Accounting Standards Board

Aldwych House, 71-91 Aldwych, London WC2B 4HN
Telephone: 020 7492 2300 Fax: 020 7492 2399
www.frc.org.uk/asb

European Financial Reporting Advisory Group
35 Square de Meeûs
B-1000
Brussels

1 October 2009

Dear Stig

IFRIC Draft Interpretation D25: 'Extinguishing Financial Liabilities with Equity Instruments'

I am writing to give the views of the Accounting Standards Boards Urgent Issues Task Force (UITF) on draft comment letter to IFRIC D25 'Extinguishing Financial Liabilities with Equity Instruments'.

The UITF has considered the draft comment letter and is in agreement with the matters raised and specifically that equity instruments issued should be measured at the fair value of the financial liability extinguished. Whilst in agreement with the view expressed by EFRAG the UITF applied a different analysis in determine how the equity instrument issued in consideration for the extinguishment of debt should be measured. The UITF also considers that in order to determine the value of the liability it may be necessary to make reference to the value of the equity issued.

I am enclosing a copy of the UITF's response to the IFRIC, which sets out the UITF reasoning.

Should you have any questions please do not hesitate to contact either myself or Michelle Crisp.

Yours sincerely

Ian Mackintosh
Chairman
DDI: 020 7492 2440
Email: i.mackintosh@frc-asb.org.uk

Accounting Standards Board
Aldwych House, 71-91 Aldwych, London WC2B 4HN
Telephone: 020 7492 2300 Fax: 020 7492 2399
www.frc.org.uk/asb

Robert Garnett
Chairman
International Financial Reporting Interpretations Committee
30 Cannon Street
London EC4M 6XH

1 October 2009

Dear Bob

IFRIC Draft Interpretation D25: 'Extinguishing Financial Liabilities with Equity Instruments'

I am writing to give the views of the Accounting Standards Boards Urgent Issues Task Force (UITF) on IFRIC D25 'Extinguishing Financial Liabilities with Equity Instruments'.

The UITF has considered the guidance provided in the draft Interpretation and supports the IFRIC in its decision to issue an Interpretation on this matter. The UITF agrees that there is diversity in practice and acknowledges that in the present economic climate such guidance will be useful.

The UITF considers that the most significant issue addressed in D25 is measurement of the equity instrument issued in consideration for the extinguishment of debt. Following detailed review of the proposals in D25 the UITF, on a majority basis, decided the equity instruments issued should be measured at the fair value of the financial liability extinguished and in order to determine the value of the liability it may be necessary to make reference to the value of the equity issued. Consequently, the UITF does not support the proposal in paragraph 5 of D25. The UITF has set out the reasoning in forming this view in Appendix to this letter.

In addition to the above matter the UITF also considered a number of other areas where in its view that the draft Interpretation could be improved. Details of these areas are also set out in Appendix to this letter.

Should you have any questions please do not hesitate to contact either myself of Michelle Sansom.

Yours sincerely

Ian Mackintosh
Chairman
DDI: 020 7492 2440
Email: i.mackintosh@frc-asb.org.uk

IFRIC Draft Interpretation D25 'Extinguishing Financial Liabilities with Equity Instruments'

Appendix – UITF recommendations

Section 1: Significant matters

Measurement of equity instruments issued to a creditor to extinguish a financial liability

1. As noted in the covering letter the UITF considers that the measurement of equity instruments issued to a creditor to extinguish a financial liability is the most significant issued addressed in the draft Interpretation. The UITF is of the view that the equity instruments issued should be measured by reference to the fair value of the debt extinguished.

2. In forming this view the UITF noted the view put forward by the IFRIC in paragraph BC10 of D25, namely that the issue of equity instruments to extinguish a financial liability could be analysed as consisting of two transactions – first the issue of a new equity instrument to the creditor for cash and second, the creditor accepting payment of that amount of cash to extinguish the financial liability. The UITF considers the core issue is the extinguishment of the liability and it is the gain or loss on derecognition of the liability that needs to be reported. Consequently the UITF is of the view that the measurement of the equity instruments issued should be derived from the value of the liability extinguished in accordance with paragraph 40 of IAS 39 'Financial Instruments: Measurement'.

3. In forming this view the UITF noted that:

   a. IFRS 7 'Financial Instruments: Disclosures' accepted that the fair value of a financial liability was measureable; paragraph 25 of IFRS 7 requires disclosure of each class of financial assets and financial liabilities in a way that permits comparison with its carrying amount; and

   b. IFRS 2 'Share-based Payments' requires the value of share-based payments by reference to the goods and services received, if the entity cannot estimate the reliably the fair value of goods or services received, only then is the entity required to measure by reference to the fair value of equity instruments granted.

4. In forming its view the UITF noted that the transaction to extinguish the debt with equity may itself change the values of any remaining the debt and the equity issued. The fair value of the debt needs to be struck immediately before the transaction was entered into. However, since any equity instruments issued only have a value after they have been issued their fair value can only be determined immediately after the transaction although in many cases it might not be possible to determine a reliable fair value. The UITF noted that in determining the fair value of debt being extinguished the fair value of the equity issued had to be considered.

5. The UITF also noted that there is an interaction between the provisions in IAS 39 and IFRIC 8 'Scope of IFRS 2', see paragraph 16(c).

6. The UITF is also concerned in relation paragraph 5 of the draft Interpretation which requires equity instruments issued to a creditor in extinguishment of the debt to be measured at the fair value of the equity instruments issued or the fair value of the liability extinguished, whichever is more reliably determinable. The UITF considers it may be difficult in practice to determine which of the measures can more reliably be measured and hence envisages possible application difficulties with the proposal as set out in the draft Interpretation.

7. In addition the UITF is concerned about the use of a 'reliability criterion' being introduced into international financial reporting standards. The UITF noted the more usual test is to permit an alternative measure only where a preferred measure cannot be reliably determined.

8. In summary the UITF does not support paragraph 5 of the draft consensus and considers it should require equity instruments issued to a creditor to extinguish all or part of a financial liability at the fair value of the liability extinguished. In order to determine the value of the liability it may be necessary to make reference to the value of the equity issued.

9. The UITF considers that the basis for conclusion should set out the reasoning being that derecognition principles in IAS 39 are applied and the value of the equity is derived from derecognition of the liability.

Scope of the draft Interpretation

10. The second matter the UITF wishes to bring to the IFRIC's attention relates to the scope of the draft Interpretation.

11. Paragraph 2 of the draft Interpretation states that interpretation addresses only the accounting by an entity that renegotiates the terms of a financial liability

and issues equity instruments to the creditor to extinguish the liability fully or partially. The application of draft interpretation is therefore limited only to circumstances where there is a renegotiation of the terms of a financial liability.

12. The UITF considers that application of the Interpretation should not be restricted to circumstances only where there is a renegotiation. In its view the Interpretation should apply 'other than where conversion of debt to equity is predetermined'.

13. In UITF also considers it would be helpful if the basis for conclusions discusses the scope of the Interpretation because of the different accounting that arises where conversion is predetermined compared to that proposed in D25. IAS 32 'Financial Instruments: Presentation' sets out the accounting for compound financial instruments which is substantially different from the proposals in the draft Interpretation in that it is accounted for at the carrying amount of the liability not its fair value. Whilst the UITF does not disagree with the recognition and presentation proposals, as set out in D25, it considers a discussion regarding the different accounting could be usefully included in the basis for conclusions to the Interpretation.

14. The UITF also considers that paragraph BC6 of the basis for conclusions requires clarification. The UITF does not consider that BC6 clearly identifies if common control transactions are within the scope of the draft Interpretation or not. Currently BC6 states that the IFRIC concluded the proposed Interpretation should not address transactions in which the creditor is also a shareholder as this is a matter of judgement.

15. The UITF noted that a similar issue is addressed in paragraph 4 of IFRS 2 'Shared-based Payments'. IFRS 2 provides that transactions with employees in his/her capacity as a holder of equity instruments of the entity is not a share-based payment transaction. The UITF considers that similar wording could be used in the Interpretation to clarify when common control transactions are within the scope of the Interpretation.

Section 2: Other matters

16. In addition to the above matters the UITF also has some drafting suggestions relating primarily to the Basis for Conclusions:

    (a) Paragraph BC16 states that "renegotiating a financial liability to permit it to be extinguished by the issue of equity instruments is always a substantial modification of the terms of the financial liability." The UITF considers that this statement should be included in the in the Interpretation rather than the basis for conclusions. The positioning of guidance of this kind is particularly important in the EU because the basis for conclusions is not part of the material that is considered for endorsement.

    (b) Paragraph BC13 implies that IFRS 2 and IFRS 3 apply the same principles when in fact they are different, and potentially conflicting principles (either the residual approach that translates to measuring the equity instruments at the fair value of the financial liability or measuring the instruments at the fair value of the equity at the date of issuance). The UITF considers these paragraphs require further attention.

    (c) The UITF also considers it would be useful if the basis for conclusions discussed the relationship with the proposals in the draft Interpretation and the requirements set out in IFRIC 8 'Scope of IFRS 2 Share-based Payments'. The UITF considers that it is possible that certain transactions within the scope of the draft Interpretation also fall within the scope of IFRIC 8.