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Mr. Robert Garnett
Chairman
International Financial Reporting Interpretations Committee
30 Cannon Street
London
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Email: ifric@iasb.org

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Dear Mr. Garnett,

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

Deloitte Touche Tohmatsu is pleased to comment on the International Financial Reporting Interpretations Committee's (the IFRIC's) Draft Interpretation D25 *Extinguishing Financial Liabilities with Equity Instruments* (referred to as the 'Interpretation').

We agree with the consensus reached by the IFRIC as expressed in the Interpretation. Specifically, we agree that an entity's equity instruments are 'consideration paid', and the extinguishment shall be determined at fair value, with any difference in the carrying value and fair value of the liability extinguished recognised in profit or loss. Our other comments are limited to the following:

- We do not believe the Interpretation is the appropriate means for introducing new disclosure requirements on derecognition. Specifically, paragraph 8 of the Interpretation requires an entity to disclose separately the gain or loss on extinguishment of the financial liability either as a separate line item in the statement of comprehensive income and the separate income statement (if presented) or in the notes. While we acknowledge this information may be informative, it would already be required to be disclosed in accordance with IAS 1.85 if material and relevant to the understanding of the entity's financial performance. The introduction of new disclosures for derecognition of financial liabilities (whether arising from the issue of equity instruments or not) should be considered as part of the Board's wider deliberations on the Exposure Draft, *Derecognition*, and its consequential amendments to IFRS 7 *Financial Instruments: Disclosure* or introduced through *Improvements to IFRSs*.

- Paragraph 5 of the Interpretation requires the extinguishment of the financial liability at the fair value of the equity instruments issued or the fair value of the liability extinguished, whichever is more readily determinable. We believe this is a practical expedient which should only apply in certain scenarios where it is clear that the exchange is an arm's length transaction, there is no other consideration paid other than the issue of

equity instruments, and no part of the consideration is for something other than the debt extinguished. We consider the principle should be expressed differently:

The extinguishment of a financial liability shall be recognised at its fair value. Equity instruments issued as consideration to extinguish the financial liability as well as other forms of consideration paid shall also be recognised at their fair value. Other forms of consideration may include a distribution or contribution in the case where the creditor is also a direct or indirect shareholder of the entity. In the case where the extinguishment is an arm's length transaction, the only form of consideration paid is the issue of equity instruments, and no part of the consideration is for something other than the debt extinguished (e.g. favourable terms on any remaining outstanding debt) an entity shall initially measure the equity instruments issued at the fair value of the equity instruments issued or the fair value of the financial liability extinguished, whichever is more readily obtainable.

We believe this proposed wording makes clear that the gain/loss on derecognition of the financial liability should equal the difference between the carrying amount of the financial liability and its fair value. In addition, the wording ensures that to the extent the creditor is a shareholder and the value of the total consideration paid differs to the fair value of the liability extinguished or the equity instruments issued then the accounting should reflect this (e.g. by recognising a distribution or contribution). Paragraph BC6 as currently drafted could imply that the amount of the gain/loss on extinguishment of the financial liability will differ depending whether the creditor is a shareholder which we do not believe should be the case. Our proposed wording would ensure the following treatment in the various scenarios illustrated below:

		Scenario	
	A	B	C
Carrying amount of liability (amortised cost)	100	100	100
Fair value of liability	60	60	60
Gain recognised in profit or loss	40	40	40
Fair value of equity	60	40	80
Contribution (distribution)	Nil	20	(20)

- IAS 39.49 requires that a financial liability with a demand feature shall be recognised at the amount payable on demand, discounted from the first date that the amount could be required to be paid. Many debt for equity swaps arise where the issuer is in financial difficulty, often when there has been a breach of covenant and the terms of the financial liability then become repayable on demand. Clarity is needed whether in such circumstances IAS 39.49 would require the entity to derecognise the financial liability at its fair value that excludes non-performance risk as indicated by IAS 39.49. Such an interpretation would result in the fair value always equaling the repayable amount (being its amortised cost) thereby not resulting in any gain/loss on derecognition, because the gain or loss would be calculated based on the fair value of the debt extinguished (rather than the equity issued).

- Paragraph 7 of the Interpretation states that "… the entity also assesses the terms of the financial liability that remains outstanding to determine whether they are substantially different from those of the original liability." It is unclear how this test is performed. For example, a financial liability may be partly extinguished by the issue of equity instruments and a concurrent adjustment to the coupon/principal on the original liability. Two approaches in performing the '10% test' are potentially possible:

Approach 1: present value the cash flows of the *original entire* financial liability immediately prior to the restructuring discounted by the original EIR compared to the present value of the cash flows of the *revised* financial liability discounted by the original EIR *plus the fair value* of the equity instruments issued.

Approach 2: present value the cash flows of the *original* financial liability immediately following extinguishment of part of the original liability arising from the issuance of equity instruments discounted by the original EIR compared to the present value of the cash flows of the *revised* financial liability discounted by the original EIR.

It is noted that Approach 1 and 2 can result in different conclusions as to whether the original and revised financial liability are substantially different. We favour Approach 1 as Approach 2 has the disadvantage of having to firstly determine how much of the original financial liability has been extinguished by the issue of equity instruments which is problematic to indentify in isolation when there is a concurrent adjustment to the terms of the original financial liability.

In addition, irrespective of which approach above is applied, if the 10% test concludes the original liability is not substantially modified, guidance is required as to what method an entity should apply in determining how much of the carrying amount of the liability should continue to be recognised. For example, whether the entity should apply a relative fair value method that derecognises the proportion of the original liability whose fair value is equal to the fair value of the equity instruments issued.

- The Interpretation is not clear whether the issue of a compound instrument, i.e. an instrument that is part financial liability and part equity instrument, as extinguishment for a financial liability is in within the scope of the Interpretation. Clarification on this aspect in the final Interpretation would be beneficial.

If you have any questions concerning our comments, please contact Ken Wild in London at +44 (0)20 7007 0907.

Yours sincerely,

Ken Wild
Global IFRS Leader