



Project	IFRIC Interpretation X <i>Extinguishing Financial Liabilities with Equity Instruments</i>
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IFRIC INTERPRETATION X

Extinguishing Financial Liabilities with Equity Instruments

IFRIC Interpretation X *Extinguishing Financial Liabilities with Equity Instruments* (IFRIC X) is set out in paragraphs 1-13. IFRIC X is accompanied by a Basis for Conclusions. The scope and authority of Interpretations are set out in paragraphs 2 and 7-17 of the *Preface to International Financial Reporting Standards*.

References

- *Framework for the Preparation and Presentation of Financial Statements*
- *IFRS 2 Share-based Payment*
- *IFRS 3 Business Combinations*
- *IAS 1 Presentation of Financial Statements*
- *IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors*
- *IAS 32 Financial Instruments: Presentation*
- *IAS 39 Financial Instruments: Recognition and Measurement*

Background

- 1 A debtor and creditor may renegotiate the terms of a financial liability with the result that the debtor extinguishes the liability fully or partially by issuing equity instruments to the creditor. These transactions are sometimes referred to as 'debt for equity swaps'. The IFRIC has received requests for guidance on the accounting for such transactions.

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in *IASB Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

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Scope

- 2 This Interpretation addresses only the accounting by an entity for a renegotiation of the terms of a financial liability such that the entity issues equity instruments to the creditor to extinguish all or part of the financial liability. It does not address the accounting by the creditor.
- 3 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 from, or contribution to, the entity.
 - (c) extinguishing the financial liability by issuing equity shares is in accordance with the original terms of the financial liability.

Issues

- 4 This 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

- 5 The issue of an entity's equity instruments to a creditor to extinguish all or part of a financial liability is consideration paid in accordance with paragraph 41 of IAS 39. An entity shall derecognise a financial liability (or part of a financial liability) from its statement of financial position when it is extinguished in accordance with paragraph 39 of IAS 39.
- 6 An entity shall initially measure equity instruments issued to a creditor to extinguish all or part of a financial liability at the fair value of the equity instruments issued, unless that fair value is not reliably determinable.

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- 7 If the fair value of the equity instruments issued is not reliably determinable then the equity instruments issued to a creditor to extinguish all or part of a financial liability shall initially be measured to reflect the fair value of all or part of the financial liability extinguished. In measuring the fair value of all or part of a financial liability extinguished that includes a demand feature (eg a demand deposit), paragraph 49 of IAS 39 is not applied.
- 8 If only part of the financial liability is extinguished, the entity shall assess whether some of the consideration paid relates to a modification of the part of the liability that remains outstanding. If part of the consideration paid does relate to a modification of the remaining part of the liability, the entity shall allocate the consideration paid between the part of the liability extinguished and the part of the liability that remains outstanding. The entity shall consider all relevant facts and circumstances relating to the transaction in making this allocation.
- 9 An entity shall recognise in profit or loss in accordance with paragraph 41 of IAS 39, the difference between the carrying amount of the financial liability (or part of that liability) extinguished, and the initial measurement amount of the equity instruments issued to extinguish the financial liability. The equity instruments issued shall be initially measured when the financial liability (or part of that liability) is extinguished.
- 10 When only part of the financial liability is extinguished, the consideration allocated to the remaining liability shall form part of the assessment of whether the terms of that remaining liability have been substantially modified. If the remaining liability has been substantially modified, the entity shall account for the modification as the extinguishment of the original liability and the recognition of a new liability as required by paragraph 40 of IAS 39.
- 11 An entity shall disclose a gain or loss recognised in accordance with paragraphs 9 and 10 as a separate line item in profit or loss or in the notes.

Effective date and transition

- 12 An entity shall apply this Interpretation for annual periods beginning on or after 1 April 2010. Earlier application is permitted. If an entity applies this Interpretation for a period beginning before 1 April 2010, it shall disclose that fact.
- 13 An entity shall apply a change in accounting policy in accordance with IAS 8 from the beginning of the earliest comparative period presented.

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Appendix

Amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

The amendment in this appendix shall be applied for annual periods beginning on or after 1 April 2010. If an entity applies this Interpretation for an earlier period, these amendments shall be applied for that earlier period.

A heading and paragraph D25 are added to Appendix D.
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Extinguishing financial liabilities with equity instruments

D25 A first-time adopter may apply the transitional provisions in IFRIC X.

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Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IFRIC X.

Introduction

- BC1 This Basis for Conclusions summarises the IFRIC's considerations in reaching its consensus. Individual IFRIC members gave greater weight to some factors than to others.
- BC2 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 question is how the entity should recognise the equity instruments issued.
- BC3 The IFRIC noted that lenders manage loans to entities in financial difficulty in a variety of ways including one or more of the following:
- (a) selling the loans in the market to other investors/lenders;
 - (b) renegotiating the terms of the loan (eg extension of the maturity date or lower interest payments); or
 - (c) accepting the creditor's equity instruments in full or partial settlement of the liability (sometimes referred to as a 'debt for equity swap').
- BC4 The IFRIC was informed that there was diversity in practice in how entities measure the equity instruments issued in full or partial settlement of a financial liability following renegotiation of the terms of the liability. Some recognise the equity instruments at the carrying amount of the financial liability and do not recognise any gain or loss in profit or loss. Others recognise the equity instruments at the fair value of either the liability extinguished or the equity instruments issued and recognise a difference between that amount and the carrying amount of the financial liability in profit or loss.
- BC5 The IFRIC published draft Interpretation D25 *Extinguishing Financial Liabilities with Equity Instruments* for public comment in August 2009 and received 33 comment letters in response to its proposals.

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Scope

- BC6 The IFRIC concluded that its Interpretation should address only the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to the creditor to extinguish part or all of the liability. It does not address the accounting by the creditor because other IFRSs already set out the relevant requirements.
- BC7 The IFRIC considered whether to provide guidance on transactions in which the creditor is also a direct or indirect shareholder and is acting in its capacity as an existing direct or indirect shareholder. The IFRIC concluded that the Interpretation should not address such transactions. It noted that determining whether the issue of equity instruments to extinguish a financial liability in such situations is considered a transaction with an owner in its capacity as an owner would be a matter of judgement depending on the facts and circumstances.
- BC8 In its redeliberations, the IFRIC clarified that transactions when the creditor and the entity are controlled by the same party or parties before and after the transaction are outside of the scope of the Interpretation when the substance of the transaction includes an equity distribution from, or contribution to, the entity. The IFRIC acknowledged that the allocation of consideration, between the extinguishment of all or part of a financial liability and the equity distribution or contribution components may not always be reliably determinable.
- BC9 Some respondents questioned whether the Interpretation should be applied to transactions when the extinguishment of the financial liability by issuing equity shares is in accordance with the original terms of the liability. In its redeliberations, the IFRIC decided that these transactions should be excluded from the scope of the Interpretation, noting that IAS 32 includes specific guidance on those financial instruments.

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

- BC10 The IFRIC noted that IFRSs do not contain specific guidance on the measurement of an entity's equity instruments issued to extinguish all or part of a financial liability. Paragraph 41 of IAS 39 requires an entity to recognise in profit or loss the difference between the carrying amount of the financial liability extinguished and the consideration paid. That paragraph describes 'consideration paid' as including non-cash assets transferred, or liabilities assumed, and does not specifically mention equity instruments issued. Consequently, some are of the view that equity instruments are not 'consideration paid'.
- BC11 Holders of this view believe that, because IFRSs are generally silent on how to measure equity instruments on initial recognition (see paragraph BC15), a variety of practices has developed. One such practice is to recognise the equity instruments issued at the carrying amount of the financial liability extinguished.
- BC12 However, the IFRIC observed that both IFRS 2 *Share-based Payment* and IFRS 3 *Business Combinations* make it clear that equity instruments are used as consideration to acquire goods and services as well as to obtain control of businesses.
- BC13 The IFRIC also observed that the issue of equity instruments to extinguish a financial liability could be analysed as consisting of two transactions — first, the issue of new equity instruments to the creditor for cash and second, the creditor accepting payment of that amount of cash to extinguish the financial liability.
- BC14 As a result of its analysis, the IFRIC concluded that the equity instruments issued to extinguish a financial liability are 'consideration paid' in accordance with paragraph 41 of IAS 39.

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How should the equity instruments be measured?

BC15 The IFRIC observed that although IFRSs do not contain a general principle for the initial recognition and measurement of equity instruments, guidance on specific transactions exists, including:

- (a) *initial recognition of compound instruments* (IAS 32). The amount allocated to the equity component is the residual after deducting the fair value of the financial liability component from the fair value of the entire compound instrument.
- (b) *cost of equity transactions and own equity instruments ('treasury shares') acquired and reissued or cancelled* (IAS 32). No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments. These are transactions with an entity's owners in their capacity as owners.
- (c) *equity instruments issued in share-based payment transactions* (IFRS 2). For equity-settled share-based payment transactions, the entity measures the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received (eg transactions with employees), the entity measures their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted.
- (d) *consideration transferred in business combinations* (IFRS 3). The total consideration transferred in a business combination is measured at fair value. It includes the acquisition-date fair values of any equity interests issued by the acquirer.

BC16 The IFRIC noted that the general principle of IFRSs is that equity is a residual and should be measured initially by reference to changes in assets and liabilities (the *Framework* and IFRS 2). IFRS 2 is clear that when goods or services are received in return for the issue of equity instruments, the increase in equity is measured directly at the fair value of the goods or services received.

BC17 The IFRIC decided that the same principles should apply when equity instruments are issued to extinguish financial liabilities. However, the IFRIC was concerned that entities might encounter practical difficulties in measuring the fair value of both the equity instruments issued and the financial liability, particularly when the entity is in financial difficulty. Therefore, the IFRIC decided in D25 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.

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- BC18 However, in response to comments received on D25, the IFRIC reconsidered whether the entity should initially measure equity instruments issued to a creditor to extinguish all or part of a financial liability at the fair value of the equity instruments issued or the fair value of the liability extinguished. The IFRIC noted that many respondents proposed that a preferred measurement basis should be determined to avoid an ‘accounting choice’ developing in practice, acknowledging that both measurement approaches would need to be used to identify which was more reliably determinable.
- BC19 Therefore the IFRIC decided to modify the proposal in D25 and identify a preferred measurement basis. In identifying this preferred measurement basis, the IFRIC noted that many respondents considered that the principles in IFRS 2 and the *Framework* referred to in paragraph BC16 support a measurement based on the fair value of the liability extinguished.
- BC20 However, some respondents argued that the fair value of the equity issued should be the proposed measurement basis. They noted that this approach would be consistent with the consensus that the issue of an entity’s equity instruments is consideration paid in accordance with paragraph 41 of IAS 39. They also considered that the fair value of the equity issued best reflects the total amount of consideration paid in the transaction, which may include a premium that the creditor requires to renegotiate the terms of the financial liability.
- BC21 The IFRIC considered that the fair value of the equity issued should be the proposed measurement basis for the reasons described in paragraph BC20. Consequently the IFRIC concluded that an entity should initially measure equity instruments issued to a creditor to extinguish all or part of a financial liability at the fair value of the equity instruments issued, unless that fair value is not reliably determinable. If the fair value of the equity instruments issued is not reliably determinable then these equity instruments should initially be measured to reflect the fair value of the liability extinguished.
- BC22 In redeliberations, the IFRIC noted that these transactions often occur in situations when the terms of the financial liability are breached and the liability becomes repayable on demand. The IFRIC agreed with comments received that paragraph 49 of IAS 39 is not applied in measuring the fair value of all or part of a financial liability extinguished in these situations. This is because the extinguishment transaction suggests that the demand feature is no longer substantive.
- BC23 In response to comments, the IFRIC also clarified that the equity instruments issued shall be initially measured when the financial liability (or part of that liability) is extinguished. This is consistent with BC341 and BC342 of IFRS 3 which discusses the views on whether equity instruments issued as consideration in a business combination should be measured at fair value at the agreement date or acquisition date, concluding that measurement shall be at the acquisition date.

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

- BC24 In accordance with paragraph 41 of IAS 39, the entity should 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. This requirement is consistent with the *Framework*'s discussion of income:
- (a) Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or *decreases of liabilities that result in increases in equity*, other than those relating to contributions from equity participants. (paragraph 70(a)) (emphasis added)
 - (b) Gains represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of an entity. Gains represent increases in economic benefits ... (paragraph 75)
 - (c) Income may also result from the settlement of liabilities. For example, an entity may provide goods and services to a lender in settlement of an obligation to repay an outstanding loan. (paragraph 77)

Full extinguishment

- BC25 The IFRIC noted that, as discussed in paragraph BC13, a transaction in which an entity issues equity instruments to extinguish a liability can be analysed as first, the issue of new equity instruments to the creditor for cash and second, the creditor accepting payment of that amount of cash to extinguish the financial liability. Consistent with paragraph BC24, when the creditor accepts cash to extinguish the liability, the entity should recognise a gain or loss in profit or loss.
- BC26 Similarly, the IFRIC noted that, in accordance with IAS 32, when an entity amends the terms of a convertible instrument to induce early conversion, the entity recognises in profit or loss the fair value of any additional consideration paid to the holder. Thus, the IFRIC concluded that when an entity settles an instrument by issuing its own equity instruments and that settlement is not in accordance with the original terms of the contract, the entity should recognise a gain or loss in profit or loss.
- BC27 As a result of its conclusions, the IFRIC decided that the entity should recognise a gain or loss in profit or loss. This gain or loss is equal to the difference between the carrying amount of the financial liability and the fair value of the equity instruments issued, or fair value of the liability extinguished if the fair value of the equity instruments issued is not reliably determinable.

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Partial extinguishment

- BC28 The IFRIC also observed that the restructuring of a financial liability can involve both the partial settlement of the liability by the issue of equity instruments to the creditor and the modification of the terms of the liability that remains outstanding. Therefore, the IFRIC decided that the Interpretation should also apply to partial extinguishments. In the case of a partial extinguishment, the discussion in paragraphs BC25-BC27 applies to the part of the liability extinguished.
- BC29 Many respondents requested clarification of the guidance on partial extinguishment included in D25. During its redeliberations, the IFRIC acknowledged 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.
- BC30 The IFRIC decided that to reflect this, an entity should allocate the consideration paid between the part of the liability extinguished and the part of the liability that remains outstanding. The entity would consider this allocation in determining the profit or loss to be recognised on the part of the liability extinguished and in its assessment of whether the terms of the remaining liability have been substantially modified.
- BC31 The IFRIC concluded that providing additional guidance on determining whether the part of the financial liability that remains outstanding has been substantially modified in accordance with paragraph 40 of IAS 39 is outside of the scope of this Interpretation.

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Presentation

BC32 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. This requirement is consistent with the *Framework* and the requirements in other IFRSs, for example:

- (a) When gains are recognised in the income statement, they are usually displayed separately because knowledge of them is useful for the purpose of making economic decisions. (paragraph 76 of the *Framework*)
- (b) An entity shall present additional line items, headings and subtotals in the statement of comprehensive income and the separate income statement (if presented), when such presentation is relevant to an understanding of the entity's financial performance. (paragraph 85 of IAS 1)
- (c) An entity shall disclose net gains or net losses on financial liabilities either in the statement of comprehensive income or in the notes. (paragraph 20 of IFRS 7)

Transition

BC33 The IFRIC decided that the Interpretation should be applied retrospectively even though it acknowledged that determining fair values retrospectively may be problematic. The IFRIC noted that IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides guidance on circumstances in which retrospective application might be impracticable. The IFRIC concluded that it was preferable to require entities that could apply the Interpretation retrospectively to do so, rather than requiring all entities to apply it prospectively to future transactions. However, to simplify transition, the IFRIC also concluded that it should require retrospective application only from the beginning of the earliest comparative period presented because application to earlier periods would result only in a reclassification of amounts within equity.

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Summary of main changes from the draft Interpretation

BC34 The main changes from the IFRIC's proposals in D25 are as follows:

- (a) Paragraph 3 was added because the IFRIC identified specific transactions that are outside of the scope of the Interpretation.
- (b) Paragraph 6 was modified to state that measurement should be based on the fair value of the equity instruments issued, unless that fair value is not reliably determinable.
- (c) Paragraph 7 was added to reflect the modification to paragraph 6. It also clarifies the intention of the IFRIC that in measuring the fair value of a financial liability extinguished that includes a demand feature (eg a demand deposit), paragraph 49 of IAS 39 is not applied.
- (d) Paragraph 8 was added, and paragraph 10 was modified, to clarify how the Interpretation should be applied, when only part of the financial liability is extinguished by the issue of equity instruments.
- (e) Paragraph 9 was modified to state when the equity instruments issued shall be initially measured.