MOORE STEPHENS

29 February 2008

The Chairman
Australian Accounting Standards Board
PO Box 204
Collins Street West
Victoria 8007

Sent by email: standard@aasb.com.au

Dear Chairman

Re: Response to Exposure Draft 161 – Group Cash-settled Share-based Payment Transactions ('ED 161')

Please find following our response to ED 161 proposing amendments to AASB 2 '*Share-based* Payment and AASB Interpretation 11 '*AASB 2 – Group and Treasury Share Transactions.*'

Our response contains two primary areas of concern. The first is in relation to the need for more clarity and explanation surrounding principles, substance, and overall accounting requirements with respect to the transfer of obligations from subsidiary to parent pursuant to 'arrangements'. The second area of concern is with respect to the measurement of a subsidiary's share-based payment expense by reference to the value of equity in another entity.

In addition, whilst we support the inclusion of additional guidance for transactions not previously contemplated by AASB 2, we are concerned at the 'bolt on' approach that the IASB is taking in relation to IFRS 2. We note that whilst transactions, such as those within the scope of IFRIC 11 are deemed to be caught by IFRS 2, they don't actually satisfy the definition of 'share-based payments' in IFRS 2. We would therefore argue for the reissue of an amended IFRS 2.

If you have any queries please contact Mr Rob Mackay on (03) 9614 4444.

Yours faithfully

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IASB Invitation to Comment

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?

Response

ED161 proposes that a subsidiary should measure the goods or services received from its suppliers in accordance with the requirements applicable to cash-settled share-based payment transactions in circumstances where the obligation to make the cash-settled share-based payment to those suppliers has been assumed by the parent entity. In this regard, the subsidiary measures the goods or services received from its suppliers on the basis of the fair value of the corresponding liability incurred by the parent (refer proposed paragraph 11B to IFRIC 11).

Depending on the terms of the cash-settled share based payment arrangement, the parent entity's aforementioned liability could be measured by reference to the price (or value) of the equity instruments of the subsidiary entity, its parent, or another entity in the group (refer proposed paragraph 3A to IFRS 2).

We advise that Moore Stephens has some concerns in relation to:-

(1) the clarity of the wording in the ED with respect to the requirements for accounting for such transactions; and

(2) whether it is inconsistent with the principles of IFRS 2 for an entity's expense, measured as a cash-settled share based payment, to be measured by reference to the value of another entity's equity as allowed in proposed paragraph 3A to IFRS 2.

1. Transfer of subsidiary's obligation to the parent or other group entity

We note the following proposed paragraphs in the ED:-

"The third issue concerns cash-settled share-based payment arrangements in which a parent incurs a liability to make cash payments to the employees of its subsidiary….. Under the arrangements, the parent has an obligation to make the required cash payments to the employees of the subsidiary. The subsidiary itself does not have any obligation to make the required cash payments to its employees or provide them with its equity instruments." [Proposed paragraph 3A to IFRIC 11]

"...Until the liability incurred by the parent is settled, the subsidiary shall recognise any changes in the fair value of the liability in profit or loss and in the subsidiary's equity as adjustments to contributions from the parent." [Proposed paragraph 11B to IFRIC 11]

Where the subsidiary has received goods or services from its suppliers (including employees), the subsidiary has incurred an obligation to compensate those suppliers. It is our belief that where a *parent entity* has made, or has committed to make, a cash-settled share based-payment in settlement of the original liability incurred by the subsidiary, this would prima facie constitute an extinguishment of the subsidiary's liability.

The ED states that *"...the subsidiary shall recognise any changes in the fair value of the liability in profit or loss and in the subsidiary's equity as adjustments to contributions from the parent."*

To give effect to this accounting outcome, it would seem apparent that "*changes in the fair value of the liability*" would need to be deemed a separate event constituting the receipt of additional value inherent in goods or services received by the subsidiary and hence the incurrence of a separate identifiable obligation to those suppliers by the subsidiary.

We are of the opinion that this is the only interpretation of the proposals in the ED that would allow the subsidiary to transfer this incremental liability to the parent and thereby allowing for the increment in the equity contributed by the parent to the subsidiary. Otherwise, a reader may be left to wonder how the mere change in the fair value of a parent's liability could, without express agreement between parent and subsidiary providing for the reimbursement of the parent's incremental liability, impact the accounts of the subsidiary that had previously extinguished that liability through its transfer. Without such an agreement, some readers may infer certain cash-settled share-based payment '*arrangements*' to be outside the scope of ED161.

Therefore, without the ED specifying that each individual event of increment to the parent's liability should be treated as a separate event sequence of (i) incurrence by the subsidiary of a separate expense and liability with (ii) accompanying assumption of liability by the parent, it would seem possible to argue that if the parent has agreed to settle the liability by way of cash-settled share based payment, the parent has also assumed the risks of future increments to that liability.

The following journals would be representative of what we believe is the appropriate accounting for the incurrence and transfer of the initial and subsequent liabilities between subsidiary and parent entities:-

Accounts of Subsidiary

i. Subsidiary incurs legal obligation to its suppliers

		DR	CR
30 Sept 2008	Employee Expense	100	
30 Sept 2008	Liability		100

ii. Parent assumes liability as deemed equity contribution

		DR	CR
30 Sept 2008	Liability	100	
30 Sept 2008	Equity		100

iii. Subsidiary incurs additional and separate legal obligation to its suppliers upon remeasurement of the Parent's liability assumed

		DR	CR
30 Dec 2008	Employee Expense	10	
30 Dec 2008	Liability		10

iv. Parent assumes additional and separate liability as deemed equity contribution

		DR	CR
30 Dec 2008	Liability	10	
30 Dec 2008	Equity		10

Accounts of Parent

v. Parent assumes liability as deemed equity contribution

		DR	CR
30 Sept 2008	Investment in Subsidiary	100	
30 Sept 2008	Liability		100

vi. Parent assumes additional and separate liability as deemed equity contribution

		DR	CR
30 Dec 2008	Investment in Subsidiary	10	
30 Dec 2008	Liability		10

If the above journals represent a correct interpretation of what the IASB is setting out to achieve, we believe that there should be further explanation as to the method by which the parent assumes the liability and the principles around the subsequent accounting for fair value remeasurement in the books of both the subsidiary and parent so as to avoid any possible misinterpretation by readers.

In addition, we note that the ED appears to be drafted more for the application of parent-subsidiary relationships yet it's scope extends to the transfer of a subsidiary's liability to other group entities. Without further explanation, we would query whether readers would come to consistent conclusions with respect to accounting in these circumstances.

Therefore, we believe there should be more explanation in relation to:-

a) how the term "*changes in the fair value of the liability*" (para 11B) should be interpreted and are deemed to effect the subsidiary where that parent has assumed liabilities to make cash-settled share based payments to the subsidiary's employees.

b) the implications where the parent assumed the obligation to compensate the subsidiary's employees but determines subsequently, without consultation to the subsidiary, that the obligation would be settled by way of cash-settled share based payment. In other words, does the subsidiary always need to be a party to the "arrangement" with respect to the method of settlement having regard to the future impact of remeasurement on the subsidiary's financial statements?

c) whether it might be possible for the parent and subsidiary to 'opt out' of the IFRIC 11 requirements where it is deemed that the substance of a particular arrangement is such that the subsidiary has actually severed its exposure to future fair value movements of the parent's liability such that the parent has actually assumed the risks associated with its future remeasurement. In this regard, in instances where the liability is measured by reference to value of the parent's equity, the parent itself would be deemed to have entered into a cash-settled share based payment with deemed suppliers pursuant to AASB Interpretation 8. In instances where the liability is measured with reference to the value of the subsidiary's equity, the parent may be deemed to have issued a derivative financial instrument to the subsidiary's employees and that is redeemable for cash.

d) how the requirements might be applied for arrangements between subsidiaries where there is no direct capital contribution by a parent.

As explained in the next section, we believe that instances where the value of the cash-settled share based payment is determined by reference to the value of the parent's equity is an issue that needs to be separately addressed and gives some weight to the arguments in point c) above that that the subsidiary should not be exposed to movements in the fair value of the parent's liability.

2. Cash-settled share based payments referenced to value of another entity's equity

We note the following proposed paragraphs in the ED:-

> *"Similarly, this IFRS also applies to arrangements in which an entity's parent (or another entity in the group) has incurred a liability to transfer cash or other assets for amounts that are based on the price (or value) of the equity instruments of the entity, its parent, or another entity in the group to parties that have supplied goods or services to the entity."* [Proposed paragraph 3A to IFRS 2]

We do not believe that an entity's cash-settled share-based payment should be capable of measurement by reference to another entity's equity, unless it can be demonstrated that the value of that other entity's equity is closely related to the value of the equity of the entity such that any variation is immaterial. This is likely to be the case where the subsidiary is the only operating entity in the group and the parent is essentially a holding company only.

We hold this view having regard to the substance of what the expense related to a share based payment represents.

Relevant principles in relation to share-based payments

The accounting requirements in relation to cash-settled share based payments are stated in IFRS 2 as follows:-

> *"For cash-settled share-based payment transactions, the entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity shall remeasure the fair value of the liability at each reporting date and at the date of settlement, with any changes in fair value recognised in profit or loss for the period." [IFRS 2.30]*

In general, where share-based payments are made to employees of an entity, the related expense booked in the accounts of the recipient entity should be representative of the value of the goods or services received. This principle is demonstrated below in extracts of some key principles contained in the Basis for Conclusions supporting IFRS 2.

> *"Given these practical difficulties in measuring directly the fair value of the employee services received, the Board concluded that it is necessary to measure the other side of the transaction, ie the fair value of the equity instruments granted, as a surrogate measure of the fair value of the services received..." [BC68]*

> *"Hence, measuring share-based payment transactions at fair value ensures that those transactions are represented faithfully in the financial statements, and consistently with other transactions in which the entity receives resources as consideration for the issue of equity instruments." [BC85]*

> *"The Board therefore concluded that, in principle, the goods or services received should be measured at their fair value at the date when the entity obtains those goods or as the services are received." [BC91]*

> *"However, if the fair value of the services received is not readily determinable, then a surrogate measure must be used, such as the fair value of the share options or shares granted." [BC92]*

> *"The Board concluded that, at grant date, it is reasonable to presume that the fair value of both sides of the contract are substantially the same, ie the fair value of the services expected to be received is substantially the same as the fair value of the equity instruments granted. This conclusion, together with the Board's conclusion that there is unlikely to be a high correlation between the fair value of the services received and the fair value of the equity instruments granted at later measurement dates, led the Board to conclude that grant date is the most appropriate measurement date for the purposes of providing a surrogate measure of the fair value of the services received." [BC96]*

"Moreover, because the intrinsic value measurement basis does not include time value, it is not an adequate measure of either the SAR liability or the cost of services consumed." [BC250]

As the IASB has explained above in relation to equity-settled share based payment transactions, the value of employee services are not readily ascertainable, and therefore measurement of the services received shall be based upon a surrogate measure being the value of the equity granted.

Therefore, it is our opinion that where the an entity has assumed a cash-settled share-based payment liability whose value is referenced to the value of its own equity, this is consistent with the principles contained in IFRS 2 since the value of the liability, and increments thereto, would be deemed an appropriate surrogate for the value of the services received.

We would also consider it appropriate for management of a subsidiary to initially determine the value of employee expenses received (and to be settled by way of cash-settled share based payment) by reference to the value of equity in another entity only where the value of that equity is considered an appropriate surrogate value for those services received. In this way, the recognition of this initial liability (including vested and unvested amounts) would be aligned to the principles of accounting in relation to equity-settled share-based payments where, for example, the employees of the subsidiary become entitled to shares or share options in a parent entity.

We would not however consider that subsequent movements in the fair value of a cash-settled share based payment liability could be deemed representative of the value of services received since there is no control over the value of that liability and no discretion available to management in ascertaining whether or not it is representative of the services received.

We believe that if the proposals in the ED are adopted, the accounts of the subsidiary entity may not be reflective of the economic resources that it has received and consumed during the periods in which the parent's liability is remeasured to fair value with corresponding charges to the subsidiary's profit and loss account.

In relation to this issue, we also see as a concern the fact that the parent's investment in the subsidiary would become inflated over time based on any increase in value of the parent's equity. This increase in the carrying value of the investment may bear little, if any, relationship to the value of the subsidiary.