STAFF PAPER

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Project	**Research Project: Share-based Payment**
Paper topic	Identification of issues arising from the application of IFRS 2 *Share-based Payment*

CONTACT(S) Nadia Chebotareva nchebotareva@ifrs.org +44 (0)20 7246 6457

The purpose of the session

1. The purpose of this session is to:

   (a) inform GPF members about the Research Project; and

   (b) ask GPF members for input on the list of application issues that arise when entities apply the existing requirements of IFRS 2 *Share-based Payment* in practice.

Background

2. IFRS 2 was issued in 2004. Since then it has attracted a number of interpretation requests and has been amended several times. For the full history of IFRS 2 (including amendments and interpretations), please see Appendix A of this paper.

3. During the 2011 Agenda Consultation, nearly all respondents who commented on IFRS 2 expressed the view that IFRS 2 was a complex Standard. Nevertheless, views varied dramatically on whether to add the project to the IASB's main projects agenda: some people believed that the project should be assigned a high priority because of the undue cost and effort that its application required, but other people believed that the project should be assigned a low priority, because although the Standard was complex it was still operational in practice.

4. In May 2012, as a result of the 2011 Agenda Consultation, the IASB decided to add a project on share-based payment arrangements to its Research Programme

for the following reason: 'there are mixed views on how effective IFRS 2 has been in practice. Although we have an IFRS that seems to work well, it also attracts a disproportionate number of interpretation requests'[1].

5. Since May 2012, when the project was added to the Research Programme, the IASB has issued further amendments to IFRS 2:

   (a) Amendments to the definitions of 'vesting condition' and 'market condition', issued in December 2013 as part of *Annual Improvements to IFRSs 2010-2012 Cycle*; and

   (b) Draft amendments *Classification and Measurement of Share-based Payment Transactions*, issued in November 2014.

6. In other words, it continues to attract interpretation requests.

7. In order to address IFRS 2 in a more 'principle-based' way, the staff plan to undertake a Research Project in order to identify and explore the main application issues that arise when entities put IFRS 2 into operation, in order to identify the most common areas of complexity. The research will, therefore, be of an exploratory nature at this stage. However, the staff also plan to indicate, whenever possible, what the main cause(s) of these areas of complexity are; for example, complexity of requirements or inconsistency of some of the principles within the Standard.

8. The initial output of the Research Project will be a Research Paper, which will enable respondents to the 2015 Agenda Consultation to consider whether the IASB should do more work on this subject.

[1] Staff paper 13B, May 2012 *Developing the IASB's Technical Programme*.

List of application issues

9. On the basis of the research performed so far, the staff have identified the following *common* application issues of IFRS 2 that appear to exist in practice:

   (a) *group share-based payment plans—accounting in separate financial statements*

   The IFRS IC has received in the past a number of interpretation requests about accounting for group share-based payment arrangements in separate financial statements of group entities. As a result of these requests, the IASB has issued two amendments to IFRS 2:

   (i) clarifying the application of IFRS 2 to arrangements involving the entity's own equity instruments and to arrangements involving equity instruments of the entity's parent (originally issued as IFRIC 11 *IFRS 2—Group and Treasury Share Transactions*, issued in 2006) and

   (ii) clarifying the scope of IFRS 2, as well as clarifying the accounting for group cash-settled share-based payment transactions in the separate (or individual) financial statements of an entity receiving the goods or services, when another group entity or shareholder has the obligation to settle the award (amendments *Group Cash-settled Share-based Payment Transactions* issued in 2009).

   (b) *complexity in classification of vesting and non-vesting conditions (six conditions in total)*

   The IFRS IC has received in the past a number of interpretation requests about how various conditions in equity-settled share-based payment arrangements should be classified. As a result of these requests the IASB has issued the following amendments to IFRS 2:

   (i) clarifying the definition of 'vesting conditions' and clarifying the accounting treatment of cancellations by the counterparty to a share-based arrangement (amendment *Vesting Conditions and Cancellations* issued in 2008);

(ii) amending the definitions of 'vesting condition' and 'market condition' and adding definitions for 'performance condition' and 'service condition' (which were previously part of the definition of 'vesting condition') (*Annual Improvements to IFRSs 2010–2012 Cycle*, issued in 2013); and

(iii) a proposal to clarify how vesting conditions affect the fair value of liabilities for cash-settled share-based payments: the accounting in the case of cash-settled share-based payments should follow the same approach as is used for equity-settled share-based payments in order to estimate the number of instruments that will vest (draft amendment *Classification and Measurement of Share-based Payment Transactions*, issued in 2014).

Although the IASB has issued a significant amount of guidance to clarify IFRS 2 and thus to assist entities with the practical application, this guidance seems instead to have actually added complexity to the Standard.

(c) 'counter-intuitive' results in accounting for some equity-settled share-based payment transactions

Accounting outcomes that some consider counterintuitive and that are frequently commented upon arise in the following situations for equity-settled share-based payment arrangements:

(i) cancellations—expense is recognised (vs forfeitures—for which expense is not recognised or, in other words, it is reversed);

(ii) 'negative' modifications—reversal of expense (ie gain) is not recognised (vs 'positive' modifications—additional expense is recognised); and

(iii) 'underwater' share options (ie with negative intrinsic value; this happens when the share option's exercise price exceeds the fair value of the shares)—expense is still recognised.

(d) complexity that arises from the existence of two measurement models

It appears that some people simply struggle to understand the *grant date* fair value measurement model intuitively, because grant date fair value does not represent the value of the consideration that an entity will ultimately give. This is especially apparent when compared to the current fair value model which exists in IFRS 2 for cash-settled share-based payment arrangements.

(e) complexity in measurement of share-based payment arrangements at fair value

Practical complexity in measurement of share options at grant date fair value in practice arises because entities need to make several assumptions (eg about the expected volatility of share prices and the life expectancy of arrangements); they also need to use complex option pricing models (eg Black-Scholes-Merton or Monte Carlo).

(f) classification of share-based payment arrangements as equity- or cash-settled

Classification of share-based payment transactions based on the expected manner of settlement has not been explicitly identified as an application issue. However, there have been two quite specific instances in which there was a need for further guidance in this application area:

(i) group share-based payment arrangements, which were addressed in (a) above; and

(ii) IFRS IC issue *Accounting for a share-based payment in which the manner of settlement is contingent on future events*. The issue was closed in April 2014 because some IASB members were concerned that the proposed amendment (by the IFRS IC) might overlap with another research project *Financial instruments with characteristics of equity*, which deals with the distinction between a liability and equity.

(g) *volume of disclosures*

IFRS 2 requires the disclosure of information that enables users to understand: (a) the nature and extent of share-based payment arrangements; (b) how the fair value was determined and (c) the effect of the share-based payment arrangements on the entity's profit or loss and its financial position. IFRS 2 is sometimes criticised for leading entities to disclose excessive information in their financial statements. There are two questions here:

(i) Are disclosures in recent practice excessive?

(ii) And, if yes, what is the reason for this? In other words, the question is whether it is IFRS 2 that is requiring too many disclosures or whether entities are providing too much detail purely on their own initiative.

10. The questions for GPF members are:

List of application issues
Do you have any comments about the list of IFRS 2 application issues identified by the staff in paragraph 9 above? Would you like to add or remove anything?

Appendix A

History of IFRS 2 *Share-based Payment*

2004	IFRS 2 *Share-based Payment* issued	Effective for annual periods beginning on or after 1 January 2005
2006	IFRIC 8 *Scope of IFRS 2* when the entity cannot specifically identify some or all of the goods or services received	Now part of IFRS 2
2006	IFRIC 11 *IFRS 2- Group and Treasury Share Transactions*	Now part of IFRS 2
2008	Amended by *Vesting Conditions and Cancellations (Amendments to IFRS 2)* to clarify the definition of vesting conditions and the accounting treatment of cancellations by the counterparty to a share-based arrangement	Effective for annual periods beginning on or after 1 January 2009
2009	Amended by *Improvements to IFRSs* (scope of IFRS 2 and revised IFRS 3) to confirm that, in addition to business combinations as defined by IFRS 3 (2008) *Business Combinations*, contributions of a business on formation of a joint venture and common control transactions are excluded from the scope of IFRS 2	Effective for annual periods beginning on or after 1 July 2009
2009	Amended by *Group Cash-settled Share-based Payment Transactions* to clarify the scope of IFRS 2, as well as the accounting for group cash-settled share-based payment transactions in the separate (or individual) financial statements of an entity receiving the goods or services when another group entity or shareholder has the obligation to settle the award	Effective for annual periods beginning on or after 1 January 2010
2013	IFRS IC agenda decision on *Timing of recognition of intercompany recharges*	n/a

2013	Amended by *Annual Improvements to IFRSs 2010–2012 Cycle* to amend the definitions of 'vesting condition' and 'market condition' and adds definitions for 'performance condition' and 'service condition' (which were previously part of the definition of 'vesting condition')	Effective for annual periods beginning on or after 1 July 2014
2014	IFRS IC agenda decision on *Price difference between the institutional offer price and the retail offer price for shares in an initial public offering*	n/a
2014	**Proposed** amendments by *Classification and Measurement of Share-based Payment Transactions* • to clarify how vesting conditions affect the fair value of liabilities for cash-settled share-based payments: the accounting in the case of cash-settled share-based payments should follow the same approach as used for equity-settled share-based payments • to include an exception in IFRS 2 so that a share-based payment in which the entity settles the share-based payment arrangement net would be classified as equity-settled in its entirety provided the share-based payment would have been classified as equity-settled if it had not included the net settlement feature • to clarify situations in which a cash-settled share-based payment changes to an equity-settled share-based payment because of modifications of the terms and conditions	TBD
2014 (April)	IFRS IC decision *Accounting* [classification] *for share-based payment transactions in which the manner of settlement is contingent on a future event that is outside the control of both the entity and the counterparty* The IFRS IC discussed this with the IASB and decided not to amend IFRS 2, because the definition of a liability is being discussed in a different project.	n/a