05 October 2009

International Financial Reporting Interpretations Committee
30 Cannon Street
LONDON EC4M 6XH
United Kingdom

Email: CommentLetters@iasb.org

Dear Sir/Madam

SAICA SUBMISSION ON THE DRAFT INTERPRETATION IFRIC D25 – *EXTINGUISHING FINANCIAL LIABILITIES WITH EQUITY INSTRUMENTS*

In response to your request for comments on the IFRIC's Draft Interpretation, IFRIC D25 – *Extinguishing Financial Liabilities with Equity Instruments*, attached is the comment letter prepared by The South African Institute of Chartered Accountants (SAICA). Please note that SAICA is not only a professional body, but also secretariat for the Accounting Practices Board (APB), the official standard-setting body in South Africa. The SAICA comment letter results from deliberations of the Accounting Practices Committee (APC), which is the technical advisory body to the APB.

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

Sue Ludolph
Project Director – Accounting

cc: Moses Kgosana (Chairman of the Accounting Practices Board)
Prof Alex Watson (Chairman of the Accounting Practices Committee)

SAICA SUBMISSION ON DRAFT INTERPRETATION IFRIC D25 – *EXTINGUISHING FINANCIAL LIABILITIES WITH EQUITY INSTRUMENTS*

GENERAL COMMENTS

We are in general agreement with the proposals contained within the draft Interpretation. We also agree with IFRIC's assessment that there is diversity in practice in the accounting for 'debt for equity swaps' because some entities recognise the equity instruments at the carrying amount of the liability with no impact on profit/loss (conversion accounting), whereas other entities recognise the equity at the fair value of either the liability or the equity instruments issued with any difference between that amount and the carrying amount of the financial liability recognised in profit/loss (settlement accounting). However, we believe that certain enhancements should be made to both the 'Scope' of the draft Interpretation and the measurement principles for equity instruments issued in 'debt for equity swaps'.

Our comments on specific paragraphs of the draft Interpretation have been set out below.

SPECIFIC COMMENTS

Scope

The [draft] Interpretation addresses only the accounting by an entity that renegotiates the terms of a financial liability and issues equity instruments to the creditor to extinguish the liability fully or partially. It does not address the accounting by the creditor.

We are of the view that that the proposed 'Scope' of the draft Interpretation does not adequately deal with transactions entered into with creditors who are also shareholders of the entity. We note that BC6 provides that the IFRIC concluded that transactions with creditors in their capacity as owners fall outside the 'Scope' of this draft Interpretation. We believe that BC6, which states that "*The IFRIC considered whether to provide guidance on situations in which the creditor is also a shareholder. However, the IFRIC concluded that determining whether the issue of equity instruments to extinguish such a financial liability is* ***a transaction with an owner in its capacity as an owner would be a matter of judgement depending on the facts and circumstances. Consequently, the IFRIC concluded that the proposed Interpretation should not address such transactions***" (emphasis added), provides useful guidance on the type of transactions that fall outside the 'Scope' of this draft Interpretation. We therefore recommend that the 'Scope' paragraph of the draft interpretation be amended to include the guidance provided in BC6, by stating that the draft Interpretation does not apply to transactions where the creditor is a shareholder and the creditor is acting in their capacity as an owner. The current drafting of BC6 could be read as meaning that the draft Interpretation will never apply when a creditor is also a shareholder, regardless of what capacity they are acting in.

Issues

Paragraph 3(a)

(a) "Are an entity's equity instruments 'consideration paid' in accordance with IAS 39 paragraph 41?"

We agree that an entity's own equity instruments are 'consideration paid' in accordance with IAS 39 – *Financial Instruments: Recognition and Measurement* ("IAS 39") paragraph 41, on the basis of the analysis contained in BC10. This proposed principle is, in our view, consistent with existing IFRS literature, for example IFRS 2 – *Share-based Payment* and IFRS 3 – *Business Combinations*, where an entity's own equity instruments are regarded as 'consideration paid' for businesses and goods or services acquired.

Paragraph 3(b)

(b) "How should an entity initially measure the equity instruments issued to extinguish a financial liability?"

We disagree with the proposed approach to measure equity instruments issued to extinguish a financial liability as detailed in paragraph 5 of the draft Interpretation, which states that *"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 or the fair value of the liability extinguished, whichever is more reliably determinable."* We believe this paragraph requires an entity to determine the fair value of both the equity instrument issued and financial liability extinguished in order to satisfy the "whichever is more reliably determinable" test. We also believe that this proposal is onerous and should be simplified by amending paragraph 5 to state that '*Equity instruments issued to a creditor to extinguish all or part of a financial liability should be measured at the fair value of the equity instruments issued. When the fair value of the equity instruments cannot be measured reliably, the fair value of the equity instruments shall be measured with reference to the fair value of the financial liability extinguished'*.

Moreover, the draft Interpretation requires an entity to measure the equity instruments granted by reference to the fair value of financial liability extinguished. We note that no guidance has been provided in the draft Interpretation on how to determine the fair value of the financial liability. It is not clear whether or not the guidance in IAS 39 paragraph 49, which states that "the fair value of a financial liability with a demand feature is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid" (the demand floor feature), is the appropriate guidance to apply in this case. The IFRIC correctly notes in BC14 that many entities that enter into 'debt to equity swaps' are in financial difficulty and we believe consequently have probably breached their loan covenants. Financial liability contracts usually provide that where an entity breaches the loan covenants then that loan becomes repayable on demand. Therefore, if the equity instruments issued are measured with reference to the fair value of the financial liability measured using the demand floor feature in IAS 39, the resulting accounting would be similar to conversion accounting (i.e. no gains or loss recognised in profit or loss), thereby ignoring the impact of credit risk and market interest rates.

Paragraph 3(c)

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"?

We agree that where the creditor is not acting in their capacity as owner, that any difference between the 'consideration paid' and the carrying value of the financial liability extinguished should be recognised in profit and loss in accordance with IAS 39 paragraph 41.

Further BC16 states that *"The IFRIC noted that renegotiating a financial liability to permit it to be extinguished by the issue of equity instruments is always a substantial modification of the terms of the financial liability."* We believe that the guidance in BC16 provides a valuable interpretation of the requirements within IAS 39 paragraph 40 as to what a substantial modification is, and we recommend that it should be included within the body of the draft Interpretation.

Effective date and transition

Retrospective application
We agree that the draft Interpretation should be applied retrospectively from the beginning of the earliest comparative period presented. We believe that no additional benefit will be obtained by applying the draft Interpretation to earlier periods, because at most it would result in a reclassification of amounts within equity (depending on individual territory legal frameworks).

Early Adoption
We agree with the proposal to permit early adoption of the draft Interpretation provided that disclosures of this fact are provided. In light of the global financial crisis, which has resulted in many entities having to enter into 'debt for equity swaps transactions', we urge the IFRIC to make this draft Interpretation available for entities to early adopt for their December 2009 financial year ends.

OTHER COMMENTS

Derecognition project

During March 2009 the IASB issued ED/2009/3 – *Derecognition*: Proposed amendments to IAS 39 and IFRS 7 – *Financial Instruments: Disclosures*, which dealt with the derecognition of financial assets and financial liabilities within the 'Scope' of IAS 39. This Exposure Draft did not provide sufficient guidance on how to account for a partial settlement of a financial liability.

Whilst we acknowledge that there is a need to address the current divergence in practice in the short term, we believe that this issue should be dealt with as part of the long term project on derecognition. We therefore suggest that this guidance be incorporated in the draft Interpretation once the amendments on derecognition have been finalised.

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