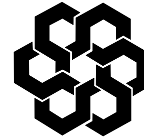

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International Accounting Standards Board

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.
These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting:	**December 2008, London**
Project:	**ED of proposed amendments to IFRS 2 and IFRIC 11 – Group cash-settled share-based payment transactions**
Subject:	**Proposed classification for accounting (question 1B of the ED) (Agenda paper 13)**

INTRODUCTION

1 At the October 2008 meeting, the Board had its first discussion of the project since publishing the ED in December 2007. The staff presented a summary of the comment analysis and of the IFRIC's discussions in May and July of 2008.

2 The Board tentatively confirmed a proposal in the ED to include all forms of group share-based payments in the scope of IFRS 2 *Share-based Payment*, regardless if they are equity-settled or cash-settled. In addition, to achieve this objective the Board also concurred with the IFRIC's recommendations to amend some of the defined terms in IFRS 2 rather than amend IFRIC 11 *IFRS 2—Group and Treasury Share Transactions* and to make it clear that –

(a) the receiving entity accounts for the goods and services received in accordance with IFRS 2; and

(b) the settling entity accounts for the settlement in accordance with IFRS 2.

3 At this meeting, the staff will ask the Board to consider possible alternatives to measure these group arrangements and the IFRIC's recommended changes from the proposed classification for accounting in the ED.

4 The Board also asked the staff to review potential interactions between the scopes of IFRS 2, IAS 19 and IAS 39 for such cash-settled share-based payment transactions. Based on the decisions recommended, the staff analysis also reviews the accounting implications for these transactions.

THE ISSUE

5 The general principle of IFRS 2 is to reflect in an entity's financial statements the effects of share-based payment transactions by recording an expense for the value of the goods and services consumed. Existing definitions and guidance are clear when the same entity receiving goods and services also settles the transaction, but not completely so for those that involve group entities, when the settling and receiving entities may be different.

6 For group *equity-settled* share-based payment arrangements, paragraph 3 of IFRS 2 requires an entity to apply IFRS 2 when 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.

7 The issue is how an entity that receives goods or services from its suppliers (including employees) should account for share-based arrangements that are *cash-settled* when the entity itself does not have any obligation to make the required payments to its employees. The ED described two examples:

- Arrangement 1 – the suppliers of the entity receive cash payments that are linked to the price of the equity instruments of the *entity;*
- Arrangement 2 – the suppliers of the entity receive cash payments that are linked to the price of the equity instruments of the *entity's parent.*

For either arrangement, the parent (not the entity itself) has an obligation to make the required cash payments to the suppliers of the entity.

8 In the financial statements of the subsidiary, neither arrangement currently meets the definition of either a cash-settled share-based payment transaction or an equity-settled share-based payment transaction. Paragraph 6 of IFRIC 8 *Scope of IFRS 2* does suggest that Arrangement 1 is within the scope of IFRS 2 in the financial statements of the subsidiary. At its October 2008 meeting, the Board tentatively decided to include all such group share-based payment transactions in the scope of IFRS 2.

9 However, IFRS 2 and IFRIC 11 do not specify how to account for the cash-settled arrangements described above in the subsidiary's financial statements.

SUMMARY OF IFRIC RECOMMENDATIONS

10 The IFRIC decided to recommend the following to the Board when the share-based payment transaction of an entity receiving goods or services will be settled by another group entity or its shareholder:

(a) The classification and measurement of the share-based payment transaction by the receiving entity and settling entity should not necessarily be the same, dependent on the circumstances.

(b) When the receiving entity has no obligation to settle the share-based payment transaction, it should measure the goods or services received in accordance with the requirements for equity-settled transactions.

(c) Accordingly, only changes in estimates associated with vesting conditions (performance conditions) other than market conditions would be reflected. The receiving entity would recognise in equity an equivalent contribution from its shareholder or parent irrespective of how the expense is calculated by the party with the obligation to settle the shared-based payment transaction.

(d) The financial statements of the group and the settling entity will reflect the IFRS 2 measurement based on the actual settlement from the perspective of the group and the settling entity, respectively.

(e) The Board should not amend IFRS 2 to address intragroup reimbursement arrangements for group share-based payment transactions.

IFRIC DISCUSSIONS

11 The IFRIC discussed two alternatives to account for group cash-settled share-based payment transactions in the separate financial statements of the entity receiving the goods or services when it has no obligation:

(a) **View 1**: Accounting as cash-settled – original proposal in the ED.

(b) **View 2**: Accounting as equity-settled – IFRIC's recommendation.

12 The IFRIC decided to recommend View 2, which received the support of significantly more IFRIC members. Two IFRIC members objected to recommending this to the Board. View 1 received support from several IFRIC members.

13 The staff presented a summary of the IFRIC's discussions and rationales to the Board at the October 2008 meeting. See Appendix A.

STAFF ANALYSIS

14 A parent company (or another group entity) may settle a share-based payment transaction in cash on behalf of the entity receiving the goods and services as an anti-dilution strategy. In addition, a parent may do so as an extension of an intercompany loan to its subsidiary, a settlement of outstanding balances the parent owed from prior normal business transactions, or an outright equity contribution to the subsidiary either in part or in full, among other reasons.

15 The IFRIC recommends that the Board not amend IFRS 2 to address intragroup reimbursement arrangements for such group transactions (see paragraph [9(e)] above). Therefore, the discussions below assume that the group cash-settled share-based payment transaction is a parent's equity contribution to the subsidiary, regardless of repayment arrangements.

16 In both Arrangements 1 and 2, the entity receiving the goods and services has no obligation to settle the transaction. In Arrangement 2, the consideration given to the employees is not the entity's own equity instruments.

17 The staff notes that, for such group transactions, regardless of how they are structured or how they are accounted for in the separate financial statements of the group entities–

(a) the accounting measurement for the consolidated financial statements of the group will be the same;

(b) the share-based payment expense measured on grant date results in the same fair value for both the entity receiving goods and services and the entity settling the transaction, regardless if measured as equity-settled or cash-settled awards.

18 In addition to IFRIC's rationales and discussions, the staff reviewed the following issues to assist the Board in determining the appropriate subsequent accounting measurement:

(a) **Issue A** – In its separate financial statements, should the subsidiary take a group perspective (View A1) or an entity perspective (View A2)?

(b) Issue B – If the Board adopts an entity perspective, what is the overriding principle to determine whether to measure such group cash-settled transactions as equity-settled or cash-settled awards – based on the nature of the consideration being given to employees (View B1) or which entity settles the payment (View B2)?

(c) Issue C – Should the subsidiary remeasure the parent's equity contribution and when? Does the remeasurement of the liability for a cash-settled award in IFRS 2 represent a true up of the value of goods or services received (View C1) or a remeasurement of the liability that is a finance cost (View C2)?

(d) **Issue D** – If the Board supports View C2 for a cash-settled share-based payment transaction, should the associated expenses be presented as two components in the consolidated and separate statements of comprehensive income – cost of goods and services received for the

fair value measured on grant date, and subsequent changes for remeasurement as finance cost?

19 The following paragraphs discuss these issues in greater detail.

Issue A – In separate financial statements, should the subsidiary take a group perspective (View A1) or an entity perspective (View A2)?

20 Current IFRSs have no broad-based guidance to address push-down accounting or the accounting in separate financial statements for the allocation of costs among group entities. IAS 27 *Consolidated and Separate Financial Statements* includes limited guidance in paragraphs 38-40 related to parent's carrying basis for investments, accounting for dividends and for reorganisation of group entities. Both IAS 27 and IAS 24 *Related Party Disclosures* also include extensive disclosure requirements for transactions involving group entities.

21 Paragraphs 34-35 of IAS 19 *Employee Benefits* address defined benefit plans that share risks between various entities under common control; they require an expense to be recorded by the subsidiary based on the cash amount charged by the group plan. When there are no repayment arrangements, it states that:

> *…… 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.* (Paragraph 34A)

22 Recently, in its Discussion Paper of Conceptual Framework (Phase D) on the reporting entity, the joint Boards' preliminary view is that IFRSs apply only to general purpose financial statements, which are the consolidated financial statements. Parent-only or other separate financial statements are not considered general purpose financial statements.

23 In the recent Exposure Draft of Conceptual Framework (Phase A), on the objective of financial reporting, the joint Boards also concluded that the

information provided by general purpose financial reporting should 'reflect the perspective of the entity rather than the perspective of the entity's equity investors….' because the reporting entity is deemed to have substance of its own, separate from that of its owners. (Paragraph OB5)

24 With respect to the employee service costs paid in the form of share-based payments, the staff notes that the guidance in IFRIC 11 only addresses a few specific scenarios of group *equity-settled* share-based payment arrangements. They include (a) one involving an entity's own equity instruments regardless of who grants or settles the transaction and (b) the other involving equity instruments of the parent that are granted by the parent versus those granted by the subsidiary.

25 The staff thinks that the consensus reached in IFRIC 11 reflects a group perspective for some scenarios and an entity perspective for others.

26 Paragraph 8 of IFRIC 11 applies a group perspective and requires the subsidiary's accounting to be the same as the parent's. That guidance states that if a parent grants *its* equity instruments to the employees of its subsidiary, provided that it is accounted for as equity-settled in the consolidated financial statements of the parent, the subsidiary measures the services received from its employees as equity-settled awards. The subsidiary will recognise a corresponding increase in equity as a contribution from the parent.

27 The staff notes that in the above scenario, although the subsidiary has no obligation to settle the transaction, the employees receives payment that is not of the subsidiary's own equity instruments. Under the group perspective, the group received services and paid equity instruments of the group for them. Hence, the staff thinks such transactions will always be accounted for as equity-settled in the consolidated financial statements of the parent.

28 The guidance in paragraphs 9 and 10 of IFRIC 11 also takes a group perspective, which addresses transfers of employees between group entities when the parent grants its equity instruments to employees. Each subsidiary allocates expenses based on the employee's vesting condition and fair value measurement under the group scheme. Therefore, the transfers do not trigger

any reversal of the charge previously recognised by the subsidiary for services received from the employees.

29 In contrast, other guidance in IFRIC 11 takes an entity perspective from the point of view of the subsidiary and requires an accounting measurement different from the parent's. The guidance in paragraph 11 of IFRIC 11 states that if a subsidiary grants rights to equity instruments of *its parent* to its employees and it has the obligation to settle, it measures the services received as cash-settled awards because the form of payment that is not the subsidiary's own equity instruments.

30 Similarly, the guidance in paragraph 7(b) of IFRIC 11 requires a subsidiary to measure the share-based payment involving the subsidiary's own equity instruments as equity-settled regardless of whether the subsidiary or its shareholder grants it or settles it.

31 The staff also identified a third hybrid perspective (**View A3**) for the subsidiary's separate financial statements. It combines both the group and the entity perspectives. (This is close to the approach adopted in IFRIC 11.) Under this view, the entity receiving goods and services first determines if it has an obligation to settle. If so, applying *an entity perspective* requires the entity to measure the expense based on the nature of consideration delivered to the employees – equity-settled if it is its own equity instruments, cash-settled if not.

32 When the entity has no obligation to settle, however, it applies *a group perspective* and records the same expense as the settling entity (e.g., its parent).

33 Many respondents to the ED commented on the tension created by its proposals, which applied the approach in IFRIC 11 to cash-settled plan and therefore generally adopted a group perspective, as being akin to the application of 'push-down' accounting. They questioned the basis for that conclusion.

34 In the absence of a reporting entity theory under IFRS, the staff thinks that if the Board decides to provide additional guidance on accounting for share-based payments involving group entities in separate financial statements, taking an entity perspective provides a better basis.

35 The entity perspective is also consistent with the Board's direction on the project for the Conceptual Framework.

36 However, the staff agrees with several IFRIC members and observers who believe that the most important result of this project is ensuring that the entity receiving the goods or services in a share-based payment transaction reflects their cost. Consequently the staff would also support application of the group perspective. The staff does not support View A3.

37 **Does the Board agree with the staff's recommendation in paragraph 34?**

38 **If not, which perspective would the Board like to adopt? How would the Board like to apply that perspective?**

Issue B – If the Board adopts an entity perspective, what is the overriding principle to determine when to measure group *cash-settled* transactions as equity-settled or cash-settled awards?

39 For Issue B, the staff considered two principles that are currently in IFRIC 11:

(a) **View B1**, based on the nature of the consideration given to the employees – therefore, measured as *equity-settled* if the entity's own equity instruments are given, regardless of who grants/settles it; otherwise measured as *cash-settled* even if the entity has no obligation.

(b) **View B2**, based on the entity that settles the payment – therefore, measured as *cash-settled* if the entity has an obligation to settle, regardless of the nature of the consideration; otherwise measured as *equity-settled*.

40 For example, consider the scenario discussed in paragraph 26 above. Under **View B1**, the subsidiary should measure them as cash-settled because the

equity instruments paid are not its own. Under **View B2**, however, the subsidiary should measure them as equity-settled because it has no liability to pay the employees and there is no outflow of the subsidiary's resources.

41 The consensus reached in IFRIC 11 reflects principles under **View B1** for some scenarios and **View B2** for others.

42 For share-based payment transactions involving an entity's own equity instruments, regardless of who grants or settles them, IFRIC 11 requires the subsidiary to measure them as equity-settled. This guidance reflects **View B1**.

43 In transactions involving equity instruments of the parent that are granted or settled by parent, IFRIC 11 requires the subsidiary to measure them as equity-settled. Those that are granted or settled by subsidiary, however, are measured as cash-settled. This guidance reflects **View B2**.

44 In the staff's view, the different principles already in IFRIC 11 for equity-settled awards (**View B1** and **View B2**) do not reflect a consistent entity approach. The staff thinks that in an entity approach (**View B3**), the share-based expense would be measured as *equity-settled* when the employees are given the entity's own equity instrument or when the entity has no obligation to settle; in all other circumstances, it is measured as *cash-settled*.

45 The staff recommends adopting **View B3** as the overriding principle to measure such group transactions because it has the following advantages:

(a) It always records an IFRS 2 expense on the subsidiary's books. This expense attribution is a definite improvement on the model under IAS 19 for group benefit plans. The IAS 19 model requires the subsidiary to record an expense based only on the amount of cash contribution paid.

(b) It addresses two concerns raised by respondents to the ED about measuring group cash-settled share-based payment transactions as *cash-settled*. Respondents did not agree that the subsidiary should (i) recognise a liability when it has no obligation to settle the payment

to the employees, and

(ii) remeasure the parent's equity contribution based on changes in the value of the *parent's* liability.

(c) It provides a reporting basis consistent with the entity perspective in the subsidiary's separate financial statements.

(d) It provides a broad and consistent principle that all separate entities can apply to group share-based payment transactions. Though not the main goal of this project, this also preserves the existing guidance in IFRIC 11 for group equity-settled share-based payment transactions.

46 **Does the Board agree with the staff's recommendation in paragraph 45?**

47 **If not, which overriding measurement principle would the Board prefer?**

Issue C – Should the subsidiary remeasure the parent's equity contribution and when? Does the remeasurement of the liability for a cash-settled award in IFRS 2 represent a true up of the value of goods or services received (View C1) or a remeasurement of the liability that is a finance cost (View C2)?

48 Many respondents are troubled by the proposal in the ED requiring a subsidiary to remeasure an equity contribution from the parent. The Board's response to **Issue C** will help clarify how to apply the general principles of recording the costs of goods or services received for group cash-settled transactions.

49 The staff agrees that reflecting the parent's measurement in the subsidiary's separate financial statements may not necessarily be the same as push-down accounting, but rather applying the principles of IFRS 2 to reflect the actual ultimate costs to the group of goods or services received by the subsidiary. However, should the subsidiary remeasure the parent's equity contribution for a group cash-settled share-based payment transaction?

50 The staff notes that IFRS 2 does not explicitly state whether the required remeasurement of the liability for cash-settled share-based payment transactions represents:

(a) **View C1** – a true up of the value of goods or services received – if so, even though remeasuring equity may not be supported in other IFRSs, remeasuring the value contributed by the parent in this case seems to comply with the principle of IFRS 2 (paragraphs BC241 and BC252 of IFRS 2); or

(b) **View C2** – a remeasurement of the liability represents a finance cost – if so, having the subsidiary remeasue the parent's contribution is inappropriate as equity is not remeasured in the absence of an obligation to disburse additional assets (paragraphs BC240, BC241, and BC252 of IFRS 2).

51 Moreover, if the Board supports **View C1** that the required remeasurement represents a true up of the value of goods or services received, the staff thinks that the period of remeasurement, if any, depends on the date at which the Board thinks the goods or services are received by the entity – at grant date, at vesting date, at service date or at settlement/exercise date.

52 The staff notes that, for equity-settled transactions, paragraph 10 of IFRS 2 requires the entity to measure the goods or services received directly at their fair value, or indirectly by reference to the fair value of the equity instruments granted if the value of the goods or services received cannot be estimated reliably. Paragraph 13 of IFRS 2 further specifies that for transactions with parties other than employees the entity should measure such fair value at the date it obtains the goods or the counterparty renders services.

53 For cash-settled transactions, paragraph 30 requires the entity to measure the goods or services received and the liability incurred at the fair value of the liability. To illustrate this requirement, paragraph IG 18 notes, '*The entity is required to recognise initially the goods or services acquired, and a liability to pay for those goods or services, when the entity obtains the goods or as the services are rendered, measured at the fair value of the liability. Thereafter, until the liability is settled, the entity is required to recognise changes in the fair value of the liability.*' It is interesting to note that, although the liability must be remeasured, no mention is made of whether the fair value of the goods or services should be adjusted subsequent to grant date.

54 The example in paragraph IG19 of IFRS 2 which deals with the accounting for share appreciation rights granted to employees as part of their remuneration, seems to indicate that goods would not be adjusted as the change in the liability is all recognised in profit or loss in the current period:

> '*Therefore, if the amount recognised for the services received was included in the carrying amount of an asset recognised in the entity's statement of financial position (e.g., inventory), the carrying amount of that asset is not adjusted for the effects of the liability remeasurement.*'

55 Even though the wording in paragraph IG19 is broad and does not clearly differentiate between the two components, some could interpret that the Board intended the required remeasurement to represent a second change in net assets when cash is disbursed at settlement, which does not affect the fair value of the services previously received by the entity.

56 This view is also consistent with the Board's rationales documented in paragraphs BC253-BC255 of IFRS 2. These paragraphs note that for cash-settled awards, the Board originally proposed that entities should separately disclose the amounts based on the fair value at grant date as if equity-settled and the changes in estimate between the grant date and settlement date. When issuing IFRS 2, the Board withdrew that proposal and did not make that requirement mandatory to address respondents' concerns that the ED proposal was burdensome.

57 In paragraph BC255 of IFRS 2, the Board explains its conclusion that the decision to adopt the SFAS 123 modified grant date method will make it more complex for entities to determine the amount for separate presentation, because it will be necessary to distinguish between the effects of forfeitures and the effects of fair value changes when calculating the amount to disclose.

58 Following this line of thinking, the staff analysed whether there is one change or two in the net assets of the subsidiary in the cash-settled group transactions being considered. If the subsidiary receives goods from its supplier, such as inventory, and its parent settles on its behalf at a later date, remeasuring the goods received at the date the parent settles seems inappropriate. There is only one change in the subsidiary's net assets as no cash or other assets are

ever paid out. The value that the subsidiary received was the value of the inventory on the date it was obtained, and this is the amount the parent contributed.

59 Similarly, if the subsidiary receives services from employees, and its parent settles on its behalf at a date later than when the services were received, remeasuring the parent's equity contribution (i.e., the costs of services received by the subsidiary) at the date the parent settles is also inconsistent with the line of thinking discussed above.

60 Therefore, the staff thinks the Board considered the remeasurement of the liability for a cash-settled award to be a finance cost (**View C2**). Consequently, the subsidiary should measure the parent's equity contribution on the date the entity receives the goods or as the employee awards vest. Subsequent changes in the value of the underlying equity instruments that are the basis of the parent's payment are a finance cost, not a part of the subsidiary's share-based payment expense.

61 This is essentially the same measurement approach as equity-settled awards when the subsidiary has no obligation, which the IFRIC recommended. That is, the subsidiary measures the expense as the fair value of the goods or services received at grant date, attributed over the vesting period, and subsequently adjusted only if vesting conditions are not met, but not adjusted for subsequent changes in the value of the underlying equity instrument.

62 Does the Board agree with the staff assessment in paragraph 60?

63 Does the Board agree with IFRIC recommendations in paragraph 61?

Issue D – If the Board supports View C2 for a cash-settled shared-based payment transaction, should the associated expenses be presented as two components in the statements of comprehensive income – cost of goods and services received for the fair value measured on grant date, and subsequent changes from remeasurement as finance cost?

64 As noted above, the Board already considered this issue specifically during the development of the ED on IFRS 2 and again during its redeliberations before issuing IFRS 2.

65 The staff does not recommend that the Board require this disclosure now even though entities would already have the information if the previous recommendations are adopted.

SCOPE REQUIREMENTS IN IFRS 2, IAS 19, AND IAS 39

66 At its October 2008 meeting, the Board also asked the staff to review potential interactions between the scopes of IFRS 2, IAS 19 and IAS 39 for such cash-settled share-based payment transactions. Based on the staff's recommendations above, the following analysis reviews the accounting implications to these transactions.

67 IAS 19 *Employee Benefits* states that it applies to employer accounting for all employee benefits, *except* those to which IFRS 2 applies. (Paragraph 1) Employee benefits in the scope of IAS 19 include a wide range of formal and informal arrangements, for example, wages, salaries and pension plans.

68 The objective of IAS 19 is similar to that of IFRS 2. It requires an entity to recognise (a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and (b) an expense when the entity consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

69 Paragraph 6 of IFRS 2 excludes from its scope share-based payment transactions in which the entity receives or acquires goods or services under a contract within the scope of:

(a) paragraphs 8-10 of IAS 32 *Financial Instruments: Presentation* (as revised in 2003), or

(b) paragraphs 5-7 of IAS 39 *Financial Instruments: Recognition and Measurement* (as revised in 2003)

70 Both IAS 32 (paragraph 4(b)) and IAS 39 (paragraph 2(c)) exclude from their respective scopes employers' rights and obligations under employee benefit plans, to which IAS 19 applies. Paragraph 2(i) of IAS 39 also includes a reciprocal of the scope requirement of IFRS 2, ie it excludes from the scope of IAS 39 '*financial instruments, contracts and obligations under share-based payment transactions to which IFRS 2 applies, except for contracts within the scope of paragraphs 5-7 of [IAS 39], to which [IAS 39] applies.*'

71 The Board explained in paragraphs BC25-BC28 of IFRS 2 what types of contracts should remain within the scope of IAS 32 and IAS 39 and should therefore be excluded from the scope of IFRS 2. These are mainly contracts '*to buy non-financial items that can be settled net in cash or another financial instruments, or by exchanging financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements.*' (Paragraph BC27)

72 IFRS 2 applies to both share-based payments issued to employees and non-employees. The staff reviewed the rationales underlying the Board's conclusions, including the other examples discussed in paragraph BC27 of IFRS 2 to illustrate what types of contracts should remain in the scope of IAS 32 and IAS 39. The staff notes that the contracts that remain within the scope of IAS 32 and IAS 39 are typically the ones issued to non-employees as consideration for goods. The contracts issued to employees as consideration in exchange for services are not intended to be within the scope of IAS 32 or IAS 39 through the scope exclusion in IFRS 2.

73 At its October 2008 meeting, the Board discussed an example for possible structuring opportunities whereby a parent entity sets up a special purpose vehicle as a subsidiary to buy shares of another unrelated entity. The employees of the group will receive employee stock options in the SPV subsidiary, settled by the parent. The settlement will not be in cash but rather in shares of the SPV subsidiary when employees perform services for other group entities in the consolidated group.

74 Some also questioned whether remuneration arrangements that are not settled in the entity's own equity instruments, or when the cash payment is not indexed to the entity's own shares, should be in the scope of IFRS 2. The transfer is of an asset and not a form of the entity's own equity.

75 A Board member expressed concerns about including this group settled share-based payment transaction in the scope of IFRS 2 when it differs little from a derivative. In this Board member's view, it should therefore be marked to market as required by IAS 39. Even though the settlement would be in shares of another group entity (other assets), not in cash, and the SPV subsidiary has no obligation to settle, that accounting should follow the remeasurement requirements for cash-settled share-based payment awards until settlement.

76 Because the employee payment here is in exchange for services performed, such arrangements would fall within the scope of IAS 19 if they are not in the scope of IFRS 2, rather than in IAS 32 or IAS 39. IAS 19 has only limited group accounting guidance that relates to group defined benefit plans. It requires the subsidiary to record an expense for the amount of cash contribution it paid. The subsidiary records no expense if there are no repayment arrangements.

77 In the example above, the staff thinks that the Board's tentative decision to include these arrangements in the scope of IFRS 2 provides a more consistent accounting with other forms of compensation arrangements indexed to the entity's shares.

78 For the example described above, the staff thinks that under the proposed accounting measurement recommended by the IFRIC and supported by the staff, the consolidated group and the settling entity will measure the share-based payment expenses as cash-settled awards under IFRS 2.

79 In their separate financial statements, the SPV subsidiary or other group entities that receive the employee services have no obligation to settle the payment. Therefore, under the accounting measurement recommended by the IFRIC, the share-based payment expenses will be measured as equity-settled awards.

80 In all the financial statements, consolidated or separate, when the employee fails to meet the vesting conditions from an individual entity perspective, the expenses previously recorded by that receiving entity (or the settling entity) will be reversed regardless if they were subsequently measured as equity-settled or cash-settled awards.

81 Given the above, combined with the fact that the SPV subsidiary will likely be consolidated by the group, the staff does not think that the entities in the assumed structure above would be able to avoid a share-based payment expense if the employees meet the vesting conditions.

82 The staff agrees that the accounting measurement subsequent to grant date could differ between the settling entity (cash-settled) and the receiving entity (equity-settled) under the IFRIC recommended approach. Those measurement differences are fundamental principles required by IFRS 2 for equity-settled and cash-settled awards. Issue B discussed earlier in this agenda paper explores what overriding measurement principles should apply to determine when to measure such group cash-settled transactions as equity-settled or cash-settled awards.

83 Based on this analysis, the staff agrees that the Board's tentative decisions at its October 2008 meeting is appropriate. Those tentative decisions include confirming a proposal in the ED to include all forms of group share-based payments in the scope of IFRS 2 *Share-based Payment*, regardless if they are equity-settled or cash-settled.

84 **Does the Board agree with the staff's conclusion in paragraph 81?**

SUMMARY

85 Overall, the staff thinks that both the accounting alternatives considered by the IFRIC as described in paragraph 11 have their pros and cons. The consolidated financial statements do not change for the ultimate group under either view and the main implications are related to the separate financial statements of the entities involved in such group transactions.

86 Based on the above staff analysis, if the Board decides to provide additional guidance on share-based payments involving group entities for separate financial statements, the staff agrees with the IFRIC recommendations.

87 Does the Board agree with IFRIC's recommendations in paragraph 10?

88 If not, how would the Board like to proceed?

89 If the Board agrees with the IFRIC recommendations, the staff proposes the following approach to amend IFRS 2:

(a) The principles and specific scenarios discussed in the text of IFRIC 8 and 11 will be included in a new section of 'Application Guidance'.

(b) The existing Illustrative Examples in the current IFRIC 8 and IFRIC 11 will be added to the existing section of Implementation Guidance.

(c) The 'general principles' for share-based payment transactions involving group entities as approved by the Board will be incorporated.

90 The new section of application guidance would illustrate the principles related to the amended IFRS 2, including the amended defined terms in its Appendix A, that address some of the circumstances when the settling and receiving entities are different.

91 If the Board approves the amendments to IFRS 2, the staff will circulate proposed drafting.

92 **Does the Board agree with the staff's proposal in paragraph 89?**

Appendix A – Extracts from Agenda Paper 14C (IASB October 2008)

IFRIC DISCUSSIONS

4 The IFRIC discussed two alternatives to account for group cash-settled share-based payment transactions in the separate financial statements of the entity receiving the goods or services when it has no obligation:

(a) **View 1**: Accounting as cash-settled – see paragraphs 7-14.

(b) **View 2**: Accounting as equity-settled – see paragraphs 15-25.

5 The IFRIC decided to recommend View 2, which received significantly more support. Two IFRIC members objected to recommending this to the Board. View 1 received support from several IFRIC members.

6 Each of the views and their underlying rationales are set out in more detail in the following paragraphs.

View 1 – Accounting as cash-settled

7 Under this approach, even though the subsidiary has no obligation in the arrangements described in the ED, its separate financial statements reflect the same share-based expenses as the total amount recorded by the parent and the equity contribution is remeasured until settlement. This approach carries forward the proposals in the ED (see Agenda Paper 14D for extracts from the ED).

8 As noted in the comment letter analysis (Agenda Paper 14A), many respondents to the ED questioned the bases for the consensus reached, citing reasons including the lack of a 'push-down' accounting concept in current IFRSs, conflicts with the *Framework* and other IFRSs that prohibit remeasurement of equity, and conflicts with the rationales in the basis for conclusions of IFRS 2.

9 The IFRIC agreed that the subsidiary has no obligation to distribute assets and the settlement by the parent is an equity contribution.

10 Supporters of this view discussed two possible bases for the subsidiary to record the subsequent changes in the value of those cash-settled awards:

   (c) push-down accounting, which the IFRIC rejected unanimously, acknowledging that it is not a basis that exists under current IFRSs; or

   (d) remeasurement because the contribution from the parent does not end on the grant date but rather on the settlement date, which the IFRIC discussed further below.

11 The IFRIC members who supported the view to continue the remeasurement in the subsidiary's separate financial statements cited different reasons:

   (e) In the receiving entity's separate financial statements, measurement as cash-settled awards should apply to all transactions not settled in the receiving entity's own equity instruments, regardless of the choice to settle in equity or cash.

   (f) Cash settlement by either the parent or the subsidiary receiving the goods or services would result in similar economics for the group and, hence, the same accounting should apply in the separate financial statements.

   (g) Reflecting the parent's measurement in the subsidiary's separate financial statements is not push-down accounting, but rather applying the principles of IFRS 2 to reflect the actual costs of goods or services received by the subsidiary, which are the same as the amount settled by the parent and the actual benefits received by the supplier.

   (h) Existing IFRSs already require a subsidiary to mirror its parent's accounting measurement (paragraph 8 of IFRIC 11).

   (i) Consolidation is easier if group entities record the same expenses.

   (j) Structuring opportunities will greatly reduce at the level of separate financial statements for the entity receiving goods or services.

12 On the other hand, the IFRIC considered the context of the Board's objective when developing IFRS 2. Ideally, equity awards are measured at their fair value at grant date including the effect of all possible outcomes of performance conditions. However, it was difficult to determine that value

objectively at grant date when taking into account all such conditions, particularly those that are not market-based. Consequently, when issuing IFRS 2, the Board introduced practical relief to exclude certain vesting conditions that are not market-based from the fair value at grant date but to adjust for them subsequently.

13 Had the Board required the expense for equity awards to be their fair value at grant date, the parent's equity contribution to the subsidiary would not change after grant date. In that case, some viewed the choice to settle with the supplier in cash or equity as a financing choice by the parent.

14 The IFRIC members who disagreed with this view identified several reasons in addition to those concerns already noted by respondents on the ED:

(k) Once the parent takes on the obligation to settle for the subsidiary, the subsidiary has no control even though it may have selected the supplier for the service and the length of vesting period. Hence, the best estimated value of the parent's equity contribution to the subsidiary is at the date of initial contribution; applying hindsight is inappropriate.

(l) Without an obligation, the costs of goods or services received should be valued at grant date, consistent with equity-settled awards.

(m) This view would still result in different classifications for accounting under IFRS 2 in the consolidated and separate financial statements.

(n) If the Board takes a group view for separate financial statements under IFRS 2, it should take that view consistently in other areas – for example, when assessing an equity instrument for classification as equity or liability under IAS 39 and IAS 32. Currently, the separate financial statements reflect the subsidiary's perspective and not the group's.

(o) Consolidation at the group's top level may be easier under this view but consolidating entries are tracked at all levels anyway for any adjustments subject to vesting conditions not being met subsequently.

(p) Regardless of how group transactions are structured, the accounting in the group's consolidated financial statements will stay the same.

View 2 - Accounting as equity-settled

15 Under this approach, the subsidiary reflects the expense as the fair value of the goods or services received at grant date, attributed over the vesting period, and subsequently adjusted if vesting conditions are not met, but not adjusted for subsequent changes in the value of the underlying equity instrument. This approach retains largely the same proposals presented in the staff paper to the IFRIC (see Appendix I).

16 The IFRIC noted that it had received requests to clarify the accounting for such group transactions partly because they do not meet the definitions in IFRS 2 as either equity-settled or cash-settled share-based payment transactions. Applying the existing guidance results in excluding some transactions from the scope, creating diversity.

17 An IFRIC observer commented that resolving the scope issue is more important. Once it is clarified that the transactions are in the scope of IFRS 2, the difference in the amounts measured as equity-settled or cash-settled is a less significant issue and could be left to judgment.

18 The IFRIC would like to include general principles that apply in the separate financial statements of all entities, following rationales that would not diverge from or conflict with the current IFRSs. That would avoid addressing the accounting for these transactions case by case, creating rules-based guidance.

19 The IFRIC discussed the general principles presented by the staff under this view (see paragraph 26 in Appendix I). Many who supported this view believed that taking the subsidiary's perspective in its separate financial statements allows a broad and consistent accounting at that level.

20 At the same time, these proposed principles preserve the interpretation already issued in IFRIC 11 without conflicting with the principles in the *Framework* or other IFRSs, or the rationales in the basis for conclusions of IFRS 2. Therefore, alternatives developed under this view would address the various concerns raised on the proposals in the ED (see paragraph 8).

21 The IFRIC members who objected to this view disagreed for the reasons discussed above in support of the original proposals in the ED (View 1).

22 One IFRIC member also suggested adopting a potential change to the staff's proposals. As summarised in paragraph 14, if the parent is viewed to have made an equity contribution at grant date, the subsidiary should not subsequently remeasure the share-based payment expenses even for changes to the vesting conditions being met, which ignores the requirements of IFRS 2.

23 The IFRIC discussed this example: if an employee of the subsidiary terminates after six months of employment but before meeting the three years of service requirement, IFRS 2 requires the subsidiary to adjust for that change in vesting condition for equity-settled awards, and reverses the cumulative compensation expenses attributed over the six months.

24 In this example, the IFRIC discussed whether the subsidiary should reverse the six months of compensation expenses or leave them on its books.

25 In the end, to avoid adding further complexity, the IFRIC decided not to modify the general principles proposed by the staff and to retain the same recognition framework in IFRS 2 for equity-settled share-based payments.