

DRAFT COMMENT LETTER

**Comments should be received by 14 March 2008 and be sent
to Commentletter@efrag.org**

March 2008

IFRS 2 and IFRIC 11 Amendments
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UK

Dear Sir/Madam,

Exposure Draft of Proposed Amendments to IFRS 2 *Share-based Payment* and IFRIC 11 *Group and Treasury Share Transactions: Group Cash-settled Share-based Payment Transactions*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft of Proposed Amendments to IFRS 2 *Share-based Payment* and IFRIC 11 *Group and Treasury Share Transactions: Group Cash-settled Share-based Payment Transactions* ('the ED'). This letter is submitted in EFRAG's capacity of contributing to the IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive IFRS and IFRIC.

Existing IFRS 2 (paragraph 3) requires an entity to account for as share-based arrangements, transfers of equity instruments of the entity's parent (or another entity in the same group) to parties that have supplied goods or services to the entity. Essentially, paragraph 3 of IFRS 2 addresses *group equity-settled share-based payments arrangements*. IFRIC 11 clarifies how such arrangements ought to be accounted for in the separate financial statements of the entity that receives the goods or services.

However, neither IFRS 2 nor IFRIC 11 provides guidance on whether group cash-settled arrangements are share-based payment arrangements and how those arrangements should be accounted for in the financial statements of the entity that receives the goods or services. The purpose of the ED is to clarify this uncertainty. In particular, the ED clarifies how an entity should account for goods or services it receives under the following types of arrangements ('the arrangements'):

- Arrangement 1 - the suppliers of the entity will receive cash payments that are linked to the price of the equity instruments of the entity.
- Arrangement 2 - the suppliers of the entity will receive cash payments that are linked to the price of the equity instruments of the parent of the entity.

(In both arrangements the entity that receives the goods or services and the entity that has incurred the obligation related to these goods and services is different.)

Specifically, the IASB is proposing to address the accounting for the above arrangements by amending:

- (a) the scope of IFRS 2 to clarify that an entity that receives goods or services from its suppliers (including employees) as a result of a group cash-settled share-based payment arrangement, must apply IFRS 2 even though it itself has no obligation to make the required share-based cash payments;
- (b) the scope of IFRIC 11 to include the arrangements referred to in (a) and the requirements of IFRIC 11 to clarify the accounting of group cash-settled arrangements in the financial statements of an entity that receives goods or services under those arrangements.

EFRAG supports the IASB's decision to address this subject.

We also support the proposal to extend the scope of both IFRS 2 and IFRIC 11 to encompass the arrangements described in the ED; and we broadly agree with the consensus reached in the amendment to IFRIC 11- that the arrangements described in paragraph 3A of the amendments to IFRIC 11 ought to be *measured* based on the requirements of a cash-settled transaction. However:

- we are concerned with the way the IASB is proposing to address the issues. In our view, a more appropriate way would have been to amend the definitions of IFRS 2 to enable the standard to be scoped clearly and to clarify the appropriate classification of the arrangements.
- we believe that the scope of the specific issues addressed in the ED is too narrow. For example, if the IASB proceeds with the amendments as drafted, the revised IFRIC 11 will not specifically scope in group share-based payment arrangements that provide either the employees or the entity with a choice on how the share-based payment arrangements will be settled. We believe that it would be more appropriate for the IASB to address group share-based payment arrangements more broadly, and consider which other group schemes, if any, ought to be accounted for as share-based payment arrangements under IFRS 2.
- in our view the accounting by an entity for the arrangements as a capital contribution from another group entity might not always be appropriate, especially if the arrangements are transactions between two or more subsidiary entities and do not involve a parent-subsidiary relationship.

Our detailed comments are set out in the appendix to this letter.

If you would like further clarification of the points raised in this letter, please do not hesitate to contact Isabel Batista or me.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

APPENDIX—EFRAG’s detailed comments on the Exposure Draft (‘ED’)

Question 1— Specifying how a subsidiary that receives goods or services from its suppliers (including employees) should account for cash-settled share-based payment arrangements described in new paragraph 3A of IFRIC 11.

The proposed amendments specify that:

- in the financial statements of a subsidiary that receives goods or services from its suppliers under the arrangements described in new paragraph 3A of IFRIC 11, the subsidiary should apply IFRS 2 to account for the transactions with its suppliers. In other words, in the financial statements of the subsidiary, such cash-settled share-based payments are within the scope of IFRS 2 (see new paragraph 3A of IFRS 2 and new paragraph 11A of IFRIC 11).
- the subsidiary should measure the goods or services received from its suppliers in accordance with the requirements applicable to cash-settled share-based payment transactions, as set out in IFRS 2 (see new paragraph 11B of IFRIC 11).

Question 1: Do you agree with the proposals? If not, why?

SCOPE

Proposed new paragraph 3A of IFRS 2

- 1 In our view an implicit objective of IFRS 2 is to ensure that when an entity enters into a transaction whereby it receives goods or services from its suppliers (or its employees) it accounts for those transactions appropriately. This ED proposes to amend the scope IFRS 2 to scope in group cash-settled share-based payment arrangements. This will mean that IFRS 2 will apply to share-based payment group arrangements that are equity-settled or cash-settled arrangements. We agree that this re-scoping is needed to ensure the implicit objective is met, so we support the proposal in principle.
- 2 However, we are concerned that the arrangements described in proposed new paragraph 3A do not meet IFRS 2’s definition of a share-based payment and that remains the case even under the proposals. The IASB explains in BC3 that existing IFRS 2 already scopes in transactions that are not share-based payment as defined. We agree that this is the case (because paragraph 3 of existing IFRS 2 requires an entity to recognise, as share-based payment transactions, transfers of equity instruments of an entity, its parent or another group entity, even if the equity instruments are not granted by the entity itself). When we commented on D17 (later issued as IFRIC 11), we explained that we did not agree that the wording of definitions should be ignored. We believe the IASB should not use the decision taken by the IFRIC when developing IFRIC 11 as a precedent to continue ignoring the definitions of IFRS 2.
- 3 For the reasons noted above, we strongly believe that the most appropriate way for the IASB to address the issues in the ED is to amend the definitions of IFRS 2 to clarify the appropriate classification of a share-based payment. In this way there would be no need for the IASB to scope in share-based payment arrangements that are outside the scope of IFRS 2.

Proposed new paragraph 3A of IFRIC 11

- 4 The ED is also proposing to extend the scope of IFRIC 11 so that it addresses the types of arrangements brought within the scope of IFRS 2 by the proposed amendment discussed above. EFRAG agrees that, subject to the concerns mentioned above, this is a sensible thing to do.

Group arrangements with a choice of settlement

- 5 Under IFRS 2, all share-based payment transactions will be classified as cash-settled, equity-settled or a hybrid of the two (an example of the latter would be an arrangement that grants a choice of settlement either to the employee or to the entity).
- 6 Existing IFRIC 11 clarifies how an entity should account for *equity*-settled share-based payment arrangements that involve two or more group entities, and the amendments proposed in the ED will result in IFRIC 11 clarifying how an entity should account for *cash*-settled share-based payment arrangements that involve two or more group entities.
- 7 However, that still means that IFRIC 11 will not provide guidance on how an entity should account for goods or services received under a group arrangement that in effect is a 'hybrid' scheme. In particular, it will not address how an entity should account for group share-based payment arrangements that give either the employees or the entity a choice on settlement. We have to accept that it is a fact that under existing IFRS 2 there are specific accounting 'rules' to determine when a 'hybrid' transaction is classified as cash-settled and when it is classified as equity-settled. For this reason we are concerned that the lack of specific guidance might be misinterpreted and result in unintended consequences.
- 8 In our view, rather than make a further narrow change to IFRIC 11, it would be more appropriate for the IASB to address group share-based payment arrangements more broadly and consider whether there are other group schemes that also ought to be accounted for under IFRS 2 and that also need to be addressed in IFRIC 11. That way the IASB can ensure that the accounting for all group share-based arrangements is appropriately addressed in the financial statements of the entity that receives goods or services, regardless of whether they are equity-settled, cash-settled or a hybrid of the two.

Parent entity's separate financial statements

- 9 The amendments do not address how the entity that provides the required cash payments should account for the arrangements. We understand that, when IFRIC 11 was developed, the IFRIC decided not to address the accounting by the parent entity. However, we believe that such guidance might be helpful, particularly now that IFRIC 11 addresses a variety of group schemes.
- 10 We understand that when IFRIC 11 was being developed, the IFRIC attempted to develop illustrative guidance on how the parent entity should account for the arrangements it was addressing. One of the 'problems' the IFRIC encountered was that from the perspective of the parent entity the arrangements were not within the scope of IFRS 2. Once again it was a share-based payment definition issue. As previously explained, we would strongly encourage the IASB to address how a share-based payment ought to be defined in IFRS 2, instead of trying to develop guidance on share-based transactions that are not within the definitions of a share-based payment.

Group arrangements that do not involve a parent-subsidiary relationship

- 11 The words used in the amendment to IFRIC 11 discuss group cash-settled share-based payment transactions in terms of a parent and its subsidiary, with the subsidiary receiving the goods or services (and capital contribution) and the parent paying for them. However, as specifically noted in paragraph 4 of the amendments to IFRIC 11, the guidance in IFRIC 11 (as amended) will also apply to similar arrangements between an entity and another entity within the same group.
- 12 We interpret that to mean that IFRIC 11 applies to share-based payment arrangements for all entities in the same group, regardless of whether the arrangements involve a parent-subsidiary relationship; whether (if there is a parent-subsidiary relationship) it is the subsidiary that is receiving the goods or services and capital contributions or the parent; and regardless of whether the group arrangement is equity-settled or cash-settled. If our interpretation is correct, we have some concerns on the accounting being proposed in the paragraph 11B of IFRIC 11 regarding the arrangements addressed in the ED and the arrangements already addressed in existing IFRIC 11. Our concerns are discussed in more detail below under the heading 'Are the arrangements always a capital contribution?'

ACCOUNTING FOR THE ARRANGEMENTS

Measuring the goods or services received

- 13 Under IFRS 2, the way the goods or services are measured will depend on how the arrangements are classified. It is clear that in the consolidated financial statements the arrangements addressed in the ED will be accounted for and hence measured, as cash-settled transactions. The proposal in the ED is that the entity receiving the goods or services should also measure the arrangement as cash-settled in its own separate financial statements. This means that the subsidiary will measure the goods or services it receives initially on the basis of the fair value of the corresponding liability incurred by the parent, and in subsequent periods will recognise any changes in the fair value of that liability in profit and loss.
- 14 We broadly agree with this conclusion. However, in BC8 of the ED, the IASB supports its proposal to measure such arrangements in the same way as cash-settled arrangements by referring to the involvement the parent entity has with the arrangements. Although we agree that the parent is involved in one way or another with the arrangements, we find this argument unconvincing.
- 15 Our reasoning is that, because the subsidiary does not have an obligation to make the required cash payments related to the goods or services, it seems reasonable to view the transaction from the perspective of the supplier of the goods and services (i.e. the employee) and ask what that supplier does receive. In such arrangements the suppliers receive cash payments. Hence, the arrangement seem 'more like' a cash-settled arrangement than an equity-settled arrangement. We think this reasoning would also not be inconsistent with the underlying rationale under existing IFRIC 11, which focuses on which entity has the obligation to deliver equity instruments to the employees of the entity.

Are the arrangements always a capital contribution?

- 16 Generally, we agree that, when dealing with arrangements that involve the subsidiary receiving the goods or services and the parent cash-settling, the 'credit side' of the arrangements represents a capital contribution from the parent to its subsidiary which

is accounted for in equity. However, as explained below, we are less comfortable with this if the arrangement does not involve a parent and its subsidiary.

- 17 As mentioned above, in our view, the accounting by an entity for the arrangements as a capital contribution from another group entity might not always be appropriate, especially if the arrangements are transactions between two or more subsidiary entities and do not involve a parent-subsidiary relationship. Consider the following example:

Subsidiary ('A') grants a cash-settled arrangement to the employees of subsidiary ('B'). Ignoring the any legal consequences, in our view it seems odd that entity B should recognise in its financial statements a capital contribution from a fellow subsidiary, entity A. In such cases, we believe that it might be more appropriate for entity B to recognise the contribution from entity A as some form of income in its profit and loss.

- 18 We therefore think it would be helpful if the ED clarified whether the amendments to IFRIC 11 also apply to arrangements which are to be settled by a non-equity holder (such as entity A), and if it does, how should those arrangements be accounted for by the entity that services the goods or services (entity B).
- 19 We also believe that changes in the fair value of the liability (incurred by the parent entity) represent a remuneration expense that should therefore be recognised by the entity (that receives the goods or services) in profit and loss. We note however, that IFRS 2 is silent as to where in profit and loss the re-measurement of the liability should be recognised. Indeed, it might be helpful if the IASB clarifies this issue, which in our view would strengthen the argument that the re-measurement ought to be recognised by the entity as an additional expense paid for by the parent entity which in effect represents an additional contribution by the parent entity. This should alleviate concerns, if any, regarding the recognition of an additional capital contribution by the subsidiary when the liability is re-measured by the parent entity.

Question 2 — Transition

The proposed amendments to IFRS 2 and IFRIC 11 would be required to be applied retrospectively, subject to the transitional provisions of IFRS 2.

Question 2: Do you agree with the proposal? If not, what do you propose and why?

- 20 We agree that the proposed amendments to IFRS 2 and IFRIC 11 should be applied retrospectively, subject to the transitional provisions of IFRS 2, which require full retrospective application for unsettled cash-settled transactions.
- 21 However, we note that IFRS 1 provides some relief to a first time adopter of IFRS regarding the application of IFRS 2, in particular when applied to a share-based payment liability. We recommend the IASB clarifies whether the relief in IFRS 1 *First-time adoption of IFRS* regarding the transitional requirements of IFRS 2, can be applied to the separate financial statements of the entity that receives the goods or services, when applying the amendments in the ED.