Project **Fair Value Measurement**

Topic **Scope considerations regarding IFRS 2 *Share-based Payment***

Purpose of this paper

1. This paper discusses the scope of an IFRS on fair value measurement with regard to IFRS 2 *Share-based Payment.*

2. This paper asks the Board to

   (a) exclude IFRS 2 from the measurement and disclosure requirements in the final IFRS on fair value measurement.

   (b) retain the term 'fair value' in IFRS 2 and the related measurement guidance.

3. This means that IFRS 2 will have its own guidance for measuring share-based payment transactions even though it uses the term 'fair value'.

Summary of the IASB's exposure draft

4. The IASB's exposure draft *Fair Value Measurement* proposed replacing the term 'fair value' with the term 'market-based value' in IFRS 2. This is because some of the measurements in IFRS 2 that use the term 'fair value' are not consistent with the guidance proposed in the exposure draft (eg because they do not take into account all factors market participants would take into account when pricing the asset or liability).

5. The Board proposed to define 'market-based value' as:

> The price that would be received or paid to sell an asset, transfer a liability, or exchange an equity instrument, in an orderly transaction between market participants at the measurement date, not taking into account market participants' assumptions for vesting conditions and reload features.

Overview of comments received on the IASB's exposure draft

6. The invitation to comment accompanying the exposure draft asked interested parties whether the proposed approach was appropriate.

7. Many respondents agreed with the IASB's proposal for IFRS 2. This is because they believe that not all the measurements in IFRS 2 are consistent with the proposed definition and guidance in the IASB's exposure draft.

8. However, some respondents think that a 'broad brush exclusion' for IFRS 2 is not appropriate. They think that *only* share-based payment transactions measured indirectly by reference to the 'fair value' of the equity instrument granted are outside the scope of the proposed fair value measurement objective. This is because fair value in IFRS 2 does not consider vesting conditions that are not market conditions, whereas the proposed fair value measurement guidance would require all vesting conditions to be taken into account.

Staff analysis and recommendation

Background

Fair value measurements in IFRS 2

9. IFRS 2 sets out measurement principles, and specific requirements, for three types of share-based payment transactions:

   (a) equity-settled share-based payment transactions, in which the entity receives goods or services as consideration for equity instruments of the entity (including shares or share options);

(b) cash-settled share-based payment transactions, in which the entity acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other equity instruments of the entity; and

(c) transactions in which the entity receives or acquires goods or services, and the terms of the arrangement provide either the entity or the supplier of those goods or services with a choice of whether the entity settles the transaction in cash or by issuing equity instruments.

10. All three of these share-based payment transactions refer to the fair value of the *goods or services* received.

Fair-value-based measurement in IFRS 2

11. However, paragraph 10 of IFRS 2 states that if an entity cannot estimate reliably the fair value of the goods or services received for equity-settled share-based payment transactions (see paragraph 9(a) of this paper), the entity is required to measure the share-based payment transaction indirectly by reference to the 'fair value' of the equity instrument granted.

12. IFRS 2 specifies that the following factors are not to be taken into account when estimating the fair value of the equity instrument granted (as an indirect measurement of the goods or services received):

(a) vesting conditions, other than market conditions; and

(b) reload features.

IFRS 2 and the IASB's exposure draft Fair Value Measurement

13. In accordance with the proposed guidance in the IASB's exposure draft, market participants would consider reload features and vesting conditions (including vesting conditions that are not market conditions) in pricing the equity instrument granted. Consequently, when entities measure the fair value indirectly by reference to equity instrument granted, and that measurement excludes non-market vesting conditions, it is not consistent with the measurement objective in the exposure draft on fair value measurement.

Perspective of the measurement

14. The IASB's exposure draft states that an entity shall measure the fair value of its equity instrument *from the perspective of a market participant who holds the instrument* as an asset. Share options accounted for in accordance with IFRS 2 are considered equity instruments.

15. However, paragraph BC 168 of the Basis for Conclusions in IFRS 2 notes that 'the objective is to estimate the fair value of the share option, not the value from the employee's perspective'. Furthermore, paragraph B10 of Appendix B to IFRS 2 states that 'factors that effect the value of the option from the individual employee's perspective only are not relevant to estimating the price that would be set by a knowledgeable, willing market participant'.

16. The assumption is therefore that if the equity instrument were to be measured from the holder's perspective in accordance with the exposure draft, this might result in unintended changes to some of the principles underlying IFRS 2.

Scoping decisions taken by the FASB

17. In US GAAP, the measurement and disclosure requirements of Topic 820 do not apply to Topic 718 (*Compensation – Stock Compensation*).[1]

18. The FASB excluded Topic 718 from the scope of Topic 820 because the fair-value-based measure in Topic 718 is specific to share-based payment transactions with employees. In addition, Topic 718 provides extensive detailed guidance for applying its fair-value-based measure. Although some measurements in Topic 718 are fair value measurements, the FASB decided for practical reasons to exclude Topic 718 in its entirety from the scope of this statement. [2]

---

[1] Topic 718 codified SFAS 123R *Share-Based Payment*

[2] See Agenda Paper 3 from the February 6, 2008 FASB meeting.

Scoping decisions taken in IFRS 3

19. IFRS 3 (revised in 2008) excludes IFRS 2 from the fair value measurement objective. Paragraph BC 311 of the Basis for Conclusions in IFRS 3 states that IFRS 2 requires a measurement of share-based payment transactions using 'fair-value-based' values. The Board decided that it would cause difficulties with subsequent accounting for these awards if share-based payment transactions were measured at their acquisition-date fair values. Consequently, IFRS 3 requires entities to measure share-based payment transactions in accordance with IFRS 2.

Staff recommendation

20. The Board can follow one of the following three approaches to deal with the relationship between IFRS 2 and the scope of the final IFRS on fair value measurement:

    (a) **Approach 1**: following the example of the FASB, the Board can exclude IFRS 2 from the measurement and disclosure requirements in the final IFRS on fair value measurement, even though some share-based payment transactions are at fair value (see paragraphs 9 to 12 of this paper). This approach will not result in any changes to existing practice in IFRS 2, and will not require any additional guidance to be developed in IFRS 2 as a result of the proposed fair value measurement guidance. However, this approach results in IFRS 2 referring to 'fair value' but not subjecting it to the measurements and disclosure requirements of the final IFRS on fair value measurement. More specifically, those measurements that are at fair value (ie share-based payment transactions based on the fair value of the goods or services received) will not be subject to the measurement guidance or disclosure requirements in the final IFRS.

    (b) **Approach 2**: the Board can replace the term 'fair value' with 'market-based value' for each instance where IFRS 2 uses the term 'fair value' to describe the measurement for equity-settled share-based payment transactions that do not take into account vesting conditions (other than market conditions) or reload features (see paragraphs 11 to 12 of this paper). This approach would result in those measurements that are at fair value being subject to the measurement *and* disclosure requirements in the final standard on fair value measurement. However, this approach has the disadvantages described in paragraph 21.

(c) **Approach 3**: the same approach as Approach 2, except that it excludes IFRS 2 from the proposed disclosure requirements in the final IFRS on fair value measurement.

21. If the Board decides to replace the term ‘fair value’, it has to keep the following in mind:

(a) Guidance in IFRS 2 will be needed to clarify that the measurement should be made from the perspective of a market participant employer and not from the perspective of an employee (see paragraphs 14 to 16).

(b) Additional measurement guidance might be required in IFRS 2 wherever the term ‘fair value’ is replaced with another term. It is not within the scope of this project to provide measurement guidance other than fair value measurement guidance.

(c) In some situations, IFRS 2 might require minor redrafting to accommodate the use of ‘fair value’ and ‘market-based value’ and to clearly distinguish the intention of the standard. For example, paragraph 37 of IFRS 2 refers to the fair value of a settlement alternative of a share-based payment transaction. This does not make it clear if it is referring to a measurement that is fair value or to a measurement that is fair-value-based (see paragraphs 9 to 12).

(d) If the term ‘fair value’ is retained in IFRS 2, both the measurement *and* the disclosure requirements in the final IFRS on fair value measurement will apply to IFRS 2. No respondents made an argument that IFRS 2 measurements should or should not be subject to the proposed disclosure requirements in the IASB’s exposure draft.

22. The staff recommend Approach 1. This is because this approach:

(a) will not require redrafting of IFRS 2, or the creation of any additional measurement guidance for the options granted that are not measured at fair value;

(b) is similar to the decision reached by the FASB for Topic 718 (see paragraph 18); and

(c) is similar to the decision reached by the IASB for IFRS 3 (see paragraph 19).

Question 1
Does the Board agree with the staff recommendation in paragraph 21? If not, which approach do you prefer and why?

23. Question 2 applies only if the Board decides to follow approach 2 or 3.

Question 2
Does the Board agree that only equity-settled share-based payment transactions (which excludes non-market vesting conditions and reload features) are *not* measured at fair value? If not, why not, and which measures in IFRS 2 are not at fair value and why?