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International Accounting Standards Board

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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: **July 2008, London**

Project: **ED of Proposed Amendments to IFRS 2 Share-Based Payment and IFRIC 11 IFRS 2–Group Treasury Share Transactions – Proposed scope of IFRS 2 (Question 1a of the ED) (Agenda Paper 2A)**

INTRODUCTION

1. The purpose of this agenda paper is to summarise the staff's analysis of the main areas of concern about the proposed scope in Question 1(a) of the ED, which the IFRIC agreed to reconsider at its May 2008 meeting.

SUMMARY OF STAFF RECOMMENDATIONS

2. The staff recommends that

   (a) related defined terms in Appendix A of IFRS 2 be amended to include share-based payment transactions involving group entities;

   (b) paragraph 2 of IFRS 2 be amended to mirror the revised defined terms;

(c) paragraph 3 of IFRS 2 be amended to articulate more clearly the principles of IFRS 2 as the Board and the IFRIC originally intended for situations when a party other than the entity receiving goods and services settles the group share-based payment transaction.

Proposed wording is included in Appendix B to this agenda paper.

BACKGROUND

3. As presented at the IFRIC meeting in May 2008, many respondents to the ED acknowledged that the principal objective of the proposals was to align the accounting for share-based transactions of similar economic substance, no matter whether they are equity-settled or cash-settled, and to remove structuring incentives prevalent among group entities. Respondents generally agreed that the narrow category of cash-settled transactions between a parent and a subsidiary described above should be within the scope of IFRS 2. Many supported the principal objective of the proposals.

4. However, many also expressed concerns about the proposed scope. The two main areas of concern are:

   (a) the scope for these arrangements with similar substance should be set out more clearly and consistently among IFRSs;

   (b) the amended scope for these arrangements should be consistent with the definitions of share-based payments in IFRS 2.

5. Appendix C of this paper includes extracts from IFRIC Agenda Paper 4 May 2008 for details of summarised comments about the proposed scope.

STAFF ANALYSIS

6. As proposed, arrangements with similar substance could still end up with different conclusions when applying the scope of IFRS 2. The conclusions differ depending on the method of settlement, which group entity has the obligation to transfer the equity or cash (or other assets), and so on.

7. In share-based payment transactions involving group entities, the parent entity has discretion over the form and structure of transactions with similar

economic substance. It will use this discretion to achieve different objectives (e.g., tax purposes).

8. The general principle of IFRS 2 is to require an entity to reflect in its profit or loss and financial position the effects of share-based payment transactions (paragraph 1 of IFRS 2).

9. If an entity receives goods or services from its suppliers (including employees) paid on its behalf through share-based payment transactions by its shareholder, or another group entity at the parent's direction, the staff thinks that the Board and the IFRIC intended for the same principle of IFRS 2 to apply to both the receiving and the settling entities. That is, the same principle of IFRS 2 applies to the entity that receives goods and services and the entity that has the obligation to settle the share-based payment.

10. IFRIC 8 and IFRIC 11 guidance clarify the scope of IFRS 2 for specific scenarios involving group entities and equity instruments of group entities. The ED proposals extend that guidance to address similar scenarios that are cash-settled by a group entity on behalf of the entity receiving the goods and services.

11. Having reviewed the guidance about the scope of IFRS 2 in the standard, IFRIC 8, and IFRIC 11, the staff agrees with some of the respondents' comments on the ED. Those respondents noted that the difficulty in determining whether a transaction is within the scope of IFRS 2 is compounded by the use of inconsistent terminology in subsequent amendments and interpretations.

12. [Paragraph omitted]

13. For example, a 'transferor' of share-based payment, in addition to being the reporting entity itself, refers to various parties in different sections of IFRSs. They include:

    (a) a 'shareholder' – paragraph 3 of IFRS 2; paragraph 6 of IFRIC 8; paragraphs 1(a)-(b) and 7(a)-(b) of IFRIC 11

    (b) a 'parent' – paragraphs 3(a) and 9 of IFRIC 11, paragraph 3A of IFRS 2 and IFRIC 11 as proposed in the ED

(c) ‘another entity in the group’ – paragraph 3A of ED amendment to IFRS 2, paragraph 4 of IFRIC 11 amended as proposed in the ED

(d) a ‘subsidiary’ – paragraphs 3(b) and 11 of IFRIC 11

14. As noted by a respondent to the ED, the terms ‘shareholder’ and ‘parent’ have different meanings: a shareholder is not necessarily a parent, and a parent does not have to be a shareholder. There is no reason why the scope for group cash-settled share-based payments should be different from the scope for group equity-settled share-based payments.[1]

15. Many respondents to the ED suggested changing the proposed new paragraph 3A of IFRS 2 to refer to the transferor as a ‘shareholder’ instead of a ‘parent’ or ‘another group entity’ as currently drafted in the ED so that it is consistent with the existing wording in paragraph 3 of IFRS 2.[2]

16. The staff believes that even though adopting this suggestion would provide some consistency in terminology, it would not accomplish the objective of including all group cash-settled share-based payment transactions in the scope of IFRS 2 as the Board intended.

17. As mentioned in paragraph 3 of Agenda Paper 2, the Board decided at its May 2008 meeting to incorporate the main principles and examples of IFRIC 8 and IFRIC 11 in IFRS 2 after the Board approves the consensus reached by the IFRIC.

18. Doing so may also help eliminate some of the unintended inconsistencies in terminology created by the interpretation of IFRS 2 by IFRIC 8 and IFRIC 11, which are subsequent clarifications of scope for narrowly focused share-based payment transactions.

19. However, the staff believes that debates will continue regarding the scope of IFRS 2 for group transactions unless the fundamental issues are resolved, that is, to broaden the related definitions of IFRS 2 to include share-based payments transferred by an entity’s shareholder or an entity of the same group,

[1] CL 37 KPMG

[2] CL 6, 14, 15, 21, 26, 27, 37, 41, 43 (The Institute of Chartered Accountants in Australia; E&Y; The Institute of Chartered Accountants in Ireland; IOSCO; D&T; PwC; KPMG; AASB; Swedish Financial Reporting Board)

involving shares or equity instruments of the entity or any entity of the same group.

20. The staff thinks that as proposed, IFRS 2, IFRIC 8 and IFRIC 11 combined, would scope in nearly all *equity-settled* share-based payment transactions involving group entities and shareholders for the financial statements of both the receiving and settling entities. [Sentence omitted]

21. However, the staff thinks that current IFRSs amended as currently proposed could still be read to exclude several scenarios from the scope of IFRS 2: when the entity receives the goods and services acquired, and the entity itself (or its shareholder) is obligated to pay cash or an amount based on the price of equity instruments of its parent or another group entity. [Sentence omitted]

22. In other words, when the obligor of the payment is either the entity itself or its shareholder, some could interpret the scope of IFRS 2 to exclude *cash-settled* share-based transactions based on the price or value of equity instruments of group entities in the same group, other than those of the entity itself.

23. In the financial statements of the entity receiving goods and services, such scenarios should be in the scope of IFRS 2. The standard should not reach a different conclusion in this situation from the other scenarios of similar economic substance. The staff thinks the same conclusion should apply in the financial statements of the entity with the obligation to pay on behalf of the receiving entity for such cash-settled share-based payment transactions.

24. The staff thinks this is consistent with what the Board and the IFRIC intended. Under the arrangements described in the ED, the parent has the obligation to make the required cash payments to the employees providing goods and services to the subsidiary. The subsidiary itself does not have any obligation.

25. When developing the ED and the interpretation, the IFRIC discussed the issues in terms of a parent and its subsidiary, but extended the proposed guidance to apply to similar arrangements between an entity and another entity in the same group (see paragraph 4 of the ED to IFRIC 11, amended as proposed).

26. The staff also notes that paragraph 3 of IFRS 2 already includes in the scope of IFRS 2 those share-based payment transactions settled by a shareholder

through the transfer of equity instruments of group entities, i.e., equity-settled, and should be amended to include similar transfers that are cash-settled share-based payment transactions.

27. Based on this analysis, to properly address the scope for these types of share-based payment transactions involving group entities, the staff believes that the related defined terms and paragraph 3 of IFRS 2 should be amended to make it clear that:

   (a) any entity that receives goods or services from a share-based payment transaction has to account for those goods and services in accordance with IFRS 2; and

   (b) any entity, including a shareholder who might not be an entity, that settles a share-based payment transaction on behalf of itself or any entity in the group has to account for settling the transaction in accordance with IFRS 2.

28. Therefore, the staff recommends the following:

   (a) the following defined terms in Appendix A of IFRS 2 be amended to include share-based payment transactions involving group entities — 'cash-settled share-based payment transaction', 'equity-settled share-based payment transaction', 'share-based payment arrangement', 'share-based payment transaction'. This will include within the scope of IFRS 2 all entities receiving goods and services from share-based payment transactions.

   (b) paragraph 2 of IFRS 2 be amended to mirror the revised defined terms.

   (c) if the defined terms above are amended as recommended, paragraph 3 of IFRS 2 be amended to ensure that all settling entities (transferors) are also included in the scope of IFRS 2 as the Board and the IFRIC originally intended for situations when a party other than the entity receiving goods and services settles the group share-based payment transaction.

29. Appendix B of this paper includes the proposed drafting for amendments to the defined terms in Appendix A, and also paragraphs 2 and 3 of IFRS 2.

30. **Does the IFRIC agree with the staff recommendations in paragraphs 27 and 28?**

31. **If not, how would the IFRIC like to proceed?**

32. **Does the IFRIC have any drafting comments on the proposals in Appendix B?**

Appendix A

[Appendix A omitted]

APPENDIX B

[Appendix B omitted]

APPENDIX C

EXTRACTS FROM IFRIC AGENDA PAPER 4 (MAY 2008)

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.

12 [1]

13 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

14 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*.

15 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 paragraph<u>s</u> 3 <u>and 3A</u> should be accounted for in the financial statements of the subsidiary that receives services from the employees. <u>For</u>

[1] CL 3

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."

16 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.

17 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]

18 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.

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

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

20 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.

21 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

22 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]

23 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