Project **IFRS 2 *Share-based Payment***

Topic **Vesting and non-vesting conditions – Cover paper**

Introduction

1. At the May 2010 IFRS Interpretations Committee (the Committee) meeting, the Committee comprehensively discussed the issues on the distinction between vesting conditions and non-vesting conditions in IFRS 2 *Share-based Payment*. No decisions were made by the Committee at that meeting. Instead, the Committee requested the staff to perform additional work to determine the impact of the proposed changes to IFRS 2 on current practice and to clarify the proposed definition of a performance condition.

2. In order to address the Committee's request, the staff explored some specific examples, which are mainly based on the inputs from the members of the Committee. The staff also performed a broad outreach to seek feedback on those examples as well as on the staff recommendations presented at the May 2010 Committee meeting.

Structure of agenda papers

3. The staff analysis is split into 4 agenda papers with each agenda paper covering the following aspects of the additional work:

   (a) 3A – (this agenda paper) includes three appendices:

      (i) Appendix A – reproduction of the staff recommendations proposed at the May 2010 Committee meeting,

(ii) Appendix B – reproduction of the new classifications proposed at the May 2010 Committee meeting, and

(iii) Appendix C – a comparison between the current classification and the newly proposed classification;

(b) 3B – detailed analysis of the attributes of a performance condition;

(c) 3C – detailed analysis of specific examples based on the new classifications proposed at the May 2010 Committee meeting; and

(d) 3D – proposed amendments to IFRS 2.

Appendix A — Summary of staff recommendations from the May 2010 Committee meeting

	Item	Staff recommendation
(a)	Vesting condition	The definition of vesting condition should be clarified to address/ incorporate the following: (1) the counterparty perspective, (2) a required explicit or implicit service requirement, and (3) the elimination of descriptions of specific conditions.
(b)	Non-vesting condition	A stand-alone definition of non-vesting condition should be incorporated into IFRSs and encompass all conditions that do not determine entitlement.
(c)	Service condition	A stand-alone definition of service condition should be incorporated into IFRSs and should be restricted to only a service requirement over a determined period of time.
(d)	Performance condition	A stand-alone definition of performance condition should be incorporated into IFRSs and should be restricted targets that relate to solely to an entity's operations or activities. Additionally, examples similar to those provided in the US GAAP definition should be incorporated.
(e)	Market condition	The definition of market condition should be removed from IFRS 2. Additionally, the concept of a market condition should continue to be captured as a vesting condition within the stand-alone definition of other vesting conditions.
(f)	Other vesting condition	A stand-alone definition of other vesting condition should be incorporated into IFRSs that should encompass all conditions that determine the counterparty's entitlement provided the condition is not categorised as a service or performance condition.
(g)	Contingent feature	Guidance on a contingent feature (inclusive of reload and non-compete provisions) as well as guidance on whether grant date measurement and subsequent measurements should be incorporated into IFRSs.
(h)	Vesting period	The definition of vesting period should be revised to capture the concept of the explicit or implicit service period required for an individual vesting condition.
(i)	Attribution period	A stand-alone definition of attribution period should be incorporated into IFRSs and capture the period of time over which the share-based payment award is recognised. This is the result of the interaction of multiple vesting conditions.
(j)	Multiple vesting conditions	Application guidance should be incorporated into IFRSs addressing the interaction of multiple conditions by either 'or' or 'and' conditions.

Appendix B — Summary chart of proposed classifications based on staff recommendations

<table>
<tr><th colspan="3">Vesting condition</th><th>Non-vesting condition</th><th>Contingent features</th></tr>
<tr><td colspan="3">Conditions that determine whether the counterparty becomes entitled to the share-based payment award</td><td>Conditions that do not determine whether the counterparty becomes entitled to the share-based payment award</td><td>Conditions that become active if contingent events occur</td></tr>
<tr><td colspan="3">All vesting conditions have an explicit or implicit service requirement</td><td>No related service requirement</td><td>No related service requirement</td></tr>
<tr><td colspan="3">Periodic re-estimation of estimated forfeitures to complete service requirement through the attribution period</td><td>Not applicable (as there is no service requirement)</td><td>Accounted for when condition occurs</td></tr>
<tr><th>Service condition</th><th>Performance condition</th><th>Market or other vesting condition</th><td rowspan="2"></td><td rowspan="2"></td></tr>
<tr><td>Target based solely on time</td><td>Target by reference to the entity’s operations</td><td>All vesting conditions that are not service or performance conditions</td></tr>
<tr><td colspan="2">Impact of future variability captured in revisions to the estimate of forfeiture</td><td colspan="2">Impact of future variability included in grant date fair value
(and not subsequently revised)</td><td>Not included in grant date fair value</td></tr>
<tr><td colspan="2">Conditions able to be influenced by an employee of the reporting entity</td><td colspan="2">Conditions not able to be influenced by an employee of the reporting entity</td><td>Conditions not able to be influenced by an employee of the reporting entity</td></tr>
</table>

<table>
<tr><th colspan="5">Example conditions</th></tr>
<tr><td>Requirement to remain in service for three years</td><td>Target based on the entity’s revenue</td><td>(1) Target based on the market price of the entity’s equity instruments or (2) target based on a specified increase the price of a commodity</td><td>Post-vesting transferability restriction</td><td>(1) reload features or (2) clawback provisions (including non-compete provisions)</td></tr>
</table>

Appendix C — Comparison between the current classification and the proposed classification

<table>
<tr><th rowspan="4">Characteristics</th><th colspan="6">Current classification</th><th colspan="4">Proposed classification</th><th></th></tr>
<tr><th colspan="3">Vesting condition</th><th colspan="3">Non-vesting condition (*)</th><th colspan="3">Vesting condition</th><th rowspan="3">Non-vesting condition</th><th rowspan="3">Contingent feature (#)</th></tr>
<tr><th rowspan="2">Service</th><th colspan="2">Performance</th><th rowspan="2">I</th><th rowspan="2">II</th><th rowspan="2">III</th><th rowspan="2">Service</th><th rowspan="2">Performance</th><th rowspan="2">Market or Other</th></tr>
<tr><th>Non-market</th><th>Market</th></tr>
<tr><td>Determines whether the counterparty becomes entitled to the share-based payment award?</td><td colspan="3">Yes</td><td colspan="3">No</td><td colspan="3">Yes</td><td>No</td><td rowspan="5">No</td></tr>
<tr><td>Includes an explicit or implicit service requirement?</td><td colspan="3">Yes</td><td colspan="3">No</td><td colspan="3">Yes</td><td>No</td></tr>
<tr><td>Probability of the conditions being satisfied included in grant date fair value?</td><td colspan="2">No</td><td colspan="4">Yes</td><td colspan="2">No</td><td colspan="2">Yes</td></tr>
<tr><td>Failure to satisfy condition results in cancellation of the award and acceleration of expense?</td><td colspan="4">No</td><td colspan="2">Yes</td><td colspan="2">No</td><td colspan="2">No</td></tr>
<tr><td>Periodic re-estimation of number of awards expected to vest?</td><td colspan="2">Yes</td><td colspan="4">No</td><td colspan="2">Yes</td><td colspan="2">No</td></tr>
<tr><td>Able to be influenced by the employee?</td><td colspan="2">Yes</td><td colspan="2">No</td><td>Yes</td><td>No</td><td colspan="2">Yes</td><td colspan="2">No</td><td>N/A</td></tr>
</table>

(*) Type I – Neither the entity nor the counterparty can choose whether the condition is met, Type II – Counterparty can choose whether to meet the condition, Type III – Entity can choose whether to meet the condition

(#) A contingent feature is not an active feature and is only relevant if an event triggers/ activates it. Therefore it's not included in determining the classification of conditions attached to the granted award but identified as a separate transaction or event.

Ernst & Young Global Limited
Becket House
1 Lambeth Palace Road
London SE1 7EU

Tel: +44 [0]20 7980 0000
Fax: +44 [0]20 7980 0275
www.ey.com

International Accounting Standards Board
IFRS Interpretations Committee
30 Cannon Street
London
EC4M 6XH

18 June 2010

Dear IFRS Interpretations Committee members

Request for feedback – Vesting and Non-vesting Conditions in IFRS 2

The global organisation of Ernst & Young is pleased to provide feedback to the IFRS Interpretations Committee (the Interpretations Committee) regarding vesting and non-vesting conditions under IFRS 2 *Share-based payment*.

In Appendix 1, we provide feedback on the Staff's recommendations presented at the May 2010 meeting of the Interpretations Committee. While the concepts articulated by the Staff could be helpful, we are concerned that the recommendations do not clarify the accounting for some more complex conditions that we regularly see in practice. In addition, some of the concepts articulated by the Staff might require further interpretation. We propose clarifying the existing principles in IFRS 2 so that conditions (such as non-compete and save-as-you-earn conditions) are more readily categorised into the existing categories of performance conditions and market conditions, based on the type of accounting that the Interpretations Committee believes is most appropriate for that type of condition.

In Appendix 2, we provide factors that the Interpretations Committee could consider when clarifying the existing principles In IFRS 2 or considering the Staff model. We acknowledge that to some extent the analysis in Appendix 2 leads to an inversion of the normal standard-setting process, in that it implicitly begins with the desired accounting outcome and works back to the principles that might underpin the outcome, we believe that this may be the most effective approach given the limited scope of this project.

In Appendix 3, we provide examples that are typical of those we see in practice, and which we believe might be affected by the Staff recommendation. We provide the current accounting under IFRS 2, and our views on the accounting under the Staff model. We also include our recommendation on how the Interpretations Committee should address these issues.

Example A	Non-compete or claw-back provision
Example B	IPO, requirement to float or be sold or change in control provision
Example C	SAYE provision
Example D	Interacting conditions: (D1) Growth rate in earnings per share that exceeds the average growth rate in earnings per share of other entities in the same industry (D2) IPO at a minimum share price

We believe that it is possible to clarify these concepts in IFRS 2, without re-visiting all of the other concepts and principles in IFRS 2. However, we believe that such clarification is beyond the scope of an IFRIC Interpretation, and will likely require further amendments to IFRS 2.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 (0)20 7951 3152.

Yours faithfully

Ernst & Young

Appendix 1 – Concerns with Staff Model

At the May 2010 meeting of the Interpretations Committee, members were asked to provide feedback on the Staff recommendations, as summarised in Appendix A of the Staff paper 3D. As noted in our covering letter, while some of the concepts articulated by the Staff could be helpful, we are concerned that others might require further interpretation in order to eliminate divergence in practice.

Conditions vs. Contingent features

The distinction between 'vesting conditions' 'non-vesting conditions' and 'contingent features' is not clear. The Staff defines a 'contingent feature' as a condition "that could impact the entity and the employee in a period after the employee has become entitled to the award" (Paper 3B, paragraph 70). Entitlement is generally defined as a guarantee of access to benefits because of rights or agreement through law. Therefore, the definition proposed by the Staff seems unclear, because it defines a contingent feature as a condition that impacts the employee after he/she is guaranteed access – how can an award be 'guaranteed' if it is contingent or conditional? Furthermore, the definition is nearly identical, in substance, to the definition of a vesting condition, which is a condition that determines whether the counterparty becomes entitled to the award.

It seems as though the difference between these categories is that a non-vesting condition is not actually a condition; rather, it is a term or clause within the agreement that exists regardless of future events and actions. In contrast, a contingent feature is a conditional term that only occurs if an action or event happens first. Neither requires service. The Staff should clarify the differences between contingent features and non-vesting conditions, given the different accounting that results from the classification.

Implicit Service Requirements

The Staff proposes to retain the notion of an 'implicit' service requirement, without providing any further clarity. We believe that the notion of 'implicit' should not be included, because, in practice, either employees are required to provide service to vest in the award, or they are not, and this is generally defined in the award agreement. In many cases, 'explicit' is incorrectly used as a synonym for 'fixed,' (e.g., 3 years) and consequently, 'implicit' is used as a synonym for 'unfixed' (e.g., the counterparty must be employed when an event occurs, such as an IPO, of which the date of occurrence is uncertain). These terms are not synonymous and should not be used as such. We recommend changing the terminology to 'fixed' and 'variable.'

One might argue that the concept of an 'implicit' service condition is needed to address non-compete agreements. However, we think that a better way of addressing the accounting for non-compete agreements is to address whether not competing is a service, as we illustrate in Example A of Appendix 3.

Alternatively, one might argue that the concept of implicit service conditions is needed to address the service component that is embedded within a performance condition or other vesting condition. However, we think that it is confusing to refer to this service component as being embedded; we would recommend that these be considered two separate conditions. How this is achieved depends on the Interpretations Committee's decision on whether, in a situation where the counterparty is required to provide service only for a portion of the period over which attainment of a target is determined, that target is a performance condition or an other vesting condition. For example, a share-based payment requires an employee to provide service for three years, and an initial public offering ('IPO') to occur within 5 years (but service is not required for years 4 and 5). Is this a performance condition (because some service is provided), an other service condition (because the employee is not required to be present at the date the performance target is met), or is the condition bifurcated into two sections – years 1-3 when service is provided, and years 4-5, where there is no service? These are common conditions in practice, which we discuss further in Example B in Appendix 3.

Accounting for Other Vesting Conditions
The Staff model in Appendix A of Staff Paper 3D shows other vesting conditions under 'periodic re-estimation of estimated forfeitures to complete service requirement through the attribution period' AND above 'impact of future variability of individual condition included in the grant date fair value.' We wonder whether the Staff meant that the likelihood of meeting the service component of the other vesting condition is re-estimated (not included in grant-date fair value), whereas the likelihood of meeting the other vesting component of the other vesting condition (e.g., minimum share price) is included in the grant-date fair value, but is not re-estimated. This should be clarified.

Performance Conditions and 'Entity's Operations'
The Staff model refers to performance conditions as 'a target solely by reference to the entity's operations.' If the Staff continue with the model set forth, the definition of a performance condition must be clear that it includes any target related to the group of entity's ultimate parent. This is because many jurisdictions require the use of IFRS for separate, individual, or sub-level parent consolidated financial statements. These entities are required to account for group share-based payment transactions under IFRS 2.

In addition, it must be clear that a performance condition can relate to the performance of a part of the entity (such as a division) or an individual employee. As the Staff noted, this language already exists in US GAAP and should be added to the IFRS definition.

We are concerned that the proposals put forth by the Staff do not clarify whether conditions that an entity float, be sold, have a change in control, or have an IPO are performance conditions (assuming that service is required). Some might argue that these conditions do not deal with the performance of the entity's operations; rather, they are conditions that relate to transactions between the entity and its shareholders (or between shareholders) that are outside of the scope of the operations of the entity, and should be accounted for similar to market conditions. Alternatively, some believe that these conditions are performance conditions (assuming that there is a related service condition). At a minimum, we believe that the Interpretations Committee should provide guidance on whether any of these activities are within the entity's control, and therefore, performance conditions. These are common conditions in practice, which we discuss further in Example B in Appendix 3.

We think that this issue reflects a broader lack of clarity within IFRS: identifying the boundary between the actions of the shareholders of an entity and the reporting entity itself. This boundary should be established in the Framework and be used to establish the principles in other IFRSs (such as the debt/equity classification, accounting for transactions with non-controlling shareholders, and employee benefits).

Ability to Influence

The Staff thinks "distinguishing between a market performance condition and a non-market performance condition may be justified in terms of the employee's influence on the results of conditions" (Paper 3B, paragraph 55). We understand that the Staff intends that this would be a criterion that would be considered by the Interpretations Committee when determining the appropriate accounting model for conditions (e.g., save as you earn conditions), which would then be classified explicitly in IFRS 2, rather than a criterion to be used by a reporting entity on a case-by-case basis when applying IFRS 2. We support this approach, and note below a number of instances where it could cause difficulty in practice if such a general principle were to be incorporated in IFRS 2 rather than simply used as the basis for the IFRIC's deliberations.

We see two approaches:

	Establish general 'ability to influence' principle	**Use 'ability to influence' principle to explicitly classify certain conditions (e.g., SAYE) – Staff Approach**
Pros	▶ Avoids having to amend IFRS 2 the next time that a new type of condition is introduced that is not contemplated under the current model	▶ Clarity regarding existing conditions
Cons	▶ Introduces greater divergence in practice, additional complexity, and an added cost of making judgments about the counterparty's degree of influence (see below)	▶ IFRS 2 might need to be amended if a new category of condition is introduced not contemplated in the current model

Generally, we support the Staff approach (as we understand it), for the reasons noted below. While 'ability to influence' might be a guiding factor in deciding how to classify existing specific types of conditions, we do not favour this being established as a general principle to be applied by analogy. However, we note that an outcome of this approach appears to be that the requirement to save in an SAYE plan is regarded as a performance condition (which, if unfulfilled would give rise to forfeiture and the potential reversal of expense), contrary to the intention of the January 2008 amendment to require a failure to save to be treated as a cancellation giving rise to an acceleration of expense.

The reason that we are concerned about articulating a broad concept of 'ability to influence' is that in some industries and for start-ups, the entity's primary aim in granting share-based payments is to manage cash flows, rather than to incentivise employees. In such entities, it is common for a low-level employee to receive a share-based payment. More generally, many lower level employees could be argued to have little ability to influence measurable targets related to the entity's operations, particularly the entity's share price. In fact, even some high-level employees who are granted share-based payments, such as internal legal counsel, have little ability to influence measurable targets related to the entity's operations. In contrast, some conditions identified by the Staff as being outside of an employee's ability to influence, such as achieving a minimum share price, may in fact be influenced by an employee, when that employee has a high-ranking position, such as Chief Executive Officer, or Chief Financial Officer. We would be concerned if using an 'ability to influence' model were to require management to perform a separate assessment for each employee.

However, even if 'ability to influence' is used as a guiding principle, it is still difficult to apply to a save-as-you-earn (SAYE) condition. Some might believe that considering an employee's ability to influence means that an SAYE condition is a performance condition, because they believe that an employee's decision of whether to save is affected primarily by factors particular to that employee (e.g., financial ability to surrender cash from salary), and less affected by the market price of the shares. However, one could also argue that an employee's decision to save is analogous to their decision to exercise an option; under that view, the failure of an employee to save should have the same accounting as when an option lapses unexercised (none). There is a third view, that the decision to save is an extension of a market condition, in the sense that the share price heavily influences an employee's decision of whether to participate in the scheme. The deduction from current payroll is effectively a pre-payment of the exercise price. We discuss the accounting for an SAYE condition further in Example C in Appendix 3. We believe that this issue can be addressed more effectively by addressing the views above, rather than by using the concept of 'vesting conditions' and 'non-vesting conditions.'

Interaction of conditions

We do not believe that the Staff model provides adequate guidance on how to account for share-based payment transactions when two conditions interact. For example, when an entity's earnings per share must exceed the average earnings per share of other entities in the same industry, is that (a) an other vesting condition (b) a performance condition, or (c) one award with two conditions, a performance condition, and an other vesting condition (assuming that service is also required)? Similarly, when an IPO must occur at a minimum share price, is that (a) a performance condition or (b) a market condition, or (c) one award with two conditions, a performance condition, and a market condition (assuming that service is also required and an IPO is a performance condition)? These are discussed further in Examples D1 and D2 in Appendix 3.

Appendix 2 – Factors to consider and simplified model

We applaud the Staff's efforts to identify underlying principles that drive the accounting for vesting and non-vesting conditions. We note that the current accounting is largely driven by the following factors (with examples):

Factors to consider

	Type 1	Type 2
Effect on grant-date measurement	Excluded from grant-date fair value	Included in grant-date fair value
Subsequent remeasurement	Periodic re-estimation of forfeitures	Not subsequently remeasured
Level of influence of the counterparties (as a whole) receiving awards with that type of feature	High influence *(service condition)*	Low influence *(market condition)*
Level of required action or passive response by the counterparty	High action *(service condition)*	Passive response *(post-vesting restrictions)*
Timing of the conditional event relative to other conditional events	Before or concurrent *(performance condition)*	After *(reload feature)*
Likelihood of the conditional event occurring	High likelihood *(service condition)*	Low likelihood

Accordingly, we think that the Interpretations Committee should consider these factors when evaluating how to treat the more complex conditions (e.g., non-compete, save-as-you-earn). While we acknowledge it is uncommon to begin with the desired accounting and work back to the principles, we believe that this is the most effective approach given the limited scope of this project.

Appendix 3 – Examples

Example A - Application of IFRS 2 to a non-compete (or claw-back) provision (based on Case A per paper 3D) *This example illustrates that the definition of 'service' is not clear.*

Award conditions

1. Entity A grants 100,000 restricted shares to an employee. Retention of the restricted shares is not contingent on future employment with Entity A.
2. However, the restricted shares are transferred to the employee based on a 4-year delayed-transfer schedule (25,000 restricted shares to be transferred at the end of each of the 4 years) if and only if a specified non-compete provision is satisfied. The restricted shares are convertible into unrestricted shares any time after transfer.
3. The non-compete provision requires that no work in any capacity may be performed for a competitor. If the non-compete provision is not satisfied, the employee loses all rights to any restricted shares not yet transferred.

Award accounting

Applying current IFRS 2

4. In practice, we are only aware of View B, subsequent to the *Vesting Conditions and Cancellations Amendment*.
5. In theory, there is diversity in opinion whether a non-compete provision should be:
   a. (**View A – broad view of service**) a performance condition (as defined in Appendix A of IFRS 2) that requires the best estimate of the number of shares expected to vest to be re-estimated each reporting period. Not competing **is** a service, because entities typically only include non-compete conditions in grants of share-based payments to employees who have competitive knowledge or customer relationships, and are likely to exploit that knowledge and those relationships through another entity if employment is terminated with the grantor. Entities do not issue share-based payment awards with non-compete agreements to random individuals with whom they have no affiliation or connection; therefore, there must be some benefit received by the entity in exchange for granting the share-based payment award with the non-compete agreement. This view is also consistent with the requirements of IFRS 3, which permit recognition of a non-compete agreement as an intangible asset (thereby implying that benefits are received by the entity). This view is also consistent with principles in paragraph 13A of IFRS 2 that require an entity to recognise expense for a share-based payment granted in exchange for unidentifiable goods or services, on the basis that the entity must have received something of benefit, otherwise it would not have granted the award. Furthermore, when non-compete agreements are violated, it is common in practice for the new employer of the employee to pay the amount due to the former employer (who granted the share-based payment award). If forfeiture accounting is **not** applied (as is the case in View B), then both entities would recognise an expense for the award granted to the employee. The entity should not recognise a charge if the employee does not vest in the award.

b. (**View B – narrow view of service**) a non-vesting condition (as listed in paragraph IG24 of IFRS 2) that is estimated at grant date and included in the grant-date fair value (and not subsequently re-estimated each period for the likelihood the condition will be satisfied). There is no service requirement since the employee may not be in employment during the period covered by the non-compete provision or might be providing service in an unrelated industry (or sitting on a beach). In addition, legal enforceability of these conditions is difficult in practice, and varies by jurisdiction. Supporters of this view also note that if View A is taken, expense is recognised over a longer period, which may not be consistent with the level of 'service' provided.

6. This diversity of views affects the grant date fair value measurement. In **View A,** both vesting conditions are excluded from the grant-date measurement and forfeiture accounting is applied. In **View B**, the grant-date fair value of the non-compete non-vesting condition is estimated at grant date and is not subsequently adjusted; cancellation accounting is applied.
7. The diversity in classification of the non-compete provision impacts the length of time over which the compensation cost is recognised. Under **View A,** there is a 4-year vesting period, whereas under **View B,** the expense is recognised immediately, because there is no vesting period.

Applying the Staff model (as proposed at the May 2010 Committee meeting)

8. Using the proposed Staff model including the 3-step approach discussed in May 2010 Committee agenda paper 3C, this example award results in the following accounting:
   a. Step 1 – list all conditions of the award
      i. Non-compete condition – It is not clear whether this is a vesting condition or a non-vesting condition, because it is not clear whether not competing is a 'service', for the reasons described in paragraph 5 above. We do not believe that the level of compensation is relevant (or if it is, it is not sufficiently explained how to apply this concept in the model). In addition, assessing the entity's history of enforcing such provisions is not operational in practice, because it means that an entity must establish a history before assessing the accounting.
   b. Step 2 – determine individual vesting periods for each vesting condition - Cannot be performed until Step 1 is complete per above.
   c. Step 3 – determine the single attribution period for the award - Cannot be performed until Step 1 and 2 are complete per above.

Recommendations

9. The Interpretations Committee should assess whether not competing meets the definition of 'service', and reconcile this conclusion with the requirements of IFRS 3 and paragraph 13A of IFRS 2. Accordingly, if it is clarified whether a non-compete is a performance condition, the entity could then follow the guidance in paragraphs 16-21 of IFRS 2, without needing the guidance in paragraph 21A of IFRS 2.

Example B - Application of IFRS 2 to a provision requiring that an entity float (IPO)

Example B illustrates that applying the Staff model is not clear when two periods are not co-terminous and service is not required for the entire period. Although this example deals with an IPO, conditions requiring that an entity be sold or have a change in control are similar and are common in practice.

Award conditions

1. An entity grants an employee a share-based payment award of 1,000 shares.
2. Each share-based payment award vests **IF BOTH** of the following occur:
   a. the employee completes 3 years of service **AND**
   b. the entity completes an IPO or is sold at any time within 5 years.
   (This means that if the employee terminates employment after three years of service, and the IPO occurs within 5 years, the employee vests in the award).

Award accounting

Applying current IFRS 2

3. There is a 3-year service condition. This service condition means that the compensation cost of the award is recognised over the 3-year period. The likelihood that the condition will be satisfied is not included in the grant date fair value measurement. The best estimate of the shares expected to vest is re-estimated each reporting period.
4. There is diversity in determining whether the flotation requirement is:
   a. (**View A**) a non-market performance condition (as defined in Appendix A of IFRS 2 and as listed in IG24 of IFRS 2). To be a performance condition, IFRS 2 only requires that service be provided. It does not specify that the service must be for the entire period over which the performance condition is fulfilled (which means that if the IPO does not occur, the entity applies forfeiture accounting).
   b. (**View B**) a non-vesting condition that is included in the grant-date fair value. Service is not provided for the entire period over which the IPO condition is fulfilled. Therefore, it does not meet the definition of a performance condition (within the definition of vesting conditions), which requires 'a specified period of service and specified performance target to be met'. Paragraph IG24 of IFRS 2 is not authoritative and does not address situations in which the conditions are performed over different periods. Therefore, regardless of whether the IPO occurs, the entity recognises an expense, so long as the service condition is fulfilled.
   c. (**View C**) a non-market condition (for the reasons described in View A) for the first three years, where the service is also required, and a non-vesting condition for years 4 and 5, where the service is not provided. However, if this view is correct, it is not clear how the measurement and accounting would occur in practice.

Applying the Staff model (as proposed at the May 2010 Committee meeting)

5. Using the proposed Staff model including the 3-step approach discussed in the May 2010 Committee agenda paper 3C, this example award results in the following accounting:
   a. Step 1 – list all conditions of the award
      i. 3-year service condition – The likelihood that the condition will be satisfied is not included in the grant date fair value measurement. The best estimate of the number of shares expected to vest is re-estimated each reporting period.
      ii. Flotation requirement– It is not clear whether this is a vesting condition or a non-vesting condition, because service is not required for the entire period, for the reasons described in paragraph 4 above.
   b. Step 2 – determine individual vesting periods for each vesting condition - Cannot be performed until Step 1 is complete per above.
   c. Step 3 – determine the single attribution period for the award - cannot be performed until Step 1 and 2 are complete per above.

Recommendations

6. Clarification is still needed on whether the IPO is a performance condition, because service is **not** required for the entire period.
7. In addition, when service **is** provided for the entire period over which the IPO must occur, the Interpretations Committee should address whether an IPO (or similar event) is a performance condition (e.g., because it is within the entity's control). However, in our view any conclusions reached by the Interpretations Committee should have regard to its broader views on the boundary between the actions of the shareholders of an entity and the reporting entity itself, as noted in Appendix 1. The Boards' views on this issue may affect whether a flotation or sale requirement is a performance condition or other vesting condition.
8. If it is clarified whether an IPO (or similar event) is a performance condition, including in circumstances where the period relating to this condition is longer than the service period, the entity could then follow the guidance in paragraphs 16-21 of IFRS 2, without needing the guidance in paragraph 21A of IFRS 2.

Example C - Application of IFRS 2 to a SAYE scheme (paragraphs 18-29, paper 3D)

This example illustrates that the service requirement and the definition of 'employer's operations' are not clear in the Staff model.

Award conditions

1. The SAYE plan has terms requiring an employee to contribute monthly a specified amount to an employee share trust for five years, through deductions from the company salary.
2. After five years, the employee has a choice to either receive his or her cash back plus accrued interest, or use the cash to acquire shares (at a discount to the market price).
3. An employee that ceases paying contributions into the trust receives a reimbursement of all amounts saved to date, plus interest, but forfeits the right to acquire shares.

Award accounting

Applying current IFRS 2

4. There is a 5-year service condition, since the employee cannot contribute to the plan without being an employee (because it has no salary from the entity from which to deduct contributions). This service condition means that the compensation cost of the award is recognised over the 5-year vesting period. The likelihood that the condition will be satisfied is not included in the grant date fair value measurement. The best estimate of the shares expected to vest is re-estimated each reporting period.
5. In practice, we are only aware of View B, subsequent to the *Vesting Conditions and Cancellations Amendment*. Theoretically, there is diversity in determining whether a requirement to contribute is:
   a. (**View A**) a performance condition (as defined in Appendix A of IFRS 2) that requires the best estimate of the number of shares expected to vest to be re-estimated each reporting period. The employee provides 'service' and completes a specific action (saving). IG24 of IFRS 2 is not authoritative.
   b. (**View B**) a non-vesting condition (as listed in paragraph IG24 of IFRS 2) that to be estimated at grant date and included in the grant-date fair value (and not subsequently re-estimated each period for the likelihood the condition will be satisfied). There is no service requirement since the service condition is already accounted for in paragraph 4 above. Therefore, the definition of a performance conditions (within the definition of vesting conditions) requiring 'a specified period of service and specified performance target to be met' is not met.

Applying the Staff model (as proposed at the May 2010 Committee meeting)

6. Using the proposed Staff model including the 3-step approach discussed in the May 2020 Committee agenda paper 3C, this example award results in the following accounting:
   a. Step 1 – list all conditions of the award
      i. 5-year service condition – The likelihood that the condition will be satisfied is not included in the grant date fair value measurement. The best estimate of the number of shares expected to vest is re-estimated each reporting period.

b. Requirement to save – It is not clear whether this is a vesting condition or a non-vesting condition, because the requirement to save does not relate to 'the employer's operations' as stated in the matrix. If the Staff intended that an SAYE requirement would be a vesting condition, this reverses the decision under current IFRS 2 – was this intended? Step 2 – determine individual vesting periods for each vesting condition - Cannot be performed until Step 1 is complete per above.
c. Step 3 – determine the single attribution period for the award - Cannot be performed until Step 1 and 2 are complete per above.

Recommendations

7. The Interpretations Committee should assess whether performing a specific act, such as saving, can ever meet the definition of a 'performance target' and therefore be defined as a performance condition. If so, the Interpretations Committee should identify the indicators that should be considered when assessing facts and circumstances to make this determination.
8. If the Interpretations Committee is persuaded that the ability of the counterparty to influence the outcome is an important factor in determining which accounting model should be applied, then it might conclude that the requirement to save should be classified as a performance condition. The argument that saving is a performance target is particularly persuasive when one believes that an employee's decision of whether to save is affected primarily by factors particular to that employee (e.g., financial ability to surrender cash from salary), and less affected by the market price of the shares.
9. One could also argue that an employee's decision to save is analogous to their decision to exercise an option; under this view, the failure of an employee to save would not trigger any change in the recognition of expense, which is consistent with the lack of accounting when an option lapses unexercised.
10. There is a third view that the decision to save could be viewed as an extension of a market condition. Under this view, the share price heavily influences an employee's decision of whether to participate in the scheme. The deduction from current payroll is viewed as a pre-payment of the exercise price.
11. The Interpretations Committee should clarify which of the views it holds, and accordingly, whether an SAYE condition is a performance condition, market condition, or analogous to exercising an option. Once clarified, the entity could then follow the guidance in paragraphs 16-21 of IFRS 2, without needing the guidance in paragraph 21A of IFRS 2. For example, by making it clear that saving is **not** a performance target, it would become clear that such condition is factored in to the grant-date fair value, and not re-assessed.

Example D – Interacting conditions

D1 - Growth rate in EPS exceeds average growth in EPS in the industry

This example illustrates that the concept of the 'employer's operations' is not clear in the Staff model, and highlights a potential change from existing IFRS. This example also highlights that the Staff model is difficult to apply when there are interacting conditions (for example a non-vesting condition and a performance condition), and determining which takes precedence.

Award conditions

1. An entity grants an employee a share-based payment award of 1,000 shares.
2. Each share-based payment award vests **IF BOTH** of the following occur:
   a. The employee completes 5 years of service **AND**
   b. Growth rate in earnings per share (EPS) exceeds average growth in earnings EPS in the industry over that period.

Award accounting

Applying current IFRS 2

3. There is a 5-year service condition. This service condition means that the compensation cost of the award is recognised over the 5-year vesting period. The likelihood that the condition will be satisfied is not included in the grant date fair value measurement. The best estimate of the shares expected to vest is re-estimated each reporting period, and forfeiture accounting is applied.
4. The condition that growth rate in EPS exceeds average growth in EPS in the industry over that period is a performance condition, because it relates to a specified performance target that must be met. This condition requires the best estimate of the number of shares expected to vest to be re-estimated each reporting period, and forfeiture accounting is applied.

Applying the Staff model (as proposed at the May 2010 Committee meeting)

5. Using the proposed Staff model including the 3-step approach discussed in the May 2010 Committee agenda paper 3C, this example award results in the following accounting:
   a. Step 1 – list all conditions of the award –
      i. 5-year service condition – The likelihood that the condition will be satisfied is not included in the grant date fair value measurement. The best estimate of the number of shares expected to vest is re-estimated each reporting period.
      ii. Growth rate in EPS exceeds average growth in EPS in the industry over that period –
         1. (**View A)** This condition is an other vesting condition, and considered in the grant-date fair value. It is not adjusted subsequently (change from existing IFRS). Because this condition compares the performance of the entity to the performance of other entities, it does **not** relate solely to the entity's performance, and therefore is **not** a performance condition.
         2. (**View B)** This condition is a performance condition, and excluded from the grant-date fair value. It is not adjusted subsequently (change from existing

IFRS). Although this condition considers the performance of other entities, it relates primarily to a measure of the entity's performance, and therefore is a performance condition. The best estimate of the shares expected to vest is re-estimated each reporting period, and forfeiture accounting is applied.

3. (**View C**) There are two conditions: a performance condition (how the entity's EPS grows) and an other vesting condition (how the EPS of other entities in the industry grows). One of these conditions 'trumps' the other, although it is not clear which one, or how to make that determination.

b. Step 2 – determine vesting periods for each condition – both are 5 years.
c. Step 3 – determine the attribution period for the award - both are 5 years.

Recommendations

6. The Interpretations Committee should clarify how to treat a condition that includes both a reference to the entity's own performance and performance of other entities. The Interpretations Committee should address whether this is a performance condition, or if one type of condition can 'trump' the other conditions.
7. We believe that a condition that compares the performance of the entity relative to the other entities should be a performance condition, because (using the indicators in **Appendix 2**) it is an event over which the entity and the counterparty have more influence. In addition, our view is influenced by the practical consideration of wanting to maintain convergence with US GAAP, which includes in its definition of performance conditions "a performance target [that is] defined by reference to the same performance measure of another entity or group of entities."

Example D2 – Flotation requirement with minimum price

This analysis is similar to D1 in that there are interacting conditions. How many separate conditions should be identified?

Award conditions

1. Each share-based payment award vests if **ALL** of the following occur:
   a. The employee completes 5 years of service **AND**
   b. The entity completes an IPO at any time during that period **AND**
   c. The IPO share price equals or exceeds £100 per share.

Applying current IFRS 2

2. There is a 5-year service condition. This service condition means that the compensation cost of the award is recognised over the 5-year vesting period. The likelihood that the condition will be satisfied is not included in the grant date fair value measurement. The best estimate of the shares expected to vest is re-estimated each reporting period, and forfeiture accounting is applied.
3. There are three theoretically possible views on how to treat the remaining conditions –
   a. (**View A**) There are two conditions (a) a performance condition – to complete the IPO and (b) a market condition, that the share price equals or exceeds £100 per share. Under this view, if the IPO is completed, but the share price target is not reached (e.g., £98 per share), the entity would still recognise expense (no forfeiture, even though the award does not vest, as long as the employee provides service).
   b. (**View B**) There is one performance condition. Although this condition includes a reference to share price, it relates primarily to a measure of the entity's performance, and therefore is a performance condition. Under this view, if the if the IPO is completed, but the share price target is not reached (e.g., £98 per share), the entity would reverse the expense (forfeiture accounting, even though the award does not vest).
   c. (**View C**) There is one market condition. Although this condition includes a reference to IPO, which is listed in IG24 as a performance condition, IG24 is not authoritative. The reference to share price automatically means that there is a market condition. Under this view, regardless of whether the IPO is completed, the entity recognises expense (as long as the employee provides service).

Applying the Staff model (as proposed at the May 2010 Committee meeting)

8. Using the proposed Staff model including the 3-step approach discussed in the May 2010 Committee agenda paper 3C, this example award results in the following accounting:
   a. Step 1 – list all conditions of the award –
      i. 5-year service condition – The likelihood that the condition will be satisfied is not included in the grant date fair value measurement. The best estimate of the number of shares expected to vest is re-estimated each reporting period.
      ii. There are three views on how to treat the remaining conditions (the same as under current IFRS 2).

b. Step 2 – determine vesting periods for each condition – all are 5 years.
c. Step 3 – determine the attribution period for the award - all are 5 years.

Recommendations

9. The Interpretations Committee should clarify how to treat a condition that includes references to performance and to share price, particularly in the fact pattern noted above. The Interpretations Committee should address whether to separate the conditions, or if one type of condition can 'trump' the other conditions.
10. We believe that a condition that an IPO at a minimum share price contains two separate conditions (View A), but that this should be clarified in IFRS 2.