STAFF PAPER

12–13 March 2013

IFRS Interpretations Committee Meeting

Project	**IFRS 2 *Share-based Payment***		
Paper topic	Modification of a share-based payment transaction from cash-settled to equity-settled		
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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. As mentioned in Agenda Paper 5, in July 2012, the IFRS Interpretations Committee (the Interpretations Committee) decided to revisit the three issues relating to IFRS 2 *Share-based Payment*. Out of the three issues, this agenda paper addresses the issue of the accounting for a modification of a share-based payment (SBP) transaction that changes its classification from cash-settled to equity-settled.

2. The objective of this agenda paper is to provide the Interpretations Committee with updates on the results of our outreach and technical analysis on this issue. This agenda paper contains two questions to the Interpretations Committee.

3. This agenda paper is structured as follows:

   (a) summary of the issue

   (b) summary of the result of outreach activities

   (c) staff technical analysis

   (d) assessment against the Interpretations Committee's agenda criteria

   (e) assessment against annual improvement criteria

   (f) staff recommendation

(g) questions to the Interpretations Committee

(h) Appendix A—Submission

(i) Appendix B—Relevant guidance in IFRS 2

(j) Appendix C—Annual improvement criteria analysis

(k) Appendix D—Excerpt from outreach request

Summary of the issue

4. In March 2011, the Interpretations Committee received a request to clarify the accounting for an SBP arrangement with employees in situations where:

   (a) a cash-settled award is cancelled and is replaced by a new equity-settled award; and

   (b) the replacement award has a higher fair value than the original award as at the replacement date.

5. The submitter states that because IFRS 2 is silent regarding this issue, diversity exists in practice, and suggests that this issue could potentially be considered as a clarification to IFRS 2, through the annual improvements project.

6. The submitter indicates that, with regard to a modification of an SBP transaction that changes its classification from equity-settled to cash-settled, the approach illustrated in IG Example 9 in the Guidance on implementing IFRS 2 is used in practice, even though the example addresses a situation in which the entity adds cash settlement alternative to an equity-settled award in the middle of the vesting period.

7. According to the submission, there are currently three different views on the accounting for the SBP transaction analysed in practice. The major difference of those views concerns the measurement of the new equity-settled award (ie grant date fair value of the original award or replacement date fair value of the new equity-settled award).

View 1: apply by analogy the modification guidance in IFRS 2

8. This approach views the cancellation and replacement as a modification and accounts for them in accordance with the guidance in paragraphs 27 and B42–B44 of IFRS 2 and IG Example 9 for IFRS 2, which deals with a modification of an equity-settled award.

9. Under this approach, **the new equity-settled award is measured at the grant date fair value of the original cash-settled award**. The unrecognised portion of the grant date fair value of the original award and the incremental fair value measured as of the modification date would be expensed over the remaining vesting period.

View 2: treat the original award as having being cancelled and replaced by a new award

10. This approach considers the cash-settled award to have been cancelled and settled by an equity-settled award. Using this approach, **the new equity-settled award is measured at the replacement date fair value of the equity-settled award**, viewing the replacement date as a grant date of the equity-settled award. The amount of the compensation expense after the replacement would be determined on the basis of the replacement date fair value of the new equity award.

11. In this view, there are two sub-views on how to account for the difference between the carrying amount of the liability and the elapsed portion of the replacement date fair value of the new equity award as of the replacement date.

    - **View 2A: recognise it over the remaining vesting period** (consistent with paragraph B43 of IFRS 2)
    - **View 2B: recognise it immediately in profit or loss** (consistent with paragraph 43(c) of IFRS 2)

12. The submission is reproduced in full in Appendix A of this agenda paper.

13. In the May 2011 meeting[1], the Interpretations Committee discussed this issue and decided that it would not propose to add this issue to an annual improvement

[1] *IFRIC Update* for the May 2011 meeting (http://media.ifrs.org/IFRICUpdateMay11.html#7)

project. **This is primarily because the potential amendment to IFRS 2 to resolve this issue would be beyond the scope of the annual improvement projects and would be better addressed as part of a separate IASB project to improve IFRS 2.**

14. In the July 2012 meeting, the Interpretations Committee decided to revisit this issue and asked the staff to update the analysis and outreach on the issue so that they could discuss it at future meetings. In response to this request, we will now provide updates on the results of the outreach activities in the following paragraphs.

Summary of the result of the outreach activities

15. We requested information from the International Forum of Accounting Standard-Setters (IFASS) and regulators to help us assess the issue against the Interpretations Committee's agenda criteria. Specifically, we asked:

    1. *In your jurisdiction, do you have similar transactions to those described below? If similar, but not identical, please tell us the differences.*
    2. *If you answered 'yes' to question 1, what is the prevalent accounting for the transactions? And if possible, could you please briefly describe the rationale for that accounting?*
    3. *On the basis of your response to question 2, to what extent do you observe diversity in the practice for accounting for these types of transactions?*
    4. *In your jurisdiction, are you aware of any significant divergent interpretations on other issues that are related to IFRS 2?*
    5. *If you answered 'yes' to question 4, please briefly describe the type of transactions and the divergent interpretations.*

16. Excerpts from the outreach request are in Appendix D of this agenda paper.

17. We have received 15 responses to this request. The views expressed below are informal opinions from national standard-setters and regulators. They do not

reflect the formal views of those organisations. The geographical breakdown of the responses is as follows:

Geographical area	**Number of respondents**
Worldwide	1
Americas	4
Asia/Oceania	5
Africa	1
Europe	4
Total respondents	15

18. Three respondents stated that a modification of terms of SBP transactions that changes its classification from cash-settled to equity-settled is common in their jurisdictions. Ten respondents answered that this type of SBP transactions are not widespread in their jurisdictions. Two other respondents stated that there is no data for assessing the relevance of this issue in their jurisdictions.

19. One of the three jurisdictions in which such an SBP transaction is widespread stated that some interested parties support View 1 and others support View 2A. Another jurisdiction out of the three answered that prevalent accounting is the one under View 2A and identified no significant diversity in practice in its jurisdiction. The other respondent mentioned that they are aware of diversity in practice and ask for clarification because some support either model under View 2 while others consider this issue to be an accounting policy choice.

20. One of the respondents answered that they think that View 1 is most appropriate while another respondent mentioned that they would support View 2A even though this type of SBP transactions is not widespread in those two jurisdictions.

Staff technical analysis

21. We note that, as stated in the submission, IFRS 2 does not have specific guidance for a modification of an SBP transaction that changes its classification from cash-settled to equity-settled. We also note that there is no general guidance in

IFRS 2 for a modification of terms of a cash-settled SBP arrangement. We think this is because a liability for a cash-settled award is remeasured to its fair value at each reporting period and therefore any modification of terms of a cash-settled award would be reflected in the carrying amount of the liability.

22. Despite the lack of principle, in the following paragraphs, we have analysed whether we could develop guidance for accounting for this type of SBP transactions by comparing accounting models under the three views and taking into consideration the general principles in IFRS 2. We use the examples described in the original submission to facilitate the understandings of these discussions.

Modification vs settlement

23. With regard to the cancellation of an equity-settled SBP award followed by the grant of a new equity-settled SBP award, paragraph 28(c) of IFRS 2 states that the replacement of the award should be accounted for in the same manner as a modification of the original grant of equity instruments. For the rationale of this, paragraph BC233 of IFRS 2 states:

> BC233 … In the Board's view, it is very unlikely that a share or share option grant would be cancelled without some compensation to the counterparty, either in the form of cash or replacement share options. Moreover, the Board saw no difference between a repricing of share options and a cancellation of share options followed by the granting of replacement share options at a lower exercise price, and therefore concluded that the accounting treatment should be the same.
> …

24. We think that this rationale should apply to the modification of terms of a cash-settled SBP award. In the SBP transaction analysed, in our view, the cancellation of the original award is compensated by the promise to issue equity instruments to the employees on the vesting date.

25. We also note that viewing the original award and the new award as being separate independent awards could result in a pattern of expense recognition of the SBP transactions, which would not faithfully represent the receipt of services from the employees. Using the examples in the submission, the cumulative expense

recognised for the original award (60) would be reversed upon the modification. At the same time, the entire modification date fair value of the equity-settled award would be expensed over the two-year period from the modification date to the vesting date (66 for each period after the modification).

26. Accordingly, we think that the SBP transaction analysed should be viewed as a modification for the purpose of IFRS 2, rather than as a cancellation of the original award followed by the beginning of a new equity-settled award.

Credit side

27. Although we concluded that the replacement of the original award should be viewed as a modification, we think that the liability recognised in respect of the original cash-settled award has been settled. This is because the entity is no longer obliged to transfer cash or other assets to the employees after the modification. The liability to pay cash for the service rendered up to the modification date under the original SBP arrangement has been settled by the promise to issue equity instruments, namely by the equity-settled award.

28. Hence, we think that on the modification date, the carrying amount of the liability (60 in the example) should be derecognised with an amount of credit entry to equity upon the modification. Regarding the measurement of the credit entry to the equity, we discuss it further in the following paragraphs.

Measurement of the SBP transaction

29. In equity-settled SBP arrangements with employees, the fair value of services received is generally measured by reference to the grant date fair value of the equity instruments (paragraph 11 of IFRS 2). In IFRS 2, the grant date fair value of the equity instruments is used as a surrogate measure of the fair value of the services received by the entity. Appendix A *Defined terms* to IFRS 2 defines grant date as (emphasis added):

> The date at which the entity and another party (including an employee) agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date the entity

> confers on the counterparty the right to cash, other assets, or equity instruments of the entity, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained.

30. In the SBP transaction analysed, the entity and the employees have a shared understanding of the terms and conditions of the equity-settled award on the modification date. At the original grant date, the shared understanding was that the entity would pay cash for services to be rendered by the employees. Consequently, we are of the view that the compensation expense with regard to the SBP award should be measured at the modification date fair value of the equity instruments (132 in the example).

31. We note that under View 1 the entity would continue to recognise the expense calculated on the basis of the grant date fair value of the original award and the incremental fair value as of the modification date (25 + 6 for each year). This accounting model derives from the requirements in paragraphs 27 and B42–44 of IFRS 2, which require the entity to recognise, as a minimum, the services received to be measured at the grant date fair value. IG Example 9 in the implementation guidance for IFRS 2 also illustrates this requirement.

32. However, we think that the 'as a minimum' requirement should not apply to the SBP transaction discussed here. This is because, in our view, the requirement is written within the context of an equity-settled SBP transaction in which the grant date fair value of the equity instruments is used as a surrogate measure of the fair value of the services rendered by the employees. Paragraph BC237 states (emphasis added):

> BC237 The Board concluded that having adopted a grant date measurement method, the requirements for modifications and cancellations should ensure that the entity cannot, by modifying or cancelling the grant of shares or share options, avoid recognising remuneration expense based on the grant date fair values. Therefore, the Board concluded that, for arrangements that are classified as equity-settled arrangements (at least initially), the entity must recognise the grant date fair value of the equity instruments over the vesting period, unless the employee fails to vest in those equity instruments under the terms of the original vesting conditions.

33. Accordingly, we are of the view that the 'as a minimum' requirement would not apply to a modification of a cash-settled award. We think that, after the modification, the modification date fair value of the equity instruments would become a basis for determining whether the entity complies with the 'as a minimum' requirement in respect of a future modification of the new equity-settled award, because the modification date is viewed as grant date for the new equity-settled award.

34. On the basis of the discussions above, we are of the view that the grant date fair value of the original cash-settled award is irrelevant to the measurement of the SBP award in this case. This SBP transaction should be measured by the reference to the modification date fair value of the equity instruments. Thus, we think that applying the approach in View 1 is inappropriate.

Measurement of the credit entry to equity

35. In this section, we will discuss the measurement of the credit entry to the equity upon the modification, which in turn determines how to account for the difference between the carrying amount of the liability (60 in the example) and the elapsed portion of the modification date fair value of the new equity-settled award (66).

36. Under the accounting model adopted in View 2A, the credit entry to equity is measured at the same value as the carrying amount of the liability. This model would result in recognising the difference (6 = 66 – 60 in the example) as expense over the remaining vesting period rather than recognising it as expense immediately.

37. We note that this model would be consistent with the requirements in paragraph B43 of IFRS 2, which requires the incremental fair value arising from the modification of an equity-settled award and attributed to future services to be recognised over the remaining vesting period. There are no requirements to identify a portion of the incremental fair value that arises from the past services.

38. We also note that this model could be supported by the argument that the compensation expense that is recognised in respect of the original cash-settled award should not be adjusted for that difference. This is because IFRS 2 adopts a

different principle for measuring employees' services received by the entity for a cash-settled award from that for an equity-settled award and because, as stated above, a shared understanding of the terms and conditions of the new equity-settled award has not been reached until the modification date.

39. On the other hand, the accounting model used in View 2B would require the entity to recognise the difference (6 = 66 – 60 in the example) as expense immediately upon the modification. This model measures the credit entry to equity at the modification date fair value of the equity-settled award to the extent that the services have been rendered. The fair value of the equity instruments issued to settle the liability for the original award represents the elapsed portion of the modification date fair value of the new equity-settled award. Using the examples, equity is established at 66 with the additional expense of 6 upon the modification.

40. Those who support View 2B would argue that the consideration paid for the settlement of a liability should be measured at fair value of the settlement date. They think that this is consistent with a general principle for the accounting for the settlement of a liability. For example, paragraph 6 of IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments* states that "when equity instruments issued to a creditor to extinguish all or part of a financial liability are recognised initially, an entity shall measure them at the fair value of the equity instruments issued, unless that fair value cannot be reliably measured."

41. They might also argue that recognising the difference between the carrying amount of the liability and the fair value of the consideration paid is consistent with the accounting requirements for a cash-settled SBP award. The ultimate amount of expense for a cash-settled SBP should be equal to the amount that is paid for settlement of the liability (paragraph BC241 of IFRS 2). We note that it could be argued that the liability to settle the services rendered up to the modification date has been remeasured by reference to the modification date fair value of the new award immediately before the settlement.

42. They also note that this approach is already taken in paragraph 43(c) of IFRS 2, even though it provides specific guidance to a situation in which the entity has a

choice of the manner of settlement and the entity elects the settlement alternative with the higher fair value as at the settlement date.

43. In addition, we note that the approach in View 2A could result in counterintuitive accounting after the modification date, if the modification involves a reduction of fair value. Assuming that the amendment reduced the fair value of the award by 80 to 40 in the examples, if the entity follows the approach in View 2A, 60 would be credited to equity on the modification date. After that, negative compensation expense would be recognised each year (-10[2]) for the remaining two years with debiting the same amount to equity to arrive at the total compensation expense of 40 (= 60 – 10*2).

44. We note that some may argue that the reduction of fair value by a modification should be viewed as capital contribution by the employee. Under this view, the decrease of the fair value measured at the modification date should be recognised as equity rather than negative compensation expense. Under this view, the amount of the compensation expense for each period would be indifferent between View 2A and View 2B (10 for each period). However, we think that in this transaction, the employee has received the award in his or her capacity as an employee rather than as a shareholder. Accordingly, we are of the view that accounting for the reduction of fair value as equity transactions is inappropriate.

45. In View 2B, expense recognised after the modification would be positive even though the amount of the expense could be negative in the period in which the modification occurs. Using the examples, equity would be established only at 20 with the decrease of fair value (40 = 120/2 – 40/2) being recognised as a reversal of the cumulative expense on the modification date. Even though the total amount of expense would be negative (-5 = 25+10 - 40) for the year 2011 because of the settlement 'gain' of 40, an expense of 10 would be recognised each year after the modification date, arriving at the total expense of 40.

46. As stated above, we are of the view that the "as a minimum" requirement in paragraph 27 of IFRS 2 would not apply to a modification of a cash-settled award. This is because the requirement is intended to make the accounting for a

[2] The replacement fair value of the new equity award 40*1/4 – the reduction of the fair value 80*1/4

modification of an equity-settled award consistent with the grant date measurement method adopted for an equity-settled award. On the basis of this view, the accounting model in View 2A could result in measuring services being received after the modification at negative value, which, in our view, would not depict the SBP transactions faithfully. Please note however that the "as a minimum" requirements would always be met in respect of the new equity-settled award because total compensation expense would be 40 in either model.

47. On the basis of the discussions above, although our approach to reaching a conclusion is slightly different from that in the submission, **we are of the view that the accounting model in View 2B is more appropriate than that in View 2A**.

Amendments to IFRS 2

48. As stated in the analysis of the outreach activities, this issue is widespread and there is significant diversity in practice on the accounting for the modification of a cash-settled award that changes the classification to an equity-settled award. Accordingly, we think that addressing this issue requires amendments to IFRS 2 by adding specific guidance to the transaction analysed here.

49. In addition, **if the Interpretations Committee agreed with proposing amendments to IFRS 2 to address this issue, we think that, as stated above, the amendments should be in line with the accounting model adopted in View 2B.**

Assessment against the Interpretations Committee's agenda criteria

50. In this section, we assess the issue against the agenda criteria of the Interpretations Committee described in paragraphs 5.16 and 5.17 of the Due Process Handbook. The Interpretations Committee should address an issue:

    (a) that has widespread effect and has, or is expected to have, a material effect on those affected;

(b) where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods;

(c) that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial Reporting*;

(d) that is sufficiently narrow in scope that it can be addressed in an efficient manner, but not so narrow that it is not cost effective; and

(e) for which a solution developed by the Interpretations Committee can be effective for a reasonable period of time. If the issue relates to a current or planned IASB project, justification of the short term improvements is necessary.

51. According to the responses from national-standard setters and regulators to our outreach request, we think that this issue is widespread in accounting practice. In addition, those responses indicated that there is significant diversity in practice, which should be addressed. As discussed above, we think that the diversity in practice is caused by the lack of applicable guidance to a modification of an equity-settled SBP award that changes it to an equity-settled award.

52. The Interpretations Committee previously concluded that this issue would be better addressed as part of a separate IASB project to improve IFRS 2 because the potential amendment to IFRS 2 would be beyond the scope of annual improvement projects. However, on the basis of the technical analysis above, we are of the view that we could develop an accounting model by referring to general principles in IFRS 2. Although there is no requirement that specifically addresses a modification of terms of a cash-settled SBP transaction in IFRS 2, we think that guidance necessary to resolve the significant divergence can be developed in an efficient manner by the Interpretations Committee.

53. Consequently, we are of the view that this issue meets the agenda criteria of the Interpretations Committee.

Assessment against annual improvement criteria

54. As stated earlier, we think that the potential amendment as outlined in paragraph 49 could be developed on the basis of the existing principles in IFRS 2. However, we think that the amendment could be perceived as being beyond a clarification of an existing requirement in IFRS 2 because there is no requirement in IFRS 2 that specifically addresses a modification of a cash-settled award. Accordingly, we are of the view that the potential amendment should be performed in a separate narrow-scope amendment project of the IASB because it would not meet the criteria of an annual improvement project. Nevertheless, we think that the Interpretations Committee could perform much of the work on such a narrow-scope amendment, on behalf of the IASB.

55. For the details about the assessment against the annual improvement criteria, please refer to Appendix C of this agenda paper.

Staff recommendation

56. In summary, we think that:

    (a) there is no specific guidance in IFRS 2 for a modification of terms of a cash-settled SBP transaction, including a modification that changes its classification to equity-settled;

    (b) there is significant diversity in practice for the SBP transaction analysed;

    (c) guidance should be added to IFRS 2 for that type of SBP transactions in line with the accounting model adopted in View 2B; and

    (d) addressing this issue would meet the agenda criteria of the Interpretations Committee; however, the amendment should be performed in a narrow-scope amendment project of the IASB because the amendment would not meet the criteria of an annual improvement project.

57. Consequently, we recommend that the Interpretations Committee should change its previous decision and propose to the IASB that it should amend IFRS 2 in a narrow-scope amendment to solve this issue. If the Interpretations Committee agrees with the recommendation to amend IFRS 2 in a narrow-scope amendment, we would like to seek the Interpretations Committee's inputs on the staff proposal that the amendment of IFRS 2 should be performed using the accounting model adopted in View 2B.

58. If the Interpretations Committee can reach a consensus on a specific approach to amending IFRS 2 in this meeting, we will bring the staff draft of the amendments to a future meeting in line with the principles agreed by the Interpretations Committee.

Questions to the Interpretations Committee

Question 1
Does the Interpretations Committee agree with the staff recommendation that it should propose to the IASB that the IASB should amend IFRS 2 in a narrow-scope amendment to resolve this issue?

Question 2
If the answer to Question 1 is 'yes', do you agree with the staff proposal that the amendment of IFRS 2 should be performed in line with the accounting model adopted in View 2B?

Appendix A—Submission

A1. The staff received the following request. All information has been copied without modification, except for details that would identify the submitter of the request and details that are subject to confidentiality.

REQUEST FOR ANNUAL IMPROVEMENTS

The issue

There is diversity in practice regarding how to account for a modification of a share-based payment (SBP) that changes its classification from cash-settled to equity-settled. The total amount recognised can differ depending upon whether the cash-settled SBP is considered to be settled or whether the general requirements for modification accounting and whether the guidance in the example for modifications that reclassify an award from equity-settled to cash-settled are applied.

Types of change: modification of terms of the arrangement.

Consider the following fact pattern:

On 1 January 2010 Company M grants 100 share appreciation rights (SARs) to its CFO, subject to a four-year service condition. The grant-date fair value of a SAR is 1; the total grant-date fair value is 100. The share price at the end of 2010 is unchanged. At the end of 2011 the original grant has a fair value of 120. M cancels the grant and in its place grants 100 share options at a fair value of 132, i.e. with an incremental fair value of 12 at that date. The new equity-settled grant is identified as a replacement of the original cash-settled grant.

If the modification example is applied by analogy then measurement of the replacement award is based on the grant date fair value of the original award plus any incremental fair value. If that guidance is not applied by analogy then two alternative approaches result in the modified award being accounted for based on the modification date fair value of the replacement award. More detailed analysis of the different vies and illustrations of the accounting are attached in Appendix A.

Reasons for the IFRIC to address the issue

(a) There are at least three different approaches supported by the published guidance of the major networks of audit firms. The difference between two of these approaches is only a timing difference. The total expense however would be different under one approach.
(b) Financial reporting would be improved if similar events were accounted for on a consistent basis.
(c) The issue is capable of interpretation or annual improvement within the confines of IFRSs and the *Framework for the Preparation and Presentation of Financial Statements.*
(d) IFRS 2 *Share-based Payment* is not currently within the scope of any of the Board's projects.

Appendix A

Current practice

We have identified three different views in practice on how to account for such an event.

View 1: Analogy to modification from equity-settled share-based payment to cash-settled share-based payment

The principles for modification and cancellation of equity-settled share-based payments should be applied by analogy to such changes in classification. IFRS 2 IG 2 illustrates that the requirements of IFRS 2.27 and IFRS 2 B42 - 44 apply to a modification that triggers a change from an equity-settled classification to a cash-settled classification. Under view 1 those principles should be applied by analogy to the opposite change in classification. Accordingly, a modification of an existing cash-settled arrangement in which the classification is changed from cash settled to equity settled should be accounted for as follows:

Distinguish between the grant-date fair value of the original cash-settled share-based payment arrangement (first component) and the remeasurement of that liability (second component).
At the date of modification, the liability recognised to the extent that services have been received as of that date is reclassified to equity.
The incremental fair value of the modification is calculated as:

- the fair value of the new grant, measured at the date of modification; less
- the fair value of the original grant, measured at the date of modification; and
- any payments made to the employees on cancellation of the original grant.

Recognise the remaining grant-date fair value of the original grant (unrecognised portion of the first component only) in addition to the incremental fair value, if any, over the remaining vesting period.

This is illustrated as follows:

End of:	Liability			Equity		
	In current period			In current period		
	Recognition of grant-date fair value of liability	Remeasure-ment	Cumulative	Unrecognised grant-date fair value of liability	Incremental fair value	Cumulative
2010	25	-	25	-	-	-
2011	25	10	60			60
2012	-	-	-	25	6	91
2013	-	-	-	25	6	122

M accounts for the transaction as follows:

	Debit	*Credit*
2010		
Expenses	25	
Liability		25

To recognise 1/4 of grant-date fair value of the liability, no remeasurement

2011		
Expenses	35	
Liability		35

To recognise 1/4 of grant-date fair value of the liability of 25 and remeasurement of 10

Liability	60	
Equity		60

To recognise reclassification from liability to equity

2012		
Expenses	31	
Equity		31

To recognise ½ of the unrecognised grant-date fair value of the original cash settled share-based payment arrangement of 25 and ½ of the incremental fair value as of modification date of 6 ((132-120)/2) as an increase in equity

	Debit	*Credit*
2013		
Expenses	31	
Equity		31

To recognise ½ of the unrecognised grant-date fair value of the original cash settled share-based payment arrangement of 25 and ½ of the incremental fair value as of modification date of 6 ((132-120)/2) as an increase in equity

Cumulative effects:

Expenses	122	
Equity		122
Liability		0

View 2: No analogy to modification from equity-settled share-based payment to cash-settled share-based payment

View 2 is to measure the equity-settled award at modification date. There are two sub-views as to when the incremental value should be expensed.

View 2 is that the requirements of IFRS 2 relating to cash-settled awards do not include guidance relating to modifications on the grounds that the liability is remeasured to its fair value and therefore any modifications would be reflected in the carrying value of the liability. If an entity cancelled a cash-settled award then, in contrast to the treatment of a cancellation for an equity-settled award, the expense would be reversed.

Under this view when a cash-settled award is "cancelled" and "replaced" by an equity-settled award the appropriate accounting would be to reverse the expense recognised up to the date of cancellation and then start to recognise an equity-settled award with a new grant date. However, this would not give an expense recognition in line with the receipt of services. Furthermore, reversal of the recognised expense would be appropriate only if the liability had been extinguished; in fact the liability has been "settled" by a promise to issue equity instruments; *therefore, the appropriate treatment for the accrued liability is to transfer it to equity*. The grant date for an equity-settled award is defined in IFRS 2 as:

> "The date at which the entity and another party (including an employee) agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date the entity confers on the counterparty the right to cash, other assets, or equity instruments of the entity, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained."

At the original grant date of the award the shared understanding was that there would be a cash payment. It is only after the "modification" date that the entity is obligated to issue equity instruments and that the shared understanding is based on issue of equity instruments. Therefore the grant date for the purpose of measuring the equity settled award is the date of modification rather than the original award date. Another way of looking at this would be in line with IFRS 2 B43(b), prior to the modification the number of equity instruments expected to vest was zero, therefore all the equity instruments are incremental and under B43(b) the incremental expense would be measured based on the fair value at the modification date[3].

[3] Also ASC 718-20-55sets out the US GAAP treatment which measures the expense based on the fair value at the time that the award is modified to equity settled. View 2 would be converged with this whilst View 1 would lead to a GAAP difference.

<u>View 2A:</u> Consider the original cash-settled liability to be settled by conversion (reclassification to equity) and account for the difference between the modification date fair value of the replacement equity-settled share-based payment arrangement and the amount reclassified to equity over the remaining vesting period.

Under this sub-view when a modification changes the classification of a share-based payment arrangement from cash-settled to equity-settled, the entity immediately reclassifies the carrying amount of the liability at the date of modification to equity. The expense recognised over the remaining vesting period is based on the modification date fair value of the replacement equity-settled share-based payment arrangement and not the grant date fair value of the original arrangement.

Taking the same fact as outline above the example below illustrates the accounting entries that arise under this view.

	Liability			Equity		
	In current period			In current period		
End of:	Recognition of grant-date fair value of liability	Remeasure-ment	Cumulative	Reclassification from liability	Unrecognised modification-date fair value of equity replacement	Cumulative
2010	25	-	25	-	-	-
2011	25	10	60	→ 60		60
2012	-	-	-	-	36	96
2013	-	-	-	-	36	132

M accounts for the transaction as follows:

	Debit	*Credit*
2010		
Expenses	25	
Liability		25
To recognise 1/4 of grant-date fair value of the liability, no remeasurement		
2011		
Expenses	35	
Liability		35
To recognise 1/4 of grant-date fair value of the liability of 25 and remeasurement of 10		
Liability	60	
Equity		60
To recognise reclassification from liability to equity		
2012		
Expenses	36	
Equity		36
To recognise 1/2 of the unrecognised modification-date fair value of the replacement equity settled share-based payment arrangement of 36 as an increase in equity (132-60)/2		
2013		
Expenses	36	
Equity		36
To recognise 1/2 of the unrecognised modification-date fair value of the replacement equity settled share-based payment arrangement of 36 as an increase in equity		
Cumulative effects:		
Expenses	132	
Equity		132
Liability		0

<u>View 2B:</u> Account for settlement of the cash-settled share-based payment on date of modification

Under this view, the change from cash-settled award to equity-settled is viewed as a settlement of the cash-settled award and any excess of the fair value of the equity instruments used to settle the liability over the amount reclassified is recognised immediately in profit or loss. That is, the fair value of the modification award is compared to the fair value of the original award, and any positive difference is expensed immediately to the extent that services have been received.

This is consistent with what is required by IFRS 2.43 (c) when an entity elects the settlement alternative with a higher fair value.

	Liability			Equity		
	In current period			In current period		
End of:	Recognition of grant-date fair value of liability	Remeasure-ment	Cumulative	Settlement of cash-settled award	Unrecognised modification-date fair value of equity replacement	Cumulative
2010	25	-	25	-	-	-
2011	25	10	60	6	-	66
2012	-	-	-	-	33	99
2013	-	-	-	-	33	132

M accounts for the transaction as follows:

	Debit	*Credit*
2010		
Expenses	25	
Liability		25

To recognise 1/4 of grant-date fair value of the liability, no remeasurement

2011		
Expenses	35	
Liability		35

To recognise 1/4 of grant-date fair value of the liability of 25 and remeasurement of 10

	Debit	*Credit*
Employee costs	6	
Liability	60	
Equity		60

To recognise reclassification from liability to equity plus the effect of settlement of the cash-settled award (6=((132-120)/2) to the extent of services provided as an increase in equity

2012

Expenses	33	
Equity		33

To recognise 1/2 of the unrecognised modification-date fair value of the replacement equity settled share-based payment arrangement of 33

2013

Expenses	33	
Equity		33

To recognise 1/2 of the unrecognised modification-date fair value of the replacement equity settled share-based payment arrangement of 33 as an increase in equity

Cumulative effects:

Expenses	132	
Equity		132
Liability		0

The total expense reflects the settlement of the original cash-settled award (66), plus the expense related to the modification equity-settled award (66).

Appendix B—Relevant guidance in IFRS 2

B1. The guidance in paragraphs 27, B42–44, 28, 39 and 43 of IFRS 2 is reproduced below for ease of reference (emphasis added):

27 The entity shall recognise, **as a minimum, the services received measured at the grant date fair value of the equity instruments granted**, unless those equity instruments do not vest because of failure to satisfy a vesting condition (other than a market condition) that was specified at grant date. This applies irrespective of any modifications to the terms and conditions on which the equity instruments were granted, or a cancellation or settlement of that grant of equity instruments. **In addition, the entity shall recognise the effects of modifications that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee**. **Guidance on applying this requirement is given in Appendix B.**

B42 Paragraph 27 requires that, irrespective of any modifications to the terms and conditions on which the equity instruments were granted, or a cancellation or settlement of that grant of equity instruments, **the entity should recognise, as a minimum, the services received measured at the grant date fair value of the equity instruments granted**, unless those equity instruments do not vest because of failure to satisfy a vesting condition (other than a market condition) that was specified at grant date. **In addition, the entity should recognise the effects of modifications that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee**.

B43 To apply the requirements of paragraph 27:

(a) **if the modification increases the fair value of the equity instruments granted** (eg by reducing the exercise price), measured immediately before and after the modification, the entity shall include the **incremental fair value** granted in the measurement of the amount recognised for services received as consideration for the equity instruments granted. **The incremental fair value granted is the difference between the fair value of the modified equity instrument and that of the original equity instrument, both estimated as at the date of the modification. If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period.** If the modification occurs after vesting date, the incremental fair value granted is

recognised immediately, or over the vesting period if the employee is required to complete an additional period of service before becoming unconditionally entitled to those modified equity instruments.

(b) similarly, if the modification increases the number of equity instruments granted, the entity shall include the fair value of the additional equity instruments granted, measured at the date of the modification, in the measurement of the amount recognised for services received as consideration for the equity instruments granted, consistently with the requirements in (a) above. For example, if the modification occurs during the vesting period, the fair value of the additional equity instruments granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the additional equity instruments vest, in addition to the amount based on the grant date fair value of the equity instruments originally granted, which is recognised over the remainder of the original vesting period.

(c) if the entity modifies the vesting conditions in a manner that is beneficial to the employee, for example, by reducing the vesting period or by modifying or eliminating a performance condition (other than a market condition, changes to which are accounted for in accordance with (a) above), the entity shall take the modified vesting conditions into account when applying the requirements of paragraphs 19–21.

B44 Furthermore, if the entity modifies the terms or conditions of the equity instruments granted in a manner that reduces the total fair value of the share-based payment arrangement, or is not otherwise beneficial to the employee, the entity shall nevertheless continue to account for the services received as consideration for the equity instruments granted as if that modification had not occurred (other than a cancellation of some or all the equity instruments granted, which shall be accounted for in accordance with paragraph 28). For example:

(a) if the modification reduces the fair value of the equity instruments granted, measured immediately before and after the modification, the entity shall not take into account that decrease in fair value and shall continue to measure the amount recognised for services received as consideration for the equity instruments based on the grant date fair value of the equity instruments granted.

(b) if the modification reduces the number of equity instruments granted to an employee, that reduction shall be accounted for as a cancellation of that portion of the grant, in accordance with the requirements of paragraph 28.

(c) if the entity modifies the vesting conditions in a manner that is not beneficial to the employee, for example, by increasing the vesting period or by modifying or adding a performance condition (other than a market condition, changes to which are accounted

for in accordance with (a) above), the entity shall not take the modified vesting conditions into account when applying the requirements of paragraphs 19–21.

28 **If a grant of equity instruments is cancelled or settled during the vesting period** (other than a grant cancelled by forfeiture when the vesting conditions are not satisfied):

(a) **the entity shall account for the cancellation or settlement as an acceleration of vesting, and shall therefore recognise immediately the amount that otherwise would have been recognised for services received over the remainder of the vesting period**.

(b) **any payment made to the employee on the cancellation or settlement of the grant shall be accounted for as the repurchase of an equity interest**, ie as a deduction from equity, except to the extent that the payment exceeds the fair value of the equity instruments granted, measured at the repurchase date. Any such excess shall be recognised as an expense. However, if the share-based payment arrangement included liability components, the entity shall remeasure the fair value of the liability at the date of cancellation or settlement. Any payment made to settle the liability component shall be accounted for as an extinguishment of the liability.

(c) **if new equity instruments are granted to the employee and, on the date when those new equity instruments are granted, the entity identifies the new equity instruments granted as replacement equity instruments for the cancelled equity instruments, the entity shall account for the granting of replacement equity instruments in the same way as a modification of the original grant of equity instruments, in accordance with paragraph 27 and the guidance in Appendix B.** The incremental fair value granted is the difference between the fair value of the replacement equity instruments and the net fair value of the cancelled equity instruments, at the date the replacement equity instruments are granted. The net fair value of the cancelled equity instruments is their fair value, immediately before the cancellation, less the amount of any payment made to the employee on cancellation of the equity instruments that is accounted for as a deduction from equity in accordance with (b) above. If the entity does not identify new equity instruments granted as replacement equity instruments for the cancelled equity instruments, the entity shall account for those new equity instruments as a new grant of equity instruments.

39 **At the date of settlement, the entity shall remeasure the liability to its fair value. If the entity issues equity instruments on settlement rather than paying cash, the liability shall be transferred direct to equity, as the consideration for the equity instruments issued**.

43 If no such obligation exists, the entity shall account for the transaction in accordance with the requirements applying to equity-settled share-based payment transactions, in paragraphs 10–29. **Upon settlement**:

(a) if the entity elects to settle in cash, the cash payment shall be accounted for as the repurchase of an equity interest, ie as a deduction from equity, except as noted in (c) below.

(b) if the entity elects to settle by issuing equity instruments, no further accounting is required (other than a transfer from one component of equity to another, if necessary), except as noted in (c) below.

(c) **if the entity elects the settlement alternative with the higher fair value, as at the date of settlement, the entity shall recognise an additional expense for the excess value given, ie the difference between the cash paid and the fair value of the equity instruments that would otherwise have been issued, or the difference between the fair value of the equity instruments issued and the amount of cash that would otherwise have been paid, whichever is applicable**.

Appendix C—Annual improvement criteria analysis

C1. In planning whether proposed amendments to Standards can be exposed as part of the Annual Improvements, the IASB assesses the proposed amendments against the criteria described in paragraphs 6.10-6.14 of the Due Process Handbook. We have assessed the potential amendment to IFRS 2 described in this agenda paper against the criteria of Annual Improvements, which are reproduced in full below:

Annual Improvements criteria	Staff assessment of the amendment
(a) The amendments are limited to changes that represent either: (i) clarifying the wording in a Standard, which involves either: • Replacing unclear wording in existing Standards; or • providing guidance where an absence of guidance is causing concern. A clarifying amendment maintains consistency with the existing principles within the applicable IFRSs and does not propose a new principle, or a change to an existing principle. (ii) correcting relatively minor unintended consequences, oversights or conflicts between existing requirements of Standards A correcting amendment does not propose a new principle or a change to an existing principle.	**Not met** We are of the view that the potential amendment could be developed on the basis of general principles in IFRS 2. However, given the fact that there is no requirement that specifically addresses a modification of a cash-settled award, we think that the amendment would be beyond a clarification of an existing requirement in IFRS 2.
(b) The proposed amendment is well defined and narrow in scope.	**Met** This issue is sufficiently narrow and well-defined because the potential amendments would be limited to a modification of a cash-settled SBP transaction that changes its classification to equity-settled.

Annual Improvements criteria	Staff assessment of the amendment
(c) It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach conclusion on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.	**Met** Even though there is no principle for a modification of a cash-settled award, we think that the IASB will be able to reach a reasonable conclusion on this issue on a timely basis by using underlying principles throughout the requirements in IFRS 2.

Appendix D—Excerpt from outreach request

D1. We sent the following request to the International Forum of Accounting Standard Setters and regulators to solicit information on this issue:

Dear all,

In the July 2012 meeting, the IFRS Interpretations Committee (the Interpretations Committee) decided to revisit the three issues related to IFRS 2 *Share-based Payment*. Previously, the Interpretations Committee decided not to add these issues to its agenda or propose annual improvements because it observed that they should be dealt with by the IASB in a broader project of IFRS 2, which includes a post-implementation review. Because the IASB does not expect to address those issues or undertake a post-implementation review of IFRS 2 in the near future, the Interpretations Committee asked the staff to update the analysis and outreach on those issues so that they can discuss them at future meetings. The three issues should clarify how:

1. to classify and measure share-based payment transactions for which the manner of settlement is contingent on either:
   (i) a future event that is outside the control of both the entity and the counterparty; or
   (ii) a future event that is within the control of the counterparty.
2. to classify a share-based payment transaction in which the entity is required to withhold a specified portion of the shares that would otherwise be issued to the counterparty upon exercise (or vesting) of the share-based payment award in order to settle the counterparty's tax obligation.
3. to measure and account for a share-based payment in situations in which a cash-settled award is cancelled and is replaced by a new equity-settled award that has a higher fair value than the original award.

For further information related to the discussions in the July 2012 Interpretations Committee meeting, please consult the following materials:

- The IFRIC *Update* for the July 2012 meeting (http://www.ifrs.org/Updates/IFRIC-Updates/Pages/IFRIC-Updates.aspx)
- Agenda Paper 9 for the July 2012 meeting (http://www.ifrs.org/Meetings/Pages/IFRICJuly2012.aspx)

In addition to these three issues, we are seeking information on significant divergence in practice on other issues that are related to IFRS 2, if you are aware of it in your jurisdiction.

Questions

For each of the three issues described in the following section, I would very much appreciate your observations on the following aspects:

1. In your jurisdiction, do you have similar transactions to those described below? If similar, but not identical, please tell us the differences.

2. If you answered 'yes' to question 1, what is the prevalent accounting for the transactions? And if possible, could you please briefly describe the rationale for that accounting?
3. On the basis of your response to question 2, to what extent do you observe diversity in the practice for accounting for these types of transactions?
4. In your jurisdiction, are you aware of any significant divergent interpretations on other issues that are related to IFRS 2?
5. If you answered 'yes' to question 4, please briefly describe the type of transactions and the divergent interpretations.

At this stage of the process I am especially interested in the observations that you have made in practice, so please feel free to send them on to me.

I would appreciate receiving your input on this issue by **14 January 2013**.

Best regards,

Ken

<u>Description of the issues</u>

Issue 1: […]

Issue 2: […]

Issue 3: Modification of a share-based payment from cash-settled to equity-settled

The Interpretations Committee received a request to clarify how to account for a share-based payment in situations where a cash-settled award is cancelled and is replaced by a new equity-settled award that has a higher fair value than the original award. The submitter identifies two different views on how to account for such an event. The second view is further split into two sub-views, which consider timing differences in the recognition of the expense.

> *View 1: apply by analogy the modification guidance in IFRS 2*
>
> This view considers that the award has been modified from being equity-settled to being cash-settled. Consequently, an entity would apply by analogy the modification guidance in IFRS 2.27 and IFRS 2.B42–B44. The supporters of this view argue that even though IFRS 2.27 and IFRS 2.B42–44 provide guidance for modifications of awards where equity-settled share-based payments were originally granted, it could be applied by analogy to a change from being cash-settled to being equity-settled.
>
> *View 2: consider that the original award has been settled and replaced by a new award rather than applying the modification guidance in IFRS 2*
>
> This approach considers that the cash-settled award has been cancelled and settled by an equity-settled award. The measurement of the equity-settled replacement award is based on the recognition of:
>
> (a) the modification-date fair value of the original award; at the date of the modification, the entity reclassifies the carrying amount of the liability that is recognised to-date to equity; and

(b) the unrecognised modification-date fair value of the replacement award (the difference between the modification date fair value of the replacement equity-settled share-based payment arrangement and the amount reclassified to equity as described in (a) above). There are two approaches for recognising this value:
   (i) View 2A: recognise it over the remaining vesting period in accordance with IFRS 2.B43(b).
   (ii) View 2B: recognise it immediately in profit or loss as an additional expense in accordance with IFRS 2.43(c) **to the extent of services provided** with the remainder expensed over the remaining vesting period.

For further details I have attached the relevant extracts from the submission. In addition, Agenda Papers used in the meetings and the IFRIC *Update* can be viewed at:

- The IFRIC *Update* for the May 2011 meeting (http://media.ifrs.org/IFRICUpdateMay11.html#7)
- Agenda Paper 7 for the May 2011 meeting (http://www.ifrs.org/Meetings/Pages/IFRSInterpretations5511.aspx)