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

Topic | **Review of the requests received by the Committee in relation to IFRS 2**

Objective of the paper

1. At its September 2010 meeting, the Board discussed the recommendations from the IFRS Interpretations Committee's (hereafter, the Committee) regarding vesting and non-vesting conditions relating to IFRS 2 *Share-based Payment*. After doing so, the Board asked the Committee to review the other requests that it had received in relation to IFRS 2 with a view to helping the staff to develop an agenda proposal that could be considered as part of the setting of the new agenda in 2011.

2. At its meeting in March 2011, the Committee reviewed a list of issues it had received in relation to IFRS 2 and the different reasons why the issues were not taken into the Committee's agenda. The Committee agreed with the staff's recommendations and agreed to refer them to the Board.

3. The purpose of this paper is to ask the Board whether it approves the Committee's recommendation of the issues that should be referred for consideration in a future agenda proposal for IFRS 2.

Structure of the paper

4. This paper:

(a) provides background information and explains the issues that the Committee has been asked to consider since 2005;

(b) describes the reasons why the Committee members (at the time) believed that the issues should not be taken onto its agenda; and

(c) includes the Committee's recommendation to the Board on whether the issues should be referred for consideration in a future agenda proposal.

List of issues considered by the Committee on IFRS 2

5. The Committee identified eight issues and the different reasons why the issues were not taken onto the Committee's agenda at the time. The list of issues is shown below along with the date of the Interpretations Committee meeting when the issue was last discussed.

Issues where IFRS 2 was thought to be clear and where significant divergence is not expected in practice.

- ***Issue # 1:*** Employee share loan plans (May 2005)
- ***Issue # 2:*** Scope of IFRS 2: Share plans with cash alternatives at the discretion of the entity (May 2006)
- ***Issue # 3:*** Grant date and vesting periods (May 2006)
- ***Issue # 4:*** Fair value measurement of post-vesting transfer restrictions (November 2006)

Issue that did not have widespread significance

- ***Issue # 5:*** Incremental fair value to employees as a result of unexpected capital restructurings (November 2006)

Issue that could be better dealt within the IASB's active projects

- ***Issue # 6:*** Employee benefit trusts in the separate financial statements of the sponsor (November 2006)

Issue recommended to be reconsidered by the Board as part of a post-implementation review of IFRS 2

- ***Issue # 7:*** Transactions in which the manner of settlement is contingent on future events (January 2010)

Issues recommended for consideration in a future agenda proposal for IFRS

- ***Issue # 8:*** Vesting and non-vesting conditions—classification of a non-compete provision and the accounting for the interaction of multiple vesting conditions (September 2010).

Description of issues considered by the Committee on IFRS 2[1]

Issue # 1: Employee share loan plans (May 2005)

Description of the issue

6. The Committee was asked to clarify the treatment of employee share loan plans. Under many such plans, employee share purchases are facilitated by means of a loan from the issuer with recourse only to the shares.

7. The submission identified two approaches to deal with this transaction:

   (a) apply IFRS 2 to the 'share issue' component and IAS 39 *Financial Instruments: Recognition and Measurement* to the 'loan' component; or

   (b) treat the plan as an 'in substance' share option in a manner similar to practice under US GAAP (SFAS 123 revised 2004).

8. The Committee was asked whether:

   (a) the loan should be considered part of the potential share-based payment, with the entire arrangement being treated as an option; or

   (b) the loan should be accounted for separately as a financial asset.

[1] The content of this section is based on the summary of past deliberations as reflected in the IFRIC Update and/or agenda papers presented by the staff dealing with those issues at the time, to provide a better understanding of the issues.

Reasons for not adding the issue to the agenda

9. The Committee noted that the issue of shares using the proceeds of a loan made by the share issuer, when the loan has recourse only to the shares, would be treated as an option grant in which options were exercised on the date or dates when the loan was repaid.

10. Because of this, the Committee decided that it would not expect diversity in practice and would not take this item onto its agenda.

The Committee's recommendation (2011)

11. The staff informed the Committee that in December 2005, the national standard setter who submitted this request, agreed with the conclusions of the IFRIC at the time and decided not to add this issue to the agenda of its Urgent Issues Group.

12. In addition, the Committee agreed that there have not been any recent amendments to IFRS 2 that could change the original conclusions that the Committee had reached on this issue. The Committee members were not aware of any further concerns on this matter or diversity in practice.

13. Consequently, the Committee does not recommend that this issue should be considered in a future agenda proposal for IFRS 2.

Issue # 2: Share plans with cash alternatives at the discretion of the entity (May 2006)[2]

Description of the issue

14. The Committee considered an employee share plan in which the employer had the choice of settlement in cash or in shares, but in which the amount of the cash alternative settlement did not vary with changes in the share price of the entity. For example, an entity agrees to pay employees a bonus based on performance criteria, with that bonus not being directly linked to its share price.

15. The Committee was asked whether this should be treated as a share-based payment transaction within the scope of IFRS 2.

[2] The staff discussion of this topic can be found in Agenda paper 10(i), *Scope of IFRS 2 - Share plans with cash alternatives at the discretion of the entity* (March 2006).

Reasons for not adding the issue to the agenda

16. The Committee noted that plans that give an entity a choice of settlement are addressed specifically in paragraphs 2(c) and 41-43 of IFRS 2, so these plans are within the scope of this standard. Specifically, paragraph 2.2(c) states that share-based payment transactions include (emphasis added):

> 2(c) transactions in which the entity receives or acquires goods or services **and the terms of the arrangement provide either the entity or the supplier of those goods or services with a choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments**.

17. In addition, the Committee noted that the definition of a share-based payment transaction does not require the exposure of the entity to be linked to movements in the share price of the entity. Paragraph 256 of the Basis for Conclusions of IFRS 2 states that for share-based payment transactions with cash alternatives (emphasis added):

> BC256 The terms of the arrangement may provide the entity with a choice of settlement, ie whether to pay the cash alternatives instead of issuing shares or share options on vesting date or instead of issuing shares upon the exercise of the share options. **The amount of the cash alternative may be fixed or variable and, if variable, may be determined in a manner that is related, or unrelated, to the price of the entity's shares**.

18. The Committee further noted that even if the amount of the settlement did not vary with changes in the share price of the entity, such share plans are share-based payment transactions in accordance with IFRS 2, because the consideration may be equity instruments of the entity. In the extreme circumstances in which the entity was given a choice of settlement and the value of the shares that would be delivered was a fixed monetary amount, those share plans would still be within the scope of IFRS 2.

19. Consequently, based on the fact that IFRS 2 is clear, the Committee believed that the issue was not expected to create significant divergence in practice.

The Committee's recommendation (2011)

20. The Committee agreed that there have not been any recent amendments to IFRS 2 that could change the original conclusions that the Committee had reached on this

issue. In addition, the Committee was not aware of any further concerns on this matter or diversity in practice. Consequently, the Committee does not recommend that this issue should be considered in a future agenda proposal for IFRS 2.

Issue # 3: Grant date and vesting periods (May 2006)[3]

Description of the issue

21. The Committee considered an employee share plan in which employees were provided with a choice to have cash at one date or shares at a later date. At the date when the transactions were entered into, the parties involved knew and understood the terms and conditions of the plans, including the formula that would be used to determine the amount of cash to be paid to each individual employee (or the number of shares to be delivered to each individual employee), but the exact amount of cash or number of shares would only be known at a future date.

22. The Committee was asked to confirm the grant date and vesting period for such share plans.

Reasons for not adding the issue to the agenda

23. The Committee noted that IFRS 2 (Appendix A) defines grant date as the date when there is a shared understanding of the terms and conditions. Moreover, IFRS 2 does not require grant date to be the date when the exact amount of cash to be paid (or the exact number of shares to be delivered) is known to the parties involved.

24. At grant date the entity confers on the counterparty the right to cash, other assets, or equity instruments of the entity, provided that the specified vesting conditions, if any, are met. If that agreement is subject to an approval process, grant date is the date when that approval is obtained.

25. The Committee further noted that share-based payment transactions with cash alternatives at the discretion of the counterparty are addressed in paragraphs 34-40

[3] The staff discussion of this topic can be found in Agenda paper 10(ii), *Share plans with cash alternatives at the discretion of employees—grant date and vesting periods* (March 2006).

of IFRS 2. Some extracts of paragraphs 35 and 38 of IFRS 2 state that (emphasis added):

> 35 If an entity **has granted the counterparty the right to choose** whether a share-based payment transaction is settled in cash or by issuing equity instruments, the entity has granted a compound financial instrument, which includes a debt component (i.e. the counterparty's right to demand payment in cash) and an equity component (i.e. the counterparty's right to demand settlement in equity instruments rather than in cash).
>
> 38 The entity **shall account separately** for goods or services received or acquired in respect of each component of the compound financial instrument.

26. The Committee, therefore, thought that the vesting period of the equity component and that of the debt component should be determined separately and the vesting period of each component may be different.

27. The Committee further noted that, since 'grant date' is defined in IFRS 2 and the requirements set out in paragraphs 34–40 of IFRS 2 are clear regarding the vesting periods that should be considered, these issues are not expected to create significant divergence in practice. The Committee consequently decided that the issues should not be taken onto the agenda.

The Committee's recommendation (2011)

28. The Committee agreed that there have not been any recent amendments to IFRS 2 that could change the original conclusions that the Committee had reached on this issue. In addition, the Committee was not aware of any further concerns on this matter or diversity in practice. Consequently, the Committee does not recommend that this issue should be considered in a future agenda proposal for IFRS 2.

Issue # 4: Fair value measurement of post-vesting transfer restrictions (Nov 2006) [4]

Description of the issue

29. The Committee was asked whether the estimated value of shares issued only to employees and subject to post-vesting restrictions could be based on an approach

[4] The staff's discussion on this topic can be found in Agenda Paper 10(iii), *Fair value measurement of a post-vesting transfer restriction* (March 2006).

that would look solely or primarily to an actual or synthetic market that consisted only of transactions between an entity and its employees and in which prices, for example, reflected an employee's personal borrowing rate. The Committee was asked whether this approach was consistent with the requirements under IFRS 2.

Reasons for not adding the issue to the agenda

30. The Committee noted that paragraphs B3 and B10 of Appendix B, and BC 168 require consideration of actual or hypothetical transactions, not only with employees, but rather with all actual or potential market participants willing to invest in restricted shares that had been or might be offered to them.

31. Extracts from the paragraphs noted by the Committee are reproduced below:

> B3 (…) **if the shares are subject to restrictions on transfer after vesting date, that factor shall be taken into account, but only to the extent that the post-vesting restrictions affect the price that a knowledgeable, willing market participant would pay for that share.** For example, if the shares are actively traded in a deep and liquid market, post-vesting transfer restrictions may have little, if any, effect on the price that a knowledgeable, willing market participant would pay for those shares.
>
> B10 (…) **factors that affect the value of the option from the individual employee's perspective only are not relevant** to estimating the price that would be set by a knowledgeable, willing market participant.
>
> BC168 (…) the objective is to estimate the fair value of the share option, **not the value from the employee's perspective.**

The Committee's recommendation (2011)

32. The Committee agreed that there have not been any recent amendments to IFRS 2 that could change the original conclusions that the Committee had reached on this issue. In addition, the Committee was not aware of any further concerns on this matter or diversity in practice. Consequently, the Committee does not recommend that this issue should be considered in a future agenda proposal for IFRS 2.

Issue # 5: Incremental fair value to employees as a result of unexpected capital restructurings (November 2006) [5]

Description of the issue

33. The Committee was asked to consider a situation in which the fair value of the equity instruments granted to the employees of an entity increased after the sponsoring entity undertook a capital restructuring that was not expected at the date of grant of the equity instruments. The original share-based payment plan contained neither specific nor more general requirements for adjustments to the grant in the event of a capital restructuring. As a result, the equity instruments previously granted to the employees became more valuable as a consequence of the restructuring. The issue was whether the incremental value should be accounted for in the same way as a modification to the terms and conditions of the plan in accordance with IFRS 2[6].

Reasons for not adding the issue to the agenda

34. The Committee believed that the specific case presented was not a normal commercial occurrence (ie it would be rare for an entity not to contain any generic terms and conditions in a share option plan, setting out what actions the parties to the plan would take in the event of an unexpected capital restructuring) and was unlikely to have widespread significance.

The Committee's recommendation (2011)

35. The Committee agreed that there have not been any recent amendments to IFRS 2 that could change the original conclusions that the Committee had reached on this issue. In addition, the Committee was not aware of any further concerns on this matter or diversity in practice. In addition, the Committee did not consider that this issue had widespread significance. Consequently, the Committee does not

[5] The staff's discussion of this topic can be found in Agenda Paper 10(x), *Incremental Fair Value to Employees as a result of unexpected Capital Restructurings* (July 2006).
[6] The staff dealing with this issue at the time noted in paragraph 5 of Agenda Paper 10(x), that paragraphs 38 to 41 of Appendix B to IFRS 2 headed *Capital Structure Effects* focus only on capital structures that are known at grant date. However, in contrast, this issue relates to unexpected capital restructurings taking place after the share options are granted.

recommend that this issue should be considered in a future agenda proposal for IFRS 2.

Issue # 6: Employee benefit trusts in the separate financial statements of the sponsor (November 2006)[7]

Description of the issue

36. The Committee discussed an issue related to an employee benefit trust (or similar entity) that has been set up by a sponsoring entity specifically to facilitate the transfer of its equity instruments to its employees under a share-based payment arrangement. The trust holds shares of the sponsoring entity that are acquired by the trust from the sponsoring entity or from the market. Acquisition of those shares is funded either by the sponsoring entity or by a bank loan, usually guaranteed by the sponsoring entity. In most circumstances, the sponsoring entity controls the employee benefit trust. In some circumstances, the sponsoring entity may also have a direct control of the shares held by the trust.

37. The issue is whether guidance should be developed on the accounting treatment for the sponsor's equity instruments held by the employee benefit trust in the sponsor's separate financial statements.

38. This issue had been submitted in connection with the amendment of SIC-12 *Consolidation—Special Purpose Entities* to include within its scope special purpose entities established in connection with equity compensation plans.

Reasons for not adding the issue to the agenda

39. The Committee discussed whether the employee benefit trust should be treated as an extension of the sponsoring entity, such as a branch, or as a separate entity. The Committee noted that the notion of 'entity' is defined neither in the *Framework* nor in IAS 27 *Consolidated and Separate Financial Statements*. The Committee then discussed whether the sponsoring entity should, in its separate financial statements, account for the net investment according to IAS 27 or rather

[7] The staff's discussion on this topic can be found in Agenda Paper 10(i) *Accounting for employee benefit trusts* from May 2006 and Agenda paper 5, *Employee benefit trusts in the individual or separate financial statements of the sponsor* from September 2006.

for the rights and obligations arising from the assets and liabilities of the trust. The Committee noted that, in some circumstances, the sponsoring entity may have direct control of the shares held by the trust. The Committee also noted that the guidance included in the Framework and in IAS 27 does not address the accounting for the shares held by the trust in the sponsor's separate financial statements.

40. The Committee concluded that it could not reach a consensus on this matter on a timely basis, given the different types of trusts and trust arrangements that exist. The Committee noted that this issue related to two active projects of the IASB: the Conceptual Framework and the revision of IAS 27 *Consolidated and Separate Financial Statements* in the course of the consolidation project. For these reasons, the Committee decided not to take the issue onto its agenda.

The Committee's recommendation (2011)

41. The Committee learned from the staff that this issue had been classified as an IFRS 2 issue when considered by the Interpretations Committee in 2006. However, the Committee agreed that it views this issue as principally a consolidation/reporting entity question, rather than a share-based payment question. The Committee is not aware of any further concerns on this matter or diversity in practice.

42. In addition, the Committee noted that SIC-12 and IAS 27 both deal with consolidation issues and the guidance in these pronouncements for consolidation of financial statements was about to be replaced by IFRS 10 *Consolidated Financial Statements*. IFRS 10 will provide guidance in the preparation of consolidated financial statements, but the issue considered by the Committee relates to separate financial statements. The Committee notes, however, that there is no Board project on separate financial statements.

43. Based on the above, the Committee does not recommend that this issue should be considered in a future agenda proposal for IFRS 2.

Issue # 7: Transactions in which the manner of settlement is contingent on future events (January 2010)[8]

Description of the issue

44. The Committee received a request to clarify the classification and measurement of share-based payment transactions for which the manner of settlement is contingent on either:

    (a) a future event that is outside the control of both the entity and the counterparty; or

    (b) a future event that is within the control of the counterparty.

Reasons for not adding the issue to the agenda

45. The Committee noted that IFRS 2 does not provide guidance on share-based payment transactions for which the manner of settlement is contingent on a future event that is outside the control of both the entity and the counterparty. However, because many other issues have been raised concerning the classification and measurement of share-based payments as cash-settled or equity-settled, the Committee therefore noted that it would be more appropriate for these issues to be considered collectively as part of a post-implementation review of IFRS 2.

46. Consequently, the Committee decided not to add these issues to its agenda and recommended that those issues should be dealt with by the IASB in a post-implementation review of IFRS 2.

The Committee's recommendation (2011)

47. The Committee agreed that there have not been any recent amendments to IFRS 2 that could change the original conclusions that the Committee had reached on this issue. In addition, the Committee learned that the Board does not expect to conduct a post-implementation review of IFRS 2. Consequently, the Committee recommends the Board to consider this issue, in a future agenda proposal for IFRS 2.

[8] The staff's discussion of this topic can be found in Agenda papers 7, 7A and 7B (November 2009) and Agenda Paper 4b (January 2010).

Issue # 8: Vesting and non-vesting conditions (September 2010)

Description of the issue

48. The Committee took on to its agenda a project to consider vesting and non-vesting conditions, acknowledging that issues that are arising are due to:

    (a) a lack of clarity in the current definition of vesting conditions, which incorporates the concepts of service conditions, performance conditions and market conditions (and vesting period);

    (b) an absence of a definition for non-vesting conditions; and

    (c) insufficient guidance on the interaction of multiple vesting conditions.

49. The Committee analysed each of the issues and sought solutions that would be consistent with the underlying principles in IFRS 2. Based on the deliberations in several meetings, the Committee reached conclusions on those issues.

50. At the November 2010 meeting, in response to the Board's request, the Committee decided to propose clarification to the definitions of service conditions and performance conditions through the next *Annual Improvements* cycle. The Committee identified the following as high-priority issues to be addressed in this way:

    (a) the correlation between an employee's responsibility and the performance target;

    (b) whether a share market index target may constitute a performance condition;

    (c) whether a performance target that refers to a longer period than the required service period may constitute a performance condition; and

    (d) whether termination of employment is a forfeiture or cancellation event.

51. The Committee concluded that the following issues, however, should be referred to the Board for consideration in a future agenda proposal for IFRS 2:

(a) *classification of a non-compete provision*—should a non-compete provision be considered (i) a service condition, (ii) a non-vesting condition or (iii) another type of condition that is not defined in IFRS 2;

(b) *accounting for the interaction of multiple vesting conditions*—over what period should compensation cost be recognised for a share-based payment transaction when it includes more than one vesting condition?

The Committee's recommendation (2011)

52. The Committee agreed that classification of a non-compete provision and the accounting for the interaction of multiple vesting conditions should be referred to the Board for consideration in a future agenda proposal for IFRS 2

Question to the Board

Question—recommendation for each identified issue
1. Does the Board agree with the Committee's recommendation for each identified issue? (refer to Appendix A in the following page) If not, what other path forward does the Board suggest? 2. Does the Board think that Issue 5 (Incremental fair value to employees as a result of unexpected capital restructuring) has widespread relevance? If so, then the Committee recommends the Board to consider this issue, in a future agenda proposal for IFRS 2.

Appendix A – The Committee's recommendation for each identified issue

A1. The table below summarises the Committee's recommendation for each identified issue:

Date	Issue	Staff/Committe comments
May 2005	**1. Employee share loan plans**	We note that there have not been any recent amendments to IFRS 2 that could change the original conclusions that the Committee had reached on this issue. The Committee is not aware of any further concerns on this matter or diversity in practice. Therefore, the Committee does not recommend that this issue should be considered in a future agenda proposal for IFRS 2.
May 2006	**2. Share plans with cash alternatives at the discretion of the entity**	There have not been any recent amendments to IFRS 2 that could change the original conclusions that the Committee had reached on this issue. In addition, the Committee is not aware of any further concerns on this matter or diversity in practice. Therefore, the Committee does not recommend that this issue should be considered in a future agenda proposal for IFRS 2.
May 2006	**3. Grant date and vesting periods**	There have not been any recent amendments to IFRS 2 that could change the original conclusions that the Committee had reached on this issue. The Committee is not aware of any further concerns on this matter or diversity in practice. Therefore, the Committee does not recommend that this issue should be considered in a future agenda proposal for IFRS 2.
November 2006	**4. Fair value measurement of post-vesting transfer restrictions**	There have not been any recent amendments to IFRS 2 that could change the original conclusions that the Committee had reached on this issue. In addition, The Committee is not aware of any further concerns on this matter or diversity in practice. Therefore, the Committee does not recommend that this issue should be considered in a future agenda proposal for IFRS 2.
November 2006	**5. Incremental fair value to employees as a result of unexpected capital restructuring**	There have not been any recent amendments to IFRS 2 that could change the original conclusions that the Committee had reached on this issue. In addition, the Committee is not aware of any further concerns on this matter or

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Appendix B

Date	Issue	Staff/Committe comments
		diversity in practice. However, if the Board thinks that this issue has widespread significance, then the Committee recommends the Board to consider this issue, in a future agenda proposal for IFRS 2.
November 2006	**6. Employee benefit trusts in the separate financial statements of the sponsor**	This issue was classified as an IFRS 2 issue when considered by the Interpretations Committee in 2006. However, the Committee views this issue as principally a consolidation/reporting entity question, rather than a share-based payment question. The Committee is not aware of any further concerns on this matter or diversity in practice. The Committee does not recommend that this issue should be considered in a future agenda proposal for IFRS 2.
January 2010	**7. Transactions in which the manner of settlement is contingent on future events**	There have not been any recent amendments to IFRS 2 that could change the original conclusions that the Committee had reached on this issue. Since January 2010 the Committee has learnt that the Board does not expect to conduct a post-implementation review of IFRS 2. Consequently, the Committee recommends the Board to consider this issue, in a future agenda proposal for IFRS 2.
September 2010	**8. Vesting and non-vesting conditions**	The classification of a non-compete provision and the accounting for the interaction of multiple vesting conditions should be referred to the Board for consideration in a future agenda proposal for IFRS 2.