STAFF PAPER

June 2013

IASB Meeting

Project	**Comprehensive review of the *IFRS for SMEs***
Paper topic	Additional issues identified outside Request for Information process

CONTACT(S) Michelle Fisher mfisher@ifrs.org +44 (0) 20 7246 6918

Purpose of this paper

1. Agenda Paper 8B (this agenda paper) asks the IASB to discuss seven additional issues identified by the staff outside the IASB's 2012 Request for Information (RFI) process.

Structure of this paper

2. This agenda paper is set out as follows:
   - (a) Introduction
   - (b) Issue 1: Offsetting deferred tax assets and liabilities
   - (c) Issue 2: Subsidiaries acquired with an intention to sell
   - (d) Issue 3: Leases with an interest rate variation clause linked to market interest rates
   - (e) Issue 4: Accounting for the liability element of a compound financial instrument
   - (f) Three issues on share-based payments
     - (i) Issue 5: Group share-based payments

(ii) Issue 6: Transactions in which the entity cannot identify specifically some or all of the goods or services

(iii) Issue 7: Measurement of employee share options

Introduction

3. The staff have identified a number of issues on requirements in the *IFRS for SMEs* independently of responses to the RFI, for example during the development of the IFRS Foundation education material on the *IFRS for SMEs*. Some of these issues relate to minor clarifications of requirements or improvements in the wording and the staff propose to address them during drafting of the Exposure Draft of proposed amendments to the *IFRS for SMEs*. However, the staff have identified seven issues where they believe changes are necessary that may affect the current accounting treatment. Therefore, these issues are included in this agenda paper for IASB discussion. For each issue the staff have included:

(a) the issue identified;

(b) staff analysis;

(c) staff recommendation; and

(d) the question(s) for the IASB to discuss

Issue 1) Offsetting deferred tax assets and liabilities (Section 29)

(Note: This issue is being addressed outside Agenda Paper 8A as it is not a change as a result of alignment with IAS 12 *Income Taxes)*

Issue

4. Under IAS 12 there are separate requirements for offsetting deferred tax assets and liabilities to avoid the need for detailed scheduling. Under Section 29 *Income Tax* the requirements for offsetting deferred tax assets and liabilities are the same as for offsetting current tax assets and liabilities.

Staff analysis

5. Paragraph 26.29 of Section 29 (and paragraph 26.35 of Section 29 (revised) in Appendix B of Agenda Paper 8A) provides the requirements for offsetting current tax assets/liabilities and deferred tax assets/liabilities:

> 29.29 An entity shall offset current tax assets and current tax liabilities, or offset deferred tax assets and deferred tax liabilities, only when it has a legally enforceable right to set off the amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously

6. IAS 12.71 and 12.74 provide the requirements for offsetting current tax assets/liabilities and deferred tax assets/liabilities under full IFRSs:

> IAS12.71 An entity shall offset current tax assets and current tax liabilities if, and only if, the entity:
>
> (a) has a legally enforceable right to set off the recognised amounts; and
>
> (b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.
>
> IAS12.74 An entity shall offset deferred tax assets and deferred tax liabilities if, and only if:
>
> (a) the entity has a legally enforceable right to set off current tax assets against current tax liabilities; and
>
> (b) the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either:
>
> (i) the same taxable entity; or
>
> (ii) different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

7. IAS 12 has separate requirements for deferred tax to avoid the need for detailed scheduling of the timing of the reversal of each temporary difference that would otherwise be required, for example in the situation set out in IAS 12.76. IAS 12.76 states "In rare circumstances, an entity may have a legally enforceable right of set-off, and an intention to settle net, for some periods but not for others. In such rare circumstances, detailed scheduling may be required to establish reliably whether the deferred tax liability of one taxable entity will result in increased tax payments in the same period in which a deferred tax asset of another taxable entity will result in decreased payments by that second taxable entity".

8. The staff think that "if, and only if," (used in IAS 12.71) may have been replaced by "only when" during drafting paragraph 29.29 with the intention of providing relief from the requirement to offset, thereby providing relief from detailed scheduling. Nevertheless, the staff does not think this modified wording actually changes the requirement. The staff believes that a strict reading of paragraph 29.29 would still require offsetting when an entity has a legally enforceable right to set off the amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Staff recommendation

9. The staff recommend modifying paragraph 29.29 as shown in underline to clarify that offset would not be required if significant detailed scheduling is required. The staff believe the wording proposed below is easier to understand than IAS 12.74 and will result in a similar outcome for SMEs:

> 29.29 An entity shall offset current tax assets and current tax liabilities, or offset deferred tax assets and deferred tax liabilities, only when the entity has a legally enforceable right to set off the amounts and <u>it is clear without undue cost or effort that</u> it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Question to the IASB
1) Does the IASB agree to amend paragraph 29.29 of the *IFRS for SMEs* as recommended by the staff in paragraph 9?

Issue 2) Subsidiaries acquired with an intention to sell (Section 9)

Issue

10. Paragraph 9.3(b) of Section 9 *Consolidated and Separate Financial Statements* states that a parent need not present consolidated financial statements if it has no subsidiaries other than one that was acquired with the intention of selling or disposing of it within one year. The exemption is expressed in the singular. This raises two issues:

(a) Does the exemption from preparing consolidated financial statements apply if an entity has more than one subsidiary acquired with the intention of sale/disposal within one year? In other words, if a company only has two subsidiaries at the year end and both are acquired with the intention of sale/disposal, is the entity exempt from preparing consolidated financial statements?

(b) If an entity is required to prepare consolidated financial statements because it has a 'normal subsidiary' (ie one that was not acquired with the intention of selling or disposing of it within one year), does it also need to consolidate any subsidiaries that are acquired with the intention of sale/disposal? In other words, if a company has two subsidiaries at the year end and only one was acquired with the intention of sale or disposal within one year, does the entity need to consolidate both entities, or only consolidate the 'normal subsidiary'?

Staff analysis

11. Paragraph 9.3 states:

> 9.3 A parent need not present consolidated financial statements if:
>
> (a) both of the following conditions are met:
>
> (i) the parent is itself a subsidiary, and
>
> (ii) its ultimate parent (or any intermediate parent) produces consolidated general purpose financial statements that comply with full IFRSs or with this IFRS; or
>
> (b) it has no subsidiaries other than one that was acquired with the intention of selling or disposing of it within one year. A parent shall account for such a subsidiary:
>
> (i) at fair value with changes in fair value recognised in profit or loss, if the fair value of the shares can be measured reliably, or
>
> (ii) otherwise at cost less impairment (see paragraph 11.14(c)).

12. The following extract from the October 2008 edition of IASB Update indicates that the IASB's intention was not to limit the exemption to the scenario where an entity only has one subsidiary and that subsidiary was acquired with the intention of selling or disposing of it within one year. The extract specifically refers to 'subsidiaries':

Consolidation - temporary control. In the light of the Board's decision at its meeting in September 2008 to eliminate the 'held for sale' classification, the Board considered whether there should be an exemption from consolidation for a subsidiary that was acquired with an intention to dispose of it in the near future. In effect, such an exemption exists under full IFRSs. The Board decided that a similar exemption from consolidation should be added for subsidiaries where on acquisition there is evidence that control is intended to be temporary (ie there is an intention to dispose of the subsidiary within twelve months and management is actively seeking a buyer). If the condition for exemption is met, the investor would need to provide specified disclosure.

Staff recommendation

13. The staff recommend that paragraph 9.3(b) should be amended to clarify the IASB's intention in paragraph 12 above, ie that there should be an exemption from consolidation for all subsidiaries acquired with the intention of sale or disposal within one year. Therefore the staff recommend making paragraph 9.3(b) a separate paragraph (paragraph 9.3A) and amending it as shown by underline and strikethrough text:

9.3A ~~it has no subsidiaries other than one that~~A subsidiary shall be excluded from consolidation if it was acquired with the intention of selling or disposing of it within one year. A parent shall account for such a subsidiary:

(i) at fair value with changes in fair value recognised in profit or loss, if the fair value of the shares can be measured reliably, or

(ii) otherwise at cost less impairment (see paragraph 11.14(c)).

14. The staff would also make the following consequential amendment to paragraph 9.2:

9.2 Except as permitted or required by paragraphs 9.3 and 9.3A, a parent entity shall present consolidated financial statements in which it consolidates its investments in subsidiaries in accordance with this IFRS. Consolidated financial statements shall include all subsidiaries of the parent.

Question to the IASB
2) Does the IASB agree that paragraph 9.3(b) of the *IFRS for SMEs* should be replaced by 9.3A as recommended by the staff in paragraph 13?

Issue 3) Leases with an interest rate variation clause linked to market interest rates (Section 12 & 20)

Issue

15. A lease with an interest rate variation clause linked to market interest rates, eg linked to changes in LIBOR, is within the scope of Section 12 *Other Financial Instrument Issues*. Such clauses are fairly common for finance leases held by SME lessees.

Staff analysis

16. An SME is required to measure all financial instruments within the scope of Section 12 at fair value and recognise changes in that fair value in profit or loss, except for equity instruments whose fair value cannot be measured reliably (and certain contracts linked to such instruments).

17. Some leases fall within the scope of Section 12. Paragraphs 12.3(f) states:

> 12.3 Section 12 applies to all financial instruments except the following:
>
> (a) ….
>
> (f) leases (see Section 20 *Leases*) unless the lease could result in a loss to the lessor or the lessee as a result of contractual terms that are unrelated to:
>
> (i) changes in the price of the leased asset;
>
> (ii) changes in foreign exchange rates; or
>
> (iii) a default by one of the counterparties.
>
> (g) …..

18. Under full IFRSs, derivatives that are embedded in leases are subject to the embedded derivatives provisions in IAS 39/IFRS 9 and, in certain circumstances, embedded derivatives must be accounted for separately from the host contract. The *IFRS for SMEs* does not require separate accounting for embedded derivatives. Instead it would require a lease contract that includes an embedded risk that is unrelated to 12.3(f)(i)-(iii) to be accounted for in its entirety at fair value.

Staff recommendation

19. The staff do not think leases with an interest rate variation clause linked to market interest rates should be excluded from Section 20 *Leases* and accounted for at fair value through profit or loss under Section 12. Such clauses are relatively common for leases entered into by SMEs and such an embedded risk (embedded derivative) would not normally require separate accounting under full IFRSs. Therefore, the staff recommend revising paragraph 12.3(f) and 20.1(e) as shown in underline to exclude such leases from Section 12, meaning they will be accounted for under Section 20:

12.3 Section 12 applies to all financial instruments except the following:

(a) ….

(f) leases (see Section 20 *Leases*) unless the lease could result in a loss to the lessor or the lessee as a result of contractual terms that are unrelated to:

(i) changes in the price of the leased asset;

(ii) changes in foreign exchange rates <u>or market interest rates</u>; or

(iii) a default by one of the counterparties.

(g) …..

20.1 This section covers accounting for all leases other than:

(a) …

(e) leases that could lead to a loss to the lessor or the lessee as a result of contractual terms that are unrelated to changes in the price of the leased asset, changes in foreign exchange rates <u>or market interest rates</u>, or a default by one of the counterparties (see paragraph 12.3(f)).

(f) …..

Question to the IASB
3) Does the IASB agree that paragraphs 12.3 and 20.1 of the *IFRS for SMEs* should be amended as recommended by the staff in paragraph 19?

Issue 4) Accounting for the liability element of a compound financial instrument (Section 22)

Issue

20. If an entity has a compound financial instrument the liability component is accounted for at amortised cost under paragraph 22.15 of Section 22 *Liabilities and Equity* even if the liability component, had it been a stand-alone instrument, would have been accounted for at fair value through profit or loss under Section 12.

Staff analysis

21. Paragraphs 22.13 – 22.15 in Section 22 address accounting for convertible debt and similar compound financial instruments:

> 22.13 On issuing convertible debt or similar compound financial instruments that contain both a liability and an equity component, an entity shall allocate the proceeds between the liability component and the equity component. To make the allocation, the entity shall first determine the amount of the liability component as the fair value of a similar liability that does not have a conversion feature or similar associated equity component. The entity shall allocate the residual amount as the equity component. Transaction costs shall be allocated between the debt component and the equity component on the basis of their relative fair values.
>
> 22.14 The entity shall not revise the allocation in a subsequent period.
>
> 22.15 In periods after the instruments were issued, the entity shall systematically recognise any difference between the liability component and the principal amount payable at maturity as additional interest expense using the effective interest method (see paragraphs 11.15–11.20). The appendix to this section illustrates the issuer's accounting for convertible debt.

Staff recommendation

22. The staff think that the liability component should be accounted for consistently with similar standalone financial liabilities and, therefore, that amortised cost measurement is only appropriate if the liability component meets the conditions in paragraph 11.9. The staff recommend amending paragraph 22.15 as shown in underline:

> 22.15 In periods after the instruments were issued, the entity shall <u>account for the liability component as follows</u>:

(a) in accordance with Section 11 *Basic Financial Instruments* if the liability meets the conditions in paragraph 11.9. The entity shall systematically recognise any difference between the liability component and the principal amount payable at maturity as additional interest expense using the effective interest method (see paragraphs 11.15–11.20). The appendix to this section illustrates the issuer's accounting for convertible debt where the liability meets the conditions in paragraph 11.9.

(b) in accordance with Section 12 *Other Financial Instruments* if the liability does not meet the conditions in paragraph 11.9.

Question to the IASB
4) Does the IASB agree that paragraph 22.15 of the *IFRS for SMEs* should be revised as recommended by the staff in paragraph 22?

Issues 5-7) Share-based payments (Section 26)

Introduction

23. In June 2009 the IASB issued *Group Cash-settled Share-based Payment Transactions* ('2009 Amendments") to clarify the scope of IFRS 2 *Share-based Payment* and the accounting for group cash-settled share-based payment transactions in the separate or individual financial statements of the entity receiving the goods or services. The 2009 Amendments incorporated in IFRS 2 the guidance contained in the following interpretations:

(a) IFRIC 8 *Scope of IFRS 2*

(b) IFRIC 11 *IFRS 2—Group and Treasury Share Transactions*

24. The 2009 Amendments were considered when initially developing the *IFRS for SMEs*. However as the *IFRS for SMEs* was finalised at a similar time to the 2009 Amendments, the final amendment was not available during drafting of the *IFRS for SMEs*. Subsequently, constituents have identified operational concerns which were resolved in the 2009 Amendments, but not carried over into the *IFRS for SMEs*. Issues 5 and 6 deal with these concerns. Issue 7 is a separate issue on share-based payments.

Issue 5) Group share-based payments (Section 26)

Issue

25. Some people are reading Section 26 *Share-based Payment* as not requiring any accounting for share-based payments in the accounts of subsidiaries when they involve the equity instruments of the parent, or another group entity, for the following reasons:

    (a) The scope of Section 26 only specifically refers to arrangements involving equity instruments of the entity. IFRS 2 *Share-based Payment* clarifies that this includes equity instruments of any other group entity.

    (b) Paragraph 26.16 could be read as permitting subsidiaries to recognise an allocation of the group expense but also allowing the option of recognising nothing at all (since paragraph 26.16 refers to both recognition and measurement).

Staff analysis

Requirements for group share based payments in the IFRS for SMEs

26. Paragraph 26.16 contains the requirements for group plans:

    > 26.16 If a share-based payment award is granted by a parent entity to the employees of one or more subsidiaries in the group, and the parent presents consolidated financial statements using either the *IFRS for SMEs* or full IFRSs, such subsidiaries are permitted to recognise and measure share-based payment expense (and the related capital contribution by the parent) on the basis of a reasonable allocation of the expense recognised for the group.

27. The staff believe the intention of paragraph 26.16 is to permit SMEs to allocate the share-based payment expense between subsidiaries on an approximate basis (e.g. in proportion to wages) rather than doing a detailed calculation for each subsidiary. For example, assumptions such as forfeiture rates and exercise behaviour may be more easily estimated for the employee population as a whole than for each individual subsidiary. The IASB decided this would provide a simplification for SMEs without significantly reducing the usefulness of the information provided.

28. Paragraph 26.1 of the *IFRS for SMEs* specifies the scope of Section 26 (identical to IFRS 2.2 before it was revised by the 2009 Amendments):

> 26.1 This section specifies the accounting for all share-based payment transactions including:
>
> (a) equity-settled share-based payment transactions, in which the entity acquires goods or services as consideration for equity instruments of the entity (including shares or share options);
>
> (b) cash-settled share-based payment transactions, in which the entity acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other equity instruments of the entity; and
>
> (c) transactions in which the entity receives or acquires goods or services and the terms of the arrangement provide either the entity or the supplier of those goods or services with a choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments.

29. The definitions of equity-settled and cash settled share-based payment transactions in 26.1(a) and (b) and the definition of share-based payment transaction are based on the definitions in IFRS 2 before they were revised by the 2009 Amendments.

Changes to the scope and definitions in IFRS 2 under the 2009 Amendments

30. The 2009 Amendments amended the scope of IFRS 2 by modifying IFRS 2.2 and adding a new IFRS 2.3A as follows:

> IFRS2.2 An entity shall apply this IFRS in accounting for all share-based payment transactions, whether or not the entity can identify specifically some or all of the goods or services received, including:
>
> (a) *equity-settled share-based payment transactions*,
>
> (b) *cash-settled share-based payment transactions*, and
>
> (c) transactions in which the entity receives or acquires goods or services and the terms of the arrangement provide either the entity or the supplier of those goods or services with a choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments,
>
> except as noted in paragraphs 3A–6. In the absence of specifically identifiable goods or services, other circumstances may indicate that goods or services have been (or will be) received, in which case this IFRS applies.
>
> IFRS2.3A A share-based payment transaction may be settled by another group entity (or a shareholder of any group entity) on behalf of the entity receiving or acquiring the goods or services. Paragraph 2 also applies to an entity that

(a) receives goods or services when another entity in the same group (or a shareholder of any group entity) has the obligation to settle the share-based payment transaction, or

(b) has an obligation to settle a share-based payment transaction when another entity in the same group receives the goods or services

unless the transaction is clearly for a purpose other than payment for goods or services supplied to the entity receiving them.

31. The 2009 Amendments also widened the definitions of equity-settled and cash-settled share-based payment transactions, and share based arrangements/transactions as follows to specifically refer to equity instruments of another group entity:

Equity settled share-based payment transaction: A share-based payment transaction in which the entity:

(i) receives goods or services as consideration for its own equity instruments (including shares or share options), or

(ii) receives goods or services but has no obligation to settle the transaction with the supplier.

Cash-settled share-based payment transactions: A share-based payment transaction in which the entity acquires goods or services by incurring a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity.

Share-based payment arrangement: An agreement between the entity (or another group entity or any shareholder of any group entity) and another party (including an employee) that entitles the other party to receive:

(i) cash or other assets of the entity for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity, or

(ii) equity instruments (including shares or share options) of the entity or another group entity

provided the specified vesting conditions, if any, are met.

Share-based payment transaction: A transaction in which the entity

(i) receives goods or services from the supplier of those goods or services (including an employee) in a share-based payment arrangement, or

(ii) incurs an obligation to settle the transaction with the supplier in a share-based payment arrangement when another group entity receives those goods or services.

Staff recommendation

Amendments to the scope to incorporate instruments of group entities (to address paragraph 25(a))

32. The staff believe that it should really be evident from the inclusion of paragraph 26.16 that Section 26 also applies to equity instruments of other group entities. However, because the staff are aware that this issue has been raised in practice they recommend amending the scope and definitions of Section 26 in line with those in IFRS 2 post 2009 Amendments to correct possible unintended consequences of the current wording. Therefore the staff recommend replacing paragraph 26.1 and adding a new paragraph 26.1A as follows:

26.1 This section specifies the accounting for all share-based payment transactions including:

- (a) *equity-settled share-based payment transactions*, in which the entity:
  - (i) receives goods or services as consideration for its own equity instruments (including shares or share options), or
  - (ii) receives goods or services but has no obligation to settle the transaction with the supplier
- (b) *cash-settled share-based payment transactions*, in which the entity acquires goods or services by incurring a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity; and
- (c) transactions in which the entity receives or acquires goods or services and the terms of the arrangement provide either the entity or the supplier of those goods or services with a choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments.

26.1A A share-based payment transaction may be settled by another group entity (or a shareholder of any group entity) on behalf of the entity receiving or acquiring the goods or services. Paragraph 26.1 also applies to an entity that

- (a) receives goods or services when another entity in the same group (or a shareholder of any group entity) has the obligation to settle the share-based payment transaction, or
- (b) has an obligation to settle a share-based payment transaction when another entity in the same group receives the goods or services

unless the transaction is clearly for a purpose other than payment for goods or services supplied to the entity receiving them.

33. The staff also propose to include the following revised definitions from IFRS 2 (set out in paragraph 31 above) as they specifically refer to equity instruments of the entity or another group entity:

    (a) Cash settled share-based payment transactions

    (b) Equity settled share-based payment transactions

    (c) Share-based payment arrangements

    (d) Share-based payment transactions

Amendments to the requirements for group plans (to address paragraph 25(b))

34. The staff recommend modifying paragraph 26.16 to

    (a) clarify that the share-based payment could be granted by a fellow subsidiary as well as a parent entity; and

    (b) delete 'and recognise' to clarify that the relief is for the measurement of the share-based payment expense and not its recognition.

35. Therefore the staff recommend amending paragraph 26.16 as shown by underline and strikethrough text to address the proposed changes in paragraph 25(a) and (b):

    26.16 If a share-based payment award is granted by a parent entity, <u>or a fellow subsidiary of the group,</u> to the employees of one or more subsidiaries in the group, and the parent presents consolidated financial statements using either the *IFRS for SMEs* or full IFRSs, such subsidiaries are permitted to ~~recognise and~~ measure share-based payment expense (and the related capital contribution by the parent) on the basis of a reasonable allocation of the expense recognised for the group.

Questions to the IASB
5) Does the IASB agree with the staff recommendation to **i) amend paragraph 26.1 of the *IFRS for SMEs* and add a new paragraph 26.1A as recommended by the staff in paragraph 32?** **ii) include the four definitions from IFRS 2 as recommended by the staff in paragraph 33?** **iii) amend 26.16 of the *IFRS for SMEs* as recommended by the staff in paragraph 35?**

Issue 6) Transactions in which the entity cannot identify specifically some or all of the goods or services (Section 26)

Issue

36. IFRS 2.13A deals with the scenario where the identifiable consideration received by an entity appears to be less than the fair value of the equity instruments granted or the liability incurred.

37. Paragraph 26.17 of the *IFRS for SMEs* deals with this but only for government-mandated plans. Therefore, unless such plans are required by law they would not strictly be required to be accounted for under paragraph 26.17. However, in some jurisdictions the issue arises in instances which are not restricted to government mandated plans.

Staff analysis

38. Paragraph 26.17 of the *IFRS for SMEs* states:

> **Government-mandated plans**
>
> 26.17 Some jurisdictions have programmes established under law by which equity investors (such as employees) are able to acquire equity without providing goods or services that can be specifically identified (or by providing goods or services that are clearly less than the fair value of the equity instruments granted). This indicates that other consideration has been or will be received (such as past or future employee services). These are equity-settled share-based payment transactions within the scope of this section. The entity shall measure the unidentifiable goods or services received (or to be received) as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received) measured at the grant date.

39. The 2009 Amendments amended the scope of IFRS 2 by modifying IFRS 2.2. In particular in relation to this issue the 2009 amendments added the words in underline to IFRS 2.2:

> IFRS 2.2 An entity shall apply this IFRS in accounting for all share-based payment transactions, <u>whether or not the entity can identify specifically some or all of the goods or services received</u>, including:
>
> (a) *equity-settled share-based payment transactions*,
>
> (b) *cash-settled share-based payment transactions*, and
>
> (c) transactions in which the entity receives or acquires goods or services and the terms of the arrangement provide either the entity or the supplier

of those goods or services with a choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments,

except as noted in paragraphs 3A–6. <u>In the absence of specifically identifiable goods or services, other circumstances may indicate that goods or services have been (or will be) received, in which case this IFRS applies</u>.

40. The 2009 Amendments also added a new paragraph IFRS 2.13A (previously the requirements were in IFRIC 8 *Scope of IFRS 2):*

IFRS2.13A In particular, if the identifiable consideration received (if any) by the entity appears to be less than the fair value of the equity instruments granted or liability incurred, typically this situation indicates that other consideration (ie unidentifiable goods or services) has been (or will be) received by the entity. The entity shall measure the identifiable goods or services received in accordance with this IFRS. The entity shall measure the unidentifiable goods or services received (or to be received) as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received). The entity shall measure the unidentifiable goods or services received at the grant date. However, for cash-settled transactions, the liability shall be remeasured at the end of each reporting period until it is settled in accordance with paragraphs 30–33.

Staff recommendation

41. The staff recommend adding a new scope paragraph 26.1B and amending paragraph 26.17 as shown in underline and strikethrough to ensure that Section 26 is applied to all share-based payment transactions where the identifiable consideration received by an entity appears to be less than the fair value of the equity instruments granted or liability incurred (and not just those established under law):

<u>26.1B In the absence of specifically identifiable goods or services, other circumstances may indicate that goods or services have been (or will be) received, in which case this section applies (see paragraph 26.17).</u>

…

~~Government-mandated plans~~ <u>Transactions in which the entity cannot identify specifically some or all of the goods or services</u>

26.17 <u>If the identifiable consideration received (if any) by the entity appears to be less than the fair value of the equity instruments granted or liability incurred, typically this situation indicates that other consideration (ie unidentifiable goods or services) has been (or will be) received by the entity. For example, </u>~~S~~some jurisdictions have programmes ~~established under law~~ by which equity investors (such as employees) are able to acquire equity without providing goods or services that can be specifically identified (or by providing goods or services that are clearly less than the fair value of the equity instruments granted). ~~These are equity-settled share-based payment transactions within the scope of this section.~~ The entity shall measure the unidentifiable goods or services received (or to be received) as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received) measured at the grant date. For cash-settled transactions, the liability shall be remeasured at the end of each reporting period until it is settled in accordance with paragraph 26.14.

Question to the IASB
6) Does the IASB agree to add paragraph 26.1B and amend paragraph 26.17 of the *IFRS for SMEs* as recommended by the staff in paragraph 41?

Issue 7) Measurement of employee share options (Section 19 & 26)

Issue

42. When accounting for share-based payments if observable market prices for the shares are not available, the *IFRS for SMEs* permits the entity's directors to use their judgement to apply the most appropriate valuation method to determine the fair value of the shares. However, for share options the *IFRS for SMEs* requires use of option pricing models. Use of option pricing models is particularly complex for entities that are not publicly traded. Other valuation techniques, eg use of intrinsic value, may provide some relief, eg from calculating volatility of the share price.

Staff analysis

43. Paragraph 26.10 and 26.11 explain how to measure the fair value of shares, share options and equity-settled share appreciation rights:

Shares

26.10 An entity shall measure the fair value of shares (and the related goods or services received) using the following three-tier measurement hierarchy:

(a) If an observable market price is available for the equity instruments granted, use that price.

(b) If an observable market price is not available, measure the fair value of equity instruments granted using entity-specific observable market data such as

(i) a recent transaction in the entity's shares, or

(ii) a recent independent fair valuation of the entity or its principal assets.

(c) If an observable market price is not available and obtaining a reliable measurement of fair value under (b) is impracticable, indirectly measure the fair value of the shares or share appreciation rights using a valuation method that uses market data to the greatest extent practicable to estimate what the price of those equity instruments would be on the grant date in an arm's length transaction between knowledgeable, willing parties. The entity's directors should use their judgement to apply the most appropriate valuation method to determine fair value. Any valuation method used should be consistent with generally accepted valuation methodologies for valuing equity instruments.

Share options and equity-settled share appreciation rights

26.11 An entity shall measure the fair value of share options and equity-settled share appreciation rights (and the related goods or services received) using the following three-tier measurement hierarchy:

(a) If an observable market price is available for the equity instruments granted, use that price.

(b) If an observable market price is not available, measure the fair value of share options and share appreciation rights granted using entity-specific observable market data such as (a) for a recent transaction in the share options.

(c) If an observable market price is not available and obtaining a reliable measurement of fair value under (b) is impracticable, indirectly measure the fair value of share options or share appreciation rights using an option pricing model. The inputs for the model (such as the weighted average share price, exercise price, expected volatility, option life, expected dividends, and the risk-free interest rate) should use market data to the greatest extent possible. Paragraph 26.10 provides guidance on determining the fair value of the shares used in determining the weighted average share price. The entity should derive an estimate of expected volatility consistent with the valuation methodology used to determine the fair value of the shares.

Staff recommendation

44. For cost-benefit reasons the staff recommend modifying paragraph 26.11(c) as shown in underline and strikethrough to allow the entity's directors to use their judgement to apply a valuation method to determine the fair value of share options to permit a similar flexibility as for determining the fair value of shares in 26.10(c):

26.11(c) If an observable market price is not available and obtaining a reliable measurement of fair value under (b) is impracticable, indirectly measure the fair value of share options or share appreciation rights using an <u>alternative valuation method such as an</u> option pricing model. The inputs for the model <u>should use market data to the greatest extent possible</u>. <u>For example, for an option pricing</u>

model ~~(~~such inputs may include ~~as~~ the weighted average share price, exercise price, expected volatility, option life, expected dividends, and the risk-free interest rate~~) should use market data to the greatest extent possible~~. Paragraph 26.10 provides guidance on determining the fair value of the shares used in determining the weighted average share price. The entity should derive an estimate of expected volatility consistent with the valuation methodology used to determine the fair value of the shares.

Question to the IASB
7) Does the IASB agree to amend paragraph 26.11(c) of the *IFRS for SMEs* as recommended by the staff in paragraph 44?