DRSC e. V. • Zimmerstr. 30 • 10969 Berlin

Telefon +49 (0)30 206412-12
Telefax +49 (0)30 206412-15
E-Mail info@drsc.de

EFRAG
Stig Enevoldsen
13-14 Avenue des Arts
B-1210 Brussels
Belgique

Berlin, 18 January 2009

Dear Stig,

EFRAG's Assessment of
IFRIC 19 '*EXTINGUISHING FINANCIAL LIABILITIES WITH EQUITY INSTRUMENTS'*

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on EFRAG's Assessment of IFRIC 18 Extinguishing Financial Liabilities with Equity Instruments.

We agree with the views set out in the assessment. As a national standard-setter we are not in a position to answer the questions regarding the costs that will arise for preparers and for users to implement the amendment and the interpretation. We therefore sent your assessment-form to the DAX30 entities and got feedback form one company.

As attachment to this letter you will find our comments to the above mentioned assessment.

If you have any further questions, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr
President

Vorstandsausschuss:
Heinz-Joachim Neubürger (Vorsitzender), Prof. Dr. Helmut Perlet (Stellvertreter),
Prof. Dr. Rolf Nonnenmacher (Schatzmeister), Dr. Kurt Bock, Dr. Werner Brandt

EFRAG
European Financial Reporting Advisory Group

INVITATION TO COMMENT ON THE EFRAG'S ASSESSMENTS OF IFRIC 19 '*EXTINGUISHING FINANCIAL LIABILITIES WITH EQUITY INSTRUMENTS*'

Comments should be sent to commentletter@efrag.org or uploaded via our website by 20 January 2010

EFRAG has been asked by the European Commission to provide it with advice and supporting material on IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments* (IFRIC 19). In order to do that, EFRAG has been carrying out a technical assessment of IFRIC 19 against the criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that may arise from its implementation in the EU.

A summary of IFRIC 19 is set out in Appendix 1.

Before finalising its two assessments, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record unless the respondent requests confidentiality. In the interest of transparency EFRAG will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

1 Please provide the following details about yourself:

(a) Your name or, if you are responding on behalf of an organisation or company, its name:

German Accounting Standards Board (GASB)

(b) Are you/Is your organisation or company a:

☐ Preparer ☐ User ☒ Other (please specify)

Standard Setter

(c) Please provide a short description of your activity/ the general activity of your organisation or company:

N/A

(d) Country where you/your organisation or company is located:

Germany

(e) Contact details including e-mail address:

Liesel Knorr

Zimmerstrasse 30, 10969 Berlin, Germany

knorr@drsc.de

2 EFRAG's initial assessment of IFRIC 19 is that it meets the technical criteria for endorsement. In other words, it is not contrary to the true and fair principle and it meets the criteria of understandability, relevance, reliability and comparability. EFRAG's reasoning is set out in Appendix 2.

(a) Do you agree with this assessment?

☒ Yes ☐ No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

(b) Are there any issues that are not mentioned in Appendix 2 that you believe EFRAG should take into account in its technical evaluation of IFRIC 19? If there are, what are those issues and why do you believe they are relevant to the evaluation?

No.

3 EFRAG is also assessing the costs that will arise for preparers and for users to implement IFRIC 19, both in year one and in subsequent years. Some initial work has been carried out, and the responses to this Invitation to Comment will be used to complete the assessment.

The results of the initial assessment are set out in Appendix 3. To summarise, EFRAG's initial assessment (see Appendix 3, paragraph 7) is that IFRIC 19 is:

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

(b) likely to involve users in little or no year one or ongoing incremental costs.

Do you agree with this assessment?

☐ Yes ☐ No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be?

We as a national standard setter are not in a position to answer this question; however, in the feedback received from a DAX 30 company, they indicated that they agree with the assessment (they ticked "yes").

4 EFRAG's initial assessment is that IFRIC 19 is likely to result in improvements in the quality of the information provided. EFRAG's initial assessment is that the benefits to be derived from applying IFRIC 19 will exceed the costs involved (Appendix 3, paragraph 8).

Do you agree with this assessment?

☐ Yes ☐ No

If you do not, please explain why you do not and what you think the implications should be for EFRAG's endorsement advice?

We as a national standard setter are not in a position to answer this question; however, in the feedback received from a DAX 30 company, they indicated that they agree with the assessment (they ticked "yes").

5 EFRAG is not aware of any other factors that should be taken into account in reaching a decision as to what endorsement advice it should give the European Commission on IFRIC 19.

Do you agree that there are no other factors?

☒ Yes ☐ No

If you do not, please explain why you do not and what you think the implications should be for EFRAG's endorsement advice?

APPENDIX 1
A SUMMARY OF IFRIC 19

1 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.

2 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'.

3 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.

4 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.

5 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.

APPENDIX 2
EFRAG'S TECHNICAL ASSESSMENT OF IFRIC 19 AGAINST THE ENDORSEMENT CRITERIA

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity as a contributor to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as adviser to the European Commission on endorsement of the final IFRS or Interpretation on the issue.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the European endorsement criteria, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

1 When evaluating IFRIC 19, EFRAG asked itself four questions:

(a) Is there an issue that needs to be addressed?

(b) If there is an issue that needs to be addressed, is an Interpretation an appropriate way of addressing it?

(c) Is IFRIC 19 a correct interpretation of existing IFRS?

(d) Does the accounting that results from the application of the IFRIC meet the criteria for EU endorsement?

IS THERE AN ISSUE THAT NEEDS TO BE ADDRESSED?

2 EFRAG understands that at present there is diversity in practice as to how entities account for transfers where the terms of settlement of a financial liability are renegotiated to allow its settlement through the issue of an entity's own equity instruments. EFRAG agrees that this diversity is undesirable and is an issue that needs to be addressed.

IS AN INTERPRETATION AN APPROPRIATE WAY OF ADDRESSING IT?

3 An Interpretation is an appropriate way of addressing diversity in accounting practice if that diversity arises because of factors other than inconsistencies between IFRS. Furthermore, in EFRAG's view, Interpretations should not be used to address major issues.

4 EFRAG's assessment is that the diversity in practice that is the subject of IFRIC 19 falls into neither of these categories. As such, EFRAG has concluded that an Interpretation is an appropriate way of addressing the uncertainties relating to how an entity should account for debt-for-equity swaps.

IS IFRIC 19 A CORRECT INTERPRETATION OF EXISTING IFRS?

5 EFRAG has considered whether IFRIC 19 is a correct interpretation of existing IFRS literature. IFRIC 19 addresses three main issues relating to how a debtor

should account for its equity instruments issued either as full or partial settlement of a financial liability following renegotiation of the terms of the liability (a debt-for-equity swap):

(a) whether an entity's equity instruments issued in a debt-for-equity swap is 'consideration paid' in accordance with paragraph 41 of IAS 39 *Financial Instruments: Recognition and Measurement*;

(b) how an entity should measure the equity instruments issued in a debt-for-equity swap; and

(c) how an entity should account for any difference between the carrying amount of the financial liability extinguished and the amount of the 'consideration paid'?

Each of these issues is discussed below.

Are equity instruments issued 'consideration paid' in accordance with IAS 39?

6 IAS 39 in paragraph 41 requires that the difference between carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, shall be recognised in profit or loss. However, IAS 39 does not explicitly refer to equity instruments as a possible means of 'consideration paid'.

7 At the same time IFRS 2 *Share-based Payment*s and IFRS 3 *Business Combinations* make it clear that equity instruments are used as 'consideration paid' to acquire goods and services as well as to obtain control of businesses.

8 The Interpretation clarifies that the issuance of equity instruments to settle a financial liability is 'consideration paid' in accordance with paragraph 41 of IAS 39. EFRAG agrees with this conclusion.

How should an entity measure the equity instruments issued in a debt-for-equity swap?

9 The IFRIC notes that IFRS literature does not contain general principles for the initial recognition and measurement of equity instruments, but guidance on specific transactions exist including:

(a) *Initial recognition of compound instruments* (IAS32) – the equity component is the residual after deducting the fair value of the financial liability component from the fair value of the entire instrument;

(b) *Cost of equity transactions and own equity instruments acquired and reissued or cancelled* (IAS 32) – no gains or losses are recognised on such transactions;

(c) *Equity instruments issued in share-based payment transactions* (IFRS 2) – equity is measured at the fair value of the goods or services received, unless that fair value cannot be reliably estimated. Where the fair value of the goods and services received is lower than the fair value of the equity instruments issued an entity shall consider whether unidentifiable goods and services were received;

(d) *Consideration transferred in a business combination* (IFRS 3) – the total consideration transferred is measured at fair value including the acquisition-date fair values of any equity interests issued by the acquirer.

9 The IFRIC noted that measurement of the debt-for-equity swap at the fair value of equity instruments issued is in line with the consensus that the issue of an entity's equity instruments is consideration paid in accordance with paragraph 41 of IAS 39. Furthermore, the IFRIC considered that the fair value of the equity instruments issued best reflects the total amount of consideration paid in the transaction, which may include a premium that the creditor requires to renegotiate the terms of the financial liability. At the same time, the IFRIC acknowledged that practical difficulties might arise in measuring the fair value of equity instruments issued, especially in times of financial difficulties.

10 Taking into account the above, the IFRIC reached a consensus that the equity instruments issued in a debt-for-equity swap should be measured at their fair value. However, if the fair value of the equity instruments cannot be reliably measured, the equity instruments issued are measured at the fair value of the financial liability extinguished.

11 EFRAG agrees that this is an appropriate interpretation of existing IFRS.

How should an entity account for any gain or loss resulting from the debt-for-equity swap?

12 Paragraph 41 of IAS 39 state the entity should recognise a gain or loss in profit or loss for any difference between the carrying amount of the financial liability extinguished and the consideration paid. This is consistent with the Framework's discussion of income:

(a) Income is increases in economic benefits during the accounting period in the form of…decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants (paragraph 70(a))

(b) Gains represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of an entity. Gains represent increases in economic benefits (paragraph 75).

(c) Income may result from the settlement of liabilities (paragraph 77).

13 IFRIC 19 stipulates that a gain or loss resulting from a debt-for-equity swap shall be accounted for in profit or loss and presented as a separate line item in the statement of comprehensive income.

14 IFRIC 19 also requires that if a financial liability is only partially extinguished and the 'consideration paid' is for both the extinguishment of part of a financial liability and the modification of the terms of the part of the liability that remains outstanding, the entity needs to allocate the 'consideration paid' accordingly. The entity has to consider this allocation in determining the profit or loss to be recognised on the part of the liability extinguished.

15 EFRAG agrees with these conclusions.

DOES THE ACCOUNTING THAT RESULTS FROM THE APPLICATION OF IFRIC 19 MEET THE CRITERIA FOR EU ENDORSEMENT?

16 Having concluded that IFRIC 19 is an appropriate interpretation of existing IFRS, EFRAG asked itself whether it believed that the information resulting from the application of IFRIC 19 would meet the criteria for EU endorsement; in other words, that:

(a) it is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

(b) it meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG also considered whether it would be in the European interest to adopt the Interpretation.

Relevance

17 According to the Framework, information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations. EFRAG considered whether IFRIC 19 would result in the provision of relevant information – i.e. information that has predictive value, confirmatory value or both.

18 EFRAG is not aware of any reason to believe that some or all of the information that results from the application of IFRIC 19 is not relevant, or that IFRIC 19 results in relevant information being omitted. In EFRAG's view, IFRIC 19 merely seeks to achieve consistency in application of existing requirements that have been judged to meet the relevance criteria.

Reliability

19 EFRAG considered the reliability of the information that will be provided by applying IFRIC 19. The Framework explains that information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it purports to represent or could reasonably be expected to represent.

20 EFRAG notes that the IFRIC acknowledged that reliability concerns might arise in fair value measurement involved in accounting for debt-for-equity swaps because these transactions occur in instances of financial distress where conditions may create difficulty in determining the fair value of the equity instruments issued to extinguish the financial liability. To address such reliability concerns, IFRIC 19 requires that if the fair value of equity instruments issued cannot be estimated reliably, entities should measure equity instruments issued by measuring the financial liability extinguished at fair value. EFRAG considers that this is an appropriate way to deal with such reliability concerns.

21 EFRAG is therefore of the opinion that the information resulting from this interpretation will meet the reliability criterion.

Comparability

22 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

23 The IFRIC's objective in issuing IFRIC 19 was to eliminate the current diversity in practice in the accounting for debt-for-equity swaps. In EFRAG's view, IFRIC 19 achieves this objective and will provide information that is more comparable than hitherto.

24 Moreover, the transitional provisions of IFRIC 19 require that its requirements be applied retrospectively. EFRAG is supportive of such transitional provisions because retrospective application maintains the comparability of the information provided over time.

Understandability

25 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.

26 'Understandability' is achieved by satisfying other qualitative characteristics. Accordingly, EFRAG believes that most aspects are covered by the discussion above about relevance, reliability and comparability (because, for example, information that represents something as similar when it is in fact dissimilar is not comparable, and that lack of comparability will mean it is also not understandable). As a result, EFRAG believes that the main additional issue it needs to consider in assessing whether the information resulting from the application of IFRIC 19 is understandable is whether that information will be unduly complex. In EFRAG's view, IFRIC 19 does not introduce any new complexities.

True and Fair

27 For the reasons set out above, EFRAG see no reason to conclude that IFRIC 19 is inconsistent with the true and fair view requirement.

Cost and Benefit

28 EFRAG has considered whether the benefits of implementing IFRIC 19 in the EU exceed the cost of doing so. EFRAG's initial assessment (as explained more fully in Appendix 3) is that the benefits of implementing IFRIC 19 .outweigh the costs involved.

Conclusion

29 After considering all the above arguments, EFRAG has concluded that, on balance, IFRIC 19 satisfies the criteria for EU endorsement and that it is likely to be in the European interest to adopt IFRIC 19. Accordingly, EFRAG recommends its endorsement in Europe.

APPENDIX 3
EFRAG'S EVALUATION OF THE COSTS AND BENEFITS OF IFRIC 19

1 EFRAG has also considered whether, and if so to what extent, implementing IFRIC 19 in the EU might involve preparers or users incurring incremental costs, and whether those costs are likely to be exceeded by the benefits to be derived from its adoption.

Costs for preparers

2 EFRAG's initial 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.

3 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.

4 In summary, EFRAG's initial 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

5 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

6 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

7 Summarising the comments above, EFRAG's initial 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 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.

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