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International
Accounting Standards
Board

INFORMATION FOR OBSERVERS

IASB Meeting:	**18 September 2008, London (Agenda Paper 12)**
Project:	**IFRS 2: Cover Note**

Introduction

1. This paper summarises the issues that have arisen since IFRS2 *Share-based Payments* was published in 2004.

2. The staff has considered whether (and, if so, how) the identified issues should be addressed. We have identified options for improving and simplifying the standard and considered the possibility of increasing convergence between IFRS 2 and *Statement of Financial Accounting Standards No. 123 (revised 2004) Share-Based Payment* [FAS123R].

3. The paper is structured as follows:

   - Staff Recommendation.
   - Summary of IFRS 2 issues taken onto the Board and IFRIC agendas.
   - Summary of outstanding IFRS2 issues.

4. The staff has also provided background information in appendices as follows:

- IFRS 2 requests developed into Interpretations or Amendments (Appendix A)
- Summary of issues not taken onto the IFRIC agenda (Appendix B).

Staff Recommendation

5. The staff recommends that the Board does not add an IFRS 2 project to its technical agenda at this time. The rationale for the staff recommendation, with reference to the IASB agenda criteria, is set out below.

  - *Existing guidance available.* A number of the issues that have arisen have been clarified by the recent amendment to IFRS 2 or will be clarified by current work in progress. In addition, a number of the issues that have arisen could be dealt with more efficiently than as a Board [IFRS 2] project. In particular, the staff notes there are five types of issues that have arisen:

    i. Those that should not be dealt with because they require a divergence from the principles underlying IFRS 2 and no new reasons have been put forward to justify this. These issues are set out in Paper 12A.

    ii. Those that should not be dealt with because the requirements of the standard are clear. These issues are set out in Paper 12B

    iii. Those that should be clarified as an annual improvement to the standard. These issues are set out in Paper 12B.

    iv. Those that should be referred to the tax convergence. These issues are set out in Paper 12B.

    v. Those that should be reconsidered after the current projects on tax convergence and liabilities and equity are completed. These issues are set out in Paper 12C.

- *The relevance to users of the information and the reliability of information that could be provided*. The staff does not think that there would be a significant difference, if any, in the relevance of information provided or the reliability of that information if the issues are dealt with as set out above rather than as a single Board project. However, the recommended approach would ensure that the issues are dealt with more quickly and the staff and Board resources required for deliberations of the issues would be less significant than if the issues were added as a separate project to the Board's technical agenda.

- *The possibility of increasing convergence.* The key areas of divergence between IFRS 2 and FAS 123R are due to the differing classifications as liability or equity, the tax treatment required and the scopes of the standards. The first two issues are currently the subject of other joint projects, namely liabilities and equity and the tax convergence projects.

  The scope of IFRS 2 is wider than the scope of FAS 123R. For example, FAS 123R excludes transactions with non-employees. The FASB decided not to revise the scope of FAS 123R or do any further work on convergence of the accounting for share-based payments until after the joint projects on liabilities and equity and tax are completed. Likewise, the staff recommends that the Board considers whether to add a project to its agenda to improve convergence between FAS 123R and IFRS 2 after the projects on liabilities and equity and tax are completed.

- *The quality of the standard to be developed*. Given the constraints on improving convergence, the robustness of guidance currently available and the possibility of the remaining issues being covered in other projects, the staff does not think that adding a Board project to review IFRS 2 would result in a significantly improved standard at this time.

- *Resource constraints.* Staff and Board resources available for this project are scarce, particularly given the decisions by the FASB and the IASB concerning the projects that form a part of the MOU.

Summary of issues taken onto the Board and IFRIC agendas

6. IFRS 2 *Share-based Payment* was issued in February 2004 with an effective date of in January 2005. A number of formal and informal requests to amend or clarify the accounting guidance in the standard have since arisen.

7. In response the Board has, so far, published one amendment *Vesting Conditions and Cancellations* and the IFRIC has published two Interpretations, IFRIC 8 *Scope of IFRS 2* and IFRIC 11 *Group and Treasury Share Transactions*.

8. The IFRIC staff is also currently working on an amendment to IFRS 2 and IFRIC 11, which aims to clarify the scope of the standard and the guidance on accounting for group transactions. That amendment is expected to be published in 2009. A summary of these projects is set out in Appendix A.

9. A number of other issues also arose that the IFRIC decided not to take onto its agenda. A summary of those issues and the rationale for not including them on the IFRIC agenda are set out in Appendix B.

10. The other issues that have arisen roughly fall into one of the following three categories:

    Category A: Issues that would require a reconsideration of the principles underlying IFRS 2. However, no new reasons have been put forward to justify this.

    Category B: Issues arising from assertions that the IFRS 2 guidance is incomplete or unclear.

    Category C: Issues arising because the explicit or implicit guidance in IFRS 2 is different from SFAS 123 (r).

11. A summary of the staff views on these issues is set out in the next section. A more detailed analysis is set out in papers 12A, 12B and 12C respectively.

Summary of outstanding issues

12. This section includes an analysis by category of the main issues raised. Some issues fall into more than one category. For instance some issues are a result of IFRS 2 being unclear and current practice is likely to result in divergence with FAS 123 (r). The staff has grouped the issues according to what has been perceived in practice to be the most pressing problem. However, as with any categorisation, these issues could be grouped differently.

Category A

13. Category A includes those issues that require a reconsideration of the principles underlying the standard. An example of this is the recent request for the review (or repeal) of IFRS 2 [part of paragraph removed from Observer Notes].

14. Other issues that fall into this category include:

- Requests for a change in the cancellation treatment of share-based payments.
- Requests for a change in the measurement and recognition date from grant date to vesting date or exercise date.
- Requests for the change in the accounting for modifications that are not intended to be beneficial to the employee

15. In all cases, no new arguments or reasons that would form a basis for reconsideration of the key principles underlying the standard were raised. The relevant arguments and the Board's conclusions in respect of them are set out in IFRS 2's Basis for Conclusions. Therefore the staff does not think that any of the issues in category A meet the criteria for inclusion as a Board project.

16. An analysis of the issues put forward together with the staff response are set out in paper 12A

Category B

17. Category B includes those issues for which some assert that the IFRS 2 guidance is incomplete or unclear.

18. The staff has split Category B issues into three sections:

- Those for which no further action is required
- Those that should be referred to the annual improvements project
- Those that should be referred to another Board project.

The staff does not recommend that the Board add any of these issues to its agenda. An analysis of the issues put forward together with the staff response are set out in paper 12B.

Category C

19. Category C includes those issues arising from an implicit or explicit divergence between IFRS 2 and SFAS 123 R.

20. In most of the cases, there is widespread agreement in practice of the appropriate treatment in accordance with IFRS 2. Therefore, the main reason for the issues being put forward is the difference from US GAAP accounting. The staff acknowledges that these differences exist. However, the staff does not recommend that the Board adds a project to its agenda to deal with these issues at this time as the main areas of divergence are the subject of two current joint Board projects: liabilities and equity and tax convergence. A more detailed analysis of each of these issues is set out in Paper 12C.

APPENDIX A

IFRS 2 requests developed into Interpretations or Amendments

The IFRIC has received a number of formal requests covering a total of ten separate issues.

Four of these issues were developed or are being developed into Interpretations or amendments of the standard. A summary of these is set out below.

Amendment to IFRS 2 – *Vesting Conditions and Cancellations*

This amendment deals with two matters. It clarifies that vesting conditions are service conditions and performance conditions only. Other features of a share-based payment are not vesting conditions. The amendment also clarifies the accounting for non-vesting conditions and, in particular, it specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment.

IFRIC 8 *Scope of IFRS 2*

The issue addressed in this interpretation is whether IFRS 2 applies to transactions in which the entity cannot identify specifically some or all of the goods or services received.

The IFRIC concluded that IFRS 2 does apply to transactions in which the entity cannot identify specifically some or all of the goods or services received. In particular, it states 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 (unidentifiable goods or services) has been (or will be) received.

IFRIC 11 *Group Shares and Treasury Transactions*

This interpretation addresses how the share-based payment arrangements set out in paragraph 3 of IFRS 2 (ie some group transactions) should be accounted for in the financial statements of the subsidiary that receives the services from the employees.

The IFRIC concluded that share-based payment arrangements involving the entity's own equity instruments should be classified as equity-settled regardless of who grants or settles the entity's obligations.

The IFRIC also concluded that share-based payments involving the equity instruments of the parent should be classified as:

- equity-settled in the separate financial statements of the subsidiary if classified as equity-settled in the consolidated financial statements of the parent and the parent is the grantor; or
- as cash-settled if the subsidiary is the grantor.

Amendment to IFRS 2 and IFRIC 11 (pending)

The Board proposes to clarify the scope of IFRS 2 and the accounting for group and treasury transactions as well as incorporating the main principles and examples of IFRIC 8 and IFRIC 11 into the main body of IFRS 2.

APPENDIX B

IFRS 2 requests not taken onto the IFRIC Agenda

The IFRIC has received a number of formal requests covering a total of ten separate issues. Six of these issues were not taken onto the agenda. This table summarises the 6 requests.

Issue	Rational for not taking onto the agenda
Employee share loan plans The IFRIC was asked to consider the accounting treatment of employee share loan plans. Under many such plans, employee share purchases are facilitated by means of a loan from the issuer with recourse only to the shares [ie if the proceeds from sale of the shares are insufficient to cover the remaining loan balance, the shortfall is forgiven]. The IFRIC was asked whether the loan should be considered part of the potential share-based payment, with the entire arrangement treated as an option, or whether the loan should be accounted for separately as a financial asset.	The IFRIC noted that the issue of shares using the proceeds of a loan made by the share issuer, when the loan is recourse only to the shares, would be treated as an option grant in which options were exercised on the date or dates when the loan was repaid. The IFRIC decided it would not expect diversity in practice and would not take this item onto the agenda.
Scope of IFRS 2: Share plans with cash alternatives at the discretion of the entity The IFRIC considered whether an employee share plan in which the employer had the choice of settlement in cash or in shares, and the amount of the settlement did not vary with changes in the share price of the entity should be treated as a share-based payment transaction within the scope of IFRS 2 *Share-based Payment*.	The IFRIC noted that IFRS 2 defines a share-based payment transaction as a transaction in which the entity receives goods or services as consideration for equity instruments of the entity or amounts that are based on the price of equity instruments of the entity. IFRIC further noted that the definition of a share-based payment transaction does not require the exposure of the entity to be linked to movements in the share price of the entity. Moreover, it is clear that IFRS 2 contemplates share-based payment transactions in which the terms of the arrangement provide the entity with a choice of settlement, since they are specifically addressed in paragraphs 41 - 43 of IFRS 2. The IFRIC, therefore, believed that, although the amount of the settlement did not vary with changes in the share price of the entity, such share plans are share-based payment transactions in accordance with IFRS 2 since the consideration may be equity instruments of the entity. The IFRIC also believed that, even in the extreme circumstances in which the entity was given a choice of settlement and the value of the shares that would be delivered was a fixed monetary amount, those share plans were still within the scope of IFRS 2. The IFRIC believed that, since the requirements of IFRS 2 are clear, the issue is not expected to create significant divergence in practice. The IFRIC, therefore, decided not to take the issue onto the agenda.

Share plans with cash alternatives at the discretion of employees: grant date and vesting periods	
The IFRIC considered an employee share plan in which employees were provided a choice to have cash at one date or shares at a later date. At the date the transactions were entered into, the parties involved understood the terms and conditions of the plans including the formula that would be used to determine the amount of cash to be paid to each individual employee (or the number of shares to be delivered to each individual employee) but the exact amount of cash or number of shares would only be known at a future date. The IFRIC was asked to confirm the grant date and vesting period for such share plans.	The IFRIC noted that IFRS 2 defines grant date as the date when there is a shared understanding of the terms and conditions. Moreover, IFRS 2 does not require grant date to be the date when the exact amount of cash to be paid (or the exact number of shares to be delivered) is known to the parties involved. The IFRIC further noted that share-based payment transactions with cash alternatives at the discretion of the counterparty are addressed in paragraphs 34 - 40 of IFRS 2. Paragraph 35 of IFRS 2 states that, if an entity has granted the counterparty the right to choose whether a share-based payment transaction is settled in cash or by issuing equity instruments, the entity has granted a compound financial instrument, which includes a debt component (i.e. the counterparty’s right to demand cash payment) and an equity component (i.e. the counterparty’s right to demand settlement in equity instruments). Paragraph 38 of IFRS 2 states that the entity shall account separately for goods or services received or acquired in respect of each component of the compound financial instrument. The IFRIC, therefore, believed that the vesting period of the equity component and that of the debt component should be determined separately and the vesting period of each component may be different. The IFRIC believed that, since ‘grant date’ is defined in IFRS 2 and the requirements set out in paragraphs 34 - 40 of IFRS 2 are clear, the issues are not expected to create significant divergence in practice. The IFRIC, therefore, decided that the issues should not be taken onto the agenda.
Fair value measurement of post-vesting transfer restrictions	
The IFRIC was asked whether the estimated value of shares issued only to employees and subject to post-vesting restrictions could be based on an approach that would look solely or primarily to an actual or synthetic market that consisted only of transactions between an entity and its employees and in which prices, for example, reflected an employee’s personal borrowing rate. The IFRIC was asked whether this approach was consistent with the requirements under IFRS 2.	The IFRIC noted the requirements in paragraph B3 of Appendix B to IFRS 2, which states that, ‘if the shares are subject to restrictions on transfer after vesting date, that factor shall be taken into account, but only to the extent that the post-vesting restrictions affect the price that a knowledgeable, willing market participant would pay for that share. For example, if the shares are actively traded in a deep and liquid market, post-vesting transfer restrictions may have little, if any, effect on the price that a knowledgeable, willing market participant would pay for those shares.’ Paragraph BC168 of the Basis for Conclusions on IFRS 2 notes that ‘the objective is to estimate the fair value of the share option, not the value from the employee’s perspective.’ Furthermore, paragraph B10 of Appendix B to IFRS 2 states that ‘factors that affect the value of the option from the individual employee’s perspective only are not relevant to estimating the price that would be set by a knowledgeable, willing market participant.’ The IFRIC noted that these paragraphs require consideration of actual or hypothetical transactions, not only with employees, but rather with all actual or potential market participants willing to invest in restricted shares that had been or might be offered to them. The IFRIC believed that the issue was not expected to create significant divergence in practice and that

	the requirements of IFRS 2 were clear. The IFRIC, therefore, decided not to take the issue onto the agenda.
Incremental fair value to employees as a result of unexpected capital restructurings The IFRIC was asked to consider a situation in which the fair value of the equity instruments granted to the employees of an entity increased after the sponsoring entity undertook a capital restructuring that was not anticipated at the date of grant of the equity instruments. The original share-based payment plan contained neither specific nor more general requirements for adjustments to the grant in the event of a capital restructuring. As a result, the equity instruments previously granted to the employees became more valuable as a consequence of the restructuring. The issue was whether the incremental value should be accounted for in the same way as a modification to the terms and conditions of the plan in accordance with IFRS 2 *Share-based Payment*.	The IFRIC believed that the specific case presented was not a normal commercial occurrence and was unlikely to have widespread significance. The IFRIC, therefore, decided not to take the issue onto the agenda.
Employee benefit trusts in the separate financial statements of the sponsor The IFRIC discussed the application to separate financial statements of an issue that had been submitted in connection with the amendment of SIC-12 *Consolidation—Special Purpose Entities* to include within its scope special purpose entities established in connection with equity compensation plans. The issue related to an employee benefit trust (or similar entity) that has been set up by a sponsoring entity specifically to facilitate the transfer of its equity instruments to its employees under a share-based payment arrangement. The trust holds shares of the sponsoring entity that are acquired by the trust from the sponsoring entity or from the market. Acquisition of those shares is funded either by the sponsoring entity or by a bank loan, usually guaranteed by the sponsoring entity. In most circumstances, the sponsoring entity controls the employee benefit trust. In some circumstances, the sponsoring entity may also have a direct control of the shares held by the trust. The issue is whether guidance should be developed on the accounting treatment for the sponsor's equity instruments held by the employee benefit trust in the sponsor's separate financial statements.	The IFRIC discussed whether the employee benefit trust should be treated as an extension of the sponsoring entity, such as a branch, or as a separate entity. The IFRIC noted that the notion of 'entity' is defined neither in the *Framework* nor in IAS 27 *Consolidated and Separate Financial Statements*. The IFRIC then discussed whether the sponsoring entity should, in its separate financial statements, account for the net investment according to IAS 27 or rather for the rights and obligations arising from the assets and liabilities of the trust. The IFRIC noted that, in some circumstances, the sponsoring entity may have direct control of the shares held by the trust. The IFRIC also noted that the guidance included in the Framework and IAS 27 does not address the accounting for the shares held by the trust in the sponsor's separate financial statements. The IFRIC concluded that it could not reach a consensus on this matter on a timely basis, given the different types of trusts and trust arrangements that exist. The IFRIC noted that this issue related to two active projects of the IASB: the Conceptual Framework and the revision of IAS 27 *Consolidated and Separate Financial Statements* in the course of the Consolidation project. For these reasons, the IFRIC decided not to take the issue onto its agenda.