IFRS

STAFF PAPER

13-14 November 2012

IFRS Interpretations Committee Meeting

Project	IFRS 2 *Share-based Payments*		
Paper topic	Timing of the recognition of intercompany recharges		
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Purpose of this paper

1. In August 2012, the IFRS Interpretations Committee (the Interpretations Committee) received a request for clarification about IFRS 2 *Share-based Payments*. The submission relates to intragroup recharges made in respect of share-based transactions.

2. In the submitter's example, the parent company of an international group grants share-based awards to the employees of its subsidiaries. The obligation to settle these awards is the parent's. The awards are based on the employee's service to the subsidiary. The subsidiary and the parent both recognise the share-based transaction in accordance with IFRS 2—typically over the vesting period of the awards.

3. The parent has also entered into recharge agreements with its subsidiaries that require the subsidiaries to pay the parent the value of the share-based awards upon settlement of the awards by the parent. The question that the submitter asks is—when should the liability for the intragroup recharge transaction be recognised in the financial statements of the subsidiary:

   (a) at the date of grant of the award; or

(b) at the date of exercise of the award?

4. Accounting for intragroup recharges was not addressed in the original revisions to IFRS 2. *IFRIC Update* September 2006 notes:

> The IFRIC considered whether the interpretation should address how to account for an intragroup payment arrangement in which the subsidiary pays the parent for the provision of the equity instruments to the employees.
>
> The IFRIC decided not to address that issue, since it did not wish to widen the scope of the interpretation to address an issue that related to accounting for intragroup payment arrangements generally.

5. The question for the Interpretations Committee is whether we want to address the timing of the recognition of these transactions now? The diversity in practice reported from outreach suggests this issue should be addressed. We think that the thinking of the IASB has progressed since 2006 in such a way that the issue of the timing of the recognition of the intragroup recharge will now be capable of resolution on a timely basis.

Paper structure

6. This paper is organised as follows:

    (a) submission received;

    (b) requirements of IFRS 2;

    (c) accounting methodologies for the intragroup recharge identified in the submission;

    (d) summary of outreach conducted;

    (e) staff analysis of possible approaches to the recognition of the intragroup recharge;

    (f) assessment against the interpretations agenda criteria; and

(g) staff recommendation.

Submission received

7. The transaction as stated in the submission is straightforward. The share-based payments to the subsidiary's employees are settled in the parent's equity. The subsidiary recognises the estimated amount of the share-based payment as an expense and a corresponding increase in equity throughout the vesting period. The recharge, when made, is accounted for as a credit to intragroup balances and a corresponding decrease in equity. The net effect of this accounting in the financial statements of the subsidiary, over the life of the award, is debit profit and loss; credit intragroup liability.

8. However, the awards granted to the employees are service-based awards and the vesting period is between 3 to 5 years. The recharge itself is not made to the subsidiary until the awards are settled in the parent's equity at the end of that vesting period.

9. Therefore, the timing of the recognition of the recharge will have a significant effect on the statement of financial position of the subsidiary. If the recharge is recognised over the vesting period, the estimated amount of the award will be recognised in each reported balance sheet as a liability. If the recharge is not recognised until the award is settled at the end of the vesting period, the estimated amount of the award will remain an increase in equity until settlement.

10. In the submission, the submitter refers to conflicting guidance about the timing of the recognition of the recharge from three accounting firms:

    (a) **[Firm A]** If the recharge is based on the value of the share-based payment transaction, the recharge is clearly linked to the share-based payment and should be recognised and measured by analogy to the requirements for cash–settled share-based payment transactions. They think that the recharge should be accounted for when the parent and the subsidiary have an agreed understanding of the terms and conditions of

the contract. Often this will be before the subsidiary makes a payment to the parent.

(b) **[Firm B]** acknowledges two possible approaches, one of which is to recognise the recharge over the vesting period because the recharge arises from the arrangement in which the employees are providing services. The other approach is to recognise the liability for the recharge in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

(c) **[Firm C]** acknowledges two possible treatments:

(i) recognise the recharge over the life of the award; or

(ii) recognise the recharge when the recharge is levied or paid.

They recommend the latter approach because they analogise the recharge to a distribution of equity and the payment of a dividend.

11. The full submission is included as Appendix A.

Requirements of IFRS 2

Recognition requirements of IFRS 2

12. The core recognition principle of IFRS 2 is that you recognise a corresponding increase in equity or liabilities as goods or services are acquired or received. The guidance on the recognition of the share-based payment transaction is set out in paragraph 7:

> 7 An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognise a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction, or a liability if the goods or services were acquired in a cash-settled share-based payment transaction.

13. Paragraphs 14 and 15 indicate that you presume services are rendered throughout the vesting period:

> 14 If the equity instruments granted *vest* immediately, the counterparty is not required to complete a specified period of service before becoming unconditionally entitled to those equity instruments. In the absence of evidence to the contrary, the entity shall presume that services rendered by the counterparty as consideration for the equity instruments have been received. In this case, on grant date the entity shall recognise the services received in full, with a corresponding increase in equity.
>
> 15 If the equity instruments granted do not vest until the counterparty completes a specified period of service, the entity shall presume that the services to be rendered by the counterparty as consideration for those equity instruments will be received in the future, during the *vesting period*. The entity shall account for those services as they are rendered by the counterparty during the vesting period, with a corresponding increase in equity.

14. Both the submitter and the guidance prepared by the firms confirm recognising the share-based payment transaction itself in accordance with this guidance. Depending on the facts and circumstance, that will generally be over time, throughout the vesting period, as the services are provided by the employee.

Intragroup transactions

15. IFRS 2 was revised in June 2009 specifically to clarify the treatment of intragroup share-based transactions. The revisions included some amendments made to the guidance previously issued as IFRIC 11 *IFRS 2–Group and Treasury Share Transactions*. That interpretation was superseded by the revised IFRS 2.

16. The requirements of IFRS 2 in respect of intragroup transactions are complex. In order to understand the source of diversity in the interpretation of these

requirements, we need to consider a number of paragraphs in that Standard in more detail.

Scope

17. Paragraphs 3A and BC 22D make it clear that group share-based payment transactions are included in IFRS 2—notwithstanding that the services are received by one group entity and the share based payment is made by another.

> 3 A share-based payment transaction may be settled by another group entity (or a shareholder of any group entity) on behalf of the entity receiving or acquiring the goods or services. Paragraph 2 also applies to an entity that
>
> (a) receives goods or services when another entity in the same group (or a shareholder of any group entity) has the obligation to settle the share-based payment transaction, or
>
> (b) has an obligation to settle a share-based payment transaction when another entity in the same group receives the goods or service unless the transaction is clearly for a purpose other than payment for goods or services supplied to the entity receiving them.
>
> BC22D When finalising the amendments issued in June 2009, the Board reaffirmed the view it had intended to convey in the proposed amendments, namely that the entity receiving the goods or services should account for group share-based payment transactions in accordance with IFRS 2. Consequently, IFRS 2 applies even when the entity receiving the goods or services has no obligation to settle the transaction and regardless of whether the payments to the suppliers are equity-settled or cash-settled. To avoid the need for further guidance on the scope of IFRS 2 for group transactions, the Board decided to amend some of the defined terms and to supersede

> paragraph 3 by a new paragraph 3A to state clearly the principles applicable to those transactions.

Specific reference to recharges

18. Paragraph 43D says that in cases of recharges between group entities, the transaction is measured as an equity-settled share-based transaction by the entity receiving the services (in this submission, the subsidiary) in accordance with IFRS 2.43B:

> 43 D Some group transactions involve repayment arrangements that require one group entity to pay another group entity for the provision of the share-based payments to the suppliers of goods or services. In such cases, the entity that receives the goods or services shall account for the share-based payment transaction in accordance with paragraph 43B regardless of intragroup repayment arrangements.

19. Some have interpreted this paragraph to mean that the group repayments transactions (the recharge) are specifically excluded from the scope of IFRS 2. That interpretation is not obvious to us. In our view, the effect of linking these transactions to 43B is to ensure that the transaction is measured as an equity-based share-based transaction, even though the transaction may be a cash-settled transaction from the perspective of the subsidiary:

> 43 B The entity receiving the goods or services shall measure the goods or services received as an equity-settled share-based payment transaction when:
>
> (a) the awards granted are its own equity instruments, or
>
> (b) the entity has no obligation to settle the share-based payment transaction.
>
> The entity shall subsequently remeasure such an equity-settled share-based payment transaction only for changes in non-market vesting conditions in accordance with paragraphs 19-21. In all other circumstances, the entity

> receiving the goods or services shall measure the goods or services received as a cash-settled share-based payment transaction.

Contribution from parent

20. B53 makes it clear that the subsidiary should recognise a corresponding increase in equity as a contribution from the parent for this expense when the subsidiary does not have a requirement to provide the shares itself:

> B53 The subsidiary does not have an obligation to provide its parent's equity instruments to the subsidiary's employees. Therefore, in accordance with paragraph 43B, the subsidiary shall measure the services received from its employees in accordance with the requirements applicable to equity-settled share-based payment transactions, and recognise a corresponding increase in equity as a contribution from the parent.

21. (It should be noted that the fact pattern in this example does not contain an intragroup recharge transaction.)

Effect of the intragroup transaction requirements

22. The effect of these various requirements is that:

    (a) The subsidiary recognises an expense in profit and loss and the corresponding credit to equity as a contribution from the parent (B53).

    (b) The parent recognises an increase in equity in accordance with IFRS 2.7. By analogy with the accounting required in the financial statements of the subsidiary, the corresponding debit in this example would be treated as a contribution to the subsidiary.

Exclusion of intragroup recharges

23. When IFRIC 11 was developed in 2006, the Interpretations Committee specifically discussed whether the accounting for intragroup recharges should be included in that interpretation. This topic was excluded from IFRIC 11 because

the Interpretations Committee did not want to address the accounting for intragroup payments generally and the IASB confirmed that recommendation.

24. In paper 14C (October 2008), this topic was re-deliberated by the IASB prior to finalising the proposed amendments to IFRS 2. The IASB accepted the recommendation of the Interpretations Committee contained in that staff paper:

> 27 Consistent with the prior conclusions reached by the IFRIC and the Board when developing IFRIC 11, the IFRIC recommends that the Board not amend IFRS 2 to address intragroup reimbursement arrangements for group share-based payment transactions. Doing so would widen the scope of share-based payment accounting to the accounting for intragroup payment arrangements and related party transactions generally.

25. Some have interpreted this to mean that accounting for the intragroup recharge transactions are outside the scope of IFRS 2—see also paragraph 19 of this paper. We do not agree with that interpretation. In our view, the Standard simply does not address the issue—presumably leaving that accounting to individual judgement.

Accounting methodologies for the intragroup recharge identified in the submission

26. The submitter identifies three methods of recognising the intragroup recharge, which are derived from guidance issued by the firms, together with a further method that represents the submitter's own point of view. These views can be summarised as:

    (a) View A—the linked transaction approach;

    (b) View B—the liabilities approach;

    (c) View C—the distribution of equity approach; and

    (d) View D—the executory contract approach.

View A The linked transaction approach

27. In this view, the recharge is linked with the share-based arrangement because the amount recharged is based on the parent's share-based payment arrangement with the employees of the subsidiary. The recharge is recognised as the employee's service is rendered throughout the vesting period, in accordance with IFRS 2.7.

Other views

28. Others view the arrangement as consisting of three separate transactions, recognised at different times:
    (a) The 'share-based transaction' (the employees' services received for shares in the parent) is accounted for by the subsidiary in accordance with IFRS 2. The share-based transaction is recognised in accordance with IFRS 2.7 as the services are rendered, throughout the vesting period, and is shown as a credit to equity in accordance with B53.
    (b) The 'recharge transaction' is a separate transaction to recognise a liability to the parent. Many think this transaction is outside the scope of IFRS 2.
    (c) The third transaction is cash settlement (Debit liability to parent, Credit cash) and is not contentious.
29. The submitter identifies three different views about accounting for the separate recharge transaction in 28(b)—Views B, C and D.

View B The liabilities approach

30. The liability to the parent should be recognised by the subsidiary in accordance with IAS 37. If this view is adopted, there may not be a present obligation until all vesting conditions have been satisfied and it is probable that employees will exercise the option. This may not occur until the payment is made to the parent.

View C The distribution of equity approach

31. Because the example in B53 credits the share-based transaction to equity, the recharge is viewed as analogous to a distribution. Distributions are only recognised when there is a present obligation and, in this case, the obligation is conditional on whether the employees exercises their option. The recharge would not be recognised by the subsidiary until the award is exercised.

Views D The executory contract approach

32. The submitter has its own view about the recognition of the intragroup recharge. The submitter suggests that the recharge agreement is an executory contract and so should not be recognised until one party has performed—either the parent by issuing the shares or the subsidiary by paying the recharge. The submitter cites the Conceptual Framework for the recognition of a liability only when one party has performed:

> 4.46 In practice, obligations under contracts that are equally proportionately unperformed (for example, liabilities for inventory ordered but not yet received) are generally not recognised as liabilities in the financial statements. However, such obligations may meet the definition of liabilities and, provided the recognition criteria are met in the particular circumstances, may qualify for recognition. In such circumstances, recognition of liabilities entails recognition of related assets or expenses.

Summary of outreach conducted

33. In order to gather information about these types of intragroup recharges, we sent requests to the International Forum of Accounting Standard-setters (IFASS), the European Securities and Markets Authority (ESMA), and the International Organization of Securities Commissions (IOSCO).

34. We asked them three questions about the four alternative views outlined in paragraphs 26 - 32:

(a) Are these types of group-recharged share-based payments common in your jurisdiction?

(b) If they are common – what is the usual accounting treatment? Is there diversity locally in the accounting treatment? (Please provide details.)

(c) Why is the accounting treatment used in your jurisdiction preferred by constituents? What basis is given for the accounting treatment used?

35. The request for information is set out in Appendix B of this paper.

Responses received from outreach conducted

36. We received 16 responses to this IFASS and regulator informal outreach:

Regulator		1
IFASS		
Europe	5	
Asia–Oceania	7	
Latin America	2	
North America	1	
Africa	1	16
Total		17

37. We also spoke separately to the technical departments of some of the major accounting firms to clarify with them the guidance in their accounting manuals.

Preliminary findings from outreach

38. Approximately half of the respondents were unable to comment or express an opinion on these types of transactions because:

(a) these recharges for share-based payments are not common in their jurisdiction or are only applicable to a small number of entities that are subsidiaries of overseas parents;

(b) the transaction eliminates on consolidation, is not separately disclosed and therefore respondents have no visibility of the transaction; and/or

(c) the transaction is accounted for by a subsidiary that does not prepare accounts in accordance with IFRSs or file accounts in any form.

39. The respondents who did comment on this type of transaction noted that there was wide diversity in accounting for the recharge. All the potential accounting views A-D were recorded to some extent, although D (executory contract) was only acknowledged by one jurisdiction.

40. Three of the respondents who commented appeared to prefer View A (recognise the recharge over time) but the sample size is not large enough to attribute significance to that view. A review of the firms' guidance suggests that recognition at the date of payment is the preferred accounting approach, whether on the basis of recognising a liability in accordance with IAS 37 or by analogy to a distribution. Again, the amount of input received means this is anecdotal rather than determinative information.

41. In addition, some commentators have suggested separately that intragroup contracts are different from contracts between parties that are at arm's length. In their view, intragroup transactions should only be recognised when settled or exercised, because intragroup recharge agreements may be cancelled or waived, or the terms of the agreement may be varied, at short notice.

42. Some respondents stated that the approach used could have significant tax effects in some jurisdictions.

43. What is clear as a result of preliminary outreach conducted is that there is wide diversity in application, both within individual jurisdictions and across jurisdictions.

Topics not addressed in this paper

44. There are two possible mismatches in accounting for intragroup transactions in accordance with IFRS 2 that caused concern to some respondents. The two mismatches relate to:

    (a) the elements recognised in the individual statements of financial position of the receiving and settling entities; and

    (b) the measurement of the transactions in the receiving and settling entities.

Potential mismatch of balance sheet elements

45. The Standard requires the receiving entity, in this submission-the subsidiary, to recognise the expense relating to the share-based payment in profit and loss, with a corresponding increase in equity that is treated as a contribution from the parent (paragraph B53). This is compatible with paragraph 43B that requires the share-based payment to be treated as an equity-settled transaction by the receiving entity.

46. In the submitter's example, the settling entity is the parent of the receiving entity and this is often the case in this type of transaction. However, in their redeliberations of the 2007 Exposure draft, the IASB made it clear that all types of intragroup share-based payment transactions should be in the scope of IFRS 2. Depending on the group structure, the settling entity could be a parent, a fellow-subsidiary or a subsidiary of the receiving entity, and vice versa. Accordingly in revised paragraph 43C of IFRS 2, the guidance given about the accounting by the settling entity is limited to:

    > The entity settling a share-based payment transaction when another entity in the group receives the goods or services shall recognise the transaction as an equity-settled share-based payment transaction only if it is settled in the entity's own equity instruments. Otherwise, the transaction shall be recognised as a cash-settled share-based payment transaction.

47. There is no equivalent of B53 to provide specific guidance about the appropriate entry in the settling entity's statement of financial position. In developing the revisions to IFRS 2, the details of the accounting by the settling entity was specifically excluded from revised IFRS 2.

Mismatch in measurement

48. Paragraph 43B requires the share-based payment transaction to be treated as an equity-settled transaction by the receiving entity. This transaction is not subsequently remeasured, in accordance with the requirements of paragraph 43B. Paragraph 43C, however, requires the settling entity to treat the share-based payment transaction as either an equity-settled transaction or a cash-settled transaction. The cash-settled transaction is initially measured on a different basis from an equity-settled transaction and, unlike the equity settled transaction, is subsequently remeasured. If the settling entity accounts for the transaction as a cash-settled transaction the measurement bases will be different for the receiving and settling group entities. This potential mismatch in measurement is specifically acknowledged in paragraph 43A.

Permanent increase or decrease in the subsidiary's equity

49. In addition to these intercompany mismatches, some respondents were also concerned that the subsidiary would recognise a permanent increase or decrease to equity because the equity-settled transactions are not remeasured. Any difference between the initial estimate of the share-based payment and the final amount recharged in respect of the share-based payment will be a permanent increase or decrease in equity in the receiving entity.

50. We do not recommend addressing any of these issues in this discussion. In our view, the accounting requirements of IFRS 2 with respect to these points are explicit.

Staff analysis of possible approaches to the recognition of the intragroup recharge

51. The question is—should the timing of the recharge transaction be recognised on the same basis as the share-based transaction or independently as either a liability, a distribution or an executory contract?

52. On the basis of the submission to the Interpretations Committee, the messages received through outreach and our correspondence with the firms, our preliminary assessment of the relative merits of each of the four identified approaches is noted below.

View 1 The linked transaction approach

53. Supporters of View 1 think that the share-based payment transaction and the recharge agreement are contracts that are clearly linked because the amount that the subsidiary is required to pay to its parent is based on the value of the share-based payment transaction. In accordance with that view, they think that the timing of the recognition of the share-based payment expense and the recharge should be the same.

54. We do not agree with the view expressed by some, in paragraph 19 above, that the wording of 43D excludes intragroup recharges from IFRS 2. Some also cite the unwillingness to address intragroup recharges in 2006 as evidence that these types of transactions are excluded from IFRS 2. Reading the relevant extract from *IFRIC Update* in paragraph 4, we think that that the Standard does not specifically **address** the issue, rather than specifically **excluding** it. In support of this view, we note that the scope of IFRS 2 was not amended in 2009 to exclude these transactions. In our view, the intragroup recharges for share-based payments are not excluded from the scope of IFRS 2, although the accounting is not specifically addressed by that Standard.

55. In addition, we think it is important that the financial statements of the individual subsidiary should accurately depict the financial position of the subsidiary. We think that it is counterintuitive to recognise the expense on an accruals basis, but recognise the related recharge by the parent on a cash-paid basis. In our view,

presenting the obligation for the share-based payment expense as an increase in equity, without recognising the adjustment for the related recharge, understates the liabilities of the subsidiary in its statement of financial position.

56. Accordingly, our preliminary assessment is that with respect to timing, the recharge should be recognised in accordance with IFRS 2.7 and IFRS 2.15.

View 2 The liability approach

57. Supporters of View 2 think that the recharge should be accounted for in accordance with the requirements of IAS 37. They argue that, applying the requirements of that Standard, no liability be recognised until all the vesting conditions have been satisfied and it is probable that the employee will exercise the option. Such criteria might not be satisfied until the recharge is paid.

58. As noted above, we do not think that intragroup recharges are outside the scope of IFRS 2 so we think that there is no need to apply IAS 37 to the recharge transaction.

59. However, even if we did need to account for this transaction in accordance with IAS 37, we do not accept that the liability would be recognised only when vesting conditions are met and the employee has exercised his or her options:

    (a) We think that it could be argued that there is a present obligation in respect of the recharge at the date of granting the award. The obligating event is the provision of services to the subsidiary by the employee. Once the employee performs, the parent has an obligation to provide the share-based benefit to the employee. If the parent is obliged to provide the benefit, the subsidiary is also obliged at that time to pay the recharge at the time stated in the agreement.

    (b) Although paragraph 14 of IAS 37 also includes a 'probability of outflows' recognition criterion, paragraph 24 of that Standard requires entities to apply this criterion to each class of obligations as a whole. In other words, an entity would not need to assess the probability of each individual employee recognising his or her options. The entity would recognise a liability if it were probable that any of the employees would

exercise the option. In most circumstances, it is unlikely that such an assessment would conclude that no employees would exercise his or her options.

View 3 The distribution of equity approach

60. Supporters of this view think that it is consistent with the initial recognition of the share-based payment obligation as a credit to equity and also with the recognition of subsequent changes in the initial amount through equity rather than profit and loss account. In their view the recharge should be recognised only when it is a strict legal liability which, in most cases, will be when it is paid.

61. We are uncomfortable with this view in two respects:

    (a) It seems counter-intuitive to base this approach on the view that the two transactions, the share-based payment and the recharge, are completely separate yet at the same time, justify the accounting basis for one (the recharge) on the accounting basis of the other (the share-based payment).

    (b) In many groups it is normal for individual group entities to provide other group entities with a variety of goods and services. One subsidiary may provide a fellow-subsidiary with raw materials or with finished goods; a parent company may provide its subsidiaries with premises or with management or treasury services. These goods and services are often recharged by the providing entity to the receiving entity and these recharges are generally recognised by the receiving entity as the goods or services are provided, ie on an accruals basis. In our view, recognising the timing of these group recharges that are related to employee services on a different basis from the timing used to recognise other recharges for goods or services (whether for intragroup or third party provision of goods and services) seems awkward.

View 4 The executory contract approach

62. The submitter thinks that the recharge transaction is an executory contract and so should not be recognised until one party has performed—either the parent by

issuing the shares or the subsidiary by paying the recharge. As stated in paragraph 53 above, we think that the share-based transaction and the recharge agreement are clearly linked. The recharge agreement would not exist in the absence of the share-based payment agreement and material terms in the recharge agreement are defined by the share-based payment agreement. The performance of the share-based payment agreement directly affects the terms of the recharge agreement.

63. For the purposes of assessing performance, we think these two contracts must be considered together. Once the share-based payment agreement has been granted to the employee, and the employee has performed, the parties to the recharge agreement must perform. If the employee does not achieve a given level of service, or if the employee does not decide to exercise the option, the amount of the recharge may be reduced or may even be zero but, once the employee performs in accordance with the share-based payment agreement, the subsidiary cannot avoid performing under the recharge agreement.

64. In support of this view, the Conceptual Framework 4.46 does note that some executory contracts will meet the recognition criteria of a liability. (The recognition of a liability in this example is discussed in paragraph 59 of this paper.)

Assessment against the interpretations agenda criteria

Interpretations agenda criteria	
The issue is widespread and has practical relevance.	Although not common in all jurisdiction, where the transaction does take place it will affect many entities.
The issue indicates that there are significant divergent interpretations (either emerging or existing in practice).	Preliminary outreach, and a review of published guidance, confirm that there is significant divergence in practice.

Interpretations agenda criteria	
Financial reporting would be improved through the elimination of the diverse reporting methods.	Although it has no effect on consolidated financial statements, it would have a significant effect on single-entity financial statements prepared in accordance with IFRSs, or the subsidiary's own (sub-) consolidated financial statements.
The issue can be resolved efficiently within the confines of existing IFRSs and the Conceptual Framework, and the demands of the interpretation process.	Yes, by an interpretation of IFRS 2.
It is probable that the Committee will be able to reach a consensus on the issue on a timely basis.	In our view, it will be possible to reach a consensus on this issue in a timely manner.
If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project?	The IASB has no planned project to address this issue.

Staff recommendation

65. We recommend that the Interpretations Committee should take this issue onto its interpretations agenda. At this time, our analysis suggests that the linked presentation approach is most likely to result in consensus on a timely basis.

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree: (a) with the staff's recommendation that this issue should be addressed; and (b) that this matter should be added to its interpretations agenda? 2. Does the Interpretations Committee have any: (a) comments on the points made in paragraphs 53—63 on the relative merits of each approach, Views 1-4; or (b) additional points that they think should be added to that analysis in order to achieve consensus?

Appendix A Original agenda request

A1. On 1 August 2012 the IFRS Interpretations Committee received a request for clarification on the timing of the recognition of a group recharge that relates to a share-based payment. The request, below, has been rendered anonymous in respect of both the submitter and the accounting firms whose guidance has been quoted.

Director of Implementation Activities

International Accounting Standards Board

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IFRS INTERPRETATIONS COMMITTEE

POTENTTIAL AGENDA ITEM REQUEST

The issue:

Group share-based payment arrangements – timing of the recharge:

The Company grants share-based awards to employees of its subsidiaries. The obligation to settle these awards is the Company's. The Company has entered into agreements with the subsidiaries (primarily written) that the subsidiaries will pay the Company the intrinsic value of the share-based awards upon settlement of the awards by the Company (recharge agreement). The existence of these recharge agreements has raised the issue of when the liability related to these recharge agreements should be initially recorded; 1) at the date of grant of the award with the liability adjusted to reflect fair value at each subsequent balance sheet date, or 2) as of the date of exercise of the award?

We have encountered various approaches from the local auditors in some of the countries we have operations and have noted significant differences in practice among the major accounting firms. While this is not an issue from a consolidated perspective the differences can and have had a significant impact on local financial reporting. We have summarized the positions of the major accounting firms below but note here that the timing differences are significant (grant date vs. exercise date) between the firms.

Current practice:

We note both through experience and through research of various non-authoritative guidance that practice varies among the major accounting firms:

Firm A articulates their view as follow:

1. If the amount a subsidiary is required to pay its parent under a recharge agreement is based primarily on the value of the share-based payment the recharge is generally considered to be "linked clearly" to the share-based payment.
2. "If a recharge arrangement that is linked clearly to a share-based payment is a contractual arrangement,… the recharge transaction should be recognized and measured by analogy to the requirements for cash-settled share-based payment transactions. We believe that accounting for a contractual recharge by analogy to cash-settled share-based payments is appropriate because:
    - IFRS 2 applies to expenses relating to share-based payments; and
    - IAS 39 does not apply to contractual expenses that are accounted for under IFRS 2."
3. "For recharges accounted for by analogy to the requirements for cash-settled share-based payments, we believe that the recharge should be accounted for when the parent and the subsidiary have a shared understanding of the terms and conditions of the contract; often this will be prior to the subsidiary making a payment to the parent to settle its obligation under the recharge arrangement. We believe that the subsidiary and parent should measure the fair value of the recharge liability at the date that a shared understanding is established and, similar to the treatment of a share-based payment, the initial measurement of the recharge should be recognized as the services are provided in respect of the share-based payment."
4. "Additional complexities arise with regard to the accounting for a recharge in which the amount of the recharge varies, e.g. the amount recharged under an exercise date intrinsic value recharge arrangement varies with changes in share price. Continuing to apply the guidance for cash-settled share-based payments by analogy, if such a recharge that is linked clearly to a share-based payment is recognized prior to the subsidiary making a cash payment to the parent to settle its obligation, then the asset and liability arising from the recharge arrangement should be measured at each reporting date until settlement for changes in fair

value. In our view, changes in the fair value of a linked recharge that is accounted for by analogy to the requirements for cash-settled share-based payments should not be recognized through profit or loss. This is because we believe that it is the nature of the payment that should determine the accounting treatment. We believe the nature of a linked recharge is that of a reimbursement of a capital transaction and therefore that changes in the fair value of the recharge liability and asset from initial recognition to settlement should be treated as a true up of the initial estimate of the net capital contribution."

Firm A's guidance only acknowledges one view.

Firm C:

"When a subsidiary is recharged by its parent for a share-based payment, the question arises as to when (if at all) a liability should be recorded for the amount that is expected to be recharged in the future, for example, when the award vests or the employees exercise their options. There are two acceptable approaches to account for the recharge. One approach is that when the arrangement can be linked to the IFRS 2 charge, recharges should not be accrued, but should be recognized when paid, for the following reasons:

- IASs 32 and 39 scope out financial instruments, contracts and obligations under share-based payment transactions, except for contracts that can be net settled and in relation to the disclosure of treasury shares. Our view is that these scope exclusions should be read broadly and that recharges clearly related to a share-based payment can be considered outside the scope of IASs 32 and 39.
- While there is no scope exclusion for share-based payment arrangements under IAS 37, under IAS 37, such recharge payments would not generally meet the recognition criteria to be recorded as liabilities until paid because:
    - The subsidiary does not have a present obligation as a result of a post event. In order for there to be a clear link between a share-based payment and a recharge, in most cases the recharge will generally be linked to employee exercising their options. Options cannot be exercised until they have vested and employees are likely to exercise their options once they are in the money. *Therefore, there is unlikely to be a present obligation on the entity until all vesting conditions have been satisfied and until it is probable that employees will exercise their options (for example, where the options are in the money).* This is further supported by the fact that distributions (such as dividends) are only provided for when an entity has a present obligation and, as discussed above, an analogy may be drawn between such recharges and distributions to shareholders. There is no present obligation since the distribution is conditional upon an uncertain future event (such as employees providing services or choosing to exercise their options) that is not wholly within the control of the entity.
    - It is not probable that an outflow of economic resources will be required. We consider that the point in time at which it becomes probable that there will be an outflow of economic resources would only be reliably known

> when the options are close to being exercised. *In most cases, we believe that a subsidiary entity would account for a recharge when the payment is made to the parent.* The recharge would be disclosed as a contingent liability during the time that the recharge payment is not recognized as a liability. It may be appropriate to recognize a liability for a recharge before the payment is made – for example, once an award has vested and the options to be exercised are deeply in the money.

There is, however, diversity in practice in this area, as there is no specific guidance on recharge arrangements in IFRS. *There is an alternative approach in which the subsidiary entity would recognize the recharge over the vesting period as the recharge payment arises from the share-based payment arrangement in which employees are providing services.* This approach may also be acceptable in practice."

Firm B:

"A further issue that arises in practice is the timing of recognition of the recharge by the parties to the arrangement. The treatment adopted might depend to some extent on the precise terms of the arrangement but, in our view, there are two possible approaches;

- to account for the recharge when it is actually levied or paid (which is consistent with accounting for a distribution); or
- to accrue the recharge over the life of the award or the recharge agreement even if, as is commonly the case, the actual recharge is only made at vesting or exercise date.

In our view, the first approach is preferable since this appears more consistent with the overall recognition of the arrangement through equity and with a situation where uncertainties are likely to exist during the vesting period about the existence of a present obligation and the estimated cash outflow. The alternative approach treats the recharge more like a provision or financial liability but, unlike the requirements of IAS 37 or IAS 39, reflects the changes in the recognized amount through equity rather than profit or loss and builds up the recharge liability over the life of the award rather than recognizing the liability in full when a present obligation has been identified."

Another firm – rendered anonymous

We have been unable to locate a written position by [this firm] on this issue.

Submitter's Position:

We believe that the recharge agreement is an unperformed executory contract and that present obligation of the subsidiary does not exist until the Company has settled the share-based award with the employee. We base our view on the guidance in Conceptual Framework paragraph 4.46 and IFRIC 12 paragraph BC 67.

Reasons for the Interpretations Committee to address the issue:

We believe the Interpretations Committee should address this issue for the following reason:

1. We believe that this is an issue that is encountered by most publicly listed multinational companies due to the prevalence of share-based awards and the requirement for some form of statutory reporting in most countries.
2. The divergence in practice results in significant timing differences depending upon which firm is auditing the local statutory financial reports and may result in a restatement if the Company were to change to one of the audit firms which only acknowledges one view for accounting for recharge agreements
3. While this is not an issue for consolidated financial statements this issue may significantly impact local statutory reporting. For example, the Company's stock price has advanced significantly over the past few years. This has resulted in a significant increase in the intrinsic and Black-Scholes value of most the Company's share-based awards. As a result the liability that some of our local auditors insist be recorded for the outstanding awards has increased materially.
4. We believe this issue can be resolved within the existing framework of IFRS's and the Conceptual Framework. Specifically we believe the guidance in IFRS 2 paragraphs 43A-43D combined with the guidance in IAS 10 paragraphs 12 and 13, provides ample guidance to resolve this issue. Additionally we believe:
    a. for contractual agreements, the guidance in IFRIC 12, BC67 and Conceptual Framework paragraph 4.46, and
    b. for non-contractual recharge arrangements, IAS 37

    provide a framework to resolve this issue without analogy to other guidance.

Appendix B-Questions sent for outreach

B1. We asked IOSCO, ESMA, and the members of IFASS for information about this submission. The specific questions asked, in relation to their jurisdiction, were:

1. Are these types of group-recharged share-based payments common in your jurisdiction?
2. If they are common – what is the usual accounting treatment? Is there diversity locally in the accounting treatment? (Please provide details.)
3. Why is the accounting treatment used in your jurisdiction preferred by constituents? What basis is given for the accounting treatment used?

The entire email request is noted below:

Definition of the problem

The parent company of an international group grants share-based awards to the employees of its subsidiaries. The obligation to settle these awards is the parent's. The parent has entered into recharge agreements with its subsidiaries that require the subsidiaries to pay the parent the value of the share-based awards upon settlement of the awards by the parent.

When should the liability for these recharges be recognised by each subsidiary:

(a) at the date of grant of the award, or
(b) at the date of exercise of the award?

Current practice

The submitter refers to conflicting guidance given by three accounting firms in their published accounting manuals.

Several possible accounting treatments can be identified in the submission:

View A Because the amount recharged is based on the parent's share-based payment arrangement with the employees of the subsidiary, the recharge is linked with that share-based arrangement. The recharge should be recognised in the subsidiary by analogy to the requirements for cash-settled share-based payments. The liability to the parent is recognised as the employee's service is rendered throughout the vesting period, in accordance with IFRS 2.7.

Others view the arrangement as consisting of three separate transactions, recognised at different times:

(a) The 'share-based transaction' (the employees' services received for shares in the parent) is accounted for by the subsidiary in accordance with IFRS 2. The share-based transaction is recognised in accordance with IFRS 2.7 as the services are rendered, throughout the vesting period, and shown as a credit to equity in accordance with B53. (Dr expense; cr equity- ie all within shareholders' funds.)
(b) The 'recharge transaction' is a separate transaction to recognise a liability to the parent.
(c) The third transaction is settlement (Dr liability to parent, credit cash) and is not contentious.

The submission identifies three different views about accounting for the separate recharge transaction, (b), above.

View B The liability to the parent should be recognised by the subsidiary in accordance with IAS 37. Under this view, there may not be a present obligation until all vesting conditions have been satisfied and it Is probable that employees will exercise the option, ie when the payment is made to the parent.

View C Because the example in B53 credits the share-based transaction to equity, the recharge is viewed as analogous to a distribution. Distributions are only recognised when there is a present obligation and, in this case, the obligation is conditional on whether the employee exercises their option. The recharge would not be recognised by the subsidiary until the award is exercised.

Views D The submitter suggests that the recharge agreement is an executory contract and so should not be recognised until one party has performed – either the parent by issuing the shares or the subsidiary by paying the recharge.

In addition, some commentators have suggested separately that intragroup contracts are different from contracts between parties that are at arms-length. In their view, intragroup transactions should only be recognised when settled or exercised because intragroup recharge agreements may be cancelled or waived at short notice.

Request for information

I'd be grateful if you could answer the following questions in relation to current practice in your jurisdiction:

4. Are these types of group-recharged share-based payments common in your jurisdiction?
5. If they are common – what is the usual accounting treatment? Is there diversity locally in the accounting treatment? (Please provide details.)

6. Why is the accounting treatment used in your jurisdiction preferred by constituents? What basis is given for the accounting treatment used?

If you have any other information that you think would be useful in analysing this issue, or any general comments to make on this topic, please include them in your response. I'd be grateful if you could let me have your comments and responses by **17 October 2012**.