Australian Government

Australian Accounting Standards Board

Level 4, 530 Collins Street
MELBOURNE VIC 3000
Postal Address
PO Box 204
Collins Street West VIC 8007
Telephone: (03) 9617 7600
Facsimile: (03) 9617 7608

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Mr Robert Garnett
Chairman – IFRIC
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Bob,

IFRIC Draft Interpretation D17
IFRS 2 – Group and Treasury Share Transactions

The Urgent Issues Group (UIG) has considered the proposals in Draft Interpretation D17, prepared by the International Financial Reporting Interpretations Committee (IFRIC). The UIG is pleased to provide its principal views in respect of the proposals for consideration by the IFRIC.

General Comments

We are concerned that consistency with one paragraph in IFRS 2 *Share-based Payment* – paragraph 3 – appears to be the main reason behind the IFRIC proposals, and that 'consistency' with this does not result in consistency with the definitions in IFRS 2. The proposals appear somewhat inconsistent between themselves and based more on the form of transaction, rather than its substance.

In summary, we disagree with:

(1) requiring different treatments in the financial statements of a subsidiary for grants of equity instruments of the parent entity, depending on whether the grant is from the parent or the subsidiary (circumstances (c)(i) and (c)(ii) in paragraph 6 of the Draft Interpretation); and

(2) the proposed amendment of IFRS 1 *First-time Adoption of International Financial Reporting Standards* to insert a reference to this Interpretation.

We are also concerned about the following aspects of the Interpretation:

(3) whether adequate consideration has been given to distinguishing, in the circumstances outlined in paragraph 6(a), situations where an entity has a choice whether to buy on market or issue its own equity instruments from situations where the entity has no choice and must buy on-market to obtain its own equity instruments to transfer to employees when they exercise their share options;

(4) whether the description of the circumstances in which a (principal) shareholder transfers part of their shareholding to an employee of an entity adequately acknowledges the in-substance involvement of the entity in such arrangements;

(5) the possibility that the treatment in the Illustrative Example, which is not part of the Interpretation, might be taken as merely indicative of one way of applying the Interpretation, thus permitting other (divergent) practices to be used; and

(6) whether the Basis for Conclusions provides sufficient background to the issues and the deliberations of the IFRIC in reaching its decisions so that the extent of the applicability of the Interpretation is readily apparent and it will be obvious that the IFRIC has considered the full range of scenarios.

We note that IFRIC members acknowledge in the Basis for Conclusions difficulties with consistency with IFRS 2. As explained further below, we suggest that if the Interpretation focussed on resolving these first, then some of the difficulties noted above might not arise.

Specific Comments

(1) Different treatments for grants of parent equity to employees of subsidiary

In relation to grants of equity instruments in a parent entity to the employees of a subsidiary, the proposal that a subsidiary treat some grants as equity-settled and others as cash-settled, depending on which entity directly made the grant, seems internally inconsistent and based on treating an artificial distinction in form as more important than substance.

The Interpretation should treat all grants of parent equity to an employee of a subsidiary in the same manner, whether direct or indirect, since it would seem unrealistic for there to be arrangements between a parent entity and an employee of a subsidiary that do not involve the subsidiary at all.

We note that the inconsistency in IFRS 2 between paragraph 3 and all the definitions is acknowledged in the Basis for Conclusions of D17, paragraph BC5. We believe it would be appropriate for this apparent inconsistency to be resolved first, before attempting to distinguish between direct grants and indirect grants. We believe that resolution of this at the principle level would help to make the interpretation clearer and more internally consistent.

We suggest resolution could be achieved through adopting one of the following two alternative approaches to the meaning of 'parent' in paragraph 3 of IFRS 2.

(i) 'Top-down' approach: the use of 'parent' could be considered as intended to provide guidance only in relation to the financial statements of a parent and a consolidated entity. The role of the Interpretation is therefore to explain how this is to be extended to apply in the financial statements of a subsidiary and, assuming the 'push down' principle is applicable, to require a subsidiary to measure and treat all grants of parent equity to its employees in the same way as the parent.

(ii) Hierarchical approach: this approach would also interpret the reference in paragraph 3 of IFRS 2 as applicable only to parent and consolidated accounting. However, it would then acknowledge that such grants are not equity of the subsidiary and not within the scope of IFRS 2. In order to ascertain the appropriate

treatment for such transactions, the hierarchy established in IAS 8 should be followed and this may lead to the conclusion that IFRS 2 provides the best guide to how to account for such transactions.

When considering how a subsidiary should account for such transactions, under either of the above approaches, we suggest this should not involve the use of a notional 'equity capital contribution' in the subsidiary, as proposed in the Illustrative Example for equity-settled share-based payment transactions. This method is limited in application to wholly-owned subsidiaries; it is not likely to be appropriate for partly-owned subsidiaries, particularly when the subsidiary is a listed company (and a notional 'equity capital contribution' cannot result in the increase of the parent's share in the net assets or its percentage ownership of the subsidiary). There are several such companies listed on the Australian Stock Exchange.

Further, we note that, depending on the amounts involved (for the 'charge' and the 'capital contribution'), the accounting by the subsidiary described in paragraph IE5 of Draft D17, in recording this 'equity-settled' transaction, could result in recognition using the same accounts (and not equity) that would be used for a cash-settled transaction in circumstances (c)(ii). There would be no difference between circumstances (c)(i) ***and*** (c)(ii) in respect of the accounts involved, but there might be a difference in measurement. If this is the intended purpose of distinguishing between the two, the message should be stated clearly.

However, the logic for treating circumstances (c)(i) differently from (c)(ii) is defective. From the subsidiary's standpoint, transactions in both circumstances fail the definition of 'share-based payment arrangement' in Appendix A, IFRS 2. If the inconsistency within IFRS 2 were resolved first, under either of the approaches suggested above, it would be clear there was no need to distinguish between them. There should not be a difference in a subsidiary's treatment of a grant of equity instruments of the parent entity to its employees, based on whether the grant is from the subsidiary or the parent. The treatment should be the same.

(2) Proposed amendment to IFRS 1

There is no need to amend IFRS 1 as a consequence of issuing an Interpretation based on Draft D17. The definition of IFRSs in IFRS 1 Appendix A, and the description of what is meant by 'first-time adoption', is sufficient to include all IFRIC Interpretations applicable at the end of the first period in which IFRSs are adopted. Effectively, IFRS 1 paragraph 7 requires application of IFRS 2 in conjunction with whatever Interpretations are in force at the entity's first IFRS reporting date. Therefore, the proposed amendment to IFRS 1 is redundant. Further, it may cause some users to wonder whether those Interpretations that are not specifically mentioned in IFRS 1 are different in some way.

As well as being unnecessary and potentially confusing to users, the proposed amendment of IFRS 1 imposes a needless burden on all national standard-setters (and even the XBRL taxonomy), by requiring re-issue of their equivalent to IFRS 1 (or the issue of an amending Standard), simply to add these few words. Of the three current IFRIC Draft Interpretations related to IFRS 2 (D11, D16 and D17), it is proposed that only two of them (D11 and D17) will each cause a change to IFRS 1, making it necessary for other standard setters to make two separate changes to their equivalents of IFRS 1, and possibly neither at the same date as the related IFRIC.

In our submission to the IFRIC in response to Draft Interpretation D16 *Scope of IFRS 2*, we strongly supported the IFRIC decision to remove (from earlier drafts) the proposal for a similar change to IFRS 1. We suggest that the IFRIC should also remove the Appendix and the proposed change to IFRS 1 from Interpretations resulting from both D11 *Changes in Contributions to Employee Share Purchase Plans* and D17. Further, we suggest that if the IFRIC considers there is a deficiency in IFRS 1 in relation to the applicability of IFRIC Interpretations, then one 'generic' amendment should be made to cover all of them. However, we do not consider such a deficiency exists.

(3) Consider distinguishing situations where entity must buy on market

We are concerned there does not appear to have been adequate consideration, in the circumstances outlined in paragraph 6(a) of D17, of the differences between situations where an entity has a choice whether to buy on market or issue its own equity instruments and situations where the entity has no choice and must buy on-market to obtain its own equity instruments to transfer to employees when they exercise their share options.

The failure in the proposals to address any difference between when an entity has a choice (whether to buy its own shares on market or to issue more shares), and when it does not, can be seen as inconsistent with the treatment of 'hybrids' in IFRS 2 (paragraphs 34 – 43) and the definition of a liability. A hybrid is a share-based payment arrangement where settlement may be in equity instruments or in cash (or other assets) based on the price of the entity's equity.

When an entity makes a grant to an employee and gives the employee the choice on settlement, IFRS 2 requires this be treated as cash-settled. However, when the entity has the choice on settlement, the transaction is not automatically classified as an equity-settled transaction. Paragraph 41 of IFRS 2 requires an entity to determine if it has any present obligation to settle in cash and, if so, to treat this as a cash-settled share-based payment transaction. It states that an entity "has a present obligation to settle in cash if the choice of settlement in equity instruments has no commercial substance (eg because the entity is legally prohibited from issuing shares) ..."

To be consistent with this, the Interpretation should distinguish between the two major categories of 'on-market' purchase in circumstance (a):

(i) where the entity has a choice whether to buy on market or to issue more shares; and

(ii) where the entity has no choice and must buy its own equity instruments on market.

In both cases, D17 proposes classification as equity-settled share-based payment transactions. However, in the second case, the IFRIC proposal seems inconsistent with the position in IFRS 2 and appears to ignore the substance of the effect on the entity. If an entity is legally prohibited from issuing more shares (by statute or contract) or has a practice of settling in cash, then granting its own equity instruments to its employees creates simultaneously the same liabilities (present obligations) as would arise if the grant were to be cash-settled. The liability to pay cash exists irrespective of whether payable to the employee or on-market.

Requiring an entity to treat all its grants of equity in circumstances (a)(ii) as equity-settled transactions fails to acknowledge these liabilities or require recognition in the balance sheet. The apparent consistency achieved by designating all transactions in circumstances (a) as equity-settled is superficial. It creates inconsistencies with IFRS 2, understates liabilities and reduces the representational quality of the financial statements.

(4) Consider amending description of transfers by principal shareholder

We are concerned that the description of the circumstances in which a (principal) shareholder transfers part of their shareholding to an employee of an entity does not adequately acknowledge the in-substance involvement of the entity in such arrangements.

When a shareholder is to provide part of its shareholding in an entity to the employees of that entity, paragraph 8 of D17 states that the entity must treat this as an equity-settled share-based payment transaction, irrespective of whether it is the entity or the shareholder that made the grant to the employee or that is required to settle with the employee. It seems inconsistent to make no distinction here that corresponds to the distinction made in paragraph 6(c). Further, if the entity is a subsidiary and the shareholder is a parent, no distinction is made between arrangements depending on whether the parent or the subsidiary made the grant or is obliged to transfer the equity instruments to the employee.

However, we disagree with the inference in the Interpretation that such transactions can exist without any involvement of the entity and suggest that instead the Interpretation should emphasise that the entity is presumed to be involved in all such arrangements, except for the circumstances outlined already in paragraph 3 of IFRS 2 or where there is clear and unambiguous evidence that the entity is not involved and does not benefit from being able to reduce its obligation to remunerate an employee when that employee is to receive a transfer of equity from the shareholder.

(5) Relocate material from Illustrative Example to Interpretation

The accompanying Illustrative Example goes beyond the Draft Interpretation in describing how the 'transaction' is to be recorded by both the subsidiary and its parent. The Interpretation refers only to the 'transaction' between the parent entity and the employee(s) of the subsidiary, but this is not what is recorded in the Illustrative Example. In the Illustrative Example, the only 'transaction' shown as recorded is the notional transaction imputed between the parent and its subsidiary. The treatment involves matters not addressed in the Interpretation, such as deeming an equity capital contribution by the parent to the subsidiary.

We suggest that the content in the Illustrative Example should be restricted to illustrating the treatment described in the Interpretation and should not introduce material that appears essential to the application of the Interpretation. Otherwise, the treatment in the Illustrative Example, which is not part of the Interpretation, might be taken as merely indicative of one way of applying the Interpretation, thus permitting other (divergent) practices to be used.

(6) Expand Basis for Conclusions

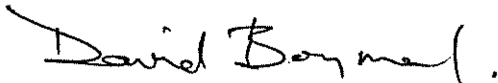
We suggest it would be useful for the Basis for Conclusions to be expanded so as to provide more information on the background to the issues and the deliberations of the IFRIC in reaching its decisions. This would assist users in understanding the reasons why the matter came to the attention of the IFRIC, the frequency and range of transactions seen in the three sets of circumstances and how widespread was the observed divergence in practices. Fewer questions are likely to arise in the future if the extent of the applicability of the Interpretation is readily apparent and it is obvious that the IFRIC has considered the full range of scenarios.

Editorial Comment

The reference in paragraph IE2 of the Illustrative Example to paragraph 8 of the Draft Interpretation is incorrect; it should refer to paragraph 9 instead, being the paragraph that addresses the (c)(i) circumstances.

Please contact us if further information or clarification is required.

Yours sincerely,



David Boymal
Chairman, AASB and UIG