Project **Committee Issues Update List**

Topic **Work in progress**

Introduction

Objective of this paper

1. The objective of this paper is to update the Committee on the current status of issues that are yet to be discussed by the Committee and the progress made by the staff.

2. The following submissions have been received by the staff and will be discussed at a future meeting:

Ref.	Topic	Brief description	Progress
IFRS 2-14	Treatment of elimination of awards on employee termination	Request for clarification on whether an award should be treated as cancelled or forfeited upon employee termination.	The staff will perform an analysis of this issue to be presented at a future meeting. See Appendix A for the submission received.
IFRS 2-15	Employer withholdings to settle employee tax liabilities	Request to modify existing IFRS 2 to permit equity classification of share-based payment arrangements with net-settlement provisions for the purpose of satisfying employee tax liabilities.	The staff will perform an analysis of this issue to be presented at a future meeting. See Appendix A for the submission received.

3. The paper does not include requests on issues that are still at a preliminary research stage, including where further information is being sought from the submitter, or other parties, to define more clearly the issue.

Question

Does the Committee have any questions or comments on the Committee Issues Update List?

Appendix A – Recent Submission

B1. Submission #1. Request for consideration on IFRS 2:

Share-based payment transactions lapsing on termination of employment

[Submitter] request[s] IFRIC to address the following issue on accounting for share-based payment transactions lapsing on termination of employment, and the application of IFRS 2 *Share-based Payment.*

The issue:
When an entity grants an award in a share-based payment transaction [1] to an employee that includes a service condition and the entity makes that employee redundant, and as a result, the options lapse, does the entity account for this lapse as a forfeiture or as a cancellation under IFRS 2?

Current practice:
View A
The lapse of the award is a forfeiture in all cases. Because of the redundancy, the employee is unable to render the service required in order for the options to vest. The first column of the table included in paragraph IG24 of the implementation guidance in IFRS 2 (see the Appendix [2]) gives, as an example of a forfeiture, an award where a requirement to remain in service 'is not met.' The passive voice in this guidance implies that it does not matter whether the failure to meet the service condition is due to the action of the employee or those of the employer.

View B
The lapse of the award is a cancellation in all cases. Since the options lapse as a direct result of the employer's action, the effect is equivalent to a cancellation of the award by the employer. The sixth column of the table included in paragraph IG24 of the Implementation Guidance of IFRS 2 gives, as an example of a non-vesting condition, the continuation of the plan by the entity. When an entity chooses to terminate a plan, it breaches a non-vesting condition within its control, requiring cancellation accounting. By analogy if the entity terminates an individual employee, this would similarly be a non-vesting condition that the entity breaches, and the accounting must also be as a cancellation.

View C
The lapse of an award on termination of employment for cause (such as gross misconduct) is a forfeiture, but a lapse on termination in other circumstances is a cancellation. Refraining from gross misconduct is an implied term of any employment contract. Therefore, an employee dismissed for such conduct did not provide services, and the award is forfeited.
Opponents of this view note that it is often difficult to determine the true reason for a termination of employment. Senior levels of management, whose employment is in reality being terminated, often agree to tender a letter of resignation for a number of reasons, ranging from employment law to media relations. Similarly, producing evidence for the real reason can be difficult to obtain.

Reasons for the IFRIC to address the issue:
There are diverse views regarding the accounting when an entity makes an employee redundant.

The implications of each treatment are extremely different (reversal of expense for a forfeiture, and acceleration of expense for a cancellation), and therefore we feel the IFRIC should address the issue to ensure consistent application. We are aware of preparers and auditors that hold each of the views above.

[**Footnotes to submission #1**]

[1] Hereafter, we use the term 'award' to mean an award in a share-based payment transaction, which is within the scope of IFRS 2.

[2] **NOTE**: This submission also included an appendix that included paragraph IG24 of IFRS 2 in its entirety for reference purposes. That appendix has not been duplicated here.

B2. Submission #2. Request for consideration on IFRS 2:

Suggested Improvements to IFRS 2 – Employer Withholdings to Settle Employee Tax Liabilities

Dear Sir David:

The Committee [of submitter] would like to take the opportunity to bring to your attention an issue in International Financial Reporting Standards 2: *Share-Based Payments* ("IFRS 2") that we believe requires clarification.

[Submitter] is a leading international organization of [finance and accounting individuals]. [Committee] is the senior technical committee of [submitter], which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. Many of the [committee] members represent multinational companies [located throughout the world] who prepare statutory financial statements in accordance with International Financial Reporting Standards ("IFRS"). This document represents the views of [the committee] and not necessarily the views of [submitter organisation] or its members individually.

In certain jurisdictions when a share-based award is settled with the employee, the employer will withhold shares from the settlement to the employee in order to settle the employee's tax obligation. In such situations the employee does not have the option to receive the gross settlement of the award but automatically receives the net shares. We understand that certain audit firms apply an interpretation of IFRS 2 that the portion of the award related to the tax withholding should be treated as a cash-settled award from grant date. The inconsistent practice among audit firms may influence a company's plan structure between gross or net settlement of tax withholding. Depending on company plan structure, in some instances it would require the issuance of additional shares out onto the market with the resulting dilutive effects on the share price.

Under U.S. GAAP, this issue is specifically addressed in paragraphs 35 and B125 of FAS 123R (now FASB Accounting Standards Codification Topic 718, Compensation – Stock Compensation) where for 'pragmatic reasons' it was decided that the tax withholding should not be treated as cash settled:

> *B125. Paragraph 35 of this Statement also indicates that a provision for direct or indirect (by means of a net-settlement feature) repurchase of shares issued upon exercise of options (or vesting of shares) to meet the employer's minimum statutory withholding requirements does not, by itself, result in liability classification of instruments that otherwise would be classified as equity. Interpretation 44 also provided that exception for accounting under Opinion 25. In concept, the Board considers a provision for repurchase of shares at, or shortly thereafter, the exercise of options, for whatever reason, to result in the employer's incurrence of a liability.* ***However, the Board decided for pragmatic reasons to continue the exception for direct or indirect repurchases to meet the employer's minimum statutory withholding requirements.***

We believe that an accounting interpretation to split the award into two parts (one with fixed plan accounting and one with liability accounting) does not give a meaningful accounting answer and brings with it unnecessary complexity. This complexity is especially evident in jurisdictions with variable tax rates (e.g., tax rates based on income levels).

Some awards (common practice with restricted stock) must be exercised on their vesting date, which may occur during a black-out period. Therefore, companies are legally and practically impeded from gross-settling awards with the employee so that an employee is not forced to sell an award when prohibited by regulators. Another pragmatic consideration is that tax withholding requirements are computed based on the fair value of the award at the vesting/distribution date. In situations where grant accounting is otherwise appropriate, it would be problematic to try to project forward to the distribution date what the tax withholding requirements would be. Lastly an additional issue is the potential risk that the employee who receives gross delivery of the awards fails to remit their taxes. In some tax jurisdictions the employer would be required to bear this risk for these unpaid taxes if the employee defaulted due to the employer's "negligence" in not withholding.

While some believe this form of settlement is akin to a repurchase of vested equity (IFRS 2.29), we recognize that the cash-settled alternative view is present in the market. The FASB has recognized this issue in paragraph B125 of FAS 123R and we recommend that this point be integrated into IFRS 2 as well to avoid confusion in the application of IFRS 2.

If you have any questions or would like any additional information on the comments we have provided, please do not hesitate to contact us.