ASCG Staff Note[1] on the Application of IFRIC 8 *Scope of IFRS 2*

1. Preliminary remarks

The International Financial Reporting Interpretations Committee (IFRIC) issued IFRIC 8 *Scope of IFRS 2* (known as IFRIC D16 during the draft stage) on 12 January 2006. The substance of this Interpretation is the clarification that IFRS 2 applies to share-based payments for which an entity cannot specifically identify the goods or services received as consideration for equity instruments it has issued. If this is the case, the fair value of the identifiable goods or services is below the fair value of the equity instruments granted. Furthermore, IFRIC 8 addresses the determination of such a difference and its accounting consequences.

The aim of this ASCG Staff Note is to summarise and explain the material content of IFRIC 8 contained firstly in the body of the Interpretation, and secondly in the accompanying Basis for Conclusions and Illustrative Example. The individual aspects are presented in the form of questions and answers.

2. Does under IFRS 2 the consideration received have to be consistent with the fair value of the equity instruments granted?[2]

Except as provided for under IFRS 2.5-6, IFRS 2 applies to share-based payments ('SBPs') in which an entity receives or acquires goods or services. 'Goods' include inventories, consumables, property, plant and equipment, intangible assets and other non-financial assets (see IFRS 2.5). Under IFRS 2.10, both the goods or services received and the corresponding increase in equity must be measured directly at the fair value of the goods or services received [IFRIC 8.1].

In this context, the IFRIC notes that there is a presumption that the goods or services received (the consideration received) must be consistent with the fair value of the share-based payments (the equity instruments granted) [IFRIC 8.BC6, sentence 1]. This becomes clear in cases where the fair value of the goods or services received cannot be estimated reliably. In such cases, the fair value of the consideration received must be measured indirectly by reference to the fair value of the equity instruments granted [IFRIC 8.BC6, sentence 2]. IFRS 2.11 expressly cites

[1] ASCG Staff Notes are prepared by the ASCG's technical staff on selected new IFRIC Interpretations and International Financial Reporting Standards, and provide a systematic analysis and explanation of the core content of the IFRSs in question (Interpretation or Standard). They do not in any way represent an interpretation of the issues addressed in the IFRSs.

[2] This section is based on the article by Schreiber/Beiersdorf in KoR 2005, pp. 338 f.

transactions with employees as such a case, because usually it is not possible to measure directly the services received for particular components of an employee's remuneration package [IFRIC 8.3].

IFRIC 8 provides guidance on another case in which it is not possible to measure directly the fair value of the services received, although this case is not expressly addressed by IFRS 2. This involves SBPs to parties other than employees in which the fair value of the identifiable goods or services is less than the fair value of the equity instruments granted. One example of such SBPs is the grant of shares to a charitable organisation for nil consideration [IFRIC 8.2].

Unless such a difference is compensated by unidentifiable goods or services (see the following two sections), this difference in fair value would result in the underlying SBPs not falling within the scope of IFRS 2 [see the explanation in the footnote to IFRIC 8.BC5]. Consequently, the consideration received and the equity instruments granted in SBP arrangements to which IFRS 2 applies must be consistent.

3. Do the goods and services received have to be identifiable for IFRS 2 to be applied?

If equity instruments are not granted under SBPs to employees or persons providing similar services, IFRS 2 specifies a rebuttable presumption that the fair value of the goods or services received can be estimated reliably. This implies that the entity receiving the goods or services is able to identify them specifically. If this is not the case, IFRS 2 may not be applicable [IFRIC 8.4].

The IFRIC notes that IFRS 2 also applies to SBP transactions in which the reporting entity cannot identify specifically some or all of the goods or services received [IFRIC 8.8]. Referring to IFRS 2.BC37, it argues that given the economic context of SBPs, it cannot be presumed that the fair value of a consideration received is less than that of the equity instruments granted. Management of the entity granting the equity instruments will ensure that the entity will receive services with an equivalent value [IFRIC 8.BC4].

The outcome of this presumption is that if the fair value of the identifiable goods or services received is less than the fair value of the equity instruments granted, the IFRIC presumes that unidentifiable goods or services have been or will be received in the amount of this difference [IFRIC 8.9]. It is therefore not necessary for an entity to be able to identify the goods or services received for IFRS 2 to be applicable [IFRIC 8.BC4].

4. If the fair value of the identifiable goods or services received is less than the fair value of the equity instruments granted, can it be presumed in all cases that the difference will always be compensated by unidentifiable goods or services received?

The IFRIC concludes that the existence of such a difference typically indicates that unidentifiable goods or services have been (or will be) received. Only in rare cases (like the one described in the example in the footnote to IFIRC 8.BC5) this will not be the case, implying that IFRS 2 is not applicable [IFRIC 8.9].

However, the wording of IFRIC 8.9 is somewhat ambiguous. In the first sentence, it is stated that in the absence of specifically identifiable goods or services particular circumstances may indicate that goods or services have been or will be received. This could be (mis)interpreted to mean that the entity granting the equity instruments is only required to apply IFRS 2 to the underlying SBPs if it can provide evidence of such circumstances. This, however, is not consistent with the second sentence of IFRIC 8.9: “If the identifiable consideration received (if any) appears to be less than the fair value of the equity instruments granted, typically this circumstance indicates that other consideration (i.e. unidentifiable goods or services) has been (or will be) received”. Taken together with the example of an exception (given in the footnote to IFRIC 8.BC5) and the remarks on the consistency of the consideration received and the equity instruments granted to be presumed in economic reality for SBPs (contained in IFRIC 8.BC4), however, it is clear that the application of IFRS 2 does not require that the entity providing evidence that it received (or will receive) goods or services. Consistency of the consideration received and the equity instruments granted is thus presumed unless the reporting entity can produce evidence to the contrary. Only in such cases is the application of IFRS 2 precluded.

The ability to produce this evidence hinges crucially on the interpretation of the terms ‘goods or services’ in IFRS 2. While IFRS 2.5 contains a non-exhaustive list of various assets, IFRS 2.8 stipulates that the qualification of the goods or services received as assets is not a criterion for the application of IFRS 2 [see also IFRIC 8.BC4]. However, it is not possible to conclude from this that, based on the explanations in IFRS 2.9, any form of consideration in the widest sense can be classified as goods or services. It therefore appears at the very least arguable whether, for example, expectations of economic benefits represent goods or services within the meaning of IFRS 2.

Although the IFRIC does not expressly address this issue, its views can be seen from the Illustrative Example that accompanies IFRIC 8 and from comments in the November and December 2005 issues of *IFRIC Update*. In the Illustrative Example, an entity grants shares to disadvantaged members of society as a means of enhancing its image. If it achieves its goal, increasing its customer base, attracting new employees, or maintaining its ability to tender successfully for contracts, represent possible economic benefits of the grant of equity instruments for nil consideration [IFRIC 8.IE1]. The IFRIC believes that IFRS 2 must be applied in this case as well, because the expected economic benefits represent goods or services within the meaning of IFRS 2 [IFRIC 8.IE3]. Ultimately, the IFRIC does not demand any analysis of whether a particular consideration counts as goods or services under IFRS 2, but merely presumes that in light of the economic context of SBPs the consideration received will be consistent with the fair value of the equity instruments granted.[3]

Consequently, any difference between the consideration received and the equity instruments granted will be deemed not to be compensated by unidentifiable goods or services only if evidence suggests that the entity granting the equity instruments has received or will receive no or insufficient economic benefits in the widest sense. Because, by adopting IFRIC 8, the IASB has confirmed the IFRIC's opinion on this issue, it can be presumed that this broad interpretation of the concept of goods or services was already inherent in IFRS 2 during its development, independently of IFRIC 8, and that IFRIC 8 merely clarifies it (albeit only expressly in the Illustrative Example). If this were not the case, IFRIC 8 would represent an extension of the scope of IFRS 2 that would have had to be governed not by an Interpretation, but by an amendment to IFRS 2.

5. Do all SBPs have to be analysed to establish whether the consideration received is less than the fair value of the equity instruments granted, and what aspects must be considered in such an analysis?

The question of whether the goods or services received are identifiable or not is of considerable importance because if some or all of them cannot be identified, the goods or services received must be measured not at their fair value, but at the fair value of the equity instruments granted. This raises the question – not addressed by IFRS 2 – of the criteria to be applied when deciding whether or not to analyse an SBP to establish whether the consideration received is less than the equity instruments granted. Although IFRIC 8.9 merely infers that this is the case if the fair value of the goods or services appears to be less than the fair value of the equity instruments granted, the IFRIC is more concrete in the Basis for Conclusions, where it notes that it is neither necessary nor appropriate to measure the fair value of goods or services for every single SBP [IFRIC 8.BC7]. However, it does not stipulate any specific criteria, so it is a matter for management's judgement whether an SBP must

[3] See specifically IFRIC Update December 2005.

be analysed to establish whether the consideration received is less than the equity instruments granted.

In any analysis of an SBP to establish whether the consideration received is less than the equity instruments granted, it is important to ensure that the particular features of the SBP in question are taken into account when measuring the fair value of the equity instruments granted. For example, the ability to transfer the shares granted may be restricted (e.g. by a government), with the consequence that their fair value is lower than that of other, unrestricted shares [IFRIC 8.5].

6. How are goods or services measured that are received in share-based payments transactions that contain unidentifiable goods or services?

Although the title of the Interpretation implies that it is restricted to issues relating to the scope of IFRS 2, the Consensus in IFRIC 8 contains three paragraphs on the measurement of goods or services received in SBP arrangements. While identifiable goods or services received in a SBP transaction must be measured in accordance with IFRS 2 [IFRIC 8.10], unidentifiable goods or services must be measured as the difference between the fair value of the identifiable goods or services received and the fair value of the equity instruments granted [IFRIC 8.11].

Under IFRS 2.7, identifiable goods or services received must be recognised and measured when the goods are obtained or the services received. In the case of unidentifiable goods or services related to SBPs falling within the scope of IFRIC 8 (i.e. in the case of agreements with parties other than employees), it is obviously impossible to establish when they were obtained or received by the entity. As a surrogate for this date, the grant date must therefore be used as the measurement date [IFRIC 8.12 and 8.BC9]. This applies irrespectively of whether an SBP contains only unidentifiable goods or services, or whether identifiable goods or services were or will also be received by the entity [IFRIC 8.BC10]. The only exception refers to the case of cash-settled SBP transactions, where the existing liability must be remeasured at each reporting date until it is settled [IFRIC 8.12].

7. Application and Transition

An entity shall apply IFRIC 8 for annual periods beginning on or after 1 May 2006. Earlier application is encouraged [IFRIC 8.13]. The Interpretation must be applied retrospectively in accordance with the requirements of IAS 8, subject to the transitional provisions of IFRS 2 [IFRIC 8.14].