

International Accounting Standards Board
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IFRIC Draft Interpretation D25 Extinguishing Financial Liabilities with Equity Instruments

Grant Thornton International is pleased to comment on the International Financial Reporting Interpretations Committee's Draft Interpretation D25 *Extinguishing Financial Liabilities with Equity Instruments* (D25). We have considered D25 along with the accompanying draft Basis for Conclusions and set out our comments below.

We agree that IFRS does not provide specific guidance on accounting for transactions in which an entity issues its own equity instruments to extinguish all or part of a financial liability. We also believe there is significant diversity in the accounting for such transactions in practice. Accordingly we support IFRIC's efforts to develop guidance in this area.

We agree with the broad thrust of the proposed Interpretation although we have reservations over the proposed measurement of the equity instruments issued. We discuss these thoughts below together with some comments on a number of other detailed matters.

Support for treating the issue of equity instruments as consideration paid
We support D25's proposed consensus that 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 *Financial Instruments: Recognition and Measurement* (IAS 39.41).

Although we support the proposed consensus, we note that various counter-arguments can be made in support of a different approach. For example, normal practice in accounting for a share issue in exchange for cash is to record the issue at the proceeds received rather than the fair value of the shares issued. The definitions of income and expense in the *Framework for the Preparation and Presentation of Financial Statements* also exclude transactions with shareholders. On balance, however, we are of the view that the arguments presented in favour of the IAS 39.41 approach by IFRIC are stronger and provide more relevant information to the users of the accounts.

Concern over the proposed measurement of equity instruments issued
D25 proposes that the equity instruments issued are measured at either their fair value or at the fair value of the liability extinguished, whichever is more reliably determinable. We do not support this approach. We believe that in many cases there will be no robust basis for deciding which measurement is more reliably determinable. D25's proposal will then create operational difficulties and may amount to a de facto accounting policy choice.

Instead, we believe that the IFRIC should decide which measurement approach is preferable from a conceptual and decision-usefulness standpoint, and require its use. We do recognise this is not straightforward, as discussed in paragraph BC12 in D25's draft Basis for Conclusions. Indeed, there are mixed views within our organisation on how the equity instruments issued should be measured.

While acknowledging this diversity of views, our preference is for the equity instruments to be measured at their fair value. This is because IFRIC has based D25's approach on the shares issued being 'consideration paid' for the purpose of IAS 39.41. In our view, the corollary of this is that the measurement of the consideration should be based on the fair value of what is paid, ie the equity instruments issued. We also believe that this approach is more intuitive and will therefore lead to more understandable information.

Under our preferred view, we do not perceive a need for an alternative of using the fair value of the liability extinguished in particular circumstances. We believe it is invariably possible to measure the equity instruments on a sufficiently reliable basis. This approach will reduce the diversity in practice referred to in paragraph BC3 of D25. It will also lead to a simpler Interpretation and avoid any need to make two different measurements in order to decide which is the more reliable.

Should IFRIC decide that measurement based on the liability is preferable from a conceptual and decision-usefulness standpoint, we agree that it may be difficult to reliably measure the fair value of the liability in the context of a restructuring. Accordingly, a practical expedient of measuring the fair value of the equity instruments may be viewed as necessary (although we are not entirely convinced of this). If the IFRIC decides that an alternative of measuring the equity instruments is needed in some circumstances, we suggest that this should be limited to cases in which the liability's fair value cannot be estimated reliably. Such an approach would also be more consistent with the principles of IFRS 2 *Share-based Payment*.

Our suggestion would be to reword D25.5 as follows:

An entity shall initially measure equity instruments issued to a creditor to extinguish all or part of a financial liability directly at the fair value of the liability extinguished, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the liability extinguished, the entity shall measure its value, indirectly, by reference to the fair value of the equity instruments issued.

Scope of the proposed Interpretation

We also have some concerns over the scope of the proposed Interpretation.

Paragraph BC6 of D25 states that IFRIC concluded that the proposed Interpretation should not address transactions with owners in their capacity as owners. If this is indeed the Board's intention, we believe that the exclusion should be reflected in the scope of the proposed Interpretation as well as the Basis for Conclusions. We also believe that the reason for the scope exclusion needs to be more clearly explained in the Basis for Conclusions.

Other matters

Determining whether a transaction is in an 'owner capacity'

We note that there is little guidance within IFRS on when a transaction is with an owner in its capacity as an owner. There are references to this issue in IFRS 2 and the recent Exposure Draft *Classification of Rights Issues*, while D25 refers to the issue in another context. We believe that determining whether or not a transaction is in an 'owner capacity' can be difficult in

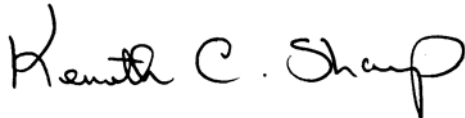
practice. We suggest then that this issue should be referred to the IASB to develop guidance.

Interaction of the proposed consensus with IAS 39.49

We note that where equity instruments issued to extinguish a financial liability are measured at the fair value of the liability extinguished, the accounting under the proposed consensus will be affected by IAS 39.49 in those relatively rare circumstances where the liability has a demand feature. IFRIC may wish to consider whether a suitable accounting outcome will be achieved in such situations.

If you have any questions on our response, or wish us to amplify our comments, please contact our Executive Director of International Financial Reporting, Andrew Watchman (andrew.watchman@gtuk.com or telephone + 44 207 391 9510).

Yours sincerely,

A handwritten signature in black ink that reads "Kenneth C. Sharp". The signature is written in a cursive, slightly stylized font.

Kenneth C Sharp
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