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**International
Accounting Standards
Board**

This observer note is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. Views expressed in this document are identified by the staff as a basis for the discussion at the IFRIC meeting. This document does not represent an official position of the IFRIC. Decisions of the IFRIC are determined only after extensive deliberation and due process. IFRIC positions are set out in Interpretations.

Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: September 2006, London

Project: IFRS 2 - Group and Treasury Share Transactions – Major proposed changes (Agenda Paper 4)

INTRODUCTION

1. At its July-2006 meeting, the IFRIC asked the staff to prepare a draft of a revised Interpretation to enable the IFRIC to conclude at its September-2006 meeting whether it will be able to reach a final Interpretation. The staff has prepared a revised draft Interpretation, which is set out in agenda paper 4(i). [Agenda paper 4(i) removed for observer note purposes.]
2. This agenda paper highlights and explains the more significant changes. Major proposed changes relate to:
 - Share-based payment arrangements involving equity instruments of the parent (or another entity in the same group)

- A parent grants rights to its equity instruments to the employees of its subsidiary and the subsidiary does not have an obligation to the employees (see paragraph 3 of this agenda paper);
- A subsidiary grants rights to equity instruments of its parent (another entity in the same group) to its employees and the subsidiary has an obligation to the employees (see paragraph 17 of this agenda paper);
- Transfers of employees between group entities (see paragraph 21 of this agenda paper); and
- A paragraph suggesting that consensus in the revised draft Interpretation may not be applicable automatically to intragroup transactions in general (see paragraph 35 of this agenda paper).

PROPOSED MAJOR CHANGES

Share-based payment arrangements involving equity instruments of the parent (or another entity in the same group)

A parent grants rights to its equity instruments to the employees of its subsidiary and the subsidiary does NOT have an obligation to its employees (see IFRIC [X]. 7 - 8 and BC 7-10 of IFRIC[X])

3. At its July meeting, the IFRIC decided that, for share-based payment arrangements in which a parent grants rights to its equity instruments direct to the employees of its subsidiary, the services received by the subsidiary in its financial statements should be measured using the equity-settled basis. IFRIC [X].7 and 8 reflect that decision.
4. The staff has considered whether guidance should be given on how to account for the other side of the transaction in the financial statements of the subsidiary. This agenda paper illustrates the following two different views:

View 1 – No detailed guidance should be given (see Alternative 1A in IFRIC [X])

5. Supporters of this view believe that the other side of the transaction depends on (i) whether there is an arrangement between the parent and the subsidiary, and (ii) the terms of the arrangement. In addition, supporters of this view note that

situations vary case by case. Therefore, they believe that guidance should not be given in detail in this Interpretation.

View 2 – Guidance should be given (see Alternative 1B in IFRIC [X])

6. Proponents of this view note that paragraph 3 of IFRS 2 requires the services received from the employees be accounted for in accordance with IFRS 2, without providing guidance on how to account for the other side of the transaction. They, therefore, believe that guidance should be given.
7. Supporters of this view believe that, if there is an arrangement between the parent and the subsidiary that requires the subsidiary to pay to the parent, the obligation to the parent in the financial statements of the subsidiary should not be accounted for in accordance with IFRS 2 because it is not an obligation to suppliers of goods or services of the subsidiary.
8. IAS 39.2 (i) excludes from the scope of IAS 39 ‘financial instruments, contracts and obligations under share-based payment transactions to which IFRS 2 Share-based Payment applies, except for contracts within the scope of paragraphs 5-7 of this Standard, to which this Standard applies.’
9. Since the obligation is not within the scope of IFRS 2, supporters of this view believe that the obligation to pay cash or other assets to the parent for the provision of equity instruments to the employees should be accounted for in accordance with IAS 39.
10. IAS 39.14 requires that an entity should recognise a financial liability on its balance sheet when, and only when, the entity becomes a party to the contractual provision of the instrument.
11. In a situation in which the intragroup payment arrangement requires the subsidiary to pay only when the employees satisfy the vesting conditions, supporters of this view believe that the subsidiary should recognise a financial liability when the subsidiary enters into a contractual arrangement with the parent (rather than when the employees meet the vesting conditions).

12. Proponents of this view believe that to the extent that there is no arrangement between the parent and the subsidiary that requires the subsidiary to pay to the parent, the subsidiary should recognise a capital contribution from the parent in its financial statements.

Staff recommendation

13. [Deleted for observer note purposes.]

Questions to the IFRIC

14. Which view does the IFRIC prefer?
15. If the IFRIC chooses View 2, does the IFRIC agree that the obligation to the parent should be accounted for in accordance with IAS 39? If not, why not?
16. Does the IFRIC have any comments on IFRIC [X].7 and 8 and BC7 - 10 of the IFRIC[X]?

A subsidiary grants rights to equity instruments of its parent (or another entity in the same group) to its employees and the subsidiary has an obligation to the employees (see IFRIC [X]. 11 and BC 11-15 of IFRIC[X])

17. At its July meeting, the IFRIC agreed that, since it would not be possible to consider all conceivable scenarios arising from such an arrangement, the staff should not address the arrangement in detail in finalizing D17. The Basis for Conclusions explains why the IFRIC decided not to address the arrangement in detail (see BC 15 of IFRIC [X] – Alternative 4C).

18. Alternatively, if the IFRIC prefers to address this arrangement, the IFRIC is asked whether the transaction with the employees should be accounted for as cash-settled or equity-settled. The staff has drafted text for both scenarios:
 - Cash-settled: Alternative 2A (see IFRIC [X]. 11) + Alternative 4A in the Basis for Conclusions)
 - Equity-settled: Alternative 2B (see IFRIC [X]. 11) + Alternative 4B in the Basis for Conclusions)

Questions to the IFRIC

19. Which alternative does the IFRIC prefer?

20. Does the IFRIC have any comments on IFRIC [X]. 11 and BC 11 – 15 of the IFRIC[X]?

Transfers of employees between group entities (see IFRIC [X]. 9-10 and BC 16-19 of IFRIC [X])

21. The respondents to D17 generally supported the proposed treatments in D17. However, some asked the IFRIC to clarify the following points:
- (a) whether the transfer of employees between group entities would be considered as a failure to satisfy a vesting condition in the financial statements of the subsidiary from which the employees transfer employment (ie whether that subsidiary should reverse the charge previously recognised in respect of the services received from such employees); and
 - (b) after the transfer of employment whether, if an employee leaves the group during the vesting period, each individual subsidiary should reverse the charge previously recognised in respect of the services from that employee during the past vesting period.

Point (a)

22. The staff notes that D17 proposed that a transfer of employees is not considered a new grant of equity instruments in the financial statements of the subsidiary to which the employees transfer employment because the equity instruments were granted by the parent (not the individual subsidiary). For the same reason, the staff recommends that the transfer should not be treated as an employee's failure to satisfy a vesting condition in the financial statements of the subsidiary from which the employees transfer employment. Thus, the transfer should not trigger any reversal of charge previously recognised in respect of the services received from those employees in the financial statements of the subsidiary from which employees transfer employment.
23. Furthermore, provided that the vesting condition requires the employees to work for the group for a particular period, the transfer of employment, in the staff's view, does not result in an employee's failure to meet a vesting condition.

24. The Basis for Conclusions has explained the above requirement (see BC 18 of IFRIC [X]).

Questions to the IFRIC

25. Does the IFRIC agree with the staff recommendation?
26. Does the IFRIC have any comments on BC 18 of IFRIC [X]?

Point (b)

27. This agenda paper illustrates two different views.

View 1 – Each subsidiary should reverse the amount of the services previously recognised

28. Supporters of this view note that IFRS 2 paragraph 19 requires the cumulative amount recognised for goods or services as consideration for the equity instruments granted to be based on the number of equity instruments that eventually vest, and, on a cumulative basis, no amount is recognised for goods or services if the equity instruments do not vest because of failure to satisfy a vesting condition.
29. In addition, proponents of this view note that, when the employee leaves the group before the vesting period, the employee fails to meet the vesting condition. Applying the principles in IFRS 2 paragraph 19, they believe that the services from that employee recognised in the financial statements of each subsidiary during the past vesting period should be reversed.

View 2 Flexibility should be given to group management as to how the reversal should be allocated

30. Supporters of this view note that the amount of the services previously recognised will be reversed in the consolidated financial statements when the employee leaves the group before the vesting period.
31. However, for employees working for a number of group entities, proponents of this view believe that flexibility should be given to group management as to how to allocate the amount of the reversal to individual financial statements of group entities. They reason that, if an employee has completed his or her service in a particular subsidiary, it is unnecessary to reverse the amount correctly recognised in respect of the services received merely because the employee has left the group plan.

Staff recommendation

32. [Deleted for observer note purposes.]

Questions to the IFRIC

33. Regarding point (b), which view does the IFRIC prefer?
34. Does the IFRIC have any comments on IFRIC[X]. 9 and 10 and BC 16-19 of IFRIC[X]?

A paragraph suggesting consensus in this Interpretation may not be automatically applicable to intragroup transactions in general (IFRIC [X]. 14 and BC 20 of IFRIC[X])

35. The staff notes that arrangements involving equity instruments of the parent (or another entity in the same entity) may involve intragroup transactions. However, IFRSs generally do not specify how intragroup transactions should be accounted for in individual or separate financial statements.
36. Because of the requirement in paragraph 3 of IFRS 2, this Interpretation deals with those intragroup transactions. However, the staff acknowledges that the consensus reached in this [draft] Interpretation may not be applicable to intragroup transactions in general. As a result, the staff recommends that a paragraph should be added in the Interpretation to clarify that the consensus in this Interpretation is not necessarily applicable to all intragroup transactions.
37. IAS 8.10 and 11 require that, in the absence of a Standard or an Interpretation that specifically applies to a transaction, management should refer to and consider the applicability of the requirements of other Standards or Interpretations dealing with similar and related issues. The staff does not believe the wording in IFRIC [X] violates the requirements in IAS 8. The wording in IFRIC [X] merely reflects that the consensus in this Interpretation may not be applicable to all intragroup transactions.

Questions to the IFRIC

38. Does the IFRIC agree to add a paragraph in the Interpretation, suggesting that entities are not required to apply the consensus in this Interpretation to all intragroup transactions?
39. Does the IFRIC have other comments on the Interpretation?