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**International
Accounting Standards
Board**

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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: 17 October 2008, London

Project: ED OF PROPOSED AMENDMENTS TO IFRS 2 AND IFRIC 11 – Group cash-settled share-based payment transactions

Subject: Proposed scope of IFRS 2 (Question 1a of the ED) (Agenda Paper 14B) (*Originally posted as observer note 7B for the September 2008 IASB Meeting*)

INTRODUCTION

- 1 The purpose of this agenda paper is to report to the Board a summary of the IFRIC discussions of the staff analysis and alternatives presented at the July 2008 IFRIC meeting (see Appendix I), and its recommended changes to the scope proposal in the ED along with their underlying rationales.
- 2 At this meeting, the staff will ask if the Board agrees with the IFRIC's recommended changes to the scope proposal in the ED.

SUMMARY OF IFRIC RECOMMENDATIONS

- 3 The IFRIC recommends that the Board
 - (a) amend certain defined terms and paragraph 3 of IFRS 2 to make it clear that, in group share-based payment transactions:

- the receiving entity has to account for the goods and services received in accordance with IFRS 2; and
- the settling entity has to account for the settlement in accordance with IFRS 2.

(b) define a ‘group’ as in paragraph 4 of IAS 27 *Consolidated and Separate Financial Statements* to include a parent and its subsidiaries.

IFRIC DISCUSSIONS

- 4 The ED considered how to include in the scope of IFRS 2 those cash-settled share-based payment transactions involving group entities (including shareholders) in which the settling entity is not the entity receiving goods and services. However, as proposed, many respondents expressed concerns that similar arrangements could still end up with different conclusions when IFRS 2 is applied.
- 5 [Paragraph omitted from Observer Notes.]
- 6 The ED proposed to amend both IFRS 2 and IFRIC 11 and include specified types of group cash-settled share-based payment arrangements from the original IFRIC submission in the scope of IFRS 2. The ED did not propose to amend the defined terms in IFRS 2. Consequently, if the ED proposals were finalised, those specified arrangements and other similar group transactions would continue to fail the definitions of a share-based payment transaction.
- 7 [Paragraph omitted from Observer Notes.]
- 8 The IFRIC agreed that the proposals in the ED did not completely achieve its objective and emphasised the importance of developing a principles-based approach for the amendments rather than continuing to develop specific guidance case by case.
- 9 The IFRIC discussed the alternatives the staff presented, which proposed that some defined terms in IFRS 2 be amended and that the Board clearly state its principles for group transactions.
- 10 To avoid further queries about the scope of IFRS 2 for group transactions, the IFRIC agreed with the staff’s proposed alternatives with no objection.

- 11 Therefore, with respect to the scope of IFRS 2 for share-based payment transactions in the separate financial statements of group entities, the IFRIC decided to recommend that the Board amend some defined terms and paragraph 3 of IFRS 2 to make it clear that:
- (a) the receiving entity has to account for the goods and services received in accordance with IFRS 2, regardless of who settles the transaction; and
 - (b) the settling entity has to account for the settlement of the transaction on behalf of itself or another entity in the same group in accordance with IFRS 2.
- 12 The proposed drafting to amend IFRS 2 in Appendix II of this paper aims to include in the defined terms of IFRS 2, and therefore its scope, all group entities involved in a share-based payment transaction regardless of which entity receives the goods or services or which entity settles the transaction.
- 13 The amended defined terms proposed in Appendix II do not cover a shareholder, which may not be an entity, that settles the transaction if the shareholder is not in the same group as the entity receiving the goods and services. As discussed below, IFRS 2 currently does not specify the accounting for such transactions by a shareholder that is not a part of the group and the proposed amendment does not intend to change that. However, for the receiving entity, transactions settled by shareholders are now included in the scope of IFRS 2 by the revised definitions being proposed. Therefore, existing paragraph 3 of IFRS 2 is no longer needed; it is proposed to be deleted in Appendix II.
- 14 **Does the Board agree with the IFRIC recommendations in paragraph 11?**
- 15 During its redeliberations, the IFRIC also discussed and clarified the boundaries of a ‘group’.
- 16 Share-based payment transactions among group entities are often directed by the parent, indicating a level of control. Therefore, the IFRIC decided to recommend that the Board adopt the same definition of ‘group’ as that in paragraph 4 of IAS 27, which includes only a parent and its subsidiaries.

17 Does the Board agree with the IFRIC recommendation in paragraph 16?

A RELATED ISSUE

- 18 These IFRIC recommendations clarify the scope of IFRS 2 so as to result in a consistent conclusion regarding its application to group entities involved in the same transaction. However, both sides of transactions involving entities that are not in the same group (including shareholders, joint ventures and associates) may not be within the scope of IFRS 2. This carries forward the existing guidance of IFRS 2 for entities not in the same group without changing it.
- 19 The staff notes that transactions involving entities not in the same group are not share-based payment transactions as defined in IFRS 2. Under the existing paragraph 3 of IFRS 2, if a shareholder settles a share-based payment transaction, the entity receiving the goods or services is in the scope of IFRS 2 but the shareholder who settles it may not be. In addition, in some cases, if a settling entity is neither the shareholder of the entity receiving the goods or services nor in the same group as the receiving entity, it is possible that both the settling and receiving entities are not required to apply IFRS 2.
- 20 Consider this example: A shareholder settles a share-based payment on behalf of its joint venture by transferring the *shareholder's* equity instruments to the joint venture's supplier.
- 21 In this example, even though the shareholder is the transferor, it issues equity instruments of an entity not in the same group as the entity receiving the goods or services. Both parties will still account for the transaction but the accounting for both may not be in accordance with IFRS 2.
- 22 As noted in Agenda Paper 14A, some respondents to the ED questioned whether the proposed guidance should apply to joint ventures.
- 23 Because the ED and related discussions focused on developing guidance for transactions involving group entities, addressing transactions involving related parties outside a group structure in their separate financial statements would significantly expand the scope of this project and change the scope of IFRS 2.

- 24 Therefore, at this time, the staff does not propose that the Board address transactions between entities not in the same group that are similar to share-based payments but outside the proposed definitions.
- 25 **Does the Board agree with the staff that the recommended changes should clarify but not change the existing scope of IFRS 2?**
- 26 **Does the Board have any drafting comments on the proposals in Appendix II?**

Appendix I

Paper presented as Agenda Paper 2A at the July 2008 IFRIC meeting

NOTES TO THE BOARD –

- * Appendix B of that IFRIC paper is omitted due to updated drafting for the amendments after the IFRIC discussions (see Appendix II to this Agenda Paper).
 - * Appendix C of that IFRIC paper is omitted due to redundant comment analysis information (see Agenda Paper 14A).
- Consequently, all references to those Appendices are marked as deleted.

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.

DELETED]

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. DELETED]

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 from Observer Notes.]
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, 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 deleted from Observer Notes.]

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)

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 deleted from Observer Notes.]
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 paragraphs 2 and 3 of IFRS 2. DELETED.]

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? DELETED]**
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Appendix A

[Appendix A deleted from Observer Notes.]

APPENDIX II

[Appendix II deleted from Observer Notes.]