

STAFF PAPER

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REG IASB Meeting

Project	IFRS 2 <i>Share-based Payment</i> research project		
Paper topic	Report on research so far		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Accounting Standards Advisory Forum, April 2016, Agenda paper 7A

The IFRS 2 *Share-based Payment* research project is currently classified as being at the *Assessment stage*, ie this project is assessing possible practice issues to understand whether there is a financial reporting problem and, if so, whether (and then how) to address it.

This paper summarises the research the staff have carried out so far in this project. During this meeting we will discuss the content of the paper. We will ask the IASB to decide at a future meeting on the next process steps, for example whether the research paper should be published in any form.

Questions for the IASB

1. Do the IASB members have any substantive comments on this paper?
2. Does the IASB believe that staff should do more work at this stage of the research project? For example, would you like to have more information about advantages and disadvantages of the two measurement models?

Objective of the research project

1. During the 2011 Agenda Consultation, many respondents commented on the complexity of IFRS 2 *Share-based Payment* (IFRS 2). It has also attracted a large number of interpretation requests.
2. The objective of this project is twofold:
 - (a) to identify whether it is IFRS 2 that is causing the perceived complexity, and if it is, to identify the most common areas of complexity. To achieve this, the project reviews the main application issues that have arisen in practice; and
 - (b) to analyse why IFRS 2 has attracted many interpretation requests.
3. Please note that this is not the intention of either this or any further planned research by the IASB to re-visit the core principle of IFRS 2, which states that ‘An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received’.¹
4. The research process is:
 - (a) perform research in accordance with the project plan, which was presented to the IASB in May 2015²; the steps of the research are summarised in Appendix B of this paper;
 - (b) present a summary of the research (ie this paper) to the IASB; and
 - (c) on the basis of the responses to the 2015 Agenda Consultation (and potentially of further outreach), the IASB will decide whether, and if so, how to move forward with further work on share-based payment.

¹ Paragraph 7 of IFRS 2.

² http://www.ifrs.org/Meetings/MeetingDocs/IASB/2015/May/AP15-IFRS_per_cent202.pdf

5. The paper has the following sections:
 - (a) Summary of findings—paragraphs 7-19
 - (b) History of IFRS 2—paragraphs 20-30
 - (c) IFRS 2 measurement models—paragraphs 31-52
 - (d) List of application issues—paragraphs 53-54
 - (e) Potential ways forward—paragraphs 55-83.

6. The paper also has the following Appendices:
 - (a) Appendix A—Analysis of main application issues
 - (b) Appendix B—Steps in the research and how they are incorporated in the paper
 - (c) Appendix C—Some statistics
 - (d) Appendix D—Summary of other IASB projects that might have an effect on this project.

Summary of findings

7. On the basis of the research and outreach that have been performed, it appears that the complexity of applying IFRS 2 in practice has two main causes. The first cause is the complexity of share-based payment arrangements themselves. The second cause—which has more of an accounting nature—is the usage of the *grant date* fair value measurement model in IFRS 2 for share-based payment arrangements that are settled in shares or in share options (ie equity-settled share-based payment arrangements). This section looks at both of these causes in turn.
8. The IASB will decide on the future of this research project once it has reviewed responses to the Agenda Consultation 2015.
9. With respect to the complexity in IFRS 2, we believe that it cannot be reduced without fundamentally reconsidering the existence of the two measurement models—and, more specifically, the *grant date* fair value measurement model—in the Standard. At this stage the staff have not carried out a reconsideration of those measurement models.

Variety and complexity of share-based payment arrangements

10. In summary, the variety and complexity of share-based payment arrangements contribute significantly to the overall perception of complexity that is ‘caused’ by IFRS 2.
11. Those people who analyse share-based payment arrangements comment on the variety, complexity and inventiveness of conditions in share-based payment arrangements. Management often structure the arrangements not only with the objective of remunerating management personnel and employees for their services, but also with the objective of achieving specific accounting results such as, for example, minimising the amount and volatility of the expense or delaying the recognition of the expense.
12. In quantitative terms, the amount of an IFRS 2 expense is often a relatively small number in an entity’s financial statements. However, in qualitative terms, this amount often attracts a significant amount of attention, because share-based payments are

often made to key management personnel. This level of attention is one driver of the variety and complexity of these arrangements.

13. The strongest interest comes from those user groups who take an active interest in corporate governance and stewardship matters. They include shareholders and their representatives, regulators and key management personnel themselves.

Grant date fair value measurement model

14. The *grant date* fair value measurement model is used in IFRS 2 for measuring some equity-settled transactions, including transactions with employees, by reference to the fair value of shares or share options at the grant date of an arrangement. That measurement is not adjusted subsequently for changes in the fair value of the shares or share options.³ In other words, the amount of the expense is ‘frozen’ at the date at which the entity and the other party (such as an employee) agree to the arrangement.⁴
15. From the analysis of the main application issues in Appendix A and their summary in paragraph 53, it appears that most of the application issues that come up in practice arise from the *grant date* fair value measurement model. The application issues include:
 - (a) difficulty in understanding the underlying principle of not measuring the assets and expenses at the value of the instruments that the entity will ultimately issue as compensation;
 - (b) perceived counterintuitive results in accounting for some transactions;
 - (c) complexity in classification of conditions as vesting or non-vesting and in how those conditions are reflected in the *grant date* fair value during subsequent measurement; and
 - (d) the need to make significant valuation assumptions at the grant date for the entire duration of the arrangement, and the fact that those assumptions are not subsequently updated.

³ Paragraphs 10-11 of IFRS 2.

⁴ The full definition of a grant date is provided in Appendix A of IFRS 2.

Way forward

16. At this stage, the IASB does not need to make any decisions about whether to undertake any future standard-setting related to IFRS 2. Further assessment will be performed in 2016 once the IASB reviews responses to the Agenda Consultation 2015.
17. The staff believe that the IASB should consider—once it has analysed the responses to the Agenda Consultation—whether to move this project to the *Development stage* of research or to discontinue it. The *Development stage* of research means that ‘The IASB has completed its assessment work and is developing proposals to respond to the problem(s) identified’.
18. On the basis of the research described in this paper, the staff believe that without reconsidering the *grant date* fair value measurement model, it will not be possible to reduce significantly the complexity that arises in applying IFRS 2. At this stage the staff have not carried out a reconsideration of those measurement models.
19. The staff also believe that the IASB and the IFRS Interpretations Committee (‘the Interpretations Committee’) should have a very high hurdle for adding more IFRS 2 issues to their agendas, because making amendments often leads to further complexity in the Standard. It also appears that the IASB and the Interpretations Committee have already addressed the most important issues that have arisen in practice since the Standard was issued.

History of IFRS 2

2004-2011

20. IFRS 2 was issued in 2004. Although it was not developed jointly with the US Financial Accounting Standards Board (FASB), many principles of IFRS 2 are consistent with US GAAP. These include: *grant date* fair value measurement model and the approach to cancellations and ‘negative’ modifications⁵ for equity-settled share-based payment arrangements.
21. With respect to the impact of IFRS 2, Ernst & Young’s publication *International GAAP 2015* has the following description: ‘share-based payment is one of the most controversial projects so far tackled by the IASB, arousing as it does strong passions not only among the IASB’s normal constituency but also at the highest political levels. The reason for this is that most share-based payment transactions undertaken by entities are awards of shares and options as remuneration to employees, in particular senior management and directors.’⁶
22. It is worth pointing out that IFRS 2 and FAS 123R *Share-Based Payment* were both issued before the financial crisis in 2008, ie during the period of market growth when most share prices were rising. Consequently—technical reasons aside—the *grant date* fair value measurement model for shares and share options seemed to be an attractive solution for many entities at the time. In other words, the expense for equity-settled share-based payment arrangements was lower than the amount that would have been recognised using the *reporting date* fair value measurement model.⁷
23. The feedback we have obtained during this research suggest that most people accept that recognising an expense on consumption of goods and services received in share-based payment transactions provides information that is relevant for economic decisions and for the assessment of stewardship in entities.

⁵ For this paper, a modification is called ‘negative’ when it is not beneficial to an employee, ie it reduces the fair value of a share-based payment arrangement.

⁶ Chapter 31, page 2209.

⁷ We created the term *reporting date* fair value for this paper. This paper uses the term ‘*reporting date* fair value’ as opposed to simply ‘fair value’ in order to draw a clearer distinction between the existing measurement models for equity- and cash-settled share-based payment arrangements in IFRS 2.

24. Nevertheless, IFRS 2 has been criticised repeatedly for its complexity. It has also attracted a number of interpretation requests and has been amended several times. Nearly all respondents who commented on IFRS 2 in response to the 2011 Agenda Consultation said that it was a complex Standard. Nevertheless, views varied significantly at the time about adding a project on this topic to the IASB’s agenda—depending on how strongly respondents felt about the Standard’s complexity—with:
- (a) some respondents indicating that the project should be assigned a high priority, because they believed that the application of IFRS 2 required undue cost and effort; and
 - (b) some respondents indicating that the project should be assigned a low priority, because they believed that although the Standard was complex, it was nevertheless operational in practice.

Interpretation requests

25. The interpretation requests received by the Interpretations Committee can be broadly grouped as relating to two main areas:
- (a) group share-based payment arrangements; and
 - (b) treatment of various conditions in the measurement of equity-settled share-based payment arrangements depending on their classification as vesting and non-vesting conditions. (The conditions are described and discussed in more detail in Appendix A.)
26. The common reason for these two areas of requests relates to the fact that there was a lack of guidance for them, especially for the first area, when IFRS 2 was originally issued. The second area, ie treatment of various conditions in the measurement of equity-settled share-based payment arrangements, has another—conceptual—reason why it has given rise to many questions. This reason relates to the *grant date* fair value measurement model and to the fact that different conditions are treated differently within this model. Several amendments were made to IFRS 2 to address both areas. It appears from the analysis of recent submissions and from discussions with specialists that the issues about these areas have largely been resolved.

27. Other interpretation requests relate either to various other, more narrow, areas of IFRS 2 or to the fact that there are two different measurement models in the Standard. Although the main areas have been addressed, some specific issues could still arise in the future.

2012-present

28. In May 2012, as a result of the 2011 Agenda Consultation, the IASB added a project on share-based payment arrangements to its Research Programme for the following reason: ‘there are mixed views on how effective IFRS 2 has been in practice. Although we have an IFRS that seems to work well, it also attracts a disproportionate number of interpretation requests’.⁸
29. Since May 2012, the IASB has issued further amendments to IFRS 2:
- (a) amendments to the definitions of ‘vesting condition’ and ‘market condition’ (including adding new definitions for ‘performance condition’ and ‘service condition’) issued in December 2013.⁹ These amendments were issued in response to the requests to the Interpretations Committee that were mentioned in paragraph 25(b).
 - (b) draft amendments *Classification and Measurement of Share-based Payment Transactions* issued in November 2014. The proposed amendments address three issues; all of these issues¹⁰ arise from differences between the two measurement models for equity-settled and cash-settled share-based payment arrangements (ie *grant date* fair value for the former and *reporting date* fair value for the latter).
30. Some respondents to the draft amendments above commented more generally on the fact that IFRS 2 seems to be continually amended.

⁸ Staff paper 13B, May 2012 *Developing the IASB’s Technical Programme*.

⁹ As part of *Annual Improvements to IFRSs 2010-2012 Cycle*.

¹⁰ Ie: 1) treatment of vesting conditions in cash-settled share-based payment arrangements; 2) a modification from a cash- to an equity-settled share-based payment arrangement and 3) classification of share-based payment transactions with net settlement features.

IFRS 2 measurement models

Fair value measurement models

31. The objective of IFRS 2 is to prescribe the accounting for transactions in which an entity receives goods or services in exchange for:
- (a) issuing equity instruments (ie shares or share options)—equity-settled share-based payment arrangements; or
 - (b) incurring liabilities to pay amounts based on the price of the entity's shares (or of other equity instruments)—cash-settled share-based payment arrangements.
32. All share-based payment transactions are recognised in the financial statements, using a fair value measurement basis over the period(s) in which an entity obtains the goods or receives the services.¹¹
33. With regards to measurement, awards granted to non-employees are measured by reference to the fair value of goods or services received. For share-based payment transactions with employees, IFRS 2 prescribes two measurement models for recognising the expense over the service period:
- (a) *grant date* fair value—for equity-settled share-based payment arrangements; and
 - (b) *reporting date* fair value—for cash-settled share-based payment arrangements.
34. It is also relevant to note that another standard, IAS 19 *Employee Benefits*, also deals with recognition of expenses for employee services over the period(s) of time. The measurement model of IAS 19 will be discussed later in this section.
35. In accordance with the *grant date* fair value measurement model in IFRS 2, an entity measures the fair value of shares and share options granted at the grant date, based on the market prices, taking into account terms and conditions of the awards granted. If market prices are not available, the *grant date* fair value of the award granted is

¹¹ Paragraphs 7 and 15 of IFRS 2.

estimated using a valuation technique.¹² This measurement is not updated subsequently for changes in the fair value of the shares or share options.

36. In accordance with the *reporting date* fair value measurement model in IFRS 2, an entity measures the fair value of the liability, both initially and at the end of each reporting period and at the date of settlement. Any changes in the *reporting date* fair value are recognised in profit or loss for the period. There is no requirement to split that change in fair value into the service cost and a remeasurement.¹³

Grant date fair value measurement model: conceptual reasons

37. When deciding how to measure equity-settled share-based payment transactions, in developing IFRS 2 as issued in 2004, the IASB considered these transactions to be conceptually different to cash-settled share-based payment transactions. For equity-settled share-based payment transactions with employees, the IASB decided to use the accounting principles that apply to equity transactions. It also concluded that the services provided by employees were the consideration that the entity receives for the equity instruments (ie shares or share options).¹⁴
38. Typically, under the existing *Conceptual Framework*, the following principles apply to measurement of equity transactions:
- (a) initially, an asset received as a consideration for an equity instrument is measured at its current value;
 - (b) subsequently, the equity (ie credit side) is not remeasured;
 - (c) neither would the asset received be remeasured for subsequent changes in the value *of the equity instruments issued*;
 - (d) however, the asset might be remeasured for subsequent changes in the value *of the asset itself*. (Assets that have already been consumed are not remeasured.)

¹² Paragraphs 16-17 of IFRS 2.

¹³ Paragraph 30 of IFRS 2.

¹⁴ Paragraphs BC 62 and BC99 of IFRS 2.

The *Conceptual Framework* does not explicitly deal with measurement of a service when it is received as a consideration for an equity instrument and, more specifically, when this service is received over a period of time that covers several reporting periods.

39. After having decided to use principles that apply to equity transactions and concluding that the goods and services should be measured at their fair value¹⁵, the IASB then considered at what date fair value should be measured. It did this by assessing both sides of the transaction: debit and credit. The following paragraphs summarise the main factors considered in making that assessment and the main conclusions the IASB reached.

Debit side

40. For the debit, ie expense, side of equity-settled share-based payment arrangements, the IASB decided that the *reporting date* fair value measurement model was inappropriate, because the fair value of the services received during a particular accounting period is not affected by subsequent changes in the fair value of the equity instrument issued in exchange.¹⁶ For example, suppose that services are received during Years 1-3 in exchange for share options that vest at the end of Year 3 and are exercised at that date. For services received in Year 1, subsequent changes in the value of share options in Years 2-3 were considered to be unrelated to, and have no effect on, the fair value of the services received in Year 1.
41. The IASB also decided that there was unlikely to be a high correlation between changes in fair value of an equity instrument and changes in the fair value of the services received over the term of the arrangement.¹⁷ This argument basically precluded updating the measurement of share-based payment expense to reflect subsequent changes since the grant date in the fair value of the equity instruments issued.
42. On the basis of these arguments, the IASB concluded that the *grant date* fair value measurement model was the most appropriate measurement model for equity-settled

¹⁵ Paragraphs BC65-66 of IFRS 2.

¹⁶ Paragraph BC91 of IFRS 2.

¹⁷ Paragraph BC95 of IFRS 2.

share-based payment arrangements. Under this measurement model, the amount of the expense reflects the fair value of equity instruments on Day 1 (the grant date) when both parties entered into the transaction.

43. In the *grant date* fair value measurement model, the amount of the expense is not remeasured for changes in fair value of shares and share options. Therefore, this model leads to less volatility than the *reporting date* fair value does. Some, but not all, people believe that this lower volatility makes the information provided more meaningful to users of financial statements.

Credit side

44. The IASB's conclusion was that the *reporting date* fair value measurement model for equity-settled share-based payment arrangements was inconsistent with the *Conceptual Framework*, because that measurement model would require remeasurement of equity.¹⁸

'Modified' grant date fair value measurement model

45. It is also important to mention another complication, namely that—within the context of the *grant date* fair value measurement model—IFRS 2 uses the term 'fair value' in a way that differs in some respects from the definition of fair value in IFRS 13 *Fair Value Measurement*.¹⁹ The main difference relates to the fact that an entity 'freezes' some but not all conditions in the fair value amount determined at the *grant date*. In other words, the entity does not remeasure the expense for most of the components, but keeps remeasuring the expense (and the entry in equity) for non-market vesting conditions at *reporting dates* over the term of the arrangement. This approach is also referred to as 'modified grant date method'.
46. It was adopted by the IASB for two main reasons: measurement practicalities and US GAAP convergence. Respondents to the Exposure Draft of IFRS 2 raised several concerns about the inclusion of vesting conditions in the grant date valuation. Some respondents were concerned about the practicality and subjectivity of including

¹⁸ Paragraph BC100 of IFRS 2.

¹⁹ Paragraph 6A of IFRS 2.

service and non-market performance conditions in the share option valuation.²⁰ As a result, the IASB decided to adopt the ‘modified grant date method’ applied in SFAS 123.²¹ This method is perceived by some as a mixture of two measurement models within one: *grant date* fair value, but with attributes of *reporting date* fair value.

47. Categories of vesting and non-vesting conditions in equity-settled share-based payment arrangements—six in total—are addressed in more detail in Appendix A, which includes an analysis of the main application issues.

Comparison with IAS 19 Employee Benefits

48. In summary, under IAS 19, the service cost (ie the debit side) and the liability (ie the credit side) for long-term employee benefits are measured using the *reporting date* measurement model. However:

- (a) the service cost is measured at each reporting date, *without* remeasurements²² of expenses recognised in previous periods. This measurement approach is a sub-set of a *reporting date* measurement model and it is also known as the *service date* measurement approach²³, and
- (b) the liability is measured at each reporting date, *with* remeasurements of the liability being recognised in other comprehensive income (OCI).

49. The *grant date* fair value measurement model for the expense (ie debit side) in IFRS 2, differs from the *service date* measurement approach in a sense that the *service date* measurement approach requires measuring services for the current period using information to reflect the conditions that exist at the end of that period (instead of information that existed at the *grant date*).

50. The *grant date* fair value measurement approach to the credit side of share-based payment arrangements is also different to the principles of IAS 19 which requires entities to measure the amount of the liability for post-employment and other long-

²⁰ Paragraph BC178 of IFRS 2.

²¹ Paragraph BC180 of IFRS 2.

²² In accordance with paragraphs 8 and 75 of IAS 19, remeasurements include the effects of changes in actuarial assumptions, which in turn comprise demographic (eg rates if employee turnover) and financial (eg benefit levels) assumptions.

²³ Please note that IAS 19 does not use this term. It comes from the Basis for Conclusions on IFRS 2.

term benefits at the end of each reporting period as an estimate of the ‘ultimate cost of the benefits to the entity’.²⁴

Summary

51. In summary, the time point of measurement under the *grant date* fair value measurement model for equity-settled share-based payment arrangements in IFRS 2 is different compared to both as summarised in the table:
- (a) the *reporting date* fair value measurement model for cash-settled share-based payment arrangements in IFRS 2; and
 - (b) the *reporting date* measurement model for long-term employee benefits in IAS 19.
52. This table summarises similarities and differences of the measurement models mentioned in this section. The numbers are provided for illustrative purposes only; they will be explained in more detail later in the paper (paragraph 69).

Standard	Measurement model	Debit / expense	Credit / obligation
IFRS 2 equity-settled arrangements	<i>Grant date</i> fair value with some remeasurements through P&L	30	Equity 30
IFRS 2 cash-settled arrangements	<i>Reporting date</i> fair value with all remeasurements through P&L	90	Liability 90
IAS 19 post-employment benefits	<i>Reporting date</i> estimated value with all remeasurements through OCI ²⁵	service cost – 74 remeasurements in OCI - 16	Liability 90

²⁴ Paragraphs 57, 58 and 155 of IAS 19.

²⁵ OCI – for defined benefit pension plans and P&L – for other long-term employee benefits

Application issues

53. As part of the research, the staff identified and explored the main application issues that exist when entities apply IFRS 2 in practice. They are summarised in the following table. The detailed analysis of the main application issues is included in Appendix A of this paper.

Application issue	Underlying issue
(1) Complexity that arises from the existence of two measurement models	Two measurement models for transactions which are similar, at least in some respects
(2) Amount of expense does not appear to reflect entity's current results	Measurement model: grant date fair value for equity-settled arrangements
(3) Perceived counterintuitive results in accounting for some transactions	
(4) Complexity in classification of vesting and non-vesting conditions	
(5) Pressure on assumptions in the <i>grant date</i> fair value measurement model because they are not being trued-up	
(6) Classification of share-based payment arrangements as equity- or cash-settled	Debt/equity classification
(7) Volume of disclosures	Principles of disclosure

54. As can be seen from the table, most of the application issues arise from the *grant date* fair value measurement model for equity-settled share-based payment arrangements.

Potential ways forward

55. This section looks at four potential ways forward—including their merits and possible pitfalls—for the IFRS 2 research project. This list is not exhaustive, but is meant to provide a starting-point for considering the best way to proceed with the project:
- (a) perform a Post-implementation Review;
 - (b) perform further research on the *grant date* fair value measurement model:
 - (i) before the outcome of the research project on *Financial instruments with characteristics of equity*;
 - (ii) after the outcome of that research project;
 - (c) make narrow-scope amendments to IFRS 2; or
 - (d) discontinue the project.

Post-implementation Review

56. Under the first potential way forward, the IASB would perform a Post-implementation Review ('PIR') of IFRS 2 as a first step and would decide on the next step(s) later.
57. In its response to the latest draft amendments to IFRS 2, EFRAG noted: 'Although EFRAG is not opposed to any of the three proposed amendments, EFRAG is concerned about the continuous changes to IFRS 2 (including exceptions to the existing principles) to address implementation issues created by specific facts, circumstances or features of share-based plans. EFRAG believes that this approach creates complexity and may result in internal inconsistencies and unintended consequences. For this reason, EFRAG would like to caution the IASB against continuing to make narrow-scope changes; the IASB should rather consider a general review of the Standard to ensure that all issues are addressed in a principle-based way. This could be achieved with a post-implementation review of the Standard.'
58. There has not been a PIR for IFRS 2, because IFRS 2 was issued before the PIR process was introduced. The IASB can decide to perform a PIR on any 'older' Standard if it believes that there is a need to do this.

59. According to the *Due Process Handbook*, a PIR has two phases:
- (a) The first involves an initial identification and assessment of matters to be examined, which are then the subject of a public consultation by the IASB in the form of a Request for Information.
 - (b) In the second phase, the IASB considers the comments it has received in response to the Request for Information along with the information it has gathered through other consultative activities. On the basis of that information, the IASB presents its findings and sets out the steps it plans to take, if any, as a result of the review.²⁶
60. On the basis of the history of IFRS 2, it appears that a PIR of IFRS 2 at this point of time would not achieve much because:
- (a) IFRS 2 has been revised several times since it was issued in 2004 in order to address emerging issues;
 - (b) no more significant issues are expected to arise; and
 - (c) we are identifying the main underlying issues that cause the practical complexity of the Standard as part of this research project.
61. In addition, a PIR is usually a lengthy process and requires a significant amount of resources.

Research on the grant date fair value measurement model

62. Under the second potential way forward, the issue of the measurement models in IFRS 2—more specifically, of the *grant date* fair value measurement model—would be reopened. The objective of this approach would be to assess whether it is possible to retain or increase the usefulness of the information that users receive about share-based payments whilst reducing complexity in accounting for these—very common—arrangements.
63. The disadvantage of this approach is that it would take a long time and require a significant amount of resources.

²⁶ Paragraph 6.54 of the *Due Process Handbook*.

64. It is also important to mention that any discussion about measurement models in IFRS 2 is also likely to need to consider classification of share-based payment arrangements as equity- or cash-settled. This is because classification of items as debt or equity is often linked to their measurement, as demonstrated in the earlier section about the IFRS 2's existing fair value measurement models.
65. In this *Assessment stage* of the research we assessed the issue (ie complexity of IFRS 2) and its causes. We have not identified and analysed all potential solutions. As a result, we have not drawn any conclusions about the appropriate measurement model(s) in IFRS 2 to be used if the IASB decides to proceed in this way. For us to draw a conclusion about the most appropriate measurement model(s), we would need to perform further research which would be classified as being at the *Development stage*.

Measurement approaches

66. Nevertheless, we have provided in this section some of the most obvious alternatives to the existing *grant date* fair value measurement model in IFRS 2. The list of the approaches is not exhaustive. Each of the approaches has its advantages and disadvantages.
67. At the moment, claims arising under equity-settled share-based payment arrangements are classified as equity (rather than liabilities) and are not remeasured after the grant date, although the cumulative expense is remeasured to reflect the effect of non-market vesting conditions (for example, an employment condition).
68. The three approaches considered in this section are:
- A. introduce a requirement to classify equity-settled share-based payment arrangements as liabilities (rather than as equity) and remeasure all equity-settled share-based payment arrangements through profit or loss, ie akin to cash-settled share-based payment arrangements;
 - B. continue to classify equity-settled share-based payment arrangements as equity but introduce a requirement to remeasure them through profit or loss; and

C. continue to classify equity-settled share-based payment arrangements as equity, but introduce a requirement to measure the service cost using *reporting date* fair values (rather than the *grant date* fair value). However, there would be no remeasurement of the previously recognised expense. This approach is akin to the *service date* measurement model discussed in paragraph 48.

69. The three approaches A-C are demonstrated in the following table:

An employee will receive 100 shares if the employee stays in employment for three years.

	Grant date	Year 1 expense in P&L	Year 2 expense in P&L	Year 3 expense in P&L	Cumulative expense in P&L	Credit
Fair value of 100 shares at the end of the period	30	60	72	90		
IFRS 2 <i>grant date</i> measurement		10 = $1/3 \times 30$	10	10	30	Equity
A <i>reporting date</i> measurement, akin to cash-settled SBPs		20 = $1/3 \times 60$	28 = $2/3 \times 72 - 20$ = $1/3 \times 72 + 4^*$	42 = $3/3 \times 90 - (20 + 28)$ = $1/3 \times 90 + 12^*$	90	Liability
B <i>reporting date</i> measurement, akin to cash-settled SBPs, but credit in equity		20 as A above	28 as A above	42 as A above	90	Equity
C <i>service date</i> measurement (measured at reporting date)		20 = $1/3 \times 60$	24 = $1/3 \times 72$	30 = $1/3 \times 90$	74	Equity

* Amounts of CU4 and CU12 are remeasurement amounts (for the reporting date fair values) of the cumulative expense amounts that were recognised in the previous years. They are calculated as:

$$CU4 = 1/3 \times 72 - 20 \text{ and}$$

$$CU12 = 2/3 \times 90 - (20 + 28)$$

70. Approach C produces in profit or loss results similar to those that IAS 19 would produce for post-employment benefits (eg defined benefit pension plans) because, under IAS 19 the service cost is measured using the *service date* measurement approach. However, the under IAS 19, liability is remeasured through other comprehensive income (OCI).²⁷ Therefore, if approach C were to be aligned with IAS 19, the amount attributed to the equity claim would be CU 90, the cumulative expense recognised in profit or loss would be CU74 and the remeasurement amount, a cumulative expense of CU16 (= CU4 + CU12), would be recorded in OCI.
71. Approaches A and B produce the same overall results in profit or loss as IAS 19 would produce for ‘other long-term employee benefits’ because, under IAS 19, the liability *for the expected cost* of benefits is remeasured through profit or loss.²⁸
72. Please note that at this point of the research we are not discussing whether the amounts in profit or loss should be split between the service cost and remeasurement. Such a split could, however, be helpful if it were introduced into the *reporting date* fair value measurement model as this will bring the two measurement models closer together.
73. The main advantages and disadvantages of the above approaches are summarised in the following table:

Approach	Advantages	Disadvantages
IFRS 2 P&L—equity at grant date FV	Reflects the manner of settlement (consistent with the <i>Conceptual Framework</i> ’s definition of a liability) Does not conflict with the concept that equity is not remeasured through P&L	Complexity Does not reflect reporting date value Inconsistent with measurement model for cash-settled arrangements
A P&L—liability at reporting date FV	Reflects reporting date value Does not conflict with the concept that equity is not remeasured through P&L Consistent with measurement model for cash-settled arrangements	Does not reflect the manner of settlement (inconsistent with the <i>Conceptual Framework</i> ’s definition of a liability) Does not necessarily split in current period between service cost and remeasurements

²⁷ Paragraph 57(d) of IAS 19.

²⁸ Paragraph 156 of IAS 19.

Approach	Advantages	Disadvantages
<p>B P&L—equity at reporting date FV</p>	<p>Reflects reporting date value</p> <p>Reflects the manner of settlement (consistent with the Conceptual Framework’s definition of a liability)</p> <p>Consistent with measurement model for cash-settled arrangements</p>	<p>Conflicts with the concept that equity is not remeasured through P&L</p> <p>Does not necessarily split between service cost in current period and remeasurements</p>
<p>C P&L—equity at reporting date FV, but without true-up</p>	<p>Reflects reporting date value for service in current period</p> <p>Reflects the manner of settlement</p> <p>Does not conflict with the concept that equity is not remeasured through P&L</p>	<p>Does not reflect remeasurements</p> <p>Inconsistent with measurement model for cash-settled arrangements</p>

74. We expect that some stakeholders might find the existing Standard—although complex—still preferable, because the *grant date* fair value measurement model produces less volatile results than the *reporting date* fair value measurement model is likely to produce.

Research project on Financial instruments with characteristics of equity

75. In addition, another research project, *Financial instruments with characteristics of equity* might potentially—but not necessarily—affect the *Conceptual Framework for Financial Reporting* and/or classification and measurement of share-based payment arrangements in the future. It might be beneficial to wait until the outcome of that project before deciding on the future of IFRS 2.
76. A few observations about the *Financial instruments with characteristics of equity* research project:
- (a) That research project deals with the distinction between liabilities and equity, which might be relevant in considering the distinction for share-based payment arrangements as well. Experience, however, demonstrates that full alignment of IFRS 2 and IAS 32 *Financial Instruments: Presentation* may be difficult to achieve; the two standards have adopted

different classification criteria historically (as described in paragraph A22). It is not clear at this stage whether that difference should continue.

- (b) Our work in the *Financial instruments with characteristics of equity* research project indicates that IFRSs may not contain sufficient presentation and disclosure requirements for instruments classified as equity. The *Financial instruments with characteristics of equity* research project will explore whether improved presentation and disclosure is needed. If so, some of that improved presentation and disclosure might also be needed for equity claims arising from share-based arrangements.
- (c) The *Conceptual Framework* Discussion Paper (issued in July 2013) explored whether to require remeasurements of some instruments classified as equity, with the effect of remeasurements reported in the statement of changes in equity. The IASB has not pursued that idea at this stage. If the IASB were to pursue that idea (or other ideas) in the *Financial instruments with characteristics of equity* research project, that might open up some possibilities for reducing the differences between the information provided under the *grant date* measurement method and the information provided under the *reporting date* measurement method.

77. The staff will keep monitoring the interaction between the two projects. However, it is difficult to predict the timing and the outcome of the *Financial instruments with characteristics of equity* research project at this stage.

Narrow-scope amendments

- 78. The third potential way forward would be to develop one or more narrow-scope amendments to IFRS 2. This research did not identify any narrow-scope amendments that would significantly reduce the complexity of the Standard.
- 79. For the future, the staff believe that the IASB and the Interpretations Committee should have a very high hurdle for adding more IFRS 2 issues to their agendas, because making amendments to the Standard often adds complexity to it.²⁹

²⁹ At the moment the Interpretation Committee has three pending amendments to IFRS 2, as described in paragraph 29(b) of this paper.

80. The US Financial Accounting Standards Board (FASB) has a project, the objective of which is to simplify aspects of US GAAP relating to share-based payment arrangements. The Exposure Draft was issued in June 2015. A summary of the project and of the proposals by the FASB is available on our *Share-based Payment* project's webpage.
81. Two of the FASB's simplification proposals would provide practical expedients for private entities:
- (a) to provide private entities with a one-time election to switch from measuring cash-settled share-based payment arrangements at fair value to measuring liability-classified awards at intrinsic value, which—in basic terms—is measured as a difference between the *reporting date* fair value of a share and the exercise price of the option to acquire this share³⁰;
 - (b) to allow private entities, in certain situations, to use, in valuations of fair value of share-based payment arrangements, a contractual term as an estimate of an expected term of an arrangement.
82. The proposals would also simplify several aspects for both public and private entities, including the accounting for income taxes, forfeitures, minimum statutory withholding requirements, classification in the statement of cash flows, and classification of awards with repurchase features. It appears that the proposed changes relating to the accounting for income taxes are more consistent with IFRSs than with current US GAAP. Regarding the other proposed changes, IFRSs do not have guidance on these issues.

Discontinue the research project

83. The fourth potential way forward would be to discontinue this research project. The disadvantage of this approach is that the complexity that arises from the existence of the two measurement models will remain in IFRS 2.

³⁰ For example, a call option with an exercise price of CU15, on a share with a fair value of CU20, has an intrinsic value of CU5. Full definition of intrinsic value is provided in Appendix A of IFRS 2.

Appendix A

Main application issues

- (1) Complexity that arises from the existence of two measurement models—paragraphs A1-A6
- (2) Amount of expense does not appear to reflect the entity's results—paragraph A7
- (3) Perceived counterintuitive results in accounting for some transactions—paragraphs A8-A10
- (4) Complexity in classification of vesting and non-vesting conditions—paragraphs A11-A16
- (5) Pressure on assumptions in the *grant date* fair value measurement model because they are not being trued-up—paragraphs A17-22
- (6) Classification of share-based payment transactions as equity- or cash-settled—paragraphs A22-A26
- (7) Volume of disclosures—paragraphs A27-A36.

Complexity that arises from the existence of two measurement models

- A1. As a reminder, awards granted to non-employees are measured by reference to the fair value of goods or services received. For share-based payment transactions with employees, IFRS 2 prescribes two measurement models:
- (a) *grant date* fair value—for equity-settled share-based payment arrangements; and
 - (b) *reporting date* fair value—for cash-settled share-based payment arrangements.
- A2. It appears that stakeholders struggle to understand the *grant date* fair value measurement model intuitively, because *grant date* fair value does not reflect the value of the consideration that the entity will ultimately give. This is especially apparent when compared to the *reporting date* fair value model that exists in IFRS 2 for cash-settled share-based payment arrangements.
- A3. For example, suppose that on the first day of 20X5 Entity A granted an award of 100 shares to two employees with the only condition being that they stay in employment

for the next year, therefore, the awards vest on the last day of 20X5. However, with respect of the settlement of the awards, the first employee will receive 100 shares (ie equity-settled share-based payment arrangement) and the second employee will receive a cash amount to the value of 100 shares (ie cash-settled share-based payment arrangement). Assume also, that the fair value of a share of Entity A was CU1 on the first day of 20X5 and CU3 on the last day of 20X5. Furthermore, assume that both employees stayed in employment and ultimately received their shares and cash respectively. Thus, Entity A ultimately pays cash of CU300 and issues 100 shares. Those shares have a fair value of CU300 when they are issued. Under IFRS 2, Entity A would recognise expense of CU100 (measured at the grant date) for the first arrangement and CU300 (measured at the settlement date) for the second arrangement.

- A4. The proponents of the *reporting date* fair value measurement model see it as having the following advantages:
- (a) it is easier to understand, because it reflects the value of the final settlement ('payment');
 - (b) it does not pose the classification challenge of distinguishing between vesting and non-vesting conditions;
 - (c) cancellations are accounted for if and when they happen (ie the expense is reversed);
 - (d) 'negative' modifications are accounted for in the same way as 'positive' modifications (ie a gain is recognised in the same way as the additional expense);
 - (e) ultimately, no expense is recognised for 'underwater' share options (ie the expense is reversed);
 - (f) the amount of an expense in financial statements would, in some jurisdictions, more often resemble the amount of the tax-deductible expense;³¹ and

³¹ In many jurisdictions tax authorities require entities to measure their tax-deductible expense based on the share prices at the date of the awards' exercise. In such cases, IAS 12 *Income Taxes* (Illustrative Example 5) requires entities to use the current fair value (of shares) and the *reporting date* intrinsic value (of share options) for the calculations.

- (g) users of financial statements might find it easier to see the ‘true’ potential dilutive effect of equity-settled share-based payment arrangements, because the cumulative expense recognised is not going to reflect awards that have been cancelled, and is unlikely to include any material amounts for awards that are so ‘underwater’ that they are highly unlikely to be exercised.
- A5. The conceptual advantage of the *reporting date* fair value measurement model is that it reflects the cost of the benefit to the entity on the basis of the current information. The main conceptual disadvantage of this measurement model, according to the Basis for Conclusions of IFRS 2, is that it requires remeasurement of equity instruments (with corresponding remeasurement of goods and services received as a consideration for those instruments).
- A6. In terms of application, the *reporting date* fair value measurement model requires more frequent valuation exercises. It might appear that this would add more complexity to IFRS 2, however, the existing *grant date* fair value measurement model in IFRS 2 requires remeasurement of the *grant date* fair value anyway for some vesting conditions at each reporting date, as described in paragraph 45. Suggestions about how valuation of the fair value measurement models can be simplified are described in paragraphs A20-A21.

Amount of expense does not appear to reflect entity’s results

- A7. As mentioned earlier in the paper, the amounts of expense for share-based payment arrangements, especially those that are granted to key management personnel and employees, are of considerable interest to owners (shareholders) and other users of financial statements. However, the accounting outcome of the IFRS 2 requirements could be difficult to explain. For example, in a share-based payment arrangement that is settled in shares and recognised over a period of time, the amount of expense in later periods sometimes appears not to reflect the entity’s results (and its share prices) during those later periods. This is because the amount of the expense was determined at the grant date of the arrangement, ie in an earlier period.

Perceived counterintuitive results in accounting for some transactions

A8. Accounting outcomes that some consider counterintuitive arise in the following situations for equity-settled share-based payment arrangements:

Transaction	IFRS 2 accounting result	IFRS 2 explanation
Cancellations	Expense continues to be recognised vs forfeitures, for example, when employees leave employment— for which expense is reversed	The expense should reflect the <i>grant date</i> fair value of an arrangement (which reflects the 100 per cent presumption that an entity will <i>not</i> cancel the plan), because the transaction has already occurred and the cancellation of the arrangement does not result in a gain for the entity, because there is no change in net assets. ³²
‘Negative’ modifications	Reversal of expense (ie gain) is not recognised vs ‘positive’ modifications— for which additional expense is recognised	The expense should reflect at least the <i>grant date</i> fair value of an arrangement. ³³
‘Underwater’ share options (ie with negative intrinsic value when the share option’s exercise price exceeds fair value of the shares)	Expense is still recognised	The expense should reflect the <i>grant date</i> fair value of an arrangement; market volatility has already been reflected in the <i>grant date</i> fair value of the options. ³⁴
Awards vesting in instalments ie graded vesting awards, for example, one-	Each instalment is treated as a separate award with a different vesting period. As a result, the total expense is front-loaded (vs one award with proportionate recognition over the vesting	Each instalment is treated separately because each instalment has a different vesting period and, therefore, the fair value of each instalment is likely to be different. ³⁵

³² Paragraphs BC219 and BC237 of IFRS 2.

³³ Paragraphs BC236 and BC237 of IFRS 2.

³⁴ Paragraph BC136 of IFRS 2.

³⁵ Paragraph IG11 of IFRS 2.

Transaction	IFRS 2 accounting result	IFRS 2 explanation
quarter of the total number of options vests each year	period)	

- A9. It appears that many people still struggle to understand these outcomes because:
- (a) some conditions are reflected in the *grant date* fair value and some other conditions (ie vesting service and vesting non-market performance conditions) are not reflected in the *grant date* fair value, as described in paragraph 45 of the ‘section of this paper on the ‘Modified’ grant date fair value measurement model; and
 - (b) some of these requirements are intended to counter the risk of people finding easy ways to abuse the Standard rather than to depict economic reality. For example, the underlying reason for the existing cancellation provisions in was a concern that if the Standard allows reversing the expense for the cancelled awards then the entities would cancel the awards more frequently, especially when the share prices fall down.
- A10. Concerns about these results are strengthened by the fact that these results arise in accounting for equity-settled share-based payment arrangements but do not arise for cash-settled share-based payment arrangements, which are accounted for at *reporting date* fair value.

Complexity in classification of vesting and non-vesting conditions

- A11. Share-based payment arrangements typically specify conditions that must happen or be fulfilled in order for the counterparty to receive the entity’s shares. There are two main categories of conditions: vesting and non-vesting conditions. Each of these categories has a further three sub-categories of conditions, bringing the total number of categories to six:
- (a) vesting conditions include:
 - (i) service conditions (for example, a requirement to remain in service);

- (ii) market performance conditions (for example, target based on the market price of entity's shares); and
 - (iii) non-market performance conditions (for example, a target based on a successful public offering);
- (b) non-vesting conditions include conditions when:
- (i) neither party can choose whether the condition is met (for example, a target based on a commodity index);
 - (ii) a counterparty can choose whether to meet the condition (for example, paying a contribution towards the exercise price); and
 - (iii) the entity can choose whether to meet the condition (for example, non-cancellation of the plan by the entity).³⁶

A12. Classification of vesting and non-vesting conditions in share-based payment arrangements plays an important role in the measurement of equity-settled share-based payment arrangements. This is because different conditions of the awards are reflected differently in the *grant date* fair value measurement model in accordance with IFRS 2. Some conditions are reflected in *grant date* fair value (for example, market performance conditions) and some are reflected in the subsequent measurement in order to estimate the number of instruments that will vest (for example, service and non-market performance conditions).

A13. The main reasons for the different treatment above of the various vesting and non-vesting conditions in the *grant date* fair value measurement model are described in paragraph 46 of the 'section of this paper on the 'Modified' grant date fair value measurement model.

A14. The Interpretations Committee had received a number of interpretation requests about how various conditions in equity-settled share-based payment arrangements should be classified so that entities would know how to reflect those conditions in measurement. As a result of these requests the IASB issued or proposed the following amendments to IFRS 2:

³⁶ Paragraph IG24 of IFRS 2.

- (a) clarifying the definition of vesting conditions and the accounting treatment of cancellations by the counterparty to a share-based arrangement (amendment *Vesting Conditions and Cancellations* issued in 2008);
- (b) amending the definitions of ‘vesting condition’ and ‘market condition’ and adding definitions for ‘performance condition’ and ‘service condition’ (which were previously part of the definition of ‘vesting condition’) (*Annual Improvements to IFRSs 2010–2012 Cycle* issued in 2013); and
- (c) proposing to clarify how vesting conditions affect the fair value of liabilities for cash-settled share-based payments. The IASB’s proposal is to follow the same approach as is used for equity-settled share-based payments in estimating how many instrument will vest (draft amendment *Classification and Measurement of Share-based Payment Transactions* issued in 2014).

A15. The *reporting date* fair value measurement model for cash-settled share-based payment arrangements does not require such a classification of vesting and non-vesting conditions, because this model accounts for all conditions (both vesting and non-vesting) in a way that reflects circumstances at the reporting date.

A16. Although the IASB has issued a significant amount of guidance to clarify IFRS 2 and thus to assist entities with its practical application in respect of vesting and non-vesting conditions, this amount of guidance appears to have added complexity to the Standard.

Complexity in measuring share-based payment arrangements at fair value

A17. This issue normally arises when people talk about measurement of equity-settled share-based payment arrangements (eg share options) at *grant date* fair value. However, please note that IFRS 2 requires an entity to measure cash-settled share-based payment arrangements (for example, Share Appreciation Rights, also known as SARs³⁷) at fair value—as opposed to intrinsic value—as well. This fair value measurement requires making assumptions.

A18. Complexity in measuring share options at fair value in practice arises because entities need to make several assumptions (for example, about the expected volatility of share

³⁷ IG Example 12 of IFRS 2.

prices and life expectancy of arrangements) at the outset of an arrangement; they also need to use complex option pricing models (for example, Black-Scholes-Merton or Monte Carlo).

- A19. In terms of usefulness of information, fair value provides information that reflects the estimated time value of the share options. However, assumptions that were made at the grant date usually are not reflected in the ultimate value of the share options when they are finally vested or exercised.
- A20. There are suggestions that the complexity that arises from measurement at *grant date* or *reporting date* fair value could be reduced if entities were required to measure all (ie both equity- and cash-settled) share-based payment arrangements at their intrinsic value. The notion of the intrinsic value was explained in paragraph 81(a) of the paper. IFRS 2 currently does allow entities to use intrinsic value for measurement, but only when the fair value of the equity instruments cannot be estimated reliably. In those circumstances, the intrinsic value is remeasured at each reporting date until the settlement date of the arrangement (ie the intrinsic value is measured at the *reporting date* not at the *grant date*).³⁸
- A21. The intrinsic value of an option, however, does not reflect its full value. For example, share options sometimes have zero intrinsic value at the grant date, because the exercise price might be set up at the level of the shares' market value at the grant date. Nevertheless, these share options have an economic value because of the right to participate in future gains (without an exposure to the downside of the shares' market value).

Classification of share-based payment arrangements as equity- or cash-settled

- A22. IFRS 2's principles for classification of share-based payment arrangements as equity- or cash-settled are based on the required manner of settlement with the counterparty—in other words, whether the required settlement is in shares or in cash. There is also specific guidance for classification of share-based payment arrangements in which either an employee or an entity has a choice of settlement. The distinction for the

³⁸ Paragraph 24 of IFRS 2.

latter type of arrangements, ie when the entity has a choice of settlement, is different from the distinction made in IAS 32 *Financial Instruments: Presentation*.^{39 40}

- A23. Classification of share-based payment arrangements was not identified as an application issue by respondents to the 2011 Agenda Consultation. This seems to indicate that overall the classification principles and guidance in IFRS 2 are well understood and work well. However, there has been a specific instance for which there was a need for further guidance in this application area: the Interpretations Committee issue ‘Accounting for a share-based payment in which the manner of settlement is contingent on future events’.
- A24. The issue deals with classification of an arrangement as equity- or cash-settled in situations in which there are two potential outcomes and neither the entity nor the counterparty can decide on the outcome and neither can they decide on the ultimate manner of settlement. The Interpretations Committee recommended that the share-based payment transaction should be classified as either cash- or equity-settled in its entirety, depending on which settlement method is probable.
- A25. Nevertheless, some IASB members were concerned that the proposed amendment would introduce a principle which would be inconsistent with IAS 32; the proposed amendment might also conflict with possible future development in another research project, *Financial instruments with characteristics of equity*, which deals with the distinction between a liability and equity and, therefore, the issue was removed from the agenda in April 2014.⁴¹
- A26. Discussions with investors have indicated that investors find information about the nature of the settlement (ie which share-based payment arrangements will be settled

³⁹ Paragraph BC 266 of IFRS 2 explains the reasons for the difference as follows: ‘During its deliberations of the proposals in ED 2, the Board noted that the classification as liabilities or equity of arrangements in which the entity appears to have the choice of settlement differs from the classification under IAS 32, which requires such an arrangement to be classified either wholly as a liability (if the contract is a derivative contract) or as a compound instrument (if the contract is a non-derivative contract). However, consistently with its conclusions on the other differences between IFRS 2 and IAS 32, the Board decided to retain this difference, pending the outcome of its long-term Concepts project, which includes reviewing the definitions of liabilities and equity’.

⁴⁰ Classification principles in IFRS 2 are different to the principles of IAS 32 also in the following sense, as explained in paragraph BC 106 of IFRS 2: ‘Although IAS 32 also considers, in its debt/equity distinction, whether an instrument contains an obligation to transfer cash or other assets; this is supplemented by a second criterion, which considers whether the number of shares to be issued (and cash to be received) on settlement is fixed or variable’.

⁴¹ <http://media.ifrs.org/2014/IASB/April/IASB-Update-April-2014.html#11>

by issuing equity and which share-based payment arrangements will be settled by using cash) to be one of the most useful pieces of IFRS 2 information for their analysis and cash flow projections.

Volume of disclosures

Criticism

A27. IFRS 2 requires the disclosure of information that enables users to understand:

- (a) the nature and extent of share-based payment arrangements;
- (b) how the fair value was determined; and
- (c) the effect of the share-based payment arrangements on the entity's profit or loss and its financial position.⁴²

IFRS 2 then states that in order to achieve these objectives entities 'shall disclose at least the following' with a list of specific disclosure requirements.

A28. IFRS 2 is sometimes criticised for leading entities to disclose excessive information in their financial statements. There are two questions here:

- (1) Are disclosures in recent practice lengthy?
- (2) If so, what is the reason for this? In other words, is the cause that IFRS 2 requires too many disclosures, or is it that entities provide too much detail on their own initiative? Or is there another reason?

Current practices

A29. With respect to the first question, about how long the IFRS 2 disclosures are in practice, the results of the survey by Corporate Reporting show that the average length of disclosure by sample companies was between 2.5 and 3 pages. The results of the entire survey are summarised in Appendix C of this paper. It is also interesting to see the results of the 2015 annual reports survey performed by Deloitte UK⁴³. The survey looked at, among other things, IFRS 2 disclosures by 100 UK listed companies

⁴² Paragraphs 44, 46 and 50 of IFRS 2.

⁴³ <http://www.iasplus.com/en/publications/uk/other/annual-report-insights-2015>—page 162.

and made the following overall observation: ‘91 companies surveyed (2014: 86) had share-based payment schemes. IFRS 2 contains extensive disclosure requirements. However, the vast majority of companies (71%) continue to limit disclosure to a maximum of two pages, in line with our prior year results’.

IFRS guidance

- A30. With respect to the second question about the required disclosures, amendments to IAS 1 *Presentation of Financial Statements* were issued in December 2014 and are effective from 1 January 2016. They clarify that materiality considerations apply to disclosures specifically required in IFRSs. Paragraph 31 of IAS 1 (amended) states: ‘Some IFRSs specify information that is required to be included in the financial statements, which include the notes. An entity need not provide a specific disclosure required by an IFRS if the information resulting from that disclosure is not material. This is the case *even if* the IFRS contains a list of specific requirements or describes them as minimum requirements’ [italics added].
- A31. We reviewed a number of financial statements of entities that have lengthy disclosures for share-based payments. It appears that the main factors contributing to the length of the disclosure are:
- (a) the number of arrangements (ie schemes) granted by the entity; and
 - (b) whether the entity discloses information about those awards in aggregate or separately.
- A32. Paragraph 45 of IFRS 2 states that an entity with substantially similar types of share-based payment arrangements may aggregate information unless separate disclosure of each arrangement provides more useful information. Consequently, preparers are in a position to use their judgement in deciding on what would disclosures would be most useful.
- A33. On the basis of the available statistics, it appears that entities do not always have lengthy IFRS 2 disclosures in their financial statements. It is to be hoped that the recent amendments to IAS 1 will further encourage entities to focus on providing relevant information in their financial statements in general and for IFRS 2 disclosures in particular.

- A34. Discussions with investors have indicated that in general investors find IFRS 2 disclosures useful (albeit still quite lengthy). They would also like to see more prominent disclosures by entities about:
- (a) which line items in a statement of financial position include liabilities for cash-settled arrangements; and
 - (b) better description of whether the awards granted will ultimately vest and/or will be exercised.

Another reason for disclosures

- A35. On the basis of the discussions held during this research, it appears that many users of financial statements, besides investors, lenders and other creditors, find the disclosed (and audited) information about the awards granted to key management personnel useful. Although these users are not primary users of the financial statements and although—strictly speaking—detailed disclosures are not required by IFRSs, entities often choose to provide these disclosures in their financial statements for those users.

Summary

- A36. In summary, from the standard-setting point of view, it appears that IFRS 2 and the amendments to IAS 1 provide entities with appropriate flexibility in how they can disclose information about their share-based payment arrangements: they are in a position to exercise judgement in deciding which disclosures will be material for their users of financial statements.

Appendix B

Steps in the research and how they are incorporated in the paper

Following the project plan, the staff performed the following steps in order to identify and explore the IFRS 2 application issues:

i. Review of responses to the 2011 Agenda consultation

The main application issues that were identified during this review are summarised in paragraph 53 and analysed in Appendix A of this paper.

ii. Review of IFRS 2-related requests to the IFRS IC

These are summarised in paragraph 25 and analysed in Appendix A of this paper.

iii. Discussions with preparers during the meeting of the Global Preparers Forum (GPF) on 5 March 2015

The main objective of the discussion was to identify the main application issues that preparers face. The summary of the discussion is available on the *Share-based Payment* project webpage.⁴⁴ Key observations included:

- Since IFRS 2 was issued in 2004, it has achieved its main objective, ie to recognise an expense for share-based payment arrangements.
- Existence of two measurement models in IFRS 2 causes complexity in application.
- The accounting outcome of the IFRS 2 requirements could be difficult to explain to users.

iv. Discussions with technical and, if possible, valuation specialists from audit firms and with IASB members; review of published material by audit firms

Key points of the discussions addressed:

- the most common application issues, including recent hot topics;

⁴⁴ <http://www.ifrs.org/Current-Projects/IASB-Projects/Share-based-payments/Pages/Share-based-payments.aspx>

- the reasons why the Interpretation Committee receives so many submissions about IFRS 2;
- reasons for complexity in the Standard. Is this avoidable?
- views on the preferred way forward in respect of IFRS 2 (for example, PIR, nothing, wait etc.)

The views expressed have been summarised and incorporated in relevant parts of the paper on a non-attributable basis.

v. *Perform user outreach with investors*

Discussions were held with three members of the Capital Markets Advisory Committee (CMAC): one debt analyst and two equity analysts. The main objective of the outreach was to find out whether there are any significant issues that investors face when they deal with share-based payment arrangements.

Key observations are:

- Investors often find IFRS 2 amounts quite small for their analysis.
- In terms of measurement, they do not usually consider it necessary to go into detail about how the amounts were calculated and they rely instead on the numbers provided in the financial statements.
- The most useful piece of information for investors appears to be information about which share-based payment arrangements are classified as equity-settled and which share-based payment arrangements are classified as cash-settled. They use this information about the nature of the settlement for their analysis and cash flow projections.
- In terms of adjusting non-GAAP measures for share-based payment expenses: there are mixed practices, depending on what investors are trying to achieve in their analysis.
- Investors do not need all the detailed information that is provided for share-based payment arrangements, but they can see its potential usefulness; for example, for situations when there is a significant potential dilution or ‘numbers are big’.

- They also believed that disclosures could be better organised and should avoid repetition. The disclosures should also be consistent with remuneration information provided elsewhere in the Annual Reports.

The views were summarised and incorporated in the relevant parts of paper (paragraphs A26 and A32) on a non-attributable basis.

vi. *Review of:*

- results from the Post-implementation Review of FAS 123(R) *Share Based Payment* by the Financial Accounting Foundation (FAF); and
- progress of the FASB's project Employee Share-Based Payment Accounting Improvements.

Key observations are:

- The PIR of FAS 123 (R) was performed in a format of discussions with 'a diverse group of stakeholders'.
- In order to simplify accounting for share-based payment arrangements, the FASB has proposed to provide some practical expedients, especially for private entities because the accounting standard was considered to be especially complex for those entities. This is mentioned in paragraphs 80-81 of this paper.

A summary of the project, the PIR report by FAF and the FASB's most recent Project Update are available on the *Share-based Payment* project webpage.

vii. *Review of a paper presented by the French standard-setter, Autorité des Normes Comptables (ANC) to the IFRS Advisory Council in November 2010 (ie before the 2011 Agenda Consultation)*

The key observation in the ANC's paper is:

- The *grant date* fair value measurement model for equity-settled share-based payment arrangements represents in IFRS 2 a mixture of two measurement models within one: grant date fair value, but with attributes of current value. This is mentioned in paragraph 4645 of the paper.

A summary of the paper and its main proposals are available on our *Share-based Payment* project webpage.

viii. Review publicly available data on the extent of IFRS 2 disclosures by entities in practice

- Some statistics about share-based payment arrangements from the survey performed by Company Reporting (in April 2015) are included in Appendix C.
- Findings about IFRS disclosures from the 2015 annual reports' survey performed by Deloitte UK are included in paragraph A29.

Appendix C

Some statistics

- C1 In April 2015 Company Reporting⁴⁵ produced a CR Common Practice report called *Share-based Payment Arrangements under IFRS: disclosure of nature and impact*. This report examines companies' disclosures in respect of share-based payment arrangements. The report also looks at the overall significance of share-based payments by considering total share-based payment expense as a percentage of profit after tax, the number of share-based payment schemes that companies have and the length of disclosure in the financial statements.
- C2 The sample examined consisted of 25 large global listed companies that prepared IFRS financial statements with periods ending between 30 June 2014 and 31 December 2014. The sample was drawn from a globally diverse range of countries and included a range of companies from different industries.
- C3 Key observations of the report include the following:
- (a) Of the sample, 100 per cent of the companies identify the recipients of share-based payment schemes, with 100 per cent having evidence of schemes for directors and key managers and 76 per cent of companies having evidence of schemes for employees.
 - (b) The expense recognised expressed relative to post-tax profit ranges from 0.16 per cent to 12.03 per cent.
 - (c) Geographical location does not appear to be a determining factor of the significance of the share-based payment expense recognised. Neither was there strong evidence to suggest that the type of industry is a determining factor of the significance of the share-based payment expense recognised.
 - (d) Two sample companies have the greatest number of schemes: seven. At the opposite end of the scale nine sample companies have evidence of only two share-based payment schemes.

⁴⁵ A best practice and IFRS benchmarking tool accessible by subscription through www.companyreporting.com

- (e) The vesting conditions applied to awards are disclosed by 96 per cent of sample companies, with 88 per cent identifying the non-market conditions applied and 60 per cent of companies identifying the market-based conditions applied.
- (f) The method of settlement of awards is disclosed by 100 per cent of sample companies with 96 per cent of companies having evidence of equity-settled schemes and 36 per cent of companies having evidence of cash-settled schemes.
- (g) The research showed that all 25 companies covered by the analysis disclose information about share-based payment arrangements in the notes to the financial statements. There is, however, some variety in the length of the disclosures. One company presents its information relating to share-based payment schemes in 0.5 pages while another company discloses its information across 6.5 pages. The average length of disclosure by sample companies is between 2.5 and 3 pages.

Appendix D

Other IASB projects that might have an effect on this project

Research project on Financial instruments with characteristics of equity

- D1 This research project addresses not only classification of financial instruments with characteristics of both liabilities and equity on the face of financial statements; it also addresses users' information needs in a broader sense, ie including presentation and disclosures of information about such financial instruments. The project is discussed in paragraphs 75-77 of the paper.
- D2 The research project might potentially—but not necessarily—affect the *Conceptual Framework* and/or classification and measurement of share-based payment arrangements in the future. It might be beneficial to wait until the outcome of that project before deciding on the future of IFRS 2.
- D3 The staff will keep monitoring the interaction between the two projects. It is difficult to predict the timing and the outcome of the *Financial instruments with characteristics of equity* research project at this stage.

Research project on Post-employment benefits (including pensions)

- D4 This research project is assessing whether it is possible to develop a model for schemes that have some features of defined contribution schemes and some features of defined benefit schemes; these schemes are also known as pension plans with contribution-based promises. The research project will address the issue of how to measure the expense and the liability arising from these schemes.
- D5 Comparison of the *grant date* fair value measurement models for share-based payment arrangements with current IAS 19 is provided in paragraphs 48-50 of the paper.
- D6 It will be beneficial to monitor this project and its recommended measurement model if the IASB decides to move the *Share-based Payment* research project to the Development stage with the objective to develop alternative solutions to the *grant date* fair value measurement model in IFRS 2.

The Conceptual Framework project

- D7 The IASB is currently working on the development of a new *Conceptual Framework for Financial Reporting*; the exposure draft was issued in May 2015.
- D8 The exposure draft addresses—at a high level—topics of recognition, measurement and classification of items of the financial statements. At this stage, we have not identified anything in it that would affect discussions or conclusions in this paper.
- D9 However, if the IASB decides to move the *Share-based Payment* research project to the *Development stage*, it will be necessary to monitor any changes to the *Conceptual Framework* in order to ensure that any new solutions which might be proposed for IFRS 2 are consistent with the final *Conceptual Framework for Financial Reporting*.