STAFF PAPER

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Project	**Annual Improvements to IFRSs—2010-2012 Cycle (ED/2012/1) comment letter analysis**
Paper topic	IFRS 2 *Share-based Payment*—definition of vesting condition

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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

Introduction

1. The Exposure Draft (ED) on *Annual Improvements to IFRSs 2010 –2012 cycle* (ED/2012/1) published in May 2012 includes the IASB's proposal to clarify the definition of *vesting conditions* in Appendix A of IFRS 2 *Share-based Payment* by separately defining a 'performance condition' and a 'service condition'.

Objective of the paper

2. The objective of this paper is to provide an analysis of the comment letters received on the proposal to amend the definition of *vesting conditions* in Appendix A of IFRS 2 *Share-based Payment* and to obtain a recommendation from the IFRS Interpretations Committee (the Interpretations Committee) for this issue to be included in the final *Improvements to IFRSs* that is planned to be published in 2013.

Structure of the paper

3. This paper:

   (a) provides background information and explains the issue;

(b) analyses the comments received as part of the Exposure Draft process and recommends changes to the proposed draft wording; and

(c) asks the Interpretations Committee to confirm whether they agree with the staff recommendation to proceed with the proposed amendment by adding some further amendments and edits that would make the proposed amendment clearer.

Background information

4. In May 2009, the IFRS Interpretations Committee took onto its agenda the project "Vesting and non-vesting Conditions" relating to share-based payments. The Committee analysed each of the issues during several meetings[1] and sought solutions consistent with the underlying principles in IFRS 2.

5. The IASB discussed the Interpretations Committee's recommendations at the 13-17 September 2010 IASB meeting[2] and asked the Interpretations Committee to prioritise the issues being addressed by this project and consider the best path forward on an issue-by-issue basis to decide whether any of the issues being addressed could be dealt with as annual improvements.

6. At the November 2010 meeting, in response to the IASB's request, the Interpretations Committee decided to propose to the IASB that clarification to the definitions of service conditions and performance conditions should be made through the next annual improvements cycle.

7. At the September 2011 meeting (refer to Agenda Paper 7D) the IASB agreed with the Interpretations Committee's recommendations about which issues should be included in annual improvements and which other issues should be considered by the IASB in a future agenda proposal for IFRS 2.

[1] The Interpretations Committee discussed this project at its May 2010 meeting (Agenda Papers 3A-3C); at its July meeting (Agenda Papers 3A–3D); at its September 2010 meeting (Agenda papers 2–2C and Agenda Paper 3); and at its November 2010 meeting (Agenda Paper 2).

[2] Refer to Agenda Paper 20.

Issues that led to the proposed amendment

8. The issues that led to the proposed amendment are:

   (a) a lack of clarity in the current definition of vesting conditions in IFRS 2, which incorporates the concepts of service conditions and performance conditions including market conditions (and vesting period);

   (b) the absence of a definition of non-vesting conditions; and

   (c) insufficient guidance on the interaction of multiple vesting conditions.

The IASB's proposal to address the issues raised

9. The IASB proposed to define separately 'performance condition' and 'service condition' and clarify these two definitions.

10. In clarifying the definitions of 'performance condition' and 'service condition', the IASB addressed the following concerns that have been raised about these definitions:

    (a) the correlation between an employee's responsibility and the performance target;

    (b) whether a share market index target may constitute a performance condition or a non-vesting condition;

    (c) whether a performance target that refers to a longer period than the required service period may constitute a performance condition; and

    (d) whether the employee's failure to complete a required service period is considered to be a failure to satisfy a 'service condition'.

11. The IASB decided that it should consider the following issues in a future agenda proposal for IFRS 2:

    (a) a proposal to define non-vesting conditions;

    (b) transactions in which the manner of settlement is contingent on future events;

(c) the classification of a non-compete provision; and

(d) the accounting for the interaction of multiple vesting conditions.

Comment letter analysis

12. In this section, we discuss and analyse the comments received from interested parties on the ED (May 2012) during the comment period, which ended on 5 September 2012.

13. The ED asked two general questions that were answered individually for each proposed amendment:

(a) **Question 1**: *Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?*

(b) **Question 2**: *Do you agree with the proposed transitional provisions and effective date for the issue as described in the exposure draft?*

14. The IASB received 84 comment letters on the ED.

15. Approximately two-thirds of the total respondents to this ED expressed their views on the proposed amendment to the definition of vesting conditions in IFRS 2.

Analysis of Question 1

16. Concerning Question 1, **three-quarters** of the respondents who replied to this question (a mix of preparers, users and standard-setters) **agree** with the proposal to amend the definition of vesting conditions in IFRS 2. This is because they think that the proposed amendment brings clarity and transparency to this definition and eliminates divergence in the application of IFRS 2.

17. The remainder, ie **one-quarter** of the respondents, agreed in general with the proposal to separately define performance conditions and service conditions; however, they raised some comments on various aspects of the proposed clarifications.

18. A few of them also suggest that the IASB should provide a definition of a 'non-vesting condition' and consider doing this as part of a future annual improvements cycle.

19. A couple of respondents[3] think that the IASB should take on a broader project on IFRS 2 to address the inconsistencies identified in the definitions. One recommends the IASB that it should conduct a comprehensive review of the standard (ie the IASB should subject IFRS 2 to a post-implementation review) instead of making numerous piecemeal amendments.

20. These comments are analysed and discussed below.

Issue 1: are conditions also linked to the performance of another group entity or parent within the group?

21. Respondents observe that it is unclear from the proposed definition of *performance condition* whether conditions linked to the performance of another entity within the same group (ie a parent or another group entity) would be considered to be performance conditions or non-vesting conditions.

22. For instance, in a group structure, some performance targets could be set by reference to the price or value of the equity instruments of another entity included within the group. For example, a subsidiary provides share-based payments to its employees based on the performance of the quoted share price of the parent entity within the group.

23. Respondents note that the proposed definition of a 'performance condition', as drafted, is capturing performance targets based on the entity's own operations (or activities) or on the price or value of its equity instruments and not on performance targets set by reference to the price or value of the equity instruments of another entity included within the group. This definition is shown below (emphasis added):

> **Performance condition**
>
> A vesting condition that requires:

[3] ICAEW and the Hundred Group

> (a) the counterparty to complete a specified period of service; and
>
> (b) specified performance targets to be met while the counterparty is rendering the service required in (a).
>
> **A performance target is defined by reference to the entity's own operations (or activities) or the price (or value) of its equity instruments (including shares and share options).** A performance target might relate either to the performance of the entity as a whole or to some part of the entity, such as a division or an individual employee.

24. Respondents think that clarification of this definition is needed. Otherwise, a performance target that is based on the performance of another entity within the group would be treated as a non-vesting condition instead of as a performance condition.

25. A few other respondents raised a similar concern about the definition of 'market condition'. They claim that the IASB should change the reference to 'the entity' in the definition of 'market condition' shown below to 'a group entity' (emphasis added):

> **Market condition**
>
> A condition upon which the exercise price, vesting or exercisability of an equity instrument depends that is related to the market price of **the entity's equity instruments,** such as attaining a specified share price or a specified amount of intrinsic value of a share option, or achieving a specified target that is based on the market price of the **entity's equity instruments** relative to an index of market prices of equity instruments of other entities.

Staff analysis

26. We agree with the respondents' views. We think that the proposed amendment to the definition of a 'performance condition' should be read as including other group entities and shareholders that are part of the group. This is because we

observe that, within the scope of IFRS 2, paragraph 3A[4] states that share-based payment transactions also include transactions in which share-based payment transactions might be settled by another group entity (or a shareholder of any group entity) on behalf of the entity receiving the goods or services. Paragraph 3A is reproduced below (emphasis added).

> **3A A share-based payment transaction may be settled by another group entity (or a shareholder of any group entity) on behalf of the entity receiving or acquiring the goods or services.** Paragraph 2 also applies to an entity that:
>
> (a) receives goods or services when another entity in the same group (or a shareholder of any group entity) has the obligation to settle the share-based payment transaction, or
>
> (b) has an obligation to settle a share-based payment transaction when another entity in the same group receives the goods or services unless the transaction is clearly for a purpose other than payment for goods or services supplied to the entity receiving them.

27. In addition, paragraphs 43A–43D of IFRS 2 require that (emphasis added):

    (a) services rendered in share-based payment transactions **among group entities**, such as those transactions that the parent has the obligation to settle, are within the scope of IFRS 2; and

    (b) the services rendered in those transactions should be recognised in the separate or individual financial statement of the entity receiving the services

28. Consequently we think that, consistently with the guidance in paragraphs 3A and 43A–43D:

[4] Paragraph 3A is part of the amendment made to IFRS 2 in 2009, to incorporate the consensus originally contained in *IFRIC Interpretation 11 IFRS 2—Group and Treasury Share Transactions* (released in 2006). Paragraphs BC268A –BC268S summarise the IASB's considerations when finalising its proposals contained in the Exposure Draft *Group Cash-settled Share-based Payment Transactions* published in December 2007.

(a) a performance target should be defined by reference to the entity's (or another group entity's) own operations (or activities) or the price (or value) of the entity's (or another group entity's) equity instruments (including shares and share options); and that

(b) a market condition could be based on the market price of the entity's (or another entity in the group's) equity instruments.

Proposed remedy

29. We suggest that the Interpretations Committee should recommend to the IASB that it should amend the second part of the definition of a 'performance condition' and also the definition of a 'market condition' by referring to the equity instruments of both the entity and, if applicable, another entity in the group.

30. This proposed amendment is shown below (new proposed text has been underlined):

Performance condition

A vesting condition that requires:

(a) the counterparty to complete a specified period of service; and

(b) specified performance targets to be met while the counterparty is rendering the service required in (a).

A performance target is defined by reference to:

(a) the entity's own operations (or activities) <u>or the operations of another entity in the same group</u> or

(b) the price (or value) of ~~it's~~ <u>the entity's</u> **equity instruments** <u>or the equity instruments of another entity in the same group</u> (including shares and **share options**).

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

31. We also propose the following amendments to the definition of a 'market condition' (new text is underlined):

Market condition

A condition upon which the exercise price, vesting or exercisability of an **equity instrument** depends that is related to the market price of the entity's **equity instruments** (<u>or the equity instruments of another entity in the same group)</u>, such as:

(a) attaining a specified share price or a specified amount of **intrinsic value** of a **share option**, or

(b) achieving a specified target that is based on the market price of the entity's, **equity instruments** (<u>or the equity instruments of another entity in the same group)</u> relative to an index of market prices of **equity instruments** of other entities.

<u>Issue 2:</u> **was the intention to exclude performance targets where the period of achieving the performance target exceeds the period of service?**

32. Some respondents note that it is unclear whether it was the IASB's intention to exclude performance targets for which the period of achieving the performance target exceeds the period of service in the definition of 'service condition' and 'performance condition'. We reproduce the comment about this from one of the respondents (emphasis added):

<u>Ernst & Young</u>

We also believe that a strict reading of BC6 could suggest that the duration of the performance condition needs to be 'wholly within the period' of the related service requirement. **There may, in limited circumstances, be instances where the period of the performance condition could begin before or after the period of the service condition** (e.g., the performance target is measured from 1/1/11 through 31/12/12 but the service period is from 1/1/12 through 31/12/12). Would these

> instances (1/1/11 through 31/12/11 in the example) also meet the definition of a performance condition? **We believe that the Board's intention was to exclude these performance targets where the period of achieving the performance target exceeded the period of service. As such, we recommend that the wording in BC6 (and in the standard) should reflect this view**.

33. Other respondents note that while the definitions of a 'performance condition' and a 'service condition' appear to be mutually exclusive, the definition of a 'performance condition' includes a requirement to satisfy the 'performance condition' while rendering services; that is, "specified performance targets have to be met while the counterparty is rendering the service". Consistently with this, these respondents think that the interaction between a 'performance condition' and 'service condition' should be made more evident.

34. We reproduce some extracts of the comments on this respect from a couple of respondents (emphasis added):

> **<u>Ernst & Young</u>**
>
> In our view, adding a cross reference to the definition of a 'service condition' **would clarify that failing to meet a service period that is part of a performance condition results in the same accounting as if that service condition is not met.** This would align with the rationale set out in BC7. To achieve this, the words '(i.e., a service condition)' could be added after criterion (a).
>
> **<u>ICAEW</u>**
>
> **In addition, while the definition of a performance condition and a service condition appear to be mutually exclusive, the definition of a performance condition includes a requirement to satisfy the performance condition whilst rendering services; ie, the individual must be employed**. Therefore a condition that says that the EPS must increase by 3% over the next three years and that an award holder must be employed at

> that time for the award to vest is a performance condition. **This therefore raises the question whether the explicit service requirement should be considered a separate service condition as well as being part of the performance condition**. This might matter if a market performance target is hit but the employee fails to be employed throughout the entire explicit service period. If the explicit service requirement is considered part of the market performance condition an entity would not true up. However, if it is considered to be a separate service condition as well then the expense would be trued up. Greater clarity would be welcomed.

Staff analysis

35. We agree with the views expressed by respondents. We think that it is the IASB's intention to state that the duration of the performance condition needs to be 'wholly within the period' of the related service requirement. This means that the period of the performance target cannot start before the start of the service period and cannot end after the service period. Consequently, the duration of the performance target needs to be within the period of the related service requirement.

36. We also think that it is the IASB's intention to highlight a feature that distinguishes a performance condition from a non-vesting condition in accordance with paragraph BC171A of IFRS 2: namely, that a performance condition has an explicit or implicit service requirement and a non-vesting condition does not. Paragraph BC171A of IFRS 2 is reproduced below (emphasis added):

> In 2005 the Board decided to take on a project to clarify the definition of vesting conditions and the accounting treatment of cancellations. In particular, the Board noted that it is important to distinguish between non-vesting conditions, which need to be satisfied for the counterparty to become entitled to the equity instrument, and vesting conditions such as performance conditions. In February 2006 the Board published an exposure draft Vesting

> Conditions and Cancellations, which proposed to restrict vesting conditions to service conditions and performance conditions. Those are the only conditions that determine whether the entity receives the services that entitle the counterparty to the share-based payment, and therefore whether the share-based payment vests. In particular, a share-based payment may vest even if some non-vesting conditions have not been met. **The feature that distinguishes a performance condition from a non-vesting condition is that the former has an explicit or implicit service requirement and the latter does not**.

37. We also agree with the comment that the first criterion of the proposed definition of 'performance condition' (paragraph (a)) is linked to the definition of 'service condition'. As we have stated in paragraphs above, in order to constitute a performance condition, any performance target needs to have an explicit or implicit service requirement. In our view failing to meet a service period that is part of a 'performance condition' results in the same accounting as if that 'service condition' had not been met.

Proposed remedy

38. We observe that, as currently drafted, the definition of performance condition does not require the duration of a performance target to be wholly within the period of the related service requirement. This definition, as currently drafted, also does not state that the service requirement can be implicit or explicit.

39. We suggest that the Interpretations Committee should recommend to the IASB that it should make it clear in the definition of a 'performance condition':

    (a) that the duration of the performance target should be wholly within the period of the related service requirement (ie an employee must be rendering service for the entire period that the performance target is being measured). The Basis for Conclusions should further clarify that performance targets for which the period of achieving the performance target exceeds the period of service are excluded from the definition of a performance condition.

(b) that the service requirement can be either explicit or implicit. This means that if the share-based payment arrangement does not contain an explicit requirement to provide services, the arrangement may still contain an 'implicit' service condition. The Basis for Conclusions should also explain that this clarification was made to highlight a feature that distinguishes a performance condition from a non-vesting condition: a performance condition has an explicit or implicit service requirement and a non-vesting condition does not, which is consistent with the explanation given in BC171A of IFRS 2.

40. We also think that that the Interpretations Committee should recommend to the IASB that it should add the words "ie a 'service condition'" after criterion (a) of the proposed definition of 'performance condition' in order to create a cross-reference to the definition of a 'service condition'.

41. Consequently, we think that the definition of performance condition could be amended as follows (new text is underlined):

> **Performance condition**
>
> A vesting condition that requires:
>
> (a) the counterparty to complete a specified period of service <u>(ie a 'service condition')</u>; and
>
> (b) specified performance targets to be met while the counterparty is rendering the service required in (a).
>
> <u>The duration of a performance target should be wholly within the period of the related service requirement for it to constitute a performance condition (ie an employee must be rendering service for the duration of the period that the performance target is being measured). The related service requirement can be implicit or explicit.</u>
>
> A performance target is defined by reference to the entity's own operations (or activities) or the price (or value) of its equity instruments (including shares and share options).

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

Issue 3: It is unclear why the performance target needs to be "influenced by an employee"

42. One respondent points out that it is unclear why the phrase ' "the target needs to be within the influence of the employee" is needed at all in paragraph BC5. We reproduce the respondent's reasoning in this respect (emphasis added):

> **Hong Kong Institute of Certified Public Accountants**
>
> It appears that the following two examples meet the definition of 'performance condition':
>
> (a) Employees of Entity A are granted share options. Share options will vest when (a) the employees work for Entity A for a service period of 5 years and (b) the share price of the ordinary shares of Entity A has increased by at least 20% at the end of year 5 as compared to the share price of the ordinary shares of Entity A at the grant date of the share options.
>
> (b) Employees of Entity B are granted share options. Share options will vest when (a) the employees work for Entity B for a service period of 3 years and (b) Entity B will become a listed entity by the end of Year 3.
>
> **It is unclear to us whether the phrase 'the target needs to be within the influence of the employee' is needed to be in the BC5; it appears that that phrase is contradictory to the proposed definition of 'performance condition' (i.e. according to BC 5, neither example (a) or (b) would be considered to be a 'performance condition').**

43. In a similar way, another respondent points out that in some circumstances it could be argued that an employee in one part of the group might be able to influence the performance target in another part of the group. More specifically,

this respondent questions whether performance targets such as the profit or the share price of a group of companies would be or would not be considered to be within the influence of the employee, or whether they would instead be considered to be remote from the influence of an employee. The respondent's comment is reproduced below (emphasis added):

> **<u>Deloitte</u>**
>
> The reference in that proposed paragraph [paragraph BC5] to **a target being 'within the influence of' the employee could be confusing as the profit or share price of a group of companies could be seen to be 'remote from the influence of' an employee of a particular subsidiary of the group.** We recommend that it be made clear that, for the purposes of applying these requirements, it is assumed that each employee has influence over an entity's (or group's) operations and the value of its equity instruments.

44. One respondent thinks that it would be helpful to further clarify the correlation level required between an employee's responsibility and the performance target as explained in paragraph BC4, because it is not clear enough.

45. Another couple of respondents are concerned that the wording in the proposed Basis for Conclusions (paragraphs BC4 and BC3) might imply that an entity should give evidence of the correlation between the award and an increase in the performance. The comment from one these respondents is shown below (emphasis added):

> **Accounting Standards Board (Canada)**
>
> The Basis for Conclusions refers to a correlation between an employee's responsibility and the performance target (paragraph BC3 (a) and BC4). **We are concerned that this statement may imply that an entity is required to prove correlation between the award and an increase in the performance, either quantum or quality, of the recipient. Therefore, we recommend that the**

correlation statement should be removed from the Basis for Conclusions.

Staff analysis

46. We agree with these respondents that the reference in paragraph BC5 that "for a target to constitute a performance condition, the target needs to be within the influence of the employee" might be confusing because it could be misinterpreted to mean that the IASB's intention is to challenge management in explaining how the performance of the employee affects the performance target.

47. We observe that in the proposed definition of 'performance condition', a performance target is defined "by reference to the entity's own operations (or activities) or the price (or value) of its equity instruments". Consequently, we think that a performance target needs to reflect the performance of the entity (or the performance of the group or part of the group of which the entity is part, see our discussion in paragraphs 21–31 of this agenda paper).

48. In addition, in the proposed definition of 'performance condition', a performance target "might relate to the performance of the entity as a whole or to some part of the entity, such as a division or an individual employee". In this respect we think that each employee (in the entity or in any entity in the group) makes a contribution to the entity's (or group's) overall performance and it is management that decides upon the link between the employee's service and the performance of the entity. We do not think it was the IASB's intention to ask an entity to further demonstrate how the performance of one employee affects the performance target.

49. We also think that it is not the IASB's intention to require an entity to demonstrate or provide evidence of the correlation between an employee's responsibility (or influence) and the performance target and we agree that this aspect is not clear enough in the proposed amendment to IFRS 2.

Proposed remedy

50. We think that the Basis for Conclusions should clarify that each employee has an influence over an entity's (or group's) overall performance, that is, over an entity's (or group's) own operations (or activities) or the price (or value) of its

equity instruments. This is because we think that it was not the IASB's intention to ask an entity to demonstrate how an employee's performance affects a performance target. In line with this, we think that the basis for conclusions could mention that the IASB decided to omit the requirement that the target "needs to be within the influence of the employee" to avoid further confusion.

51. We also think that the Basis for Conclusions should point out that:

(a) management is responsible for establishing the link between the employee's service or performance to a given performance target.

(b) an entity is not required to demonstrate the correlation between an employee's responsibility and the performance target in order for that target to be a performance condition.

Issue 4: if an entity's share price makes up a substantial part of the share market index should it still be considered a non-vesting condition?

52. One respondent observes that it is not clear from the drafting in paragraph BC5 whether a share market index target would still be considered a non-vesting condition if the entity's share price makes up a substantial part of the index. The respondent's comment is reproduced below (emphasis added):

> **ICAEW**
>
> **The company's share price may make up a substantial part of the index, as is certainly possible with some narrowly-drawn indices. In this case the index would not be 'predominantly affected by external variables' and would not be 'remote from the influence of the employee' or 'unrelated to the performance of the entity'. This paragraph should therefore be redrafted to clarify the Board's intention**. The text should confirm that performance comparative to an index is fine; eg, company's share price must increase by greater percentage than index, since the employee's service can be seen as influencing one leg of the test. If a 'share market index' is not to be used as an example,

> this raises a question about other types of index. Again, the Board’s intention is unclear because of lack of clarity in drafting.

Staff analysis

53. We disagree with this respondent because we think that the proposed definition of ‘performance condition’ clearly states that a performance target is defined “by reference to the entity’s own operations (or activities) or the price (or value) of its equity instruments”. In this respect we observe that a share market index that is related substantially (but not entirely) to the performance of the entity is not a performance target, because it partly reflects the performance of other entities outside the group.

54. We think that in situations in which a share market index is substantially made up by the entity’s own share price, management could choose instead to define the performance target by reference to the entity’s share price so that the performance target is considered a performance condition (and not a non-vesting condition).

55. Consequently, we think that it is appropriate that the proposed Basis for Conclusions further clarifies that in *any* circumstance in which a share market index is used as a performance target, it is considered a non-vesting condition because a share market reflects the performance of other entities *outside* the group.

56. We also note that the existing definition of a market condition includes a condition that would involve attaining a specified share relative to an index of prices. We observe that in this case the measure for assessing the condition is still the entity’s share price and the benchmark against which the share price is measured is an index instead of a fixed value.

57. Based on our discussion above, we think that the Interpretations Committee should not recommend any further amendments to the definition of ‘performance condition’ to the IASB because the IASB’s intention is clear in this respect.

Issue 5: The focus of analysis of a performance target should not be based on external factors or variables

58. One respondent observes that the fact that a share market index target is affected by many external variables and factors should not be given as a reason to support the view that such a target is a non-vesting condition. This is because this respondent thinks that determining whether a performance target is affected by external variables or factors is questionable. In the respondent's view, the fact that a share market index is not related to the performance of the entity should be enough reason to determine that it is a non-vesting condition. An extract of the respondent's comments is provided below (emphasis added):

> **IDW**
>
> **It might make more sense not to focus on whether the target is predominantly affected by many external variables or factors, which may be questionable**. Such external variables or factors exist in many cases and are difficult to weight in relation to the influence the employee may have. **Instead, an explicit statement could be included to clarify that a performance target is defined by reference to the entity s own operations (or activities) or the price (or value) of its equity instruments, irrespective of the question whether the target is also affected by external variables or factors**

Staff analysis

59. We agree with the respondent's comment that a performance target constitutes a performance condition if it reflects the performance of an entity. Consequently, we think that the fact that the target might be affected by external variables or factors need not be cited as another decisive reason for not considering it as a performance condition.

Proposed remedy

60. We think that the proposed definition of 'performance condition' is clear that a performance target is defined "by reference to the entity's own operations (or

activities) or the price (or value) of its equity instruments". We think that the only reason that should be provided for regarding a share market index target as not constituting a performance target is that it does not reflect the performance of an entity, because it also reflects the performance of other entities outside the group. Consequently, we think that the Interpretations Committee should recommend to the IASB that it should amend the Basis for Conclusions to state that explicitly.

Issue 6: how should the words "specified period of service" be interpreted?

61. One respondent notes an apparent contradiction between the proposed definition of 'performance condition' in Appendix A and the language in paragraph 15(b) of IFRS 2 in regard to the length of the period of service. This respondent observes that within the proposed definition of performance condition the period of service that the employee has to render is "specified" (or "fixed" as we think this respondent takes it to mean), but the respondent also observes that, consistently with the guidance in paragraph 15(b) of IFRS 2, the vesting period (ie period of service) could be "variable". This respondent thinks that the proposed guidance should be made consistent to avoid any contradiction. An extract from the respondent's views is shown below (emphasis added):

> **The Bank of New York**
>
> However, as points of clarification, we note that the proposed definition of "performance condition" at Appendix A requires "the counterparty to complete a specified period of service...", which is inconsistent with the language in the proposed paragraph 15, which states "..and the length of the vesting period varies depending on when that performance condition is satisfied...". **We believe that the definition language should accommodate the variability in the vesting period for possible instances where if the performance condition is met the share-based payment becomes fully vested**.

Staff analysis

62. We disagree that there is an apparent contradiction between the definition of a performance condition and the guidance in paragraphs 15 and 15(b) of IFRS 2. We provide below an extract from this guidance (emphasis added):

> **Paragraph 15** (extract)
>
> If the equity instruments granted do not vest until the counterparty completes a specified period of service, **the entity shall presume that the services to be rendered by the counterparty as consideration for those equity instruments will be received in the future, during the vesting period.** The entity shall account for those services as they are rendered by the counterparty during the vesting period, with a corresponding increase in equity
>
> **Paragraph 15 (b) (Extract)**
>
> if an employee is granted share options conditional upon the achievement of a performance condition and remaining in the entity's employ until that performance condition is satisfied, **and the length of the vesting period varies depending on when that performance condition is satisfied**, the entity shall presume that the services to be rendered by the employee as consideration for the share options will be received in the future, over the expected vesting period. The entity shall estimate the length of the expected vesting period at grant date, based on the most likely outcome of the performance condition.

63. We observe that paragraphs 15 and 15(b) of IFRS 2 refer to the "vesting period" of a share-based payment arrangement, which is the period during which the specified vesting conditions are to be satisfied. In accordance with paragraph 15 there is a presumption that the services to be rendered by the counterparty as consideration for those equity instruments will be received in the future, during the vesting period.

64. In a performance condition the "vesting period" is subject to the period in which the counterparty completes a specified period of service and a specified performance target. As we have discussed above, the length of the performance target is subject to the length of the period of service.

65. If the vesting period is a function of the specified period of service, and in accordance with paragraph 15(b) this period can be variable, then we think that there is no doubt that the specified period of service is also variable and not fixed as we think the respondent interpreted.

66. Based on the above we do not think that the Interpretations Committee should recommend to the IASB that it should further clarify the meaning of "specified period of service".

Issue 7: IFRS 2 should define a "non-vesting condition"

67. A few respondents mentioned that clarity could be improved further in IFRS 2 by defining a 'non-vesting condition'. In this respect, one respondent notes (emphasis added):

> **BDO**
>
> The proposed paragraph BC5 notes **that a 'share market index target is a non-vesting condition because it is not related to the performance of the entity, even if the entity's shares form part of that index'. T**his is not clear from the proposed revised definitions. **We find it strange that there is not a specific definition of a non-vesting condition.** Although BC171A notes that 'The feature that distinguishes a performance condition from a non- vesting condition is that the former has an explicit or implicit service requirement and the latter does not', **we do not believe that it is appropriate to include a 'quasi definition' in the Basis for Conclusions.** We therefore suggest that the definition of a vesting condition is modified (taking into account our suggested amendments above), and a definition of a non- vesting condition is added.

Staff analysis

68. We note that there is no formal definition of a non-vesting condition in IFRS 2, but implementation guidance on the split between vesting and non-vesting conditions is provided in a flowchart in paragraph IG24 of IFRS 2 ("Summary of conditions that determine whether a counterparty receives an equity instrument granted"). According to the guidance in this flowchart, the conditions that determine whether a counterparty receives an equity instrument granted as part of a share-based payment transaction may be categorised into vesting conditions and non-vesting conditions. Examples of non-vesting conditions according to this paragraph are:

    (a) a target based on a commodity index;

    (b) paying contributions towards the exercise price of a share-based payment; and

    (c) continuation of the plan by the entity.

69. We also observe that the definition of a non-vesting condition could be inferred from paragraphs BC170–BC184 of IFRS 2, which clarify the definition of vesting conditions. More specifically, we reproduce some extracts from paragraphs BC171A and BC171B below (emphasis added):

> **BC171A**
>
> (…) **The feature that distinguishes a performance condition from a non-vesting condition is that the former has an explicit or implicit service requirement and the latter does not**.
>
> **BC171B**
>
> (…) Therefore, **conditions such as non-compete provisions and transfer restrictions**, which apply after the counterparty has become entitled to the share-based payment, are not vesting conditions. The Board revised the definition of 'vest' accordingly.

70. In our opinion there are two possible remedies to address the respondents' concerns:

(a) do not create a stand-alone definition of a 'non-vesting condition'. Consequently, if a condition is not a vesting condition it must be, by default, a non-vesting condition.

(b) create a stand-alone definition of a 'non-vesting condition'. This approach would clarify the concept that a non-vesting condition is a condition that does not determine whether a counterparty becomes entitled to a share-based payment award.

71. In our view, the creation of a stand-alone definition of a non-vesting condition would not be the best alternative for providing clarity on this issue. This is because we think that the concept of a non-vesting condition can be inferred from the guidance in IFRS 2 and can be assumed to be any condition that does not determine "whether the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity, under a share-based payment arrangement". In other words, a non-vesting condition is one that is not a vesting condition.

72. On the basis of our analysis above, we think that the Interpretations Committee should not recommend to the IASB that it should add a definition of non-vesting condition.

Issue 8: **indicate that a 'performance condition' might include a 'market condition'**

73. One of the respondents notes that the final sentence of the definition of a *vesting condition* which states that "a performance condition might include a market condition" is contradictory. This is because the respondent observes that a market condition:

(a) is a target that is related to the market price of the entity s equity instruments; and

(b) includes no explicit requirement for the counterparty to complete a specified period of service.

74. A couple of respondents think that the last sentence under the definition of vesting condition (ie a ‘performance condition’ might include a ‘market condition’) should be moved to the definition of ‘performance condition’ to improve clarity.

75. The comments from one of the respondents are reproduced below:

> **The Hundred Group**
>
> A performance condition includes a target that relates to the performance of the entity in whole or in part while **a market condition is a target that is related to the market price of the entity’s equity instruments. Moreover, the definition of a market condition includes no explicit requirement for the counterparty to complete a specified period of service.** We recommend that the Board address these inconsistencies.

Staff analysis

76. We disagree with the respondent’s view because we think that the guidance in IFRS 2 is internally consistent.

77. The definition of performance condition requires the counterparty to:

(a) meet a specified performance target (which could be related or not related to the market price of an entity’s equity instruments) ; and

(b) complete a specified period of service.

78. We observe that in accordance with Appendix A of IFRS 2, a market condition, is a condition is related to the share price of the entity’s equity instruments. The definition of performance condition implies that if a performance condition is subject to a performance target that is related to the market price of an entity’s equity instruments **and** to the completion of a specified period of service, then the market condition becomes a subcomponent of a performance condition.

79. We agree with the view of those respondents who think that to avoid confusion, the definition of a ‘performance condition’ should clearly state that performance conditions include market conditions.

Proposed remedy

80. We think that the Interpretations Committee should suggest to the IASB that it should:

(a) delete the last sentence under the definition of vesting condition (ie a 'performance condition' might include a 'market condition')

(b) indicate within the definition of 'performance condition' that performance conditions are either market conditions or non-market conditions.

81. We consequently propose the following addition to the definition of a performance condition:

> **Performance condition**
>
> A vesting condition that requires:
>
> (a) the counterparty to complete a specified period of service; and
>
> (b) specified performance targets to be met while the counterparty is rendering the service required in (a).
>
> A performance target is defined by reference to the entity's own operations (or activities) or the price (or value) of its equity instruments (including shares and share options).
>
> A performance target might relate either to the performance of the entity as a whole or to some part of the entity, such as a division or an individual employee.
>
> <u>A performance condition can be a market condition or a non-market performance condition. In a market condition that is a performance condition, the performance target relates to the market price of the equity instruments of an entity. In a non-market performance condition, the performance target is not related to the market price of the equity instruments of an entity.</u>

Issue 9: the reason for the employee's failure to complete a required period service is relevant

82. Three respondents question the IASB's clarification in paragraph BC7 that if the employee fails to complete a service period, the employee fails to satisfy a 'service condition', regardless of what the reason for that failure is.

83. For example, one of the respondents[5] thinks that in a situation in which an individual is made redundant during the vesting period as a good leaver or dies in service, benefiting in either case from accelerated vesting of unvested share-based payment awards, accounting for a service condition as a forfeiture would be an inappropriate way to account for the share-based payment.

84. Another respondent[6] observes that "where an employee is unable to perform the service condition by completing the stipulated service period e.g. through ill health, or is otherwise treated as a 'good leaver', it would normally be expected that a part of the award would be capable of vesting e.g. pro rata to the actual proportion of the originally specified service period". This respondent thinks that to the extent that a portion of the award remains capable of vesting, that proportion should be recognised as an expense.

85. Another respondent[7] points out that in cases in which the vesting of share-based payment awards is frequently accelerated on termination of an employee's employment with the result that the employee is entitled to retain any previously unvested awards, the related compensation expense should not be reversed.

Staff analysis

86. We agree with the respondents' comments. We observe that the circumstances that the proposed amendments was referring to were the ones in which the share-based payment did not vest, whereas the comments received all relate to circumstances in which the share-based payments either partly or fully vest on

[5] The Hundred Group.

[6] Association of British Insurers

[7] AFME

cessation of employment. These are two different circumstances and the accounting for these different circumstances, accordingly, should be different.

87. In circumstances where the share-based payment does not vest, we observe that paragraph 19 of IFRS 2 states that the employee's failure to complete a specified service period is a failure to meet the 'service condition'. In accordance with this paragraph (emphasis added):

> 19 (...) on a cumulative basis, **no amount is recognised for goods or services received if the equity instruments granted do not vest because of failure to satisfy a vesting condition, eg the counterparty fails to complete a specified service period, or a performance condition is not satisfied**, subject to the requirements of paragraph 21.

88. In addition, paragraph BC268R of IFRS 2 states that

> **in applying the principles in paragraph 19, the IFRIC concluded that when the employee fails to satisfy a vesting condition** other than a market condition, **the services from that employee recognised in the financial statements of each group entity during the vesting period should be reversed**.

89. In circumstances where the share-based payment vests, (either partially or fully) on the termination of the employee's employment, we observe that consistent with paragraph 23 of IFRS 2, the entity should not subsequently reverse the compensation expense even if previously granted awards (that have vested) are forfeited by the employee on termination of their employment or in the case of share options, the options are not exercised. We reproduce paragraph 23 below (emphasis added):

> 23 Having recognised the goods or services received in accordance with paragraphs 10–22, and a corresponding increase in equity, **the entity shall make no subsequent adjustment to total equity after vesting date. For example, the entity shall not subsequently reverse the**

> **amount recognised for services received from an employee if the vested equity instruments are later forfeited or, in the case of share options, the options are not exercised.** However, this requirement does not preclude the entity from recognising a transfer within equity, ie a transfer from one component of equity to another.

Proposed remedy

90. On the basis of the guidance above, we think that the Interpretations Committee could suggest to the IASB that it should modify the Basis for Conclusions to clarify that:

 (a) the objective of the proposed amendment to the definition of 'service condition' is to clarify that the termination of an employee's employment is a situation where the employee fails to complete a specified service period, and consequently, is considered a situation where the service condition is not met.

 (b) in circumstances where the equity instruments do not vest, paragraph 19 of IFRS 2 states that "on a cumulative basis no amount is recognised for goods or services received if the equity instruments granted do not vest because of a failure to satisfy a vesting condition".

 (c) in circumstances where the equity instruments either partly or fully vest on cessation of employment, paragraph 23 of IFRS 2 states that "the entity shall make no subsequent adjustment to total equity after vesting date".

Other minor comments

91. One respondent suggests a minor change to the definition of 'performance condition' in regard to the use of the term 'counterparty'. This respondent states:

> **<u>Securities and Exchange Board of India</u>**

> **The definition of 'Performance condition' uses the term 'counterparty'. However, paragraphs 15-19 of the Standard as well as the Basis for Conclusions, viz., BC3 and other paragraphs indicate that the performance conditions are applicable only in case of employees.** Further, the requirement (b) in the definition, whereby rendering of the service is essential, also indicates that the performance condition is meant to be used only in case of the share-based payments to employees. **If this is the intention then, instead of using the term 'counterparty', the term 'employee' may be used.** Otherwise, it creates an impression that there can be performance conditions for share-based payments to parties other than employees.

92. We disagree with the respondent's comment. We think that the use of the term 'counterparty' in the definition of 'performance condition' is correct and is used widely throughout IFRS 2.

93. Another respondent identified a minor inconsistency between the definitions of a 'performance condition' and a 'market condition', as follows (emphasis added):

> **KPMG IFRG Limited**
>
> **The definition of a market condition**, which would remain unchanged after the proposed amendments, **refers to 'the market price of the entity's equity instruments'**. However, the proposed definition of a **performance condition refers to 'the price (or value) of its equity instruments'**. We suggest that the Board address this inconsistency.

94. We agree that to be consistent with the definition of 'performance condition', the definition of 'market condition' could refer to (emphasis added): 'the market price <u>(or value)</u> of the entity's equity instruments'.

95. Anone respondent observes that in the definition of 'performance condition' the "specified performance targets" are a separate performance condition and the

paragraph should be amended to refer to a "specific performance target to be met".

96. We disagree with the change proposed by this respondent, because we think that while performance targets might be specific, they are also specified (decided upon) by management.

Other changes to IFRS 2 suggested by respondents that are not the subject of the proposed amendments

97. In the following paragraphs we summarise some of the comments received from a small number of respondents who proposed additional changes to IFRS 2. These comments are not addressed in this agenda paper because they were not part of the proposed amendments to IFRS 2.

(a) One respondent[8] thinks that the IASB could clarify what it intends with respect to awards based on total shareholder return (TSR). TSR is a function of both the market share price and of dividends paid, and so is not wholly based on the market price. We note that this issue could be referred to the IASB for consideration in a future agenda proposal for IFRS 2.

(b) One respondent[9] consider that there is inadequate guidance within IFRS 2 with regard to deciding the vesting period where there are multiple vesting conditions that can act independently of one another. In this respect we note that IFRS 2 does not provide guidance on how to assess the interaction of multiple vesting conditions. This issue was derived from the primary issues on which the original submissions requested clarifications to IFRS 2. For the sake of efficiency, the Interpretations Committee decided during its deliberations to focus its analysis on the primary issues rather than on the derived issues.

[8] BP

[9] The Hundred Group

(c) One respondent[10] notes that there is diversity in practice in the classification of share-based payments where the award is dependent on an entity listing on a public market, or where there is a change of control, with some taking the view that these are performance conditions and others that they are non-vesting conditions. We note that this issue could be referred to the IASB for consideration in a future agenda proposal for IFRS 2.

Analysis of Question 2

98. With respect to Question 2, respondents that agreed with the amendment also **agree** with the transition requirements and with the effective date of the proposed amendment to IFRS 2. This proposed amendment will be applied in annual periods beginning on or after 1 January 2014 with earlier application permitted

Staff recommendation

99. On the basis of the analysis in the previous section, we think that the Interpretations Committee should recommend to the IASB that it should proceed with the proposed amendments to the definitions of a 'vesting condition', a 'performance condition', and a 'service condition', but add some further amendments and edits that would make the proposed amendments clearer.

100. Our recommended changes are included as appendices:

(a) **Appendix A** shows the amendment, including our recommendations in this paper, highlighting differences from the currently effective Standard; and

(b) **Appendix B** shows revisions to the wording in the previously published Exposure Draft, following our recommendations in this paper (new text is <u>underlined</u> and deleted text is ~~struck through~~).

[10] BDO

Questions to the IFRS Interpretations Committee
1. Does the Interpretations Committee agree to recommend to the IASB that it should proceed with the amendments to IFRS 2 and add some further amendments and edits that would make the proposed amendments clearer? 2. Does the Interpretations Committee agree with the proposed amendments to the Basis for Conclusions, which are based on our discussion above?

Appendix A—Changes for finalising the amendment

A1. The ~~proposed~~ amendment to the definition of vesting conditions is presented below.

The IASB amended IFRS 2 by adding paragraph 63B and amending paragraphs 15 and 19 and Appendix A *Defined terms*, which is an integral part of the Standard. In Appendix A, the definition of 'vesting conditions' and 'market condition' are amended and the definitions of 'performance condition', 'service condition' are added.

The amendment is marked up in the text of IFRS 2 (new text is underlined and deleted text is struck through).

The following Basis for Conclusions accompanies, but is not part of, the amendment. It sets out the reasons why the IASB decided to amend IFRS 2. This basis is included in the Basis for Conclusions on IFRS 2 *Share-based Payment*, which is not part of the Standard.

Equity-settled share-based payment transactions

Transactions in which services are received

15 If the equity instruments granted do not vest until the counterparty completes a specified period of service, the entity shall presume that the services to be rendered by the counterparty as consideration for those equity instruments will be received in the future, during the *vesting period*. The entity shall account for those services as they are rendered by the counterparty during the vesting period, with a corresponding increase in equity. For example:

(a) if an employee is granted share options conditional upon completing three years' service (ie a *service condition*), then the entity shall presume that the services to be rendered by the employee as consideration for the share options will be received in the future, over that three-year vesting period.

(b) if an employee is granted share options conditional upon the achievement of a ~~performance condition~~ *performance condition* and remaining in the entity's employ until that performance condition is satisfied, and the length of the vesting period varies depending on when that performance condition is satisfied, the entity shall presume that the services to be rendered by the employee as consideration for the share options will be received in the future, over the expected vesting period. …

Transactions measured by reference to the fair value of the equity instruments granted

Treatment of vesting conditions

19 A grant of equity instruments might be conditional upon satisfying a specified *vesting condition* or specified ~~*vesting conditions*~~ vesting conditions. …

Effective date

63B *Annual Improvements to IFRSs 2010–2012 Cycle* issued in [date] amended paragraphs 15 and 19 and the definition of *vesting conditions* <u>and *market condition* are amended</u> and added definitions for *performance condition*, and *service condition* to Appendix A *Defined terms*. An entity shall apply that amendment for annual periods beginning on or after 1 January 2014. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

Appendix A

Defined terms

market condition

A condition upon which the exercise price, vesting or exercisability of an **equity instrument** depends that is related to the market price (or value) of the entity's **equity instruments** (or the equity instruments of another entity in the same group), such as:

(a) attaining a specified share price or a specified amount of **intrinsic value** of a **share option**, or

(b) achieving a specified target that is based on the market price (or value) of the entity's **equity instruments** (or the equity instruments of another entity in the same group), relative to an index of market prices of **equity instruments** of other entities.

performance condition

A **vesting condition** that requires:

(a) the counterparty to complete a specified period of service (ie a 'service condition'); and

(b) specified performance targets to be met while the counterparty is rendering the service required in (a).

The duration of a performance target should be wholly within the period of the related service requirement for it to constitute a performance condition (ie an employee must be rendering service for the duration of the period that the performance target is being measured). The related service requirement can be implicit or explicit.

A performance target is defined by reference to:

(a) the entity's own operations (or activities) or the operations or activities of another entity in the same group or

(b) the price (or value) of the entity's **equity instruments** or the equity instruments of another entity in the same group (including shares and **share options**).

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

A performance condition can be a **market condition** or a non-market performance condition. In a market condition that is a performance condition, the performance target relates to the market price of the equity instruments of an entity. In a non-market performance condition, the performance target is not related to the market price of the equity instruments of an entity.

service condition A **vesting condition** that requires the counterparty to complete a specified period of service. If the counterparty, regardless of the reason, ceases to provide service during the **vesting period**, the counterparty has failed to satisfy the condition. A 'service condition' does not require a performance target to be met.

vesting conditions ~~The~~ A condition~~s~~ that determines whether the entity receives the services that entitle the counterparty to receive cash, other assets or **equity instruments** of the entity, under a **share-based payment arrangement**. A ~~V~~vesting condition~~s~~ ~~are~~ is either ~~service conditions~~ a **service condition** or ~~performance conditions~~ a **performance condition**. ~~Service conditions require the counterparty to complete a specified period of service. Performance conditions require the counterparty to complete a specified period of service and specified performance targets to be met (such as a specified increase in the entity's profit over a specified period of time). A performance condition **performance condition** might include a **market condition**.~~

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

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

Definition of vesting condition[11] (2012 amendments)

BC334 The IASB identified the need to clarify the definition of 'vesting conditions' in IFRS 2 to ensure the consistent classification of conditions attached to a share-based payment. Previously, this IFRS did not separately define a 'performance condition' or a 'service condition', but instead describes both concepts within the definition of 'vesting conditions'.

BC335 The IASB decided to separate the definitions of a 'performance condition' and a 'service condition' from the definition of a 'vesting condition' and thus make the description of each condition clearer.

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

(a) whether a performance target can be set by reference to the price (or value) of another entity included within the group;

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

(c) whether the specified period of service that the counterparty is required to complete can be either implicit or explicit;

(d) whether a performance target needs or not to be influenced by an employee;

(e) whether a share market index target may constitute a performance condition or a non-vesting condition;

(f) whether the definition of 'performance condition' should indicate that it includes a 'market condition';

(g) whether a definition of 'non-vesting condition' is needed; and

(h) whether the employee's failure to complete a required service period is considered to be a failure to satisfy a service condition.

[11] Paragraphs BC333 –BC367 are added as a consequence of Annual Improvements to IFRSs 2010–2012 Cycle.

(a) Whether a performance target can be set by reference to another entity (or entities) within the group

BC337 The IASB decided to clarify that within the context of a share-based payment transaction among entities in the same group, a performance target can be defined by reference to the price (or value) of the equity instruments of another entity in the group or by the operations (or activities) of another entity in the group or of the group as a whole. This amendment is consistent with the guidance in paragraphs 3A and 43A-43D of IFRS 2. Paragraph 3A, which provides guidance about the scope of IFRS 2, states that "a share-based payment transaction may be settled by another group entity (or a shareholder of any group entity) on behalf of the entity receiving or acquiring the goods or services".

BC338 The IASB decided to make a similar amendment to the definition of 'market condition' to indicate that a market condition can be based on the market price of the entity's (or another entity in the group's) equity instruments.

(b) Whether a performance target that refers to a longer period than the required service period may constitute a performance condition

BC339 The IASB observed that the IFRS 2 did not explicitly require a performance target to coincide with a service requirement for it to constitute a performance condition. Consequently, it does not explicitly require the duration of a performance target to be wholly within the period of the related service requirement for it to constitute a performance condition. For example, some believe that a performance target should be taken to constitute a performance condition even if the achievement of the performance target is assessed over a period that exceeds the period for which the employee is required to provide service.

BC340 The IASB decided to clarify that the duration of the performance condition needs to be 'wholly within the period' of the related service requirement. This means that the period of the performance target cannot start before the start of the service period and cannot end after the service period. Consequently, the duration of the performance target needs to be within the period of the related service requirement. The IASB observed that, otherwise, the generic definition of 'vesting conditions' may be compromised where service is not received during a portion of the performance target period.

BC341 The IASB also decided to add the words "ie a 'service condition'" after criterion (a) of the proposed definition of 'performance condition' in order to create a cross reference to the definition of a 'service condition'.

(c) whether the specified period of service that the counterparty is required to complete can be either implicit or explicit

BC342 The IASB decided to highlight in the definition of 'performance condition' a feature that distinguishes a performance condition from a non-vesting condition in accordance with paragraph BC171A of IFRS 2, namely, that a performance condition has an explicit or implicit service requirement and a non-vesting condition does not. This is so that, in order to constitute a performance condition, a performance target needs to be accompanied by a service requirement that can be implicit or explicit. The IASB observed that if the share-based payment arrangement does not contain an explicit requirement to provide services, the arrangement may still contain an 'implicit' service condition.

(d) whether a performance target needs to be influenced by an employee

BC343 During its deliberations the IASB observed that for a target to constitute a performance condition, the target needs to be "within the influence" of the employee and also in the interest of the entity. Consequently, the IASB proposed that the definition of a 'performance condition' should make clear that a performance target is defined by reference to the entity's own operations (or activities) or the price (or value) of its equity instruments (including shares and share options).

BC344 In response to the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle (Proposed amendments to International Financial Reporting Standards)* some respondents pointed out that that it was unclear why the performance target needed to be within the influence of the employee and found it to be contradictory to the proposed definition of 'performance condition', where the performance target is defined by reference to the performance of the entity, this is, by reference to the entity's own operations (or activities) or the price (or value) of its equity instruments. Some other respondents also raised some difficulties expected in applying the proposed guidance. In this respect these respondents pointed out that determining whether a performance target is within the influence of the employee would be difficult to apply in the case of a group of entities; for example, the profit or share price of a group of companies could be seen to be 'remote from the influence of' an employee of a particular subsidiary of the group.

BC345 The IASB observed that requiring a performance target to be within the influence of the employee could be misinterpreted as meaning that the IASB's intention was to challenge management to explain how the performance of the employee affects the performance target. The IASB confirmed that it was not the IASB's intention to ask an entity to demonstrate how an employee's performance affects a performance target. The IASB observed that the link between the employee's service/performance against a given performance target is management's sole responsibility. The IASB noted that each employee has, in varying degrees, an influence over an entity's (or group's) overall performance, that is, over an entity's (or group's) own operations (or activities) or the price (or value) of its equity instruments. Consequently, the IASB decided to omit the requirement that the target "needs to be within the influence of the employee" to avoid further confusion.

BC346 In its review of the definition of a 'performance condition' the IASB also considered what, if any, level of correlation is required between an employee's responsibility and the performance target. Potential diversity in practice had emerged, because some were of the view that if share-based payment awards are granted to employees conditional on the entity-wide profit, it is not clear that the profit target constitutes a 'performance condition' on the basis that the employee might have so little influence on the entity-wide profit that it is not clear that the target is able to sufficiently incentivise an individual employee's actions. Others held the view that because the entity is in business in order to make a profit, it is reasonable to assume that all employees contribute directly or indirectly to the entity-wide profit, ie that the whole body of employees contribute towards entity-wide profit.

BC347 In the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle (Proposed amendments to International Financial Reporting Standards)* the IASB observed that it is reasonable to assume that the performance target set by management for an employee's share-based payment appropriately incentivises the employee to provide an increased quality and/or quantity of service to benefit the entity. Consequently, the IASB decided that the definition of a 'performance condition' should make clear that a performance target may relate either to the performance of the entity as a whole or to some part of the entity, such as a division or an individual employee.

BC348 Respondents to the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle (Proposed amendments to International Financial Reporting Standards)* questioned whether it was the IASB's intention to require an entity to demonstrate, or provide evidence of, the correlation between an employee's responsibility and the performance target in order for that target to be a 'performance condition'. During its deliberations the IASB confirmed that it was not the IASB's intention to require an entity to prove this correlation.

(e) Whether a share market index target may constitute a performance condition or a non-vesting condition

BC349 The IASB analysed the case in which a share-based payment is conditional on a share market index target and decided whether it would be considered a performance condition or a non-vesting condition. For example, a grant might be conditional on a stock exchange index reaching a specified target and the employee remaining in service up to the date the target is met.

BC350 The IASB observed that some might argue that the share market index target with the implicit service requirement constitutes a 'performance condition' because an employee is required to provide service to the entity and the time estimated to affect the share market index target implicitly determines how long the entity receives the required service. Others might argue that the share market index target is a non-vesting condition because it is not related to the performance of the entity (ie instead it is related to or based on the entity's share price and the share price of other unrelated entities).

BC351 In the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle (Proposed amendments to International Financial Reporting Standards)* the IASB observed that the share market index target would be considered a non-vesting condition because it is not related to the performance of the entity or of another entity in the same group, even if the shares of the entity or of another entity in the same group form part of that index. The IASB also observed that a share market index target may be predominantly affected by many external variables or factors involved in its determination, including macroeconomic factors such as the risk-free interest rate or foreign exchange rates, and consequently, it is remote from the influence of the employee.

BC352 Respondents to the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle (Proposed amendments to International Financial Reporting Standards)* agreed that it would be reasonable to assume that the share market index target is a non-vesting condition but some respondents thought that it should not be based on the level of influence exercised by an employee over the performance target or on whether the target is affected by external variables or factors. This is because in their view the level of influence and the effect of external variables are subjective reasons that are difficult to measure.

BC353 The IASB decided to reaffirm its position that a share market index is a non-vesting condition, but on the basis of the comments received, the IASB decided to clarify that the reason why it is a non-vesting condition is because a share market index does not reflect solely the performance of an entity and reflects, instead, also the performance of other entities outside the group.

BC354 The IASB also considered a similar case in which the entity's share price makes up a substantial part of the share market index. The IASB determined that even if the entity makes up a substantial part of the share market index it would still be considered a non-vesting condition because it reflects the performance of other entities outside the group.

(f) whether the definition of 'performance condition' should indicate that it includes a 'market condition'

BC355 A respondent to the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle (Proposed amendments to International Financial Reporting Standards)* noted that the final sentence of the definition of a 'vesting condition' which states that "a performance condition might include a market condition" is contradictory. This is because the respondent observes that a market condition:

(a) is a target that is related to the market price of the entity s equity instruments; and

(b) includes no explicit requirement for the counterparty to complete a specified period of service.

BC356 The IASB observed that, on the basis of the definition of performance condition, a performance target that is related to the market price of an entity's equity instruments and to the completion of a specified period of service, is considered a market (performance) condition. Consequently, the IASB disagreed that an inconsistency existed in the definitions of a performance condition and a market condition.

BC357 To avoid confusion in the definitions of a 'performance condition' and a 'market condition', the IASB decided to:

(a) delete the last sentence under the definition of 'vesting condition' (ie a 'performance condition' might include a 'market condition'); and

(b) indicate within the definition of 'performance condition' that performance conditions are either market conditions or non-market conditions.

(g) whether a definition of 'non-vesting condition' is needed

BC358 Respondents to the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle (Proposed amendments to International Financial Reporting Standards)* thought that clarity could be improved further in IFRS 2 by defining a 'non-vesting condition'.

BC359 The IASB noted that there is no formal definition of a non-vesting condition in IFRS 2, but implementation guidance on the split between vesting and non-vesting conditions is provided in a flowchart in paragraph IG24 of IFRS 2 ("Summary of conditions that determine whether a counterparty receives an equity instrument granted"). The IASB also observed that the definition of non-vesting conditions could also be inferred.

BC360 The IASB determined that the creation of a stand-alone definition of a non-vesting condition would not be the best alternative for providing clarity on this issue. This is because the IASB observed that the concept of a non-vesting condition can be inferred from paragraphs BC170-BC184 of IFRS 2, which clarify the definition of vesting conditions. In accordance with this guidance it can be inferred that a non-vesting condition is any condition that does not determine "whether the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity, under a share-based payment arrangement". In other words, a non-vesting condition is one that is not a vesting condition. On the basis of its analysis the IASB decided it should not add a definition of non-vesting condition.

(h) Whether the employee's failure to complete a required service period is considered to be a failure to satisfy a service condition

BC361 In considering a possible revision of the definition of 'service condition', the IASB observed that in IFRS 2 there is no specific guidance on how to account for a share-based payment award resulting from the entity's termination of an employee's employment.

BC362 The IASB noted, however, that paragraph 19 of this IFRS regards the employee's failure to complete a specified service period as a failure to satisfy a service condition. In the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle (Proposed amendments to International Financial Reporting Standards)* the IASB proposed to make clear within the definition of a 'service condition' that if the employee fails to complete a specified service period, the employee fails to satisfy a service condition, regardless of what the reason for that failure is. The IASB also noted that the accounting consequence is that the compensation expense would therefore need to be reversed if an employee fails to complete a specified service period.

BC363 Some respondents to the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle (Proposed amendments to International Financial Reporting Standards)* thought that more clarity could be provided in the proposed guidance. This is because they noted that in some circumstances where an employee is unable to perform the service condition by completing the stipulated service period (such as when the employee is ill or dies in service) it would normally be expected that part of the award would be capable of vesting and that the related compensation expense should not be reversed. They noted that to the extent that a portion of the award remains capable of vesting, that portion should be recognised as an expense.

BC364 In response to the comments received, the IASB noted that the objective of the proposed amendment to the definition of 'service condition' is to clarify that the termination of an employee's employment is a situation where the employee fails to complete a specified service period, and consequently, is considered a situation where the service condition is not met.

BC365 The IASB observed that in circumstances where equity instruments do not vest because of failure to satisfy a vesting condition, paragraph 19 of IFRS 2 states that "on a cumulative basis no amount is recognised for goods or services received if the equity instruments granted do not vest because of a failure to satisfy a vesting condition".

BC366 The IASB observed that in circumstances where the equity instruments either partly or fully vest on cessation of employment, paragraph 23 of IFRS 2 states that "the entity shall make no subsequent adjustment to total equity after vesting date".

BC367 Noting the guidance already provided in paragraphs 19 and 23 of the standard, the IASB concluded that further guidance was not necessary.

Appendix B—Changes from the Exposure Draft published in May 2012 following our recommendations in this paper[12]

B1 The ~~proposed~~ amendment to the definition of vesting conditions is presented below.

The IASB ~~proposes to~~ amend<u>ed</u> IFRS 2 by adding paragraph 63B and amending paragraphs 15 and 19 and Appendix A Defined terms, which is an integral part of the IFRS. In Appendix A, the definition of 'vesting conditions' <u>and 'market condition' are</u> ~~is~~ amended and the definitions of 'performance condition', and 'service condition' are added.

The ~~proposed~~ amendment is marked up in the text of IFRS 2 (new text is underlined and deleted text is struck through). ~~The definition of 'market condition' is not proposed for amendment but is included here for ease of reference.~~

The following Basis for Conclusions accompanies, but is not part of, the ~~proposed~~ amendment. It sets out the reasons why the IASB ~~proposes the amendment~~ <u>decided to amend IFRS 2</u>. ~~If the amendment is approved, this~~ <u>This</u> basis ~~will be~~ <u>is</u> included in the Basis for Conclusions on IFRS 2 *Share-based Payment*, which is not part of the IFRS.

Equity-settled share-based payment transactions

Transactions in which services are received

15 If the equity instruments granted do not vest until the counterparty completes a specified period of service, the entity shall presume that the services to be rendered by the counterparty as consideration for those equity instruments will be received in the future, during the *vesting period*. The entity shall account for those services as they are rendered by the counterparty during the vesting period, with a corresponding increase in equity. For example:

(a) if an employee is granted share options conditional upon completing three years' service (ie a *service condition*), then the entity shall presume that the services to be rendered by the employee as consideration for the share options will be received in the future, over that three-year vesting period.

(b) if an employee is granted share options conditional upon the achievement of a *performance condition* and remaining in the entity's employ until that performance condition is satisfied, and the length of the vesting period varies depending on when that performance condition is satisfied, the entity shall presume that the services to be rendered by the employee as consideration for the share options will be received in the future, over the expected vesting period. …

[12] This section tracks the proposed changes made to the Standard and to the proposed basis for conclusions included in the ED.

Transactions measured by reference to the fair value of the equity instruments granted

Treatment of vesting conditions

19 A grant of equity instruments might be conditional upon satisfying a specified *vesting condition* or specified vesting conditions. …

Effective date

63B *Annual Improvements to IFRSs 2010–2012 Cycle* issued in [date] amended paragraphs 15 and 19 and the definition of *vesting conditions* <u>and *market condition* are amended</u> and added definitions for *performance condition*, and *service condition* to Appendix A *Defined terms*. An entity shall apply that amendment for annual periods beginning on or after 1 January 2014. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

Appendix A (of IFRS 2)

Defined terms

…

market condition

A condition upon which the exercise price, vesting or exercisability of an **equity instrument** depends that is related to the market price (or value) of the entity's **equity instruments** (or the equity instruments of another entity in the same group) such as:

(a) attaining a specified share price or a specified amount of **intrinsic value** of a **share option**, or

(b) achieving a specified target that is based on the market price (or value) of the entity's **equity instruments** (or the equity instruments of another entity in the same group), relative to an index of market prices of **equity instruments** of other entities.

performance condition

A **vesting condition** that requires:

(a) the counterparty to complete a specified period of service (ie a 'service condition'); and

(b) specified performance targets to be met while the counterparty is rendering the service required in (a).

The duration of a performance target should be wholly within the period of the related service requirement for it to constitute a performance condition (ie an employee must be rendering service for the duration of the period that the performance target is being measured). The related service requirement can be implicit or explicit.

A performance target is defined by reference to:

(a) the entity's own operations (or activities) or the operations or activities of another entity in the same group or

(b) the price (or value) of ~~it's~~ the entity's **equity instruments** or the equity instruments of another entity in the same group (including shares and share options).

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

A performance condition can be a **market condition** or a non-market performance condition. In a market condition that is a performance condition, the performance target relates to the market price of the equity instruments of an entity. In a non-market performance condition, the performance target is not related to the market price of the equity instruments of an entity

service condition

A **vesting condition** that requires the counterparty to complete a specified period of service. If the counterparty, regardless of the reason, ceases to provide service during the **vesting period**, the counterparty has failed to satisfy the condition. A 'service condition' does not require a performance target to be met.

vesting conditions

~~The~~ A condition~~s~~ that determines whether the entity receives the services that entitle the counterparty to receive cash, other assets or **equity instruments** of the entity, under a **share-based payment arrangement**. A ~~V~~vesting condition~~s~~ ~~are~~ is either ~~service conditions~~ a **service condition** or ~~performance conditions~~ a **performance condition**. ~~Service conditions require the counterparty to complete a specified period of service. Performance conditions require the counterparty to complete a specified period of service and specified performance targets to be met (such as a specified increase in the entity's profit over a specified period of time). A performance condition **performance condition** might include a **market condition**.~~

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

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

Definition of vesting condition[13] (2012 amendments)

BC~~1~~334 The IASB identified the need to clarify the definition of 'vesting conditions' in IFRS 2 to ensure the consistent classification of conditions attached to a share-based payment. Previously, this IFRS did not separately define a 'performance condition' or a 'service condition', but instead describes both concepts within the definition of 'vesting conditions'.

BC~~2~~335 The IASB decided to separate the definitions of a 'performance condition' and a 'service condition' from the definition of a 'vesting condition' and thus make the description of each condition clearer.

BC~~3~~336 ~~In its proposed revision, the Board:~~ In response to the comments received on the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle (Proposed amendments to International Financial Reporting Standards)* the IASB addresses the following concerns that have been raised about the~~se~~ definitions~~:~~ of a 'performance condition', 'service condition' and 'market condition':

~~(a) the correlation between an employee's responsibility and the performance target;~~

(a) whether a performance target can be set by reference to the price (or value) of another entity included within the group;

(b) ~~(c)~~ whether a performance target that refers to a longer period than the required service period may constitute a performance condition;

(c) whether the specified period of service that the counterparty is required to complete can be either implicit or explicit;

(d) whether a performance target needs or not to be influenced by an employee;

(e) ~~(b)~~ whether a share market index target may constitute a performance condition or a non-vesting condition;

(f) whether the definition of 'performance condition' should indicate that it includes a 'market condition';

(g) whether a definition of 'non-vesting condition' is needed; and

(h) ~~(d)~~ whether the employee's failure to complete a required service period is considered to be a failure to satisfy a service condition.

[13] Paragraphs BC333 –BC367 are added as a consequence of Annual Improvements to IFRSs 2010–2012 Cycle.

(a) Whether a performance target can be set by reference to another entity (or entities) within the group

BC337 The IASB decided to clarify that within the context of a share-based payment transaction among entities in the same group, a performance target can be defined by reference to the price (or value) of the equity instruments of another entity in the group or by the operations (or activities) of another entity in the group or of the group as a whole. This amendment is consistent with the guidance in paragraphs 3A and 43A-43D of IFRS 2. Paragraph 3A, which provides guidance about the scope of IFRS 2, states that "a share-based payment transaction may be settled by another group entity (or a shareholder of any group entity) on behalf of the entity receiving or acquiring the goods or services".

BC338 The IASB decided to make a similar amendment to the definition of 'market condition' to indicate that a market condition can be based on the market price of the entity's (or another entity in the group's) equity instruments.

(b) Whether a performance target that refers to a longer period than the required service period may constitute a performance condition

BC~~6~~339 The IASB observed that the IFRS 2 did not explicitly require a performance target to coincide with a service requirement for it to constitute a performance condition. ~~However, the Board noted that the definition of 'vesting conditions' makes clear that a vesting condition (including a performance condition) must "determine whether the entity receives the services that entitle the counterparty to receive" the share-based payment. In addition, paragraph BC171A elaborates on the definition of a 'vesting condition' by highlighting a feature that distinguishes a performance condition from a non-vesting condition: a performance condition has an explicit or implicit service requirement and a non-vesting condition does not. Consequently, the Board proposes to make clear the length of the performance period within the definition of 'performance condition'. This is so that, in order to constitute a performance condition, any performance target needs to have an explicit or implicit service requirement for at least the period during which the performance target is being measured.~~ Consequently, it does not explicitly require the duration of a performance target to be wholly within the period of the related service requirement for it to constitute a performance condition. For example, some believe that a performance target should be taken to constitute a performance condition even if the achievement of the performance target is assessed over a period that exceeds the period for which the employee is required to provide service.

BC340 The IASB decided to clarify that the duration of the performance condition needs to be 'wholly within the period' of the related service requirement. This means that the period of the performance target cannot start before the start of the service period and cannot end after the service period. Consequently, the duration of the performance target needs to be within the period of the related service requirement. The IASB observed that, otherwise, the generic definition of 'vesting conditions' may be compromised where service is not received during a portion of the performance target period.

BC341 The IASB also decided to add the words "ie a 'service condition'" after criterion (a) of the proposed definition of 'performance condition' in order to create a cross reference to the definition of a 'service condition'.

(c) whether the specified period of service that the counterparty is required to complete can be either implicit or explicit

BC342 The IASB decided to highlight in the definition of 'performance condition' a feature that distinguishes a performance condition from a non-vesting condition in accordance with paragraph BC171A of IFRS 2, namely, that a performance condition has an explicit or implicit service requirement and a non-vesting condition does not. This is so that, in order to constitute a performance condition, a performance target needs to be accompanied by a service requirement that can be implicit or explicit. The IASB observed that if the share-based payment arrangement does not contain an explicit requirement to provide services, the arrangement may still contain an 'implicit' service condition.

(d) whether a performance target needs to be influenced by an employee

BC343 During its deliberations the IASB observed that for a target to constitute a performance condition, the target needs to be "within the influence" of the employee and also in the interest of the entity. Consequently, the IASB proposed that the definition of a 'performance condition' should make clear that a performance target is defined by reference to the entity's own operations (or activities) or the price (or value) of its equity instruments (including shares and share options).

BC344 In response to the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle (Proposed amendments to International Financial Reporting Standards)* some respondents pointed out that that it was unclear why the performance target needed to be within the influence of the employee and found it to be contradictory to the proposed definition of 'performance condition', where the performance target is defined by reference to the performance of the entity, this is, by reference to the entity's own operations (or activities) or the price (or value) of its equity instruments. Some other respondents also raised some difficulties expected in applying the proposed guidance. In this respect these respondents pointed out that determining whether a performance target is within the influence of the employee would be difficult to apply in the case of a group of entities; for example, the profit or share price of a group of companies could be seen to be 'remote from the influence of' an employee of a particular subsidiary of the group.

BC345 The IASB observed that requiring a performance target to be within the influence of the employee could be misinterpreted as meaning that the IASB's intention was to challenge management to explain how the performance of the employee affects the performance target. The IASB confirmed that it was not the IASB's intention to ask an entity to demonstrate how an employee's performance affects a performance target. The IASB observed that the link between the employee's service/performance against a given performance target is management's sole responsibility. The IASB noted that each employee has, in varying degrees, an influence over an entity's (or group's) overall performance, that is, over an entity's (or group's) own operations (or activities) or the price (or value) of its equity instruments. Consequently, the IASB decided to omit the requirement that the target "needs to be within the influence of the employee" to avoid further confusion.

BC346 In its review of the definition of a 'performance condition' the IASB also considered what, if any, level of correlation is required between an employee's responsibility and the performance target. Potential diversity in practice had emerged, because some were of the view that if share-based payment awards are granted to employees conditional on the entity-wide profit, it is not clear that the profit target constitutes a 'performance condition' on the basis that the employee might have so little influence on the entity-wide profit that it is not clear that the target is able to sufficiently incentivise an individual employee's actions. Others held the view that because the entity is in business in order to make a profit, it is reasonable to assume that all employees contribute directly or indirectly to the entity-wide profit, ie that the whole body of employees contribute towards entity-wide profit.

~~Correlation between an employee's responsibility and the performance target~~

BC~~4~~347 In the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle (Proposed amendments to International Financial Reporting Standards)* ~~In its review of the definition of a 'performance condition',~~ the ~~Board~~ IASB observed that it is reasonable to assume that the performance target set by management for an employee's share-based payment appropriately incentivises the employee to provide an increased quality and/or quantity of service to benefit the entity. Consequently, the ~~Board~~ IASB ~~proposed~~ decided that the definition of a 'performance condition' should make clear that a performance target may relate either to the performance of the entity as a whole or to some part of the entity, such as a division or an individual employee.

BC348 Respondents to the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle (Proposed amendments to International Financial Reporting Standards)* questioned whether it was the IASB's intention to require an entity to demonstrate, or provide evidence of, the correlation between an employee's responsibility and the performance target in order for that target to be a 'performance condition'. During its deliberations the IASB confirmed that it was not the IASB's intention to require an entity to prove this correlation.

(e) Whether a share market index target may constitute a performance condition or a non-vesting condition

~~BC5 The Board noted that for a target to constitute a performance condition, the target needs to be 'within the influence of' the employee and also in the interest of the entity. The Board observed that a share market index target may be predominantly affected by many external variables or factors involved in its determination, including macroeconomic factors such as the risk-free interest rate or foreign exchange rates. It is therefore remote from the influence of the employee. Accordingly, the Board observed that the share market index target is a non-vesting condition because it is not related to the performance of the entity, even if the entity's shares form part of that index. Consequently, the Board proposes that the definition of a 'performance condition' should make clear that a performance target is defined by reference to the entity's own operations (or activities) or the price (or value) of its equity instruments (including shares and share options).~~

BC349 The IASB analysed the case in which a share-based payment is conditional on a share market index target and decided whether it would be considered a performance condition or a non-vesting condition. For example, a grant might be conditional on a stock exchange index reaching a specified target and the employee remaining in service up to the date the target is met.

BC350 The IASB observed that some might argue that the share market index target with the implicit service requirement constitutes a 'performance condition' because an employee is required to provide service to the entity and the time estimated to affect the share market index target implicitly determines how long the entity receives the required service. Others might argue that the share market index target is a non-vesting condition because it is not related to the performance of the entity (ie instead it is related to or based on the entity's share price and the share price of other unrelated entities).

BC351 In the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle (Proposed amendments to International Financial Reporting Standards)* the IASB observed that the share market index target would be considered a non-vesting condition because it is not related to the performance of the entity or of another entity in the same group, even if the shares of the entity or of another entity in the same group form part of that index. The IASB also observed that a share market index target may be predominantly affected by many external variables or factors involved in its determination, including macroeconomic factors such as the risk-free interest rate or foreign exchange rates, and consequently, it is remote from the influence of the employee.

BC352 Respondents to the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle (Proposed amendments to International Financial Reporting*

Standards) agreed that it would be reasonable to assume that the share market index target is a non-vesting condition but some respondents thought that it should not be based on the level of influence exercised by an employee over the performance target or on whether the target is affected by external variables or factors. This is because in their view the level of influence and the effect of external variables are subjective reasons that are difficult to measure.

BC353 The IASB decided to reaffirm its position that a share market index is a non-vesting condition, but on the basis of the comments received, the IASB decided to clarify that the reason why it is a non-vesting condition is because a share market index does not reflect solely the performance of an entity and reflects, instead, also the performance of other entities outside the group.

BC354 The IASB also considered a similar case in which the entity's share price makes up a substantial part of the share market index. The IASB determined that even if the entity makes up a substantial part of the share market index it would still be considered a non-vesting condition because it reflects the performance of other entities outside the group.

(f) whether the definition of 'performance condition' should indicate that it includes a 'market condition'

BC355 A respondent to the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle (Proposed amendments to International Financial Reporting Standards)* noted that the final sentence of the definition of a 'vesting condition' which states that "a performance condition might include a market condition" is contradictory. This is because the respondent observes that a market condition:

(a) is a target that is related to the market price of the entity s equity instruments; and

(b) includes no explicit requirement for the counterparty to complete a specified period of service.

BC356 The IASB observed that, on the basis of the definition of performance condition, a performance target that is related to the market price of an entity's equity instruments and to the completion of a specified period of service, is considered a market (performance) condition. Consequently, the IASB disagreed that an inconsistency existed in the definitions of a performance condition and a market condition.

BC357 To avoid confusion in the definitions of a 'performance condition' and a 'market condition', the IASB decided to:

(c) delete the last sentence under the definition of 'vesting condition' (ie a 'performance condition' might include a 'market condition'); and

(d) indicate within the definition of 'performance condition' that performance conditions are either market conditions or non-market conditions.

(g) whether a definition of 'non-vesting condition' is needed

BC358 Respondents to the Exposure Draft *Annual Improvements to IFRSs 2010–2012 Cycle (Proposed amendments to International Financial Reporting Standards)* thought that clarity could be improved further in IFRS 2 by defining a 'non-vesting condition'.

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BC360 The IASB determined that the creation of a stand-alone definition of a non-vesting condition would not be the best alternative for providing clarity on this issue. This is because the IASB observed that the concept of a non-vesting condition can be inferred from paragraphs BC170-BC184 of IFRS 2, which clarify the definition of vesting conditions. In accordance with this guidance it can be inferred that a non-vesting condition is any condition that does not determine "whether the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity, under a share-based payment arrangement". In other words, a non-vesting condition is one that is not a vesting condition. On the basis of its analysis the IASB decided it should not add a definition of non-vesting condition.

(h) Whether the employee's failure to complete a required service period is considered to be a failure to satisfy a service condition

BC~~7~~361 In considering a possible revision of the definition of 'service condition', the IASB observed that in IFRS 2 there is no specific guidance on how to account for a share-based payment award resulting from the entity's termination of an employee's employment. ~~The Board noted, however, that paragraph 19 of this IFRS regards the employee's failure to complete a specified service period as a failure to satisfy a service condition. Consequently, the Board proposes to make clear within the definition of a 'service condition' that if the employee fails to complete a specified service period, the employee fails to satisfy a service condition, regardless of what the reason for that failure is. The accounting consequence is that the compensation expense would therefore need to be reversed if an employee fails to complete a specified service period.~~

BC362 The IASB noted, however, that paragraph 19 of this IFRS regards the employee's failure to complete a specified service period as a failure to satisfy a service condition. In the Exposure Draft *Annual Improvements* *to IFRSs 2010–2012 Cycle (Proposed amendments to International Financial Reporting Standards)* the IASB proposed to make clear within the definition of a 'service condition' that if the employee fails to complete a specified service period, the employee fails to satisfy a service condition, regardless of what the reason for that failure is. The IASB also noted that the accounting consequence is that the compensation expense would therefore need to be reversed if an employee fails to complete a specified service period.

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BC364 In response to the comments received, the IASB noted that the objective of the proposed amendment to the definition of 'service condition' is to clarify that the termination of an employee's employment is a situation where the employee fails to complete a specified service period, and consequently, is considered a situation where the service condition is not met.

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BC366 The IASB observed that in circumstances where the equity instruments either partly or fully vest on cessation of employment, paragraph 23 of IFRS 2 states that "the entity shall make no subsequent adjustment to total equity after vesting date".

BC367 Noting the guidance already provided in paragraphs 19 and 23 of the standard, the IASB concluded that further guidance was not necessary.