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**International
Accounting Standards
Board**

This observer note is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. Views expressed in this document are identified by the staff as a basis for the discussion at the IFRIC meeting. This document does not represent an official position of the IFRIC. Decisions of the IFRIC are determined only after extensive deliberation and due process. IFRIC positions are set out in Interpretations.

Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: May 2008, London
PROJECT: ED Proposed Amendments to IFRS 2 *Share-Based Payment* and IFRIC 11 *IFRS 2 Group Treasury Share Transactions – Group Cash-Settled Share-Based Payment Transactions Preliminary comment analysis and project plan (Agenda Paper 4)*

INTRODUCTION

- 1 The Board concurred with the IFRIC's recommendation and consensus and published its exposure draft of proposed amendments to IFRS 2 *Share Based Payment* and IFRIC 11 *Group and Treasury Share Transactions* in December 2007. The comment period ended on 17 March 2008 and the Board received 44 comment letters.
- 2 This agenda paper summarizes the preliminary analysis of the comments received on the ED. The staff ask the IFRIC to consider the significant points raised in the comment letters and as result:
 - (a) decide on the areas requiring redeliberations; and
 - (b) approve the staff's project plan

BACKGROUND

- 3 For group *equity-settled* share-based payment arrangements, paragraph 3 of IFRS 2 requires an entity to apply IFRS 2 even though its shareholders transfer equity instruments of the entity or the entity's parent (or another entity in the same group) to parties that have supplied goods or services to the entity. IFRIC 11 provides guidance on how the entity that receives the goods or services from its suppliers should account for such *equity-settled* transactions in its financial statements.

- 4 The ED addresses how an entity that receives goods and services from its suppliers (including employees) should account for similar share-based arrangements that are *cash-settled* when the entity itself does not have any obligation to make the required payments to its employees. Paragraph 3 of the Introduction in the ED described two examples:
 - Arrangement 1 – the suppliers of the entity will receive cash payments that are linked to the price of the equity instruments of the *entity*
 - Arrangement 2 – the suppliers of the entity will receive cash payments that are linked to the price of the equity instruments of the *parent of the entity*.For either arrangement, the parent (not the entity itself) has an obligation to make the required cash payments to the suppliers of the entity.

- 5 In the financial statements of the subsidiary, neither arrangement meets the definition of either a cash-settled share-based payment transaction or an equity-settled share-based payment transaction. Although paragraph 6 of IFRIC 8 *Scope of IFRS 2* suggests that Arrangement 1 is within the scope of IFRS 2 in the financial statements of the subsidiary, IFRS 2 does not specify how to account for the cash-settled arrangements described above in the financial statements of the subsidiary.

- 6 In the IFRIC's July and September 2007 meetings, and the Board's October 2007 meeting, both the Board and the IFRIC noted that these arrangements are: (a) for the purpose of providing benefits to the employees of the subsidiary in return for employee services, and (b) share-based and cash-settled.

PROPOSAL

- 7 To clarify the accounting for these types of share-based payment transactions, the ED proposes that:
- a) With respect to scope (Question 1(a) of the ED), an entity that receives goods or services from its suppliers must apply IFRS 2 even though it has no obligation to make the required share-based cash payments itself, regardless of whether there is a reimbursement arrangement between a parent and its subsidiary. (New paragraph 3A and amended paragraph 5 of IFRS 2, and new paragraph 11A of IFRIC 11)
 - b) For convenience, the proposal to amend IFRIC 11 only discusses the issues in terms of a parent and its subsidiary, however, IFRIC 11 as amended also applies to similar arrangements between an entity and another entity in the same group. (Amended paragraph 4 of IFRIC 11)
 - c) With respect to measurement (Question 1(b) of the ED), an entity that receives goods or services from its suppliers under arrangements described the ED's Introduction should measure the goods or services in accordance with the requirements applicable to cash-settled share-based payment transactions. (New paragraph 11B of IFRIC 11)
 - d) With respect to transition (Question 2 of the ED), the amendments to IFRS 2 and IFRIC 11 would be applied retrospectively, subject to the transition of IFRS 2. (New paragraph 60A of IFRS 2 and new paragraph 12A of IFRIC 11)
- 8 In summary, respondents generally agreed with the proposals outlined in (a) and (c) above for the narrow category of 'group arrangements' between parent and subsidiary. However, many expressed concerns for similar arrangements between entities beyond these explicitly described arrangements. With respect to the measurement proposal outlined in (c) above, varying views were expressed and a number of respondents either questioned or opposed the bases underlying the consensus reached, citing different reasons.
- 9 Agenda paper 4A contains a full list of respondents to the invitation to comment and a breakdown of respondent categories by type and geography.
- 10 The balance of this paper is the staff's preliminary analysis of the comments received. This summary identifies the significant issues the staff believes should be reconsidered before finalizing the amendments. The staff plans to bring additional analysis of these issues and recommendations in subsequent

papers for redeliberations. At that time, the staff will incorporate and expand on the comments as we present the relevant agenda papers. In addition, comments on more minor issues will be discussed on the IFRIC has reconsidered the significant issues.

PRELIMINARY COMMENT ANALYSIS

Scope (Question 1a of the ED)

11 Respondents generally agreed that the narrow category of cash-settled transactions between a parent and a subsidiary described in the ED’s Introduction and paragraph 4 of this Agenda Paper should be within the scope of IFRS 2. Supporters believed that including these arrangements is consistent with IFRS 2’s main principle of recognizing the goods and services that an entity receives in a share-based transaction. Because such cash-settled transactions have similar economic substance as group equity-settled transactions explicitly addressed in paragraph 3(a) of IFRIC 11, accounting for them consistently also removes an incentive to structure arrangements to be outside of IFRS 2’s scope.¹

12 However, respondents also expressed the following concerns about the proposed scope, as further explained in the paragraphs below:

- Lack of clarity and inconsistency in scope among IFRSs
- Inconsistency with definitions of share-based payments

Lack of clarity and inconsistency in scope among IFRSs

13 Most respondents noted that the proposal’s principle objective is to align the subsidiary’s accounting for similar share-based arrangements that are *cash-settled*, when the subsidiary itself does not have any obligation to make the required payments to its suppliers of goods and services, with the existing accounting already addressed in IFRIC 11 for those that are *equity-settled*.

14 For example, the proposed amendment to paragraph 4 of IFRIC 11 states as follows:

“This Interpretation addresses how the share-based payment arrangements set out in paragraphs 3 and 3A should be accounted for in the financial

¹ CL 3

statements of the subsidiary that receives services from the employees. For convenience, this Interpretation discusses the issues in terms of a parent and its subsidiary. However, this Interpretation also applies to similar arrangements between an entity and another entity in the same group.”

15 This proposed amendment results in existing IFRIC 11 accounting guidance, if discussed in examples between a parent and subsidiary, to be applicable to arrangements between an entity and another entity in the same group, regardless of the arrangements’ substance and the group entities’ relationship.

16 While most supported the scope extension to the narrow cases explicitly described between parent and subsidiary, there are conflicting views about the appropriateness, and the Board’s intent (or the lack thereof), to require application of the proposed amendments beyond these narrow cases to other group entities such as transfers by shareholders, fellow subsidiaries, or joint ventures. Some questioned if the proposed ‘push-down’ accounting and recording a contribution in equity from parent should always apply to arrangements other than those between a parent and subsidiary.² For example, a respondent commented on the implications to existing guidance in paragraph 8 of IFRIC 11 for equity-settled share-based payments if the entities are not in a parent-subsidiary relationship.³

17 Many also expressed concerns about the inconsistent scopes between IFRS 2 and IFRIC 11 as proposed. Different terminologies are used in IFRS 2, IFRIC 8, and IFRIC 11. For example, the proposed amendments to both paragraphs 3A of IFRS 2 and IFRIC 11 for cash-settled share-based transactions do not mirror the reference to the entity’s *shareholders* as the grantor that is in the existing paragraph 3 of IFRS 2 and paragraph 7(b) of IFRIC 11, which specifically include such transfers in the scope. Instead, the proposals only include in the scope those cases when the entity’s *parent (or another entity in the group)* incurs a liability for the cash-settled share-based payments to the subsidiary’s employees.

18 For example, the comment letter from the Institute for the Accountancy Profession in Sweden (CL 19) includes a one-page table and bullets on page two as their attempt to illustrate their understanding of the different scopes

² CL 5, 6, 10, 14, 15, 18, 19, 21, 22, 23, 25, 26, 27, 29, 35, 37, 41, 43, 44

³ CL 19

between equity-settled and cash-settled share-based transactions as required by IFRS 2 and IFRIC 11 with the proposed amendments.

- 19 According to this table, equity-settled share-based transactions, where the grantor is *the entity's shareholder*, are within the scope pursuant to paragraph 3 of IFRS 2 (and paragraph 7(b) of IFRIC 11, which was not mentioned by the comment letter). However, neither IFRS 2 nor IFRIC 11 specifies the scope for similar cash-settled transactions. On the other hand, cash-settled share-based transactions where the grantor is *the entity itself* are within the scope pursuant to paragraph 2(b) of IFRS 2, and paragraphs 3(b) and 4 of IFRIC 11 with the proposed amendment. However, neither IFRS 2 nor IFRIC 11 specifies the scope for similar equity-settled transactions.
- 20 These inconsistencies result in unexplained scope differences applicable to equity-settled and cash-settled arrangements that are of the same substance. Generally, most recommended aligning the scope and terminology consistently among these IFRSs.⁴

Inconsistency with definitions of share-based payments

- 21 A number of respondents emphasized the importance of consistency for definitions in IFRSs. Many expressed concerns of the rule-based approach of the ED to extend the scope on a case-by-case basis. They also noted that such cases, as amended, do not meet the definitions of share-based payments in Appendix A of IFRS 2, similar to specific cases previously addressed by IFRIC 11.⁵
- 22 These respondents recommended a direct amendment to broaden the definitions of 'equity-settled share-based payments' and 'cash-settled share-based payments' in Appendix A of IFRS 2 so that transactions between group entities with similar characteristics are included in the scope of IFRS 2. Some respondents also recommended that, because the proposals amend both IFRS 2 and IFRIC 11, the Board should take this opportunity to incorporate the main principles of IFRIC 11 (and IFRIC 8) into IFRS 2, and move the specific cases described to the appendix of Implementation Guidance or Illustrative Examples sections? of IFRS 2 to avoid fragmented guidance.⁶

⁴ Same CLs as footnote 2

⁵ CL 5, 12, 18, 24, 26, 27, 30, 40, 41, 44

⁶ CL 6, 14, 17, 23, 28, 34, 35

Measurement by the entity receiving goods and services (Question 1b of the ED)

- 23 The proposal amends paragraph 11B of IFRIC 11 and requires the subsidiary to measure the goods and services received from its employees as cash-settled share-based payments, and to recognise any changes in the fair value of the parent's liability in profit or loss and in the subsidiary's equity as adjustments to contributions from the parent until the parent's liability is settled.
- 24 Most respondents supported the proposed classification and measurement for the narrow category of cash-settled transactions between a parent and a subsidiary as described in the ED's Introduction and paragraph 4 of this Agenda Paper. However, several respondents objected to the proposals⁷ and a number of others questioned the bases underlying the consensus reached, citing different reasons.⁸
- 25 Some also questioned if the proposed 'push-down' accounting and recording a contribution in equity from parent should always apply to arrangements other than those between a parent and subsidiary.⁹
- 26 The main concerns expressed by respondents are as follows:
- Classification and measurement as cash-settled share-based payments by the entity receiving the goods and services
 - Attribution of the parent's liability by the subsidiary

Classification and measurement as cash-settled share-based payments

- 27 Several respondents opposed the classification of these arrangements as cash-settled share-based payments in the subsidiary's financial statements on the basis that the subsidiary has no liability in either of the arrangements explicitly described in the ED.¹⁰ Classifying them as cash-settled share-based payments conflicts with the rationales in paragraphs BC238, BC240-BC241 of IFRS 2, and BC8-BC9 and BC16-BC18 of IFRIC 11, which distinguish cash-settled

⁷ CL 20, 24, 36, 40

⁸ CL 17, 18, 19, 35, 37

⁹ Same CLs as footnote 2

¹⁰ CL 24, 35, 37

from equity-settled share-based payments as those where the subsidiary has the obligation to transfer cash to suppliers of goods and services.¹¹

- 28 Some respondents expressed concerns about the proposed measurement of the goods and services received by the subsidiary in its financial statements. Many questioned and several objected to the remeasurement of changes in fair value of the parent's liability in the subsidiary's profit and loss.¹²
- 29 Respondents objected to this proposal on the basis that it conflicts with paragraphs 70, 78, 94-98 of the *Framework*, and is prohibited by IFRSs, because the subsidiary itself does not have any obligation. Therefore, the change in fair value is not a change in the subsidiary's own liability but rather, a change in the fair value of an equity owner's (parent's) liability.¹³
- 30 One respondent commented that paragraph IG19 of IFRS 2 defines the value of goods and services received in a cash-settled share-based payment as the fair value of the award on the date of grant, and that the remeasurement of the parent's liability does not have to be attributed to the entity. In addition, this respondent also commented that the lack of obligation of the subsidiary suggests that the share-based payments in these arrangements would be classified as equity-settled in the subsidiary's financial statements even though it will be classified as cash-settled in the consolidated financial statements.¹⁴
- 31 One respondent commented that IFRS 2 requires remeasurement until the liability is settled, whereas the proposals require remeasurement after settlement has effectively taken place.¹⁵ This respondent believed that the proposals conflicts with paragraph 30 of IFRS 2 because settlement occurs when the parent commits to making the payment to the subsidiary's employees and not when the employees are paid.
- 32 Other constituents have different understandings about when the 'contribution' from the parent takes place, and the related accounting at initial recognition and subsequent measurement. They requested clarification of whether the fair value of the parent's liability should be recognized by the subsidiary as a liability initially, then subsequently as a contribution from parent in equity

¹¹ Same CLs as footnote 10, CL 26

¹² CL 17, 20, 21, 23, 24, 25, 26, 35, 37

¹³ CL 17, 20, 24, 25

¹⁴ CL 37

¹⁵ CL 23

when settled, or whether the amount should initially be recognized in the subsidiary's equity, similar to the changes in the fair value of the parent's liability.¹⁶

- 33 In addition to concerns related to the appropriateness of accounting for the credit entry as a contribution from parent in the subsidiary's equity at initial recognition and subsequent measurement, a number of respondents questioned whether the credit entry should always be a contribution of equity either for parent or non-parent contributors.¹⁷

Attribution of the parent's liability by the subsidiary

- 34 Several respondents commented that the Basis for Conclusions in the ED has not articulated the IFRS principle that results in applying 'push-down' accounting of the parent's liability in the subsidiary's financial statements and recording changes in fair value of the parent's liability through the subsidiary's profit and loss, when the subsidiary has no obligation to make a cash payment.¹⁸

- 35 One respondent limited their support to attribution of the grant-date fair value only. The main concern about requiring attribution of the remeasurement in the subsidiary's financial statements is the broader issue that no clear concept in IFRSs addresses when, and if so how, a transaction with shareholders should be attributed to an entity. The respondent acknowledged that paragraph 3 of IFRS 2 is the first time that IFRSs provides for such attribution although that change in concept only focused on equity-settled share-based payments. Many other circumstances where a parent provides benefits for or on behalf of a subsidiary would not require attribution, but rather, disclosures according to IAS 24 *Related Party Disclosures*.¹⁹

- 36 Other respondents shared similar concerns about the risk of analogy to this proposal for other types of corporate allocation expenses among group entities.²⁰

Transition (Question 2 of the ED)

¹⁶ CL 21

¹⁷ CL 5, 7, 17, 19, 21, 36, 44

¹⁸ CL 18, 35, 37, 42

¹⁹ CL 37

²⁰ CL 3, 6, 25

37 Most respondents agreed with the retrospective application of the proposals except for minor clarifications. For example, respondents requested clarification about whether the transition would apply only to outstanding cash-settled share-based payment plans as of the effective date of this amendment, whether the same relief to first-time adopters in IFRS 1 *First-time Adoption of International Financial Reporting Standards* applies to the entity receiving the goods and services and identifying the specific transitional paragraphs under IFRS 2 to which the proposal is linked..²¹

Other issues

38 There are some additional issues raised by respondents besides those on which the Board and the IFRIC requested comments. For example, many respondents requested clarification about when the entity itself has an obligation to the employees for the cash-settled share-based payments, whether the proposed accounting should apply. Other similar requests include additional guidance for other intra-group transactions, arrangements with reimbursements from the subsidiary, contributor accounting, hybrid share-based payments that are partially cash-settled and equity-settled, or when the employees or grantors have a choice in the method of settlement, and so on.

39 Once the IFRIC reaches consensus on the issues discussed in this Agenda Paper we will decide whether some of these additional issues need to be addressed. The staff proposes to bring an analysis of these remaining issues in a subsequent paper.

PROJECT PLAN

40 Expected timetable for subsequent redeliberations:

Tasks	Expected Time
Preliminary comment analysis	May 2008 IFRIC meeting
Redeliberations of issues raised	
- Scope	July 2008 IFRIC meeting
- Classification	July 2008 IFRIC meeting
- Measurement	September 2008 IFRIC meeting
Redeliberations of consensus reached	October 2008 IASB meeting

²¹ CL 4, 12, 17, 19, 23, 26, 28, 35, 41, 44

Review of revised amendments	October 2008
Balloting and drafting	November 2008
Publication of revised amendments to IFRS 2 and IFRIC 11	December 2008 Expected effective date: —to be determined

QUESTIONS FOR THE IFRIC

- 41 **Are there additional issues that the IFRIC identified in its review of the comment letters that it would like the staff to consider?**
- 42 **Does the IFRIC agree with the staff's project plan?**