Conseil National de la Comptabilité
3, Boulevard Diderot
75572 PARIS CEDEX 12
Téléphone **01 53 44 52 01**
Télécopie **01 53 18 99 43/01 53 44 52 33**
Internet http://www.cnc.bercy.gouv.fr
Mel jean-francois.lepetit@cnc.finances.gouv.fr

Le Président
JFL /JC
N°

Paris, le 19 mars 2008

IASB
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

We are pleased to comment on the proposed amendments to IFRS 2 and IFRIC 11 with regards to group cash settled share based payment transactions.
We agree with the IASB that there is a need to clarify the accounting treatment for group cash settled arrangements.
However, we disagree with the approach followed consisting in limited amendments to IFRS 2 and IFRIC 11 that result in additional rules applicable to the specific transactions described in the exposure draft, rather than in providing clarity about the principles that shall apply in various circumstances.
We believe that if the proposed amendments are issued, there are likely to raise additional issues, diversity in practice and structuring opportunities. You will find a detailed description of our concerns in the attached appendix.
We therefore urge the IASB to handle a more comprehensive review of the scope of IFRS 2 and to clarify the principles in this Standard that should apply to determine the nature and measurement of various types of group share-based transactions.

Jean-François Lepetit

APPENDIX

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?

We support both the overall objective of the proposed amendments to solve inconsistencies in the accounting for share-based payment transactions within a group and the explicit requirement for a subsidiary to apply IFRS 2 to account for share-based payment arrangements settled in cash by the parent.

However, we do not support piecemeal amendments to IFRIC 11 to address a specific situation. Rather we believe there is a need for a more fundamental reconsideration of the scope of IFRS 2, and a clarification of the principles to apply to determine the nature and measurement of the various types of complex arrangements within groups that exist in practice. Without such reconsideration, we believe that the proposed amendments are likely to be considered as additional rules and as a consequence to raise significant and frequent implementation issues and structuring opportunities as described hereafter.

This issue is a great opportunity for the IASB, after 3 years of application of IFRS 2, to revisit on a broader basis the difficulties raised by group arrangements. If principle-based solutions are developed, we believe the amendments should make it possible to incorporate, within IFRS 2, all the guidance necessary to determine the accounting treatment for group share-based arrangements, and to withdraw IFRIC 11.

a) Scope.

As currently drafted, the proposed amendments seem to limit the requirements of IFRS 2 and IFRIC 11 to the specific cases described in the exposure draft, leaving preparers and auditors with uncertainties as to whether or not proposed amendments should also apply to other arrangements that may appear economically similar. As a consequence the lack of clarity as to the intended scope of the amendments gives room for further diversity in practice.

While IFRS 2 applies to transfers of equity instruments by its **shareholders** (not only by the parent) to parties that have supplied goods or services to the entity (paragraph 3), we note that paragraph 3A of the proposed amendments to IFRS 2 uses a different wording than paragraph

3 and appears to cover only "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 entity, its parent, or another entity in the group to parties that have supplied goods or services".

Conversely, paragraph 6 of IFRIC 8 states that "**IFRS 2 applies to transactions in which** an entity or **an entity's shareholders have** granted equity instruments or **incurred a liability to transfer cash or other assets for amounts that are based on the price (or value) of the entity's shares or other equity instruments of the entity.**" (emphasis added)

In our view, the scope should be clarified and the rationale explained in the basis for conclusions. For example, if an entity has two shareholders who collectively agree to make payments (up to their respective ownership interests) for amounts that are based on the price (or value) of the entity to the entity's employees, paragraph 6 of IFRIC 8 would imply that IFRS 2 applies, whereas it may be considered that the amended scope of IFRS 2 would not.

Moreover, while we note that paragraph 3A of the proposed amendments to IFRS2 includes liabilities incurred by another entity in the group, we also note that 3A of the proposed amendments to IFRIC11 only refers to liabilities incurred by the parent. For the avoidance of doubt, we believe the scope of IFRIC 11 should be consistent with the proposed amendments to the scope of IFRS 2.

We further note that paragraph 3A of the proposed amendments to IFRIC 11 indicates that the proposed amendments apply to arrangements by which "the subsidiary itself does not have any obligation to make the required cash payments to its employees or provide them with its equity instruments". Therefore, we understand that different considerations would apply to a 100% owned subsidiary depending on whether:

- The subsidiary grants free shares to its employees that are then puttable to (callable by) the parent ("*Arrangement 1*") or
- the parent grants phantom shares of the subsidiary and will make the required cash payments ("*Arrangement 2*").

However, we fail to understand the real intent of the IASB: shall Arrangement 1 be measured as equity-settled in the financial statements of the subsidiary whereas Arrangement 2 would be measured as cash-settled? If so, what is the rationale behind the different accounting treatments considering that both arrangements (1) would be considered as cash-settled share-based payments in the consolidated financial statements of the group and (2) seem to be (using the basis for conclusions set out in paragraph BC 6 of the proposed amendments):
(a) for the purpose of providing benefits to the employees of the subsidiary in return for employee services, and
(b) share-based and cash-settled?

Once again, we believe that clear principles should be identified within IFRS 2 in order to avoid diversity in the accounting treatment for transactions that appear to be economically similar, and to be able to draw from those principles a logic that can then be applied to various arrangements, both in separate and consolidated financial statements of any individual group entity affected by the transaction.

b) Rationale for truing up the expense.

We are not convinced that the requirement for the subsidiary to measure employee services according to the requirements applicable to cash-settled share-based payment derives directly from principles contained in IFRS 2, and that this requirement is fully consistent with the principles of this Standard. We note that the basis for conclusions to the proposed amendments do not clearly explain the rationale for this conclusion. In our view, the statement in paragraph BC5 that the arrangements addressed in the draft amendments are "share-based and cash settled" is not supported by an appropriate demonstration: this statement may be appropriate from the point of view of the consolidated group, and from the employee's perspective, but we fail to understand how this is correct from the point of view of the entity receiving employee services.

In our view, the proposed amendments establishes a "push down" accounting rule whereby all accounting consequences of a share-based payment granted by a parent on behalf of a subsidiary should be reflected in the subsidiary's accounts, and the consistency of this rule with previous decisions is not clear.

We understand that IFRS 2's primary objective, with respect to share-based payment arrangements with employees, is to recognise in the financial statements of an entity the fair value of the employee services received by reference to the fair value of the equity instruments granted measured at grant date. The reason why a remeasurement is necessary in the case of cash-settled share-based payments appears to be solely due to the existence of a liability, which value varies between grant date and settlement date. This is explained in the basis for conclusions to IFRS 2 as follows:

BC 240 : In an equity-settled transaction, only one side of the transaction causes a change in assets, ie an asset (services) is received but no assets are disbursed. The other side of the transaction increases equity; it does not cause a change in assets. Accordingly, not only is it not necessary to remeasure the transaction amount upon settlement, it is not appropriate, because equity interests are not remeasured.

BC241: In contrast, in a cash-settled transaction, both sides of the transaction cause a change in assets, ie an asset (services) is received and an asset (cash) is ultimately disbursed. Therefore, no matter what value is attributed to the first asset (services received), eventually it will be necessary to recognise the change in assets when the second asset (cash) is disbursed. Thus, no matter how the transaction is accounted for between the receipt of services and the settlement in cash, it will be 'trued up' to equal the amount of cash paid out, to account for both changes in assets.

We understand from the above that, in a share-based payment arrangement with an employee:

- the value attributed to services received is grant date fair value,
- if the transaction involves a subsequent change in other assets, truing up is necessary.

Although we note that in *Arrangement 2* described previously there is no equity interest issued by the subsidiary, we also note that the transaction does not either involve a change in assets and the reason for "truing up" remains unclear. Truing up in the financial statements of the subsidiary further appears to be against the explanation provided in the current paragraph BC8 of IFRIC 11 which states that "because the subsidiary does not have an obligation to deliver cash or other assets to its employees, the IFRIC proposed in D 17 that it was not appropriate to account for the transaction as cash-settled in the financial statements of the

subsidiary. Instead, the IFRIC suggested that the equity-settled basis was more consistent with the principles in IFRS 2."

Furthermore, we understand from the requirements of the current IFRIC 11 and its basis for conclusions that the IASB/ IFRIC gave greater weight to the nature of the obligation of the entity itself than to the obligation of the consolidated group or to what the employee will receive. This perspective seems to be confirmed by paragraph BC 16 of current IFRIC 11, which states that: "The IFRIC noted that arrangements described in paragraph BC7(a) and (b) might be the same in the consolidated financial statements of the parent, and also from the perspective of the employees who receive the equity instruments. However, from the perspective of the subsidiary, the IFRIC observed that the two arrangements are different. The IFRIC noted that under arrangement (a) the parent, rather than the subsidiary, has the obligation to provide its employees with the equity instruments, whereas under arrangement (b) it is the subsidiary that has that obligation."

We acknowledge that the remeasurement of the expense would be consistent with the cash outflow that the parent will eventually have to make, and that it may be considered appropriate to measure a capital contribution received by the subsidiary at the amount of the cost recognised by the contributor, but this principle does not exist in IFRS 2, as IFRS 2 focuses on the accounting for services received and disregards intragroup transactions, and we do not believe that it is a general principle under IFRS current literature. Therefore, we do not believe it is appropriate to introduce such principle as part of limited amendments to IFRS 2 without considering more broadly the issue of capital contributions in other types of transactions.

Absent any clear principles underlying the reasons why the expense should be trued up, we believe that diversity in practice is likely to remain in the accounting for several group share-based transactions.

For example, a group is composed of three different entities: GP (grand-parent), P (parent wholly owned by GP) and S (subsidiary wholly owned by P).
Arrangement 3: P grants P shares to S employees. These shares are puttable to (callable by) GP.
It appears that *Arrangement 3* would be measured as:

- a cash-settled arrangement in GP consolidated financial statements
- an equity-settled arrangement in P consolidated financial statements (based on last sentence of paragraph 3A of the proposed amendments to IFRIC 11)

The appropriate conclusion in S financial statements is unclear.

Arrangement 4: P grants GP shares to S employees.
We understand that *Arrangement 4* would be measured as:

- an equity-settled arrangement in GP consolidated financial statements
- a cash-settled arrangement in P consolidated financial statements (based on current paragraph 11 of IFRIC 11)

The appropriate conclusion in S financial statements is unclear.

While we understand that the amendments cannot address the detailed accounting for all specific circumstances, we believe these examples illustrate the need for clear guidance and principles that could help determining the accounting in all circumstances.

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?

We agree with the proposal. However since transitional provisions of IFRS 2 are different for equity-settled and cash-settled transactions, we believe that for the avoidance of doubt, the amendment should clarify which transitional provisions one would apply.

Other comments

We acknowledge that the purpose of the draft amendment is not to deal with the accounting of the transaction in the parent's separate financial statements. However, we believe that a comprehensive review of IFRS 2 principles applicable to group share-based arrangements should also result in a clarification of the nature of the transaction in the separate financial statements of the entity making the cash payment: is that a share-based payment in the scope of IFRS 2? Furthermore, wonder whether the remeasurement by the subsidiary of the contribution received from the parent would involve a remeasurement by the parent of its investment in the subsidiary. The principles that would allow such symmetry are also unclear. For example, we note that paragraph 30 of IFRS 2 requires that changes in the fair value of the liability incurred until settlement are recognised in profit or loss (also mentioned in IFRS 2.IG19).