount of the financial liability extinguished and the consideration paid.

Partial extinguishment

17. The IFRIC decided that the Interpretation should apply to partial extinguishments.

18. Many respondents requested clarification of the guidance on partial extinguishments included in the draft Interpretation. During redeliberations, the IFRIC clarified that the issue of an entity's equity shares may reflect consideration paid for both the extinguishment of part of a financial liability and the modification of the part of the liability that remains outstanding.

19. To reflect this, an entity should allocate consideration paid between the part of the liability extinguished and the part of the liability that remains outstanding. This allocation will affect profit or loss to be recognised on the part of the liability extinguished and the assessment of whether the terms of the remaining liability have been substantially modified.

20. Respondents to the draft Interpretation also requested that additional guidance be provided on determining whether the part of the financial liability that remains outstanding has been substantially modified. The IFRIC concluded that such guidance is outside of the scope of this Interpretation.

Presentation

21. The IFRIC decided that an entity should disclose the gain or loss on the extinguishment of the financial liability by the issue of equity instruments as a separate line item in profit or loss or in the notes.

Re-exposure

22. At its November 2009 meeting, the IFRIC concluded that the changes made to D25 reflect clarification that the constituents requested, specifically in identifying a preferred measurement basis and clarifying guidance on partial extinguishment situations. The fundamental requirements of the Interpretation had **not** changed from those exposed for comment.

23. Consequently the IFRIC decided that the Interpretation does not need to be re-exposed.

Effective date and transition

24. The IFRIC decided that if the Board ratifies the Interpretation at this meeting and the Interpretation is published by the end of December that it shall be applied for annual periods beginning on or after 1 April 2010 with earlier application permitted.

Amendment to IFRS 1

25. The IFRIC recommends that the Board approve an amendment to IFRS 1 (refer to page 4 of agenda paper 14A for details) as part of its approval of the Interpretation.

Question for the Board

Question 1 for the Board
Does the Board ratify the Interpretation?