Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Our Ref.: C/FRSC

By e-mail and by post

18 August 2005

The International Financial Reporting Interpretations Committee,
International Accounting Standards Board,
30 Cannon Street,
London EC4M 6XH,
United Kingdom.

Dear Sirs,

Comment Letter
IFRIC Draft Interpretations D16 and D17

The Hong Kong Institute of CPAs welcomes the opportunity to provide you with our comments on the Draft Interpretations D16 and D17.

D16 *Scope of IFRS 2*

We appreciate that the IFRIC takes an initiative to provide accounting guidance for the issue addressed in the Draft Interpretation but we do not consider that it interprets IFRS 2 fairly. The underlying principle of IFRS 2 is that an entity receives or acquires goods or services. Pursuant to paragraph 5 of IFRS 2, goods include inventories, consumables, property, plant and equipment, intangible assets and other non-financial assets. It seems to us that goods or services in some form must have been provided should IFRS 2 apply. However, the Draft Interpretation specifies that IFRS 2 applies to particular situations in which an entity cannot specifically identify some or all of the goods or services received.

In addition, the Draft Interpretation presumes that if the identifiable consideration received (if any) appears to be less than the fair value of the equity instruments granted or liability incurred, typically this circumstance indicates that other consideration (i.e. goods or services) has been (or will be) received, in which case IFRS 2 applies. We believe that this would have significant implications as an entity may interpret the Interpretation in such a way that measurement is based on the higher of the fair value of the goods or services received and the fair value of equity instruments granted.

In light of the above, we would like the IFRIC to reconsider the Draft Interpretation before finalising it.

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<u>D17 *IFRS 2 – Group and Treasury Share Transactions*</u>

Question

Paragraph 9 of the draft Interpretation proposes that share-based payment transactions in which a parent entity grants rights to its equity instruments direct to a subsidiary entity's employees should be accounted for as equity-settled transactions. Paragraph 11 proposes that, for transactions in which a subsidiary entity grants to its employees rights to equity instruments of its parent, the subsidiary entity should account for those transactions as cash-settled transactions. Therefore, in the subsidiary's individual financial statements, the accounting treatment of transactions in which a subsidiary's employees are granted rights to equity instruments of its parent would differ, depending on whether the parent or the subsidiary granted those rights to the subsidiary's employees. This is because the IFRIC concluded that, in the former situation, the subsidiary has not incurred a liability to transfer cash or other assets of the entity to its employees, whereas it has incurred such a liability in the latter situation (being a liability to transfer equity instruments of its parent). Do you agree with these proposals?

IFRS 2 distinguishes between liabilities and equity on the basis of whether the entity has an obligation to transfer cash or other assets. That distinction is based on the definitions of liabilities and equity in the IASB *Framework.* It follows that the classification of share-based payment proposed in the Draft Interpretation is consistent with IFRS 2. That is, transactions in which a parent entity grants rights to its equity instruments direct to a subsidiary entity's employees should be accounted for as equity-settled transactions, whereas transactions in which a subsidiary entity grants rights to its employees equity instruments of its parent should be accounted for as cash-settled transactions in the subsidiary's separate financial statements as the subsidiary is obliged to transfer cash or other assets to satisfy its obligations in the latter situation.

However, we express concern that the above classification which is based on who granted an award would lead to structuring of arrangements to achieve a desired accounting.

If you have any questions on our comments, please do not hesitate to contact the undersigned at schan@hkicpa.org.hkT.

Yours faithfully,

Stephen Chan
Executive Director

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