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

Topic **Vesting and non-vesting conditions – Analysis of terms**

Objective

1. This May 2010 Committee Agenda Paper 3B (Agenda Paper 3B) is an integral component of the overall staff analysis of the Committee's agenda issue on Vesting and Non-vesting Conditions. Agenda Paper 3B should be read in conjunction with the three corresponding May 2010 Committee Agenda Papers 3A, 3C and 3D.

2. The objective of this Agenda Paper 3B is to analyse, provide staff recommendations and ask questions of the Committee on the following items:

   (a) **Vesting condition**;

   (b) **Non-vesting condition**;

   (c) **Service condition**;

   (d) **Performance condition**;

   (e) **Market condition**;

   (f) **Other vesting condition**;

   (g) **Contingent feature**; and

   (h) **Different accounting treatments for different types of conditions**.

3. Each of the above items is analysed separately. Each analysis includes the following:

   (a) current guidance of IFRS 2;

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the 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 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 Committee or the IASB can make such a determination.

Decisions made by the Committee are reported in Committee *Update*.

Interpretations are published only after the 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*.

(b) potential diversity or confusion and its cause;

(c) corresponding guidance in US GAAP;

(d) possible remedies; and

(e) staff recommendations.

Staff analyses and recommendations

Vesting condition

Current guidance of IFRS 2

4. Currently, IFRS 2 defines ‘vesting conditions’ as [emphasis added]:

> 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. Vesting conditions are either service conditions or performance conditions. Service conditions require the counterparty to complete a specified period of service. Performance conditions require the counterparty to complete a specified period of service and specified performance targets to be met (such as a specified increase in the entity’s profit over a specified period of time). A performance condition might include a market condition.

5. The current definition is phrased from the perspective of the entity. This perspective was introduced as part of *Vesting Conditions and Cancellations* (Amendment to IFRS 2) issued in January 2008. It is noteworthy that the original definition of vesting conditions was phrased from the perspective of the employee. The original definition of ‘vesting conditions’ was [emphasis added]:

> The conditions that must be satisfied for the **counterparty to become entitled** to receive cash, other assets or equity instruments of the entity, under a share-based payment arrangement. Vesting conditions include service conditions, which require the other party to complete a specified period of service, and performance conditions, which require specified performance targets to be met (such as a specified increase in the entity’s profit over a specified period of time).

6. Paragraphs BC171–BC171B of IFRS 2 provide the Board’s rationale for both the original definition (in BC171) and the Amendment to IFRS 2 (BC171A and BC171B). Paragraphs BC171–BC171B state [emphasis added]:

> BC171 Vesting conditions ensure that the **employees provide the services required to ‘pay’ for their share options**. For example,

the usual reason for imposing service conditions is to retain staff; the usual reason for imposing other performance conditions is to provide an incentive for the employees to work towards specified performance targets.

BC171A In 2005 the Board decided to take on a project to clarify the definition of vesting conditions and the accounting treatment of cancellations. In particular, the Board noted that it is important to distinguish between non-vesting conditions, which need to be satisfied for the counterparty to become entitled to the equity instrument, and vesting conditions such as performance conditions. In February 2006 the Board published an exposure draft *Vesting Conditions and Cancellations*, which proposed to restrict vesting conditions to service conditions and performance conditions. Those are the only conditions that determine whether ***the entity receives the services*** that entitle the counterparty to the share-based payment, and therefore whether the share-based payment vests. **In particular, a share-based payment may vest even if some non-vesting conditions have not been met. The feature that distinguishes a performance condition from a non-vesting condition is that the former has an explicit or implicit service requirement and the latter does not.**

BC171B In general, respondents to the exposure draft agreed with the Board's proposals but asked for clarification of whether particular restrictive conditions, such as 'non-compete provisions', are vesting conditions. **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.

Potential diversity or confusion and its cause

7. The primary issue asked of the Board that initiated the Amendment to IFRS 2 is the treatment of the termination of employee contributions into a Save-As-You-Earn (SAYE) plan. Before the Amendment to IFRS 2, the employee obligation to pay contributions towards an exercise price in a SAYE plan was viewed by some as a vesting condition because the employee must pay contributions to be entitled to the granted award. Another view was that employee contributions are simply a prepayment of the exercise price to purchase the equity instrument.

8. The diversity surrounding the employee obligation to pay contributions into a SAYE plan has been clarified by the Amendment to IFRS 2, in part because the Amendment to IFRS 2 switched the perspective from the employee to the entity. Using the amended definition of 'vesting conditions' it is apparent that the

employee obligation to contribute to the SAYE plan does not determine whether the **entity receives the required services** in return for entitlement in the award. Therefore, the requirement to contribute to a SAYE plan is considered to be a non-vesting condition. Paragraph IG24 of IFRS 2 was newly added as part of the Amendment to IFRS 2 and provides additional information with a specific example condition of 'Paying contributions towards the exercise price of a share-based payment'. This example is listed as a 'Non-vesting condition' where the 'Counterparty can choose whether to meet the condition'.

9. The switch of perspective was not included in the exposure draft that resulted in the Amendment to IFRS 2. Rather it was included by the Board to address comments received on the exposure draft. While the switch of perspective may clarify the accounting treatment for SAYE plan contributions, the switch of perspective may have increased confusion with regard to the treatment of other conditions, for example a non-compete provision. A non-compete provision is analysed in detail in a separate section of this agenda paper titled 'Contingent feature'.

Corresponding guidance in US GAAP

10. There is no formal definition in US GAAP of the exact term 'vesting conditions'. Instead, US GAAP captures this concept in the definition of 'vest' indicating that a vesting condition is a condition that determines whether the counterparty does or does not earn the rights to a share-based payment award. US GAAP specifies that conditions that 'vest' are restricted to a service condition and a performance condition. FASB ASC Master Glossary (and ASC 718-10-20 Glossary) defines vest as follows [emphasis added]:

> **To earn the rights to**. A share-based payment award becomes vested at the date that the employee's right to receive or retain shares, other instruments, or cash under the award is **no longer contingent on satisfaction of either a service condition or a performance condition. Market conditions are not vesting conditions.**
>
> The stated vesting provisions of an award often establish the requisite service period, and an award that has reached the end of the requisite service period is vested. However, as indicated in the definition of requisite service period, the stated vesting period may differ from the requisite service period in certain circumstances. Thus, the more precise (but cumbersome) terms

would be options, shares, or awards for which **the requisite service has been rendered** and end of the requisite service period.

11. The definition of 'vest' in US GAAP specifies that:
    (a) it determines whether the recipient earns the rights to the share-based payment award;
    (b) it only encompasses a service condition and a performance condition;
    (c) a market condition is not a vesting condition; and
    (d) the perspective is from the employee (who earns the rights to the award as a result of providing the requisite service and, as applicable, the performance conditions are met) (ie entitlement).

Possible remedy

12. In the staff's opinion, many of the <u>aspects of the US GAAP definition of 'vest' are consistent with IFRS 2</u> and could easily be used as a starting point to clarify IFRS 2. These aspects include:
    (a) Specifying that vesting conditions determine whether the recipient earns the rights to the share-based payment award (ie entitlement), and
    (b) Separating all other embedded informal definitions (such as a service condition and a performance condition and the reference to a market condition),

13. In the staff's opinion, other <u>aspects of the US GAAP definition of 'vest' are **not** consistent with IFRS 2</u> and therefore those aspects should not be used within IFRS 2:
    (a) The idea that a vesting condition only encompasses a service condition and a performance condition – US GAAP specifies (in the last sentence of the definition of 'vest') that a market condition is not a vesting condition. IFRS 2 is clear that a 'market condition' is a sub-component of performance conditions which are vesting conditions. This is also evidenced in BC183 of IFRS 2 (and surrounding BC paragraphs) where the treatment of a market condition is compared and contrasted with other types of vesting conditions.

14. Despite the US GAAP definition of ‘vest’ excluding market conditions, ASC 718-10-55-60 states [emphasis added]:

> An employee’s share-based payment award becomes vested at the date that the employee’s right to receive or retain equity shares, other equity instruments, or assets under the award is no longer contingent on satisfaction of either a performance condition or a service condition. **This Topic distinguishes among market conditions, performance conditions, and service conditions that affect the vesting or exercisability of an award** (see paragraphs 718-10-30-12 and 718-10-30-14). **Exercisability is used for market conditions in the same context as vesting is used for performance and service conditions.** Other conditions affecting vesting, exercisability, exercise price, and other pertinent factors in measuring fair value that do not meet the definitions of a market condition, performance condition, or service condition are discussed in paragraph 718-10-55-65.

15. Therefore, while the formal US GAAP definition of ‘vest’ is not consistent with the formal guidance within IFRS 2 regarding a market performance condition, in the staff’s opinion, the economic impact to the counterparty is the same for both. The counterparty either has an award that it is not entitled to (ie unvested in accordance with IFRS 2) or it has an award that is not exercisable (ie inability to exercise in accordance with FASB ASC Topic 718).

16. A different item relating to the definition of vesting conditions is the <u>perspective (from either the employee or employer)</u> of the share-based payment transaction. This item is an area that the staff requests views and consideration from the Committee. In the staff’s opinion, the decisions taken on perspective may impact several other aspects of this project. Specifically, the staff note that the:

    (a) employer perspective (ie whether the entity receives the services) is included in the current IFRS 2 and was introduced as a result of the Amendment to IFRS 2.

    (b) employee perspective (ie whether the employee provides the services required to ‘pay’ for the award) was the perspective in the original IFRS 2 (issued February 2004) and is consistent with current US GAAP.

Staff recommendation

17. The staff recommends that the definition of vesting condition should be clarified to:

(a) specify that a vesting condition determines whether the recipient earns the rights to the share-based payment award (ie entitlement);

(b) specify that a vesting condition always requires some form of service as a means for the employee to 'pay' for the award; and

(c) not describe any other type of condition (such as a service condition and a performance condition or the reference to a market condition) as those conditions can be separately defined for greater clarity.

18. Additionally, the staff believes that a change in perspective back to the employee (as included in the original IFRS 2 and consistent with current US GAAP) is appropriate and consistent with the rest of IFRS 2. In the staff's opinion, the underlying issue addressed by the Amendment to IFRS 2 (of payments into a SAYE plan) can still be addressed by returning to the employee perspective. This can be accomplished by clarification of whether payments into a SAYE plan represent a performance condition or not. This issue of perspective and the interaction with payments into a SAYE plan is analysed in greater detail in the non-vesting condition section of this agenda paper and also in Agenda Paper 3D.

Non-vesting condition

Current guidance of IFRS 2

19. There is no formal definition of a non-vesting condition in IFRS 2, but implementation guidance is provided in IG24 of IFRS 2. According to that guidance, the conditions that determine whether a counterparty receives an equity instrument granted as part of a share-based payment transaction may be categorised into one of two primary conditions:

(a) vesting condition, or

(b) non-vesting condition.

20. A vesting condition has already been analysed earlier in this agenda paper (starting at paragraph 4). A vesting condition determines whether a counterparty becomes entitled to a share-based payment award. This section of this agenda paper focuses on a non-vesting condition and analyses whether a formal

definition of a non-vesting condition would assist in clarifying IFRS 2 or whether it is not necessary.

21. Paragraphs BC170–BC184 of IFRS 2 provide the Board's rationale for 'vesting conditions'. Specifically, BC171A and BC171B (included in paragraph 6 of this agenda paper) were added as a consequence of the Amendment to IFRS 2 that focused, in part, on clarifying the definition of 'vesting conditions'.

22. From this rationale in paragraphs BC170–BC184, staff believes the concept of a non-vesting condition can be assumed to be any condition that does not 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'.

Corresponding guidance in US GAAP

23. US GAAP does not have an explicit definition of a non-vesting condition. However, as explained earlier in this agenda paper, US GAAP does have a straight forward definition of 'vest' (as noted in paragraph 10 of this agenda paper).

Possible remedy

24. In the staff's opinion there are two possible remedies for the formal definition of a non-vesting condition:
    (a) Do nothing. That is, do not create a stand-alone definition of a non-vesting condition. This approach would be similar to US GAAP in that by default, if a condition is not a vesting condition it must be a non-vesting condition. To the extent other items within this project are addressed, there may be a reduction in diversity without a need to have a stand-alone definition of a non-vesting condition.
    (b) Create a stand-alone definition of a non-vesting condition. This approach would clarify the concept that a non-vesting condition is a condition that does not determine whether a counterparty becomes entitled to a share-based payment award.

25. Additionally, as part of the overall consideration of all items being analysed within this agenda paper, the staff has analysed the current segregation into three types of non-vesting conditions that is captured in paragraph IG24 of IFRS 2. This analysis is included later in this agenda paper in the section titled '<u>Different accounting treatments for different types of conditions</u>'.

Staff recommendation

26. In the staff's opinion, the creation of a stand-alone definition of a non-vesting condition would be the best alternative for providing clarity on this issue.

Service condition

Current guidance of IFRS 2

27. Currently, IFRS 2 does not separately define a service condition, but rather describes the concept within the definition of 'vesting conditions' as follows [emphasis added]:

> 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. Vesting conditions are either service conditions or performance conditions. **Service conditions require the counterparty to complete a specified period of service.** Performance conditions require the counterparty to complete a specified period of service and specified performance targets to be met (such as a specified increase in the entity's profit over a specified period of time). A performance condition might include a market condition.

28. Additionally, IG4A of IFRS 2 (which provides guidance on the split between vesting and non-vesting conditions) restricts a service condition to a vesting condition that requires ***only*** a specified period of service to be completed.

Potential diversity or confusion and its cause

29. The staff does not believe there is current diversity surrounding a basic service condition. However, the staff believes that the current description of a service condition that is embedded within the definition of 'vesting conditions' and supported by the guidance in paragraph IG4A of IFRS 2 does not provide sufficient clarity for more complex situations. For example, the concept of the implicit service requirement that is embedded within a non-market performance

condition or a market performance condition can be confusing to some IFRS users since there is no stand-alone definition of what is (and what is not) a service condition.

Corresponding guidance in US GAAP

30. The FASB ASC Master Glossary (and ASC 718-10-20 Glossary) defines a service condition as follows [emphasis added]:

> A condition affecting the vesting, exercisability, exercise price, or other pertinent factors used in determining the fair value of an award that **depends solely on an employee rendering service**. A condition that results in the acceleration of vesting in the event of an employee's death, disability, or termination without cause is a service condition.

Possible remedy

31. In the definition of service condition, US GAAP makes clear that a service condition requires ***only*** a specified period of service to be completed. The staff believes that US GAAP is consistent with IFRS 2 on this item (given the guidance in paragraph IG4A of IFRS 2) and may help solidify IFRSs.

32. The staff believes that providing clarity on what a service condition is would address the issue. This could be in the form of a stand-alone definition of service condition being incorporated into IFRSs. It could also be addressed through an explanation or guidance on what is and what is not a service condition.

Staff recommendation

33. The staff recommends that a stand-alone definition of service condition should be incorporated into IFRSs. This definition should confine a service condition to only a service requirement over a specified period of time.

Performance condition

Current guidance of IFRS 2

34. Currently, IFRS 2 does not separately define a performance condition, but rather describes the concept within the definition of 'vesting conditions' as follows [emphasis added]:

> 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. Vesting conditions are either service conditions or performance conditions. Service conditions require the counterparty to complete a specified period of service. **Performance conditions require the counterparty to complete a specified period of service and specified performance targets to be met (such as a specified increase in the entity's profit over a specified period of time). A performance condition might include a market condition**.

35. Additionally, IG4A of IFRS 2 illustrates through a flowchart that a performance condition is a condition that requires some condition to be met in addition to a service condition (ie a performance target).

36. For reference, the Amendment to IFRS 2 added the last sentence within the definition of vesting conditions ('A performance condition might include a market condition'). It also added paragraphs IG4A and IG24.

37. IFRS 2 divides performance conditions into the following two types:
    (a) 'other performance conditions', also referred to as 'non-market performance conditions', and
    (b) 'performance conditions that are market conditions', also referred to as 'market performance conditions'.

38. The two types of performance conditions capture the uncertainty of future events through different accounting mechanics:
    (a) A non-market performance condition is excluded from the measurement of the grant date fair value of equity-settled share-based payment awards and instead these conditions are reflected in management's estimate of the number of awards expected to vest, with 'true-ups' at each reporting period for revisions to the estimate of the number of equity instruments expected to vest.
    (b) A market performance condition is included in the measurement of the grant date fair value of equity-settled share-based payments, with no 'true-ups' at each reporting period for revisions to the estimate of the number of equity instruments expected to vest as a result of changes in the estimate of whether the market performance condition will be met (however, estimates of the number of equity instruments for which the

required period of service will be provided are still adjusted for revisions to service conditions and other performance conditions).

Potential diversity or confusion and its cause

Explicit, implicit and separate service conditions

39. When combined with a service requirement, some constituents may consider the condition to be a performance condition (inclusive of a non-market performance condition and a market performance condition) while other constituents may consider the condition to be a non-vesting condition that is separate and independent from the service condition. An example is an equity-settled share-based payment arrangement that is conditional on the Dow Jones index reaching a specified target at any point in time in the next three years and the employee remaining in service up to the date the Dow Jones index target is met.

    (a) Some argue that the Dow Jones index target with the implicit service requirement constitute a performance condition because employee is required to provide service to the entity and the time estimated to reach the Dow Jones index target implicitly determines how long the entity receives the required service.

    (b) Others argue that the Dow Jones index target is a non-vesting condition because it is not related to the performance of the entity and the service requirement is a separate vesting condition, ie service condition. Using this rationale, the Dow Jones index target would be considered a non-vesting condition.

40. Said another way, potential diversity exists in determining whether a performance condition must have an explicit or implicit service requirement in addition to the performance target or whether a performance target with no service requirement is acceptable as long as there is a separate explicit service condition within the share-based payment arrangement.

41. The current definition of 'vesting conditions' states, in part, that 'performance conditions require the counterparty to complete a specified period of service and specified performance targets to be met (such as a specified increase in the

entity's profit over a specified period of time).' However, while the concept of a performance condition appears to require its own explicit or implicit service period, the interaction of an implicit service condition and other conditions that are explicit is still not clear. For reference, the staff has separately analysed the general issue of the interaction of multiple vesting conditions in Agenda Paper 3C.

Proximity of employee service to performance target

42. An additional area for potential diversity in practice is ambiguity over the meaning of 'determine whether the entity receives the services that entitle the counterparty…', when it comes to a performance condition. This area of potential diversity is a result of the change in perspective (from the employee paying to the employer receiving) that was introduced as part of the Amendment to IFRS 2. More specifically potential for diversity occurs when asking: how close must the correlation be between the performance target and the operations of the reporting entity or the measurable results of the individual employee that is a party to the share-based payment arrangement?

43. Although a performance condition is described as 'an incentive for the employees to work towards specified performance targets' in BC171, it is not clearly set out in the definition of 'vesting conditions'. The Board's rationale is also not explained in the basis for conclusions thereon how strong the incentive or how closely associated with the employee's duties should be. On the other hand, the IFRS 2 definition of a market condition, which is a subset of the concept of a performance condition, does set out the degree of that correlation. The IFRS 2 definition of market condition requires that the market performance target is related to the market price of the entity's equity instruments. This lack of specificity for a non-market performance condition has lead to diversity in practice.

Corresponding guidance in US GAAP

44. The FASB ASC Master Glossary (and ASC 718-10-20 Glossary) defines 'performance condition' as follows [emphasis added]:

> A condition affecting the vesting, exercisability, exercise price, or other pertinent factors used in determining the fair value of an award that relates to **both of the following**:
>
> (a) An employee's **rendering service for a specified (either explicitly or implicitly) period of time**.
>
> (b) achieving a specified **performance target that is defined solely by reference to the employer's own operations (or activities).**
>
> Attaining a specified growth rate in return on assets, obtaining regulatory approval to market a specified product, selling shares in an initial public offering or other financing event, and a change in control are examples of performance conditions. A performance target also may be defined by reference to the same performance measure of another entity or group of entities. For example, attaining a growth rate in earnings per share (EPS) that exceeds the average growth rate in EPS of other entities in the same industry is a performance condition. **A performance target might pertain either to the performance of the entity as a whole or to some part of the entity, such as a division or an individual employee.**

Possible remedy

45. US GAAP makes clear that the performance target is defined solely by reference to the employer's own operations (or activities). This includes the entity as a whole or some part of the entity. Additionally, US GAAP provides explicit examples of targets that are performance conditions.

46. The staff believes that US GAAP is consistent with IFRS 2. Additionally, in the staff's opinion, the use of US GAAP as a foundation for developing a stand-alone definition within IFRSs may clarify the nature and breadth of a performance target. (As noted above, market conditions are not performance conditions in US GAAP, but the consequence is equivalent.)

Staff recommendation

47. The staff recommends that a stand-alone definition of a performance condition should be incorporated into IFRSs and it should confine a performance condition to solely the entity's operations or activities. Additionally, the staff recommends that examples similar to those provide in the US GAAP definition be incorporated into the IFRSs definition or incorporated elsewhere within IFRSs.

Market condition

Current guidance of IFRS 2

48. Currently, the IFRS 2 definition of 'vesting conditions' specifies that 'a performance condition may include a market condition'. Additionally, IFRS 2 separately defines a market condition as [emphasis added]:

> A condition upon which the exercise price, vesting or exercisability of an equity instrument depends that is **related to the market price of the entity's equity instruments**, such as attaining a specified share price or a specified amount of intrinsic value of a share option, or achieving a specified target that is based on the market price of the entity's equity instruments relative to an index of market prices of equity instruments of other entities.

Potential diversity or confusion and its cause

49. The staff does not believe that there is significant diversity surrounding a market performance condition. However, the staff observes that a market performance condition is a sub-category of a performance condition even though the accounting mechanics for a market performance condition is markedly different from the accounting treatment for a (non-market) performance condition. Additionally, the staff believes that the specific terminology used within IFRS 2 for non-market performance condition and market performance condition are confusing and could be clarified for ease of use.

Corresponding guidance in US GAAP

50. The FASB ASC Master Glossary (and ASC 718-10-20 Glossary) defines a market condition as follows [emphasis added]:

> A condition affecting the exercise price, exercisability, or other pertinent factors used in determining the fair value of an award under a share-based payment arrangement that relates to the achievement of **either of the following**:
>
> (a) A **specified price of the issuer's shares** or a specified amount of intrinsic value indexed solely to the issuer's shares.
>
> (b) A specified price of the issuer's shares in terms of a similar (or index of similar) equity security (securities). The term similar as used in this definition refers to an equity security of another entity that has the same type of residual rights. For example, common stock of one entity generally would be similar to the common stock of another entity for this purpose.

51. In addition to US GAAP having stand-alone definitions of a market condition and a performance condition, US GAAP also excludes a market condition from vesting conditions. ASC 718-10-30-27 states [emphasis added]:

> Performance or service conditions that affect vesting are not reflected in estimating the fair value of an award at the grant date because those conditions are restrictions that stem from the forfeitability of instruments to which employees have not yet earned the right. However, the effect of a market condition is reflected in estimating the fair value of an award at the grant date (see paragraph 718-10-30-14). For purposes of this Topic, a **market condition is not considered to be a vesting condition**, and an award is not deemed to be forfeited solely because a market condition is not satisfied.

52. However, as noted in paragraph 15 of this agenda paper, while US GAAP explicitly excludes a market condition from being a vesting condition, in the staff's opinion, the economic impact to the counterparty is the same for both a market performance condition (that is a vesting condition in IFRS 2) and a market condition (that is not a vesting condition in US GAAP). The counterparty either has an award that it is not entitled to (ie unvested in accordance with IFRS 2) or it has an award that is not exercisable (ie exercisability in accordance with FASB ASC Topic 718).

Possible remedy

53. In literal terms, US GAAP does not seem to be consistent with IFRS 2. This is because in US GAAP a market condition is not considered to be a vesting condition. However, the staff notes the following:

    (a) The economic impact to the counterparty is the same for an IFRS 2 market condition that does not vest and a US GAAP market condition that is not exercisable.

    (b) For the entity, there is no difference in the accounting treatment of a market (performance) condition between IFRS 2 and US GAAP.

54. The staff believes that the notion of a market condition in US GAAP is consistent with IFRS 2. Additionally, in the staff's opinion, US GAAP distinguishing a market condition separately from a performance condition may reduce the potential for diversity from grouping together a market performance condition and a (non-market) performance condition.

55. The staff also thinks that 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. For reference, the detailed staff analysis of this differentiation is included in the section of this agenda paper titled 'Different accounting treatments for different conditions'.

56. However, the staff does not believe that it is appropriate to exclude a market condition from vesting conditions. Instead, the staff recommends that all conditions that determine whether an employee is entitled to retain (or forfeits) the equity instruments received in a share-based payment arrangement should be classified as a vesting condition. Said another way, the staff recommends that the general understanding of vesting and entitlement and the concept included in current IFRS 2 that a market performance condition is a vesting condition should remain.

Staff recommendation

57. The staff recommends that a market condition should be separated from a performance condition. The staff also recommends that a market condition should continue to be classified as a vesting condition.

58. Dependant on the Committee's conclusions on the next section (Other vesting condition) of this agenda paper, the staff recommends that the current stand-alone definition of a market condition could be removed since the concept of a market condition would be included within the concept of an other vesting condition.

Other vesting condition

Current guidance of IFRS 2

59. Currently, in IFRS 2 'vesting conditions' are restricted to a service condition, a non-market performance condition and a market performance condition. There is no concept of an other vesting condition.

Potential diversity or confusion and its cause

60. Conditions that are currently classified as non-vesting conditions may determine whether the counterparty becomes entitled to the share-based payment award.

Although expected to be limited in practice, these are conditions that determine entitlement of the award and are not (1) only service related (ie not a service condition) or (2) related solely to the entity's operations (ie not a non-market performance condition) or (3) related to the share price of the entity (ie not a market performance condition). An example is a share-based payment arrangement that an employee becomes entitled to if the price of gold increases by 10% at any point in time during the next 5 years and the employee is in employment with the entity at the time the target is met. Therefore, while these conditions do determine entitlement to an award, they cannot be categorised as a service condition, non-market performance condition or market performance condition, respectively.

61. For reference, related analysis of this issue is included in the non-vesting condition section of this agenda paper (analysing more generally what is and what is not a vesting condition).

Corresponding guidance in US GAAP

62. US GAAP does not have a stand-alone definition of an other vesting condition; however, US GAAP does address factors that are not a 'market, performance, or service condition' by requiring liability classification of the entire share-based payment arrangement. The required liability classification is consistent with other aspects of the US GAAP classification distinction that focuses on equity classification requiring the counterparty to bear the risks and rewards normally associated with equity ownership for a reasonable period of time from the date the requisite service is rendered and the share is issued. Because of this focus in US GAAP, a share-based payment arrangement that determines entitlement (or its value) based on criteria not included in the definition of a market, performance, or service condition impacts the value of the award in a manner that is not consistent with the risks and rewards normally associated with equity ownership. Therefore, in US GAAP this type of a condition would result in an award being liability classified.

63. FASB ASC 718-10-55-65 states [emphasis added]:

> An award may be indexed to a factor in addition to the entity's share price. **If that factor is not a market, performance, or service condition, that**

> **award shall be classified as a liability** for purposes of this Topic (see paragraphs 718-10-25-13 through 25-14). An example would be an award of options whose exercise price is indexed to the market price of a commodity, such as gold. Another example would be a share award that will vest based on the appreciation in the price of a commodity such as gold; that award is indexed to both the value of that commodity and the issuing entity's shares. If an award is so indexed, the relevant factors shall be included in the fair value estimate of the award. Such an award would be classified as a liability even if the entity granting the share-based payment instrument is a producer of the commodity whose price changes are part or all of the conditions that affect an award's vesting conditions or fair value.

Possible remedy

64. If the Committee agrees with the staff's recommendations in the vesting condition and non-vesting condition sections of this agenda paper, all conditions that affect entitlement to the equity instruments received in a share-based payment transaction (and have an explicit or implicit service condition) will be vesting conditions. Therefore, for example, a share-based payment arrangement in which an employee becomes entitled to the award based on the employee remaining in service until the price of gold increases 10 % at any time during the next 5 years (provided the employee remained in employment through the date the target was met) would be a vesting condition. Since this example condition does not fit within the proposed service condition or performance condition definitions, it would be categorised as an 'other vesting condition'.

65. In the staff's opinion, there are several options for the Committee to consider:

    (a) Introducing a stand-alone definition of 'other vesting condition' that would capture a condition that does determine entitlement (ie vesting) of the share-based payment award, but that condition does not fit within the definition of a service condition, non-market performance condition, or market performance condition. In this option, an other vesting condition would remain distinct and separate from a market performance condition.

    (b) Introduce a stand-alone definition of 'other vesting condition' as noted above, but include within this definition the concept of a market condition. Since the accounting mechanics are the same for a market performance condition and an other vesting condition, the staff believes

that a simplification of IFRSs could be achieved by combining these concepts into one definition. Additional analysis of this option is included in the section of this agenda paper titled 'Different accounting treatments for different conditions'.

Staff recommendation

66. The staff recommends that a stand-alone definition of 'other vesting condition' should be incorporated into IFRSs. The staff also recommends that this definition incorporate the concept of a market performance condition (and remove the stand-alone definition of market performance condition).

Contingent feature

Current guidance of IFRS 2

67. Currently, IFRS 2 does not provide guidance on the general topic of a contingent feature. Instead paragraph 22 of IFRS 2 provides specific guidance on one example of a contingent feature. Specifically, paragraph 22 of IFRS 2 provides guidance on a reload feature and a reload option that states:

> For options with a *reload feature*, the reload feature shall not be taken into account when estimating the fair value of options granted at the measurement date. Instead, a *reload option* shall be accounted for as a new option grant, if and when a reload option is subsequently granted.

68. IFRS 2 defines reload feature and reload option as follows:

> **reload feature**
>
> A feature that provides for an automatic grant of additional share options whenever the option holder exercises previously granted options using the entity's shares, rather than cash to satisfy the exercise price.
>
> **reload option**
>
> A new share option granted when a share is used to satisfy the exercise price of a previous share option.

Potential diversity or confusion and its cause

69. Since IFRS 2 does not provide general guidance addressing all contingent features, diversity exists in practice regarding items other than a reload feature. This is the case for a non-compete provision where no guidance exists in IFRS 2

other than one sentence included in paragraph BC171B of IFRS 2 that was included as part of the Board's rationale for the Amendment to IFRS 2. The staff believe that the change in perspective that occurred as a consequence of the Amendment to IFRS 2 may have introduced the potential for diversity regarding non-compete provisions.

70. In the staff's opinion, a contingent feature must relate to a condition within a share-based payment arrangement that could impact the entity and the employee in a period after the employee has become entitled to the award. Conversely, if the condition could impact an award that the employee is not yet entitled to (ie the award is not yet vested), the condition is not a contingent feature. Instead it would be classified as a vesting condition or non-vesting condition in accordance with the other guidance in IFRS 2 (or the staff recommendations).

71. A non-compete provision is a condition that precludes an employee or former employee from competing against the entity (typically by precluding employment with a competitor of the entity) for a specified period of time. If a non-compete provision is broken, the employee is required to return equity instruments (or the gain from the sale of the equity instruments) or in limited circumstances forfeits the rights to the equity instruments.

72. There are two different perspectives that could be taken when reviewing a share-based payment arrangement. These are from the employee perspective and employer perspective, before and after the Amendment to IFRS 2, respectively. In the context of a non-compete provision, when an employee terminates employment with an entity and does nothing to pursue any other competitor job opportunity (that would violate the non-compete provision):

    (a) using the original definition of vesting conditions (ie from the perspective of the employees), it might be argued that the employees are providing the required services to the entity because they 'pay' opportunity cost for doing nothing. Consequently, the non-compete provision might be considered a vesting condition.

    (b) using the current definition of vesting condition (ie from the perspective of the entity), it is understood that the entity receives no more service from ex-employees. Consequently, the non-compete provision should

not be considered a vesting condition (and is therefore a non-vesting condition).

73. Despite of the change of perspective (from employee to employer), some argue that a non-compete provision could continue to be considered a vesting condition. That argument reasons that the Amendment to IFRS 2 was not targeted at a non-compete provision (rather it was targeted at a SAYE plan). Therefore, the treatment of a non-compete provision should not be affected by the Amendment to IFRS 2 (and not affected by the change of perspective). Others argue that a non-compete provision does not determine whether the entity receives the services that entitle the counterparty to the award and therefore non-compete provisions are non-vesting conditions.

Corresponding guidance in US GAAP

74. US GAAP provides guidance on a reload and a contingent feature. FASB ASC 718-10-30-23, 718-10-30-24 and 718-10-55-8 state:

> 30-23 The fair value of each award of equity instruments, including an award of options with a reload feature (reload options), shall be measured separately based on its terms and the share price and other pertinent factors at the grant date. **The effect of a reload feature in the terms of an award shall not be included in estimating the grant-date fair value of the award. Rather, a subsequent grant of reload options pursuant to that provision shall be accounted for as a separate award when the reload options are granted**.
>
> 30-24 **A contingent feature of an award** that might cause an employee to return to the entity either equity instruments earned or realized gains from the sale of equity instruments earned for consideration that is less than fair value on the date of transfer (including no consideration), such as a clawback feature (see paragraph 718-10-55-8), **shall not be reflected in estimating the grant-date fair value of an equity instrument**.
>
> 55-8 Reload features and contingent features that require an employee to transfer equity shares earned, or realized gains from the sale of equity instruments earned, to the issuing entity for consideration that is less than fair value on the date of transfer (including no consideration), such as **a clawback feature, shall not be reflected in the grant-date fair value of an equity award. Those features are accounted for if and when a reload grant or contingent event occurs. A clawback feature can take various forms but often functions as a noncompete mechanism.** For example, an employee that terminates the employment relationship and begins to work for a competitor is required to transfer to the issuing entity (former

> employer) equity shares granted and earned in a share-based payment transaction.

75. US GAAP provides guidance on the subsequent measurement of equity classified awards that have a contingent feature. FSAB ASC 718-20-35-2 states:

> 35-2 **A contingent feature** of an award that might cause an employee to return to the entity either equity instruments earned or realized gains from the sale of equity instruments earned for consideration that is less than fair value on the date of transfer (including no consideration), such as a clawback feature (see paragraph 718-10-55-8), **shall be accounted for if and when the contingent event occurs**. Example 10 (see paragraph 718-20-55-84) provides an illustration of an award with a clawback feature.

76. US GAAP provides two illustrative examples of contingent features. These examples have been included in Appendix A to this agenda paper.

Possible remedy

77. The staff believes that the guidance in US GAAP could be incorporated into IFRSs. This could be the addition of guidance on the treatment of a contingent feature or the addition of illustrative guidance. The staff believes that such explicit and detailed guidance will remove diversity and confusion surrounding all contingent features including a non-compete provision and will provide more consistency of accounting treatment (as either vesting conditions or non-vesting conditions) for transactions that are structured differently, but have similar economic results.

Staff recommendation

78. The staff recommends that the US GAAP guidance on a contingent feature be incorporated into IFRSs. Additionally, the staff recommends that the US GAAP guidance specific to non-compete provisions be incorporated into IFRSs.

Different accounting treatments for different types of conditions

Current guidance of IFRS 2

79. Currently, IFRS 2 requires different accounting mechanics based on the type of vesting condition:
    (a) A service condition and a non-market performance condition are:

(i) excluded from the measurement of the grant date fair value of an equity-settled share-based payment award, and

(ii) revisions to the estimate of the number of equity instruments expected to vest are 'trued up' at each reporting period; and

(b) a market performance condition, is:

(i) included in the measurement of the grant date fair value of an equity-settled share-based payment award, and

(ii) revisions to the estimate of the number of equity instruments expected to vest (regarding whether the market performance condition is or is not probable of being met) are not trued up at each reporting period.

80. IFRS 2 is clear that a service condition, a non-market performance condition and a market performance condition are all vesting conditions. Paragraphs BC175–BC184 of IFRS 2 provide the Board's rationale for the different accounting mechanics. The staff specifically note paragraphs BC179, BC183 and BC184 that state [emphasis added]:

> BC179 Some respondents suggested the alternative approach applied in SFAS 123, referred to as the modified grant date method. Under this method, service conditions and non-market performance conditions are excluded from the grant date valuation (ie the possibility of forfeiture is not taken into account when estimating the grant date fair value of the share options or other equity instruments, thereby producing a higher grant date fair value), but are instead taken into account by requiring the transaction amount to be based on the number of equity instruments that eventually vest. Under this method, on a cumulative basis, **no amount is recognised for goods or services received if the equity instruments granted do not vest because of failure to satisfy a vesting condition (other than a market condition), eg the counterparty fails to complete a specified service period, or a performance condition (other than a market condition) is not satisfied**.
>
> BC183 Under SFAS 123, market conditions (eg a condition involving a target share price, or specified amount of intrinsic value on which vesting or exercisability is conditioned) are included in the grant date valuation, without subsequent reversal. That is to say, when estimating the fair value of the equity instruments at grant date, the entity takes into account the possibility that the market condition may not be satisfied. Having allowed for that possibility in the grant date valuation of the equity instruments, no adjustment is made to the number of equity instruments included in the calculation of the transaction amount, irrespective of the

outcome of the market condition. In other words, the entity recognises the goods or services received from a counterparty that satisfies all other vesting conditions (eg services received from an employee who remains in service for the specified service period), irrespective of whether that market condition is satisfied. **The treatment of market conditions therefore contrasts with the treatment of other types of vesting conditions.** As explained in paragraph BC179, under the modified grant date method, vesting conditions are not taken into account when estimating the fair value of the equity instruments at grant date, but are instead taken into account by requiring the transaction amount to be based on the number of equity instruments that eventually vest.

BC184 The Board considered whether it should apply the same approach to market conditions as is applied in SFAS 123. It might be argued that it is not appropriate to distinguish between market conditions and other types of performance conditions, because to do so could create opportunities for arbitrage, or cause an economic distortion by encouraging entities to favour one type of performance condition over another. However, the Board noted that it is not clear what the result would be. On the one hand, some entities might prefer the 'truing up' aspect of the modified grant date method, because it permits a reversal of remuneration expense if the condition is not met. On the other hand, if the performance condition is met, and it has not been incorporated into the grant date valuation (as is the case when the modified grant date method is used), the expense will be higher than it would otherwise have been (ie if the performance condition had been incorporated into the grant date valuation). Furthermore, some entities might prefer to avoid the potential volatility caused by the truing up mechanism. Therefore, it is not clear whether having a different treatment for market and non-market performance conditions will necessarily cause entities to favour market conditions over non-market performance conditions, or vice versa. Furthermore, **the practical difficulties that led the Board to conclude that non-market performance conditions should be dealt with via the modified grant date method rather than being included in the grant date valuation do not apply to market conditions, because market conditions can be incorporated into option pricing models.** Moreover, it is difficult to distinguish between market conditions, such as a target share price, and the market condition that is inherent in the option itself, ie that the option will be exercised only if the share price on the date of exercise exceeds the exercise price. For these reasons, the Board concluded that the IFRS should apply the same approach as is applied in SFAS 123.

81. Paragraph IG24 of IFRS 2 currently divides non-vesting conditions into one of three types. The portion of paragraph IG24 of IFRS 2 that relates to non-vesting conditions states:

Type	A	B	C
	Neither the entity nor the counterparty can choose whether the condition is met	Counterparty can choose whether to meet the condition	Entity can choose whether to meet the condition
Example conditions	Target based on a commodity index	Paying contributions towards the exercise price of a share-based payment	Continuation of the plan by the entity
Include in grant-date fair value?	Yes	Yes	Yes(a)
Accounting treatment if the condition is not met after the grant date and during the vesting period	No change to accounting. The entity continues to recognise the expense over the remainder of the vesting period. (paragraph 21A)	Cancellation. The entity recognises immediately the amount of the expense that would otherwise have been recognised over the remainder of the vesting period. (paragraph 28A)	Cancellation. The entity recognises immediately the amount of the expense that would otherwise have been recognised over the remainder of the vesting period. (paragraph 28A)

Additional information for reference and separate deliberation by the Committee

Ability to influence by employee	No	Yes	No

Potential diversity or confusion and its cause

82. The staff does not note significant diversity in practice in the application of the two different accounting mechanics (periodic revision of estimates expected to vest and inclusion in the grant date fair value measurement). Rather, the diversity occurs in the classification of the various conditions as a service condition, a non-market performance condition, a market performance condition or a non-vesting condition. This classification then impacts the accounting mechanics to be used in determining the compensation cost to be recognised for the share-based payment transaction.

83. Additionally, the staff note the potential for diversity as a result of the guidance included in paragraph IG24 of IFRS 2. That guidance requires conditions to be grouped together within one of three non-vesting condition types. The three types of non-vesting conditions have two different accounting treatments if the condition is not met after the grant date and during the vesting period (attribution period if using the new terminology proposed by the staff in Agenda Paper 3C).

Type A

84. Type A conditions are where neither the entity nor the counterparty can choose whether the condition is met. Type A conditions may capture conditions that do determine whether the counterparty becomes entitled to a share-based payment award in addition to conditions that do not determine entitlement. Therefore, these conditions may fit into one aspect of current IFRS 2 definition of vesting conditions (ie 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). This first aspect is consistent with the general understanding of vesting conditions. However, a second aspect of the current IFRS 2 definition of vesting conditions restricts vesting conditions to a service condition and a performance condition (inclusive of both a performance condition that is a market condition and other performance conditions).

85. An example of a Type A condition that appears to determine entitlement is an award that states that entitlement/ vesting of an equity-settled share-based payment arrangement is conditional on a Dow Jones index reaching a specified target at any point in time in the next three years provided the employee remains in service up to the date the Dow Jones index target is reached.

86. Because not all conditions that determine whether a counterparty receives an equity instrument granted as part of a share-based payment arrangement are considered vesting conditions in IFRS 2, the notion of ‘vest’ in IFRS 2 is confusingly different from the general understanding of the term. In the example given in the preceding paragraph, some constituents believe it is appropriate to classify the Dow Jones index target as a non-vesting condition since it does not meet the definition of a service condition or a performance condition. Those

constituents believe that IFRS 2 indicates that the share-based award may vest even if the Dow Jones index target has not been met, as long as the employee has completed the three years of service.

87. However, the share-based payment arrangement with a Dow Jones index target that is not achieved in the specified time period (even though all 'vesting conditions' are satisfied) does not result in the employee being 'entitled' to the award. Conversely, a general understanding of the term 'vest' implying that the share-based award has not vested until the Dow Jones index target has been reached and the share-based payment award becomes exercisable is consistent with the actual fact pattern. While this general understanding appears correct and consistent with the actual fact pattern, it is not consistent with current definition within IFRS 2.

Type B

88. Type B conditions are directly influenced (and sometimes controlled) by the employee. If combined with a service requirement requiring (either explicitly or implicitly) that the employee remains in employment the distinction between a Type B non-vesting condition and a performance condition is not clear. Presuming that Type B conditions are able to be influenced by an employee (eg an employee's sales target or a sales target of the division or the entity to which the employee belongs), in the staff's opinion, it could be argued that these conditions are not 'non-vesting conditions' but rather vesting conditions (more specifically non-market performance conditions). This diversity of views is one of the primary issues underlying this project.

Type C

89. Type C conditions are not within the direct influence of the employee (and usually within the control of the entity). In the staff's opinion, non-vesting conditions that are within the control of the entity are similar to the entity having the unilateral ability to cancel the share-based payment arrangement.

90. Additionally, footnote (a) to paragraph IG24 states, 'In the calculation of the fair value of the share-based payment, the probability of continuation of the plan by the entity is assumed to be 100 per cent.' Given that the example condition provided for Type C conditions is the continuation of the plan by the entity, some

believe it is unclear whether footnote (a) to paragraph IG24 relates only to the fact pattern for the specific example provided or if any non-vesting condition within the control of the entity should always be presumed to be 100 per cent likely to occur.

91. Another example of a condition that would not be within the employee's influence (and likely within the entity's control) is that an employee will become entitled to a share-based payment award if the entity hires 10 new sales associates on a cumulative basis at any time during the next three years.

92. Currently, a Type C condition (listed in paragraph IG24 of IFRS 2 as 'Entity can choose whether to meet the condition') and the entity's ability to cancel a share-based payment arrangement may be distinguished from each other by some constituents. Paragraph IG24 of IFRS 2 specifies that Type C conditions should be included in the measurement of grant date fair value. However, footnote (a) states that it should be presumed (with a 100% probability) that the plan will continue. Therefore, other constituents may imply that the concept of a contingent feature (that is specified within FASB ASC Topic 718, but that IFRS 2 does not define or provide guidance on) is the appropriate concept to apply. These constituents believe that entity's ability to cancel a share-based payment award is not considered until it occurs.

93. In the staff's opinion, this diversity has the consequence that the grant date fair value of the award with a Type C condition (such as an award vesting if an entity hires 10 sales associates) may necessarily differ from the grant date fair value of the award deemed to have a contingent feature (for which the entity may cancel the award at a future date prior to the employee becoming entitled to the award that otherwise has similar vesting conditions to the award with a Type C condition). That is, while the economic impact to the employee is the same, the accounting treatment is different.

Corresponding guidance in US GAAP

94. US GAAP has a similar split between two different accounting mechanics. SFAS 123 and the US GAAP standard that replaced it, SFAS 123R *Share-based Payment* issued in December 2004 (now FASB ASC Topic 718 *Compensation –*

Stock Compensation), include rationale similar to the Board's rationale for IFRS 2. This is a result of the Board using the US GAAP guidance as a foundation for making many of its decisions within IFRS 2. IFRS 2 includes references to SFAS 123 *Accounting for Stock-based Compensation* issued in October 1995 most specifically in BC276 and surrounding paragraphs of IFRS 2.

95. The Basis for Conclusions on IFRS 2 notes that a primary focus of the different accounting mechanics for a market condition as compared to a service condition or a performance condition is required because the IASB and FASB believe that valuation experts do not have the ability to capture within the grant date fair value the impact of a service condition or a non-market performance condition. Conversely, the IASB and FASB believe that valuation experts do have the ability to capture within the grant date fair value the impact of a market performance condition.

96. Additionally, US GAAP does not have multiple types of non-vesting conditions.

Possible remedy

97. During analysis of this project, the staff has noted a potential link between the accounting mechanics of vesting (and non-vesting) conditions. The split between conditions that have the future uncertainty captured through periodic updating of forfeitures vs captured through inclusion within the grant date fair value measurement can be seen as:

    (a) conditions that are determined to be satisfied by results that the employee can influence, or

    (b) conditions that are determined to be satisfied by results that the employee does not have the ability to influence.

98. Therefore, the staff proposes the introduction of concepts that explain the split between the two different types of accounting mechanics. Modified grant date accounting does not incorporate a service or non-market performance condition into the grant date fair value. Conversely, grant date accounting does incorporate a market performance condition into the grant date fair value (as well as a non-vesting condition and items that would be classified as an other vesting condition when applying the staff recommendations).

99. The staff believes a boundary between the two different types of accounting mechanics currently exists based on whether the condition is able to be influenced by the employee. The following list lines up the various vesting conditions along the spectrum of the employee's ability to influence.

    (a) Conditions that are broadly within the employee's influence are those conditions that should be excluded from the measurement of the grant date fair value of equity-settled share-based payments. Instead these conditions are reflected in management's estimate of the number of awards expected to vest, with 'true-ups' at each reporting period for revisions to these estimates. They are either:

        (i) a service condition, which is within the control or direct influence of the employee; or

        (ii) a performance condition, which is within the direct influence of the employee.

    (b) Conditions that are broadly outside the employee's influence are those conditions that should be included in the measurement of the grant date fair value of equity-settled share-based payments, with no 'true-ups' at each reporting period for revisions to the estimate of the number of awards expected to vest. They are either:

        (i) a market condition, which is not within the direct influence of the employee; or

        (ii) an other vesting condition, which is completely outside the influence of the employee.

100. For example, the determination of whether a service condition is satisfied is able to be influenced by the employee. The employee can decide whether to stay at an entity and continue to work or the employee can decide to leave employment of the entity. Similarly, in the staff's opinion, the determination of whether a performance condition is satisfied is able to be influenced by the employee.

101. Conversely, conditions that the employee does not have the ability to influence include a market performance condition, other vesting conditions (as defined using the staff recommendations) and some non-vesting conditions (that are not able to be directly influenced by the employee).

Staff recommendation

102. The staff recommends additional consideration of the incorporation into IFRSs of the concept of the employee's ability to directly influence as an appropriate rationale for use of the different accounting mechanics.

103. Additionally, the staff believes that a comprehensive review of paragraph IG24 should be undertaken as part of this project to ensure consistency with the other conclusions reached by the Committee.

Questions for the Committee

104. The staff requests the Committee review the following questions and provide guidance for the staff to continue this project.

Question 1 – Vesting condition
1. Does the Committee agree with the staff recommendation that the definition of a vesting condition should be clarified: (a) to include all conditions that determine entitlement? (b) to exclude the currently embedded concepts of service condition, performance condition and market condition? (b) with a focus on the employee perspective consistent with the Board's rationale as explained in BC171 of IFRS 2?

Question 2 – Non-vesting condition
2. Does the Committee agree with the staff recommendation that a stand-alone definition of a non-vesting condition be incorporated into IFRSs?

Question 3 – Service condition
3. Does the Committee agree with the staff recommendation that a stand-alone definition of a service condition should be incorporated into IFRSs and it should be confined to a service requirement only?

Question 4 – Performance condition
4. Does the Committee agree with the staff recommendation that a stand-alone definition of a performance condition should be incorporated into

IFRSs and it should confine a performance condition to solely the entity's operations or activities?

4.1 Does the Committee agree with the staff recommendation that the reference to a market condition within a performance condition should be removed?

Question 5 – Market condition

5 Does the Committee agree that a market condition should be merged into 'other vesting conditions' because there is no difference in accounting treatment and no purpose for separation?

Question 6 – Other vesting conditions

6. Does the Committee agree with the staff recommendation that a stand-alone definition of other vesting conditions should be incorporated into IFRSs?

Question 7 – Contingent feature

7. Does the Committee agree with the staff recommendation that guidance on a contingent feature should be incorporated into IFRSs?

Question 8 – Employee's ability to directly influence

8. Does the Committee agree with the staff recommendation to introduce into IFRSs of the concept of the employee's ability to directly influence as an appropriate rationale for use of the different accounting mechanics?

8.1 Does the Committee agree that a comprehensive review of the guidance in paragraph IG24 of IFRS 2 should be undertaken to ensure consistency with the rest of the decisions taken by the Committee on this project?

Appendix A – US GAAP illustrative examples of contingent features

A1. These examples are included in FASB ASC 718-20-55-84 through 718-20-55-92.

Example 10: Share Award with a Clawback Feature

55-84 This Example illustrates the guidance in paragraph 718-20-35-2.

55-85 On January 1, 20X5, Entity T grants its chief executive officer an award of 100,000 shares of stock that vest upon the completion of 5 years of service. The market price of Entity T's stock is $30 per share on that date. The grant-date fair value of the award is $3,000,000 (100,000 × $30). 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 (as defined by the award) within three years after vesting, the shares or their cash equivalent on the date of employment by the direct competitor must be returned to Entity T for no consideration (a clawback feature). The chief executive officer completes five years of service and vests in the award. Approximately two years after vesting in the share award, the chief executive officer terminates employment and is hired as an employee of a direct competitor. Paragraph 718-10-55-8 states that contingent features requiring an employee to transfer equity shares earned or realized gains from the sale of equity instruments earned as a result of share-based payment arrangements to the issuing entity for consideration that is less than fair value on the date of transfer (including no consideration) are not considered in estimating the fair value of an equity instrument on the date it is granted. Those features are accounted for if and when the contingent event occurs by recognizing the consideration received in the corresponding balance sheet account and a credit in the income statement equal to the lesser of the recognized compensation cost of the share-based payment arrangement that contains the contingent feature ($3,000,000) and the fair value of the consideration received. This guidance does not apply to cancellations of awards of equity instruments as discussed in paragraphs 718-20-35-7 through 35-9. The former chief executive officer returns 100,000 shares of Entity T's common stock with a total market value of $4,500,000 as a result of the award's provisions. The following journal entry accounts for that event.

Treasury stock	$4,500,000	
Additional paid-in capital		$1,500,000
Other income		$3,000,000

To recognize the receipt of consideration as a result of the clawback feature.

55-86 If instead of delivering shares to Entity T, the former chief executive officer had paid cash equal to the total market value of 100,000 shares of Entity T's common stock, the following journal entry would have been recorded.

Cash	$ 4,500,000	
Additional paid-in capital		$ 1,500,000
Other income		$ 3,000,000

To recognize the receipt of consideration as a result of the clawback feature.

Example 11: Certain Noncompete Agreements and Requisite Service

55-87 Paragraphs 718-10-25-3 through 25-4 require that the accounting for all share-based payment transactions with employees or others reflect the rights conveyed to the holder of the instruments and the obligations imposed on the issuer of the instruments, regardless of how those transactions are structured. Some share-based compensation arrangements with employees may contain noncompete provisions. **Those noncompete provisions may be in-substance service conditions because of their nature. Determining whether a noncompete provision or another type of provision represents an in-substance service condition is a matter of judgment based on relevant facts and circumstances.** This Example illustrates a situation in which a noncompete provision represents an in-substance service condition.

55-88 Entity K is a professional services firm in which retention of qualified employees is important in sustaining its operations. Entity K's industry expertise and relationship networks are inextricably linked to its employees; if its employees terminate their employment relationship and work for a competitor, the entity's operations may be adversely impacted.

55-89 As part of its compensation structure, Entity K grants 100,000 restricted share units to an employee on January 1, 20X6. The fair value of the restricted share units represents approximately four times the expected future annual total compensation of the employee. The restricted share units are fully vested as of the date of grant, and retention of the restricted share units is not contingent on future service to Entity K. However, the units are transferred to the employee based on a 4-year delayed-transfer schedule (25,000 restricted share units to be transferred beginning on December 31, 20X6, and on December 31 in each of the 3 succeeding years) if and only if specified noncompete conditions are satisfied. The restricted share units are convertible into unrestricted shares any time after transfer.

55-90 The noncompete provisions require that no work in any capacity may be performed for a competitor (which would include any new competitor formed by the employee). Those noncompete provisions lapse with respect to the restricted share units as they are transferred. If the noncompete provisions are not satisfied, the employee loses all rights to any restricted share units not yet transferred. Additionally, the noncompete provisions stipulate that Entity K may seek other available legal remedies, including damages from the employee. Entity K has determined that the noncompete is legally enforceable and has legally enforced similar arrangements in the past.

55-91 The nature of the noncompete provision (being the corollary condition of active employment), the provision's legal enforceability, the employer's

intent to enforce and past practice of enforcement, the delayed-transfer schedule mirroring the lapse of noncompete provisions, the magnitude of the award's fair value in relation to the employee's expected future annual total compensation, and the severity of the provision limiting the employee's ability to work in the industry in any capacity are facts that provide a preponderance of evidence suggesting that the arrangement is designed to compensate the employee for future service in spite of the employee's ability to terminate the employment relationship during the service period and retain the award (assuming satisfaction of the noncompete provision). Consequently, Entity K would recognize compensation cost related to the restricted share units over the four-year substantive service period.

55-92 Example 10 (see paragraph 718-20-55-84) provides an illustration of another noncompete agreement. That Example and this one are similar in that both noncompete agreements are not contingent upon employment termination (that is, both agreements may activate and lapse during a period of active employment after the vesting date). A key difference between the two Examples is that the award recipient in that Example must provide five years of service to vest in the award (as opposed to vesting immediately). Another key difference is that the award recipient in that Example receives the shares upon vesting and may sell them immediately without restriction as opposed to the restricted share units, which are transferred according to the delayed-transfer schedule. In that Example, the noncompete provision is not deemed to be an in-substance service condition. In making a determination about whether a noncompete provision may represent an in-substance service condition, the provision's legal enforceability, the entity's intent to enforce the provision and its past practice of enforcement, the employee's rights to the instruments such as the right to sell them, the severity of the provision, the fair value of the award, and the existence or absence of an explicit employee service condition are all factors that shall be considered. Because noncompete provisions can be structured differently, one or more of those factors (such as the entity's intent to enforce the provision) may be more important than others in making that determination. For example, if Entity K did not intend to enforce the provision, then the noncompete provision would not represent an in-substance service condition.