Topic

# Research Project on IFRS 2 *Share-based Payment*

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# Research Project on IFRS 2 «  Share-based Payment »

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# Contents

# Reminder of the scope of IFRS 2 – Illustrative examples

- The entity shall apply IFRS 2 for all share-based payment transactions:
  - Equity-settled share-based payment

    Ex: stock options of the entity granted to employees in exchange of services received (work of employee over a period and/or achievement of a performance).

    *The entity grants 100 share options to each of the 500 employees if they work in the entity over the next three years. Grant date fair value of options : 10 € each*

    - *Total expense after 3 years: 500 000 €*

  - Cash-settled share-based payment

    Ex: cash paid to employees whose amount depends on the value of the entity's share in exchange of services received (presence or performance)

    *The entity grants 100 Share Appreciation Rights (SARs) to each of the 500 employees. If they work in the entity over the next three years, they will receive the intrinsic value of the SAR. Grant date fair value of SAR : 10 € each; Intrinsic value of SAR after 3 years: 15 € each*

    - *Total expense after 3 years: 750 000 €*

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# Background of the Project

- A need for clarification of the standard
  - IFRS 2 was issued in February 2004
  - The standard has been subject to a considerable number of requests for clarification illustrating its complexity
    - 2 amendments of the standard already issued
    - IFRIC has issued 2 interpretations, many rejections and is currently considering a new request
  - The IASB decided in 2008 to carry out a review of IFRS 2 and the ANC agreed to take on the project
- Post-implementation review of the standard and application matters are out of the scope of the project

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# Objectives of the Project

- Initial Objectives of the project agreed with the IASB
  - Clarify (rather change) the core principles
  - Ensure the consistency of these principles within IFRS 2 and, as much as possible, in relation to other IFRSs
  - Make the standard easier to understand and to apply, especially on equity-settled share-based payments and for the treatment of renegotiations

- Expected output: A research paper
  - The project finally goes beyond the initial objective of clarification as it offers some avenues to modify the standard in order to better represent transactions with a suppression of anti-abuse rules
  - The IASB and ANC agreed on a final report to be considered as a research paper exploring some possibilities to modify the standard

# The two alternative proposals

- Current IFRS 2 inconsistencies:
  - Initial objective was to represent services received
    - Measurement provisions are consistent with this objective by using the Grant date fair value
  - Treatment of vesting conditions portrays the final “payment” to employees
    - Cancellation of the expenses related to non-vested awards

  ↳ These led to the introduction of several anti-abuse provisions

- The ANC proposes that the standard makes a clear choice between those two objectives :
  - Representation of service received (The Unit of Service approach)
  - Representation of payment (The Payment approach)

- There is no decisive argument in the Conceptual Framework to decide for the most appropriate approach

# The Unit of Service approach

- Accounting objective of this approach
  - Represent assets or services received by the entity irrespective of whether there is an identifiable "payment" finally made by the entity

- Proposed accounting treatment
  - Services are recognized proportionally according to the duration of service. The counterparty is accounted in equity.
  - A fair value per unit of service (UoS) is determined at grant date
  - The entity expenses the number of UoS it receives
  - No reversal of the previous expense if the employee leaves without completing the vesting period

↳ This approach may involve complexity to calculate UoS' Grant date fair value and to follow the number of UoS received

# The Payment approach

- Accounting objective of this approach
  - Represent "service paid". Under this approach the services are deemed to be received only if all vesting conditions are fully completed

- Proposed accounting treatment
  - Services are recognized over the vesting period on the basis of the number of instruments expected to vest.
  - The counterparty is accounted in liabilities until vesting date.
  - The fair value of equity instruments to be issued is remeasured at each reporting date and adjusted at the vesting date
  - When an employee leaves without completing the vesting period the expenditure is reversed accordingly

➥ This approach may involve significant volatility in net income

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# Consistency of approaches

- Analyze of the accounting treatment of similar transactions

| | *IFRS 2 today* | *UoS approach* | *Payment approach* |
|---|---|---|---|
| *Forfeiture / Cancellation of plan* | Different | Identical | Identical |
| *Disadvantageous Modification/ Cancellation of plan* | Different | Identical | Identical |
| *Market condition/ Non market condition* | Different | Identical | Identical |

Proposed approaches would improve the consistency of the standard and permit the removal of anti abuse provisions

# Next steps

- The ANC conclusions may imply changes in the Standard that can not be addressed through the annual improvement process

- Does the Council believe that a project to change IFRS 2 should be added to post 2011 IASB Agenda?

- How conclusions of the ANC's research paper should be communicated to the IASB and staff?

- Process for revising IFRS 2?

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# Appendix – Examples of the two approaches

- Assumptions:
  - 100 share options granted to each employee with a required period of service of 3 years
  - Estimated fair value of options

| Grant Date | Year 1 | Year 2 | Year 3 |
|---|---|---|---|
| 15 € | 15 € | 12 € | 20 € |

  - 500 employees initially, estimated turnover before the end of year 3 : 20% (1/3 each year with employees leaving in the middle of the year)
- Scenario 1: everything happens as expected
- Scenario 2: the number of employees leaving is less than expected
  - 20 employees leave the company in year 1, 22 employees leave the company in year 2 and 15 employees leave the company in year 3.
  - Year 1, the company revises its estimation of forfeiture over the period from 20% to 15%. Year 2, it revises the estimation from 15% to 12%.

# Appendix – Example of the Unit of service approach

- Value of the Unit of service:
  - Estimated number of UoS : 400 employees (80%) x 3 years + 100 employees (20%) x 1,5 years = 1.350 UoS.
  - Estimated value of UoS : 500 x 100 x 80% x15€ = 600.000 / 1.350 = 444.44€.

- Proposed accounting treatment

| in K€ | Scenario 1 | | | Scenario 2 | | |
|---|---|---|---|---|---|---|
| | Expenses for the period | | Cumulated | Expenses for the period | | Cumulated |
| Year 1 | (467 + (33 x 0,5)) x 444.44 | 215 K€ | 215 K€ | (480 + (20 x 0,5)) x 444.44 | 218 K€ | 218 K€ |
| Year 2 | (433 + (34 x 0,5)) x 444.44 | 200 K€ | 415 K€ | (458 + (22 x 0,5)) x 444.44 | 208 K€ | 426 K€ |
| Year 3 | (400 + (33 x 0,5)) x 444.44 | 185 K€ | 600 K€ | (443 + (15 x 0,5)) x 444.44 | 200 K€ | 626 K€ |

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# Appendix – Example of the Payment approach

- Proposed accounting treatment

| in K€ | Scenario 1 | | | Scenario 2 | | |
|---|---|---|---|---|---|---|
| | Expenses for the period | | Cumulated | Expenses for the period | | Cumulated |
| Year 1 | 500* 100 * 80% * 15 € *1/3 years | 200 K€ | 200 K€ | 500* 100 * 85% * 15 € *1/3 years | 212 K€ | 212 K€ |
| Year 2 | 500* 100 * 80% * 12 € *2/3 years – 200 K€ | 120 K€ | 320 K€ | 500* 100 * 88% * 12 € *2/3 years – 212 K€ | 140 K€ | 352 K€ |
| Year 3 | 500* 100 * 80% * 20 € - 320 K€ | 480 K€ | 800 K€ | (500 – 57) * 100 * 20 € - 352 K€ | 534 K€ | 886 K€ |

# Further information

- Our last detailed intermediate research paper has been presented to NSS meeting of September 2010 in Rome and is available by double-clicking on the document "*2010-10-01-Research_on_IFRS_2_update_NSS*" below:

2010-10-01-Resear
ch_on_IFRS_2_update_NSS

- You may also view all related working papers on our website at the following address:

http://www.anc.gouv.fr/sections/la_recherche_a_l_anc/travaux_en_cours_et/folder_view