Project **Annual Improvements—2010-2012 cycle**

Topic **IFRS 2 *Share-based Payment* —modification of a share-based payment from cash-settled to equity-settled**

Purpose of this paper

1. In March 2011 the IFRS Interpretations Committee (the Committee) received a request to clarify the accounting for a modification of a share-based payment that changes its classification from cash-settled to equity-settled.
2. More specifically, the request raises an issue about how to measure the replacement award in situations where:
   (a) a cash-settled award is cancelled and is replaced by a new equity-settled award; and
   (b) the replacement award has a higher fair value than the original award.
3. The submitter states that, because IFRS 2 *Share-based Payment* is silent regarding this issue, diversity exists in practice, and suggests that this issue could potentially be considered as a clarification to IFRS 2, through the annual improvements project (AIP). The submission is reproduced in full in Appendix C to this paper.
4. This paper:
   (a) provides background information on the issue;
   (b) includes the staff analysis and recommendation and

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

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

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

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

(c) asks the Committee whether they agree with the staff recommendation.

Background information

Current guidance in IFRS 2

5. When the terms and conditions of an award are modified, cancelled or settled, IFRS 2 provides the following guidance:

   (a) **modification** to the terms and conditions on which **equity instruments** were granted (IFRS 2.27, B42-44);

   (b) **cancellation or settlement** of **equity-settled** awards in cash (IFRS 2.28);

   (c) share-based payment transactions in which the terms of the arrangement provide **the counterparty** with a **choice of settlement** (IFRS 2.39); and

   (d) share-based payment transactions in which the terms of the arrangement provide **the entity** with a **choice of settlement** (IFRS 2. 43);

   The full guidance in the paragraphs mentioned above is reproduced in **Appendix B** of this paper.

   IFRS 2 also contains guidance on situations where a cash-settlement alternative is added **to an equity-settled award** after grant date (IG Example 9).

6. The submission provides a fact pattern of a cash-settled award that is cancelled and is replaced by a new equity-settled award with a higher fair value and identifies **two different views** on how to measure the replacement award. The second view is further split into two sub-views, which consider timing differences in the recognition of the expense. These different approaches are described briefly below.

View 1: apply by analogy the modification guidance in IFRS 2

7. This approach considers that the award has been **modified** from being equity-settled to being cash-settled. Consequently, an entity would apply by analogy the modification guidance in IFRS 2.27 and IFRS 2.B42–B44.

8. Under the modification guidance in IFRS 2, the measurement of the equity-settled award is based on:

   (a) the **grant-date fair value** of the original award; with such cost being recognised over the original vesting period; and

   (b) the recognition of an **incremental fair value** (modification-date fair value of the entire **modified award** less the grant-date fair value of the entire **original award** plus any payments made to employees), which is recognised over the period from the date of modification until the remainder of the vesting period.

View 2: do not apply the modification guidance in IFRS 2 and instead consider that the original award has been settled and replaced by a new award

9. This approach considers that the cash-settled award has been **cancelled** and **settled** by an equity-settled award. The argument is made that the requirements in IFRS 2 relating to **cash-settled awards** do not include guidance regarding modifications on the grounds that the liability is remeasured to its fair value and any modifications for the original award would therefore be automatically reflected in the carrying value of the liability. However, this “modification” is more significant, in so far as a cash-settled award is replaced by an equity-settled one. There is therefore no “automatic” reflection of the change. View 2 attempts to overcome this concern by viewing the change as settlement of the cash-settled award followed by replacement with an equity-settled award.

10. The measurement of the equity-settled replacement award is based on the recognition of:

(a) the **modification-date fair value** of the **original** award; at the date of the modification, the entity reclassifies to equity the carrying amount of the liability recognised to-date; and

(b) the unrecognised modification-date fair value of the replacement award (difference between the **modification date fair value** of the replacement equity-settled share based payment arrangement and the amount reclassified to equity as described in a) above). There are two approaches for recognising this value:

(i) **View 2A:** recognise it over the remaining vesting period in accordance with IFRS 2.B43(b).

(ii) **View 2B:** recognise it immediately in profit or loss as an additional expense in accordance with IFRS 2.43(c) to the extent of services provided.

11. The table below summarises the Views (and sub-views) presented above:

	Subsequent to modification – replacement award (equity)				
	Unrecognised **grant-date** fair value (1)	Incremental fair value (2)	Unrecognised **modification-date** fair value (3)	**Effect of settlement** expensed immediately (4)	Unrecognised **modification-date** fair value after effect of settlement (5)
View 1	X	X	-	-	-
View 2A	-	-	X	-	-
View 2B	-	-	-	X	X

(1) Unrecognised portion of the grant date fair value of original award, recognised over remaining vesting period.
(2) Modification date fair value of entire replacement award less grant date fair value of entire original award, recognised over remaining vesting period.
(3) Modification date fair value of entire replacement award less the recognised liability measured at modification date and reclassified to equity, recognised over remaining vesting period (This amount equals (4) + (5) below).
(4) Modification date fair value of entire replacement award less grant date fair value of entire original award, recognised as an expense on modification date.
(5) Modification date fair value of entire replacement award less the settlement of the original cash-settled award (which includes the recognised liability and the amount in 4)) recognised over the remaining vesting period.

Staff analysis

View 1: apply by analogy the modification guidance in IFRS 2

12. Some argue that because IFRS 2.27 and IFRS 2.B42-44 provide guidance for modifications of awards where equity-settled share-based payments were originally granted, then this guidance could be applied for modifications of equity-settled awards to cash-settled awards. It is unclear, however, whether the same guidance in IFRS 2 regarding modifications of awards could be similarly applied to situations where cash-settled share-based payments (and not equity-settled share-based payments) are granted.

13. In our view, the guidance for modification in IFRS 2 is framed upon the modification of the terms and conditions of equity-settled share-based payment awards (for example, a reduction or increase of the equity instruments awarded, or a modification of the exercise price of the award). That is, the guidance in IFRS 2 appears to have been written in the context of modifications that do not change the classification of the award. We do not think that it was intended to deal specifically with situations where, during the vesting period, an award is modified either from:

    (a) being an equity-settled share-based payment to being a cash-settled share based-payment; or

    (b) being a cash-settled share-based payment to being an equity-settled share-based payment (the latter being the subject of the submission received).

14. Nevertheless, because IFRS 2 is silent regarding this type of transaction, we agree that the modification guidance in IFRS 2 could be applied by analogy when recognising awards that change from being cash-settled to being equity-settled, on the grounds that the terms and conditions of the award have 'changed', irrespective of whether equity-settled share based payments were originally granted.

Measurement under View 1

15. When analysing the fact pattern under View 1 we observe that the application of the modification principles in IFRS 2 to the modified 'cash-settled award' result in this award not reflecting the value of the new equity-settled award. That is, when the vesting period ends, the modified award reflects a value of CU122, that is, the fair value of the original award at modification date (CU60) plus the unrecognised grant-date fair value of the original award of CU50 plus an incremental fair value of CU12, instead of a value of CU132, which represents the cumulative value of the equity-settled award replacing the cash-settled award in accordance with the fact pattern.

16. We observe that this is because the cost of the original award remains 'frozen' at its original grant-date fair value because, in accordance with paragraph 27 of IFRS 2, an entity must recognise at a minimum the cost of the *original* award at its grant date fair value as if it had not been modified. Consequently, the cost of the original award is not updated from the modification date and until the award vests. That is, this approach omits the recognition of CU10 which represents the increase in value of the original award from original grant date to modification date that has not yet been recognised because vesting has not yet been completed.

Our opinion of View 1

17. We question whether the principle of 'freezing' the value of the original award at a **grant-date fair value** date makes sense for an award that originally was classified as cash-settled. This is because, in line with paragraph 30 in IFRS 2, the measurement of a cash-settled award must reflect the remeasurements of the fair value of the liability at the end of each reporting period until the award vests. Paragraph 30 is reproduced below (emphasis added):

> 30 For cash-settled share-based payment transactions, the entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability. **Until the liability is settled**, the entity **shall remeasure the fair value of the liability at the end of each reporting period and at the date of**

> **settlement, with any changes in fair value recognised in profit or loss for the period**.

18. Consequently, even though we agree with the submitter's interpretation and application by analogy of the modification guidance in IFRS 2, we think that this guidance is not adequate for valuing awards that change from being cash-settled to being equity-settled, because it contradicts the measurement for a cash-settled award. This is because, in accordance with paragraph 30 in IFRS 2, the valuation of a cash-settled award does not follow a grant date fair-value approach in its valuation and instead follows a remeasurement fair-value approach.

View 2: do not apply the modification guidance in IFRS 2 and instead consider that the original award has been settled and replaced by a new award

19. We observe that under this approach, there is a shared understanding at the original grant date that the payment would be settled in cash; but at the date of the modification, the shared understanding changes and the entity is obliged to issue equity instruments. The cash-settled award is cancelled and replaced by an equity settled award.

20. Because IFRS 2 lacks specific guidance applicable to situations where a cash-settled award is cancelled and replaced by an equity-settled award, the submitter refers to other guidance in IFRS 2 that is applicable when awards are settled. This guidance is discussed in the following paragraphs.

Measurement at modification date

21. Under Views 2A and 2B, at the date of settlement (which in this case is equivalent to the date of modification in View 1), the liability is remeasured to its fair value and reclassified to equity (CU60). We think that the submitter followed by analogy the guidance in paragraph IFRS 2.39, which is applicable to situations when the counterparty has a choice to settle a share-based payment transaction in equity instruments rather than paying cash.

Measurement under View 2A

22. Under View 2A the submitter applies by analogy the guidance in paragraph B43(b) of IFRS 2 and identifies the replacement equity-settled grant as an award that 'settles' the original cash-settled award. As opposed to View 2B, an entity would not recognise immediately any additional expense and instead, would recognise over the remaining vesting period, the unrecognised fair value portion related to the replacement equity-settled award, based on the modification date fair value of the entire replacement equity-settled award less the recognised liability measured at modification date.

Measurement under View 2B

23. Under View 2B, we observe that the submitter applies by analogy the guidance in paragraph 43 of IFRS 2 applicable to circumstances when an entity has a choice of settlement and elects a settlement alternative (ie a new equity-settled award) that has a higher fair value. Based on the guidance of this paragraph the entity recognises immediately on modification date, as an additional expense, any excess of the modification date fair value of the entire replacement equity-settled award over the grant-date fair value of the entire original award (referred to as 'effect of settlement').

24. The entity also recognises over the remaining vesting period the unrecognised fair value portion related to the replacement equity-settled award, based on the modification date fair value of the entire replacement equity-settled award less the settlement value of the original cash-settled award (which includes the value of the recognised liability plus the 'effect of settlement' recognised immediately as an additional expense as described above).

Our opinion of View 2

25. In contrast to View 1 that reflects a value of the new award of CU 122, View 2 (including View 2A and View 2B) results in the new award showing the actual value of the share options granted (CU 132). However, to arrive at this, the submitter had to apply different sources of guidance from IFRS 2, which do not necessarily replicate the assumptions of the fact pattern described in the submission. For instance, in the fact pattern presented, the entity originally granted a cash-settled award, then cancelled this grant and decided to issue an equity-settled award. We observe that in the fact pattern:

    (a) the entity did not have a choice of settlement; but the submitter still applied the guidance in paragraph 39 to measure the original cash-settled share based-payment transaction at the date of settlement in View 2A and View 2B; and

    (b) the counterparty did not have a choice of settlement; but, the submitter still applied by analogy the guidance in paragraph 43(c) to measure the original cash-settled share based-payment transaction at the date of settlement in View 2B.

26. Consequently, although we agree with the resulting valuation of the replacement equity award shown in View 2A and 2B, this would imply analogising the transaction to different sources of guidance in IFRS 2 which adds confusion and subjectivity to this valuation. In our opinion the measurement of cash-settled share based payment transactions replaced by equity-settled share-based payment transaction should be clear in IFRS 2 to avoid this. The following paragraphs discuss whether this clarification could be made in IFRS 2.

Our preference

27. We support **View 1**, which is based on the modifications guidance included in paragraphs 27 and B42–B44 of IFRS 2, because we think that :

(a) the principles applicable to modifications of equity awards can be extended to apply to other types of modifications; and

(b) the fact pattern reflects, in substance, a modification of the terms of the agreement from being cash-settled to being equity-settled.

28. Our conclusion is supported also in the content of paragraph 28(c) of IFRS 2 which states that when new equity instruments are granted, these are identified as replacement equity instruments for the cancelled equity instruments and the entity shall account for them in the same way as a modification of the original grant. Based on this, we think that the transaction analysed in the submission is in substance a modification.

29. We have considered making a clarification to the modification guidance in IFRS 2 (paragraphs 27 and B42–B44) to state that when a cancellation of an award is followed by a replacement or a new award, and the two transactions are made in contemplation of each other, then in substance this is a modification and the modification guidance in IFRS 2 should be applied.

30. However, we think that making this clarification is outside the remit of the annual improvement process, for the following reasons:

(a) the current guidance in IFRS appears to be written in the context of modifications that do not change the classification of the award; and

(b) adding a clarification to the modifications guidance may require reconsideration of the measurement principles in IFRS 2 that are applicable to modifications, cancellations or settlements of arrangements, either by:

(i) creating new general principles that would be applicable to any type of modification of arrangements, or by

(ii) creating specific principles for each possible type of modification

Assessment against the new annual improvements criteria

31. We have assessed our conclusion against the enhanced annual improvements criteria. In our view, the clarification or correction criteria are not satisfied, because as the current guidance in IFRS 2 does not refer explicitly to modifications that change the classification of an award from one type to another, we think that there is no specific guidance we could clarify or correct through a potential annual improvement. Because we are not proposing any amendment to IFRS 2, the remaining annual improvements criteria are not applicable.

Staff recommendation

32. On the basis of the assessment under the annual improvements criteria, we do not recommend that this issue should be included in the 2010-2012 annual improvements cycle. Instead, we think that a modification of a share-based payment that changes its classification from cash-settled to equity-settled should be considered in a future agenda proposal for IFRS 2.

33. Our proposed tentative agenda decision is shown in **Appendix A**.

Question to the Interpretations Committee

Question 1—Modifications of arrangements (cash-settled to equity-settled)
Does the Committee agree with the staff recommendation in paragraph 32 and our proposed tentative agenda decision in Appendix A?

Appendix A—proposed wording for tentative agenda decision

A.1 We propose the following wording for the tentative agenda decision:

The Committee received a request to clarify how to measure and account for a share-based payment in situations where a cash-settled award is cancelled and is replaced by a new equity-settled award and the replacement award has a higher fair value than the original award. The Committee noted that the cancellation of an award accompanied by the granting of a replacement award is in substance the same as a modification of the original award. The Committee also noted that IFRS 2 *Share-based Payment* does not provide guidance on modifications of a share-based payment in which the classification changes from cash-settled to equity-settled (or vice versa). However, the Committee noted that the modifications guidance in IFRS 2 included in paragraphs 27 and B42–B44 could be applied by analogy.

The Committee observed that amendments that would be necessary to IFRS 2 to provide specific guidance on this matter would be beyond the scope of the Annual Improvements project and would be better suited to being addressed as part of a separate IASB project to improve IFRS 2.

Consequently, the Committee [decided] not to add this issue to its agenda and recommended that this issue be considered by the IASB as part of a future agenda proposal for IFRS 2.

Appendix B—guidance in IFRS 2 for modifications, cancellations and settlements

B.1 The guidance in paragraphs 27, B42-44, 28, 39 and 43 of IFRS 2 is reproduced below for ease of reference (emphasis added):

27 The entity shall recognise, **as a minimum, the services received measured at the grant date fair value of the equity instruments granted**, unless those equity instruments do not vest because of failure to satisfy a vesting condition (other than a market condition) that was specified at grant date. This applies irrespective of any modifications to the terms and conditions on which the equity instruments were granted, or a cancellation or settlement of that grant of equity instruments. **In addition, the entity shall recognise the effects of modifications that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee**. **Guidance on applying this requirement is given in Appendix B.**

B42 Paragraph 27 requires that, irrespective of any modifications to the terms and conditions on which the equity instruments were granted, or a cancellation or settlement of that grant of equity instruments, **the entity should recognise, as a minimum, the services received measured at the grant date fair value of the equity instruments granted**, unless those equity instruments do not vest because of failure to satisfy a vesting condition (other than a market condition) that was specified at grant date. **In addition, the entity should recognise the effects of modifications that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee**.

B43 To apply the requirements of paragraph 27:

(a) **if the modification increases the fair value of the equity instruments granted** (eg by reducing the exercise price), measured immediately before and after the modification, the entity shall include the **incremental fair value** granted in the measurement of the amount recognised for services received as consideration for the equity instruments granted. **The incremental fair value granted is the difference between the fair value of the modified equity instrument and that of the original equity instrument, both estimated as at the date of the modification. If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period.** If the modification occurs after vesting date, the incremental fair value granted is recognised immediately, or over the vesting period if the employee is required to

complete an additional period of service before becoming unconditionally entitled to those modified equity instruments.

(b) similarly, if the modification increases the number of equity instruments granted, the entity shall include the fair value of the additional equity instruments granted, measured at the date of the modification, in the measurement of the amount recognised for services received as consideration for the equity instruments granted, consistently with the requirements in (a) above. For example, if the modification occurs during the vesting period, the fair value of the additional equity instruments granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the additional equity instruments vest, in addition to the amount based on the grant date fair value of the equity instruments originally granted, which is recognised over the remainder of the original vesting period.

(c) if the entity modifies the vesting conditions in a manner that is beneficial to the employee, for example, by reducing the vesting period or by modifying or eliminating a performance condition (other than a market condition, changes to which are accounted for in accordance with (a) above), the entity shall take the modified vesting conditions into account when applying the requirements of paragraphs 19–21.

B44 Furthermore, if the entity modifies the terms or conditions of the equity instruments granted in a manner that reduces the total fair value of the share-based payment arrangement, or is not otherwise beneficial to the employee, the entity shall nevertheless continue to account for the services received as consideration for the equity instruments granted as if that modification had not occurred (other than a cancellation of some or all the equity instruments granted, which shall be accounted for in accordance with paragraph 28). For example:

(a) if the modification reduces the fair value of the equity instruments granted, measured immediately before and after the modification, the entity shall not take into account that decrease in fair value and shall continue to measure the amount recognised for services received as consideration for the equity instruments based on the grant date fair value of the equity instruments granted.

(b) if the modification reduces the number of equity instruments granted to an employee, that reduction shall be accounted for as a cancellation of that portion of the grant, in accordance with the requirements of paragraph 28.

(c) if the entity modifies the vesting conditions in a manner that is not beneficial to the employee, for example, by increasing the vesting period or by modifying or adding a performance condition (other than a market condition, changes to which are accounted for in accordance with (a) above), the entity shall not take the modified vesting conditions into account when applying the requirements of paragraphs 19–21.

28 **If a grant of equity instruments is cancelled or settled during the vesting period** (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied):

(a) **the entity shall account for the cancellation or settlement as an acceleration of vesting, and shall therefore recognise immediately the amount that otherwise would have been recognised for services received over the remainder of the vesting period**.

(b) **any payment made to the employee on the cancellation or settlement of the grant shall be accounted for as the repurchase of an equity interest**, ie as a deduction from equity, except to the extent that the payment exceeds the fair value of the equity instruments granted, measured at the repurchase date. Any such excess shall be recognised as an expense. However, if the share-based payment arrangement included liability components, the entity shall remeasure the fair value of the liability at the date of cancellation or settlement. Any payment made to settle the liability component shall be accounted for as an extinguishment of the liability.

(c) **if new equity instruments are granted to the employee and, on the date when those new equity instruments are granted, the entity identifies the new equity instruments granted as replacement equity instruments for the cancelled equity instruments, the entity shall account for the granting of replacement equity instruments in the same way as a modification of the original grant of equity instruments, in accordance with paragraph 27 and the guidance in Appendix B.** The incremental fair value granted is the difference between the fair value of the replacement equity instruments and the net fair value of the cancelled equity instruments, at the date the replacement equity instruments are granted. The net fair value of the cancelled equity instruments is their fair value, immediately before the cancellation, less the amount of any payment made to the employee on cancellation of the equity instruments that is accounted for as a deduction from equity in accordance with (b) above. If the entity does not identify new equity instruments granted as replacement equity instruments for the cancelled equity instruments, the entity shall account for those new equity instruments as a new grant of equity instruments.

39 **At the date of settlement, the entity shall remeasure the liability to its fair value. If the entity issues equity instruments on settlement rather than paying cash, the liability shall be transferred direct to equity, as the consideration for the equity instruments issued**.

43 If no such obligation exists, the entity shall account for the transaction in accordance with the requirements applying to equity-settled share-based payment transactions, in paragraphs 10–29. **Upon settlement**:

(a) if the entity elects to settle in cash, the cash payment shall be accounted for as the repurchase of an equity interest, ie as a deduction from equity, except as noted in (c) below.

(b) if the entity elects to settle by issuing equity instruments, no further accounting is required (other than a transfer from one component of equity to another, if necessary), except as noted in (c) below.

(c) **if the entity elects the settlement alternative with the higher fair value, as at the date of settlement, the entity shall recognise an additional expense for the excess value given, ie the difference between the cash paid and the fair value of the equity instruments that would otherwise have been issued, or the difference between the fair value of the equity instruments issued and the amount of cash that would otherwise have been paid, whichever is applicable**.

Appendix C – Request for Annual Improvements

C.1 The staff received the following request. All information has been copied without modification, except for details that would identify the submitter of the request and details that are subject to confidentiality.

REQUEST FOR ANNUAL IMPROVEMENTS

The issue

There is diversity in practice regarding how to account for a modification of a share-based payment (SBP) that changes its classification from cash-settled to equity-settled. The total amount recognised can differ depending upon whether the cash-settled SBP is considered to be settled or whether the general requirements for modification accounting and whether the guidance in the example for modifications that reclassify an award from equity-settled to cash-settled are applied.

Types of change: modification of terms of the arrangement.

Consider the following fact pattern:

On 1 January 2010 Company M grants 100 share appreciation rights (SARs) to its CFO, subject to a four-year service condition. The grant-date fair value of a SAR is 1; the total grant-date fair value is 100. The share price at the end of 2010 is unchanged. At the end of 2011 the original grant has a fair value of 120. M cancels the grant and in its place grants 100 share options at a fair value of 132, i.e. with an incremental fair value of 12 at that date. The new equity-settled grant is identified as a replacement of the original cash-settled grant.

If the modification example is applied by analogy then measurement of the replacement award is based on the grant date fair value of the original award plus any incremental fair value. If that guidance is not applied by analogy then two alternative approaches result in the modified award being accounted for based on the modification date fair value of the replacement award. More detailed analysis of the different vies and illustrations of the accounting are attached in Appendix A.

Reasons for the IFRIC to address the issue

(a) There are at least three different approaches supported by the published guidance of the major networks of audit firms. The difference between two of these approaches is only a timing difference. The total expense however would be different under one approach.
(b) Financial reporting would be improved if similar events were accounted for on a consistent basis.
(c) The issue is capable of interpretation or annual improvement within the confines of IFRSs and the *Framework for the Preparation and Presentation of Financial Statements.*
(d) IFRS 2 *Share-based Payment* is not currently within the scope of any of the Board's projects.

Appendix A

Current practice

We have identified three different views in practice on how to account for such an event.

View 1: Analogy to modification from equity-settled share-based payment to cash-settled share-based payment

The principles for modification and cancellation of equity-settled share-based payments should be applied by analogy to such changes in classification. IFRS 2 IG 2 illustrates that the requirements of IFRS 2.27 and IFRS 2 B42 - 44 apply to a modification that triggers a change from an equity-settled classification to a cash-settled classification. Under view 1 those principles should be applied by analogy to the opposite change in classification. Accordingly, a modification of an existing cash-settled arrangement in which the classification is changed from cash settled to equity settled should be accounted for as follows:

Distinguish between the grant-date fair value of the original cash-settled share-based payment arrangement (first component) and the remeasurement of that liability (second component).
At the date of modification, the liability recognised to the extent that services have been received as of that date is reclassified to equity.
The incremental fair value of the modification is calculated as:

- the fair value of the new grant, measured at the date of modification; less
- the fair value of the original grant, measured at the date of modification; and
- any payments made to the employees on cancellation of the original grant.

Recognise the remaining grant-date fair value of the original grant (unrecognised portion of the first component only) in addition to the incremental fair value, if any, over the remaining vesting period.

This is illustrated as follows:

End of:	Liability			Equity		
	In current period		Cumulative	In current period		Cumulative
	Recognition of grant-date fair value of liability	Remeasure-ment		Unrecognised grant-date fair value of liability	Incremental fair value	
2010	25	-	25	-	-	-
2011	25	10	60			60
2012	-	-	-	25	6	91
2013	-	-	-	25	6	122

M accounts for the transaction as follows:

	Debit	*Credit*
2010		
Expenses	25	
Liability		25

To recognise 1/4 of grant-date fair value of the liability, no remeasurement

2011		
Expenses	35	
Liability		35

To recognise 1/4 of grant-date fair value of the liability of 25 and remeasurement of 10

Liability	60	
Equity		60

To recognise reclassification from liability to equity

2012		
Expenses	31	
Equity		31

To recognise ½ of the unrecognised grant-date fair value of the original cash settled share-based payment arrangement of 25 and ½ of the incremental fair value as of modification date of 6 ((132-120)/2) as an increase in equity

	Debit	*Credit*
2013		
Expenses	31	
Equity		31

To recognise ½ of the unrecognised grant-date fair value of the original cash settled share-based payment arrangement of 25 and ½ of the incremental fair value as of modification date of 6 ((132-120)/2) as an increase in equity

Cumulative effects:

	Debit	Credit
Expenses	122	
Equity		122
Liability		0

View 2: No analogy to modification from equity-settled share-based payment to cash-settled share-based payment

View 2 is to measure the equity-settled award at modification date. There are two sub-views as to when the incremental value should be expensed.

View 2 is that the requirements of IFRS 2 relating to cash-settled awards do not include guidance relating to modifications on the grounds that the liability is remeasured to its fair value and therefore any modifications would be reflected in the carrying value of the liability. If an entity cancelled a cash-settled award then, in contrast to the treatment of a cancellation for an equity-settled award, the expense would be reversed.

Under this view when a cash-settled award is "cancelled" and "replaced" by an equity-settled award the appropriate accounting would be to reverse the expense recognised up to the date of cancellation and then start to recognise an equity-settled award with a new grant date. However, this would not give an expense recognition in line with the receipt of services. Furthermore, reversal of the recognised expense would be appropriate only if the liability had been extinguished; in fact the liability has been "settled" by a promise to issue equity instruments; *therefore, the appropriate treatment for the accrued liability is to transfer it to equity*. The grant date for an equity-settled award is defined in IFRS 2 as:

> "The date at which the entity and another party (including an employee) agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date the entity confers on the counterparty the right to cash, other assets, or equity instruments of the entity, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained."

At the original grant date of the award the shared understanding was that there would be a cash payment. It is only after the "modification" date that the entity is obligated to issue equity instruments and that the shared understanding is based on issue of equity instruments. Therefore the grant date for the purpose of measuring the equity settled award is the date of modification rather than the original award date. Another way of looking at this would be in line with IFRS 2 B43(b), prior to the modification the number of equity instruments expected to vest was zero, therefore all the equity

instruments are incremental and under B43(b) the incremental expense would be measured based on the fair value at the modification date[1].

<u>View 2A:</u> Consider the original cash-settled liability to be settled by conversion (reclassification to equity) and account for the difference between the modification date fair value of the replacement equity-settled share-based payment arrangement and the amount reclassified to equity over the remaining vesting period.

Under this sub-view when a modification changes the classification of a share-based payment arrangement from cash-settled to equity-settled, the entity immediately reclassifies the carrying amount of the liability at the date of modification to equity. The expense recognised over the remaining vesting period is based on the modification date fair value of the replacement equity-settled share-based payment arrangement and not the grant date fair value of the original arrangement.

Taking the same fact as outline above the example below illustrates the accounting entries that arise under this view.

	Liability			Equity		
	In current period			In current period		
End of:	Recognition of grant-date fair value of liability	Remeasure-ment	Cumulative	Reclassification from liability	Unrecognised modification-date fair value of equity replacement	Cumulative
2010	25	-	25	-	-	-
2011	25	10	60	→ 60		60
2012	-	-	-	-	36	96
2013	-	-	-	-	36	132

[1] Also ASC 718-20-55sets out the US GAAP treatment which measures the expense based on the fair value at the time that the award is modified to equity settled. View 2 would be converged with this whilst View 1 would lead to a GAAP difference.

M accounts for the transaction as follows:

	Debit	*Credit*
2010		
Expenses	25	
Liability		25
To recognise 1/4 of grant-date fair value of the liability, no remeasurement		
2011		
Expenses	35	
Liability		35
To recognise 1/4 of grant-date fair value of the liability of 25 and remeasurement of 10		
Liability	60	
Equity		60
To recognise reclassification from liability to equity		
2012		
Expenses	36	
Equity		36
To recognise 1/2 of the unrecognised modification-date fair value of the replacement equity settled share-based payment arrangement of 36 as an increase in equity (132-60)/2		
2013		
Expenses	36	
Equity		36
To recognise 1/2 of the unrecognised modification-date fair value of the replacement equity settled share-based payment arrangement of 36 as an increase in equity		
Cumulative effects:		
Expenses	132	
Equity		132
Liability		0

View 2B: Account for settlement of the cash-settled share-based payment on date of modification

Under this view, the change from cash-settled award to equity-settled is viewed as a settlement of the cash-settled award and any excess of the fair value of the equity instruments used to settle the liability over the amount reclassified is recognised immediately in profit or loss. That is, the fair value of the modification award is compared to the fair value of the original award, and any positive difference is expensed immediately to the extent that services have been received.

This is consistent with what is required by IFRS 2.43 (c) when an entity elects the settlement alternative with a higher fair value.

	Liability			Equity		
	In current period			In current period		
End of:	Recognition of grant-date fair value of liability	Remeasure-ment	Cumulative	Settlement of cash-settled award	Unrecognised modification-date fair value of equity replacement	Cumulative
2010	25	-	25	-	-	-
2011	25	10	60	6	-	66
2012	-	-	-	-	33	99
2013	-	-	-	-	33	132

M accounts for the transaction as follows:

	Debit	*Credit*
2010		
Expenses	25	
Liability		25

To recognise 1/4 of grant-date fair value of the liability, no remeasurement

	Debit	*Credit*
2011		
Expenses	35	
Liability		35

To recognise 1/4 of grant-date fair value of the liability of 25 and remeasurement of 10

	Debit	*Credit*
Employee costs	6	
Liability	60	
Equity		60

To recognise reclassification from liability to equity plus the effect of settlement of the cash-settled award (6=((132-120)/2) to the extent of services provided as an increase in equity

2012

Expenses	33	
Equity		33

To recognise 1/2 of the unrecognised modification-date fair value of the replacement equity settled share-based payment arrangement of 33

2013

Expenses	33	
Equity		33

To recognise 1/2 of the unrecognised modification-date fair value of the replacement equity settled share-based payment arrangement of 33 as an increase in equity

Cumulative effects:

Expenses	132	
Equity		132
Liability		0

The total expense reflects the settlement of the original cash-settled award (66), plus the expense related to the modification equity-settled award (66).