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**International  
Accounting Standards  
Board**

*This document is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. It does not represent an official position of the IFRIC. IFRIC positions are set out in Interpretations.*

*Note: These notes are based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because these notes are less detailed, some paragraph numbers are not used.*

### **INFORMATION FOR OBSERVERS**

**IFRIC meeting: May 2006, London**

**Project: Review of published tentative agenda decisions (Agenda Paper 9)**

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#### **Background information**

1. At an IFRIC meeting held in March 2006, the IFRIC reviewed the following matters, which the Agenda Committee had recommended not be taken onto the IFRIC agenda:
  - a) IFRS 2 *Share-based Payment* – Scope of IFRS 2: Share plans with cash alternatives at the discretion of the entity;
  - b) IFRS 2 *Share-based Payment* – Share plans with cash alternatives at the discretion of employees: grant date and vesting periods; and
  - c) IFRS 2 *Share-based Payment* – Fair value measurement of a post-vesting transfer restriction
2. The deadline for constituents who disagree with the proposed agenda decisions published in March-2006 IFRIC Update was 24 April 2006. Two comment letters have been received in connection with the third tentative agenda decision - Fair value measurement of a post-vesting transfer restriction. The comment letters are set out in Appendices I and II to this agenda paper. Further comments received by 10 May 2006 (if any) will be reported to the IFRIC.

## **Tentative agenda decision published in March 2006 IFRIC Update**

### ***(a) IFRS 2 Share-based Payment – Scope of IFRS 2: Share plans with cash alternatives at the discretion of the entity***

The IFRIC considered whether an employee share plan in which the employer had the choice of settlement in cash or in shares, and the amount of the settlement did not vary with changes in the share price of the entity should be treated as a share-based payment transaction within the scope of IFRS 2 *Share-based Payment*.

The IFRIC noted that IFRS 2 defines a share-based payment transaction as a transaction in which the entity receives goods or services as consideration for equity instruments of the entity or amounts that are based on the price of equity instruments of the entity.

The IFRIC further noted that the definition of a share-based payment transaction does not require the exposure of the entity to be linked to movements in the share price of the entity. Moreover, it is clear that IFRS 2 contemplates share-based payment transactions in which the terms of the arrangement provide the entity with a choice of settlement, since they are specifically addressed in paragraphs 41 – 43 of IFRS 2. The IFRIC, therefore, believed that, although the amount of the settlement did not vary with changes in the share price of the entity, such share plans are share-based payment transactions in accordance with IFRS 2 since the consideration may be equity instruments of the entity.

The IFRIC also believed that, even in the extreme circumstances in which the entity was given a choice of settlement and the value of the shares that would be delivered was a fixed monetary amount, those share plans were still within the scope of IFRS 2.

The IFRIC believed that, since the requirements of IFRS 2 are clear, the issue is not expected to create significant divergence in practice. The IFRIC, therefore, decided not to take the issue onto the agenda.

### ***(b) IFRS 2 Share-based Payment – Share plans with cash alternatives at the discretion of employees: grant date and vesting periods***

The IFRIC considered an employee share plan in which employees were provided a choice to have cash at one date or shares at a later date. At the date the transactions were entered into, the parties involved understood the terms and conditions of the plans including the formula that would be used to determine the amount of cash to be paid to each individual employee (or the number of shares to be delivered to each individual employee) but the exact amount of

cash or number of shares would only be known at a future date. The IFRIC was asked to confirm the grant date and vesting period for such share plans.

The IFRIC noted that IFRS 2 defines grant date as the date when there is a shared understanding of the terms and conditions. Moreover, IFRS 2 does not require grant date to be the date when the exact amount of cash to be paid (or the exact number of shares to be delivered) is known to the parties involved.

The IFRIC further noted that share-based payment transactions with cash alternatives at the discretion of the counterparty are addressed in paragraphs 34 - 40 of IFRS 2. Paragraph 35 of IFRS 2 states that, if an entity has granted the counterparty the right to choose whether a share-based payment transaction is settled in cash or by issuing equity instruments, the entity has granted a compound financial instrument, which includes a debt component (i.e. the counterparty's right to demand cash payment) and an equity component (i.e. the counterparty's right to demand settlement in equity instruments). Paragraph 38 of IFRS 2 states that the entity shall account separately for goods or services received or acquired in respect of each component of the compound financial instrument. The IFRIC, therefore, believed that the vesting period of the equity component and that of the debt component should be determined separately and the vesting period of each component may be different.

The IFRIC believed that, since "grant date" is defined in IFRS 2 and the requirements set out in paragraphs 34 - 40 of IFRS 2 are clear, the issues are not expected to create significant divergence in practice. The IFRIC, therefore, decided that the issues should not be taken onto the agenda.

### **(c) IFRS 2 *Share-based Payment* – Fair value measurement of a post-vesting transfer restriction**

The IFRIC received a request in connection with employee share purchase plans in which employees can buy shares of the employing entity at a discount to the market price but are not permitted to sell those shares for a certain period beyond vesting date. The issue was whether the value of such post-vesting restrictions could be based on the "opportunity cost" borne by employees, determined based on a two-stage approach which assumed that employees would (1) sell forward the shares that cannot be disposed of within the restriction period and (2) buy the same number of freely traded shares with a personal unsecured loan. The value of the forward sale (step 1) would reflect a market participant's perspective, while the cost of the loan (step 2) would reflect an employee specific rate. The IFRIC was asked

whether this approach is consistent with the requirements under IFRS 2.

The IFRIC noted the requirements in paragraph B3 of Appendix B to IFRS 2, which states that, “if the shares are subject to restrictions on transfer after vesting date, that factor shall be taken into account, but only to the extent that the post-vesting restrictions affect the price that a knowledgeable, willing market participant would pay for that share. For example, if the shares are actively traded in a deep and liquid market, post-vesting transfer restrictions may have little, if any, effect on the price that a knowledgeable, willing market participant would pay for those shares.” Entity-specific and employee-specific assumptions are not relevant in determining the value of such post-vesting transfer restrictions. Therefore, the IFRIC did not believe that the approach mentioned in the request was consistent with the requirements under IFRS 2.

The IFRIC believed that, since the requirements of IFRS 2 are clear, the issue was not expected to create significant divergence in practice. The IFRIC, therefore, decided not to take the issue onto the agenda.

## APPENDIX I – 1<sup>ST</sup> COMMENT LETTER



A F E P  
Association Française des Entreprises Privées



IFRIC  
To the attention of all IFRIC members  
30 Cannon Street  
London EC4M 6XH  
UK

Paris, April 19, 2006

Re: Post vesting transfer restrictions: IFRIC's proposed wording for rejection

ACTEO, AFEP & MEDEF would like to express very strong concerns in relation to IFRIC's proposed wording for rejection on post vesting transfer restrictions. We request that either the IFRIC undertake an interpretation or redraft the wording for rejection entirely.

*1- The observer note supporting IFRIC's discussion at their March meeting is not a comprehensive report of the issue*

The observer note (which is supposed to replicate, but for the last paragraph, IFRIC agenda paper) includes, in the description of the issue, the conclusion that is expected from IFRIC members. The observer note indeed does not describe at all the content of the guidance to which it silently refers (the issue deals indeed with a non-mandatory guidance issued by the French standard setter in December 2004).

The observer note claims that employee-specific inputs have been selected for valuation purposes. Anyone familiar with fair value concepts and principles knows that only market inputs are to be used for fair value purposes. Everyone is therefore able to easily conclude that there is no circumstance in which employee-specific inputs are acceptable in an IFRS compliant fair value model.

A careful analysis of the guidance under IFRIC's scrutiny would have revealed that:

- the guidance refers to relevant extracts of IFRS 2 and other IFRS, including IFRS 2.B3; the guidance is indeed derived from these extracts;
- inputs selected are meant to feature the equilibrium price which would be reached between market participants and the entity, would a market for the specific transaction exist; valuation is therefore meant to be carried out from the entity's perspective.

A careful analysis of the guidance under IFRIC's scrutiny would have revealed that the whole issue was about how to identify in practice the relevant "market participants"; these market participants serving as reference in transactions with the entity for a specific asset or liability.

**IFRIC should therefore re- deliberate whether the item should be taken to its agenda, on the basis of a fair and comprehensive analysis of the issue.**

- 2- *IFRS are not clear at present on solving the issue presented, i.e, how to identify “a market participant”*

Last September, the IASB decided to undertake an active project on “how to fair value”. Observations by members of the Board at the time the decision was made included references to instances where Board members had been faced to fair valuing practices which in their views did not match the principles they believed should apply. It was deemed critical to provide adequate guidance.

To do so, the IASB decided that they would issue as an exposure draft the soon-to-be-published SFAS dealing with “how to fair value”, after deliberations of several issues which, in their view, required some IASB common thinking.

The definition of “reference market” (and hence the identification of the relevant “market participants”) was identified among the issues in need for discussion. No guidance so far in IFRS designates how such a market participant is to be identified.

**The acknowledged need for an appropriate guidance demonstrates that, at present, no such guidance is available: therefore, the wording for rejection should not refer to IFRS being “clear”.**

- 3- *Although IASB has made the tentative decision to issue as is the soon- to- be- published SFAS on how to fair value, there is no reference in the staff’s paper to the working draft available. However it is our understanding that the guidance under IFRIC’s scrutiny is compliant with this coming standard.*

Employee share schemes addressed in the guidance subject to IFRIC’s scrutiny are only one of the numerous transactions or schemes that involve the delivery of restricted shares. Fair value measurement of restricted shares is an issue of very wide relevance. Not surprisingly, the soon-to-be-published SFAS addresses how to measure restricted shares. This is indicated as an improvement in the introduction to the standard (working draft introduction, page ii) :

- paragraph 31 in the SFAS draft indicates how to determine the fair value of a restricted share: it “shall be estimated based on a quoted price for an otherwise identical unrestricted security of the same issuer, adjusted as appropriate to reflect the effect of the restriction, that is, the amount a marketplace participant would demand to assume the risk arising from the inability to access a public market for the security for the specified period.” It is our understanding that the guidance issued by the CNC is compliant with such requirements: the fair value of a non-restricted share is to be adjusted for the amount that a market participant would have to pay to avoid the effects of the restriction.

As mentioned in paragraph 2 of this letter, the SFAS also addresses the issue of identification of a market participant:

- “marketplace participants are buyers and sellers in the reference market for the asset or liability” (Working draft, #7)
- “the reference market is the most advantageous market in which the entity would transact for the asset or liability” (Working draft, #8).

In preparing its guidance, the CNC has concluded that employees of the entity are the only market participants in the entity’s reference market for employee share plans.

**We believe IFRIC should make its agenda decision in light of the active project on IASB’s agenda.**

4- *Assessing whether market input selection is relevant to specific facts and circumstances is outside IFRIC's scope*

All throughout discussions held on how to ensure consistency in the implementation of IFRS, IASB and IFRIC have made adamantly clear that the IFRIC should not deal with how to account for specific transactions. Doing so would indeed mean dropping the objective of issuing and maintaining a set of principles-based standards. Assessing whether a selection of market inputs to fair value modelling is relevant to specific facts and circumstances is not within IFRIC's responsibilities.

5- *Conclusion*

Measurement of restricted shares is needed all over the world in various transactions and schemes. French employee share plans are only one of the many examples in which such fair value measurements are needed.

We therefore recommend IFRIC:

- issue a wording for rejection justified by:
  - o the fair value measurement project being active on the IASB's agenda,
  - o the assessment of models and market inputs relevant for specific sets of facts and circumstances being the sole responsibility of preparers and auditors.
- encourage IASB to clearly include restricted shares delivered under employee share schemes in the scope of the standard to be exposed for comments.

If you would like further clarification of the points raised in this letter, please do not hesitate to contact us.

Yours sincerely


**ACTEO**

Le Président

  
Patrice Marteau

**AFEP**

Le Directeur Général

  
Alexandre TESSIER

**MEDEF**

La Directrice des Affaires Economiques,  
Financières et Fiscales

  
Agnès LEPINAY

## **APPENDIX II – 2<sup>ND</sup> COMMENT LETTER**

### **RESPONSE FROM THE CHAIRMAN OF THE CONSEIL NATIONAL DE LA COMPTABILITÉ"**

At its March 2006 meeting, the IFRIC took the tentative decision to reject a request for interpretation of IFRS 2 Share Based Payment – Fair value measurement of a post vesting transfer restriction.

Although there is no reference to it, the issue is very similar to one that was considered by the Conseil national de la comptabilité in December 2004, dealing with the accounting for shares granted to French employees under Articles L 225-138 and L 443-5 of the French company law.

The issue actually deals with shares that are sold to employees at a discount to the market price, on the condition that those shares would not be sold for a certain period of time.

The reasons why the CNC issued views on the issue are the following:

- paragraph B 3 of Appendix B states that “if the shares are subject to restrictions on transfer after the vesting date, that factor shall be taken into account but only to the extent that the post vesting restrictions affect the price that a willing knowledgeable market participants would pay for that share. For example, if the shares are actively traded in a deep and liquid market, post vesting transfer restrictions may have little, if any, effect on the price that a knowledgeable, willing market participant would pay for those shares”- in the case of the schemes dealt with by the Conseil national, it was unclear who were the market participants paragraph B 3 is referring to;
- there is empirical evidence that transfer restrictions may have a non-nil value. In that context, we refer to the working draft of the FASB dealing with Fair value measurements, where the concept of “restricted securities” is developed: the fair value of a restricted security “shall be estimated based on a quoted price for an otherwise identical unrestricted security of the same issuer, adjusted as appropriate to reflect the effect of the restriction, that is, the amount a marketplace participant would demand to assume the risk arising from the inability to access a public market for the security for the specified period.” We also observe that in IFRIC 8, IFRIC has accepted the idea that restricted

shares may have a fair value that is less than the fair value of otherwise identical shares that do not carry such restrictions (§5).

The objective of the CNC was then to propose a methodology to determine the value of the adjustment to be made to the quoted price of the security to take account of the restriction.

It was based on the elaboration of a strategy enabling the market participants (the only market participants we have identified being here the purchasers/employees of the issuers) to exchange their restricted shares for identical shares that do not carry such restrictions.

The relevant envisaged strategy was to combine a forward contract on the restricted shares with a credit purchase of identical unrestricted shares. The valuation of the cost of the strategy has to take into account assumptions that are relevant to the participants of the referenced market.

The wording of the rejection “the value of the forward sale would reflect a market participant’s perspective while the cost of the loan would reflect an employee specific rate” does not reflect the cnc’s rationale. The objective of the CNC was to value the cost of the most relevant strategy offered to the market place participants to recover their ability to trade their shares on a deep and liquid market.

The CNC very clearly refers to IAS 39 AG 71 which states that “*The objective of determining fair value for a financial instrument that is traded in an active market is to arrive at the price at which a transaction would occur at the balance sheet date in that instrument in the most advantageous active market to which the entity has immediate access*”. Market inputs relevant to market participants have been used in each step of the valuation process; employees having been identified as “*market participants*”, in application of IAS 39 AG71.

Indeed, the only participants on the restricted shares market are the issuers, the companies, and the only possible purchasers, the employees. There is no share with such restricted rights being traded outside of that market. Therefore, the guidance took into consideration assumptions relevant to the only market participants existing as of today on the restricted shares market.

The CNC should however remind users that the valuation of the cost of the strategy must take into account the most advantageous assumptions for the market participants.

The reference to paragraph B3 of IFRS 2 is also present in the CNC views. There is therefore no conflict between this reference and the CNC's guidance, since the provisions in that guidance are derived from IFRS 2.B3.

We believe that the CNC's guidance provides useful input for the preparation of financial statements. We also believe that it is in line with the current IASB and FASB works on fair value measurements. It does not contradict any requirement of IFRS 2.

**On the process,** IFRIC members should have been made aware that, in this particular instance, the stakeholder putting the request forward was addressing a non mandatory view issued by a national standard setter, in order to:

- a. Help solve a valuation issue specific to a transaction governed by national legislation ;
- b. Promote implementation consistency, since there were a lot of disagreements on how to approach the accounting of this specific issue.

If we are right in assuming that March 2006 IFRIC rejection deals with the issue described above, we believe that the wording of the rejection does not fairly reflect the issue dealt with the Conseil National de la Comptabilité 2002 the conclusions reached. The present wording of the rejection could lead to further confusion and be prejudicial to the production of financial statements in our jurisdiction.

**On the substance** the wording for rejection as proposed takes a technical position against selected inputs to a model used in a specific transaction. This, in our understanding, is in breach with IFRIC's policies and procedures, first because IFRIC is not supposed to review specifics of any single transaction, second because wording for rejections should remain totally neutral as to the technical assessment of the issue being rejected. Technical assessments belong to interpretations which should only be made after thorough investigation.

**In conclusion**, if IFRIC sticks to its position not to take such an issue on to its agenda, it should state other reasons for rejection:

- IFRIC should not address issues dealt with by a IASB/FASB's active working group. The issue of the valuation of shares with restricted rights is currently addressed by the IASB/FASB project on Measurement basis for financial reporting
- it should not include any technical position: the question whether the fair value of a restricted share is less than the fair value of an identical share that does not carry any restrictions has been addressed in IFRIC 8 and might be further addressed in the draft dealing with fair value measurements
- the appropriate selection of specific valuation consideration under the responsibility of preparers, under the control of auditors and enforcers, and should rely on judgement applied to specific facts and circumstances.

As agreed, we will provide you with a more in depth presentation in a meeting scheduled on May 9th, with slides on market data and additional accounting theoretical rationale.

Best regards

Antoine BRACCHI