STAFF PAPER

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IFRS Interpretations Committee Meeting

Project	**Exposure Draft of proposed amendments to IFRS 2 (ED/2014/5)—Classification and Measurement of Share-based Payment Transactions**
Paper topic	Comment letter analysis

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This paper has been prepared 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. The Exposure Draft ED/2014/5 *Classification and Measurement of Share-based Payment Transactions* (Proposed amendments to IFRS 2 *Share-based Payment*) ('the ED') was published in November 2014 to address:

   (a) the effects of vesting conditions on the measurement of a cash-settled share-based payment;

   (b) the classification of share-based payment transactions with net settlement features; and

   (c) the accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled.

Objective

2. The objective of this paper is to provide an analysis of the comment letters received on the ED and to obtain a recommendation from the IFRS Interpretations

Committee ('the Interpretations Committee') for the IASB to proceed with the amendments.

3. The proposal in the ED was based on the concerns identified by the Interpretations Committee and the recommendations that it made to the IASB. Consequently, this paper is intended to draw on the Interpretations Committee's experience on these issues and to ask whether it agrees that the staff's recommendations are adequate.

Structure of the paper

4. This paper:

   (a) provides a brief description of the issues that led to the proposed amendments;

   (b) analyses the comments received as part of the Exposure Draft process; and

   (c) asks the Interpretations Committee whether it agrees with the staff's recommendation to include some additional clarifications and proceed with the proposed amendments.

5. The suggested wording of the proposed amendments to IFRS 2 is included in **Agenda Paper 2A** of July 2015.

Description of the issues

Effects of vesting conditions on the measurement of a cash-settled share-based payment

6. Paragraph 33 of IFRS 2 requires an entity to measure the liability for a cash-settled share-based payment initially and at the end of each reporting period until settled, at the fair value of the cash-settled share-based payment, taking into account the terms and conditions on which the cash-settled share-based payment was granted and the extent to which the employees have rendered service to date.

However, IFRS 2 does not specifically address the impact of vesting and non-vesting conditions on the measurement of the fair value of the liability incurred in a cash-settled share-based payment transaction.

7. The IASB proposed to clarify that accounting for the effects of vesting and non-vesting conditions on the measurement of a cash-settled share-based payment should follow the approach used for measuring equity-settled share-based payments in paragraphs 19–21A of IFRS 2.

Classification of share-based payment transactions with net settlement features

8. An entity may be obliged by tax laws or regulations to withhold an amount for an employee's tax obligation associated with share-based payments and then transfer the amount, normally in cash, to the taxation authorities. To fulfil this obligation, the terms of some employee share-based payment arrangements permit or require the entity to deduct from the total number of equity instruments that would otherwise be issued to the employee upon exercise (or vesting) of the share-based payment, the number of equity instruments needed to equal the monetary value of the employee's tax obligation in order to meet the statutory tax withholding obligation.

9. Under the current requirements in paragraph 34 of IFRS 2, the transaction with net settlement features would have been bifurcated into its two different components and accounted for in accordance with how each component is settled.

10. The amendments propose an exception to the requirements in IFRS 2 to remove the requirement to bifurcate if certain conditions are met. These amendments were proposed to reduce operational complexity and avoid undue burden in applying the requirements in IFRS 2. The IASB proposes to specify that if the entity settles the share-based payment arrangement net by withholding a specified portion of the equity instruments to meet the statutory tax withholding obligation, then the transaction should be classified as equity-settled in its entirety. However, this

would only be applicable if the entire share-based payment would otherwise be classified as equity-settled if it had not included the net settlement feature.

Accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled

11. Modifications to the terms and conditions of a cash-settled share-based payment may cause its classification to change to an equity-settled share-based payment. In other circumstances, an entity might replace a cash-settled share-based payment with a new equity-settled share-based payment. IFRS 2 does not specifically address such situations.

12. The IASB proposes to amend IFRS 2 so that:

    (a) the share-based payment transaction is measured by reference to the modification-date fair value of the equity instruments that are granted as a result of the modification;

    (b) the liability recognised in respect of the original cash-settled share-based payment is derecognised upon the modification, and the equity-settled share-based payment is recognised to the extent that the services have been rendered up to the modification date; and

    (c) the difference between the carrying amount of the liability as at the modification date and the amount recognised in equity at the same date is recorded in profit or loss immediately.

Comment letter analysis

13. In this section, we discuss and analyse the comments received on the ED from interested parties during the comment period, which ended on 25 March 2015.

14. The ED asked five questions, which were answered individually for each proposed amendments:

(a) **Question 1—Effects of vesting conditions on the measurement of a cash-settled share-based payment**: the IASB proposes to clarify that the accounting for the effects of vesting and non-vesting conditions on the measurement of a cash-settled share-based payment should follow the approach used for measuring equity-settled share-based payments in paragraphs 19–21A of IFRS 2. Do you agree? Why or why not?

(b) **Question 2—Classification of share-based payment transactions with net settlement features**: the IASB proposes to specify that a share-based payment transaction in which the entity settles the share-based payment arrangement net by withholding a specified portion of the equity instruments to meet the statutory tax withholding obligation should be classified as equity-settled in its entirety. This is required if the entire share-based payment transaction would otherwise have been classified as an equity-settled share-based payment transaction if it had not included the net settlement feature. Do you agree? Why or why not?

(c) **Question 3—Accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled**: the IASB proposes to specify the accounting for modifications to the terms and conditions of a cash-settled share-based payment transaction that results in a change in its classification from cash-settled to equity-settled. The IASB proposes that these transactions should be accounted for in the following manner:

   (a) the share-based payment transaction is measured by reference to the modification-date fair value of the equity instruments granted as a result of the modification;

   (b) the liability recognised in respect of the original cash-settled share-based payment is derecognised upon the modification and the equity-settled share-based payment is recognised to the extent

that the services have been rendered up to the modification date; and

(c) the difference between the carrying amount of the liability as at the modification date and the amount recognised in equity at the same date is recorded in profit or loss immediately.

Do you agree? Why or why not?

(d) **Question 4—Transition**: the IASB proposes prospective application of the three proposed amendments, but also proposes to permit the entity to apply the amendments retrospectively if it has the information needed to do so and this information is available without the use of hindsight. Do you agree? Why or why not?

(e) **Question 5—Other comments**: Do you have any other comments on the proposals?

15. The IASB received **70** comment letters on the ED[1]. Most respondents generally agreed with the three amendments proposed in the ED and with the proposed transition guidance but some respondents expressed views on Questions 1–4.

16. About a dozen respondents[2] expressed their concerns about the number of recent separate narrow-scope amendments that the IASB has recently made or proposed to IFRS 2. They think that the IASB should instead undertake a post-implementation review of IFRS 2.

Section 1: analysis of Question 1 (effects of vesting conditions on the measurement of a cash-settled share-based payment)

17. With reference to the respondents who replied to Question 1:

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[1] These comment letters can be accessed in the following link: http://www.ifrs.org/Current-Projects/IASB-Projects/IFRS-2-Clarifications-Classification-and-Measurement/ED-November-2014/Pages/Comment-letters.aspx

[2] For example: European Financial reporting Advisory Group (EFRAG) (CL 22), Association of Chartered Certified Accountants (ACCA) (CL 45), Mazars (Cl 67), European Securities and Markets Authority (ESMA), Moore Stephens LLP (CL 17), or RSM International Limited (CL 53).

(a) there were no respondents who disagreed with the principle of the proposed amendment; however,

(b) some respondents who agreed with the proposed amendments nevertheless expressed comments or requested further clarification.

18. The main reasons why respondents *support* the IASB's proposal are because aligning the requirements with the corresponding requirements for equity-settled awards:

(a) will result in the consistent application of the principles of the fair value measurement included in paragraph 6A of IFRS 2 to both equity-settled and cash-settled share-based payment transactions;

(b) will be simpler to apply in practice; and

(c) will provide practical solutions that would reduce diversity in practice.

19. Some of the respondents requested further clarifications on the proposed amendment and expressed the following additional comments:

(a) the reference in the third sentence of paragraph 33 to 'vesting conditions' should exclude market conditions (hereafter, **Issue 1**);

(b) clarify whether the proposed guidance in paragraphs 33–33B is limited to the measurement of share appreciation rights only or whether it is applicable to the measurement of all cash-settled share-based payments (hereafter, **Issue 2**);

(c) clarify the meaning of the notion of 'best available estimate of the number of awards that are expected to vest ' in proposed paragraph 33A (hereafter, **Issue 3**);

(d) require the disclosure of a contingent liability when vesting is not probable (hereafter, **Issue 4**);

(e) the proposed amendment will increase divergence between the guidance in IFRS 2 and IAS 19 *Employee Benefits* (hereafter, **Issue 5**);

(f) include more examples to illustrate the effects of vesting and non-vesting conditions (hereafter, **Issue 6**).

20. We will analyse each of these issues in the following paragraphs.

Issue 1: the reference in paragraph 33 to 'vesting conditions' should exclude market conditions

21. Some respondents noted that the reference to vesting conditions in the third sentence of paragraph 33 is confusing because it seems to state that *all* vesting conditions (including market conditions) should be taken into account when estimating the fair value of the cash-settled share-based payment. These respondents think that paragraph 33 should refer to vesting conditions and exclude market conditions[3]. For example, one respondent said (emphasis added):

> We are concerned that the proposed wording in paragraph 33 raises unintended questions. **This is because the last sentence in that paragraph requires (all) 'vesting conditions' to be taken into account by adjusting the number of awards (instead of when measuring grant-date fair value).** However, IFRS 2.BC3 to BC5 of the amendment explain that the IASB's intention was to align the requirements with those for equity-settled share-based payments and hence, 'non-market vesting conditions', i.e. **service conditions and non-market performance conditions shall be taken into account by adjusting the number of awards expected to vest** (instead of when measuring grant-date fair value). **Hence we propose to insert a 'such' after 'instead' as illustrated below**. We further would like to encourage the IASB to amend paragraph 19 for the same issue. [KPMG]

[3] For example: SAICA (CL 41), Telefonica (CL 70), Institute of Public Auditors in Germany (CL 9), KPMG (CL 52).

Staff analysis and recommendation

22. We agree with the respondents that the current drafting of the third sentence in paragraph 33 is misleading and consequently we think that the Interpretations Committee should recommend to the IASB including some wording changes in paragraph 33 to clarify that the measurement of the fair value of the liability:

 (a) includes the impact of performance and service conditions; but

 (b) excludes the impact of market conditions.

23. We also think that similar changes should be made to paragraph 19 of IFRS 2 to align the guidance for the treatment of vesting conditions for cash-settled and equity-settled awards.

Issue 2: clarify whether the proposed guidance in paragraphs 33–33C is limited to the measurement of share appreciation rights only or whether it is applicable to the measurement of all cash-settled share based payments

24. Some respondents note that the guidance in paragraph 33 for measuring the liability incurred in a cash-settled share-based payment appears to apply more specifically to 'share appreciation rights' whereas the proposed guidance in paragraphs 33A–33C appears to apply more broadly to all cash-settled share-based payments.[4]

25. Some of these respondents think that the IASB should correct that inconsistency and clarify that the guidance in paragraphs 33–33C is meant to be applied to the measurement of all cash-settled share-based payments. For example, one respondent said (emphasis added):

> While we understand that the intention of the IASB was to refer to SARs only as an example of cash-settled share-based payments, **questions might be raised whether the guidance in paragraph 33 is applicable to the measurement of all cash-settled**

[4] For example: EY (CL 35), Repsol (CL56), ESMA (CL 2), IOSCO (CL 64) and SAICA (CL 41).

share-based payments or to SARs only. Therefore, adding new guidance applicable to all cash-settled share-based payments to paragraph 33 of IFRS 2 might lead to enforceability issues and inconsistent application in relation to cash-settled share-based payments other than SARs. [ESMA].

Staff analysis and recommendation

26. We agree with the respondents that there is an inconsistency between the guidance we added to paragraph 33 of IFRS 2 and the wording in paragraph 33 which seems to apply only to share appreciation rights.

27. We note, however, that the guidance for the measurement of the liability incurred in paragraphs 30 –33 of IFRS 2 should apply to all cash-settled share-based payment transactions. Moreover, we observe that paragraph 32 of IFRS 2 mentions that share appreciation rights are an example of cash-settled share-based payment transactions.

28. We think that to address the respondents' concerns, the Interpretations Committee should recommend the IASB to emphasise that:

    (a) the guidance in paragraphs 30 –33C of IFRS 2 for measuring the liability incurred should be applied to all cash-settled awards; and

    (b) share appreciation rights are an example of cash-settled share-based payment transactions as mentioned in paragraph 32 of IFRS 2.

29. We think that this could be done by adding a footnote to paragraph 33 of IFRS 2 after the phrase 'at the fair value of the share appreciation rights'.

30. We also think that the Interpretations Committee should recommend to the IASB that it should change, when applicable, the references to 'cash-settled awards' or 'award' to 'share appreciation rights' in paragraphs 33A–33B. This is because we observe that:

    (a) paragraph 31 of IFRS 2 already indicates that share appreciation rights are an example of cash-settled awards; and

(b) a number of paragraphs in the main body of the Standard, in the Basis for Conclusions and in the implementation guidance contain a reference to share appreciation rights[5].

Issue 3: clarify the meaning of the notion of 'best available estimate of the number of awards that are expected to vest' in paragraph 33A

31. Some respondents think that the IASB should clarify the meaning of the notion of 'best available estimate of the number of awards that are expected to vest' in paragraph 33A; this paragraph, proposes guidance for estimating the fair value of the cash-settled share-based payment.[6]

32. Some respondents think that determining the 'best available estimate of the number of awards that are expected to vest' implies:

    (a) the use of a 'most likely outcome' approach; or

    (b) the use of a probability-weighted average of the expected outcomes (ie an 'expected value').

33. For example, one respondent said (emphasis added):

> Finally, EFRAG observes that, for the determination of the number of awards expected to vest, **paragraph 33A refers to the notion of 'best available estimate'; which may be interpreted to refer either to a 'most likely outcome' or an 'expected value' approach . We believe that the drafting of paragraph 33A should be improved to more explicitly indicate that, consistent with the provisions applicable to equity-settled awards, a most likely outcome approach should be applied,** and therefore, as shown in the proposed illustrative example 12A, no cost is

[5] We counted 8 occurrences in the main body of the Standard (paragraphs 31–33, 37, and 51); and 11 occurrences in the Basis for Conclusions and in the implementation guidance of IFRS 2.

[6] For example: EY (CL 35), SAICA (CL 41), EFRAG (CL 22), Grant Thornton (CL 15), PwC (CL 36), Hong Kong Institute of Certified Public Accountants (HKICPA (CL 65), Dutch Accounting Standards Board (DASB) (CL 4), RSM International Limited (CL 53).

recognised for instruments that are less likely than not to vest. [EFRAG]

34. Another respondent said (emphasis added):

> In the example no expense is recognised in year 1, as the probability that the revenue target will be met is 40%. **The IASB seems to apply the IAS 37 probability recognition principle in this example instead of an expected value approach.** IFRS 2.33A requires that the amount shall be based on the best available estimate of the number of awards that are expected to vest. **We believe that the IASB should explain why the approach in the example is in line with IFRS 2.33A. We believe that it's important that the IASB also confirms if a same approach should be applied for vesting conditions relating to equity-settled share-based payments** (applying IFRS 2.20) [DASB].

Staff analysis and recommendation

35. We observe that IFRS 2 does not explain the meaning of 'best available estimate of the number of awards that are expected to vest' and that the notion of 'best available estimate' is mentioned only in:

(a) the proposed paragraph 33A, which proposes guidance for estimating the fair value of the cash-settled share-based payment; and also

(b) paragraph 20 of IFRS 2, which provides guidance for estimating the fair value of an equity-settled share-based payment.

36. We observe that IAS 37 provides its own interpretation of the term 'best estimate' in paragraphs 36 –40. In this respect we note that within the context of provisions, paragraphs 39 and 40 of IAS 37 state that (emphasis added):

> **Uncertainties surrounding the amount to be recognised as a provision are dealt with by various means according to the circumstances. Where the**

> **provision being measured involves a large population of items, the provisions is estimated by weighting all possible outcomes by their associated probabilities. The name for this statistical method of estimation is 'expected value'.** The provision will therefore be different depending on whether the probability of a loss of a given amount is, for example, 60 percent or 90 per cent. Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used [par. 39 of IAS 37]
>
> …
>
> **Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability. However, even in such a case, the entity considers other possible outcomes.** Where other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount. (…) [par. 40 of IAS 37].

37. We observe that some Standards provide guidance for a particular estimation process. For example, paragraph 53 of IFRS 15 *Revenue from Contracts with Customers* provides guidance to determine the amount of variable consideration. We reproduce this paragraph below (emphasis added):

> **An entity shall estimate an amount of variable consideration by using either of the following methods**, **depending on which method the entity expects to better predict the amount of consideration to which it will be entitled** (emphasis added):
>
> (a) **The expected value—the expected value is the sum of probability-weighted amounts in a range of possible consideration amounts.** An expected value may be an appropriate estimate of the amount of variable

consideration if an entity has a large number of contracts with similar characteristics.

(b) **The most likely amount—the most likely amount is the single most likely amount in a range of possible consideration amounts (ie the single most likely outcome of the contract).** The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not). [par. 53 of IFRS 15]

38. We are of the view that an entity should use its judgement in determining its best available estimate. This is we think that management should choose the methodology that the entity thinks would better predict the outcome of the condition(s) that affect the award. So, an entity could, for example, determine its best available estimate either by using:

(a) an expected value (ie a probability-weighted sum of the possible outcomes). Under this approach an entity would consider a probability-weighted sum of all the possible outcomes (ie the arithmetical 'mean' of a distribution of outcomes); or

(b) a 'most likely amount'. Under this approach an entity would determine the individual outcome that is more likely to occur than any other individual outcome (ie the arithmetical 'mode' in a distribution of outcomes).

39. We observe that some examples included in the implementation guidance in IFRS 2 (ie Example 1A, Example 2, Example 3 or Example 7) state that the impact of service conditions and non-market performance conditions on equity-settled share-based payments has been based on a weighted-average probability approach. We think that this approach is used because these examples take into consideration a large population of employees, as well as different variations on the service period, or on the number or price of the equity instruments granted.

40. On the other hand, we observe that:

    (a) in Example 6 in the implementation guidance in IFRS 2, an entity is required to estimate the length of the expected vesting period at grant date, based on the *most likely outcome* of the performance condition that is consistent with paragraph 15 of IFRS 2[7]; and

    (b) in the proposed Example 12A, the estimation process of the impact of a performance condition on a cash-settled share-based payment follows a 'most likely outcome' because there is one individual outcome that is more likely to occur (ie the likelihood of a performance target being met, which implies a yes/no decision).

41. On the basis of our analysis above we suggest to the Interpretations Committee that it should recommend to the IASB that it should include in the Basis for Conclusions in IFRS 2 the view that:

    (a) management should use its judgement in determining the best available estimate of the number of instruments that will effectively vest in paragraphs 20 and 33A of IFRS 2; and

    (b) an entity could use, for example, a probability-weighted sum of the possible outcomes or a 'most likely amount' approach in determining its best estimate.

Issue 4: require the disclosure of a contingent liability when vesting is not probable

42. A small number of respondents observed that in a situation in which the vesting of the award is not probable, but may nevertheless happen in the future (as illustrated

[7] We are only aware of a reference to the 'most likely outcome' in paragraph 15 of IFRS 2, which provides guidance for estimating the length of the expected vesting period. This paragraph states that: (emphasis added) **'the entity shall estimate the length of the expected vesting period, based on the most likely outcome of the performance condition**, and to revise that estimate, if necessary, if subsequent information indicates that the length of the vesting period is likely to differ from previous estimates'

in Example 12A in the ED), the IASB should require the disclosure of a contingent liability, consistently with paragraph 28 of IAS 37.[8, 9]

43. For example, one respondent said (emphasis added):

> **The proposed clarification means that a liability will not be recognised for awards that are not probable of vesting. We therefore suggest that additional disclosure of the potential liability be required, consistent with the requirement in IAS 37 to disclose a contingent liability** where an outflow is not probable but not remote. [PwC]

Staff analysis and recommendation

44. We agree, in principle, with the respondents' suggestion to require the disclosure of a contingent liability during the vesting period, in circumstances such as the one illustrated in Example 12A included in ED, in which the award is subject to a performance condition that is not initially expected to be met (but might be in the future).

45. Nevertheless, we think that Example 12A is very narrow and limited to very specific circumstances and should not prompt the addition of a general requirement in IFRS 2 to disclose a contingent liability because there is no initial expectation that a condition will be met. Take for example the case of an award subject to a market condition or a non-vesting condition. The impact of these conditions is always taken into account in determining the fair value of the cash-settled award granted, according to the proposed paragraph 33B even if there is a small probability that these conditions will be met.

46. Moreover we observe that the proposed disclosure is not needed because paragraph 50 of IFRS 2 contains a general disclosure requirement to "disclose information that enables users of the financial statements to understand the effect

[8] SAICA (CL 41) and PwC (CL 36).

[9] Paragraph 28 of IAS 37 states that 'A contingent liability is disclosed, as required by paragraph 89, unless the possibility of an outflow of resources embodying economic benefits is remote'.

of share-based payment transactions on the entity's profit or loss for the period and on its financial position".

47. On the basis of the above we do not think that the Interpretations Committee should recommend to the IASB that it should require the disclosure of a contingent liability as suggested by the respondents.

Issue 5: The proposed amendment will increase divergence between the guidance in IFRS 2 and IAS 19

48. A small number of respondents noted some inconsistencies between the proposed amendment and the reference in paragraphs BC244 –BC245 of IFRS 2 regarding the recognition of a liability derived from a cash-settled award during the vesting period in accordance with IFRS 2[10]. For example one respondent noted the following:

> The proposed amendment will increase divergence between the guidance in IFRS 2 and IAS 19 for the timing of expense recognition for cash-settled arrangements and is inconsistent with the reference to the Basis for Conclusions in IAS 19 quoted in IFRS 2, BC 244 [PwC (CL 36)].

49. We reproduce paragraph BC245 of IFRS 2 below:

> Therefore, the Board concluded that, to be consistent with IAS 19, which covers other cash-settled employee benefits, **a liability should be recognised in respect of cash-settled SARs during the vesting period, as services are rendered by the employees. Thus, no matter how the liability is measured, the Board concluded that it should be accrued over the vesting period, to the extent that the employees have performed their side of the arrangement.** For example, if

[10] PwC (CL 36) and Hong Kong Institute of Certified Public Accountants (CL 65).

the terms of the arrangement require the employees to perform services over a three-year period, the liability would be accrued over that three-year period, consistently with the treatment of other cash-settled employee benefits

Staff analysis and recommendation

50. We agree with those respondents who think that the proposed guidance is inconsistent with the explanations in BC244 –BC245 of IFRS 2 because we observe that proposed Example 12A illustrates a case where the entity will not accrue a liability during the vesting period because the performance target is not likely to be met.

51. However we note that the proposed guidance in paragraphs 33A –33C is consistent with the application by analogy of the effect of vesting conditions and non-vesting conditions on equity-settled awards to the measurement of cash-settled awards despite of appearing to contradict the explanations in BC244 – BC245 of IFRS 2.

52. We think that including an explanation of the notion of 'best available estimate' in the basis for conclusions (as we have recommended in our analysis of **Issue 3**) will further clarify how an entity measures the liability derived from a cash-settled award and consequently we think that this guidance will eliminate any misunderstandings created by the explanations in paragraph BC244 –BC245 of IFRS 2. Moreover we do not propose modifying the existing explanations in the basis for conclusions of IFRS 2 because that text records the IASB's thinking at that time.

Issue 6: include more examples to illustrate the effects of vesting and non-vesting conditions

53. Some respondents think that the IASB should provide more examples on how non-vesting conditions and other (market) vesting conditions should be

considered on the measurement of the liability.[11] This is because they observe that Example 12A illustrates the impact of a performance condition on the measurement of a cash-settled share-based payment transaction and does not illustrate the impact of other market vesting or non-vesting conditions.

54. For example, one of these respondents said that (emphasis added):

> **Examples could be added to illustrate that even if a non-vesting or market condition is not probable of being met, then the measurement of the liability would reflect this small probability and would not be zero simply because it is not probable that the conditions will be met.** However, if it is a non-market vesting condition that is not probable of being met, then the resultant liability would be zero, since no instruments are expected to vest. [KPMG]

55. One respondent thinks that the IASB should also provide guidance on how to consider market vesting conditions and non-market vesting conditions in situations in which the services received in connection with a share-based payment transaction qualify for asset recognition.[12]

Staff analysis and recommendation

56. We disagree with the respondents' proposal to add more examples to IFRS 2 because we do not think that this is necessary.

57. We observe that the proposed guidance regarding the measurement of cash-settled awards subject to vesting and non-vesting conditions is based on an analogy of the effect of those conditions on equity-settled awards. We further observe that the implementation guidance in IFRS 2 includes a number of examples that illustrate the effects of vesting and non-vesting conditions in measuring equity-settled

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[11] For example: Federation of Accounting Professions [Thailand] (CL 29), KPMG (CL 52), Larsen &Toubro (CL 69).

[12] Accounting Standards Committee of Germany (ASCG) (CL 18).

awards. Consequently, we think that these illustrations could be applied by analogy in measuring cash-settled awards.

58. Likewise, we do not think that an illustrative example should be included in the implementation guidance regarding cash-settled share-based payments in which the services received qualify for asset recognition, because we observe that Example 12 in the implementation guidance of IFRS 2 already provides this type of guidance.

Questions to the Interpretations Committee on Section 1

Section 1: Effects of vesting conditions on the measurement of a cash-settled share based payment
1. (Issue 1) Does the Interpretations Committee agree to recommend to the IASB to include some wording changes in paragraphs 19 and 33 of IFRS 2 to clarify that the measurement of the fair value of cash-settled and equity-settled awards: (a) includes the impact of performance and service conditions; but (b) excludes the impact of market conditions? 2. (Issue 2) Does the Interpretations Committee agree to recommend to the IASB to emphasise in paragraph 33 that: (a) the guidance in paragraphs 30–33C of IFRS 2 for measuring the liability incurred should be applied to all cash-settled awards; and (b) share appreciation rights are an example of cash-settled share-based payment transactions as mentioned in paragraph 32 of IFRS 2? 3. (Issue 2) Does the Interpretations Committee agree to recommend to the IASB to change, when applicable, the references to ‘cash-settled awards’ or ‘award’ to ‘share appreciation rights’ in paragraphs 33A–33B? 4. (Issue 3) Does the Interpretations Committee agree to recommend to the IASB to include in the Basis for Conclusions in IFRS 2 the view that:

(a) management should use its judgement in determining the best available estimate of the number of instruments that will effectively vest in paragraphs 20 and 33A of IFRS 2; and

(b) an entity could use, for example, a probability-weighted sum of the possible outcomes or a 'most likely amount' approach in determining its best estimate?

5. (Issue 4) Does the Interpretations Committee agree not to recommend to the IASB to add a standalone requirement for the disclosure of a contingent liability when vesting of the award is not probable and no liability has been recognised?

6. (Issue 5) Does the Interpretations Committee agree not to recommend to the IASB to make any amendments in respect of the observation that the proposed amendment will increase divergence between IFRS 2 and IAS 19?

7. (Issue 6) Does the Interpretations Committee agree not to recommend to the IASB to add additional examples to illustrate the effects of vesting and non-vesting conditions?

Section 2: analysis of Question 2 (classification of share-based payment transactions with net settlement features)

59. With reference to the respondents who replied to Question 2:

    (a) some respondents disagreed with the principle of the proposed amendments.[13]

    (b) a majority of respondents agreed with the principle of the proposed amendment. However, half of these respondents expressed concerns or requested further clarification.

60. The main reasons why respondents *disagreed* with the proposed amendment are because they think that:

[13] For example: CINIF (CL 26), PwC (CL 36), South African Institute of Chartered Accountants (SAICA) (CL 41), and Polish Accounting Standards Committee (PASC) (CL 50).

(a) the IASB's proposals would not reflect the substance of the share-based payment with net settlement features. These respondents think that awards with net settlement features should be bifurcated instead into their equity-settled component to reflect the portion that the entity settles by the issue of equity instruments and into their cash-settled component to reflect the entity's obligation to pay cash on the employee's behalf. The think that this bifurcation reflects the substance of transactions with net settlement features and is consistent with the principle in IFRS 2 that the classification is driven by whether or not the entity uses cash or shares to settle its obligation.

(b) the amendment will not reduce complexity. For example, it can be difficult to establish whether the tax withheld matches or exceeds the statutory requirement, particularly when employees in many jurisdictions are affected.

61. The main reasons that respondents gave for their *support* of the IASB's proposal are because they think that the proposed amendment:

(a) provides a pragmatic solution that would reduce divergence in the application of IFRS 2;

(b) reduces operational complexity, because requiring each component of the share-based payment to be accounted for in a manner that is consistent with the manner of settlement would cause further complexity;

(c) reflects appropriately the economic substance of the share-based payment transaction with net settlement features described in the ED, which is that:

(i) the entity is acting as an agent withholding and transferring an amount in cash to the taxation authorities in order to fulfil an employee's tax obligation; and

(ii) the plan in its entirety is, in substance, an equity-settled share-based payment arrangement.

62. A small number of respondents also note that in their jurisdictions it is common to find share-based payment transactions with net settlement features and observe that such transactions are accounted for in a manner consistent with the proposed amendment.

63. Some respondents who *generally agreed* with the proposed amendment expressed the following comments:

    (a) the proposed classification for the share-based payment transaction with net settlement features described in the ED should not be categorised as an exception to the requirements to IFRS 2 (hereafter, **Issue 7**) [14]

    (b) clarify whether the proposed exception in paragraph 33D of the ED is applicable to other types of net settlement features (hereafter, **Issue 8**).[15]

    (c) the proposed amendment does not address the accounting for any difference that may arise between (a) the amount of the cash that needs to be paid to the tax authority and the amount of expense recognised during the vesting period; and between (b) the tax obligation and the portion of instruments withheld (hereafter, **Issue 9**).

    (d) the IASB should follow the discussions of the US standard-setter, the Financial Accounting Standards Board (FASB) on minimum statutory withholding requirements and determine whether any further amendments to IFRS 2 would be appropriate (hereafter, **Issue 10**).

64. We will analyse each of these issues in the following paragraphs.

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[14] These respondents provided some of these reasons, which we will refer to in the analysis of this issue.

[15] These respondents provided examples of these situations, which we will refer to in the analysis of this issue.

Issue 7: the proposed classification for the share-based payment transaction with net settlement features described in the ED should not be categorised as an exception to the requirements to IFRS 2

65. Some respondents expressed concern about the assertion in paragraph BC15 in the ED that the proposed classification for the share-based payment transaction with net settlement features described in this ED is an exception to the requirements to IFRS 2.[16] This is because these respondents think that there are valid reasons to support the view that the proposed classification is not an exception, because they think that:

    (a) the employee is the one that has incurred a tax obligation on the equity instruments under the share-based payment arrangement; in contrast, the employer only has an obligation imposed by tax laws or regulations to withhold and remit to the tax authority an amount equivalent to the tax obligations of the employee on its behalf.

    (b) the employer does not control or bear risks associated with the portion of equity instruments withheld.

    (c) the entity transfers cash to a third party (ie the tax authority) rather than to the counterparty in the share-based payment (ie the employee).

Staff analysis and recommendation

66. We disagree with the respondents. We observe that the proposed accounting is an exception to the requirements in IFRS 2 because the entity settles the employee's tax obligation by using its own cash rather than by issuing equity. Moreover, the amount to be withheld and paid to the tax authorities is a liability, as it is a "…present obligation of the entity arising from past events and the settlement of

[16] For example: Barclays PLC (CL 57), BusinessEurope (CL 68), German Insurance Association (CL 11), Korean Institute of Certified Public Accountants (KICPA) (CL 32), RSM International Limited (CL 53), Shell International B.V (CL 40), Singapore Accounting Standards Council (ASC) (CL 23), The Japanese Institute of Certified Public Accountants (JICPA) (CL 39), European Financial Reporting Advisory Group (EFRAG) (CL 22), The Institute of Public Accountants (IPA) [Australia] (CL 8), Accounting Standards Committee of Germany (ASCG) (CL 18).

which is expected to result in an outflow from the entity of resources embodying economic benefits”[17].

67. Furthermore, we observe that the payment to the tax authority represents a payment on behalf of the counterparty for the services received from the counterparty, regardless of the fact that the tax authority is the one receiving the cash payment. This is because:

    (a) when the entity assumes a liability to pay the amount withheld on behalf of the employee to the tax authority, the entity is acting as an agent for the employee; however,

    (b) the entity is also acting simultaneously as a principal, because it is fulfilling the obligation that the entity has towards the employee (ie the counterparty) to transfer cash or other assets for the goods or services received.

68. Accordingly, the payment to the tax authority represents in substance, a payment to the employee.

69. Likewise, as BC11 in the ED explains, the classification of share-based payments by IFRS 2 is driven by the manner of settlement and in circumstances where a share-based payment might be settled in cash or shares, IFRS 2 adopts a ‘components’ approach to the classification. Accordingly, absent the amendment, the portion withheld by the entity should be accounted for as a cash-settled share-based payment. However, as explained in the proposed paragraphs BC13 and BC15 of the ED the IASB decided instead to treat the whole transaction as equity-settled as an exception to the requirements in IFRS 2. This was to:

    (a) reduce operational complexity; and

    (b) eliminate an undue burden when applying IFRS 2

70. We think that to avoid any misunderstandings, the Interpretations Committee should recommend to the IASB that it should reinforce the reasons why the

[17] The *Conceptual Framework* includes the definition of a ‘liability’ in paragraph 4.4(b).

proposed classification represents an exception to the requirements in IFRS 2 as we have described above.

Issue 8: clarify whether the proposed exception in paragraph 33D of the ED is applicable to other types of share-based payments with net settlement features

71. Some respondents noted that proposed paragraph 33D introduces a classification exception that is applicable to a limited type of tax withholding arrangement in which an entity has a statutory obligation to withhold the tax associated with an employee's share-based payment.[18] These respondents expressed concern that such an exception might not be available for other arrangements in which entities are obliged to withhold an employee's tax obligation and some think that it is unnecessarily restrictive.

72. These respondents encourage the IASB to consider whether that exception should be broadened to apply to other arrangements that are similar in substance. For example we reproduce below the comments from three of the respondents (emphasis added):

> The proposed amendment **therefore scopes out entities which have a contractual or constructive obligation** to employees to: (a) deduct from the total number of equity instruments that would otherwise be issued to the employee upon exercise (or vesting) of the share-based payment the number of equity instruments needed to equal the monetary value of the employee's tax obligation; and (b) pay that amount in cash to the tax authorities on the employee's behalf. **The amendment is therefore narrowly worded and does not appear to apply to other**

[18] For example: Institute of Public Auditors in Germany (CL 9), European Financial Reporting Advisory Group (EFRAG) (CL 22), Institute of Singapore Chartered Accountants (ISCA) (CL 30), EY (CL 35), South African Institute of Chartered Accountants (SAICA) (CL 41), Deloitte (CL 42), Israel Securities Authority (ISA) (CL 43), Baker Tilly UK Audit LLP (CL 47), Federación Argentina de Consejos Profesionales de Ciencias Económicas (FACPCE) (CL 58), Organismo Italiano di Contabilità (OIC) (CL 61).

arrangements which might be similar in substance and which are frequently seen in practice in many jurisdictions. In such cases, the amendment would mean that many entities would still have to differentiate between an equity-settled portion and a cash-settled portion (for the amount relating to the contractual or constructive tax obligation) [CL 35 EY]

Another respondent said (emphasis added):

We do not consider that the substance of the transaction is any different where, for example, equity instruments are not withheld and the employees' tax liability is settled by the entity directly rather than by cash generated from sale of equity instruments. In all such cases, the withheld amount is not an expense of the entity but tax paid, acting as an agent, on behalf of the employees to settle their obligations [Shell International B.V (CL 40)]

Another respondent said (emphasis added):

While we support the proposed amendment, EFRAG believes that, as explained in paragraph 19 below, the IASB should consider a general review of the Standard. In that context, **the IASB should re-consider in a more comprehensive way how a net settlement feature (be it due to tax regulations, contractual terms or other facts) affects the classification of a share-based plan.** [EFRAG (CL 22)]

Staff analysis and recommendation

73. As mentioned in paragraphs 33D and in paragraphs BC8 and BC15 of the ED, the proposed exception applies to a limited type of share-based payment arrangement in which:

(a) the entity is required to:

(i) withhold, by deducting the number of shares issued to the employee (from the employee's compensation) the number of shares needed to satisfy the employee's tax liability incurred as a result of the share-based payment transaction, and

(ii) pay to the tax authority in cash the amount withheld from the employee's compensation;

(b) the employee will receive shares net of the number of shares equal to the employee's tax liability (that will be satisfied by the entity in (a)(ii) above) upon exercise (or vesting); and

(c) the entire award would be classified as an equity-settled share-based payment transaction without the net settlement feature (this is, provided the features creating (a) and (b) did not exist).

74. We observe that the relevant feature of the share-based payment transaction that is being described in the ED is the existence of a net settlement provision (determined by law) for the purpose of satisfying withholding tax requirements.

75. We however, think that the proposed exception would *not* be applicable if:

(a) the entity does not have a statutory tax withholding obligation. We think that this would occur, for example, when an entity opts to withhold the employee's tax amount or when an entity agrees with the employee that it would withhold the tax amount by means of net settlement.

(b) there is no net cash outflow from the entity's cash resources.

76. We do not think that the proposed amendment should specify the circumstances in which the proposed exception would not apply as we think that management should use its judgement in applying the proposed guidance. Nevertheless, in the following paragraphs we refer to some situations that respondents claim that are similar in substance to the arrangement with net settlement features described in the ED. We provide some comments about whether we think that the proposed exception would apply to these arrangements.

A: There is no statutory tax withholding obligation and it is merely an entity's normal practice to withhold the amount of an employee's tax obligation.

77. We observe that the proposed exception would not apply when there is no statutory tax withholding obligation because a relevant feature of the share-based payment transaction that is being described in the ED is the existence of a net settlement provision determined by law.

B: An entity has a contractual or constructive obligation to employees to deduct and pay the tax amount to the taxation authorities; the entity deducts the tax amount from the employee's salary instead of deducting equity instruments from the total amount of equity instruments that would otherwise be delivered to the employee

78. The proposed amendment applies in circumstances in which equity instruments are withheld and cash is paid by the entity instead. The fact pattern described above does not involve the withholding of equity instruments, but the withholding of cash from salary, consequently the proposed amendment would not affect the accounting in this circumstance.

C: An entity sells in the market the equity instruments that would otherwise be delivered to the employee in order to obtain the cash to pay the tax amount on behalf of the employee[19.]

79. We are of the view that a situation in which an entity sells shares in the market to obtain the cash to pay the tax amount on behalf of the employee, is economically different from the transaction described in the ED. This is because we observe that in the situation mentioned by the respondents, all of the shares granted are issued to the employee and the entity does not use its own cash resources to pay the employee's tax to the tax authority.

[19] One respondent (ISA) (CL 43)) further asked whether the proposed exception would apply if the shares were not tradable on a public market.

80. Consequently, we think that the situation mentioned by some respondents, by which an entity sells in the market shares to obtain the cash to pay the tax authority, results in the entire share-based payment (including the portion for the tax withheld) being classified as an equity-settled share-based payment transaction. This is not because the proposed exception applies, but because this classification reflects the economic substance of the transaction and is consistent with the requirements with IFRS 2.

D: An entity is required to pay social security contributions on share-based payment transactions in addition to the taxation deducted from the amount due to the employee

81. Clarity is needed about whether the social security contributions are the employee's contributions or the employer's contributions. Equity instruments would only be withheld in respect of the employee's contributions, not the employer's contributions. To the extent that the employee's social security contributions are viewed as a tax on the employee's share-based remuneration, then we think the proposed amendment would apply to the withholding of equity instruments to meet that tax on the share-based payment, provided that there is a statutory withholding obligation..

E: An entity calculates the number of shares needed to meet the tax withholding obligation based on the maximum tax rate because there is no flat statutory rate in some jurisdictions[20].

82. We think that the proposed exception would apply in situations where the tax withholding obligation is based on a maximum tax rate. This is because we observe that paragraph 33D does not restrict the tax withheld to a specific amount and we think that the tax withholding rate could be the maximum applicable by law.

[20] The Institute of Public Auditors in Germany (CL 9) claims that this is the case in Germany.

F: An entity calculates the number of shares needed to meet the tax withholding obligation based on a high tax rate and a large increase in the fair value of the equity instrument compared with the grant-date fair. Consequently a large part (if not the majority) of the share-based payment would be settled in cash

83. We recognise that the combination of a high tax rate and a large increase in the fair value of the equity instrument could result in the amount paid in cash in respect of the tax charge on the share-based payment could exceed the total expense recognised in profit or loss for the share-based payment. Example 12B included later in the paper at paragraph [93] in our discussion of Issue 9 illustrates such a situation. In that example, the amount paid in cash to satisfy the tax obligation is CU400, which is double the expense recognised in profit or loss for the entire share-based payment over the 4 year vesting period (CU200). We think this is an inevitable consequence of granting the exception. We do not think that qualifying for the exception should be subject to an arbitrary limit on the amount of tax that can be paid through withholding of equity instruments.

84. So as illustrated in Example 12B, notwithstanding the fact that the amount of tax is significantly high than the total amount of compensation expense, the entire share-based payment is classified as equity-settled[21].

85. On the basis of our analysis above of concerns A to F, we think that the description of the share-based payment with net settlement features in paragraph 33D is sufficient and we do not recommend adding more guidance to this paragraph, nor do we think that the scope of the exception should be extended. We, however, would like to ask the Interpretations Committee whether it agrees with our analysis for A to F above, and on our conclusions about retaining the existing scope.

[21] A similar case is discussed in Agenda Paper 12E of February 2014 (refer to paragraphs 22–23).

Issue 9: the proposed amendment does not address the accounting for any difference that may arise between (a) the amount of the cash that needs to be paid to the tax authority and the amount of expense recognised during the vesting period; and between (b) the tax obligation and the portion of instruments withheld

86. Some respondents note that the proposed amendment does not address the accounting for any difference that may arise between the amount of the cash that needs to be paid to the tax authority and the amount of expense recognised during the vesting period equivalent to the portion of instruments withheld to meet the tax obligation. These respondents observe that paragraph 33D does not specifically address the accounting for such difference (ie it merely refers to the application of paragraphs 19–21 of IFRS 2)[22].

87. To address this omission, these respondents suggest that the IASB should:

    (a) include a reference to paragraph 29 of IFRS 2 in paragraph 33D to state that such a difference would be accounted for as a repurchase of vested instruments; and

    (b) add an illustrative example.

88. For example, one respondent said (emphasis added):

> We note that when the entity settles the tax on behalf of its employees, the cash payments may differ from the amount recognised during the vesting period. **As the last sentence of the proposed paragraph 33D requires the share-based payment to be accounted for in accordance with paragraphs 10-29, some may be of the view that the entity shall recognise this difference as its expense**.

[22] For example: The Hong Kong Association of Banks (HKAB) (CL 6), Financial Reporting Council (FRC) [Mauritius] (CL 13), The Swedish Financial Reporting Board (CL 14), Grant Thornton International Ltd (CL 15), Accounting Standards Committee of Germany (ASCG)(CL 18), Norwegian Accounting Standards Board (CL 21), European Financial Reporting Advisory Group (EFRAG) (CL 22), RSM International Limited (CL 53), Malaysian Accounting Standards Board (MASB) (CL 33).

> We do not believe this is the intent of the IASB as the tax is not the entity's expense but is the employee's. In this regard, **we recommend the IASB to provide an illustrative example** to clarify its intent to circumvent any divergent views or confusion that may arise based on the proposed new paragraph 33D **and the reference to the existing paragraph 29**. [MASB (CL 33)]

89. Some respondents also noted that the proposed amendment does not clarify the accounting consequences when the number of equity instruments withheld is different from the number needed to satisfy the tax obligation[23]. For example one respondent mentioned the following (emphasis added):

> **In several countries, eg in Germany, a flat statutory tax rate does not exist. Therefore, when determining the number of equity instruments needed to equal the monetary value of the tax withholding obligation, entities often do not know the precise amount of the tax withholding obligation with respect to each employee on settling the award. For this reason, entities tend to calculate the number of shares needed to meet the tax withholding obligation based on the maximum tax rate applicable. Consequently, this number of shares is too high in relation to the actual tax withholding obligation when it becomes payable.** Once the entity has transferred the tax to the tax authorities, it pays an amount representing the difference between the maximum tax rate and the actual tax rate to the employee in cash. IFRS 2 might require this cash payment to be classified as a separate cash-settled share-based payment transaction instead of accounting for the entire transaction as equity-settled. Classifying a component of the transaction as cash-settled would be

[23] For example Institut der Wirtschaftsprufer in Deutschland e.V. (IDW) (CL9)

> inconsistent with the Board's intention and should be (more) clearly precluded in the final document.[Institut der Wirtschaftsprufer in Deutschland e.V. (IDW) (CL9)]

Staff analysis and recommendation

90. We agree with the respondents.

91. We observe that paragraph 33D broadly addresses the accounting for the entire share-based payment transaction by referring to the application of the requirements in paragraphs 10 –29 of IFRS 2. However, paragraph 33D does not refer specifically to the accounting for the difference between the amount of cash that has to be paid to the tax authority and the cost recognised during the vesting period or how to account for any difference between the number of equity instruments withheld and the number required to satisfy the tax obligation.

92. We think that the difference between the amount of cash paid to the tax authority and the cost recognised during the vesting period should be accounted for in accordance with paragraph 29 of IFRS 2 (ie being deducted from equity). Paragraph 29 states that:

> If an entity repurchases vested equity instruments, the payment made to the employee shall be accounted for as a deduction from equity, except to the extent that the payment exceeds the fair value of the equity instruments repurchased, measured at the repurchase date. Any such excess shall be recognised as an expense.

93. However, as we comment below at paragraphs [97 –101] in a situation where the value of the tax liability does not equal the value of the shares withheld by the entity it is not clear whether paragraph 29 of IFRS 2 would also apply to this difference.

94. We illustrate our views using Example 12B below[24]:

[24] This example is based on a similar example presented by the staff to the IASB at its February 2014 meeting (refer to Appendix A of Agenda Paper 12E).

Example 12B

Background

On 1 January 20X0 Entity A grants an award of 100 shares to one of its employees subject to a four-year service condition. Entity A expects that the employee will complete the service period. The employee's tax associated with the award is calculated based on the fair value of the shares on the vesting date. The entity is obliged by the tax law to withhold an amount of the tax, and immediately remit to the tax authority, in cash, the amount of the tax withheld. On 31 December 20X1, Entity A expects that the tax rate applicable to the employees will be 40 per cent. At grant date, the fair value of each share is CU2. The fair values of each free share subsequent to the grant date are:

31 December X1: CU4
31 December X2: CU3
31 December X3: CU2
31 December X4: CU10

Entity A settles the transaction net by issuing a reduced number of shares to the employee to meet the entity's tax withholding obligation. Accordingly, on the exercise date, Entity A issues 60 shares to the employee and remits CU400 (100 shares × CU10 × 40%) to the taxation authority on behalf of the employee. Consequently, it is assumed that all the vested shares were issued to the employee and at the same time 40 shares were repurchased by Entity A.

Entity A pays the amount of the employee's tax obligation from its own cash resources.

Application of requirements

Year	Calculation	Expense for the period CU	Equity CU	Liability CU
X1	100 shares × CU2 × $^1/_4$	50	(50)	0
X2	100 shares × CU2 × $^2/_4$ —CU50	50	(50)	0
X3	100 shares × CU2 × $^3/_4$ —(CU50 + CU50)	50	(50)	0
X4	100 shares × CU2 × $^4/_4$ —(CU50 + CU50 + CU50)	50	(50)	0
	Total	200	200	

95. We think that in Example 12B an entity applying the proposed exception and treating the share-based payment as equity-settled in its entirety would record the following accounting entries:

Dr Expense 200

Cr. Equity 200

Compensation cost recognised over the vesting period for 100 shares

Dr Equity 400

Cr. Liability 400

Recognition of the tax liability

Dr Liability 400

Cr. Cash 400

Cash paid to the tax authority at the date of settlement.

96. However, we note that if in Example 12B the entity had recorded the transaction using a 'bifurcation approach' (ie accounting for each component according to the manner of settlement) the following accounting entries would be recorded:

Dr Expense 120

Cr. Equity 120

Compensation cost recognised over the vesting period for the equity-settled award on the basis of 60 shares

Dr Expense 400

Cr. Liability 400

Compensation cost recognised over the vesting period for the cash-settled award on the basis of 40 shares

Dr Liability 400

Cr. Cash 400

Cash paid to the tax authority at the date of settlement.

97. Furthermore, we observe that there could be a situation where the value of the tax liability might not equal the value of the shares withheld by the entity. This could happen for example, when an entity estimates that the tax rate would be higher than the actual tax rate upon vesting of the shares. So an entity would have withheld from the employee's compensation a higher number shares (than it should have) to satisfy the employee's tax liability.

98. To illustrate this situation consider Example 12B. The entity estimated a withholding tax rate of 40 percent based on the highest marginal tax rate for the employee, so the entity had decided to withhold 40 shares to meet this tax liability. However, assume that upon vesting of the shares the employee's actual marginal tax rate is only 35 per cent (and not 40 per cent) so the entity needs 35 shares instead of 40 shares to meet the tax liability. The entity remits CU350 (100 shares × CU10 × 35 per cent) to the tax authority on behalf of the employee; and issues 60 shares to the employee. However, there is a difference of CU50 (5 shares × CU10) that the entity did not remit to the tax authority. Having withheld the shares, the entity pays the remaining cash of CU50 to the employee. The question is how to account for this difference.

View 1

99. Some could argue that because those 5 shares are part of the entity's original estimation of the number of shares that had to be issued to the employee, the payment of CU50 to the employee should be accounted under the proposed exception as a deduction in equity. In this case the payment of cash of CU50 to the employee would be debited to equity

View 2

100. We think that accounting for the cash payment to the employee in respect of the additional 5 shares withheld as equity settled, is not consistent with the objective of the exception. The additional 5 shares withheld were in excess of the statutory withholding requirement. However, given the estimations required in practice, we think it would be unreasonable to void the exception for all 40 shares that were withheld. Consequently we think that the cash payment to the tax authority in respect of the 35 shares should be accounted for as described above, ie as a deduction from equity, but we think that the cash payment to the employee should be accounted for as a cash-settled share-based payment.

101. We note that an amount of CU10 (5 shares × CU2) has already been credited to equity in respect of these 5 shares in accordance with the accounting for an equity-settled share-based payment. Had the payment in respect of these 5 shares been accounted for as a cash-settled share-based payment from inception, there would have been no amount credited to equity. Consequently we think that the amount credited to equity in respect of these 5 shares should be reversed, and the balance charged to profit or loss. This view is illustrated in the following accounting entries:

During vesting period:

Dr Expense 200

Cr. Equity 200

Compensation cost recognised over the vesting period for 100 shares

Dr Equity 350

Cr. Liability 350

Recognition of the tax liability

After vesting:

Dr Liability 350

Cr. Cash 350

Cash paid to the tax authority at the date of settlement.

Dr Equity 10

Dr Expense 40

Cr. Liability 50

Cash paid to the employee in lieu of the shares that were withheld, including reversal of the amount previously credited to equity.

Issue 10: the IASB should follow the FASB's discussions on minimum statutory withholding requirements and determine whether any further amendments to IFRS 2 would be appropriate

102. Some respondents note that the FASB has recently been discussing potential improvements to the accounting for share-based payment awards with net-settlement features under its *Employee Share-Based Payment Accounting Improvements* project. In the light of these developments, some respondents:

    (a) encourage the IASB to follow the FASB's discussions and determine whether any further amendments to IFRS 2 would be appropriate to reach a converged solution; and

(b) think that the IASB should not finalise the proposed amendment on share-based payments with net settlement features until it knows the outcome of the FASB's project. [25]

Staff analysis and recommendation

103. The IASB staff is following FASB's discussions on minimum statutory withholding requirements. However, as we explain below, we do not think that the Interpretations Committee should suggest further changes to IFRS 2 on the basis of those discussions.

Current guidance in US GAAP

104. We note that section 10-25-18 from Topic 718 in the FASB's Accounting Standards Codification (ASC)® provides guidance to account for share-based payments that are subject to minimum statutory withholding requirements. We reproduce this guidance below (emphasis added):

> **Similarly, a provision for either direct or indirect (through a net-settlement feature) repurchase of shares issued upon exercise of options (or the vesting of nonvested shares), with any payment due employees withheld to meet the employer's minimum statutory withholding requirements** resulting from the exercise, **does not, by itself, result in liability classification of instruments that otherwise would be classified as equity.** However, **if an amount in excess of the minimum statutory requirement is withheld, or may be withheld at the employee's discretion, the entire award shall be classified and accounted for as a liability**.

[25] For example: EY (CL 35), Korea Accounting Standards Board (KASB) (CL 38), Deloitte (CL 42), Grupo Latinoamericano de Emisores de Normas de Información Financiera (GLENIF) (CL 48), Accounting Standards Board of Canada (AcSB) (CL 68).

Recent developments

105. We note that the FASB has proposed a simplification to the accounting for transactions in which an employer uses a net settlement feature to meet an employee's minimum statutory withholding requirements. In this respect we note that the minutes from the October 8, 2014 FASB meeting reported the following (emphasis added):

> **The Board decided to modify the current exception to liability classification when an employer uses a net-settlement feature to withhold shares to meet an employee's minimum statutory withholding requirements.** Specifically, the partial cash settlement of an award for tax withholding purposes would not result, by itself, in liability classification of the award **provided the amount withheld does not exceed the highest applicable marginal tax rate in the applicable jurisdictions**[26].

106. We think that FASB's proposal amends the requirements in Topic 718 (10-25-18) to:

(a) allow an employer with a statutory income tax withholding obligation to repurchase an employee's shares to cover income taxes on the award without triggering liability accounting, as long as

(b) the value of the shares repurchased does not exceed the amount calculated using the *highest applicable marginal tax rate* in the applicable jurisdiction. Under current guidance, if the fair value of the shares withheld exceeds the minimum statutory withholding obligation, the entire award must be classified as a liability.

107. We observe that the FASB's simplification could potentially result in broadening the current exception[27] to liability classification. However, we do not think that

[26] This memo is publicly available and can be accessed here (refer to page 2 in this memo).

[27] The minutes from the October 8, 2014 FASB meeting refers this accounting treatment as an exception.

the IASB should be considering an amendment similar to the one considered by the FASB. This is because when contrasting the proposed exception in paragraph 33D with the guidance in Topic 718 (10-25-18) we observe that the proposal in paragraph 33D does not restrict the amount withheld to a minimum or to a maximum amount.

108. We note that if the proposed the exception in paragraph 33D did not exist, the transaction with net settlement features would have been bifurcated into its two different components and accounted for in accordance with how each component is settled in accordance with IFRS 2[28].

109. We observe that the respondents to the ED did not report that the proposed exception was difficult to apply in practice and respondents in general did not mention any difficulties in determining the tax withholding rate.

110. On the basis or our analysis above we do not think that further clarification is needed.

Questions to the Interpretations Committee on Section 2

Section 2: Classification of share-based payment transactions with net settlement features
1. (Issue 7) Does the Interpretations Committee agree to recommend to the IASB to reinforce the reasons why the proposed classification for the share-based payment with net settlement features described in paragraph 33D represents an exception to the requirements in IFRS 2 by: (a) stating that the payment to the tax authority represents a payment on behalf of the counterparty for the services received from the counterparty, regardless of the fact that the tax authority is the one receiving the cash

[28] One of the respondents (PwC (CL 36)) who disagreed with the proposed exception in the ED, notes that the need for including an exception under US GAAP is more apparent than in IFRS. This is because this respondent notes that Topic 718 *Compensation—Stock Compensation* in the Accounting Standards Codification® (ASC) generally does not permit bifurcation into a cash-settled and equity-settled settlement. This respondent states that 'without the US GAAP exception, a net tax withholding feature would mean liability classification for the entire award and the accounting would not reflect the substance of the arrangement'

payment and that this payment in substance represents a payment to the employee; and

(b) emphasising that the entity settles the employee's tax obligation by using its own cash rather than by issuing equity?

2. (Issue 8) Does the Interpretations Committee agree with our analysis in cases A and F above (refer to our analysis of Issue 8)?

3. (Issue 8) Does the Interpretations Committee agree with our conclusion to retain the existing scope of the proposed exception in paragraph 33D?

4. (Issue 9) Does the Interpretations Committee agree that it should recommend the IASB to include Example 12B to illustrate the accounting for the difference that may arise between the amount of the cash that needs to be paid to the tax authority and the amount of expense recognised during the vesting period (when the portion of instruments withheld is equivalent to the tax obligation)?

5. (Issue 9) Does the Interpretations Committee have any comments on Example 12B?

6. (Issue 9) Does the Interpretations Committee agree that the difference between the cash paid and the cost recognised during the vesting period should be recognised as a deduction from equity in line with paragraph 29 of IFRS 2?

6. (Issue 9) Does the Interpretations Committee agree that any excess of shares withheld over the tax liability, when that excess is paid as cash to the employee, should be accounted for as a cash-settled share-based payment?

7. (Issue 10) Does the Interpretations Committee agree that no additional clarification or amendment is needed in the light of the FASB's proposals for changes to US GAAP in this area?

Section 3: analysis of Question 3 (accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled)

111. With reference to the respondents who replied to Question 3:

(a) the majority of the respondents agreed with the principle of the proposed amendment. However, about a quarter of these respondents requested further clarifications.

(b) some respondents *partially agreed* with the proposed amendment and a few respondents *fully disagreed*.

112. The main reasons that respondents gave for their *support* of the IASB's proposal are because:

(a) they agreed with the proposed accounting treatment and with the rationale set out in the Basis for Conclusions;

(b) the proposed amendment provides a practical solution that will reduce divergent practices in the application of IFRS 2; and

(c) the proposed amendment reflects the substance of the transaction, which is that the original cash-settled award has been settled and replaced with a promise to issue equity-settled instruments.

113. The main reason why respondents *partially agreed* or *fully disagreed* with the proposed amendment is because they think that in paragraph B41A the difference between the carrying amount of the liability at the modification date and the amount recognised in equity at the same date should not be recognised immediately in profit or loss, and should instead be recognised over the remaining service period (hereafter, **Issue 11**).

114. Some respondents who *generally agreed* with the proposed amendment expressed the following comments:

(a) clarify the accounting treatment when the replacement award has a lower fair value than the original award at the modification date (hereafter, **Issue 12);**

(b) clarify the accounting for other types of modifications of share-based payments (hereafter, **Issue 13**);

(c) add an example illustrating the accounting for a modification of a share-based payment transaction that changes the classification from cash-settled to equity-settled (hereafter, **Issue 14**).

115. One of the respondents who partially disagree with the proposed amendment thinks that the IASB should clarify the interaction of the accounting for a modification of a share-based payment transaction that changes the classification from cash-settled to equity-settled with existing guidance elsewhere in IFRS 2 (hereafter , **Issue 15**).

116. We will analyse each of these issues in the following paragraphs.

Issue 11: the difference between the carrying amount of the liability at the modification date and the amount recognised in equity at the same date should not be recognised immediately in profit or loss

117. Some respondents think that the difference between the carrying amount of the liability at the modification date and the amount recognised in equity at the same date should not be recognised immediately in profit or loss, and should instead be recognised over the remaining service period.[29, 30]

118. These respondents think that recognising this difference over the vesting period is more consistent with the guidance in paragraphs 26–27 of IFRS 2 (and corresponding application guidance in paragraphs B42 –B44) for modifications to equity-settled share-based payment arrangements in which incremental fair value has been granted. Otherwise they think that the proposed approach in the ED will create differences in respect of the accounting for modifications applicable to equity-settled and cash-settled awards.

119. For example, one respondent said the following (emphasis added):

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[29] Respondents that agree: Belgian Accounting Standards Board (CL 16), Institute of Singapore Chartered Accountants (ISCA) (CL 30), Deloitte (CL 42), Israel Securities Authority (ISA) (CL 43), GLASS (CL 48), Federación Argentina de Consejos Profesionales de Ciencias Económicas (FACPCE) (CL 58), Accounting Standards Board of Canada (AcSB) (CL 62), EY (CL 35).

[30] Respondents that disagree: Israel Accounting Standards Board (IASB) (CL 3), South African Institute of Chartered Accountants (SAICA) (CL 41) and Larsen & Toubro Ltd (CL 69).

Our understanding of the proposed amendment is that for the incremental value of the award, there would be a 'catch up expense' for the service periods vested in the current year of the modification. As the benefit is only promised on modification of the award, **we believe it is more appropriate to spread the incremental charge promised at that point in time over the remaining vesting period. This is consistent with the accounting treatment for equity-settled modifications where incremental value has been granted.** [SAICA (CL 41)]

Another respondent said (emphasis added):

As noted by the Board in paragraph BC18, the immediate recognition of the difference in profit or loss differs from the accounting treatment of modifications of equity-settled awards under IFRS 2.27 and B43, but **no explanation has been given as to why a modified settlement approach (more akin to equity-settled awards that are accounted for as cancelled and replaced (i.e. IFRS 2.28)), rather than a prospective spreading approach over the remaining vesting period, has been adopted in the amendments**. [EY (CL 35)]

120. Two respondents further refer that crediting the difference between the amount of the liability and the amount recognised in equity in profit or loss deviates from the guidance in IFRS 2.[31] More specifically, they state that this deviates from the guidance in:

(a) paragraph 43 of IFRS 2, which is applicable to share-based payment transactions that provide an entity with a choice of settlement; this respondent states that:

In addition, the recognition of a credit in profit or loss—whilst consistent with the cancellation or settlement of a

[31] Institute of Singapore Chartered Accountants (ISCA) (CL 30), EY (CL 35).

cash-settled liability—**is not consistent with the approach in IFRS 2.43 for the settlement of awards where an entity has a choice of settlement method and where it is only incremental expense that is taken to profit or loss and any credit must remain within equity** [EY (CL 35)]

(b) paragraph B43(a) of IFRS 2, which is applicable to modifications of equity-settled share-based payment arrangements; in this respect this respondent notes that:

In our view, the difference should be recognised over the period from the modification date until the date when the equity instrument vest. Our view is based on the following reasons:

- **the incremental fair value upon modification of the cash-settled share-based payment transaction is not related to the original grant, but to the replacing equity instruments; and**
- **the proposed accounting treatment deviates from the principles stated in paragraph B43(a) of IFRS 2.** Paragraph B43(a) states that if the modification of an equity-settled share-based payment transaction occurs during the vesting period, **the incremental fair value is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period.** Following the same principles prescribed in paragraph B43(a) of IFRS 2, if a cash-settled share-based payment transaction is modified to an equity- settled share-based payment transaction during the vesting

> period, **the difference between the carrying amount of the liability at the modification date and the amount recognised in equity should be recognised over the period from the modification date until the date when the equity instruments vest** [Institute of Singapore Chartered Accountants (ISCA) (CL 30)]:

Staff analysis and recommendation

121. We disagree with the respondents who think that the incremental value be recognised over the vesting period consistent with paragraph B43(a) of IFRS 2.

122. As paragraph BC18 explains, the IASB decided not to apply by analogy the guidance in paragraphs 27 and B42–B44 of IFRS 2, which are applicable to modifications of equity-settled share-based payments. Moreover, the accounting for this difference between the liability derecognised and the amount of equity recorded is consistent with paragraph 30 of IFRS 2, because this paragraph requires that any changes in the fair value of the liability should be recognised in profit or loss.

123. Moreover we observe that recognising the difference in value between the original and the new award in profit or loss is also consistent with the accounting for the extinguishment of a financial liability (that has been extinguished fully or partially by the issue of equity instruments) in paragraph 3.3.3 of IFRS 9 *Financial Instruments* and with paragraph 9 of IFRIC Interpretation 19 *Extinguishing Financial Liabilities with Equity Instruments*. We reproduce paragraph 3.3.3 of IFRS 9 below:

> The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, shall be recognised in profit or loss.

124. We think that the Interpretations Committee should recommend the IASB to include in the basis for conclusions a reference to paragraph 3.3.3 of IFRS 9 and

paragraph 9 of IFRIC Interpretation 19 to reinforce the reasons of why the difference between the liability derecognised and the amount of equity should be recognised in profit or loss.

Issue 12: clarify the accounting treatment when the replacement award has a lower fair value than the original award at the modification date

125. Some respondents note that the proposed amendment addresses a situation in which the replacement award has a higher fair value than the original award at the replacement date. However, they observe that the proposed amendment does not address a situation in which the replacement award has a lower fair value than the original award at the replacement date. These respondents think that the IASB should clarify the accounting treatment when the latter situation occurs[32].

126. For example, one respondent said (emphasis added):

> The proposed amendment requires that the difference between the carrying amount of the liability as at modification date and the amount recognised in equity as at that date be recognised in profit or loss immediately. **This approach potentially creates differences between the accounting treatment of modifications to equity-settled and cash-settled awards and, in our view, does not adequately differentiate between the accounting for instances where there is an incremental fair value and those where there is a reduction in fair value**
>
> **(…)**
>
> If it is not the Board's intention to create divergence between the respective accounting treatments of modifications to cash-settled and equity-settled awards, then **we suggest an amendment to require that any reduction in the value be ignored and only an increase**

[32] For example: Institute of Chartered Accountants Ireland (ICAI) (CL 66), KPMG (CL 52) or EY (CL 35).

> **in value be spread over the period in which the services are provided.** This will be more reflective of the compensation given in return for the receipt of services over time. Alternatively, we suggest that similar language to that used in IFRS 2.43 be included. [EY (CL35)].

Staff analysis and recommendation

127. We disagree with the respondents' comments. We observe that the proposed paragraph B41A states that (emphasis added) '**any** difference between the liability derecognised and the amount of equity recorded is recognised immediately in profit or loss'. Consequently, we think that the proposed guidance applies to a difference that is either positive or negative, therefore

    (a) if a new award (ie the equity award) has a greater fair value than the original (cash-settled) award, the difference would recorded as a an expense at the date of modification; and

    (b) if a new award (ie the equity award) has a lower fair value than the original (cash-settled) award, the difference would be recorded as a gain at the date of modification.

128. Likewise, as mentioned in our analysis of **Issue 11** the accounting for this difference between the liability derecognised and the amount of equity recorded is consistent with paragraph 30 of IFRS 2, because this paragraph requires that any changes in the fair value of the liability to be recognised in profit or loss. Moreover, the proposed accounting treatment is also consistent with the accounting for the extinguishment of a financial liability (that has been extinguished fully or partially by the issue of equity instruments) in accordance with paragraph 3.3.3 of IFRS 9 and paragraph 9 of IFRIC Interpretation 19.

129. On the basis of our analysis above we do not think that any further clarification is needed in the guidance proposed.

Issue 13: clarify the accounting for other types of modifications of share-based payments

130. Some respondents think that the IASB should clarify the accounting for other types of modifications of share-based payments. [33] For example, one respondent mentioned that (emphasis added):

> However, we think that there are several other modifications to share-based payment transactions that are being accounted for differently in practice and therefore warrant additional IASB consideration. **These transactions may include, but are not limited to, modifications to the terms and conditions of; share-based payments that change the classification of the transaction from equity-settled to cash-settled; an IAS 19 arrangement that changes the award to be in the scope of IFRS2; and an IFRS 2 arrangement that changes the award to be in the scope of IAS 19.** [AcSB Canada]

Staff analysis and recommendation

131. We acknowledge the respondents' request that the IASB should address other types of modifications. However, we observe that the ED addresses a very particular type of modification, which is where the terms and conditions of a share-based payment are modified in such a way that it triggers a change in classification from a cash-settled share-based payment to an equity-settled share-based payment.

132. We observe that Example 9 of the implementation guidance in IFRS 2 illustrates a grant of shares with a cash alternative subsequently added. We think that such example could be used as guidance when accounting for modifications from equity-settled to cash-settled.

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[33] For example: Accounting Standards Board of Canada (AcSB) (CL 62), Baker Tilly UK Audit LLP (CL 47), RSM International Limited (CL 53), Accounting Standards Committee of Germany (ASCG) (CL 18), the Japanese Institute of certified Public Accountants (CL 39), EY (CL 35).

133. Furthermore, we are of the view that the analysis of modifications that change an arrangement from being within the scope of IFRS 2 to being instead within the scope of IAS 19 *Employee Benefits* (or vice versa) is beyond the scope of the proposed amendments to IFRS 2. However, we think that such modifications could potentially be addressed as part of the IASB's research project on share-based payments because this project has considered within its scope the classification of share-based payment arrangements as equity- or cash-settled (and the debt-equity classification) (refer to page 8 in Agenda paper 15 of May 2015).

Issue 14: add an example illustrating the accounting for a modification of a share-based payment transaction that changes the classification from cash-settled to equity-settled

134. Some respondents think that it would be useful if the IASB were to add an example illustrating the accounting for a modification of a share-based payment transaction that changes the classification from cash-settled to equity-settled.[34] For example, one respondent said the following (emphasis added):

> However, as some may be confused as to how to attribute unvested amounts between services provided in the past and services to be provided in the future, **we recommend that the IASB adds an illustrative example to illustrate the accounting at the modification date, as well as the subsequent accounting until the vesting of the equity-settled share-based payment.** [Hong Kong Institute of Certified Public Accountants (HKICPA) (CL 65)]

Staff analysis and recommendation

135. We agree that an illustrative example should be provided. We propose adding Example 12C illustrating a modification of the terms and conditions of a cash-

[34] For example: China Accounting Standards Committee (CASC) (CL 34), Hong Kong Institute of Certified Public Accountants (HKICPA) (CL 65) or KPMG (CL 52).

settled share-based payment that results in the share-based payment transaction being settled by issuing equity instruments.[35]

136. In this example, the original cash-settled share-based payment is considered to be settled by the granting of the equity-settled award at the modification date. Hence:

(a) the liability is derecognised at the date of modification;

(b) the modification date fair value of the equity-settled award (adjusted to reflect the extent to which service has been received) is compared to the fair value of the cash-settled award (adjusted to reflect the extent to which service has been received) and any difference between the amount of the liability derecognised and the amount of equity recorded is recognised immediately in profit or loss at the date of the modification.

(c) the future share-based payment cost is based on the modification-date fair value of the award and recognised over the remaining vesting period from the date of the modification.

137. We present this example below:

IG Example 12C
Background On 1 January 20X1 an entity grants 100 share appreciation rights (SARs) to 100 employees on the condition that the employee will remain in its employment for the next four years. The entity estimates that the fair value of the SARs is CU10 and therefore, the value of the original grant is CU100,000.. At the end of 20X2, the entity cancels the grant of the SARs and in its place grants 100 share options each with a fair value of CU13.20 for a total fair value of CU132,000 (ie with an incremental fair value of CU12,000) on the condition that the employee remains in its employment for the next year. The fair value of the share option remains the same until 20X4. At the end of 20X2 the fair value of each SAR is CU12, so the total fair value of the original grant is CU120,000. **Application of requirements** The entity identifies the grant of the share options as the replacement share-based payment for the cancelled SARs. Hence, the original cash-settled share-based payment is considered to be settled by

[35] The staff discussed another example with the IASB at its February 2014 (refer to proposed 'Example 12B' in Agenda Paper 12G). This example illustrates the accounting for an award that changes its classification from cash-settled to equity-settled; and the modified award has the same fair value as the original award.

the grant of share options.

Accordingly, at the modification date (31 December 20X2), the fair value of the equity-settled award (adjusted to reflect the extent to which service has been received) is compared to the fair value of the cash-settled award (adjusted to reflect the extent to which service has been received) and any difference between the amount of the liability derecognised and the amount of equity recorded is recognised immediately in profit or loss at the date of the modification.

The entity determines that the replacement award (CU132,000 × $2/4$ = CU66,000) is higher than the fair value of the original award (CU120,000 × $2/4$ = CU60,000). The entity recognises the increase in value (CU6,000) immediately in profit or loss (as an expense) at the date of the modification, with a corresponding credit to equity.

The share options granted are measured by reference to the fair value of the share options at grant date in accordance with paragraph 11 of IFRS 2. Grant date is defined as the date when the entity and the counterparty have a shared understanding of the terms and conditions of the share-based payment arrangement. In this example, the entity and employees share an understanding of the terms and conditions of the grant of share options on the modification date.

The remainder of the fair value of the equity-settled share-based payment is recognised in profit or loss over the remaining two-year vesting period from the date of the modification.

Year	Calculation	Cumulative expense CU	Expense CU	Equity CU	Liability CU
1	100 employees ×100 SARs x CU10 × $1/4$		25,000		25,000
2	*Remeasurement before the modification* 100 employees x 100 SARs × CU12.00 × $2/4$—25,000	60,000	35,000		35,000
	Reclassification of the liability to equity and recognition of the effect of settlement for CU6,000 (100 employees x 100 SARs × CU13.20 × $2/4$)—(100 employees x 100 SARs × CU12.00 × $2/4$)	66,000	6,000	66,000	(60,000)
3	100 employees × 100 SARs × CU13.20 × $^3/_4$—CU66,000	99,000	33,000	33,000	
4	100 employees x 100 SARs × CU13.20 × $^4/_4$—CU99,000	132,000	33,000	33,000	
	Total			132,000	0

Issue 15: clarify the interaction of the accounting for a modification of a share-based payment transaction that changes the classification from cash-settled to equity-settled with existing guidance elsewhere in IFRS 2

138. One respondent thinks that it would be helpful if the IASB were to clarify the interaction of the proposed amendment with existing guidance elsewhere in

IFRS 2.[36] In the following paragraphs we describe the areas in which this respondent thinks that more clarification is needed, along with our analysis and recommendations for the areas identified.

Interaction with the guidance applicable to modifications of equity-settled share-based payment arrangements and cancellations or settlements of equity instruments granted

139. The respondent notes that it is unclear whether, for modifications that occur during the vesting period, the IASB intends to follow a similar accounting treatment to the one applicable for equity-settled share-based payment arrangements in paragraphs B43(a) and B44.

140. Furthermore, the respondent notes that the wording in the proposed paragraph B41B (which applies when a cash-settled share-based payment is cancelled and replaced by equity instruments) is similar to the wording in paragraph 28(c) of IFRS 2. This respondent observes that paragraph 28(c) appears to allow: (a) modification accounting and (b) cancellation accounting followed by the treatment of the replacement award as a completely new grant, and asks whether paragraph B41B will allow the same accounting choice[37].

Staff analysis and recommendation

141. As mentioned in our analysis of **Issue 11**, the IASB decided that the guidance in IFRS 2 for equity-settled awards should not be applied by analogy to account for the changes in the classification of an award, from being cash-settled to being equity-settled. Consequently, paragraph B41B does not follow a similar accounting treatment to the one applicable to modifications of equity-settled awards (including cancellations and settlements).

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[36] EY (CL 62).

[37] We reproduce an extract of this paragraph, as follows: '(c) if new equity instruments are granted to the employee and, on the date when those new equity instruments are granted, the entity identifies the new equity instruments granted as replacement equity instruments for the cancelled equity instruments, the entity shall account for the granting of replacement equity instruments in the same way as a modification of the original grant of equity instruments, in accordance with paragraph 27 and the guidance in Appendix B'.

The amendment should distinguish between changes in the fair value and changes in the terms and conditions of the award

142. The respondent notes that in paragraph BC17 ‘it is not clear whether the change in fair value is expected to arise solely from a modification that changes the classification of a transaction from cash-settled to equity-settled or whether it also relates to other modifications to the terms of the arrangement’. This respondent thinks that the guidance applicable to modifications of awards from cash-settled to equity-settled should distinguish between these two types of changes in a similar way to how paragraphs B43–B44 in IFRS 2 do[38].

Staff recommendation and analysis

143. We observe that the proposed guidance in paragraph B41A would apply when an entity changes the terms and conditions of the share-based payment in such a way that this would trigger a change in classification from being cash-settled to being equity-settled. Moreover, in accordance with the same paragraph, any increase or decrease in value of the original award would be immediately recognised in profit or loss, because this is consistent with the measurement of cash-settled awards in accordance with paragraph 30 of IFRS 2.

144. Consequently, we do not think that any further clarification is needed in paragraph B41A.

Clarify whether the guidance in paragraphs B14A–B14B would apply for modifications that occur during the vesting period or where the vesting period is extended

145. The respondent notes that the ED does not specify in the proposed amendment whether the proposed guidance in paragraphs B14A–B14B would apply for modifications of cash-settled awards to equity-settled awards that occur during the vesting period. This respondent also notes that the proposed amendment does not

[38] We note that paragraphs B43–B44 provide different accounting guidance depending on whether the modification causes an increase or a decrease in the value of the award and depending on whether this modification changes the fair value of the equity instruments or the number of equity instruments granted.

provide guidance in a situation in which the vesting period is extended as a consequence of the modification from cash-settled to equity-settled.

Staff recommendation and analysis

146. In our view the guidance in proposed paragraph B14A is implicitly considering that a change in classification from a cash-settled classification to an equity-settled classification occurs during the vesting period. However, we do not disagree that this could be further specified as part of the guidance in those paragraphs.

147. We agree that proposed paragraph B14A do not specify how the guidance in this paragraph would be applied when the vesting period is extended. In our view, when this occurs, an entity should recognise any difference immediately in profit or loss for the vested portion of the award by reference to the modified vesting period. We illustrate this view with the following example:

Example[39]

An employee is granted a cash-settled share-based payment with a vesting period of one year. The award is replaced by an equity-settled award shortly before the end of Year 1, which has a further one-year vesting period from the modification date. The fair value of the equity-settled award at the modification date is CU150. The total fair value of the cash-settled liability at the modification date is CU100 and an expense of CU100 is recognised in the period prior to modification.

Application of the requirements

At the modification date the liability is derecognised. The entity compares the fair value amount of the original cash-settled award and the fair value amount of the equity-settled award and determines the difference. This difference is recognised immediately in profit or loss for the vested portion of the award by reference to the modified vesting period (in the example, 50 per cent throughout a total vesting period of two years), as follows:

(CU150 × $^{1}/_{2}$ = 75)—(CU100 × ½ = 50) = CU 25

The entity will recognise a future expense for the equity-settled award of CU25 (CU150 × $^{2}/_{2}$) – CU 125 = CU 25) over one year from the modification date.

[39] This example is based on an example provided by EY(CL 35) in its comment letter.

148. On the basis of our analysis above, we suggest that the Interpretations Committee should recommend to the IASB that it should include additional guidance to state that:

(a) the guidance in paragraph B14A would apply to modifications that occur during the vesting period.

(b) when the vesting period is extended, the accounting for a modification in accordance with paragraph B14A should be done by reference to the modified vesting period.

Questions to the Interpretations Committee on section 3

Section 3: Accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled
1. (Issue 11) Does the Interpretations Committee agree that it should recommend to the IASB to include in the basis for conclusions a reference to paragraph 3.3.3 of IFRS 9 and paragraph 9 of IFRIC Interpretation 19 to reinforce the reasons of why the difference between the liability derecognised and the amount of equity should be recognised in profit or loss?
2. (Issue 12) Does the Interpretations Committee agree not to recommend to the IASB to add further clarification about the accounting treatment when the replacement award has a lower fair value than the original award at modification date?
3. (Issue 13) Does the Interpretations Committee agree not to recommend to the IASB to add further clarification of the accounting for other types of modifications of share-based payments?
4. (Issue 14) Does the Interpretations Committee agree that it should recommend the IASB to include Example 12C to illustrate a modification of the terms and conditions of a cash-settled share-based payment that results in the share-based payment transaction being reclassified as equity-settled?
5. (Issue 14) Does the Interpretations Committee have any comments on Example 12C?

6. (Issue 15) Does the Interpretations Committee agree that paragraph B41A should specify that a change in classification from a cash-settled classification to an equity-settled classification occurs during the vesting period?

7. (Issue 15) Does the Interpretations Committee agree that additional guidance should be included in paragraph B14A to specify that when the vesting period is extended, an entity should recognise any difference immediately in profit or loss for the vested portion of the award by reference to the modified vesting period?

Section 4: analysis of Question 4—Transition

149. With reference to the respondents who replied to Question 4:

(a) about **two-thirds** of the respondents *fully supported* the transition provisions in the ED for the reasons provided (ie prospective application and allowing entities to perform retrospective application if the necessary information to do so is available without the use of hindsight).

(b) about a **quarter** of respondents *disagreed* with the proposed transition requirements, because they think that the IASB should require full retrospective application for all the three proposed amendments. (hereafter **Issue 16**).

(c) a small number of those respondents think that the IASB could consider, as an alternative approach, requiring different transition requirements for each of the three amendments included in the ED (hereafter, **Issue 17**)

(d) the remaining respondents *partially agreed* with the proposed transition provisions, because they think that the IASB should explain the what is meant by 'prospective application' within the context of the proposed amendments in the ED (hereafter, **Issue 18**).

Issue 16: require full retrospective application for all the three proposed amendments

150. Some respondents think that the IASB should require full retrospective application for all the three proposed amendments consistently with paragraph 22 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, unless it is impracticable to do so. This is because they think that requiring retrospective application enhances the comparability and consistency of the information in the financial statements and results in more useful information.[40]. For example one respondent said:

> As we agree with the Board that retrospective application of the proposed amendments is achievable (ED.BC23), **we are in favour of requiring their retrospective application,** unless impracticable (in which case the changes are applied as at the beginning of the earliest period for which retrospective application is practicable, consistent with IAS 8). **In our view, information about the comparative period is useful in itself and enhances comparability.** [RSM CL 53]

Staff analysis and recommendation

151. We observe that the IASB considered requiring retrospective application for the issue of share-based payments with net settlement features and for the issue of modifications that change the classification from cash to equity because it observed that most entities would have the information necessary to apply the amendments retrospectively. However, for the issue on the accounting for the effects of vesting conditions on a cash-settled share based payment, the IASB

[40] For example: EFRAG (CL 22), Institute of Certified Public Accountants of Kenya (CL 49), Indonesian Institute of Accountants (IAI) (CL 46), ESMA (CL 2), The Institute of Chartered Accountants of Zimbabwe (CL 31), Singapore Accounting Standards Council (ASC) (CL 23), Financial reporting Council (Mauritius) (CL 13), PwC (CL 36), the Association of Accounting Technicians (AAT) (CL 55), RSM International Limited (CL 53), The Institute of Public Accountants (IPA) (CL 8), The Malaysian Institute of Certified Public Accountants (CPA) (CL 7).

determined that the cost of retrospective application would outweigh the benefits from doing so[41].

152. We are of the view that it is preferable for the transition guidance for all three amendments to be consistent. Consequently we think that retrospective application should not be required for all three proposed amendments.

153. We note, however, that, proposed paragraph 63D allows retrospective application for the three proposed amendments, if the entity has the information necessary to do so and this information is available without the use of hindsight.

Issue 17: the IASB could consider, as an alternative approach, requiring different transition requirements for each of the three amendments included in the ED

154. A small number of those respondents think that the IASB could consider, as an alternative approach, requiring different transition requirements for each of the three amendments included in the ED. For example:

(a) *retrospective* application for cash-settled awards with vesting conditions and for share-based payments with net settlement features; and

(b) *prospective* application for the arrangements modified from cash-settled to equity-settled.[42]

155. For example, one respondent stated (emphasis added):

> We believe **a preferable approach would be to apply the amendments in respect of vesting conditions of cash-settled share-based payments and in respect of share-based payments settled net of tax retrospectively to awards granted before the date of initial application of the amendments that have not**

[41] More information about the discussion held by the IASB about the transition requirements for the 3 amendments can be found in Agenda Paper 12F of April 2014.

[42] For example: Telefonica (CL 70), Deloitte (CL 42), KPMG (CL 52).

vested at that date. This approach would ensure that the calculation of share-based payment expense is consistent for all unvested awards and should be practicable without the use of hindsight given that it would not require any additional inputs into a valuation exercise.

We recommend that **the amendments in respect of modifications resulting in a change of classification from cash-settled to equity-settled be applied prospectively to modifications occurring after the date of initial application of the amendments**. [Deloitte (CL 42)].

Staff analysis and recommendation

156. We acknowledge that each proposed amendment is independent from each other. However, we observe that it was the IASB's intention to align the transition requirements for all the three proposed amendments to ease the implementation burden and impact of the amendment for preparers and users of the financial statements. The IASB proposed a single transition method for new awards and outstanding awards (refer to agenda paper 12F of April 2014).

157. Nevertheless, we agree that further clarification is needed regarding the application of the transition provisions for each one of the three proposed amendments as we discussed in the following section.

Issue 18: the proposed transition guidance is unclear

158. Some respondents think that the proposed transition guidance is unclear and they think that the IASB should state whether the proposed amendments are intended to be applied:

(a) to *new* and *outstanding* (non-vested) share-based payments (including being applied to *modifications of share-based payment transactions that have not vested* as at the effective date);

(b) to *new* and *outstanding* (non-vested) share-based payments, but *excluding* modifications *of share-based payment transactions that have not vested* before the effective date of the amendment (thus, including *new modifications* only); or

(c) to *new* share-based payment arrangements that take place on or after the effective date of the amendment.[43]

159. For example, one respondent said (emphasis added):

> While we welcome prospective application because prior periods are not required to be restated, **it is unclear to us what is meant by prospective application for awards outstanding at the effective date. For example, assume that a share-based payment with a net settlement feature was granted in 2014 and that the proposed amendment needs to be applied from 1 January 2017**. Assume that the share-based payment was accounted for previously as cash-settled because of the net settlement feature. **Does prospective application mean that the share-based payment is recognised as equity-settled on 1 January 2017 (but still using the original grant date value) and that any resultant adjustments (i.e. to remove any re-measurements since grant date and to de-recognise the cash-settled liability) are recognised in profit or loss at that date?** Or are they recognised against opening retained earnings at that date? **Or are no adjustments made to outstanding awards, i.e. the proposed amendments are applied only to new awards made after the effective date? The same uncertainties exist for outstanding awards which were modified from cash-settled to equity-settled prior to the effective**

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[43] For example: GLENIF (CL 48), ACTEO (CL 24), SAICA (CL 41), KPMG (CL 52), Deloitte (Cl 42), FACPE (CL 58), PwC (CL 36).

date. We encourage the Board to clarity the approach to be followed. [KPMG (CL 52)]

Staff analysis and recommendation

160. We agree with the respondents who think that the transition provisions are not clear. This is because we observe that the transition requirements proposed in paragraph 63D are not as specific as the explanations in paragraph BC22 of the basis for conclusion because:

(a) proposed paragraph 63D does not explain whether the proposed transition requirements should be applied to new awards only or to new and non-vested awards; whereas,

(b) paragraph BC22 in the ED explains that the three amendments included in the ED should be applied to *new awards* (non-vested) and to *outstanding awards* (awards that have not vested).

161. Consequently we think that paragraph 63D should make clear that the three amendments should be applied to new awards and outstanding awards (ie existing unvested awards) as further specified in this paragraph and paragraphs 163-165. We think that this requirement would mean that the proposed amendments apply to:

(a) all modifications that occurred after the date the amendments are first applied;

(b) existing unvested share based-payment awards that have net settlement features (as described in the ED); and

(c) existing unvested cash-settled share-based payments that are subject to vesting and non-vesting conditions.

162. We observe that for some respondents it is unclear how the proposed amendments would be applied to unvested, outstanding share-based payments. We observe that paragraph 63E should explain this aspect for each one of the proposed amendments.

163. We think that for modifications that change the classification from cash-settled to equity-settled, the new proposed accounting would apply to the modifications that occur after the date the amendments first applied. Consequently, in this case the accounting for modifications would be event-driven.

164. For the existing unvested cash-settled awards that are subject to vesting and non-vesting conditions, an entity would need to adjust the carrying amount of the liability in the statement of financial position in the period of change on the date the amendment is first applied and to recognise the effect of the change, ie any cumulative catch-up adjustment, in equity (ie retained earnings) at the beginning of the annual period in which the amendment is first applied.

165. We observe that the proposed amendment for awards with net settlement features addresses not only a change in measurement but also a change in classification. So we think that at the date the amendment is first applied an entity would need to assess the existing unvested arrangements with net settlement features that have been classified as cash-settled or that have been classified using a 'bifurcation' approach (ie in accordance with paragraph 34 of IFRS 2). If the entity reaches the conclusion that such arrangements should be classified as equity-settled, we think that an entity would reclassify the current carrying value of the liability into equity. An entity would need to adjust the measurement of the unvested award due to the new classification. We think that this adjustment should be recognised in equity (ie retained earnings) at the beginning of the period when the amendment is first applied.

166. We also think that the transition provisions should make clear that for all the three proposed amendments no adjustment should be made to comparative information.

Questions to the Interpretations Committee

Section 4: Transition
1. (Issue 16) Does the Interpretations Committee agree that it should only allow retrospective application if the entity has the information necessary to do so and this information is available without the use of hindsight)?
2. (Issues 17 and 18) Does the Interpretations Committee agree that paragraph 63D should provide specific transition guidance for applying the proposed amendments to new awards or existing unvested awards? Does the Interpretations Committee agree with the guidance proposed?

Staff recommendation

167. On the basis of the analysis in the previous section of the paper, we think that the Interpretations Committee should recommend to the IASB that it should proceed with the proposed amendments to IFRS 2.

168. We also propose to the Interpretations Committee that it should recommend to the IASB that it should make some changes to clarify the proposed amendments to IFRS 2. These amendments are summarised in **Appendix A**. The staff draft of the wording of the proposed amendments is presented in **Agenda Paper 2A**.

Appendix A—Summary of proposed solutions to address the comments received on the ED

A1. The following table shows a summary of the issues raised on the ED and our proposed solutions.

Issue raised	Action proposed
Issue 1: the reference in paragraph 33 to 'vesting conditions' should exclude market conditions	• Include some wording changes in par. 19 and 33 of IFRS 2 to clarify that the measurement of the fair value: o includes the impact of performance and service conditions; but o excludes the impact of market conditions
Issue 2: clarify whether the proposed guidance in paragraphs 33–33C is limited to the measurement of share appreciation rights only or whether it is applicable to the measurement of all cash-settled share based payments	• Indicate that the guidance in IFRS 2 for measuring the liability incurred in paragraphs 30 –33C should be applied to all cash-settled awards and that share appreciation rights are an example of cash-settled share-based payment transactions. • change, when applicable, the references to 'cash-settled awards' or 'award' in paragraphs 33A–33B to 'share appreciation rights'.
Issue 3: clarify the meaning of the notion of 'best available estimate of the number of awards that are expected to vest' in paragraph 33A	In the Basis for Conclusions mention that: • the notion of 'best available estimate' in paragraph 20 and paragraph 33A of IFRS 2 is determined on the measure that management judges to be the best depending on the circumstances; and • an entity could use, for example, a probability-weighted sum of the possible outcomes or a 'most likely amount' approach in determining its best estimate
Issue 4: require the disclosure of a contingent liability when vesting is not probable	The proposed disclosure is not considered necessary because paragraph 50 of IFRS 2 contains a general disclosure requirement to "disclose information that enables users of the financial statements to understand the effect of share-based payment transactions on the entity's profit or loss for the period and on its financial position.
Issue 5: the proposed amendment will increase divergence between the guidance in IFRS 2 and IAS 19 *Employee Benefits*	By including an explanation of the notion of 'best available estimate in the basis for conclusions (as we have recommended in our analysis of Issue 3) will further clarify how an entity measures the liability derived from a cash-settled award and consequently we think that this guidance will eliminate any misunderstandings created by the explanations in paragraph BC244 –BC245 of IFRS 2.
Issue 6: include more examples to illustrate the effects of vesting and non-vesting conditions	No further examples are proposed because the existing examples in IFRS 2 illustrating the effects of vesting and non-vesting conditions in measuring equity-settled awards could be applied by analogy in measuring cash-settled awards.
Issue 7: the proposed classification for the share-based payment transaction with net settlement features described in the ED should	In the Basis for Conclusions reinforce the reasons why the proposed classification represents an exception to the requirements in IFRS 2

Issue raised	Action proposed
not be categorised as an exception to the requirements to IFRS 2	by: • stating that the payment to the tax authority represents a payment on behalf of the counterparty for the services received from the counterparty, regardless of the fact that the tax authority is the one receiving the cash payment. Consequently, in substance, this is a payment to the employee; and • emphasising that the entity settles the employee's tax obligation by using its own cash rather than by issuing equity.
Issue 8: clarify whether the proposed exception in par. 33D of the ED is applicable to other types of net settlement features	We do not think that the proposed scope of the exception should be changed.
Issue 9: the proposed amendment does not address the accounting for any difference that may arise between (a) the amount of the cash that needs to be paid to the tax authority and the amount of expense recognised during the vesting period; and between (b) the tax obligation and the portion of instruments withheld	• We propose adding Example 12B to the implementation guidance in IFRS 2 which illustrates the accounting for the transaction with net settlement features described in paragraph 33D. • We think that the difference between the amount of cash paid to the tax authority and the cost recognised during the vesting period should be accounted for in accordance with paragraph 29 of IFRS 2. • We think that any excess of shares withheld over the tax liability, when that excess is paid as cash to the employee, should be accounted for as a cash-settled share-based payment.
Issue 10: the IASB should follow the FASB's discussions on minimum statutory withholding requirements and determine whether any further amendments to IFRS 2 would be appropriate.	• No further action is proposed. This is because when contrasting the proposed exception in paragraph 33D with the guidance in Topic 718 (10-25-18) we observe that the proposal in paragraph 33D does not restrict the amount withheld to a minimum or to a maximum amount; and requires the entire award to be classified as equity-settled.
Issue 11: the difference between the carrying amount of the liability at the modification date and the amount recognised in equity at the same date should not be recognised immediately in profit or loss	• Include in the basis for conclusions a reference to paragraph 3.3.3 of IFRS 9 and paragraph 9 of IFRIC Interpretation 19 to reinforce the reasons of why accounting for the difference between the liability derecognised and the amount of equity should be recognised in profit or loss.
Issue 12: clarify the accounting treatment when the replacement award has a lower fair value than the original award at the modification date	• We do not think that any further clarification is needed because we observe that the proposed paragraph B41A states that (emphasis added) '**any** difference between the liability derecognised and the amount of equity recorded is recognised immediately in profit or loss'.
Issue 13: clarify the accounting for other types of modifications of share based payments	• No further action is needed. This is because we observe that Example 9 of the implementation guidance in IFRS 2 illustrates a grant of shares with a cash alternative subsequently added. We think that such example could be used as guidance to account for modifications from equity-settled to cash-settled. • Moreover, we observe that the analysis of modifications that change an arrangement from being within the scope of IFRS 2 to being instead within the scope of IAS 19 (and viceversa) is

Issue raised	Action proposed
	beyond the scope of the proposed amendments to IFRS 2 and such modifications could potentially be addressed as part of the IASB's research project on share-based payments.
Issue 14: add an example illustrating the accounting for a modification of a share-based payment transaction that changes the classification from cash-settled to equity-settled	• We propose adding Example 12C to the implementation guidance in IFRS 2. This example illustrates a modification of the terms and conditions of a cash-settled share-based payment that results in the share-based payment transaction being settled by issuing equity instruments.
Issue 15: clarify the interaction of the accounting for a modification of a share-based payment transaction that changes the classification from cash-settled to equity-settled with existing guidance elsewhere in IFRS 2	• We do not think that further clarification is needed because as mentioned in our analysis of Issue 11 the IASB decided that the guidance in IFRS 2 for equity-settled awards should not be applied by analogy to account for the changes in the classification of an award (from being cash-settled to being equity-settled). • We think that paragraph B14A could further specify that: o a change in classification from a cash-settled classification to an equity-settled classification occurs during the vesting period. o when the vesting period is extended, an entity should recognise any difference immediately in profit or loss for the vested portion of the award by reference to the modified vesting period
Issue 16: require full retrospective application for all the three proposed amendments	• We are of the view that retrospective application should not be required for all the three proposed amendments. We observe that it was the IASB's intention to align the transition requirements for all the three proposed amendments to avoid confusion.
Issue 17: the IASB could consider, as an alternative approach, requiring different transition requirements for each of the three amendments included in the ED	
Issue 18: the proposed transition provisions regarding prospective application are unclear	• We recommend that paragraphs 63D–63G should explain how the three amendments included in the ED should be applied for new awards and for outstanding awards (awards that have not vested). We also think that the transition provisions should make clear that for all the three proposed amendments no adjustment should be made to comparative information.