October 2018

IFRS® Standards
Project Summary

Share-based payment—research on sources of accounting complexity

The Board's research programme

The International Accounting Standards Board (Board) conducts research projects to gather evidence so that it can assess whether an accounting problem exists, whether the problem is sufficiently important that standard-setting is required and whether a feasible solution can be found.

This Project Summary

This Project Summary summarises work performed and conclusions reached in the research project on sources of complexity in accounting for share-based payments.

This Project Summary was compiled by the staff of the IFRS Foundation. It summarises material prepared by the staff for discussion by the Board and the Board's discussion of that material. This Project Summary does not change any existing requirements and adds no new requirements. This Project Summary does not provide advice and has no authority.

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Contents of this Project Summary

At a glance

In 2015 and 2016, the International Accounting Standards Board (Board) conducted a research project on sources of complexity in applying IFRS 2 *Share-based Payment*.

The objectives of the project were to:

- identify the most common areas of complexity in accounting for share-based payments and the main causes;
- analyse why IFRS 2 attracted many interpretation requests; and
- assess whether there is a financial reporting problem in this area, and whether and how to address any such problem.

After reviewing the evidence gathered, the Board concluded that there were no significant financial reporting problems pointing to a need to amend IFRS 2.

Why did the Board do this research?

Many respondents to the Board's Agenda Consultation in 2011, especially preparers of financial statements, commented that:

- accounting for share-based payment is complex.
- IFRS 2 was difficult to interpret. This difficulty had led to many requests to the IFRS Interpretations Committee.

In response, the Board carried out a research project to consider the issues raised.

Summary of findings

The research project identified two main sources of complexity and, thus, of requests for interpretations:

- the variety and complexity of terms and conditions of share-based payments; and
- some features of the grant-date fair value measurement model used by IFRS 2 for share-based payments settled in shares or share options.

The review of interpretation requests indicated that the Board and the IFRS Interpretations Committee have already addressed the main issues that have arisen in practice since IFRS 2 was issued.

Feedback and conclusion

In May 2016, the Board completed its review of the findings of the project and of feedback from stakeholders. The purpose of this review was to assess whether the Board should consider amending IFRS 2. In the light of the evidence gathered, the Board concluded that:

- there were no significant financial reporting problems pointing to a need to amend IFRS 2; and
- there was no need to perform further research on this topic or to seek further feedback from stakeholders.

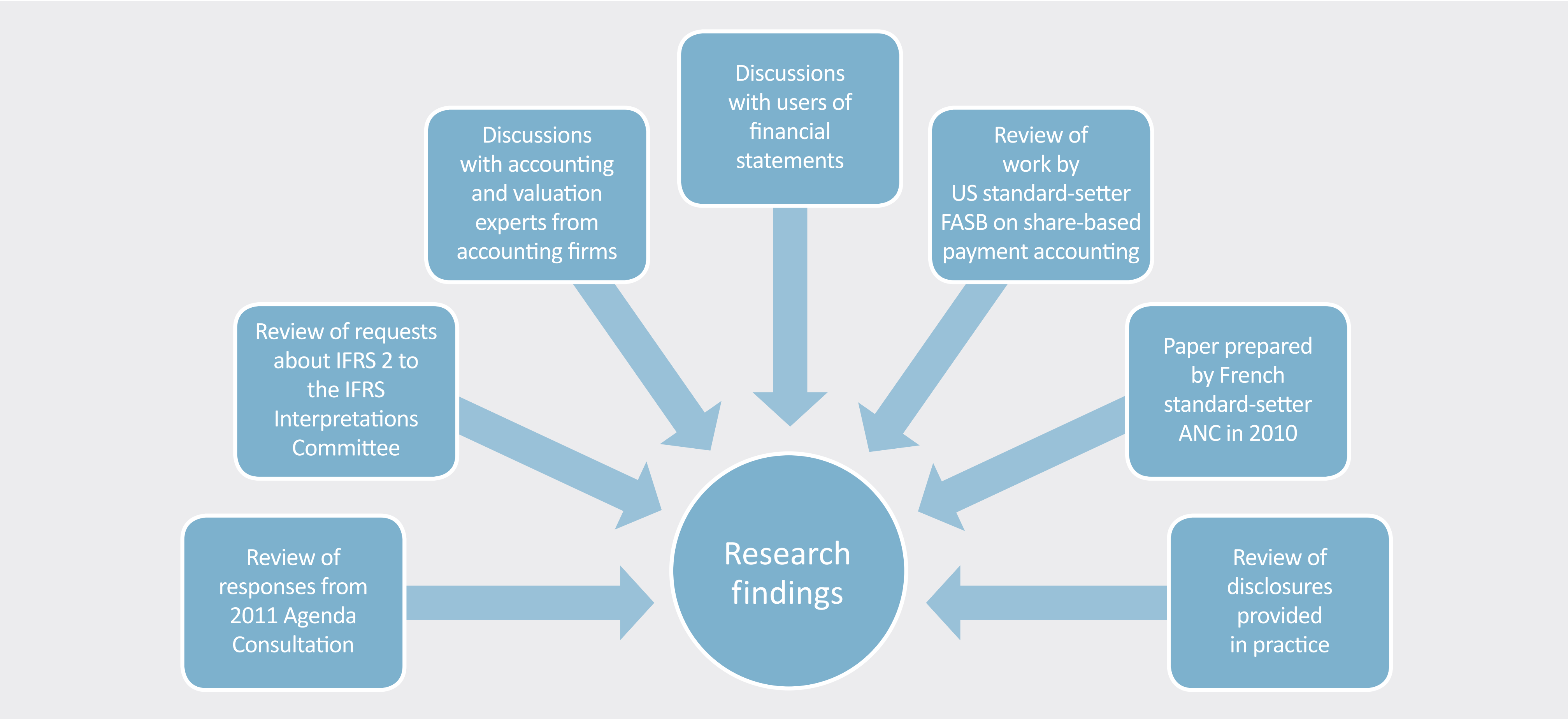
For more information

Information about the research project is available on the Board's web site at:

http://www.ifrs.org/projects/work-plan/share-based-payment/.

Sources of information

The staff used the following sources in their research:



Research findings

The main output of the research project was a staff paper *Report on research so far* presented to the Board in November 2015. This identified two main sources of complexity in accounting for share-based payments:

- the variety and complexity of the terms and conditions of share-based payments; and
- some features of the grant-date fair value measurement model used for equity-settled share-based payments.

The staff paper also comments on disclosure.

Variety and complexity of terms and conditions of share-based payments

Entities often structure share-based payments in particular ways to achieve a range of objectives. Those objectives include providing management personnel and employees with incentives intended to improve their performance and retention, and may also include achieving particular accounting outcomes. Those accounting outcomes may include limiting the amount and volatility of the expense or delaying the recognition of the expense.

To meet these objectives, the terms and conditions of share-based payments are varied and complex. This variety and complexity contribute significantly to complexity in accounting for transactions involving these payments.

Accounting standards cannot remove the complexity arising from the variety and complexity of terms and conditions of share-based payments.

For background information on the measurement models used in IFRS 2, and on what the resulting information tells users of financial statements, please see Appendices A and B.

Grant-date fair value measurement

The research project found that, in practice, most application issues for entities applying IFRS 2 arise from features of the grant-date fair value measurement model used for share-based payments settled in shares or share options (equity-settled share-based payments). These application issues include:

- **difficulty in understanding why changes in share price do not affect the accounting for equity-settled share-based payments.** The accounting for such payments does not reflect changes after the grant date in the price of equity instruments that the entity must ultimately issue in payment. In contrast, accounting for cash-settled share-based payments does reflect such changes after the grant date because those price changes affect the amount of cash the entity must ultimately pay. The staff paper *Report on research so far* explains that, for equity-settled share-based payments, not accounting for changes in price after the grant date:
  - is consistent with the accounting for other obligations that must be settled by issuing equity instruments in payment; and
  - reflects the fact that the value of services received is unlikely to change after the grant date in line with changes in the share price.

Research findings continued

- **complexity in classifying conditions of share-based payments as vesting or non-vesting.** IFRS 2 identifies several categories of vesting conditions and non-vesting conditions and treats them differently in measuring share-based payments. Treating the categories differently has some advantages because it makes the resulting information more useful, but also causes some complexity. The research found that reducing that complexity significantly would require fundamental changes that:
  - would negate the advantages of the grant-date fair value measurement model; and
  - could be inconsistent with the distinction made between liabilities and equity in accounting for other obligations that must be settled by issuing equity instruments in payment.
- **apparently counterintuitive results for some actions that change equity-settled share-based payments.** The staff paper *Report on research so far* describes results that some stakeholders find counterintuitive, including continuing to recognise expense for cancelled share-based payments and not reversing expense for 'negative' modifications of share-based payments. That paper also summarises the explanations that the Basis for Conclusions on IFRS 2 provides for the approach to these items.

Disclosure

The staff paper discusses (on pages 34–36) criticisms that IFRS 2 leads entities to disclose excessive information in their financial statements. The discussion comes to the following main conclusions:

- the average length of disclosure on share-based payment by a sample of entities was between 2.5 and 3 pages.
- the main factors contributing to the length of the disclosure are:
  - the number of share-based payment arrangements (ie schemes) operated by the entity; and
  - whether the entity discloses information about those payments separately or, as permitted by IFRS 2, in aggregate.
- IFRS 2, and amendments made in 2014 to IAS 1 *Presentation of Financial Statements*, provide appropriate flexibility in how entities can disclose information about share-based payments. Thus, entities can exercise judgement in deciding which information is material and therefore must be disclosed. In 2017, the Board provided guidance on such judgement by issuing IFRS Practice Statement 2 *Making Materiality Judgements*.

Feedback on research findings and conclusion

Feedback on research findings

The Board obtained feedback on its research findings from:

The Global Preparers Forum, in March 2016, and the Accounting Standards Advisory Forum, in April 2016[1]

Members of these forums generally agreed with the findings, and indicated the Board should:

- not perform further research; and
- not reconsider the grant-date fair value measurement model.

The 2015 Agenda Consultation

Most respondents to the 2015 Agenda Consultation viewed work on share-based payments as of only low or medium priority. They commented that:

- most implementation issues have been resolved since IFRS 2 was issued in 2004; and
- overall, the Standard is considered to be operational.

Conclusion

In May 2016, the Board reviewed the above feedback, contained in a second staff paper *Project Update and Agenda Consultation Feedback*. In the light of the evidence gathered and that feedback, the Board concluded that:

- there were no significant financial reporting problems pointing to a need to amend IFRS 2; and
- there was no need to perform further research on this topic or to seek further feedback from stakeholders.

1 The Global Preparers Forum is an independent body providing the Board with input from companies preparing financial statements. The Accounting Standards Advisory Forum is an advisory group of national standard-setters and regional bodies that contributes to and supports the Board in its development of high-quality accounting standards by providing technical input.

Appendix A—Measurement models in IFRS 2

IFRS 2 specifies how entities should account for goods or services received in exchange for share-based payments. A common example is receiving services from employees in exchange for issuing shares or share options. For simplicity, this summary focuses on transactions with employees. In many cases, employees need to provide their services over a number of years before the employees' benefits vest—ie before the employees' right to receive the shares or share options is no longer conditional on further service.

IFRS 2 identifies two types of share-based payment transactions:

- **equity-settled**: an entity pays for goods or services by issuing equity instruments, such as shares or share options.
- **cash-settled**: an entity pays for goods or services in cash, but the amount to be paid depends on the price of equity instruments issued by the entity.

Equity-settled transactions

The measurement of equity-settled share-based payment transactions reflects the price of the shares or share options at the grant date. Grant date is the date at which the entity and the recipient of the shares or share options (for example, employees) agree to the arrangement and have a shared understanding of its terms and conditions. If the shares or share options are not traded in an active market, their price needs to be estimated.

The measurement of equity-settled share-based payment transactions is not updated after the grant date to reflect changes in the price of the shares or share options. This is for the following reasons:

- changes in the price of the shares or share options do not change the value of the goods or services received; and
- this treatment is consistent with how entities measure other equity instruments—such as many share warrants—issued in exchange for cash received. Entities do not update measurements of those instruments for changes in the price of those instruments.

Many equity-settled share-based payments are subject to service conditions and other vesting conditions (for example, a requirement to remain in service for a specified number of years) or non-vesting conditions (for example, a requirement to achieve a specified target). IFRS 2 requires different accounting treatments for different types of conditions. For example:

- for conditions based on an entity's own share price, the entity does not update the measurement after the grant date to reflect changes in the share price; but
- for vesting conditions requiring employees to provide services for a specified number of years, an entity does update the measurement to reflect changes in its estimate of how many employees will satisfy those conditions.

When the measurement of an equity-settled share-based payment is updated to reflect changes in estimates, that change in measurement is reported in profit or loss as part of the expense for employees' services.

Appendix A—Measurement models in IFRS 2 continued

The grant-date fair value measurement model used in IFRS 2 for equity-settled transactions updates some inputs used in the measurement, but not all. Although that mixed treatment causes some complexity, it has advantages because it means the measurement:

- is updated in cases when the Board concluded that updating the input would provide useful information to users of financial statements, at a cost that does not exceed the benefits of that information. One example of the use of updated estimates is in estimating the number of employees who will satisfy vesting conditions that require them to provide service for a specified number of years.
- is not updated to reflect, for example, changes in the entity's own share price. Updating the measurement to reflect changes in the entity's own share price would be inconsistent with the measurement of other equity instruments—such as many share warrants—issued in exchange for cash.

The research found that reducing that complexity significantly would require fundamental changes that would negate those advantages of the grant-date fair value measurement model, and that could be inconsistent with the accounting for other obligations that must be settled by issuing equity instruments in payment.

Cash-settled transactions

For cash-settled transactions, the amount of cash to be paid depends on the price of an equity instrument issued by the entity. The liability to pay that cash is measured on a basis that reflects the price of that equity instrument. The resulting measurement is updated at each reporting date to reflect:

- changes in the price of that equity instrument; and
- an updated estimate of the effect that all conditions have on the amount of cash to be paid.

Changes in the measurement of the liability are reported in profit or loss as part of the expense for employees' services.

Appendix A—Measurement models in IFRS 2 continued

Overview of accounting under IFRS 2 for share-based payments to employees

Table 1 summarises the accounting requirements for equity-settled and cash-settled share-based payment transactions. For simplicity, the table focuses on transactions with employees.

Table 1 Accounting under IFRS 2 for share-based payment transactions with employees

	Equity-settled	**Cash-settled**
Expense recognised when services are received?	Yes	Yes
Obligation to pay recognised when services are received?	Yes—as equity	Yes—as a liability
Subsequent measurement based on fair value at …	… grant date	… reporting date
After the grant date, do changes in the entity's share price affect measurement of the obligation and of the expense for services received?	No	Yes
After the grant date, if payments are subject to conditions and there are changes in estimates of whether the conditions will be met, do those changes in estimates affect measurement of the obligation and of the expense for services received?	For some conditions	Yes—for all conditions

Appendix B—What does information required by IFRS 2 tell users of financial statements?

For simplicity, the following summary focuses on transactions with employees.

Cost of services provided by employees

The expense recognised for services provided by employees in the current period provides users of financial statements with information about the cost of those services, regardless of whether payment is in cash or by issuing equity. That information can help users estimate the cost of services that employees will provide in future periods. Thus, that information is relevant for economic decisions and for the assessment of stewardship by management. The feedback obtained during the research indicated that most stakeholders agree that this information is relevant to users of financial statements.

Some people argue that the amount recognised as an expense for the cost of services provided by employees during the current period should not include the effect of share-based payments. In their view, including that effect leads to double counting because the denominator used in computing diluted earnings per share already reflects potential future dilution that will occur if employees become entitled to receive shares or to exercise share options.

However, the research confirmed that no double counting occurs. When an entity receives services from employees in exchange for share-based payments, those transactions have two separate effects:

- employees provided services to the entity during the current period, in exchange for share-based payment. The cost of those services is recognised as an expense in profit or loss. Hence, that cost, including the effect of share-based payment, is included in the *numerator*—'earnings'—of both basic earnings per share and diluted earnings per share.
- in the future, if employees exercise share options they receive in exchange for services they provided to the entity in current or prior periods, the interest of existing shareholders in future profits will be diluted. This potential future dilution increases the *denominator* of diluted earnings per share—the number of shares after dilution.

The denominator reflects only one of these effects—potential future dilution. It does not reflect the cost of services provided by employees in the current period.

Obligation to pay cash for services already provided by employees

The amount reported as a liability for cash-settled payments reflects an up-to-date estimate of the cash to be paid for services already provided by employees.

Appendix C—Other IFRS Standards and other projects

The staff paper *Report on research so far* compares IFRS 2 with some other IFRS Standards and discusses possible implications of other projects on the Board's workplan. Table 2 below summarises the comparison and implications. From that comparison and review, the Board identified no need for amendments to IFRS 2 or other Standards.

Table 2 Other IFRS Standards and other projects	
IAS 19 *Employee Benefits*	The staff paper contains (on pages 14–15) a comparison of the measurement model for long-term employee benefits within the scope of IAS 19 with the measurement models for share-based payment transactions within the scope of IFRS 2. IAS 19 requires entities to split pension costs between the cost of services for the current period and remeasurement of the cost of services for prior periods. The staff paper notes that IFRS 2 does not require such a split for cash-settled or equity-settled share-based payment transactions.
Research project on Financial Instruments with Characteristics of Equity	The staff paper mentions (on pages 22–23) the research project on Financial Instruments with Characteristics of Equity. That research project focuses on instruments within the scope of IAS 32 *Financial Instruments: Presentation* and the Board does not expect to amend IFRS 2 as a result of that project. Nevertheless, if approaches being explored in that project were also to be applied to share-based payment transactions: • the information provided for equity-settled share-based payment transactions might show more clearly the effect of changes in an entity's share price after the grant date and might be more comparable with information for cash-settled payments; and • the classification of some share-based payment transactions as equity-settled or as cash-settled might change.

Notes

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