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Ref: AC/FRC

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Dear Ms Pust Shah

**FRED 61 - Draft amendments to FRS 102: *The Financial Reporting Standard applicable in the UK and Republic of Ireland* – Share-based payment transactions with cash alternatives**

Ernst & Young LLP welcomes the opportunity to comment on FRED 61 issued by the Financial Reporting Council ('the FRC').

We agree in principle with the objective of some simplification in FRS 102 of the requirements of FRS 20 (IFRS 2) *Share-based Payment* and with the intention of converging to a greater extent the requirements of FRS 102 and those of IFRS and previous UK and Irish GAAP.

However, while the proposed amendments are likely to achieve the stated objectives for many arrangements accounted for under FRS 102, in our view they might have the unintended effect of requiring an entity to recognise as cash-settled liabilities certain types of award that would currently be classified as equity-settled share-based payments under FRS 102. The introduction in 26.15(a) of the requirement for the entity to have an unconditional right to settle in equity appears to extend the requirements for cash-settled accounting beyond those in FRS 20 (IFRS 2). We comment in more detail on this matter in our response to Question 1 of the FRC's consultation in the appendix to this letter.

If there are any points arising from the content of our response, please do not hesitate to contact me.

Yours sincerely

Tony Clifford  
Partner, Financial Reporting Group

## Responses to FRC questions

### Question 1

The proposed requirements for share-based payment transactions with cash alternatives:

- (a) align the requirements in FRS 102 with full IFRS and previous UK and Irish GAAP in cases where the entity can choose to settle in cash or equity;
- (b) retain the current requirements of FRS 102 to recognise a liability where the recipient can require settlement in cash; and
- (c) generalise the requirements to include those cases where the settlement method is dependent on an external event.

Do you agree with this proposal and the draft amendments to paragraph 26.15 of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*? If not, why not?

We believe that the amendments generally meet the intended objectives in situations where the entity has a choice of settlement method. We agree with the intention of converging to a greater extent the requirements of FRS 102 and those of IFRS and previous UK and Irish GAAP in such situations.

We agree in principle with the objective of some simplification in FRS 102 of the requirements of FRS 20 (IFRS 2). However, while the proposed amendments are likely to achieve the stated objectives for many arrangements accounted for under FRS 102, they might have the unintended effect of requiring an entity to recognise as liabilities certain types of award that would currently be classified as equity-settled under FRS 102. The introduction in 26.15(a) of the requirement for the entity to have an unconditional right to settle in equity appears to extend the requirements for cash-settled accounting beyond those in FRS 20 (IFRS 2).

For example, some share-based payment arrangements are structured in such a way that the cash and equity alternatives have significantly different values. We know that it is common for listed companies to enter into such arrangements (for example, so-called 'matching schemes') but suspect that this will also be the case for certain entities likely to apply FRS 102. In a situation where the counterparty has a choice between cash and equity alternatives and is highly unlikely to take the lower cash award, the proposed amendments require an entity to account for the entire award as a liability, but based on the higher value of the equity alternative.

Such a situation could result in entities having to recognise a 'liability' which is only ever expected to result in a transfer to equity on vesting of the award and having to remeasure that liability at each reporting date before settlement. By contrast, paragraph 26.15(b) as currently drafted means that the entity is likely to determine that the cash settlement option has no commercial substance and so the entire award is equity-settled.

The 'unconditional right' is also likely to cause difficulty in situations where the settlement method depends not on the choice of the entity or the counterparty but on the outcome of a contingent event that is outside the control of either the entity or the counterparty, or both. The addition of the words 'unconditional right' appears to be intended to give greater clarity on accounting for situations where there are uncertain settlement methods (see paragraph 18 of the Accounting Council's Advice). However, we believe that this wording may remove an important element of judgement - currently

available under IFRS 2 or FRS 20 - from an entity's assessment of whether or not it has a present obligation.

For example, a scheme might be equity-settled other than in a situation where an employee dies during the vesting period. As the occurrence of this contingent event would result in an unavoidable cash payment for the entity, it would have to account for the entire scheme as cash-settled under the amended wording, regardless of the likelihood of any of the awards being settled in cash.

Therefore we suggest the inclusion of wording, either in bullet (a) or below bullets (a) to (c), to allow an entity to take into consideration situations where the substance of the arrangement is that it is equity-settled because:

- (a) the cash settlement amount bears no relationship to, and is likely to be lower in value than, the fair value of the equity instrument (as currently reflected in 26.15(b)); and/or
- (b) the likelihood of the contingent event giving rise to cash settlement is remote.

#### **Question 2**

The amendments are proposed to be effective from 1 January 2015. Nevertheless, entities were able to apply FRS 102 to accounting periods commencing prior to 1 January 2015 and if so, may have adopted the extant requirements paragraph 26.15 of FRS 102. Based on the assumption that this will not be an issue for many entities, if any, FRED 61 does not contain any transitional provisions. Do you agree that transitional provisions are not required for the purposes of this proposed amendment? If not, please tell us what transitional provisions you would suggest and why.

We agree with the proposed effective date of 1 January 2015 and agree that transitional provisions are not required.