STAFF PAPER

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IASB Meeting

Project	**Narrow-scope amendments to IFRS 2 *Share-based Payment***
Paper topic	Other issues including the accounting for reclassification of share-based payments in which the manner of settlement is contingent on future events

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Introduction

1. Agenda Paper 12D(i) addresses the amendment to IFRS 2 for the issue related to the classification of share-based payment transactions in which the manner of settlement is contingent on a future event that is outside the control of both the entity and the counterparty.

2. We have recommended to the IASB that it should clarify the classification of the share-based payment in line with the probable approach that was recommended by the Interpretations Committee in Agenda Paper 12D(i).

3. Applying the probable approach, a share-based payment with a contingent settlement feature would be reclassified from cash-settled to equity-settled or vice versa when the probable settlement method changes before the settlement date. Thus, if the IASB agrees with the staff recommendation in Agenda Paper 12D(i), the IASB needs to consider how changes in classification of the share-based payment under the probable approach should be accounted for.

4. This Agenda Paper provides the IASB with a summary of the discussions in the meetings of the Interpretations Committee, staff analysis of the issue, and the Interpretations Committee's recommendation to the IASB, in terms of the accounting for reclassification of the share-based payment that arises from a change in the probable settlement method.

5. This Agenda Paper also includes our analysis on transition requirements of this particular amendment for existing IFRS preparers and first-time adopters, and whether consequential amendments to other IFRSs are required.

Accounting for a change in classification

6. The Interpretations Committee analysed two alternative methods for the accounting for reclassification of the share-based payment with a contingent settlement feature. We have prepared illustrative examples in **Appendix A** to show journal entries for each method by using a simplified fact pattern.

Alternative methods identified by the staff

Method 1—account for the change in classification by reference to the guidance for a failure to satisfy a non-market vesting condition (the single measurement method)

7. Using this method, the entity accounts for a change in the classification as if the settlement alternative originally expected had failed to satisfy a non-market vesting condition. For example, if the share-based payment is reclassified from equity-settled to cash-settled, the entity would derecognise the amount recorded in equity for the equity-settled share-based payment with a credit to profit or loss (paragraph 19 of IFRS 2), and record a liability with a corresponding expense at an amount determined as if the share-based payment had been accounted for as cash-settled. This method effectively requires an entity to apply the new classification from the inception of the arrangement and record catch-up adjustments in the period in which the classification change occurs. This method results in no restatements of comparative periods, consistently with the requirements in paragraph 19 of IFRS 2.

8. Those who support this method think that a change in the estimate for the most probable settlement method is a change in an accounting estimate. Thus, they think that the effects of the change should be recognised prospectively rather than restating prior periods in accordance with paragraph 36 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

9. The total amount of expense recognised in this method would represent the measurement determined in accordance with the requirements for either a cash-settled share-based payment or an equity-settled share-based payment, depending on whether it is settled in cash or equity instruments.

Method 2—account for the change in classification by reference to the guidance for a modification of the terms and conditions of the share-based payment (the multiple measurement method)

10. Using this method, a change in the classification of the share-based payment with a contingent settlement feature would be accounted for as if a modification of the terms and conditions of a share-based payment transaction had occurred. Consequently, if the share-based payment is reclassified from equity-settled to cash-settled, the cumulative amount of compensation expenses recognised for the equity-settled share-based payment prior to the date of reclassification would not be adjusted.

11. After the reclassification date, an amount of compensation expense is determined in accordance with the requirements for cash-settled share-based payments in paragraphs 30-33 of IFRS 2 and with the requirements for modifications to the terms and conditions of equity-settled share-based payments in paragraphs 26-29 and B42-B44 of IFRS 2. Thus, if the reclassification-date fair value of the cash-settled alternative is greater than that of the equity-settled alternative, the incremental fair value would be included in the measurement of the amount recognised for services received over the period from the reclassification date until the vesting date, in addition to the amount based on the grant-date fair value of the equity-settled share-based payment (paragraph B43 of IFRS 2). If the reclassification-date fair value of the cash-settled alternative is lower than that of the equity-settled alternative, the entity would not take into account that decrease in fair value and continue to measure the amount recognised for services received based on the grant-date fair value of the equity-settled share-based payment (paragraph B44 of IFRS 2).

12. Using this method, the total amount of expense recognised would represent a mix of measurements determined in accordance with the requirements for both cash-settled share-based payments and equity-settled share-based payments.

13. We understand that US GAAP provides guidance that a specific share-based payment that is classified as equity, but subsequently becomes a liability because the contingent cash settlement event is probable of occurring, is accounted for similar to modifications of the terms and conditions of the share-based payments. Thus, this model would result in consistent accounting with that under US GAAP for specific transactions with contingent cash settlement features (eg an IPO).

14. We note however that the guidance in US GAAP does not address changes in classification of share-based payments with other cash settlement features, such as death or disability of employees, that do not meet the definition of performance conditions under US GAAP. Hence, the scope of the issue discussed in this project is broader than that of the guidance in US GAAP

The method preferred by the Interpretations Committee

15. The Interpretations Committee noted that neither approach can be directly derived from the existing guidance in IFRS 2. This is because in this fact pattern, the changes in classification are not caused by a failure to meet the vesting conditions or by a modification to the terms and conditions of the arrangement. The classification of the share-based payment changes because of a change in the most likely settlement method.

16. However, a majority of the members of the Interpretations Committee supported Method 1 (the single measurement method) for various reasons, including:

    (a) Applying a new classification from the inception of the arrangement better matches a share-based payment that is a single share-based payment but with two settlement alternatives from the inception of the arrangement.

    (b) A change in the most likely settlement method should be viewed as a change in an accounting estimate. Thus, financial statements in prior periods should not be restated. The effects of a change in classification for prior periods should be recognised in the period of the change (paragraph 36 of IAS 8).

    (c) Method 1 is more straightforward to implement.

17. Accordingly, the Interpretations Committee decided to recommend to the IASB that it should add guidance to IFRS 2 that specifies that a change in classification of the share-based payment arising from a change in the most likely settlement method should be accounted for by recording a cumulative adjustment at the point in time that the change in classification occurs, in such a way that the cumulative cost will be the same as if the change in classification had occurred at the inception of the arrangement.

Transition requirements

18. We considered whether the amendment related to share-based payments with contingent settlement features should be applied retrospectively in accordance with the requirements in IAS 8. The proposed amendment may require the entity affected to change the classification of a share-based payment with a contingent settlement feature in previous periods. However, if the IASB agrees with Method 1 (the single measurement method) for the accounting for reclassification, the amendment would affect only the timing and amount of the expense recognised at each reporting date, but would not affect the cumulative expense. This is because reclassification of the share-based payment would be accounted for as if the new classification had been expected from the inception of the arrangement with any effects of the reclassification being recognised in the period of the reclassification.

19. Accordingly, if the amendment is considered on its own, we think that the proposed amendment should be applied prospectively, because we think that the cost of retrospective application would outweigh the benefits from doing so. We collectively analyse the transition requirements for all the amendments proposed in this narrow-scope amendment project in Agenda Paper 12G.

First-time adopters

20. We think that no specific guidance is necessary for first-time adopters in the application of the proposed amendments, because appropriate relief is already given through the exemptions for share-based payments in paragraphs D2-D3 in

Appendix D of IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

Consequential amendments

21. We have reviewed other IFRSs for potential consequential amendments triggered by this proposed amendment. As a result of this review, we do not propose any consequential amendments.

Staff recommendation

22. We recommend to the IASB that, if it decides to proceed with the particular amendment in line with the probable approach, it should propose reclassification of a share-based payment with a contingent settlement feature should be accounted for in line with the approach recommended by the Interpretations Committee. Applying this approach, reclassification of the share-based payment would be accounted for by recording a cumulative adjustment in the period of the reclassification, in such a way that the cumulative cost will be the same as if the change in classification had occurred at the inception of the arrangement.

Question for the IASB

Question
Does the IASB agree with the staff recommendation that, if it decides to take the probable approach for the classification of a share-based payment with a contingent settlement feature, the IASB should propose that reclassification of the share-based payment should be accounted for in line with the approach recommended by the Interpretations Committee, which would account for the reclassification by recording a cumulative adjustment as if the new classification had been expected from the inception of the arrangement?

Appendix A—Illustrative example

A1. The illustrative example below presents journal entities of reclassification of a share-based payment with a contingent settlement feature under Method 1 (the single measurement method) and Method 2 (the multiple measurement method). This example uses a situation in which the fair value of the share-based payment as of the reclassification date is lower than the grant date fair value of the share-based payment.

Example

In January 20X1, an entity enters into a share-based payment transaction with its employees. The terms of the arrangement are as follows:

- The entity grants one free share to each of 10 employees.
- Each grant is conditional upon the employee working for the entity over the next four years.
- The granted shares will vest immediately and be settled in cash at the fair value of the shares at the date of settlement if a change in control occurs during the vesting period.

Assumptions:

- No employees are expected to leave the entity over the next four years.
- At the grant date and the end of 20X1, the management estimates that it is not probable that a change in control will occur in the vesting period.
- At the end of 20X2, the management changed the estimate and it expects that a change in control will occur in 20X3.
- At the end of 20X3, a change in control occurs and employees receive cash.
- The fair value of each free share is:
  At the grant date: CU10[1]
  At the end of 20X1: CU10
  At the end of 20X2: CU6
  At the end of 20X3: CU6

	Method 1 **Single measurement method**			**Method 2** **Multiple measurement method**		
20X1	Debit CU	Credit CU		Debit CU	Credit CU	
Dr Employee expense	25			25		
Cr Equity		25	(a)		25	(a)

[1] In this Agenda Paper, currency amounts are denominated in 'currency units' (CU).

(a) CU10×10×1/4-0

20X2	Debit CU		Credit CU		Debit CU		Credit CU	
Dr Employee expense	5	(a)			25	(d)		
Cr Liability			30	(b)			30	(b)
Dr Equity	25	(c)			5	(e)		

(a) CU10×10×2/4-25 - a gain from the decline of fair value (CU10×10×2/4 - CU6×10×2/4)
(b) CU6×10×2/4-0 (Recognition of a liability)
(c) (CU10×10×2/4-25) - CU 10×10×2/4 (Reversal of cumulative amount for equity component)
(d) CU10×10×2/4-25 (Recognition of expense for the grant date fair value because IFRS 2 requires recognition of a minimum amount based on the grant date fair value)
(e) Cumulative amount of equity component is not reversed in full to recognise the minimum amount based on the grant date fair value

20X3	Debit CU		Credit CU		Debit CU		Credit CU	
Dr Employee expense	30				50	(b)		
Cr Liability (Cash)			30	(a)			30	(a)
Cr Equity			0				20	

(a) CU6×10×4/4-30
(b) CU10×10×4/4-(25+25) (Recognition of expense for the grant date fair value)

20X4	Debit CU	Credit CU	Debit CU	Credit CU

No journal entries because the share-based payment is settled upon the occurrence of the change in control at the end of 20X3.