Hong Kong Institute of
Certified Public Accountants
香港會計師公會

HK(IFRIC) – Int 19 *Extinguishing Financial Liabilities with Equity Instruments*

HKICPA Standard Setting Department Staff Summary (March 2010)

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The HKICPA Standard Setting Department welcomes your comments and feedback, which should be sent to commentletters@hkicpa.org.hk.

Introduction

1. HK(IFRIC) – Int 19 *Extinguishing Financial Liabilities with Equity Instruments* clarifies the requirements of HKFRSs when an entity renegotiates the terms of a financial liability with its creditor and the creditor agrees to accept the entity's shares or other equity instruments to settle the financial liability fully or partially (that is, a "debt for equity swap").

2. The Interpretation does not apply to:

   (a) Transaction where the creditor is also a direct or indirect shareholder and is acting in such capacity;
   (b) Common control transaction and the substance of which is an equity contribution or distribution;
   (c) Transaction where extinguishing the financial liability by issuing equity shares is in accordance with the original terms of the financial liability (for example, conversion of a convertible bond into shares of the issuing entity).

3. HK(IFRIC) – Int 19 applies retrospectively and is effective for annual periods beginning on or after 1 July 2010 but may be applied earlier.

Reasons for issuing HK(IFRIC) – Int 19

4. The objective of the Hong Kong Institute of Certified Public Accountants (HKICPA) in issuing HK(IFRIC) – Int 19 is to maintain international convergence arising from the issuance of IFRIC 19 by the International Financial Reporting Interpretations Committee (IFRIC).

5. The IFRIC was informed that there was diversity in practice in how entities measured own equity instruments issued in a debt for equity swap. As a result, HK(IFRIC) – Int 19 is issued which addresses the following issues:

   (a) Whether the issue of equity instruments meets the definition of "consideration paid" in accordance with paragraph 41 of HKAS 39 *Financial Instruments: Recognition and Measurement*;

(b) How should an entity initially measure the equity instruments issued to extinguish such a financial liability; and
(c) How should an entity account for any difference between the carrying amount of the financial liability extinguished and the initial measurement amount of the equity instruments issued.

Main features of HK(IFRIC) – Int 19

6. HK(IFRIC) – Int 19 clarifies that equity instruments issued to creditor to extinguish a financial liability are "consideration paid" in accordance with paragraph 41 of HKAS 39.

7. The IFRIC is of the view that the issue of equity instruments to extinguish a financial liability could be analysed as consisting of two transactions – first, the issue of new equity instruments to the creditor for cash and second, the creditor accepting payment of that amount of cash to extinguish the financial liability.

8. An entity shall initially measure equity instruments issued to a creditor to extinguish all or part of a financial liability at the fair value of the equity instruments issued at the date when the financial liability is extinguished. If the fair value of the equity instruments issued cannot be reliably measured then the equity instruments shall be measured to reflect the fair value of the financial liability extinguished.

9. 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 terms of the liability that remains outstanding. If part of the consideration paid does relate to a modification of the terms of the remaining part of the liability, the entity shall allocate the consideration paid between the part of the liability extinguished and the part of the liability that remains outstanding. In such case, the consideration allocated to the remaining liability shall form part of the assessment of whether the terms of that remaining liability have been substantially modified.

10. If the remaining liability has been substantially modified, the entity shall account for the modification as the extinguishment of the original liability and the recognition of a new liability.

11. HK(IFRIC) – Int 19 requires the difference between the carrying amount of the financial liability extinguished and the consideration paid shall be recognised in profit or loss.

Other references on IFRIC 19

1. Deloitte IAS Plus on IFRIC clarifies accounting for debt for equity swaps

   http://www.deloitte.com/assets/Dcom-China/Local%20Assets/Documents/Services/Audit/IAS%20newsletter%202009/cn_audit_0912ifric19_301209.pdf

2. Ernst & Young Supplement to IFRS outlook on extinguishing financial liabilities with equity instruments

   http://www.ey.com/Publication/vwLUAssets/Supplement_62/$File/Supplement_62_GL_IFRS.pdf

3. KPMG IFRS Briefing Sheet on IFRIC Interpretation 19

   http://www.kpmg.com.hk/en/virtual_library/Audit/IFRS_briefingsheet/IFRSBS09163.pdf

4. PricewaterhouseCoopers HKFRS News on HK(IFRIC) – Int 19

   http://www.pwchk.com/webmedia/doc/633977068008495215_hkfrs_news_jan2010.pdf

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