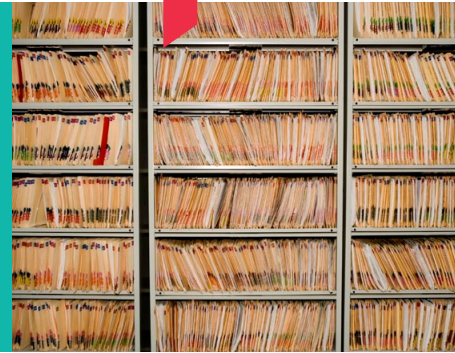


INTERNATIONAL FINANCIAL REPORTING BULLETIN 2010/03

IFRIC 19 EXTINGUISHING FINANCIAL LIABILITIES WITH EQUITY INSTRUMENTS



Background

The International Financial Reporting Interpretations Committee (IFRIC) has published IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments* (IFRIC 19). IFRIC 19 applies where an entity renegotiates the terms of a financial liability and as a result, issues its own equity instruments to the creditor to settle all or a part of the financial liability. Such situations are commonly referred to as debt for equity swaps.

IFRIC 19 clarifies how such transactions are accounted for under IFRSs, and is aimed at eliminating diversity in practice. Some entities have recognised equity instruments issued at the carrying amount of the debt extinguished, with no gain or loss recognised in profit or loss. Others did recognise a gain or loss but some recognised the equity instruments issued at the fair value of the debt extinguished and others at the fair value of the equity instruments issued.

IFRIC 19 does not apply to transactions in situations where:

- (i) the creditor is also a direct or indirect shareholder and is acting in this capacity;
- (ii) the entity and creditor are controlled by the same party or parties before and after the transaction and the substance of the transaction includes equity distributions by, or contributions to the entity; and
- (iii) extinguishing the financial liability by issuing equity is in accordance with the original terms of the financial liability.

Situations (i) and (ii) have been excluded from the scope of the IFRIC as judgement will be required in determining whether the transaction constitutes a transaction with shareholders in their capacity as such.

Requirements

When an entity issues its own equity instruments to a creditor to settle a financial liability (in whole or in part), as a result of renegotiating the terms of that financial liability, the equity instruments issued are the 'consideration paid'. The equity instruments are recognised initially and measured at their fair value on the date the financial liability (or part thereof) is extinguished. The difference between the carrying amount of the financial liability (or part thereof) extinguished and the consideration paid is recognised in profit or loss. The amount recognised in profit or loss is disclosed either as a separate line item, or in the notes.

If the fair value of the equity instruments issued cannot be reliably measured, then the equity instruments are measured to reflect the fair value of the liability extinguished. If the financial liability includes a demand feature, paragraph 49 of IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39) which states that the fair value of a financial liability with a demand feature cannot be less than the amount payable on demand, is not applied when measuring the fair value of the financial liability. It was noted that debt for equity swaps often take place when the terms of a financial liability have been breached, often meaning it is payable on demand. However, it was considered that in the circumstances of a debt for equity swap, the demand feature is no longer substantive.

STATUS


Final

EFFECTIVE DATE

Annual periods beginning on or after 1 July 2010
Earlier application permitted.

ACCOUNTING IMPACT

Clarifies accounting for the renegotiation of the terms of a financial liability that results in the debtor extinguishing all or part of the liability by issuing its own equity instruments to the creditor.



When only part of a financial liability is extinguished, an entity is required to assess whether some of the consideration paid relates to a modification of the terms of the liability that remains outstanding. If this is determined to be the case, an entity allocates the consideration paid between the part of the liability that was extinguished and the part that remains outstanding. All relevant facts and circumstances relating to the transaction are required to be considered when making this allocation.

In addition, the consideration allocated to the remaining liability forms part of an assessment that then needs to be carried out to determine whether the terms of the remaining liability have been 'substantially modified' (see IAS 39.40 and IAS 39.AG62). If it is determined that the remaining liability has been substantially modified then the modification is accounted for as an extinguishment of the original liability and the recognition of a new liability.

Effective date

The effective date of IFRIC 19 is annual periods beginning on or after 1 July 2010. Earlier application is permitted. If IFRIC 19 is applied for a period beginning before 1 July 2010 that fact is required to be disclosed. In addition, a change in accounting policy is applied in accordance with IAS 8 (i.e. full retrospective application) from the beginning of the earliest comparative period presented.

For entities reporting in accordance with EU-endorsed IFRSs, IFRIC 19 has not yet received EU endorsement and this might be taken to mean that it cannot currently be applied. However, as IFRIC 19 is an interpretation of existing IFRS guidance, an entity applying EU endorsed IFRSs could apply the requirements of an IFRIC prior to endorsement. If an entity reporting in accordance with EU-endorsed IFRSs did adopt the requirements of IFRIC 19 before it is endorsed, it would not be able to take advantage of the transitional relief in IFRIC 19 that does not require restatement for transactions that took place before the start of the earliest comparative period presented in the financial statements for the annual period in which IFRIC 19 is adopted for the first time,

Amendments to other standards

The interpretation also includes an amendment to IFRS 1 to allow first time adopters to apply the transitional provisions in IFRIC 19.

Action required

Entities that have recently renegotiated, are currently renegotiating or are expecting to renegotiate any of their financial liabilities and have issued or expect to issue equity instruments to extinguish all or part of the liability should assess the affect of IFRIC 19. A review of tax consequences may also be appropriate in advance of finalising any arrangements.

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