EFRAG

European Financial Reporting Advisory Group

The costs and benefits of implementing IFRIC Interpretation 19 *Extinguishing Financial Liabilities with Equity Instruments*

Introduction

1 Following discussions between the various parties involved in the EU endorsement process, the European Commission decided in 2007 that more extensive information than hitherto needs to be gathered on the costs and benefits of all new or revised Standards and Interpretations as part of the endorsement process. It has further been agreed that EFRAG will gather that information in the case of IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments.*

2 EFRAG first considered how extensive the work would need to be. For some Standards or Interpretations, it might be necessary to carry out some fairly extensive work in order to understand fully the cost and benefit implications of the Standard or Interpretation being assessed. However, in the case of IFRIC 19, EFRAG's view is that the cost and benefit implications can be assessed by carrying out a more modest amount of work. (The results of the consultations EFRAG has carried out seem to confirm this.) Therefore, as explained more fully in the main sections of the report, the approach EFRAG has adopted has been to carry out detailed initial assessments of the likely costs and benefits of implementing IFRIC 19 in the EU, to consult on the results of those initial assessments, and to finalise those assessments in the light of the comments received.

EFRAG's endorsement advice

3 EFRAG also carries out a technical assessment of all new and revised Standards and Interpretations issued by the IASB and IFRIC against the so-called endorsement criteria and provides the results of those technical assessments to the European Commission in the form of recommendations as to whether or not the Standard or Interpretation assessed should be endorsed for use in the EU. As part of those technical assessments, EFRAG gives consideration to the costs and benefits that would arise from implementing the new or revised Standard or Interpretation in the EU. EFRAG has therefore taken the conclusion at the end of this report into account in finalising its endorsement advice.

A summary of IFRIC 19

4 Entities assume and settle financial liabilities as a normal function of financing activities. Financial liabilities are settled in accordance with terms and conditions set at its inception, normally in cash. However, in times of financial difficulty an entity may not be able to settle its financial liabilities in accordance with the original terms of the liability. In such instances, entities often renegotiate the terms to allow settlement through the issue of their own equity instruments.

5 IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments* provides guidance on how a debtor should account for its equity instruments issued in full or partial settlement of a financial liability following renegotiation of the terms of the liability, sometimes referred to as a 'debt-for-equity swap'.

6 IFRIC 19 concludes that equity instruments issued to extinguish a financial liability should be treated as 'consideration paid' and shall be measured at their fair value as determined on the date when the financial liability is extinguished. However, IFRIC 19 acknowledges that in some cases entities might be unable to measure equity instruments reliably. In that case, IFRIC 19 states that the fair value of the financial liability extinguished will serve as a proxy.

7 IFRIC 19 further clarifies that 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 with the entity. If that is the case, 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 in making this allocation.

8 A gain or loss resulting from a debt-for-equity swap shall be recognised in profit or loss and presented as a separate line item in the statement of comprehensive income.

EFRAG's initial analysis of the costs and benefits of IFRIC 19

9 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users from implementing IFRIC 19, both in year one and in subsequent years. The results of EFRAG's initial assessment can be summarised as follows. The implementation in the EU of IFRIC 19 is likely to:

(a) involve some additional year one and little or no ongoing costs for some preparers. EFRAG's initial assessment is that, when considered in aggregate, those costs will not be significant;

(b) involve no year one or ongoing incremental costs for users; and

(c) result in an improvement in the comparability, and therefore the quality, of the information provided and thus bring benefits to users.

10 EFRAG published its initial assessment and supporting analysis on 14 December 2009. It invited comments on the material by 20 January 2010. In response, EFRAG received five comment letters. Two respondents agreed with EFRAG's assessment of the benefits of implementing IFRIC 19 and the associated costs involved for users and preparers. The other three respondents did not comment specifically on EFRAG's initial assessment of the costs and benefits of implementing IFRIC 19 in the EU, but supported EFRAG's recommendation that IFRIC 19 be adopted for use in Europe.

EFRAG's final analysis of the costs and benefits of IFRIC 19

11 Based on its initial analysis and stakeholders' views on that analysis, EFRAG's detailed final analysis of the costs and benefits of IFRIC 19 is presented in the paragraphs below.

Costs for preparers

12 EFRAG's assessment is that IFRIC 19 will not involve preparers in incremental year one costs, except for those who have to change their existing practice. These preparers will incur what EFRAG understands to be insignificant year one costs to amend their procedures and apply the amendment retrospectively.

13 In addition, preparers would have had to measure these transactions at fair value and the Interpretation only clarifies which instrument's fair value should be used. To this extent preparers are unlikely to incur any significant incremental year one or ongoing costs.

14 In summary, EFRAG's assessment is that IFRIC 19 will result in some incremental year one costs for some preparers and little or no ongoing costs.

Costs for users

15 EFRAG is not aware of any aspect of IFRIC 19 that is likely to increase the costs users will incur in analysing the financial statements as a result of its adoption.

Benefit for preparers and users

16 In EFRAG's view, IFRIC 19 will enhance the comparability of the information provided by eliminating some of the uncertainty that currently exists about the application of existing IFRS. It is expected that this will result in a reduction in the diversity of current practice.

Conclusion

17 Summarising the comments above, EFRAG's assessment is that IFRIC 19 is likely to:

(a) involve some additional year one and little or no ongoing costs for some preparers. EFRAG's assessment is that, when considered in aggregate, those costs will not be significant;

(b) involve no year one or ongoing incremental costs for users; and

(c) result in an improvement in the comparability, and therefore the quality, of the information provided and thus bring benefits to users.

18 EFRAG's assessment is that the benefits to be derived from adopting IFRIC 19 are likely to outweigh the costs involved.

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