STAFF PAPER

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Prepared for the Global Preparers Forum Meeting

Project	**Research project on IFRS 2 *Share-based Payment***
Paper topic	Future of the research project

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The purpose of the session

1. As part of the research project on IFRS 2 *Share-based Payment*, the GPF discussed in March 2015 issues that arise in applying IFRS 2. The main objective of the discussion was to identify the main application issues that preparers face. The summary of the discussion is available on the *Share-based Payment* project webpage.[1]

2. During this meeting we would like to discuss with GPF members their views on whether the IASB should carry out further research on this topic.

Contents of this paper

3. This paper contains an extract from a staff paper (Agenda paper 16) presented to the Board in November 2015. The extract summarises the findings of the research. The full paper can be found at: http://www.ifrs.org/Meetings/MeetingDocs/IASB/2015/November/AP16-IFRS-2-Share-based-payment.pdf.

[1] Key observations of the discussion included:

(a) Since IFRS 2 was issued in 2004, it has achieved its main objective, ie to recognise an expense for share-based payment arrangements.

(b) Existence of two measurement models in IFRS 2 causes complexity in application.

(c) The accounting outcome of the IFRS 2 requirements could be difficult to explain to users.

4. The IASB will decide on the future of this research project once it has reviewed responses to the Agenda Consultation 2015. A summary of the feedback received is included in Appendix A.

Summary of research findings

5. On the basis of the research and outreach that have been performed, it appears that the complexity of applying IFRS 2 in practice has two main causes. The first cause is the complexity of share-based payment arrangements themselves. The second cause—which has more of an accounting nature—is the use of the *grant date* fair value measurement model. IFRS 2 uses this model for share-based payment arrangements that are settled in shares or in share options (ie equity-settled share-based payment arrangements). This section looks at both of these causes in turn.

6. With respect to the complexity in IFRS 2, the staff believe that it cannot be reduced without fundamentally reconsidering the existence of the two measurement models—and, more specifically, the *grant date* fair value measurement model—in the Standard. The Board have not instructed the staff to reconsider those measurement models.

Variety and complexity of share-based payment arrangements

7. In summary, the variety and complexity of share-based payment arrangements contribute significantly to the overall perception of complexity that is 'caused' by IFRS 2.

8. Those people who analyse share-based payment arrangements comment on the variety, complexity and inventiveness of conditions in share-based payment arrangements. Management often structure the arrangements not only with the objective of remunerating management personnel and employees for their services, but also with the objective of achieving specific accounting results such as, for example, minimising the amount and volatility of the expense or delaying the recognition of the expense.

9. In quantitative terms, an IFRS 2 expense is often a relatively small number in an entity's financial statements. However, in qualitative terms, this amount often attracts a significant amount of attention, because share-based payments are often made to key management personnel. This level of attention is one driver of the variety and complexity of these arrangements.

10. The greatest attention comes from those user groups who take an active interest in corporate governance and stewardship matters. They include shareholders and their representatives, regulators and key management personnel themselves.

Grant date fair value measurement model

11. The *grant date* fair value measurement model is used in IFRS 2 for measuring some equity-settled transactions, including transactions with employees, by reference to the fair value of shares or share options at the grant date of an arrangement. That measurement is not adjusted subsequently for changes in the fair value of the shares or share options.[2] In other words, the amount of the expense is 'frozen' at the date at which the entity and the other party (such as an employee) agree to the arrangement.[3]

12. From the analysis of the main application issues in Appendix A of the paper presented to the Board in November 2015 and their summary on page 16 of that paper, it appears that most of the application issues that come up in practice arise from the *grant date* fair value measurement model. The application issues include:

    (a) difficulty in understanding the underlying principle of not measuring the assets and expenses at the value of the instruments that the entity will ultimately issue as compensation;

    (b) perceived counterintuitive results in accounting for some transactions;

    (c) complexity in classification of conditions as vesting or non-vesting and in how those conditions are reflected in the *grant date* fair value during subsequent measurement; and

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[2] Paragraphs 10-11 of IFRS 2.

[3] The full definition of a grant date is provided in Appendix A of IFRS 2.

(d) the need to make significant valuation assumptions at the grant date for the entire duration of the arrangement, and the fact that those assumptions are not subsequently updated.

Way forward

13. The research done on this project has involved assessing possible practice issues to understand whether a financial reporting problem exists in this area and, if so, whether (and then how) to address it. The staff documented their research so far in the paper for the November 2015 Board meeting.

14. Once the Board has analysed the responses to the Agenda Consultation, the staff will ask the Board:

    (a) to complete the Board's assessment of whether a financial reporting problem exists; and

    (b) to decide how to move forward, by either:

        (i) stopping work on this topic; or

        (ii) carrying out further research to develop proposals to respond to any problem(s) identified. After that research, the IASB would consider whether to start work on a project to amend IFRS 2.

15. On the basis of the research described in the paper presented to the Board in November 2015, the staff believe that without reconsidering the *grant date* fair value measurement model, it will not be possible to reduce significantly the complexity that arises in applying IFRS 2. The Board have not instructed the staff to reconsider the measurement models used in IFRS 2.

16. The staff also believe that the IASB and the IFRS Interpretations Committee ('the Interpretations Committee') should have a very high hurdle for adding more IFRS 2 issues to their agendas, because making amendments often leads to further complexity in the Standard. It also appears that the IASB and the Interpretations Committee have already addressed the most important issues that have arisen in practice since the Standard was issued.

17. The IASB does not intend to re-visit the core principle of IFRS 2. This states that 'An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received'.

Future of research project *Share-based Payment*
1. Does IFRS 2 cause any unnecessary complexity, or any other financial reporting problems? If so, is it possible to reduce that complexity (or remove those problems) without changing the main principles in IFRS 2? 2. Do you have any comments about the research project?

Appendix A

Agenda Consultation 2015: summary of feedback

	Importance	Urgency
High	4	4
Medium	18	17
Low	37	36
Total responses	59	57
No responses on this project	59	61
Overall total	118	118

A1. Overall observation about respondents

Respondents primarily included: standard-setters, accounting firms and various associations. Surprisingly few preparers (6) provided responses about this project; their responses were varied.

A2. Who thinks it is unimportant?

Of the respondents who commented on this project, over half of them assigned low priority to this project. There was no obvious trend in terms of which groups of respondents held this point of view.

A3. Criteria for unimportance

The main reason given by respondents for classifying this project as 'unimportant' was that this project had a lower priority compared to other projects. This seemed to suggest that the Standard is overall considered as operational.

Some respondents also stated that no further project was necessary because they believed that most practical issues arising from IFRS 2 have been addressed through subsequent amendments.

One respondent was concerned that major amendments to IFRS 2 might lead to divergence with US GAAP. (As a reminder, IFRS 2 and its US GAAP equivalent are broadly converged in the main areas.)

A4. Who thinks it is medium priority?

There was no obvious trend in terms of which groups of respondents held this point of view.

A5. Criteria for medium priority

Complexity of IFRS 2 requirements appeared to be the most common reason given by respondents for ranking this project as important. However, the fact that the respondents in this category then assigned a medium priority to this project seems to indicate that they were not too concerned about complexity in practice.

A6. Who thinks it is highly important?

ACCA, The Canadian Securities Administrators (CSA), China Accounting Standards Committee (CASC), FirstRand Ltd.

A7. Criteria for importance

Complexity of IFRS 2 requirements is the most common reason given by respondents for ranking this topic as highly important.

One preparer (in South Africa) commented extensively on why they assigned high priority to this project. Their main concern was that they believe that economic hedges of share-based payment arrangements are not reflected faithfully at the moment.

A8. Links to other projects

A few respondents (3)[4] – from all priority groups – believed that the IFRS 2 should be considered simultaneously with, or after, the research project on *Financial Instruments with Characteristics of Equity*.

[4] Please note that I have not reviewed responses to the research project on *Financial Instruments with Characteristics of Equity*.