

INVITATION TO COMMENT ON THE EFRAG'S ASSESSMENTS OF AMENDMENTS TO IFRS 2 "GROUP CASH-SETTLED SHARE-BASED PAYMENT TRANSACTIONS"

Comments should be sent to commentletter@efrag.org or uploaded via our website by 4 September 2009

EFRAG has been asked by the European Commission to provide it with advice and supporting material on the Amendments to IFRS 2 *Group Cash-settled Share-based Payment Transactions* ("the Amendments"). In order to do that, EFRAG has been carrying out a technical assessment of the Amendments against the criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from their implementation in the EU.

A summary of the Amendments is set out in Appendix 1.

Before finalising its two assessments, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record unless the respondent requests confidentiality. In the interest of transparency EFRAG will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

1 Please provide the following details about yourself:

- (a) Your name or, if you are responding on behalf of an organisation or company, its name:

- (b) Are you/Is your organisation or company a:

Preparer User Other (please specify)

- (c) Please provide a short description of your activity/the general activity of your organisation or company:

- (d) Country where you/your organisation or company is located:

(e) Contact details including e-mail address:

2 EFRAG’s initial assessment of the Amendments is that they meet the technical criteria for endorsement. In other words, they are not contrary to the true and fair principle and they meet the criteria of understandability, relevance, reliability and comparability. EFRAG’s reasoning is set out in Appendix 2.

(a) Do you agree with this assessment?

Yes No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG’s endorsement advice.

(b) Are there any issues that are not mentioned in Appendix 2 that you believe EFRAG should take into account in its technical evaluation of the Amendments? If there are, what are those issues and why do you believe they are relevant to the evaluation?

3 EFRAG is also assessing the costs that will arise for preparers and for users to implement the Amendments, both in year one and in subsequent years. Some initial work has been carried out, and the responses to this Invitation to Comment will be used to complete the assessment.

The results of the initial assessment are set out in Appendix 3. To summarise, EFRAG’s initial assessment (see Appendix 3, paragraphs 8 and 9) is that the Amendments are:

- (a) likely to involve preparers in incurring only insignificant incremental ongoing and virtually no day one costs; and
- (b) likely to involve users in no year one or ongoing incremental costs.

Do you agree with this assessment?

Yes No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be?

- 4 EFRAG’s initial assessment is that 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. EFRAG’s initial assessment is that overall the benefits to be derived from applying the Amendments will exceed the costs involved (Appendix 3, paragraphs 10 - 13).

Do you agree with this assessment?

Yes No

If you do not, please explain why you do not and what you think the implications should be for EFRAG’s endorsement advice?

- 5 EFRAG is not aware of any other factors that should be taken into account in reaching a decision as to what endorsement advice it should give the European Commission on the Amendments.

Do you agree that there are no other factors?

Yes No

If you do not, please explain why you do not and what you think the implications should be for EFRAG’s endorsement advice?

APPENDIX 1 A SUMMARY OF THE AMENDMENTS

- 1 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’.
- 2 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.

- 3 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.
- 4 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.
- 5 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.
- 6 The Amendments require that the entity receiving 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.
- 7 The Amendments specify that the entity settling 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.
- 8 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.
- 9 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.
- 10 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.

APPENDIX 2 EFRAG’S TECHNICAL ASSESSMENT OF THE AMENDMENTS AGAINST THE ENDORSEMENT CRITERIA

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG’s capacity as a contributor to the IASB’s due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as adviser to the European Commission on endorsement of the final IFRS or Interpretation on the issue.

In the latter capacity, EFRAG’s role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the European endorsement criteria, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG’s thinking may evolve.

- 1 When evaluating the Amendments, EFRAG considered whether the accounting that results from their application meets the criteria for EU endorsement, in other words, that the accounting:
 - (a) is not contrary to the ‘true and fair principle’ set out in Article 16(3) of Council Directive 83/349/EEC and in Article 2(3) of Council Directive 78/660/EEC and
 - (b) meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG also considered whether it would be in the European interest to adopt the Interpretation.

Does the accounting that results from the application of the Amendments meet the criteria for EU endorsement?

Relevance

- 2 According to the Framework, information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations. EFRAG considered whether the Amendments would result in the provision of relevant information; in other words, information that has predictive value, confirmatory value or both.
- 3 Existing IFRS 2 requires that an entity recognises goods or services received in a share-based payment transaction when that transaction is settled in equity instruments either at Group level or by its shareholders, or when the transaction is settled in cash by the entity also receiving the goods or services. However, because of uncertainty as to whether transactions that are settled in cash by another entity in the Group or by its shareholders are within the scope of IFRS 2, the effect of such transactions might not currently be being recognised in financial statements. The Amendments eliminate this uncertainty by ensuring that the effects of these transactions are recognised, thus enhancing the relevance of the information provided.

- 4 Neither existing IFRS 2 nor IFRIC 11 *IFRS 2 - Group and Treasury Share Transactions* address explicitly how a share-based payment transaction should be accounted in the separate financial statements of an entity that assumes the obligation to settle the transaction when another entity in the Group receives the goods or services. Therefore, currently an entity assuming such an obligation may recognise the transaction only at the moment of settlement. The Amendments make it clear that in such circumstances the entity should recognise a liability unless it settles the transaction with its own equity instruments thus enhancing the relevance of the information provided.
- 5 As such, the Amendments ensure that an entity will consistently recognise the cost of goods and services received in its separate financial statements and the obligation incurred whenever there is a share-based payment arrangement in place. This requirement is consistent with the overall objective of IFRS 2, which is to require an entity to reflect in its profit and loss and financial position the effect of share based payment transactions, including expenses associated with transactions in which share options are granted to employees”.
- 6 Based on the above, EFRAG concluded that the application of the Amendments would enhance the relevance of the information provided.

Reliability

- 7 EFRAG also considered the reliability of the information that will be provided by applying the Amendments. The Framework explains that information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.
- 8 EFRAG’s assessment was that the Amendments do not raise any issues concerning faithful representation or completeness; indeed, EFRAG’s assessment is that, by addressing some of the uncertainties that currently exist in how to apply aspects of IFRS 2, the Amendments will enhance the faithfulness of the representation provided. EFRAG considered whether the accounting in the Amendments would raise concerns about risk of error. However, the Amendments do not introduce any new requirements in terms of measurement; they simply extend explicitly the measurement criteria already included in IFRS 2 to arrangements that are settled in cash by another entity in the Group. Therefore, EFRAG does not believe that the Amendments create any new reliability issues.

Comparability

- 9 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.
- 10 In EFRAG’s view, the clarification that the scope of IFRS 2 includes arrangements that are settled in cash by another entity in the Group to the entity that receives the goods or services eliminates the uncertainty that previously existed on this issue, and will as a result reduce the diversity in practice and enhance comparability. The Amendments will mean that all entities receiving goods or services in a share-based payment transaction shall disclose the effect of that transaction in their statement of comprehensive income and statement of financial position regardless of the manner of the settlement or the settling entity.

- 11 The Amendments’ clarification of how group cash-settled share-based payment transactions should be classified will also eliminate the uncertainty that previously existed on this issue, and will as a result reduce the diversity in practice and enhance comparability. For example, the Amendments require that an entity accounts for all share-based payments transactions in which it receives goods or services as equity settled, unless the entity assumes an obligation to settle the transaction with any asset other than its own equity instruments. This enhances comparability with other transactions in which an entity issues its own equity instruments in transactions with third parties, such as business combinations.

Understandability

- 12 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.
- 13 Although there are a number of aspects to the notion of ‘understandability’, EFRAG believes that most aspects are covered by the discussion above about relevance, reliability and comparability (because, for example, information that represents something as similar when it is in fact dissimilar is not comparable, and that lack of comparability will mean it is also not understandable). As a result, EFRAG believes that the main additional issue it needs to consider in assessing whether the information resulting from the application of the Amendments is understandable is whether that information will be unduly complex. In EFRAG’s view users are already familiar with IFRS 2 accounting model and the Amendments do not change that model in any significant respect.

True and Fair

- 14 For the reasons set out above, EFRAG sees no reason to conclude that the Amendments are inconsistent with the true and fair view requirement.

European Interest

- 15 EFRAG considered whether the costs of implementing the Amendments in the EU might exceed the benefits expected from applying the accounting the Amendments require. Our initial assessment is that that will not be the case. EFRAG sees no other reason to believe that endorsement of the Amendments would not be in the European interest.

Conclusion

- 16 After considering all the above, EFRAG concluded that the Amendments satisfy the criteria for EU endorsement and that therefore EFRAG should recommend their endorsement.

APPENDIX 3 EFRAG’S EVALUATION OF THE COSTS AND BENEFITS OF THE AMENDMENTS

- 1 EFRAG has also considered whether, and if so to what extent, implementing the Amendments in the EU might involve preparers and users incurring incremental costs, and whether those costs are likely to be exceeded by the benefits to be derived from their adoption.

Costs for preparers

- 2 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.
- 3 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 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 initial assessment is that that will be the case here too.
- 4 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.
- 5 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 initial 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 initial assessment is that this will not require additional information and will involve only insignificant ongoing incremental costs.

- 6 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.
- 7 In summary, EFRAG’s initial 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 initial assessment is that the Amendments will involve virtually no day one costs for preparers.

Costs for users

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

Benefits

- 9 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 initial assessment is that the Amendments eliminate this uncertainty, which is beneficial to preparers.
- 10 EFRAG’s initial 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 Member countries.

Conclusion

- 11 Summarising the comments above, EFRAG’s initial 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.

- 12 EFRAG’s initial assessment is that overall the benefits of implementing the Amendments in the EU are likely to outweigh the costs involved.