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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: Group and Treasury Share Transactions (Agenda Paper 7)

Introduction

1. Draft Interpretation (D17) *IFRS 2 Group and Treasury Share Transactions* was published in May 2005. D17 addresses the following:
 - a) when an entity grants rights to its equity instruments to its employees, and either chooses or is required to buy those equity instruments from another party to satisfy its obligations to its employees, the issue is whether the transaction shall be accounted for as equity-settled or cash-settled in accordance with IFRS 2;
 - b) when an entity's employees are granted rights to equity instruments of the entity, either by the entity itself or by its shareholder, and the shareholder provides the equity instruments, the issue is whether the transaction should be treated as equity-settled or cash-settled in the financial statements of the entity;
 - c) when a parent entity grants rights to its equity instruments direct to a subsidiary entity's employees, the issue is whether the transaction with the employees shall be accounted for as equity-settled or cash-settled; and

- d) when a subsidiary entity grants to its employees rights to equity instruments of its parent, the issue is whether the transaction with the employees shall be accounted for as equity-settled or cash-settled.
2. 40 comments have been received in connection with D17. The staff presented the analysis of comments and gave its recommendations at the IFRIC meeting held in November 2005. In respect of issues (c) and (d) above, the staff at that meeting illustrated four alternatives aimed at helping the IFRIC members determine whether those transactions are classified as equity-settled or cash-settled (see paragraph 20 of this agenda paper). However, no consensus was reached. At the meeting, some IFRIC members believed that the IFRIC should stop the discussion on D17 because the issues addressed in D17 were related to the lack of a higher principle concerning the representation of group transactions in a subsidiary's separate financial statements. Other IFRIC members saw merit in developing an Interpretation. The IFRIC requested the staff to prepare another agenda paper to discuss the above issues (particularly issues (c) and (d) above). The IFRIC would then consider whether or not it should continue with D17. To help the IFRIC determine whether an Interpretation is required on the above four issues, the staff has prepared the following analysis based on the sequence set out in the draft Interpretation.

Issue (a) When an entity grants rights to its equity instruments to its employees, and the entity can choose or is required to buy its equity instruments from another party to settle its obligations to its employees, should the transaction be accounted for as equity-settled or cash-settled in accordance with IFRS 2?

Consensus in D17

3. D17 recommends that share-based payment transactions in which an entity receives services from its employees as consideration for equity instruments of the entity be accounted for as equity-settled, irrespective of whether the entity chooses or is required to buy those equity instruments from another party to satisfy its obligations to its employees.

Comments from respondents

4. Respondents generally did not disagree with D17 in this respect (15 agree; 24 no comments (out of 40 comments)) (see Agenda Paper 7 November 2005 for details). Three respondents requested the IFRIC to clarify whether the entity should recognise a financial liability in accordance with IAS 32 *Financial Instruments: Presentation* when it enters into a contractual obligation to reacquire its own equity instruments.

Staff recommendation

5. The staff believes that the transaction could be viewed as comprising two transactions in substance – one in which the entity reacquires its own equity instruments from another party, and another in which the entity grants those equity instruments to its employees in return for services.
6. The first transaction should be accounted for in accordance with paragraph 33 of IAS 32. Paragraph 33 of IAS 32 states that, if an entity reacquires its own equity instruments, those equity instruments shall be deducted from equity. In addition, paragraph 23 of IAS 32 states that a contract that contains an obligation for an entity to purchase its own instruments for cash or another financial asset gives rise to a financial liability for the present value of the redemption amount¹.
7. The second transaction, in the staff view, should be accounted for as an equity-settled share-based payment transaction in accordance with IFRS 2. IFRS 2 clearly defines an equity-settled share-based payment transaction as one in which an entity receives goods or services as consideration for equity instruments of the entity. The definition of an equity-settled share-based payment transaction does not require that the transaction be settled through the issuance of equity instruments by the entity.
8. The staff believes that issue (a) is sufficiently narrow and the relevant requirements in IAS 32 and IFRS 2 are sufficiently clear that no Interpretation is necessary.

¹ IAS 32, IE 2-6 provide examples on how to account for transactions in which an entity purchases its own equity instruments under different scenarios.

Issue (b) When an entity's employees are granted rights to equity instruments of the entity, either by the entity itself or by its shareholder, and the shareholder provides the equity instruments needed, should the transaction be treated as equity-settled or cash-settled in the financial statements of the entity?

Consensus in D17

9. D17 recommends that share-based payment transactions in which an entity receives services from its employees as consideration for equity instruments of the entity shall be accounted for as equity-settled, irrespective of whether the employees' rights to the entity's equity instruments were granted by the entity itself or by its shareholder(s); or the share-based payment arrangement was settled by the entity itself or by its shareholder(s).

Comments from respondents

10. The respondents broadly did not disagree with D17 in this respect (15 agree; 24 no comments (out of 40 comments)) (see Agenda paper 7 for November-2005 IFRIC meeting).

Staff recommendation

11. Paragraph 3 of IFRS 2 requires that transfers of an entity's equity instruments by its shareholders to parties that have supplied goods or services to the entity (including employees) should be treated as share-based payment transactions, unless the transfer is clearly for a purpose other than payment for goods or services supplied to the entity.
12. In accordance with paragraphs 19-22 of the Basis for Conclusions of IFRS 2, the Board noted that in some situations, an entity might not issue its equity instruments direct to its employees, but instead, its shareholders might transfer the equity instruments to the employees. The Board viewed such an arrangement as being, in substance, two transactions – one in which the entity reacquired the equity instruments for nil consideration, and another one in which the entity received services as consideration for equity instruments issued to the employees. The Board concluded that the second transaction was a share-based payment transaction, and that the entity should account for

transfers of equity instruments by shareholders to employees or other parties in the same way as other share-based payment transactions.

13. IFRS 2 clearly defines an equity-settled share-based payment transaction as a transaction in which the entity receives goods or services as consideration for equity instruments of the entity. The staff, therefore, believes that, since the consideration involved in issue (b) is equity instruments of the entity, the share-based payment transaction should be accounted for as equity-settled.
14. The staff believes that the first transaction (i.e. the transaction in which the entity reacquired the equity instruments for nil consideration) should be accounted for in accordance with paragraph 33 of IAS 32, which states that, if an entity reacquires its own equity instruments, those equity instruments shall be deducted from equity, and no gain or loss shall be recognised in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments.
15. As the principles set out in paragraph 3 of IFRS 2 together with paragraphs 19 – 21 of the Basis for Conclusions of IFRS 2 are clear, the staff recommends that no Interpretation be developed for issue (b).

Issues (c) & (d) In situations when a parent entity grants rights to its equity instruments direct to a subsidiary entity's employees, and when a subsidiary entity grants to its employees rights to equity instruments of its parent, how should these transactions be accounted for?

Consensus in D17

16. Paragraph 3 of IFRS 2 states that transfers of equity instruments of the entity's parent, or equity instruments of another party in the same group as the entity, to parties that have supplied goods or services to the entity are share-based payment transactions.
17. D17 suggests that share-based payment transactions in which a parent entity grants rights to its equity instruments direct to a subsidiary entity's employees shall be accounted for as equity-settled. This applies to the separate or individual financial statements of the parent entity and the subsidiary entity and also to the group's consolidated financial statements. For share-based payment transactions in which a subsidiary grants to its

employees rights to equity instruments of its parent, the subsidiary entity shall account for the share-based payment transaction with its employees as cash-settled.

Comments from respondents

Comments	Issue (c) – when a parent entity grants rights to its equity instruments to the employees of the subsidiary	Issue (d) – when a subsidiary grants rights to the equity instruments of the parent to its employees
Agree (including “agree” with clarification)	19	10
Disagree	8	24
No comment	13	6

- 19. Many respondents disagreed with the accounting treatments of issues (c) and (d) on the grounds that the substance of the two transactions were the same, and they, therefore, should be accounted for using the same accounting treatment.
- 20. Four alternatives as a basis for the classification of such transactions under both issues (c) and (d) were recommended by respondents and discussed at the November 2005 IFRIC meeting. They are summarised and analysed in paragraph 23 of this agenda paper.

Staff analysis

- 21. The staff views the transaction under issue (c) as one in which the parent entity issues equity instruments to the employees of a subsidiary entity in order to settle the obligation of the subsidiary, and the subsidiary entity is not required to pay anything to the parent entity. The staff views the transaction under issue (d) in a similar way - with the difference that the subsidiary entity is required to pay the parent entity for the equity instrument in the transaction under issue (d) whereas it is not required to pay anything in the transaction under issue (c).
- 22. The staff believes that the parent entity can always determine how to structure intragroup transactions in order to achieve desired results (e.g. tax purposes). Given the fact that the transactions are so similar (except for the difference over whether or not the subsidiary entity is required to pay anything to the parent entity), and that equity-settled and cash-settled share-based payment transactions are accounted for completely differently in

accordance with IFRS 2, the staff agrees with the respondents that the transactions under issues (c) and (d) should be accounted for in the same way.

23. The respondents recommended the following four alternatives as a basis for the classification of transactions under issues (c) and (d):

- Suggestion 1 - Transactions should be classified as equity-settled with a broader interpretation of the definition of an equity-settled share-based payment transaction (i.e. equity-settled share-based payment should include transactions in which the entity receives goods or services as consideration for equity instruments of the entity or its parent).
- Suggestion 2 - Transactions should be classified as cash-settled. Regardless of whether the parent entity or the subsidiary entity grants the equity instruments, the transactions should be accounted for as if the subsidiary entity granted the equity instruments. As a result, because the subsidiary entity has incurred a liability to deliver other assets (i.e. equity instruments of the parent entity) to its employees, the transactions should be classified as cash-settled.
- Suggestion 3 - Transactions should be classified based on whether the subsidiary has an obligation to pay cash as a result of the share-based payment transaction. If the subsidiary has an obligation to pay cash, the transaction should be treated as cash-settled. On the other hand, if the subsidiary has no obligation to pay cash, the transaction should be treated as equity-settled.
- Suggestion 4 - Transactions should be classified based on which entity has the obligation to transfer the equity instruments to the employees. If the subsidiary entity has the obligation, the transaction should be classified as cash-settled in the financial statements of the subsidiary (because the subsidiary entity has an obligation to deliver assets (i.e. equity-instruments of the parent entity to its employees). Alternatively, if the parent entity has the obligation, the transaction should be treated as equity-settled (because the parent does not have an obligation to transfer cash or other assets to the subsidiary's employees since the parent's own equity instruments are not assets of the parent).

24. In the staff's view, the above suggested approaches are unfortunately not flawless. One of the fundamental issues is that IFRS 2 sets out only the accounting treatments of equity-settled share-based payment transactions and cash-settled share-based payment transactions. In accordance with IFRS 2, equity-settled share-based payment transactions are transactions in which the entity receives goods or services as consideration for equity instruments of the entity while cash-settled share-based payment transactions are transactions in which the entity acquires goods or services by incurring a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's equity instruments. Theoretically, regardless of whether the subsidiary is required to pay anything to the parent entity, the transaction at the subsidiary level does not meet the definition of either an equity-settled share-based payment transaction or a cash-settled share-based payment transaction. In the circumstance in which the subsidiary entity is not required to pay its parent, the transaction is not equity-settled because the equity instruments to be delivered to the employees are not equity instruments of the subsidiary entity (although the staff notes that the IFRIC did acknowledge this weakness and consider that it was the most consistent treatment in accordance with IFRS 2 at previous IFRIC meetings). Similarly, in the situation in which the subsidiary entity is required to pay its parent, the transaction is neither equity-settled nor cash settled. Again, this is because the equity instruments to be delivered to the employees are not equity instruments of the subsidiary entity. In addition, the cash payment to the parent entity is not linked to the price of the equity instruments of the subsidiary.
25. Moreover, paragraph 5 of IFRS 2 states that the Standard applies only to share-based payment transactions in which an entity acquires or receives goods or services. "Goods" in IFRS 2 includes inventories, consumables, property, plant and equipment, intangible assets and other non-financial assets. Therefore, in the separate financial statements of the parent entity, regardless of whether the subsidiary entity is required to pay anything to the parent entity, is the transaction within the scope of IFRS 2? Or should the transaction be accounted for in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*? In that case, inconsistent accounting treatments still exist between the parent's separate financial statements and the subsidiary's financial statements.
26. Furthermore, for suggestions (3) and (4), as explained earlier in this agenda paper, the parent entity always has discretion over how to structure intragroup transactions in order

to achieve different purposes. The staff does not believe that the bases for determining whether the transactions are equity-settled or cash-settled should solely depend on (1) whether the subsidiary entity has the obligation to pay or (2) the identity of the group entity that has the obligation to transfer equity instruments.

27. The staff believes that, unless those fundamental issues are solved (e.g. through amendments to IFRS 2), debates will continue and it is highly unlikely that a consensus could be reached on a timely basis.

Additional considerations

28. The staff acknowledges that IFRS 2 gives no guidance on how the transactions should be accounted for in the financial statements of the subsidiary entity and the separate financial statements of the parent entity. However, to avoid continuing debates as to whether the transactions should be treated as equity-settled or cash-settled, some recommend the following two alternatives to help determine how the transactions should be accounted for in the financial statements of the subsidiary entity and the separate financial statements of the parent entity:

“Push-down” accounting

29. Paragraph 3 of IFRS 2 explicitly states that transfers of equity instruments of the parent entity or equity instruments of another entity in the same group as the entity to parties that have supplied goods or services to the entity are share-based payment transactions. The staff has no doubt that, in the consolidated financial statements of the parent entity, both transactions are share-based payment transactions and should be accounted for as equity-settled share-based payment transactions in accordance with IFRS 2.
30. This view is that, since the transactions are accounted for as equity-settled share-based payment transactions on consolidation (i.e. the amount of expense recognised on consolidation is based on the fair value of the equity instruments of the parent entity at the grant date), an equivalent amount of expense should be recognised in the financial statements of the subsidiary entity (using ‘push-down’ accounting), with details as follows:

Issue (c) – the subsidiary entity is not required to pay anything to the parent entity

Consolidated financial statements of the parent entity	Financial statements of the parent entity	Financial statements of the subsidiary entity
DR Expense (recognised and measured in accordance with IFRS 2)	DR Investment in the subsidiary entity	DR Expense (equal to the amount of the expense recognised in the consolidated financial statements of the parent entity)
CR Equity (recognised and measured in accordance with IFRS 2)	CR Equity (equal to the amount that would be recognised on consolidation)	CR Capital contribution (if the parent entity acts in its capacity of an equity participant)

Issue (d) – the subsidiary entity is required to pay the parent entity

Consolidated financial statements of the parent entity	Financial statements of the parent entity	Financial statements of the subsidiary entity
DR Expense (recognised and measured in accordance with IFRS 2)	DR Amount due from the subsidiary entity	DR Expense (equal to the amount of the expense recognised in the consolidated financial statements of the parent entity)
CR Equity (recognised and measured in accordance with IFRS 2)	CR Equity (equal to the amount that would be recognised on consolidation)	CR Amount due to the parent entity

31. The above journal illustration in connection with issue (d) is simplified in that the parent entity charges the subsidiary entity an amount exactly equal to the fair value of the share options measured at grant date. Another question arises if the parent entity charges more than the fair value of the share options measured at grant date. In that situation, the staff believes the excess amount (i.e. the difference between the amount charged by the parent entity and the fair value of the share options at grant date), in substance, represents a distribution to the parent entity. A potential journal illustration is set out below:

Consolidated financial statements of the parent entity	Financial statements of the parent entity	Financial statements of the subsidiary entity
DR Expense (recognised and measured in accordance with IFRS 2)	DR Amount due from the subsidiary entity	DR Expense (equal to the amount of the expense recognised in the consolidated financial statements of the parent entity)
CR Equity (recognised and measured in accordance with IFRS 2)	CR Equity (equal to the amount that would be recognised on consolidation)	DR Distribution to the parent entity (i.e. the excess of the amount charged by the parent entity over the fair value of the share options measured at grant date)
	CR Distribution from the subsidiary entity (income statement)	CR Amount due to the parent entity

32. The staff does not deny that “push-down” accounting could potentially be one of the solutions. Indeed, this approach appears to be the most reasonable method that reflects the substance of the arrangements between the parent entity, the subsidiary entity and the employees (as compared with those suggested by the draft Interpretation and the respondents).
33. However, the staff notes that current IFRS literature does not state whether “push-down” accounting should be applied in separate or individual financial statements. Nor does current IFRS literature give any explicit guidance on how the effect of charges made between group entities should be accounted for. The staff has consulted IASB’s project team on IFRS 3 and IAS 27 regarding whether or not such issues have been taken onto the Board’s agenda. The staff understanding is that at this moment the Board is not going to address these issues.
34. The staff, therefore, believes that, since the issues relate to how intragroup transactions should be accounted for in the financial statements of the subsidiary entity and in the separate financial statements of the parent entity, development of an Interpretation to address the issues on this basis might require reconsidering other aspects of existing IFRSs applicable to accounting for intragroup transactions.

Exemption per IAS 19.34A

35. Paragraph 34A of IAS 19 *Employee Benefits* deals with defined benefit plans that share risks between various entities under common control. It states that, if there is a contractual agreement or stated policy for charging the net defined benefit cost for the plan as a whole measured in accordance with IAS 19 to individual group entities, the entity shall, in its separate or individual financial statements, recognise the net defined benefit cost so charged. If there is no such agreement or policy, the net defined benefit cost shall be recognised in the separate or individual financial statements of the group entity that is legally the sponsoring employer for the plan. The other group entities shall, in their separate or individual financial statements, recognise a cost equal to their contribution payable for the period.
36. As a result, some suggest that the amounts of expenses recognised in the financial statements of the subsidiary entity could be based on the amount charged by the parent entity (if the subsidiary is required to pay). If the subsidiary is not required to pay anything, no expense would be recognised in the financial statements of the subsidiary.
37. However, the staff is concerned with the applicability of the approach set out in paragraph 34A of IAS 19 to share-based payment transactions under issues (c) and (d). The relief given in IAS 19 is due to practical difficulties in making allocations of the appropriate amounts of defined benefits (in particular, the movements of liabilities arising from defined benefits) among group entities. On the basis that the measurement of share-based payment arrangements is less complex and that share-based payment arrangements usually have shorter lives, than defined benefit plans, it is difficult for the staff to see the rationale that justifies why the same relief should be given to share-based payment transactions under issues (c) and (d) (even in the case where there is more than one subsidiary).

Staff recommendation

[Paragraphs 38 through 40 are deleted for observer notes purposes.]