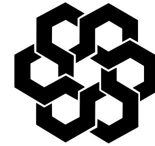

30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
E-mail: iasb@iasb.org Website: www.iasb.org

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: **July 2008, London**

Project: **ED of Proposed Amendments to IFRS 2 *Share-Based Payment* and IFRIC 11 IFRS 2–*Group Treasury Share Transactions* – Proposed classification for accounting (Question 1b of the ED) (Agenda Paper 2B)**

INTRODUCTION

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

SUMMARY OF STAFF RECOMMENDATIONS

2. The staff recommends that the IFRIC reconsider the basis underlying the accounting guidance in the ED for the group cash-settled share-based payment transactions. At this meeting, the staff will ask IFRIC members for their views on alternative bases for the accounting of group share-based payment transactions as equity-settled or cash-settled.

BACKGROUND

3. As presented at the IFRIC meeting in May 2008, most respondents supported the proposed classification and measurement for the narrow category of cash-settled transactions between a parent and a subsidiary described in the ED's Introduction. However, several respondents objected to the proposals and a number of others questioned the bases underlying the consensus reached for different reasons.

4. 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. The main concerns expressed by respondents are as follows:

   (a) the classification and measurement for these arrangements as cash-settled transactions by the entity when it does not have any obligation;

   (b) the attribution of the parent's liability and remeasurement by the subsidiary in the absence of existing concepts in IFRSs and the risk of unintended analogy for other transactions.

5. Appendix A of this paper includes extracts from IFRIC Agenda Paper 4 May 2008 for details of summarised comments about the proposed accounting measurement in the ED.

STAFF ANALYSIS

6. The staff mentioned at the IFRIC May 2008 meeting that some respondents differentiated the classification issue from the measurement issue when commenting on the proposals in the ED. Some respondents may only oppose the proposed remeasurement requirement but not necessarily the classification as 'cash-settled' transactions.

7. The staff believes that this distinction made by respondents, in part, results from the narrow category of group cash-settled share-based payment transactions that do not meet the definitions in Appendix A of IFRS 2. In addition, even though paragraph 3 of IFRS 2 extends the scope of the standard by addressing transfers by shareholders, the interpretation of that guidance in

practice varied because it does not clearly specify transfers that are cash-settled in form or transfers that are made by an entity in the same group.

8. Consequently, for group share-based payment transactions, when constituents submitted requests, the IFRIC debated and provided interpretations to clarify the scope and to specify the measurement requirements for each type of narrowly focused share-based payment transaction involving group entities.

9. The staff also notes that current IFRSs, amended as proposed in the ED, only clarified the measurement guidance for the receiving entity, i.e., the entity receiving goods and services, in these narrowly focused cases addressed by the IFRIC in IFRIC 11.

10. If the IFRIC and the Board continue to address these transactions on a case-by-case basis, the applicable accounting will continue to be case-specific and rule-based. Because share-based payment transactions involving group entities could take various forms but have similar economic substance, developing specified accounting under this approach will further compound the difficulty of applying the general principles of IFRS 2.

11. In addition, the staff thinks that the notion of an entity incurring a liability is a key feature and rationale for the accounting required by *cash-settled* share-based payment transactions, and the subsequent remeasurement of that liability is also a key difference from *equity-settled* share-based payment transactions.

12. Therefore, the staff agrees with some of the respondents' comments on the ED that, when the receiving entity has no obligation to make any payment,

    (a) classifying the arrangements described in the ED as cash-settled share-based payments in the subsidiary's financials conflicts with the rationales in the Basis for Conclusions in both IFRS 2 and IFRIC 11.

    (b) requiring the remeasurement of changes in fair value of the parent's liability to be recognised in the subsidiary's profit and loss conflicts with the *Framework,* and is prohibited by IFRSs because the subsidiary does not have a liability.

    See paragraphs 27 and 29 of Appendix A.

13. Although some respondents differentiated the classification of such group share-based payment transactions from the related remeasurement issues in their comments, the staff has different views.

14. The staff does not think this distinction is appropriate because the staff thinks the remeasurement proposed in the ED is a consequence of the IFRIC's conclusion that these group share-based payment transactions should be accounted for as *cash-settled* in accordance with the requirements in IFRS 2.

15. Under the proposals in the ED, the staff also thinks that the entity receiving the goods and services may be required to apply different accounting to group share-based payment arrangements that are similar in economic substance, for similar purposes.

16. To illustrate, a respondent to the ED sought to clarify the general principles behind the ED, and provided examples of a couple of arrangements as follows[1]:

    (a) *Arrangement A* – The subsidiary grants free shares to its employees that are then puttable to (callable by) the parent;

    (b) *Arrangement B* – The parent grants phantom shares of the subsidiary to the subsidiary's employees and will make the required cash payments.

17. In the consolidated financial statements of the group, the staff thinks that both of these arrangements will be measured in accordance with *cash-settled* share-based payment transactions.

18. However, in the separate financial statements of the receiving entity, i.e., the subsidiary, the staff thinks that the following accounting would apply:

    (a) for Arrangement A – current paragraph 7 of IFRIC 11 would require the subsidiary to measure the expense of goods and services received in accordance with the requirements of *equity-settled* share-based payment transactions.

    (b) for Arrangement B – the new paragraph 11B of IFRIC 11 as proposed in the ED would require the subsidiary to measure the expense of

[1] CL 35 Conseil national de la comptabilité

goods and services acquired in accordance with the requirements of *cash-settled* share-based payment transactions, and remeasure every period until settlement.

19. Both arrangements are share-based and cash-settled, and are for the purpose of compensating the suppliers of goods and services to the subsidiary receiving them. These are the same reasons cited in paragraph BC5 of the ED, which led to the conclusions of the proposed accounting as 'cash-settled' in paragraph BC6 of the ED.

20. The staff does not think that these two arrangements should have different accounting given the similar economic substance.

21. The staff thinks that the IFRIC and the Board should consider an alternative basis to account for the expense of the goods and services received by the entity.

22. When the receiving entity has no obligation to settle the share-based payment transaction, the contribution from its shareholder (or an entity in the same group at its parent's discretion) is an equity transaction. Subsequent changes in fair value of the contributing entity's liability is not part of the receiving entity's cost for the goods and services acquired, but rather, a part of the contributing entity's financing cost when it settles that transaction in cash or other assets instead of its own equity instruments.

23. The staff thinks that an alternative to the accounting by the receiving entity proposed in the ED is to measure the transaction in accordance with the requirements for *equity-settled* share-based payment transactions. This will not only accomplish the objective of the general principles of IFRS 2 by requiring a consistent accounting for transactions with similar economics by the receiving entity, but will also resolve the various conflicts created by the remeasurement applicable to *cash-settled* share-based payment transactions proposed in the ED. (See Appendix A)

24. Considering the nature of these group share-based payment transactions, the staff agrees with the guidance in IFRIC 11, and as proposed in the ED, with respect to the credit being recognised in equity of the receiving entity as

contribution from its shareholder, or, its parent if an entity in the same group is directed to do so at the parent's discretion.

25. From the perspective of the receiving entity, the staff believes that this accounting is appropriate irrespective of how the expense is calculated by the party with the obligation to settle the shared-based payment transaction. The amount of equity contribution from the settling entity is determined on the date of grant for the award, subject to vesting (or performance) conditions other than market conditions being met.

26. In summary, based on the analysis above, the staff believes that the overall accounting principles for share-based payments involving group entities should be as follows:

    (a) in the **separate** financial statements when the share-based payment transactions will be settled by the entity receiving goods and services, the classification and measurement of share-based payment expense should apply the general principles based on the defined terms in Appendix A of IFRS 2, as further expanded in other parts of the standard, amended as recommended in Agenda Paper 2A; and

    (b) in the **separate** financial statements, in circumstances when a *share-based payment transaction* will be settled by an entity other than the entity receiving or acquiring the goods and services, the classification and measurement of the share-based payment expense by the receiving entity and settling entity does not have to be the same. Specifically, the following general principles should be applied by:

        (i) the *receiving entity* – when an entity receives the goods or services in exchange for an award settled on its behalf by its shareholder or an entity in the same group (including its parent),

            - the share-based payment transaction is measured as *equity-settled* and reflects the changes in estimates associated with the vesting conditions (performance

conditions) other than a market condition. (Paragraph 7b and paragraph 8 of IFRIC 11)

- the settlement by another entity is recognised in equity as a contribution from shareholder or parent irrespective of how the expense is calculated by the party with the obligation to settle the shared-based payment transaction. (Paragraph 8 of IFRIC 11)

(ii) the *settling* entity – when an entity has the obligation to settle the share-based payment transaction on behalf of a subsidiary, an investee or another group entity,

- the classification and measurement of the share-based payment obligation should apply the general principles based on the defined terms in Appendix A of IFRS 2, as further expanded in other parts of the standard, amended as recommended in Agenda Paper 2A.

- because the settling entity does not receive goods and services, the amount of the obligation does not necessarily result in the recognition of an expense through profit or loss. The settling entity should consider the substance of the arrangement, which may vary on the basis of facts and circumstances.

(c) in the **consolidated** financial statements of the group, when a *share-based payment transaction* will be settled by an entity other than the entity receiving or acquiring the goods and services, the following general principles should apply:

(i) when the entity with the obligation to settle the share-based transaction is in the same **consolidated** group, the classification and measurement of the share-based payment expense should be that determined by the entity

with the obligation to settle the share-based payment transaction.

(ii) when the entity with the obligation to settle the share-based transaction is not in the same **consolidated** group (e.g., a non-controlling shareholder), the **consolidated** group is a *receiving* entity and should apply the accounting described in (b)(i) above.

27. The staff thinks that these principles allow a *receiving* entity to account consistently for group share-based payment transactions with similar economic substance in its separate financial statements. The staff also thinks these principles allow the *consolidated* financial statements of the group that includes the *receiving* entity to do the same.

28. Consistent with the prior conclusions reached by the IFRIC and the Board when developing IFRIC 11, the staff does not think any amendments to IFRS 2 at this time should address how to account for an intragroup payment arrangement requiring the subsidiary to pay the parent for the provision of the equity instruments to the employees. (See paragraph BC12 of IFRIC 11)

29. Doing so would widen the scope of share-based payment accounting to the accounting for intragroup payment arrangements and related party transactions generally. The staff also agrees with some respondents on the ED, who expressed concerns about the risk of analogy to share-based payment accounting for other types of corporate allocation expenses among group entities. (See paragraph 36 of Appendix A to this paper)

30. **Does the IFRIC agree with the staff's recommendations on the general principles that should apply to share-based payment transactions involving group entities as set out in paragraph 26?**

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

32. If the IFRIC agrees with the staff's recommendations, and decides to recommend them to the Board for consideration, the staff proposes the following approach to amend IFRS 2:

(a) The principles and specific scenarios already discussed in the text of IFRIC 8 and 11 be included in a newly added section of 'Application Guidance' of IFRS 2.

(b) The existing Illustrative Examples in the current IFRIC 8 and IFRIC 11 be added to the existing section of Implementation Guidance of IFRS 2.

(c) IFRS 2 be amended to incorporate the 'general principles' for share-based payment transactions involving group entities set out in paragraph 26 of this paper.

33. The newly added section of application guidance would illustrate the principles related to the amended defined terms in Appendix A, and amended paragraph 3 of IFRS 2 that addresses 'shareholder' settling a group share-based payment transaction on behalf of the receiving entity, as proposed in Agenda Paper 2A.

34. Once the IFRIC reaches consensus on the general principles, and the Board has a chance to redeliberate and approve revised amendments to IFRS 2 based on the IFRIC's recommendation, the staff will draft a revised amendment of IFRS 2 for discussion at a future IFRIC meeting.

35. **Does the IFRIC agree with the staff's proposal in paragraph 32?**

APPENDIX A

EXTRACTS FROM IFRIC AGENDA PAPER 4 (MAY 2008)

PRELIMINARY COMMENT ANALYSIS

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 the ED's Introduction and paragraph 4 of this Agenda Paper. However, several respondents objected to the proposals[1] and a number of others questioned the bases underlying the consensus reached, citing different reasons.[2]

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.[3]

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.[4] Classifying them as cash-settled share-based payments

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[1] CL 20, 24, 36, 40
[2] CL 17, 18, 19, 35, 37
[3] CL 5, 6, 10, 14, 15, 18, 19, 21, 22, 23, 25, 26, 27, 29, 35, 37, 41, 43, 44
[4] CL 24, 35, 37

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 from equity-settled share-based payments as those where the subsidiary has the obligation to transfer cash to suppliers of goods and services.[5]

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.[6]

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.[7]

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.[8]

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.[9] 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

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[5] CL 24, 26, 35, 37
[6] CL 17, 20, 21, 23, 24, 25, 26, 35, 37
[7] CL 17, 20, 24, 25
[8] CL 37
[9] CL 23

the parent's liability should be recognized by the subsidiary as a liability initially, then subsequently as a contribution from parent in equity 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.[10]

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.[11]

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.[12]

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*.[13]

36 Other respondents shared similar concerns about the risk of analogy to this proposal for other types of corporate allocation expenses among group entities.[14]

[10] CL 21
[11] CL 5, 7, 17, 19, 21, 36, 44
[12] CL 18, 35, 37, 42
[13] CL 37
[14] CL 3, 6, 25