EFRAG's evaluation of the costs and benefits of implementing of the Amendments to IFRS 2 *Group Cash-settled Share-based Payment Transactions*

Introduction

1 Following discussions between the various parties involved in the EU endorsement process, the European Commission decided in 2007 that more extensive information than hitherto needs to be gathered on the costs and benefits of all new or revised Standards and Interpretations as part of the endorsement process. It has further been agreed that EFRAG will gather that information in the case of the Amendments to IFRS 2 *Group Cash-settled Share-based Payment Transactions* (the Amendments).

2 EFRAG first considered how extensive the work would need to be. For some Standards or Interpretations, it might be necessary to carry out some fairly extensive work in order to understand fully the cost and benefit implications of the Standard or Interpretation being assessed. However, in the case of the Amendments, EFRAG's view is that the cost and benefit implications can be assessed by carrying out a more modest amount of work. (The results of the consultations EFRAG has carried out seem to confirm this). Therefore, as explained more fully in the main sections of the report, the approach EFRAG has adopted has been to carry out detailed initial assessments of the likely costs and benefits of implementing the amendment in the EU, to consult on the results of those initial assessments, and to finalise those assessments in the light of the comments received.

EFRAG's endorsement advice

3 EFRAG also carries out a technical assessment of all new and revised Standards and Interpretations issued by the IASB and IFRIC against the so-called endorsement criteria and provides the results of those technical assessments to the European Commission in the form of recommendations as to whether or not the Standard or Interpretation assessed should be endorsed for use in the EU. As part of those technical assessments, EFRAG gives consideration to the costs and benefits that would arise from implementing the new or revised Standard or Interpretation in the EU. EFRAG has therefore taken the conclusion at the end of this report into account in finalising its endorsement advice.

A summary of the Amendments

4 Entities often grant shares or share options to employees or other parties. Share plans and share option plans are a common feature of employee remuneration for directors, senior executives and many other employees. Some entities issue shares or share options to pay suppliers, such as suppliers of professional services. Such transactions are known as 'share-based payment transactions'.

5 IFRS 2 *Share-based Payment* sets out how such transactions should be accounted for. Put simply, IFRS 2 requires the value of the transaction to be determined and then recognised over the period during which services are being received or at the point at which the goods are received. How that value is determined and what the other side of the entry is depends on the type of share-based payment transaction involved.

(a) In an equity-settled share-based payment transaction the entity receives goods or services in exchange for its own equity instruments. In this case, the value of the transaction is credited to equity.

(b) In a cash-settled share-based payment transaction, the entity receives goods or services in exchange for a cash payment based on the price of its own equity instruments. In this case the value of the transaction is recognised as a liability until a cash payment is made in settlement of the liability.

The measurement of the transaction shall be different according to its nature.

6 Sometimes, a share-based payment transaction is not settled by the entity receiving the goods or services. The party settling the transaction may be a shareholder of the entity receiving the goods or services, another entity in the same group, or a shareholder of any group entity.

7 There has been some uncertainty if an entity should apply IFRS 2 to share-based payment transactions in which the supplier of the goods or services is paid in cash and the obligation is incurred by another group entity (ie group cash-settled share-based payment transactions) and, to the extent that they are, whether (and when) they should be accounted for as an equity-settled or as a cash-settled share-based payment transaction. There has also been some uncertainty as to the detailed accounting treatment that should be applied in such cases. The Amendments seek to clarify those aspects of IFRS 2.

8 The Amendments made it clear that all group cash-settled share-based payment transactions are within the scope of IFRS 2. They also make it clear that the classification of the transaction (as either equity-settled or cash-settled) shall be done at the reporting entity level. Thus, a transaction might be classified in one way for the purposes of the consolidated financial statements, and in another way for the purposes of the separate financial statements of one or both of the group entities involved.

9 The Amendments require that the entity <u>receiving</u> the goods or services in a share-based payment transaction accounts for the arrangement in its separate financial statements as an equity-settled share-based payment transaction in accordance with IFRS 2 when:

(a) the arrangement is settled in the entity's equity instruments; or

(b) the entity does not have an obligation to settle.

10 The Amendments specify that the entity <u>settling</u> the share-based payment transaction when another group entity is receiving the goods and services shall account for the transaction in its separate financial statements as a cash-settled share-based payment transaction, unless the entity settles with its own equity instruments; and in doing so shall apply IFRS 2.

11 Thus, if one entity in a group (Entity A) receives goods or services from a supplier and the supplier is paid in cash by a second entity in the group (Entity B) in a transaction that meets the definition of a share-based payment, although the transaction will be accounted for as a cash-settled share-based payment transaction in the consolidated financial statements and in the separate financial statements of Entity B, Entity A will account for it in its separate financial statements as an equity-settled share-based payment transaction.

12 When a group share-based payment transaction takes place, the group entity receiving the goods or services may be required under the terms of an arrangement between group entities to pay the group entity that is settling the transaction. The Amendments do not address the accounting to be applied to such intra-group payment arrangements.

13 The Amendments also do not address the accounting treatment to be applied to share-based payment transactions where either the entity receiving the goods or services or the entity paying the supplier of the goods or services is an associate or is a jointly controlled entity. Such transactions, though, similar to share-based payment transactions, are not share-based payment transactions as defined and are therefore not within the scope of IFRS 2.

EFRAG's initial analysis of the costs and benefits of the Amendments and stakeholders' views on it

14 EFRAG carried out an initial assessment of the costs and benefits expected to arise for preparers and for users both in year one and in subsequent years from implementing the Amendments in the EU. The tentative conclusions reached as a result of that initial assessment were that:

(a) preparers are likely to incur only insignificant incremental ongoing costs and virtually no day one costs implementing the Amendments;

(b) users are likely to incur no increase of costs in using the information resulting from the Amendments;

(c) the Amendments are likely to result in improvements in the relevance and comparability of the information provided— although that benefit will be greatest in the case of entities preparing separate financial statements in accordance with IFRS—and will also benefit preparers by reducing uncertainty as to whether and how to apply IFRS 2; and

(d) those benefits are likely to exceed the costs involved.

15 EFRAG published its initial assessment and supporting analysis on 10 July 2009 and invited comments on the material by 4 September 2009. The results of this consultation can be summarised as follows.

(a) Where specific responses to the questions posed were provided by the respondents: respondents agreed with EFRAG's initial assessment as summarized above.

(b) None of the other respondents indicated that they disagreed with EFRAG's initial assessment.

EFRAG's final analysis of the costs and benefits of the Amendments

16 Based on its initial analysis and on stakeholders' views on that analysis, EFRAG's detailed final analysis of the costs and benefits of implementing the Amendments in the EU is presented in the paragraphs below

Costs for preparers

17 The Amendments do two things: they eliminate the uncertainty over whether group cash-settled transactions fall within the scope of IFRS 2 and they clarify how group share-based payment transactions should be accounted for in the separate financial statements of the entities involved.

18 EFRAG's understanding is that most entities will already have been accounting for such transactions as share-based payment transactions. That means that the scope clarification will have an impact on only a few entities. However, although those entities will need to incur the costs of applying IFRS 2 to the transactions involved for the first time, EFRAG's assessment at the time it issued its endorsement advice on the original IFRS 2 was that the benefits of implementing the standard exceeded the cost of its implementation, and EFRAG's assessment is that that will be the case here too.

19 The clarification as to how to apply IFRS 2 might mean that some entities will need to change the way they are accounting for certain of their share-based payment transactions. Furthermore, in certain cases this will mean that the measurement of the transaction in the separate financial statements of an entity will differ from the measurement in the consolidated financial statements of the group or in another group entity's separate financial statements.

20 In particular, the Amendments require that an entity receiving goods or services in a share-based payment transaction that is settled in cash at group level should in certain circumstances account for it in its separate financial statements as an equity-settled share-based payment transaction. However, EFRAG's assessment is that:

(a) at grant date having to account for the transaction in two different ways will not involve significant additional cost, because the same option pricing models can be used for both equity-settled share-based payments and cash-settled share-based payments.

(b) for subsequent measurement, the entity will need to amend its equity-settled share-based payment numbers only for changes in vesting conditions. That information is also needed to update the fair value of the liability in the consolidated financial statements.

Therefore, although there may be cases where preparers will need to perform two calculations where previously they were performing just one, EFRAG's assessment is that this will not require additional information and will involve only insignificant ongoing incremental costs.

21 EFRAG has also considered whether preparers will incur significant 'year one' costs when first applying the Amendments to arrangements already in place. The Amendments shall be applied retrospectively for annual periods beginning or on after 1 January 2010, subject to the transitional provisions of IFRS 2. However, as the Amendments allow entities to use amounts previously recognised in consolidated financial statements if the information necessary for retrospective application is not available, an entity that was not already accounting for the transactions in conformity with the Amendments will not be compelled to retrospectively estimate the grant date fair value of the rights; thus, EFRAG's assessment is that entities will incur virtually no costs to adopt the Amendments.

22 In summary, EFRAG's assessment is that, although the adoption of the Amendments is likely to involve preparers in incurring some incremental ongoing costs, those costs are likely to be insignificant. Furthermore, EFRAG's assessment is that the Amendments will involve virtually no day one costs for preparers.

Costs for users

23 EFRAG is not aware of any aspect of the Amendments that will increase the costs users will incur in analysing the financial statements.

Benefits

24 Prior to the Amendments, there was some uncertainty as to which transactions were within the scope of IFRS 2 and how some transactions should be accounted for under IFRS 2. As a result, preparers had to try to determine the appropriate accounting bearing in mind the circumstances. EFRAG's assessment is that the Amendments eliminate this uncertainty, which is beneficial to preparers.

25 EFRAG's assessment is also that application of the Amendments will:

(a) enhance the relevance of the information provided because entities will recognise in their separate financial information goods and services received and any obligation incurred according to the nature of the share-based payment arrangement in place; and

(b) eliminate the diversity in the way the transactions within the scope of the Amendments are accounted for. EFRAG notes that some of this diversity arises only in separate financial statements, and adopting IFRS for separate financial statements is not required or even allowed in some EU member states.

Conclusion

26 Summarising the comments above, EFRAG's assessment is that:

(a) the Amendments are likely to involve preparers in incurring only insignificant additional ongoing costs, and virtually no day one costs;

(b) the Amendments are not likely to involve users in any incremental costs; and

(c) the Amendments are likely to result in benefits for both users and preparers, although those benefits will be greatest in the case of entities preparing separate financial statements in accordance with IFRS.

27 EFRAG's assessment is that overall the benefits of implementing the Amendments in the EU are likely to outweigh the costs involved.

Stig Enevoldsen
EFRAG, Chairman
14 September 2009