EFRAG

European Financial Reporting Advisory Group

11 April 2008

ED of Proposed Amendments to IFRS 2 and IFRIC 11
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—*IFRS 2 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'):

(a) The suppliers of the entity will receive cash payments that are linked to the price of the equity instruments of the entity.

(b) 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 above 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:

(a) 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;

(b) that the amendments do not address how the entity that provides the cash payments should account for the arrangements;

(c) that the language and, more importantly, some of the proposed accounting requirements assumes that it will be a parent entity that is making the cash payments and a subsidiary that will be receiving the goods or services. In some cases the roles might be reversed, and in other cases two subsidiaries might be involved. 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 making the payments and a subsidiary receiving the goods or services.

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 Sven Morich 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:

(a) 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).

(b) 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).

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 into IFRS 2 arrangements that are not share-based payment arrangements.

Proposed new paragraphs 3A and 4 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 following concern, this is a sensible thing to do.

5 Under the proposals, the standard and interpretation apply when one group entity accepts a liability to pay the suppliers of goods and services to another group entity an amount based on the price of equity instruments issued by one or other of those entities or a third group entity. We have a concern that this broad scope is not reflected in the language used in the non-scope parts of IFRIC 11 in particular and, as a result, might not even be compatible in places with the accounting described. For example, although the language used covers the subsidiary's accounting for grants by its parent of cash-settled awards over either the parent's or the subsidiary's shares, as explained more fully later in this appendix we are not sure that it covers grants by the subsidiary of cash-settled awards over the parent's shares.[1]

Group arrangements with a choice of settlement

6 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). The existing IFRS also contains specific accounting 'rules' to determine when a hybrid transaction is accounted for as cash-settled and when it is accounted for as equity-settled.

7 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. However, IFRIC 11 as amended by the proposals in the ED will not provide specific 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.

8 We have considered whether IFRIC 11 needs to set out specific guidance on such hybrid transactions. We believe that in principle-based standards the purpose of guidance should generally be to illustrate the principles rather than to add to them. In the absence of robust definitions that are applied without exception (see paragraphs 2 and 3 above), we do not think there is a clear principle, so the issue becomes whether it is clear, without additional guidance, what is required. We have heard differing views on this, and therefore suggest that the IASB considers the matter further.

9 Alternatively, rather than make a further narrow change to IFRIC 11, the IASB could address group share-based payment arrangements more broadly and in a more principle-based way. This would help prevent the narrowly-based material in this proposed amendment being misinterpreted and ought to reduce the risk of there being unintended consequences. It would also 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.

[1] For convenience, the Interpretation discusses the issues in terms of a parent and a subsidiary, with the parent entity incurring the liability to make cash payments to the subsidiary's suppliers. For consistency, EFRAG uses that same terminology in this letter unless stated otherwise.

Parent entity's separate financial statements

10 The amendments do not address how the entity that provides the required cash payments should account for the arrangements. We believe that such guidance might be helpful, particularly now that IFRIC 11 addresses a variety of group schemes. In some ways it seems odd that no analysis is carried out of the debit entry that the parent company should record bearing in mind the work the IASB is doing in one of its other projects on how to account for the cost of an investment in a subsidiary.

11 We understand that when IFRIC 11 was being developed, the IFRIC attempted to develop illustrative guidance on how a parent entity that is making the cash payments should account for the arrangements. 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. So, once again, a share-based payment definition issue is causing problems. 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

12 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 two entities within the same group.

13 As we have already explained, 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. As we mentioned in paragraph 4 above, we are concerned as to whether that interpretation is compatible with some of the accounting described in IFRIC 11. In particular, we have some concerns about the accounting being proposed in paragraph 11B of IFRIC 11 when a parent-subsidiary relationship is not involved or when it is not the subsidiary taking on the liability to pay the parent's suppliers. 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

14 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. We agree with this conclusion.

Are the arrangements always a capital contribution?

15 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 by the subsidiary.

16 In such circumstances, when the estimate of the fair value of the liability (incurred by the parent entity) changes, proposed new paragraph 11B of IFRIC 11 makes it clear that the change in fair value should be:

(a) accounted for in equity by the subsidiary. We also support that proposal.

(b) recognised by the subsidiary in profit or loss. We believe that such changes in value represent a remuneration expense. We note however, that IFRS 2 is silent as to where in profit and loss the re-measurement of the liability should be recognised. We think it might be helpful if the IASB clarifies this issue.

17 Although we agree that, when the subsidiary receives the goods or services and the parent cash-settles, the ‘credit side’ of the arrangements represents a capital contribution from the parent to its subsidiary, we are less comfortable with this if the arrangement does not involve a subsidiary receiving goods or services and a parent cash-settling. For example, if the arrangement is that the employee of the parent entity will receive cash payments that are linked to the price of the equity instruments of a group entity and the subsidiary has an obligation to make the required cash payments to the employee, we are not certain what IFRIC 11 is proposing but it would seem odd to us if the parent would be required to recognise a capital contribution from its subsidiary. We are similarly unsure about the position if two subsidiaries are involved. We think IFRIC 11 needs to be clearer on this issue. We also think this reinforces the comments we made in paragraphs 10 and 11 about the need to address how the entity that provides the required cash payments should account for the arrangements.

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.

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

18 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.

19 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 E*D.*