

STAFF PAPER

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Project	Annual improvements 2010–2012 cycle		
Paper topic	IFRS 2 <i>Share-based Payment</i> —definition of performance condition: performance target achieved after the service period		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Purpose of this paper

1. The objective of this paper is to:
 - (a) inform the IASB about the US Emerging Issues Task Force (EITF)'s recent consensus that a performance target that is achieved after the requisite service period is a performance condition; and
 - (b) ask the IASB whether any further action is needed in response to the US EITF's consultation.

Introduction

2. The Exposure Draft *Annual Improvements to IFRSs 2010–2012 cycle* ('ED/2012/1') published in May 2012 includes the IASB's proposal to clarify the definition of 'vesting conditions' in Appendix A of IFRS 2 *Share-based Payment* by separately defining a 'performance condition' and a 'service condition'. In doing this, the IASB was responding to concerns about the definition of vesting conditions and diversity in practice in its application.
3. One of the issues addressed by the proposed Annual Improvement to IFRS 2 was the interrelationship between the period over which service was required to be

rendered by the employee and the period over which the performance condition was measured.

4. In its proposals in ED/2012/1 the IASB sought to make clear that “in order to constitute a performance condition, any performance target needs to have an explicit or implicit service requirement for at least the period during which the performance target is being measured” (paragraph BC6 of ED/2012/1).
5. During its deliberations at the February 2013 meeting of the comments received on ED/2012/1 (for more information see [Agenda Paper 8A](#)), the IASB reaffirmed its decision that the duration of the performance condition needed to be wholly within the period of the related service requirement in the definition of performance condition. This meant that the period of assessment of the performance target could not start before the start of the service period and could not end after the service period.
6. In the course of finalising the proposed amendment to IFRS 2, the IASB received some input from interested parties who raised concerns with the requirement that the duration of the performance condition needed to be wholly within the period of the related service, because they asserted that it was common for a performance target to start before the service period.
7. In response to the comments received, at the June 2013 meeting the IASB redeliberated the length of the performance target with respect to the period of service (see [Agenda Paper 14](#)) and more specifically, whether a performance target that starts before the service period is a performance condition or a non-vesting condition.
8. At that meeting, IASB members agreed that share-based payment award for which the performance target starts before the service period, should be accounted for as a performance condition provided other criteria were met. The IASB thought that such a performance target should be accounted for as a performance condition only if the difference in the commencement period for the performance target and the service period was not substantial and provided that the period over which the

performance target is assessed did not extend beyond the end of the required service period.

9. This decision was consistent with the proposed definition of ‘performance condition’ in IFRS 2 which:
 - (a) requires the counterparty to complete a specified period of service (ie a service condition);
 - (b) allows the service requirement to be explicit or implicit; and
 - (c) requires specified performance target(s) to be met while the counterparty is rendering the service required in (a).
10. Consequently, the IASB decided to further clarify within the proposed definition of performance condition that the measurement period of the performance target(s):
 - (a) may start before the service period, on the condition that the period of achieving the performance target substantially coincides with the commencement of the service period; but
 - (b) shall not extend beyond the end of the service period.

US EITF discussion

11. In drafting the final amendment to IFRS 2 we became aware that the US Emerging Issues Task Force (EITF) is currently considering an issue that is largely the same as the one addressed by the IASB. That issue, “Determination of Whether a Performance Target That Is Allowed to Be Met after the Requisite Service Has Been Provided by the Employee Is a Vesting Condition or a Nonvesting Condition” has been discussed by the EITF at its June¹ and September 2013 meetings.

¹ Further detail of this discussion can be found in the EITF’s Meeting Materials: [Issue Summary No. 1](#) (Issue No. 13-D): "Determination of Whether a Performance Target That Is Allowed to Be Met after the

12. During its discussions, the EITF acknowledged the existence of situations in which the measurement period of the performance target could commence before the start of the service period, but determined that this was not an area in which guidance was being sought. Consequently, it did not address the sweep issue that the IASB had discussed in June 2013.
13. At its June 11 2013 meeting, the EITF proposed that a performance target that is achieved after the requisite service period is a performance condition. The EITF observed that their supported approach diverges from the one taken under IFRS. This is because under IFRS if the measurement period for performance target is longer than the service period, the performance target would be considered a non-vesting condition and not a performance condition. We reproduce below an extract of the [EITF's June 2013 EITF Meeting Minutes](#)² (emphasis added):

Current EITF Discussion

11. At the June 11, 2013 EITF meeting, the Task Force discussed and acknowledged the merits of all alternative views, focusing on the performance condition approach and the non-vesting condition approach. **The Task Force also observed that the view that would treat the performance target as a non-vesting condition would be more consistent with recent tentative decisions reached under International Financial Reporting Standards (IFRS). The Task Force noted the opportunity for substantial convergence but also observed that this approach may add additional measurement uncertainty to the grant-date fair value of the awards, which would add complexity to the measurement of the awards.**

Requisite Service Has Been Provided by the Employee Is a Vesting Condition or a Condition That Affects the Grant-Date Fair Value of the Awards" (Agenda Paper 13D) from June 2013.

² Source: [June 11, 2013 EITF Meeting Minutes](#), p. 25 –27 (Issue No. 13-D).

12. A majority of the Task Force members expressed initial support for treatment of the performance target as a performance condition because the measurement of the grant-date fair value of the awards is less complex when applying this approach, when compared with applying the non-vesting condition approach. However, some Task Force members and some Board members raised concern that this approach would weaken the main recognition principle of Topic 718, Compensation—Stock Compensation, that compensation cost should be recognized when the employee services are received, and would result in a different approach than under IFRS. The Task Force directed the FASB staff to perform additional analysis on this Issue to assist the Task Force in making a decision on this Issue.

14. At its 2 October, 2013 meeting, the FASB ratified the consensus-for-exposure reached at the 13 September 2013 EITF meeting and decided to expose it for public comment for a period of 60 days. A summary of this decision as published on the FASB's website³, is presented below:

³ Source:

http://www.fasb.org/cs/ContentServer?c=FASBContent_C&pagename=FASB%2FFASBContent_C%2FActionAlertPage&cid=1176163479790

Issue 13-D, “Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period”

A performance target that could be achieved after the requisite service period should be treated as a performance condition that affects the vesting of the awards. A reporting entity would apply existing guidance in Topic 718, Compensation—Stock Compensation, as it relates to awards with performance conditions that affect vesting. That is, compensation cost would be recognized if it is probable that the performance condition will be achieved. The total amount of compensation cost recognized during and after the requisite service period would reflect the number of awards that are expected to vest and would be adjusted to reflect those awards that ultimately vest.

No additional incremental disclosures would be required by this Issue.

The amendments in the proposed Update would be applied prospectively to share-based payment awards granted or modified on or after the effective date. Early adoption would be permitted. Transition disclosures in Subtopic 250-10, Accounting Changes and Error Corrections—Overall, would apply in the period of adoption.

Comparison of the approaches taken by the IASB and the EITF

15. The following table summarises the different approaches taken by the IASB and the EITF in the case in which the measurement period of the performance target

extends beyond the service period, as well as summarising the accounting implications derived from the two approaches:

Description of the issue	EITF/FASB proposed approach:	IFRS 2 proposed approach (annual improvements to IFRS 2):
Required accounting treatment when the measurement period of the performance target extends beyond the service period (Assuming the service period is satisfied)	The performance target would be treated as a performance condition that affects vesting. Performance conditions that affect vesting are ignored when calculating the grant-date fair value of the award.	The performance target is treated as a non-vesting condition and is reflected within the grant-date fair value of the award.
Attribution period of the compensation cost	The compensation cost is recognised over the vesting period when the achievement of the performance condition is considered 'probable', which may be some years after the requisite service period when the recipient is no longer in service. It may indeed never happen.	The compensation cost is recognised over the service period, which is the period over which the entity receives the employee services.
Reversal treatment of the compensation cost	The compensation cost recognised in profit or loss is based on the number of awards that vest. Any previously recognised compensation cost is reversed if the performance condition is not achieved.	No previously recognised compensation cost should be reversed once the requisite service is completed, irrespective of the outcome of the performance target.

Staff observations

16. We note that the amendment to IFRS 2 was developed to address concerns about diversity in practice. We also note that the amendment focuses on, and is consistent with, the principle set out in paragraph 7 of IFRS 2, that “An entity shall recognise the goods or services required or acquired in a share-based payment transaction when it obtains the goods or the services are received”.

17. We note that during its discussions, the EITF observed that the approach taken by the IASB and the IFRS Interpretations Committee “may add additional measurement uncertainty to the grant-date fair value of the awards, which would add complexity to the measurement of the awards”. During our consultation process we did not hear similar concerns about the complexity of the amendments or about related difficulties in applying them.
18. We therefore want to ask the IASB if, in the light of the EITF developments, it thinks any further work is needed prior to finalising the amendment to IFRS 2 through Annual Improvements. If the IASB thinks that more work is needed, then we suggest that the proposed amendment to IFRS 2 is removed from the 2010-2012 annual improvements cycle so that the remaining amendments in that cycle can be finalised without delay.

Question to the IASB

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1. Does the IASB think that any further work is needed prior to finalising the proposed amendments to IFRS 2 in Annual Improvements?

Appendix A—Proposed definition of ‘performance condition’

- A1. As part of the amendments to IFRS 2, the IASB has proposed to separate the definitions of a ‘performance condition’ and a ‘service condition’ from the definition of a ‘vesting conditions’ and thus make the description of each condition clearer.
- A2. In this Appendix we are showing the proposed final drafting of the definition of ‘performance condition’.

Appendix A

Defined terms

performance condition

A **vesting condition** that requires:

- (a) the counterparty to complete a specified period of service (ie a '**service condition**'); the service requirement can be explicit or implicit and
- (b) specified performance targets to be met while the counterparty is rendering the service required in (a).

The period of achieving the performance target(s) shall not extend beyond the end of the service period but it may start before the service period on the condition that the period of achieving the performance target substantially coincides with the commencement of the service period.

A performance target is defined by reference to:

- (c) the entity's own operations (or activities) or the operations or activities of another entity in the same group (ie a non-market condition); or
- (d) the price (or value) of the entity's **equity instruments** or the equity instruments of another entity in the same group (including shares and **share options**) (ie a **market condition**).

A performance target might relate either to the performance of the entity as a whole or to some part of the entity (or part of the group), such as a division or an individual employee.

Basis for Conclusions on amendments to IFRS 2 *Share-based Payment*

This Basis for Conclusions accompanies, but is not part of, the proposed amendments.

Definition of vesting condition⁴ (2012 amendments)

BC334 (...)

BC336 In response to the comments received on the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle* (Proposed amendments to International Financial Reporting Standards) the IASB addresses the following concerns that have been raised about the definitions of ‘performance condition’, ‘service condition’ and ‘market condition’:

(a) (...)

(b) whether a performance target that refers to a longer period than the required service period 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

BC339 The Board observed that IFRS 2 was not clear about the duration of a performance target relative to the duration of the related service condition. Some understood IFRS 2 to require that the duration of the performance has to be wholly within the period of the related service requirement; others understood that a performance target could be achieved over a period that extends beyond the period for which the employee is required to provide a service.

BC340 During its deliberations prior to the issue of the ED, the Board decided to clarify that the duration of the performance condition needed to be wholly within the period of the related service requirement. This meant that the period of achieving the performance target could not start before, or end after, the service period. This requirement was reflected in the ED.

BC341 Some respondents to the ED disagreed with the requirement that the duration of the performance condition needed to be wholly within the period of the related service, because they asserted that it was common for a performance target to start before the service period. For example, a performance target could be set as a measure of the growth in earnings per share (the ‘EPS target’) between the most recently published financial statements on the grant date and the most recently published financial statements before the vesting date.

⁴The IASB confirmed at the February 2013 meeting to add paragraphs BC333 –BC369 as part of *Annual Improvements to IFRSs 2010–2012 Cycle*.

- BC342 Other respondents noted that if the beginning of the period for achieving the performance target was restricted, then a relatively minor difference in the way that the awards are structured could lead to a different classification of the performance target (ie as either a non-vesting condition or as a performance (vesting) condition), which could consequently lead to differences in the way that the award would be accounted for in accordance with the guidance in IFRS 2.
- BC343 In response to the comments received on the ED, the Board decided to revise the proposed definition of performance condition. In this revision, the Board decided to ease the restriction on when the period for a performance target could start. It therefore decided to clarify that the start of the period of achieving the performance target could start before the service period, provided the period over which the performance target is achieved substantially coincides with the commencement of the service period.
- BC344 However, the Board decided to retain the proposal in the ED that the period over which the performance target is achieved should not extend beyond the service period. It thought that this decision was consistent with the definition of a performance condition, which requires the counterparty to complete a specified period of service and to meet the performance target(s) while the counterparty is rendering the service required. The definition of performance condition reflects the principle in paragraph 7 of IFRS 2 which states that “An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received”.
- BC345 The Board also decided to add the words “ie a service condition” into criterion (a) of the definition of performance condition in order to create a cross-reference to the definition of service condition.