IFRS

STAFF PAPER

14–15 May 2013

IFRS Interpretations Committee Meeting

Project	IFRS 2 *Share-Based Payment*		
Paper topic	Share-based payment transactions where the manner of settlement is contingent on future events		
CONTACT(S)	Kenichi Yoshimura	kyoshimura@ifrs.org	+44 (0)20 7246 6905

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. 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*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

Introduction

1. In July 2012, the IFRS Interpretations Committee (the Interpretations Committee) decided to revisit three issues related to IFRS 2 *Share-based Payment*. This agenda paper addresses, one of the three issues, namely, an issue of the classification and measurement of share-based payment transactions in which the manner of settlement is contingent on future events. The other two issues were discussed in the March 2013 Interpretations Committee meeting[1].

2. The objective of this paper is to provide the Interpretations Committee with updates on the results of our outreach and technical analysis on this issue. This agenda paper contains one question to the Interpretations Committee.

3. This agenda paper is organised as follows:

   (a) summary of the issue

   (b) previous discussions by the Interpretations Committee

   (c) summary of the result of outreach activities

   (d) staff technical analysis

[1] Please refer to Agenda Paper 5, 5B and 5C for the March 2013 Interpretations Committee meeting.

(e) assessment against the Interpretations Committee's agenda criteria

(f) staff recommendation

(g) question for the Interpretations Committee

(h) Appendix A—Submission

(i) Appendix B—Excerpt from outreach request

(j) Appendix C—Excerpt from *IFRIC Update* in January 2010.

Summary of the issues

4. The Interpretations Committee received a request to clarify how to account for 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 (Issue A); or

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

5. The submitter states that IFRS 2 provides guidance on the classification of a share-based payment transaction in cases in which either the entity or the counterparty can choose whether the transaction is settled in cash (or other assets) or by issuance of equity instruments (paragraphs 34-43 of IFRS 2). The difference between 4(b) above and the share-based payment transactions in which the counterparty can choose the manner of settlement as described in paragraphs 35-40 of IFRS 2 is that in the situation described in 4(b) above, the counterparty needs to fulfil a condition that is within the control of the counterparty. The submitter argues that there is no clear guidance on the two cases described above and therefore, there are divergent views on Issue A and Issue B as follows:

Issue A

6. The submitter describes a share-based payment transaction in which an entity that grants to its employees its own shares that vest upon a number of years of service.

It also has a cash alternative provision in which the granted shares will vest immediately and be settled in cash at the fair value of the shares at the date of settlement, if a specified event such as a successful initial public offering (IPO)[2] that is outside the control of both parties occurs. If such an event does not occur until the date of settlement, the share-based payment is settled in the shares. According to the submitter, there are four alternative views on the accounting for this type of arrangement:

View 1: the condition should be viewed as being similar to a non-market vesting condition in IFRS 2

7. The table in paragraph IG24 of IFRS 2 lists "target based on a successful initial public offering with a specified service requirement" as one of non-market vesting conditions. IFRS 2 requires the compensation expense to be based on the expectation of whether a vesting condition will be met (paragraph 20 of IFRS 2). Under this view, the expectation of the occurrence or non-occurrence of an uncertain future event such as a successful IPO[3] would be assessed at each reporting date. If it is expected that the condition will be met, the share-based payment arrangement will be reclassified from equity-settled to cash-settled.

8. Accordingly, if the occurrence of the future event becomes probable, the cumulative entries to equity would be reversed and then a liability measured at fair value would be established.

View 2: the guidance for a circumstance where the counterparty has the choice should be applied by analogy

9. In this view, the occurrence of the future event is not considered to be a vesting or non-vesting condition. The proponents of this view state that the entity does not have control over whether this arrangement will be settled in cash. This indicates

---

[2] With regard to the events outside the control of both the entity and the counterparty, the submission lists IPO and change in control as examples. When the Interpretations Committee discussed this issue in the past, it addressed more general circumstances whereby a contingent event is outside the control of both parties rather than the specific fact pattern in the submission, acknowledging that whether IPO and change in control are outside the entity's control is a matter of judgement that is supplementary to the question of classification. The analysis and discussions below follow the same approach as the above.

[3] See the footnote 2 above.

that, from the entity's perspective, the share-based payment transaction is similar to a share-based payment transaction in which the counterparty has a choice of the manner of settlement, because the entity does not have an unconditional right to avoid transferring cash or other assets. Accordingly, the guidance in paragraphs 35-40 of IFRS 2 (the compound financial instrument approach) should apply to this transaction.

10. Using this approach, the entity would first measure the fair value of the debt component, and then measure the fair value of the equity component—taking into account that the counterparty must forfeit the right to receive cash in order to receive the equity instrument (paragraph 37 of IFRS 2). As a result, the whole arrangement would be, in general, classified as a cash-settled share-based payment award because such a share-based payment transaction is often structured so that the fair value of one settlement alternative is the same as the other. The cash-settled award is then remeasured at each reporting date in accordance with the requirements for cash-settled share-based payment in paragraphs 30–33 of IFRS 2.

View 3: IAS 37 should be applied by analogy

11. Those who support this view argue that there is no specific guidance in IFRS 2 for this type of transaction. Accordingly, the requirements in other Standards that deal with similar issues should be referred to in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. They think that the guidance in paragraph 25 of IAS 32, which addresses a financial instrument with a contingent settlement feature, should not be applied to this case because, in their view, the IASB concluded that the requirements in IAS 32 are not applicable to IFRS 2 (paragraphs BC 106-110 and BC266 of IFRS 2). Accordingly, the entity should refer to the requirements in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to decide the classification of this type of transaction. Although IAS 37 has no requirements specifically relating to liability-equity classification, it sets out general principles regarding the identification and recognition of liabilities.

12. Applying this view, similarly as for the approach under View 1, the share-based payment transaction would be classified as equity-settled first and would then be changed into a cash-settled share-based payment transaction, with any previous equity entry reversed if the occurrence of the future event becomes probable.

View 4: the arrangement should be accounted for separately as two mutually exclusive awards

13. The submitter states that some argue that the share-based payment transaction in the submission should be divided into two mutually exclusive awards: an equity-settled award and a cash-settled award, and accounted for separately in accordance with the requirements for an equity-settled share-based payment transaction and a cash-settled share-based payment transaction, respectively.

14. Unlike the approach in View 2, the fair value of the share-based payment award would be allocated to the equity-settled part and cash-settled part by using the probability of the occurrence of the future event so that the total fair value of the two parts become equal to the fair value of the share-based payment award. In addition, once the occurrence of the future event becomes probable, the total expense recognised in respect of the equity-settled part would be reversed. On the other hand, if the share-based payment award is settled in the shares, the amount of the liability decreases to nil.

Issue B

15. As another type of cash settlement alternative for a share-based payment transaction, the submitter describes a circumstance in which employees will receive the cash value of the shares if they deposit the exercise price with the entity over the vesting period; otherwise, the share options granted will be settled in equity. According to the submitter, there are primarily two views on the accounting for this type of arrangement:

View 1: the transaction should be viewed as one in which the employees are provided with a choice of settlement

16. Proponents of this view think that the arrangement effectively provides employees with a choice of settlement, because they have control over whether to deposit the exercise price with the entity. Accordingly, the entity should follow the approach described in paragraph 10 of this agenda paper when deciding the classification of the share-based payment.

View 2: the condition should be viewed as a non-vesting condition

17. Those who support this view argue that even though the arrangement is considered to be one in which the employees have control over the way of settlement, this should not be considered to be as a simple counterparty choice but instead is akin to a share-based payment with a non-market vesting condition (ie a number of years of services) and a non-vesting condition (ie to deposit the exercise price). Consequently, using this view would result in an approach that takes into account the requirements related to a non-vesting condition in paragraphs 21A and 28A of IFRS 2.

18. For ease of reference, the text of the submission is reproduced in Appendix A to this agenda paper.

Previous discussions by the Interpretations Committee

19. In the discussions in the Interpretations Committee meetings in November 2009[4] and January 2010 (refer to Appendix C), divergent views were expressed by the members of the Interpretations Committee especially on Issue A. In particular, they were concerned that IFRS 2 lacks a principle for deciding the accounting for and measurement of share-based payment transactions for which the manner of settlement is contingent on a future event that is outside the control of both the

[4] *IFRIC Update* for November 2009 (http://media.iasb.org/November09IFRICUpdate.html)

The comment letters on the tentative agenda decision are included in the Agenda Paper 4B for January 2010 meeting of the Interpretations Committee.

entity and the counterparty. In addition, the Interpretations Committee noted that many other issues have been raised associated with the classification and measurement of share-based payment transaction as cash-settled or equity-settled. Accordingly, in its January 2010 meeting, the Interpretations Committee concluded that it would be more appropriate for these issues to be considered comprehensively as part of a post-implementation review of IFRS 2.

20. In the July 2012 meeting, the Interpretations Committee decided to revisit the issues and asked the staff to update the analysis and outreach on those issues so that they can discuss them at future meetings. In response to this request, the staff are now first providing updates on the results of outreach activities in the following paragraphs.

Summary of the result of outreach activities

21. We requested information from the International Forum of Accounting Standard Setters (IFASS) and regulators to help us assess the Interpretations Committee's agenda criteria. Specifically, we asked:

    (i) *In your jurisdiction, do you have similar transactions to those described below? If similar, but not identical, please tell us the differences.*

    (ii) *If you answered 'yes' to question 1, what is the prevalent accounting for the transactions? And if possible, could you please briefly describe the rationale for that accounting?*

    (iii) *On the basis of your response to question 2, to what extent do you observe diversity in the practice for accounting for these types of transactions?*

    (iv) *In your jurisdiction, are you aware of any significant divergent interpretations on other issues that are related to IFRS 2?*

    (v) *If you answered 'yes' to question 4, please briefly describe the type of transactions and the divergent interpretations.*

22. Excerpts from the outreach request are attached as Appendix B to this agenda paper.

23. We have received fifteen responses to the request. The views expressed below are informal opinions from national standard-setters and regulators. They do not reflect the formal views of those organisations. The geographical breakdown of the responses is as follows:

Geographical area	**Number of respondents**
Worldwide	1
Americas	4
Asia/Oceania	5
Africa	1
Europe	4
Total respondents	15

Issue A

24. Four respondents answered that this issue is widespread in their jurisdictions while nine respondents stated that this issue is not common in their jurisdictions. One respondent mentioned that it has no data to assess the relevance in the jurisdiction. The other respondent stated that this issue is seen in practice but not very common in the jurisdiction.

25. According to the information from the four respondents who stated that this issue is widespread, in one jurisdiction, most entities apply the approach in View 3 and therefore there is no significant divergence in practice. Entities in two jurisdictions apply the approach under View 3 or View 4 but the majority of them take View 3 because they think it is easier to apply. In another jurisdiction, entities hold the view that this issue is a matter of policy choice.

26. One respondent stated that even though this transaction is not common in their jurisdiction, in their view, View 3 would be most appropriate. Two respondents stated that the accounting for this type of transaction should be clarified, primarily

because accounting firms' views are divergent and provide a policy choice, which could result in significant diversity in practice.

Issue B

27. With regard to Issue B, there were no respondents who stated that this issue is widespread in their jurisdictions.

Staff technical analysis

Issue A

28. The views described in the submission refer to the requirements in IFRS 2 or other Standards because there is no guidance in IFRS 2 that directly deals with this type of transaction. We think that View 1, View 2 and View 4 refer to the requirements in IFRS 2 while View 3 refers to the requirements in other Standards. We also analysed this issue in terms of the definition of a liability in the *Conceptual Framework*.

Reference to the requirements in IFRS 2

29. As stated above, the approach under View 1 treats the condition of the cash settlement as a non-market vesting condition of the share-based payment arrangement.

30. IFRS 2 defines vesting conditions as "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". We think that the conditions described in the submission would not meet the definition of the vesting condition, because the conditions do not determine whether the employees are entitled to the share-based payment. Although the award vests immediately upon the occurrence of the contingent event, those conditions are not necessary conditions for the counterparty to be entitled to the award. The condition dictates only the manner of settlement of this specific transaction and should not be viewed as vesting conditions. In our view,

the vesting condition in this specific case is the service condition (ie a number of years of service).

31. Consequently, we are of the view that principles in IFRS 2 would preclude an entity from taking View 1 because the view treats a cash settlement provision as a non-market vesting condition.

32. Those who support View 2 argue that the transaction in the submission is similar to share-based payment transactions in which the counterparty has a choice of the manner of settlement, and therefore, the compound financial instrument approach in paragraphs 35-40 of IFRS 2 should be applied. This is because, in both cases, the entity does not have an unconditional right to avoid transferring cash or other assets to the counterparty. However, we note an argument that applying this rationale could lead us to an approach in paragraph 25 of IAS 32 rather than the compound financial instrument approach.

33. This is because paragraph 35 of IFRS 2 clearly states that the compound financial instrument approach in paragraphs 35-40 of IFRS 2 applies to a share-based payment transactions in which the counterparty has a choice of settlement. On the other hand, paragraph 25 of IAS 32 provides specific guidance on how to classify a financial instrument that requires an entity to transfer cash or another financial asset in the event of occurrence or non-occurrence of uncertain future events that are beyond the control of both the issuer and the holder. Paragraph 25 of IAS 32 states (emphasis added):

> **Contingent settlement provisions**
>
> 25 **A financial instrument may require the entity to deliver cash or another financial asset, or otherwise to settle it in such a way that it would be a financial liability, in the event of the occurrence or non-occurrence of uncertain future events (or on the outcome of uncertain circumstances) that are beyond the control of both the issuer and the holder of the instrument**, such as a change in a stock market index, consumer price index, interest rate or taxation requirements, or the issuer's future revenues, net income or debt-to-equity ratio. **The issuer of such an instrument does not have the unconditional right to avoid delivering cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability). Therefore, it is a financial liability of the issuer unless**:

> (a) the part of the contingent settlement provision that could require settlement in cash or another financial asset (or otherwise in such a way that it would be a financial liability) is not genuine;
>
> (b) […]; or
>
> (c) […].

34. Accordingly, we think that the fact that the entity does not have an unconditional right to avoid transferring cash or other assets to the counterparty does not necessarily provide a rationale for referring to the requirements for compound instruments in IFRS 2.

35. We think that View 4 also uses the guidance in IFRS 2 for compound financial instruments in paragraphs 35-40 for splitting an award into two mutually exclusive awards. However, we note that the compound instrument approach in IFRS 2 does not use a probability-weighted approach to split an award into an equity component and a liability component.

36. On the basis of the above, we think that it is difficult for the entity to decide the classification of this share-based payment transaction by the reference to the requirements in IFRS 2.

Reference to the requirements in other Standards and the Conceptual Framework

37. As discussed above, because we think that the requirements in IFRS 2 do not provide a clear answer to this issue, we analyse in the following paragraphs whether the entity can refer to other Standards or the *Conceptual Framework* to develop an accounting policy for this transaction.

38. We note that paragraph 34 of IFRS 2 indicates a fundamental principle for the classification of share-based payment transactions with cash alternatives as following (emphasis added):

> 34 For share-based payment transactions in which the terms of the arrangement provide either the entity or the counterparty with the choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments, the entity shall account for that transaction, or the components of that transaction, as a cash-settled share-based payment transaction **if, and to the extent that, the entity**

has incurred a liability to settle in cash or other assets, or as an equity-settled share-based payment transaction if, and to the extent that, no such liability has been incurred.

39. Paragraph 4.4(b) of the *Conceptual Framework* defines a liability as follows:

> A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

40. We are of the view that the entity has a liability in this share-based payment transaction under the *Conceptual Framework*. We think that there has been an obligating event which gives rise to a liability because the counterparty has rendered services on the basis of the share-based payment arrangement agreed by the entity and the counterparty. Even though the future cash outflow is dependent on the occurrence or non-occurrence of an uncertain future event, the future event is outside the control of the entity. Because the event is outside the control of the entity, the entity has an unconditional obligation to 'stand ready' to make a cash payment if the event occurs. However, we admit that there is no clear guidance for the distinction between a liability and equity in the *Conceptual Framework,* which we think is key to this issue. Accordingly, we are of the view that the *Conceptual Framework* does not provide clear guidance for this issue.

41. Taking View 3 (IAS 37 model), no amount could be classified as a liability even if there is a present obligation to transfer cash. Those who support View 3 argue that the recognition criteria in paragraph 14(b) of IAS 37 should be considered when deciding the classification of this share-based payment. If a liability is recognised for a present obligation for which future cash outflow is not probable, such financial information would not be relevant to the users. They also insist that the entity should not refer to the requirements in in paragraph 25 of IAS 32 for the reasons described in paragraph 11 of this agenda paper.

42. As discussed earlier, paragraph 25 of IAS 32 requires the issuer to classify such a financial instrument as a liability, except for limited circumstances such as when the contingent settlement provision in the arrangement is not genuine[5].

43. Consequently, in our view, if the entity follows the approach in IAS 32, the default classification of the share-based payment transaction would be a liability. On the other hand, if the entity takes into consideration the recognition criteria in IAS 37 for the classification of this share-based payment transaction, the entity would conclude that the default classification of the share-based payment transaction is equity.

44. We are of the view that it is not clear which guidance (ie IAS 37 or IAS 32) should be analogised for the classification of this share-based payment transaction.

45. We sympathise with the argument that general principles of IFRS 2 in relation to liability-equity classification are different from those of IAS 32. In addition, share-based payment transactions are, for the most part, outside the scope of IAS 32 as set out in paragraph 4 of that Standard. However, we think that it is not necessarily clear that the IASB's intention was so restrictive on referring to the requirements in IAS 32 that the entity can never apply principles in IAS 32 when deciding the classification of a share-based payment transaction.

46. Further, the requirements of IAS 37 are also different from those of IFRS 2—IAS 37 has different recognition requirements from those in IFRS 2 (ie there is a probability hurdle in addition to an existence hurdle). Thus, it could be argued that, for the same reasons as IAS 32 is not an appropriate standard to apply, by analogy, neither is IAS 37.

47. Consequently, we are of the view that it is not clear which guidance (ie IAS 37, IAS 32, or the *Conceptual Framework*) would be a better analogy for this specific fact pattern.

---

[5] Paragraph AG28 in IAS 32 describes 'not genuine' as extremely rare, highly abnormal and very unlikely to occur.

Summary of technical analysis

48. On the basis of the analysis above, we think that the divergence in practice is caused by three major issues as follows:

    (a) IFRS 2 does not provide guidance for a share-based payment transaction in which the manner of settlement is contingent on future events that is outsider the control of both parties;

    (b) applying the guidance in IAS 37 and IAS 32 could result in a different classification of the share-based payment transaction from each other; and

    (c) the definition of a liability in the *Conceptual Framework* does not provide a clear guidance for this issue

49. In order to solve this issue, in our view, we need to develop a guidance specific to the classification of this type of share-based payment transaction. This process would involve the development of a principle in IFRS 2 by considering the consistency with the principles for the definition of and the recognition criteria for a liability and the principles for liability-equity classification in other Standards and the *Conceptual Framework*. More specifically, we need to address issues of:

    (a) whether there is a liability as defined in the *Conceptual Framework* (we think that there is a liability in this share-based payment transaction);

    (b) whether a recognition criteria described in IAS 37 should be considered for the classification of share-based payment; and

    (c) whether the entire award could or should be split into an equity-settled award and cash-settled award and if so how.

50. We think that this principle might be clearer once the IASB has made progress on its review of the definition of a liability and the distinction between a liability and equity in the *Conceptual Framework* project. However, we are of the view that it is difficult for the Interpretations Committee to address this issue in any case because of the broad nature of this issue.

Issue B

51. The results of our outreach activities do not indicate that this issue is significantly widespread in accounting practice. Consequently, we are not providing updates on the staff technical analysis on this issue, which was provided in previous meetings.

Assessment against the Interpretations Committee's agenda criteria

52. In this section, we assess the issues against the agenda criteria of the Interpretations Committee described in paragraphs 5.16 and 5.17 of the Due Process Handbook. The Interpretations Committee should address an issue:

    (a) that has widespread effect and has, or is expected to have, a material effect on those affected;

    (b) where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods;

    (c) that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial Reporting;*

    (d) that is sufficiently narrow in scope that it can be addressed in an efficient manner, but not so narrow that it is not cost-effective; and

    (e) for which a solution developed by the Interpretations Committee can be effective for a reasonable period of time. If the issue relates to a current or planned IASB project, justification of the short-term improvements is necessary.

Issue A

53. As stated in the summary of outreach activities, with regard to criteria (a)-(b), we think that this issue is widespread in accounting practice. In addition, the responses to our outreach request indicated that even though this type of transaction is accounted for under View 3 by a majority of entities, there is diversity in interpreting the requirements in IFRS 2 within the jurisdictions. In

addition, accounting manuals published by large accounting firms indicate that there is diversity in views on this issue. Consequently, we are of the view that this issue meets the criteria (a)-(b) of the agenda criteria.

54. However, we note that divergent views were expressed in the previous Interpretations Committee meetings on this issue because of the lack of a principle for the classification of this type of share-based payment transactions. In addition, since this issue was last discussed by the Interpretations Committee, we are not aware of any changes or new information that would lead us to reach a different conclusion. We note that the IASB currently has no plan to conduct a post-implementation review of IFRS 2. Notwithstanding the above, we think that the Interpretations Committee's primary reasons for rejecting this issue in January 2010 remain. Accordingly, we think that this issue does not meet the agenda criterion (d) because this issue is too broad for the Interpretations Committee to solve on a timely basis.

55. On the basis of the above, we are of the view that this issue does not meet the agenda criteria of the Interpretations Committee because this issue cannot be resolved efficiently. This issue would be better addressed in a broader project of the IASB relating to IFRS 2 taking into considerations the direction of the discussions on the definition of a liability and the distinction between a liability and equity in the IASB's Conceptual Framework project.

Issue B

56. As stated in paragraph 27, the results of our outreach activities indicate that this issue is not significantly widespread in accounting practice. Consequently, we think that Issue B does not meet the agenda criteria of the Interpretations Committee.

Staff recommendation

57. For Issue A, we think that this issue is too broad for the Interpretations Committee to address on a timely basis. This is consistent with the primary reasons for the

Interpretations Committee's deciding not to add this issue to its agenda in the last meeting. We are not aware of any changes or new information that would lead the Interpretations Committee to change the previous decision.

58. Accordingly, we recommend that the Interpretations Committee should not change the previous agenda decision not to add Issue A to its agenda. Instead, we think that the Interpretations Committee should recommend to the IASB that it should consider this issue on its own or as part of a broader project on revisions of IFRS 2 in the light of the results of the discussions with regard to the definition of a liability and the distinction between a liability and equity in the IASB's Conceptual Framework project.

59. For Issue B, the results of the outreach indicate that this issue is not significantly widespread in practice. Consequently, we think that the Interpretations Committee should not change the previous decision not to add this issue to its agenda.

Question for the Interpretations Committee

Question
Does the interpretations Committee agree with the staff recommendation that it should not change the previous decision that the Interpretations Committee should not add either Issue A and Issue B to its agenda?

Appendix A—Submission

A1. The text below is the excerpt from the Interpretations Committee agenda request received.

A2. Background The Standard provides guidance on whether a share-based payment arrangement should be treated as cash-settled or equity-settled in cases where either the entity, or the counterparty, can choose the cash alternative.

A3. In scenarios where the cash settlement is not within the control of either party, it is not clear what principle should be applied. It could be argued that, in the absence of specific guidance, it is appropriate to apply the general principle in IAS 32 and require liability treatment even if cash settlement is contingent. However, IFRS 2 guidance is not always consistent with the requirements of IAS 32. Alternatively, it could be argued that a condition that impacts only the method of settlement, and not whether the counterparty receives payment, should be classified as vesting or non-vesting.

A4. We set out below two examples that demonstrate the different approaches that might be taken in practice and would produce very different outcomes in the financial statements. We note that any principle to be applied to these scenarios would also need to be capable of applying to the opposite situation, where a cash-settled arrangement is settled in equity contingent on the occurrence of an event outside the control of either party.

Issue (a) Contingent cash settlement where neither the entity nor the counterparty can determine method of settlement

A5. An entity issues shares to employees that vest upon a number of years of service. However, if there is an IPO or change in control, the arrangement will vest immediately, and the employees will receive cash equal to the fair value of the shares at that date.

Alternative views

View 1

A6. The table in IFRS 2.IG24 describes a "target based on a successful initial public offering with a specified service requirement" as a non-market vesting condition. Therefore, cash settlement is dependent on this vesting condition of successful IPO, and equity settlement is dependent on vesting condition of the IPO not occurring. The Standard requires the compensation charge to be based on the expectation of whether a vesting condition will be met. If this principle is used, then the expectation of a successful IPO would be assessed at each reporting date and if it is expected that the condition will be met, the share-based payment arrangement will be accounted for as cash-settled. If it is not expected, then the share-based payment would be reflected as equity-settled. In practice this is likely to lead to the arrangement being treated as equity-settled until the IPO/change in control is probable, when it would become a cash-settled arrangement with any equity entry reversed.

View 2

A7. Under this view, the cash settlement provision is not considered to be a vesting or non-vesting condition, and accordingly it is necessary to consider what other guidance may be relevant. The entity does not have control over whether this arrangement is cash-settled and therefore the guidance in the Standard where the counterparty has control might be most appropriately applied (consistent with an IAS 32: Financial Instruments: Presentation approach).

A8. In this example, the probability of meeting the cash settlement criteria is not factored in, such that the fair value of the settlement alternatives is the same at grant date. The fair value is considered to be the fair value of the debt component with the equity component valued at nil. Therefore the whole arrangement would be treated as cash-settled, remeasured at each balance sheet date. If it was ultimately equity-settled, the liability would be reversed to equity.

View 3

A9. Like under view 2, a condition impacting the manner of settlement of an award is not considered to be a vesting or non-vesting condition. Further, there is no specific guidance in IFRS 2 on how to classify share-based payment transactions that are contingently cash-settleable and whose contingent event is not within the control of the entity or counterparty.

A10. Guidance exists in IAS 32 for the classification as a financial liability of an equity instrument with contingent cash-settlement terms. However, the IASB concluded that the requirements in IAS 32 should not be applied in IFRS 2 (see IFRS 2.BC 106-110 and IFRS 2.BC 266). Consequently, an entity should not refer to IAS 32 to determine the classification of a share-based payment transaction under IFRS 2.

A11. By analogy with the treatment of contingent liabilities under IAS 37, the classification of a contingently cash-settleable plan whose contingent event is not within the control of the entity or counterparty depends on whether the contingent event is probable.

A12. If the event's occurrence is not probable, and the share-based payment would otherwise be classified as equity, then it shall be classified as equity-settled. If the event's occurrence is probable, then the share-based payment shall be classified as cash-settled, with any previous equity entry reversed.

View 4

A13. There is another view expressed by some constituents, that an award with a contingent cash settlement provision should be accounted for as two mutually exclusive awards. One award is equity-settled, the other cash-settled.

A14. For the equity settlement alternative, a charge is recognised to the extent that the award is expected to be settled in equity. The charge to equity will reflect the fair value of the award at grant date. If equity settlement was no longer probable or did not subsequently occur, the charge would be reversed.

A15. For the cash settlement alternative, the fair value would be assessed, reflecting the probability of cash settlement, and this liability recognised and remeasured at each

reporting date. While the value of the award is affected by the probability of the IPO occurring, the award always has a fair value over the vesting period, falling to nil if the award is settled in equity.

A16. In summary:

	View 1	View 2	View 3	View 4
	Cash linked to vesting condition:			
Classification if IPO not probable	Equity-settled	Cash-settled	Equity-settled	Equity-settled and Cash-settled portion
Classification if IPO probable	Cash-settled	Cash-settled	Cash-settled	Cash-settled
Measurement	If the IPO is not probable the equity charge will represent the grant date fair value. If the IPO is probable a liability will be recognised and remeasured at fair value. If the IPO subsequently becomes probable the equity charge would be reversed and a liability at fair value would be established. If the reverse occurs, then the liability would be reversed to equity	The liability is continually measured at fair value. If it is ultimately settled in equity the entry would be: Dr Liability Cr Equity	Same treatment as view 1.	The probability of cash settlement is factored into the initial fair value such that total fair value equals the fair value of the liability plus the equity residual. The equity piece remains at the grant date fair value and the liability piece is remeasured throughout. If the IPO became not probable the liability portion’s fair value would be zero.

Issue (b) Contingent cash settlement dependent on non vesting condition within the control of the counterparty

A17. An entity issues share options to employees that vest conditionally upon three years of service. However, if the employees save the exercise price with the entity over the three years, the employees will receive the cash value of the shares on vesting. If the employees do not save, the options will be settled in equity.

Alternative Views

View 1

A18. This arrangement could be viewed simply as one in which the employee has control of whether to receive cash rather than share options. This is because the employee has control over whether to save the exercise price, and therefore whether this is cash-settled. Applying the guidance applicable to awards for which the counterparty has a choice of settlement and taking into account the fact that the value of the two settlement options is the same, the scheme will be treated as a cash-settled scheme unless and until it is settled otherwise.

View 2

A19. An alternative view is that while the scheme is considered one in which the counterparty has control over whether to receive cash, this is not a simple counterparty choice, but is linked to a non vesting condition, the requirement to save the exercise price. This is consistent with View 1 of Example A above.

Other Views

A20. The principles expressed in views 2 and 4 above in relation to Example A, are also possible views for this example.

Reasons for the IFRIC to address these issues

A21. The effective date of the amendment to IFRS 2 is for annual periods beginning on or after 1 January 2009, so we are not yet aware of divergence in practice. However, we are aware that constituents are not clear on which is the most appropriate of the views to adopt on implementation and therefore divergence in practice is expected. Given the range of possible outcomes, such divergence could lead to significant variance in financial results.

A22. A clear rational for treatment in the above scenarios would enable wider application of principles agreed and positions reached.

A23. We believe that these matters are sufficiently narrow in scope to be capable of interpretation, and note that revisions to IFRS 2, as previously amended, are not currently on the agenda of the IASB. Hence, this issue of interpretation is relevant today and will continue to be.

Appendix B—Excerpt from outreach request

B1. We sent the following request to the International Forum of Accounting Standard Setters and regulators to solicit information on this issue:

Dear all,

In the July 2012 meeting, the IFRS Interpretations Committee (the Interpretations Committee) decided to revisit the three issues related to IFRS 2 *Share-based Payment*. Previously, the Interpretations Committee decided not to add these issues to its agenda or propose annual improvements because it observed that they should be dealt with by the IASB in a broader project of IFRS 2, which includes a post-implementation review. Because the IASB does not expect to address those issues or undertake a post-implementation review of IFRS 2 in the near future, the Interpretations Committee asked the staff to update the analysis and outreach on those issues so that they can discuss them at future meetings. The three issues should clarify how:

1. to classify and measure share-based payment transactions for which the manner of settlement is contingent on either:
   (i) a future event that is outside the control of both the entity and the counterparty; or
   (ii) a future event that is within the control of the counterparty.
2. to classify a share-based payment transaction in which the entity is required to withhold a specified portion of the shares that would otherwise be issued to the counterparty upon exercise (or vesting) of the share-based payment award in order to settle the counterparty's tax obligation.
3. to measure and account for a share-based payment in situations in which a cash-settled award is cancelled and is replaced by a new equity-settled award that has a higher fair value than the original award.

For further information related to the discussions in the July 2012 Interpretations Committee meeting, please consult the following materials:

- The IFRIC *Update* for the July 2012 meeting (http://www.ifrs.org/Updates/IFRIC-Updates/Pages/IFRIC-Updates.aspx)
- Agenda Paper 9 for the July 2012 meeting (http://www.ifrs.org/Meetings/Pages/IFRICJuly2012.aspx)

In addition to these three issues, we are seeking information on significant divergence in practice on other issues that are related to IFRS 2, if you are aware of it in your jurisdiction.

Questions

For each of the three issues described in the following section, I would very much appreciate your observations on the following aspects:

1. In your jurisdiction, do you have similar transactions to those described below? If similar, but not identical, please tell us the differences.

2. If you answered ‘yes’ to question 1, what is the prevalent accounting for the transactions? And if possible, could you please briefly describe the rationale for that accounting?
3. On the basis of your response to question 2, to what extent do you observe diversity in the practice for accounting for these types of transactions?
4. In your jurisdiction, are you aware of any significant divergent interpretations on other issues that are related to IFRS 2?
5. If you answered ‘yes’ to question 4, please briefly describe the type of transactions and the divergent interpretations.

At this stage of the process I am especially interested in the observations that you have made in practice, so please feel free to send them on to me.

I would appreciate receiving your input on this issue by **14 January 2013**.

Best regards,

Ken

Description of the issues

Issue 1: Transactions in which the manner of settlement is contingent on future events

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

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

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

Issue 1 (i)

The submitter describes a share-based payment arrangement as an entity that grants its own shares to its employees with a service condition. It also has a cash alternative provision in which the granted equity instruments will be settled in cash at the fair value of the shares at the date of settlement, if a specified event that is outside the control of both parties occurs. The submitter argues that there are divergent views on the accounting for such an arrangement because of the lack of clarity in the principles under IFRS 2.

With regard to the events outside the control of both the entity and the counterparty, the submission lists IPO and change in control as examples. When the Interpretations Committee discussed this issue, it addressed more general circumstances whereby a contingent event is outside the control of both parties rather than the specific fact pattern in the submission, acknowledging that whether IPO and change in control are outside the entity’s control is a matter of judgment which is supplementary to the question of classification. At the moment, we think that applicable circumstances would include, but are not limited to, those in which the manner of settlement is contingent on a change in a stock market index, consumer price index, interest rate or taxation requirement.

The submission describes the following four alternative views on this issue:

View 1: the condition should be viewed as being similar to a non-market vesting condition in IFRS 2

In this view, the expectation of the occurrence or non-occurrence of the future event would be assessed at each reporting period. If it is expected that the condition will be met at each reporting date, the share-based payment will be accounted for as cash-settled with any equity entry to date reversed. The submission states that this view is supported by the principle in IFRS 2 that requires the compensation charge to be based on the expectation of whether a vesting condition will be met.

View 2: the guidance for a circumstance where the counterparty has control should be applied by analogy

In this view, the cash settlement condition is not considered to be a vesting or non-vesting condition. Instead, the proponents of this view argue that the guidance that is applicable to a situation in which the counterparty has a choice of settlement should be applied to this type of arrangement. They think that this view is consistent with the requirement in paragraph 28 of IAS 32 *Financial Instruments: Presentation*. Under this approach, the share-based arrangement would be accounted for as a compound financial instrument. As a result, the whole arrangement would be treated as cash-settled arrangement which is then remeasured at each balance sheet date in accordance with paragraphs 35–40 of IFRS 2.

View 3: IAS 37 should be applied by analogy

Like View 2, this view does not consider the condition to be a vesting or non-vesting condition. Those who support this view think that there is no specific guidance in IFRS 2 to this type of arrangement and therefore requirements in other Standards that deal with similar and related issues should be applied by analogy in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. They think that the guidance in IAS 32 for the classification of equity instrument with contingent cash-settlement terms should not be applied to this case because, in their view, the IASB concluded that the requirements in IAS 32 are not applicable to IFRS 2 (IFRS 2.BC106–110 and IFRS 2.BC266). Instead, they are of the view that the entity should apply IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to this arrangement. The share-based payment transaction would be classified as equity-settled first and would then be changed into an equity settled share-based payment transaction later, with any previous equity entry reversed once the occurrence of the event becomes probable.

View 4: the arrangement should be accounted for separately as two mutually exclusive awards

The submitter states that some argue that the share-based payment transaction in the submission should be divided into an equity-settled award and cash-settled award, and accounted for separately in accordance with the requirements for equity-settled share-based payments and cash-settled share-based payments, respectively.

Issue 1 (ii)

As another type of cash settlement alternative for a share-based payment transaction, the submitter describes a circumstance in which employees will receive the cash value of the shares if they save the exercise price with the entity over the vesting period, or otherwise the share options granted will be settled in equity.

According to the submitter, there are two views on the accounting for this type of arrangement:

View 1: the transaction should be viewed as one in which the employees are provided a choice of settlement

Proponents of this view think that the arrangement effectively provides employees with a choice of settlement because they have control over whether to save the exercise price with the entity.

View 2: the condition should be viewed as a non-vesting condition

Those who support this view argue that even though the arrangement is considered to be one in which the employees have control over the way of settlement, this should not be considered to be as a simple counterparty choice but instead is liked to a non-vesting condition. Consequently, the accounting for the award depends on the expectation of whether the condition will be met.

For further details I have attached the relevant extracts from the submission. In addition, Agenda Papers that were used in the meetings and the IFRIC *Update* can be viewed at:

- The IFRIC *Update* for the January 2010 meeting (http://media.ifrs.org/IFRICUpdateJan2010.html)
- Agenda Paper 4B for the January 2010 meeting (http://www.ifrs.org/Meetings/Pages/IFRIC-Meeting--7-January-2010.aspx)
- Agenda Paper 7 for the November 2009 meeting (http://www.ifrs.org/Meetings/Pages/IFRIC-Meeting-November-2009.aspx

Issue 2: […]

Issue 3: […]

Appendix C—Excerpt from the IFRIC Update in January 2010

IFRS 2 *Share-based Payment* - Transactions in which the manner of settlement is contingent on future events

The IFRIC 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 future event that is outside the control of both the entity and the counterparty; or
- a future event that is within the control of the counterparty.

The IFRIC noted that paragraphs 34-43 of IFRS 2 provide guidance only on share-based payment transactions in which the terms of the arrangement provide the counterparty or the entity with a choice of settlement.

The IFRIC 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. The IFRIC noted that many other issues have been raised concerning the classification and measurement of share-based payments as cash-settled or equity-settled. The IFRIC 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.

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