IFRS Interpretations Committee Meeting

Staff Paper

Agenda reference 3C

Date July 2010

Project IFRS 2 *Share-based Payment*

Topic **Vesting and non-vesting conditions – Specific examples**

Purpose of this paper

1. The objective of this paper is to provide detailed analysis of specific examples based on the new classifications proposed at the May 2010 Committee meeting in comparison with current accounting treatments.

Structure of this paper

2. The staff analysis on each example is presented in a separate Appendix:

   (a) Appendix A – Saving requirement under a SAYE plan

   (b) Appendix B – Non-compete provision I

   (c) Appendix C – Non-compete provision II

   (d) Appendix D – Initial Public Offering (IPO)

   (e) Appendix E – Change of control

   (f) Appendix F – Market index target

   (g) Appendix G – Performance target measured over a period exceeding the service period

   (h) Appendix H – Interaction of multiple vesting conditions

   (i) Appendix I – IPO with minimum price

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IFRS Interpretations Committee.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IFRS Interpretations Committee or the IASB. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*.

Interpretations are published only after the IFRS Interpretations Committee and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in IASB *Update*.

Summary

3. The following table provides a summary of the current accounting and proposed accounting based on the staff recommendations:

	Current accounting	Proposed accounting
Appendix A – Saving requirement under a SAYE plan	clear guidance (non-vesting condition)	revised guidance (performance condition)
Appendix B – Non-compete provision I	diverse interpretation	specific guidance for non-compete provisions
Appendix C – Non-compete provision II	diverse interpretation	specific guidance for non-compete provisions
Appendix D – Initial Public Offering (IPO)	clear guidance (performance condition)	clear guidance (performance condition)
Appendix E – Change of control	diverse interpretation	clear guidance (performance condition)
Appendix F – Market index target	diverse interpretation	clear guidance (market or other vesting condition)
Appendix G – Performance target measured over a period exceeding the service period	diverse interpretation	specific guidance on determining the attribution period
Appendix H – Interaction of multiple vesting conditions	no clear guidance but no diversity	specific guidance on the interaction of multiple vesting conditions
Appendix I – IPO with minimum price	diverse interpretation	specific guidance (performance condition)

Questions for the Committee

4. The staff request the Committee address the following question:

Question – Specific examples
Does the Committee agree with the staff analysis and rationale supporting the staff's recommendations for the specific examples?

Appendix A — Saving requirement under a SAYE plan

Fact pattern

1. An entity set up a Save-As-You-Earn (SAYE) plan under which employees are granted equity-settled share options. The employees can only buy the shares (ie satisfy the exercise price of the options) using amounts the employees saved under a special SAYE savings contract.

2. The employees agree to save at a bank (ie a third party trustee) a fixed amount each month for a fixed period under a special SAYE savings contract. If the employees exercise their share options, they must pay for the shares from the amounts saved through their savings contract. The amount that the employees agree to save each month is withheld by the entity directly from the employees pay and sent to the bank.

3. The employees can exercise their options to buy shares at any time during the six month period after they complete their three-year SAYE contract. The employees are only able to exercise the options if they remain in employment through the date the options are exercised.

4. Additionally, if the employees decide to stop saving before they have completed their three year SAYE contract they are not able to exercise the share options.

5. If the employees do not exercise the share options for whatever reason they will receive their savings back at the end of the six month option exercisability period plus the accrued tax-free interest on the savings account.

Current accounting treatment

6. Paragraph IG24 of IFRS 2 specifies that the saving requirement under the SAYE plan is an example of a ***non-vesting condition*** that the employee can choose whether to meet the condition.

Grant date fair value

7. The condition to continue saving into the SAYE plan should be ***included*** in determining the fair value of a share option at the grant date.

Subsequent accounting

8. The variability (ie changes in likelihood of forfeiture) on the saving requirement under the SAYE plan is ***not subsequently revised***.

9. The event of an employee deciding to discontinue saving into the SAYE plan is considered a ***cancellation*** of the granted share options (whether or not the employee continues to remain in service). Therefore, the entity must ***accelerate*** and immediately recognise all remaining previously unrecognised compensation cost that was determined as of the grant date.

Proposed accounting treatment

10. The saving requirement under the SAYE plan is considered to be a vesting condition because it:

    (a) determines whether the employees become entitled to the share options; and

    (b) contains an implicit 3-year service requirement.

11. Specifically, the saving requirement is classified as a ***performance condition*** in accordance with the broader notion of performance condition (refer to agenda paper 3B).

Grant date fair value

12. The condition to continue savings is ***not included*** in determining the fair value of a share option at the grant date.

Subsequent accounting

13. The condition to continue savings is taken into account at each reporting period by ***adjusting the number*** of share options expected to vest.

14. The event of an employee deciding to discontinue contributing into the plan is considered to be a failure to meet the performance condition. That is, the employee ***forfeits*** the award (whether or not the employee continues to remain in service). Therefore, the entity must ***reverse*** all previously recognised compensation cost that was determined as of the grant date.

Appendix B — Non-compete provision I

Fact pattern

1. An entity grants an employee an award of 100,000 shares that vest upon the completion of 5 years of service.

2. The shares become freely transferable upon vesting; however, the award provisions specify that, in the event of the employee's termination and subsequent employment by a direct competitor within three years after vesting, the shares or their cash equivalent on the date of employment by the direct competitor must be returned to the entity for no consideration.

3. The employee completes five years of service and vests in the award. Two years after vesting in the share award, the employee terminates employment and is hired as an employee of a direct competitor.

Current accounting treatment

4. There is no clear guidance in the authoritative section of IFRS 2 on non-compete provisions, but paragraph BC171B of IFRS 2 indicates that non-compete provisions which apply after the holder is entitled to the awards are not vesting conditions [emphasis added]:

> The Board noted that a share-based payment vests when the counterparty's entitlement to it is no longer conditional on future service or performance conditions. Therefore, conditions such as **non-compete provisions** and transfer restrictions, **which apply after the counterparty has become entitled to the share-based payment, are not vesting conditions**. The Board revised the definition of 'vest' accordingly.

5. There may be three different interpretations:

   (a) Interpretation A – Any non-compete provision should be treated as a ***non-vesting condition*** in accordance with paragraph BC171B of IFRS 2 regardless of the other specific facts of the award.

   (b) Interpretation B – The non-compete provision referred to in paragraph BC171B is a specific example, ie a non-compete provision which applies after the counterparty has become entitled to the share-based payment, and the rationale should not be automatically extended to all the other cases which involve non-compete provisions. ***Depending on facts and circumstances*** it may be treated as either 'a non-vesting condition or a service condition' despite the counterparty already being 'entitled to the share-based payment' as written in the share-based payment agreement.

(c) Interpretation C – Not providing service to a competitor would be regarded as rendering 'in-substance service' or 'indirect service' to the employer, whether the employee remains in employment or not, given there is no restrictive/ specific definition of 'service' in IFRSs. Additionally, paragraph BC171B of IFRS 2 is non-authoritative and only notes that non-compete provisions with certain characteristics are not vesting conditions, Therefore, any non-compete provision should be treated as *a* ***service condition***.

Grant date fair value

6. Each interpretation results in a different measurement at the grant date:

   (a) Interpretation A - The non-compete provision is ***included*** in determining the fair value of a share at the grant date.

   (b) Interpretation B

      (i) Service condition - The same as under Interpretation C

      (ii) Non-vesting condition - The same as under Interpretation A

   (c) Interpretation C – The non-compete provision is ***not included*** in determining the fair value of a share at the grant date.

Subsequent accounting

7. Also, each interpretation results in a different accounting treatment:

   (a) Interpretation A

(i) The variability on the non-compete provision is ***not subsequently revised*** each reporting period.

(ii) **It is unclear** whether the event of the non-compete provision not being met brings about ***no change*** **or an** ***acceleration*** of previously unrecognised compensation cost that was determined as of the grant date. Paragraph IG24 of IFRS 2 currently provides for both types of accounting treatment depending on the facts and circumstances. This fact pattern (of a non-compete provision) is not an explicit example and no additional principles or guidance is provided.

(b) Interpretation B

(i) Deemed 'non-vesting condition' - The same as under Interpretation A

(ii) Deemed 'service condition' - The same as under Interpretation C

(c) Interpretation C

(i) The non-compete provision should be taken into account at each reporting date by ***adjusting the number*** of shares expected to vest.

(ii) The event of the non-compete provision not being met is considered failure to meet a service condition, ie ***forfeiture***. Therefore, the entity must ***reverse*** previously recognised compensation cost that was determined as of the grant date.

Proposed accounting treatment

8. There is a presumption that a non-compete provision is a contingent feature. The rationale is that the former employee is not providing (and the entity is not receiving) any direct service. Rather, at most, the former employee is deemed to be providing indirect service to the entity as a result of not providing service directly to a competitor.

Grant date fair value

9. The non-compete provision is considered a contingent feature and it is ***not included*** in determining the fair value of a share at the grant date.

Subsequent accounting

10. Since the non-compete provision is considered a contingent feature, it results in ***no periodic/ subsequent change*** to the measurement of the transaction amount. The event of the non-compete provision not being met is considered ***neither forfeiture nor cancellation***. Instead, the effect of the contingent event should be accounted for when it occurs. Therefore, in the event a non-compete provision is broken, the entity will simply record the transaction of receiving the equity instruments or other compensation initially paid to the counterparty (in the shape of treasury shares or cash) and corresponding reversal of the original transaction recorded when the non-compete provision was entered into.

Appendix C — Non-compete provision II

Fact pattern

1. An entity grants 100,000 restricted shares to an employee. The restricted shares are fully vested as of the date of grant, and retention of the restricted shares is not contingent on future service to the entity.

2. However, the restricted shares are transferred to the employee based on a 4-year delayed-transfer schedule (all of the restricted shares to be transferred at the end of year 4) 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.

4. The non-compete provision lapses with respect to the restricted shares as they are transferred (all at once at the end of the 4-year transfer schedule).

5. If the non-compete provision is not satisfied, the employee loses all rights to any restricted shares not yet transferred.

6. The fair value of the restricted shares is material to the total compensation of the employee representing approximately four times the expected future annual total compensation of the employee.

Current accounting treatment

7. The same analysis is applicable as Appendix B.

Proposed accounting treatment

8. The same analysis is applicable as Appendix B. There is a presumption that a non-compete provision is a contingent feature. The rationale is that the former employee is not providing (and the entity is not receiving) any direct service. Rather, at most, the former employee is deemed to be providing indirect service to the entity as a result of not providing service directly to a competitor.

9. However, if certain facts and circumstances result in the non-complete provision effectively requiring continued service to the current employer (which then never becomes the 'former employer'), it may be appropriate to treat the non-compete provision as part of an award having a service condition. In this instance, the award should be accounted for as including a deemed service condition and the cost of the award would be recognised over the attribution period consistent with other share-based payment transactions. In the staff's opinion, this can be dealt with by practice on a facts and circumstances basis.

Appendix D — Initial Public Offering (IPO)

Fact pattern

1. An entity grants 100 share options each to 10 of its employees (for a total of 1,000 share options granted).

2. The share options do not vest until an IPO occurs provided the employees have remained in service until the date of the successful IPO. If the employees terminate employment with the entity before the IPO occurs, the award is forfeited.

Current accounting treatment

3. According to paragraph IG24 of IFRS 2, a target based on a successful initial public offering with a specified service requirement is an example of a non-market performance condition.

4. Paragraph BC171A explains that the performance condition is distinguished from a non-vesting condition as ‘the former has an explicit or implicit service requirement and the later does not.’ In this example, there is an implicit service requirement that the employees must work for the entity until the IPO target is satisfied.

5. Therefore, the IPO target constitutes a ***performance condition***.

Grant date fair value

6. The IPO target is ***not included*** in determining the fair value of a share option at the grant date.

Subsequent accounting

7. The IPO target should be taken into account each reporting period by ***adjusting the number*** of share options expected to vest.

8. The event of the IPO target not being met is considered a failure to meet the performance condition, ie ***forfeiture*** (whether or not the employee continues to remain in service). Therefore, the entity ***reverses*** previously recognised compensation cost that was determined as of the grant date.

Proposed accounting treatment

9. The IPO target is considered to be a vesting condition because it:

   (a) determines whether the employees become entitled to the share options; and

   (b) contains an implicit service requirement.

10. Specifically, the IPO target is classified as a ***performance condition*** in accordance with the broader notion of performance condition (refer to agenda paper 3B).

Grant date fair value

11. There is ***no change*** from the current grant date fair value measurement. See paragraph 6 of this appendix.

Subsequent accounting

12. There is ***no change*** from the current subsequent accounting treatment. See paragraphs 7-8 of this appendix.

Appendix E — change of control

Fact pattern

1. An entity grants 100 share options each to 10 of its employees (for a total of 1,000 share options granted).

2. The share options do not vest upon a change of control provided the employees have remained in service until the date of the change of control. If the employees terminate employment with the entity before a change of control occurs, the award is forfeited.

Current accounting treatment

3. There is an implicit service requirement that the employees must work for the entity until a change of control occurs. However, there is no specific guidance on a change of control provision (whether or not combined with a service requirement).

4. There may be two different interpretations:

   (a) Interpretation A - The change of control provision constitutes a ***performance condition*** jointly with the service requirement because the condition requires the employee to complete a specified period of service (variable depending on when the target is met) and also the change of control provision, which is considered a ‘performance target’, must be satisfied.

   (b) Interpretation B - The change of control provision is a ***non-vesting condition*** because it is not a ‘performance target’, ie not related to the performance of the entity, and the service requirement is a separate vesting condition, ie service condition.

Grant date fair value

5. Each interpretation results in a different measurement at the grant date:

(a) Interpretation A - The change of control provision is ***not included*** in determining the fair value of a share option at the grant date.

(b) Interpretation B - The change of control provision is ***included*** in determining the fair value of a share option at the grant date.

Subsequent accounting

6. Also, each interpretation results in a different accounting treatment:

(a) Interpretation A:

(i) The change of control provision should be taken into account each reporting period by ***adjusting the number*** of share options expected to vest.

(ii) The event of the change of control provision not being satisfied is considered failure to meet the performance condition, ie ***forfeiture*** (whether or not the employee continues to remain in service). Therefore, the entity must ***reverse*** previously recognised compensation cost that was determined as of the grant date.

(b) Interpretation B:

(i) The variability on the change of the control provision is ***not subsequently revised***.

(ii) The event of the change of control provision not being satisfied would likely result in ***no change*** to previously recognised compensation cost that was determined as of the grant date (unless the employee leaves the entity prior to the end of the attribution period). This is because the change of control provision is considered a non-vesting condition and would likely be classified as ‘neither the entity nor the counterparty can choose whether the condition is met’ as noted in paragraph IG24 of IFRS 2.

Proposed accounting treatment

7. The change of control provision is considered to be a vesting condition because it:

   (a) determines whether the employees become entitled to the share options; and

   (b) contains an implicit service requirement.

8. Specifically, the change of control provision is classified as a ***performance condition*** in accordance with the broader notion of performance condition (refer to agenda paper 3B).

Grant date fair value

9. The change of control provision is ***not included*** in determining the fair value of a share option at the grant date.

Subsequent accounting

10. The change of control provision should be taken into account each reporting period by ***adjusting the number*** of share options expected to vest.

11. The event of the change of control provision not being satisfied is considered failure to meet the performance condition, ie ***forfeiture*** (whether or not the employee continues to remain in service). Therefore, the entity must ***reverse*** previously recognised compensation cost that was determined as of the grant date.

12. The proposed accounting treatment is consistent with Interpretation A in the current accounting treatment analysis.

Appendix F — Market index target

Fact pattern

1. An entity grants 100 share options each to 10 of its employees (for a total of 1,000 share options granted).

2. The grant is conditional on the FTSE 100 reaching 6,500 at any point in time in the next three years and the employee remaining in service up to the date that the FTSE 100 target is satisfied.

Current accounting treatment

3. Given the market index target is combined with a service requirement, there may be two different interpretations:

   (a) Interpretation A - The market index target constitutes a ***performance condition*** jointly with the service requirement because the condition requires the employee to complete a specified period of service (variable depending on when the target is met) and also the market index target, which is considered a 'performance' target, must be met.

   (b) Interpretation B - The market index target is a ***non-vesting condition*** because it is not a 'performance' target, ie not related to the performance of the entity, and the service requirement is a separate vesting condition, ie service condition.

Grant date fair value

4. Each interpretation results in a different measurement at the grant date:

   (a) Interpretation A - The market index target is ***not included*** in determining the fair value of a share option at the grant date.

   (b) Interpretation B - The market index target is ***included*** in determining the fair value of a share option at the grant date.

Subsequent accounting

5. Also, each interpretation results in a different accounting treatment:

   (a) Interpretation A:

      (i) The market index target should be taken into account each reporting period by ***adjusting the number*** of share options expected to vest.

      (ii) The event of the market index target not being met is considered failure to meet the performance condition, ie ***forfeiture*** (whether or not the employee continues to remain in service). Therefore, the entity must ***reverse*** previously recognised compensation cost that was determined as of the grant date.

   (b) Interpretation B:

      (i) The variability on the market index target is ***not subsequently revised*** each reporting period.

      (ii) The event of the market index target not being met brings about ***no change*** to previously recognised compensation cost that was determined as of the grant date (unless the employee leaves the entity prior to the end of the attribution period). This is consistent with current paragraph IG 24 of IFRS 2 for the non-vesting condition where 'neither the entity nor the counterparty can choose whether the condition is met'.

Proposed accounting treatment

6. The condition is a vesting condition because it:

   (a) determines whether the employee becomes entitled to the share options; and

   (b) has an implicit service requirement.

7. Specifically, the condition is classified as a '***market or other vesting condition***' because it:

(a) has a requirement (ie a target) more than a service requirement; and

(b) the target is neither influenced by the employee nor in the interest of the entity, ie not a performance condition.

Grant date fair value

8. The market index target is ***included*** in determining the fair value of a share option at the grant date.

Subsequent accounting

9. The variability on the market index target is ***not subsequently revised*** each reporting period.

10. The event of the market index target not being met brings about ***no change*** to previously recognised compensation cost that was determined as of the grant date. The recognition of compensation cost from grant date throughout the attribution period should occur unless the employee leaves the entity (or otherwise forfeits the award).

11. The proposed accounting treatment is consistent with Interpretation B under current accounting treatment, except that the market index target is not classified as a non-vesting condition and is classified as a market or other vesting condition.

Appendix G — Performance target measured over a period exceeding the service period

Fact pattern

1. An entity grants an employee share options.

2. The employee is entitled to the share options (ie vests) only if

   (a) the employee works for the entity over the next two years; and

   (b) the entity achieves a target cumulative profit determined at the end of year three.

Current accounting treatment

3. IFRS 2:

   (a) defines vesting conditions as the conditions that determine whether the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity under a share-based payment arrangement; and

   (b) describes (within the definition of vesting condition) performance conditions as the conditions that require the counterparty to complete a specified period of service and specified performance targets to be met.

4. Paragraph BC171A elaborates on the definition by highlighting a feature that distinguishes a performance condition from a non-vesting condition, which is that a performance condition has an explicit or implicit service requirement and a non-vesting condition does not.

5. There are two views taken in practice:

   (a) Interpretation A – for any performance target to be classified as a ‘performance condition’, that target needs to have an explicit or implicit service requirement for the duration of the period the performance target is being determined in order to constitute a performance condition. Otherwise, the generic definition of vesting conditions may be compromised where service is not received during a portion of the performance target period.

Using Interpretation A, the employee may choose to leave the entity and retain the share options at the end of year 2 (prior to completion of year 3) and just wait until the cumulative profit target is met at the end of year 3. To put it another way, service is not required and may not be received by the entity in year 3. Consequently, the cumulative profit target partly combined with a service requirement does not meet the definition of vesting condition and therefore is not a performance condition. Supporters of Interpretation A classify the cumulative profit target as a ***non-vesting condition***.

(b) Interpretation B – the 3 year performance target period should be separated into a 2 year period during which there is required service and a subsequent 1 year period for which there is no required service. The first 2 year period would result in the target being classified and accounted for as a **performance condition**. The subsequent 1 year period would be accounted for as a **non-vesting condition**.

Grant date fair value

6. Each interpretation results in a different measurement at the grant date:

(a) Interpretation A - The cumulative profit target is ***included*** in determining the fair value of a share option at the grant date.

(b) Interpretation B:

(i) Two thirds of the cumulative profit target, which are deemed to be for the first two years, are ***not included*** in determining the fair value of a share option at the grant date.

(ii) One third of the cumulative profit target, which is deemed to be for year 3, is ***included*** in determining the fair value of a share option at the grant date.

Subsequent accounting

7. Also, each interpretation results in a different accounting treatment:

   (a) Interpretation A:

      (i) The variability on the cumulative profit target is ***not subsequently revised***.

      (ii) The event of the cumulative profit target not being satisfied results in ***no change*** to previously recognised compensation cost that was determined as of the grant date (unless the employee leaves the entity prior to the end of the attribution period). This is because the cumulative profit target is considered a non-vesting condition and would likely be classified as 'neither the entity nor the counterparty can choose whether the condition is met' as noted in paragraph IG24 of IFRS 2.

   (b) Interpretation B:

      (i) For the first two years, the cumulative profit target should be taken into account each reporting period by ***adjusting the number*** of share options expected to vest.

      (ii) For year 3:

         a. The variability of whether the cumulative profit target is satisfied is ***not subsequently revised*** in any reporting period within year 3.

         b. The cumulative profit target not being satisfied would likely result in ***no change*** to previously recognised compensation cost that was determined as of the grant date. This is because the cumulative profit target is considered a non-vesting condition in year 3 and would likely be classified as 'neither the entity nor the counterparty can choose whether the condition is met' as noted in paragraph IG24 of IFRS 2.

Proposed accounting treatment

8. The proposed accounting treatment is the same as the accounting treatment described in Interpretation A. That is, the performance target is considered a non-vesting condition and the accounting treatment is as follows:

    (a) classification - the two-year service requirement is a service condition and the cumulative profit target is a ***non-vesting condition***;

    (b) initial measurement - the cumulative profit target is ***included*** in determining the fair value of a share option at the grant date;

    (c) subsequent measurement - the variability on the cumulative profit target is ***not subsequently revised*** each reporting period; and

    (d) recognition - the event of the cumulative profit target not being met brings about ***no change*** to previously recognised compensation cost. (Achievement or not of the required 2 year service condition would be separately determined.)

Appendix H — Interaction of multiple vesting conditions

Fact pattern

1. An entity grants employees share options that vest upon the achievement of either:

   (a) a share price increase of 10 percent; or

   (b) cumulative profit of 10 million.

2. The employee must be employed by the entity when the relevant condition is satisfied and the award must vest within five years of the grant date.

3. The entity determines that the expected period over which the share price target will be met is 4 years.

4. The entity estimates that the most likely period over which the cumulative profit target will be met is 3 years.

Current accounting treatment

5. The share options are subject to:

   (a) An implicit ***service condition*** (to be employed until either of the performance conditions is met); plus

   (b) either of two performance conditions, ie

      (i) a ***market condition*** (share price target); or

      (ii) a ***non-market performance condition*** (cumulative profit target).

6. There is no specific guidance on the interaction of multiple vesting conditions either at inception or for ongoing/ periodic reporting requirements.

Cost attribution period

7. The current definition in IFRS 2 of vesting period states that it is the period during which 'all' specified vesting conditions are to be satisfied and the vesting

period is considered to be the cost attribution period for a share-based payment. This definition therefore, presumes that if a share-based payment arrangement has multiple vesting conditions, the interaction must be an ‘and’ interaction. Said another way, the current definition of vesting period does not appropriately reflect share-based payment arrangements that vest at the earlier of different vesting conditions being satisfied (ie an ‘or’ interaction) such as the above example.

8. Nonetheless, if the phrase of ‘all specified vesting conditions’ is interpreted to mean ‘all **necessary** vesting conditions’, the vesting period in question may be determined through the following analysis:

   (a) The implicit service condition is necessary at all times.

   (b) The non-market performance condition (cumulative profit target) is considered to be necessary because it is expected to precede the market condition (share price target).

   (c) The market condition (share price target) is not considered to be necessary because it is expected to be satisfied after the non-market performance condition (cumulative profit target).

   Consequently, the (expected) vesting period is ***3 years***.

Grant date fair value

9. There is no clear guidance on the measurement of an award with multiple vesting conditions using an ‘or’ interaction. Nonetheless, it may be interpreted in terms of both:

   (a) ‘whether the condition is necessary or not’ and

   (b) ‘whether the condition is a market condition or not’.

10. As of the grant date:

    (a) the service condition and the cumulative profit target are necessary, but the share price target is not considered to be necessary; and

(b) the service condition and the cumulative profit target are non-market conditions, but the share price target is a market condition.

11. In determining the fair value of a share option at the grant date:

    (a) the service condition is ***not included*** (consistent with the treatment for all service conditions);

    (b) the cumulative profit target is ***not included*** (consistent with the treatment for all non-market performance conditions); and

    (c) the share price target is ***not included*** (because it is not a necessary condition).

12. When estimating at each reporting date the number of share options that are expected to vest at the grant date:

    (a) the service condition is ***included***;

    (b) the cumulative profit target is ***included***; and

    (c) the share price target is ***not included*** (because it is a market performance condition).

Change in estimate

13. Given the rationale for the cost attribution period listed in paragraphs 7 and 8 of this appendix , if the estimate of the period over which the non-market performance condition (cumulative profit target) will be met changes to 5 years,

    (a) the service condition and the market condition (share price target) estimated to be satisfied in 4 years are now considered to be necessary; but

    (b) the non-market performance condition is now considered to be unnecessary.

14. Consequently, the (expected) vesting period is **revised to 4 years** based on the ‘necessary’ conditions that must be satisfied.

15. The market based measure used for the total estimated compensation cost will be revised to reflect the inclusion of the market condition in the grant date fair value because it is now a necessary condition.

16. In re-determining the grant date fair value of a share option after the grant date:

    (a) the implicit service condition is ***not included***;

    (b) the cumulative profit target is ***not included***; and

    (c) the share price target is ***included*** (because it is now considered necessary).

17. When re-estimating the number of share options that are expected to vest after the grant date:

    (a) the implicit service condition is ***included***;

    (b) the cumulative profit target is ***not included*** (because it is no longer necessary); and

    (c) the share price target is ***not included*** (because it is a market performance condition).

Proposed accounting treatment

18. At the May 2010 Committee meeting, the staff recommended that:

    (a) the definition of the vesting period should be amended to be the explicit or implicit period over which an individual vesting condition will be satisfied; and

    (b) the new definition of attribution period should be incorporated into IFRS 2 with attribution period being the end result of the interaction between multiple vesting conditions. More specifically it will be the composite of the vesting periods of each relevant vesting condition. This new definition will capture the concept of the period an employee is required to provide services, a share-based payment award is expected to vest and the period over which compensation cost should be recognised.

19. Also, the staff noted that the attribution period should be determined through the following three-step process:

    (a) Step 1 – Identify all specified vesting conditions within the share-based payment arrangement.

    (b) Step 2 – Determine the explicit or implicit vesting period for each vesting condition.

    (c) Step 3 – Compare the interaction of the individual vesting periods depending on the interaction of each vesting condition. That is are they 'and' conditions or 'or' conditions. The end result is the attribution period for the share-based payment arrangement.

20. The share options in the example in this appendix are subject to:

    (a) An implicit service condition (as the employee is required to be employed until either the performance condition or market or other vesting condition is satisfied); plus

    (b) either of these two vesting conditions is satisfied:

        (i) a market or other vesting condition (increase in the share price); or

        (ii) a performance condition (a cumulative increase in profits).

21. Applying the process to this example:

    (a) Step 1 – There is a separate/ explicit performance condition and separate/ explicit market or other vesting condition specified within the share-based payment arrangement. The implicit service condition is not its own/ explicit condition.

    (b) Step 2 –The performance condition has an implicit estimated 3-year vesting period. The market or other vesting condition has an estimated 4-year vesting period.

    (c) Step 3 – There is an 'or' interaction between the performance condition and the market or other vesting condition. Consequently, the attribution period is ***3 years***, ie the shortest of the individual vesting periods.

Grant date fair value

22. The same measurement as utilized in the current accounting treatment as documented in paragraphs 10-11 of this appendix is required.

Change in estimate

23. If the estimate of the period over which the non-market performance condition (cumulative profit target) will be met changes to 5 years,

    (a) the market condition (share price target) estimated to be satisfied in 4 years is considered to be necessary; but

    (b) the performance condition is now considered to be unnecessary.

24. Consequently, the (expected) vesting period is **revised to 4 years** based on the 'necessary' conditions that must be satisfied.

25. The same changes to the measurement as described in the current accounting treatment as documented in paragraphs 15-16 of this appendix is required.

Appendix I — IPO with minimum price

Fact pattern

1. An entity grants 100 share options each to 10 of its employees (for a total of 1,000 share options granted).

2. The award expires after 5 years if not vested.

3. The share options vest if all of the following occur:

   (a) The entity completes an IPO at any time during that period and

   (b) The IPO share price must equal or exceed CU100 per share.

4. The employee must remain in employment from the date of grant through the date of the above IPO and share price conditions must be satisfied for the employee to become entitled to the award (ie an implicit service requirement).

Current accounting treatment

5. There is no clear guidance and the staff believes there may be three different interpretations:

   (a) Interpretation A – There are two vesting conditions that must be satisfied:

      (i) Non-market performance condition (a performance target (IPO)), and

      (ii) Market condition (a specified share price target)

   (b) Interpretation B – There is one performance condition. Although the condition includes a reference to share price, it relates primarily to a measure of the entity's performance, and therefore is a performance condition.

   (c) Interpretation C – There is one vesting condition that must be satisfied, a market condition (a specified share price target with an implicit service requirement and a precondition (IPO)).

Grant date fair value

6. Each interpretation results in a different measurement at the grant date:

   (a) Interpretation A notes that:

      (i) the IPO target is ***not included***; and

      (ii) the share price target is ***included***.

   (b) Interpretation B notes that the IPO target is ***not included***.

   (c) Interpretation C notes that bundling of the IPO target and the share price target is ***included***.

Subsequent accounting

7. Under each of the interpretations, the implicit ***service requirement*** should be taken into account each reporting period by ***adjusting the number*** of share options expected to vest. The event of the service requirement not being met is considered failure to meet the service condition, ie ***forfeiture***. Therefore, the entity must reverse previously recognised compensation cost that was determined as of the grant date.

8. With respect to the IPO target and the share price target, each interpretation results in a different accounting treatment:

   (a) Interpretation A:

      (i) IPO target:

         a. The IPO target should be taken into account by ***adjusting the number*** of share options included in the measurement of the transaction amount on a continuing basis.

         b. The event of the IPO target not being met is considered failure to meet the performance condition, ie ***forfeiture*** (whether or not the employee continues to remain in service). Therefore, if any cost was recognised previously, the entity must reverse previously recognised compensation cost that was determined as of the grant date.

(ii) Share price target:

a. The variability on the share price target is ***not subsequently revised***.

b. The event of the share price target not being met brings about ***no change*** to previously recognised compensation cost that was determined as of the grant date (unless the employee leaves the entity prior to the end of the service period).

(b) Interpretation B – IPO target:

(i) The IPO target should be taken into account by ***adjusting the number*** of share options included in the measurement of the transaction amount on a continuing basis.

(ii) The event of the IPO target not being met is considered failure to meet the performance condition, ie ***forfeiture*** (whether or not the employee continues to remain in service). Therefore, if any cost was recognised previously, the entity must reverse previously recognised compensation cost that was determined as of the grant date.

(c) Interpretation C:

(i) The variability on ***either the IPO target or the share price target*** is ***not subsequently revised*** because there is deemed to be only one market condition therefore the IPO target is deemed to be embedded within the market condition.

(ii) The event of ***either the IPO target or the share price target*** not being met brings about ***no change*** to previously recognised compensation cost that was determined as of the grant date (unless the employee leaves the entity prior to the end of the service period).

Proposed accounting treatment

9. The staff notes that:

(a) the IPO target and the share price target does not constitute

(i) a single target, such as price-earnings ratio, or

(ii) a net target, such as a share price target outperforming a market index target, and

hence may not be merged into a single condition; and

10. Therefore, the staff thinks that neither Interpretation B or Interpretation C are consistent with the proposed approach. However, the staff thinks that ***Interpretation A*** is consistent with the staff recommendations made at the May 2010 Committee meeting.

11. Additionally, the staff note that Interpretation A is consistent with the current guidance in FASB ASC Topic 718 *Compensation – Stock Compensation* and related international firm guidance on this subject.

Grant date fair value

12. In determining the fair value of a share option at the grant date;

(a) the implicit service requirement is ***not included***;

(b) the IPO target is ***not included***; and

(c) the share price target is ***included***.

Subsequent accounting

13. The implicit ***service requirement*** should be taken into account by ***adjusting the number*** of share options included in the measurement of the transaction amount on a continuing basis. The event of the service requirement not being met is considered failure to meet the service condition, ie ***forfeiture***. Therefore, the entity must reverse previously recognised compensation cost that was determined as of the grant date.

14. With respect to the IPO target and the share price target:

(a) The ***IPO target*** should be taken into account at each reporting date by ***adjusting the number*** of share options expected to vest. The variability on the ***share price target*** is ***not subsequently revised*** even if the IPO target is (probable of being) satisfied.

(b) The event of the ***IPO target*** not being satisfied is considered failure to meet the performance condition, ie ***forfeiture*** (whether or not the employee continues to remain in service). Therefore, if the entity had previously recognised any compensation cost, the entity must ***reverse*** previously recognised compensation cost that was determined as of the grant date.

15. In the event that the share price target is not satisfied, but the IPO is successfully completed (and the employee remains in service until the IPO is completed), compensation cost would be recognised regardless of the achievement of the share price target.

16. The staff recommends that this example should be added to 'Guidance on Implementing IFRS 2'.