IFRS 2 "Share-based Payment" review project

Comments on the research paper presented to the NSS in Frankfurt, September 2009

Andrew Lennard, Director of Research, Accounting Standards Board (UK)

1 A copy of the research paper accompanies this note in which comments have been added and some drafting suggestions made. Both this note and the points made in the accompanying paper represent the personal views of the author, and not necessarily those of his colleagues or of the ASB.

2 The authors and the working group are to be congratulated on a well reasoned and cogent piece of work.

3 The work is particularly timely given the growing awareness of the complex and—according to some—illogical results that are being encountered in the application of IFRS 2. Current controversies about the remuneration structures used in the finance industry may add to the timeliness of this study.

4 I have noted (but struggled with) the restriction of the scope of the paper, which is to maintain the core principles of IFRS 2, in particular the measurement at grant date. That said, the paper itself demonstrates that various difficulties arise with it. Substantial improvement to IFRS 2 is likely to be extremely difficult within this restriction, and it should therefore be reconsidered. It might, for example, be possible to confine the main report within its restricted scope, but outline a possible more satisfactory reform within an Appendix.

5 Because I have struggled to deal with all the points that the paper discusses within its restrictions, it seems helpful to set out my views as to how employee share options should be accounted for.

- All options should be recorded at the time the exchange happens which is when the employee provides services (that is, over the vesting period) and measured at fair value on that date—by debiting employee remuneration and crediting a liability.
- The liability should be remeasured to fair value at vesting date, which is when, for accounting purposes, the options are taken as issued.

- Remeasurement of the liability (truing up, if you will) should not be reported as employee remuneration but as some other kind of expense/income.

- At vesting date the liability should be transferred to equity. Equity should not be remeasured.

6 This is, of course, not quite in accordance with the *Framework*, because of its definition of a liability. But that definition is not quite right, because it confuses the existence of a liability with how it may be settled. (And, of course, IASB are rewriting their definitions.) After the employee has rendered service the employer is obliged to pay for them, and so has a liability. The settlement of that liability is another issue. On vesting date all that is in issue is an option which is an equity instrument.

7 The fundamental premise is that options should be reflected at their full value. Leaving aside the changes between initial recognition and vesting, it is in my view beside the point whether or not they correspond to the value of the employee services: it has been agreed that the employer will provide options and that is part of the remuneration cost. But it is clear that subsequent changes in value (Including declines to nil) are not part of, and do not affect, past remuneration costs.

8 I previously discussed these issues in an essay I wrote a while ago, and a copy of that is also attached. I am sending the full document because the section of share options (paragraphs 69-73) are only part of a larger argument and the context may be helpful.

Report back on the IFRS 2 "Share-based Payment" review project –September 2009

1. Reminder of the background and objectives of the project

IFRS 2 "Share-based Payment" was issued in February 2004 for application to annual periods beginning on or after the 1st January 2005. Since that date IFRS 2 has been subject to a considerable number of requests for interpretation and amendment, which illustrate the complexity of the Standard. Some of these requests have lead to interpretations and amendments whilst several requests for interpretation have been rejected by the IFRIC :

- The interpretation IFRIC 8 clarified the scope of IFRS 2 in January 2006;
- The interpretation IFRIC 11 clarified the accounting treatment of Group and Treasury Share Transactions in November 2006;
- A first amendment to IFRS 2 on Vesting Conditions and Cancellations was issued in January 2008;
- A second amendment to IFRS 2 on Group Cash-settled Share-based Payment Transactions was issued in June 2009; this amendment also incorporated in IFRS 2 the guidance contained in IFRIC 8 and IFRIC 11.

Considering the number of requests for changes they continued to receive, some of which questioning the underlying principles of IFRS 2, the IASB decided in 2008 to carry out a review of IFRS 2 in order to clarify the underlying accounting principles.

As part of its relationship with "National Standard Setters" (NSS), the IASB decided to ask at the NSS meeting in Melbourne (April 2008) if one NSS would agree to be responsible for the review project on IFRS 2. The ANC agreed to take on the project.

After some discussion about the general direction and the scope of the project, the IASB and the ANC agreed on the objectives and scope of the review at a meeting on 14 January 2009.

It was agreed that the aim of the project was to:

- Clarify rather than change the core principles.
- Ensure the consistency of these principles both within IFRS 2 and in relation to other IFRSs.
- Make the standard easier to understand and to apply.

In particular, a certain number of principles have been identified on which IFRS 2 is based:

- An asset or an expense is recognised by the entity when an asset or a service in exchange for a share-based payment;
- In an equity-settled share-based payment transaction, the reference date for measuring the asset or the expense when the entity cannot estimate reliably the fair value of the goods or service received is the grant date for the related equity instruments;
- The asset or expense is measured based on a fair value model.

Supprimé : Where under a share-based payment an entity receives

Supprimé : that

Supprimé : an asset or an expense is recognised by the entity

Commentaire : But it is the date of receipt, not grant date, except in the case of transactions with employees (IFRS 2, paragraph 13;BC 128).

These principles are considered as underlying assumptions and will not be challenged in the project. When redrafting IFRS 2 into a principles-based standard encompassing all issues considered through current provisions of IFRS 2, basic principles identified above will not be altered.

Following the meeting in January 2009, the ANC working group drew up a draft list of accounting principles and their related assumptions for presentation to the EFRAG, the IASB and to the NSS on the 8th and 9th of April 2009.

At the NSS meeting on the 8th and 9th of April 2009 the following objectives were confirmed:

- To redraft IFRS 2 to make the standard more principles-based without developing detailed application guidance;
- To maintain the above-mentioned core principles : to recognise an asset or expense as counterpart to a share-based payments, to measure the transaction by reference to the grant date, and to use a fair value (renamed "market-based value" in the ED on Fair Value Measurement issued in May 2009) model;
- To eliminate any inconsistencies within the standard and with other standards when redrafting IFRS 2.

Since the April meeting the working group has:

- Made contact with NSS interested in taking part in the project;
- Carried out a more detailed analysis of the principles and the way they are applied in the standard;

- Identified two alternative accounting objectives that could be set to IFRS 2, as well as possible related recognition and measurement approaches, including the definition of the notion of service rendered;
- Started analysing the interpretation and the related accounting treatment to be applied to modifications and cancellations of share-based payment plans to employees.

2. Analysis of the key accounting principles

The ANC working group identified and analysed 7 key accounting principles in IFRS 2 as well as the specific assumptions on which these principles are based. These principles are defined below and an analysis is provided of their application in general and significant specific situations with developments on the underlying rationale.

When undertaking this analysis, the ANC working group considered that it was necessary to examine in particular the application of these principles to the specific case of share-based payment plans signed between employees and their employer. The ANC working group noted that equity-settled payments to employees are one of the most frequent forms of share-based payments. However, equity-settled payments to employees have a number of specific characteristics:

- the services rendered by employees are generally difficult to identify and measure directly, which makes it necessary to develop specific approaches in such a respect;
- the granting and the vesting of such instruments are generally not simultaneous, i.e. the final vesting of such instruments by employees is usually subject to a vesting period as well as to the satisfaction of other conditions;
- the conditional nature of the grant of equity instruments to employees raises different recognition and measurement issues which should be dealt with.

As a result of the particular characteristics of these transactions, it appeared necessary to make specific assumptions or exceptions in applying general accounting principles. The ANC working group therefore decided to develop a specific focus, within the analysis of the underlying accounting principles, on equity-settled payments to employees in order to bring out the related specific assumptions and exceptions to general accounting principles.

Accounting principle 1

An entity shall recognize goods or services received in exchange for share-based payments[1] as an asset or expenditure respectively[2].

General case

When goods or services are acquired from a third party they can generally be easily identified as a contract is generally required where considerations exchanged are precisely defined. The contract will also usually specify the transaction price, as well as exchange conditions and timing.

Commentaire : I wonder what, in the context of a transaction to be settled by shares, is meant by 'the transaction price' and why it would be relevant.

Specific case

However, some services cannot be clearly identified. This is the case in particular of services received from employees in exchange for share-based payments. They are by nature difficult to identify and measure directly independently from the usual work to be provided by employees in exchange for their basic cash salaries.

It is assumed that when an entity makes a share-based payment it receives corresponding consideration irrespective of whether that consideration can be clearly identified. This assumption applies to services received from employees in exchange for share-based payments.

Rationale

As stated in IFRS 2 BC 37, the entity's directors would be in breach of their fiduciary duties to the shareholders if employees provided nothing in return for a share-based payment. It would be rational to consider as a general economic principle that where consideration is given an equivalent amount of consideration will be received in exchange. If an employer offers a share-based payment to his

[1] These share-based payments are not made with a shareholder acting in his capacity as a shareholder.

[2] This analysis will not challenge the statement that share-based payments should be considered as an expense of the issuing entity. This basic assumption, which has been extensively discussed when IFRS 2 was initially elaborated, forms part of the frame of reference of the project.

employees (with the agreement or preliminary authorization of the shareholders) in addition to the rest of their remuneration package, this may mean that this additional remuneration is necessary to obtain the employees' agreement to provide an additional service[3]. The fact that this additional service (or this part of the usual work – see footnote 3) cannot be clearly identified or differentiated does not necessarily mean that the service does not exist.

Comments

Some types of plan ("broad-based employee share plans") are open to all employees. It has been argued that where employment is the only condition for participating then there is no (specific?) service rendered by employees. Employee share-purchase plans, which are often broad-based, generally enable an employee to acquire equity instruments in exchange for a period of service. In some jurisdictions, schemes encouraging employee shareholdings may primarily reflect government rather than corporate policy. Moreover, the discounts granted to employees as compared to market price may be minimal. It has been argued that such employee share-purchase transactions do not represent remuneration in exchange for services i.e. there may be very little remuneration in the form of financial incentives to employees to acquire the instruments, whilst no particular service other than "staying employed" may be identified.

The ANC working group has not yet studied this category of share plans. It would, however, appear that where some form of discount, albeit a small one, is granted to employees as a result of their contract of employment that benefit represents remuneration in the form of a share-based payment. The service rendered in exchange could be seen in terms of motivation and fidelity for employee share-holders.

Commentaire : I agree with the conclusion, but perhaps because I am influenced by a belief that, in principle one should always reflect the fair value of the equity issued first, and then worry about what has been received in exchange.

[3] Sometimes, especially in start-up entities, the share-based payment is part of the normal remuneration package of the employees and will pay a part of their usual work.

Accounting principle 2

An asset or an expense shall be recognized even if the share-based payment is made by a shareholder of the entity or another group entity.

General case

When a shareholder of the entity or another entity of the same group makes a share-based payment to a supplier or to employees of the entity, it is assumed to be in consideration for an asset or service received by the entity.

In this case, the entity receiving the goods or services without the obligation to settle the share-based payment transaction to the supplier or its employees recognizes an equity-settled share-based payment transaction. The shareholder or entity of the same group which settles the share-based payment transaction recognizes it as an equity-settled share-based payment transaction if it is settled in their own equity instruments. Otherwise, they recognise it as a cash-settled share-based payment transaction.

Rationale

The ANC working group has not identified reasons to question this accounting treatment which has been clarified by the June 2009 amendment to IFRS 2. There are merits in applying consistent accounting treatment in the separate financial statements of the entity receiving the goods or services as well as of the entity settling the share-based payment, and in the consolidated financial statements of the group.

Comments

The ANC working group considers that it is not necessary that the shareholder or entity of the same group settling the share-based payment necessarily exercises control over the investee. This type of payment may therefore be made for an associate or a jointly-controlled entity.

Moreover, it is not clear what should be recognized in the separate financial statements of the paying entity on the debit side of the share-based payment

transaction (investment? loan? expense?). This may be part of an additional analysis to be carried out by the ANC working group.

Commentaire : I would have thought the paying entity would recognise a debtor (to the extent that the value of the share-based payment was recoverable from the other group entity) and otherwise an increase in its investment in the other group entity. Either of these might, of course, lead to an impairment.

Accounting principle 3

The asset is recognized when received and an expense is recognized when the asset received is consumed or the service rendered.

General case

For assets or services that can be readily identified, it is generally easy to identify the date when the asset is received or the period over which the service is rendered. This date or period will be considered as the date or period of recognition.

Specific case

When, as for most services rendered by employees, the asset or service cannot be readily identified the recognition date or period need to be determined indirectly by reference to the terms of the contract:

- Where entitlement to the share-based payment is linked to the completion of a vesting period, the service is assumed to be carried out evenly over that period unless otherwise indicated
- Where entitlement to the share-based payment is not linked to the completion of a vesting period, the service is assumed to be carried out immediately

Rationale

When a service cannot be readily identified, and therefore the date when, or period over which, it is rendered cannot be directly determined, the most objective way to approximate this date or period is to refer to the terms of the contract. Therefore, if the terms of the contract include a vesting period, it may be assumed that the services are required to be provided during this period.

In IFRS 2 BC 201, it is noted that some argued that services may have been provided before the vesting period, whereas other argued that services may continue to be provided after the vesting period.

If share-based payments are provided for past services, they should logically be granted immediately, i.e. without a vesting period. The accounting treatment of such share-based payment is immediate recognition of the expense. This seems to be the adequate accounting treatment as the related services were provided before the grant date and if the payment is immediate and unconditional. When a vesting period is required for the granting of all or part of the share-based payment, it may be assumed that the related services have not yet been provided. Otherwise, granting share-based payment without a vesting period in exchange for a service that has not yet been provided would put the entity into a situation where it bears the expense whatever subsequently happens. Therefore, it would be appropriate to recognise the expense immediately in this case. As concluded in IFRS 2 BC 202, it may appear reasonable to consider that presuming the services are received during the vesting period, if any, is a good approximation when these services cannot be readily identified or distinguished.

After completion of the vesting period, employees owning equity instruments of the entity may have an interest in acting in order to enhance the fair value of the entity's equity instruments. They also may develop some strategy related to their expectations of subsequent fair value changes of their equity instruments, depending on the exercise conditions. This may result in these employees providing additional services to the entity in some cases. However, the existence and value of these services would depend on circumstances that no longer have a close relationship with the initial agreement achieved at the grant date.

Accounting principle 4

Consideration given for the goods or services received is recognized in equity or in debt according to the type of payment.

General case

The ANC working group noted that the current definition of equity and debt in IFRS 2 is very concise and makes reference to the Framework only. This creates differences with the definition of equity and debt in IAS 32 on the grounds that it is a service being measured and not a financial instrument, as well as that in certain cases the number of share options to which the employees are entitled varies (IFRS 2 BC 107).

Some differences in practice can be noted, such as:

- A settlement of a variable number of shares (issue of a variable number of shares in exchange for a fixed amount) can be considered as an equity-settled share-based payment;
- Constructive obligation to pay in cash resulting in the share-based payment being considered as cash settled;
- Contingent settlement not dealt with;
- Split accounting being slightly different from IAS 32.

The classification will depend on the nature of the instrument the entity ultimately remits to the beneficiary.

The ANC working group considers that the distinction between equity and debt should be consistent with the requirements of IAS 32 although this is not the case in the current version of IFRS 2.

Rationale

As mentioned above, IFRS 2 BC 107 highlighted that in some cases the number of share options to which employees are entitled may vary depending, for example, on whether, and to the extent that, a particular performance target is exceeded. Applying the definition of equity in IAS 32, which requires the number of equity

instruments to be issued on settlement to be fixed, would in such cases result in considering the share-based payment as cash-settled and therefore in re-measuring it after the grant date. The Board considered that such a re-measurement should be avoided and therefore that the definition of equity in IAS 32 should not be applied to IFRS 2.

The ANC working group acknowledges that some contracts include provisions that may make the number of equity instruments granted to employees vary depending on a particular performance target being exceeded. However, it may be noted that this does not mean that, for a given performance achieved, the number of equity instruments granted is variable. It may be considered that, in such cases, there are a fixed number of equity instruments granted for each element of service or performance performed. For example, if 10 equity instruments are granted if a certain level of performance is achieved and 5 more if a higher level of performance is achieved, one may consider that the number of equity instruments granted is fixed for each required level of performance: 10 for the first one, 5 more for the second one (achieving the second one means that the first one has already been achieved and the 10 first equity instruments have already vested). The ANC working group has not yet identified a contract where the number of equity instruments granted may vary for a given service or level of performance.

Therefore, it could be considered that there is no inconsistency between the definition of equity in IAS 32, including the requirement that the number of equity instruments to be issued on settlement should be fixed, to be applied in IFRS 2 and the accounting principle that equity instruments granted should not be re-measured subsequently. Applying the definition of IAS 32 would therefore create no undesirable consequence in this respect, while achieving a consistent approach between IFRS 2 and IAS 32.

It may also be noted that it would be easier to implement the expected new definition of equity and debt in the future when the current provisions of IFRS are consistent on this point in all the standards.

Concerning the fact that IFRS 2 focuses on the measurement of the service instead of the financial instrument, it may be noted that recognition of the counterpart of the services (or goods) as equity or debt is a question of classification, not measurement, and can be solved independently from the recognition of the service.

Accounting principle 5

The asset or service received is measured at the fair value of what is received or of what is given up according to the general principles applicable to exchange transactions.

General case

For cash-settled share-based payment transactions, the entity shall measure the goods or services received at the fair value of the liability incurred.

For equity-settled share-based payment transactions, the entity shall measure the goods or services received directly at the fair value of the goods or services received (unless that fair value cannot be estimated reliably).

Specific case

If the fair value of the goods or services received cannot be estimated reliably, the entity shall measure their value indirectly by reference to the fair value of the equity instruments granted.

The ANC working group has not seen significant reasons to question this accounting treatment.

Rationale

The ANC working group has analysed if the general principles relating to exchange transactions were applied in IFRS 2 (in particular in BC 61 to 68) consistently with the way they have been applied in other IFRSs. Therefore, the relevant requirements of IAS 16 *Property, Plant and Equipment* which are amongst the most detailed in IFRSs setting out the general principles applicable to exchange transactions have been closely examined.

IAS 16 paragraph 23 requires that, when an asset or service is received in exchange for a fixed amount of cash at the recognition date, the fixed amount of cash is assumed to represent the fair value of the consideration received. This is consistent with the statement in IFRS 2 considering that, for cash-settled share-based payment transactions, the goods or services received and the liability incurred are measured at the fair value of the liability.

Commentaire : No, IAS 16 paragraph 23 is about cost, not fair value.

For payments of a non-monetary nature, IAS 16 paragraph 26 states that the fair value of the asset given up is used to measure the asset or service received unless the fair value of the latter is more reliable. This is consistent with the statement in IFRS 2 considering that, in general cases where an equity-settled share-based payment is made, the entity shall measure the goods or services received directly at the fair value of the goods or services received (unless that fair value cannot be estimated reliably), as the measurement of this fair value is assumed to be more reliable than the measurement of the fair value of the equity instruments given up. Moreover, some may argue that the equity instruments given up are not assets by nature, but only a difference between the total assets and total liabilities of an entity.

However, in the specific case of an equity-settled share-based payment made in exchange for services rendered by employees, the fair value of the equity instruments given up may appear more reliable than that of services received since the latter are difficult or impossible to identify and measure directly. Therefore the fair value of the equity instruments given up is used to measure the transaction. This is consistent with paragraph 26 of IAS 16 that requires using the fair value of the asset given up when the fair value of the asset received is not more reliable.

As a conclusion, it seems that the application of the general principles applicable to exchange transactions in IAS 16 and IFRS 2 are consistent with one another.

Comments

Some argued that in IFRS 3, there were provisions applicable to exchange transactions that may differ from those mentioned above. This may be investigated further.

Accounting principle 6

Initial measurement is made (at the fair value) at the exchange date.

General case

When the asset or service received is readily identifiable, the date or period of exchange can generally be easily identified in conformity with Accounting principle 3, and measurement takes place at that date in conformity with Accounting principle 5.

Specific case

When the asset or service received is not readily identifiable, such as in the case of services rendered by employees, the date or period of exchange is determined by reference to the contract and in particular by reference to the vesting period where applicable, as explained in specific cases dealt with in applying Accounting principle 3.

As stated in Accounting principle 5 above, equity-settled share-based payments for employee services are measured at the fair value of the equity instruments given up.

This fair value is determined at "grant date"[4].

Rationale

The fair value at "grant date" is considered as the reference for measuring the transaction at the exchange date on the grounds that it is the date at which the two parties agree on the terms of the exchange. As explained in IFRS 2 BC 96, the fair value at "grant date" represents the balanced value on which the parties agreed to exchange considerations.

[4] This analysis will not challenge the statement that "grant date" is an appropriate surrogate measure of the fair value of the services rendered. This basic assumption, which has been extensively discussed when IFRS 2 was initially elaborated, forms part of the frame of reference of the project. Arguments are only provided as a reminder .

It may be argued that the "grant date" is not the date (or period) when the considerations are effectively exchanged. The "service date" or vesting period could be considered as more representative of when the exchange effectively takes place. However, there may be concerns about whether the subsequent changes in fair value of the share-based payment granted are representative of the value on which parties to the contract agreed to exchange considerations. As noted by the Board in IFRS 2 BC 95 and 104, it is unlikely that subsequent changes in the fair value of the instrument to be issued could be considered as highly correlated with changes in the fair value of services rendered. It is for this reason that measurement at "service date" i.e. re-measurement during the vesting period is not considered appropriate.

Commentaire : I strongly agree with the first two sentences. What the parties thought they were agreeing to exchange and what they actually did exchange are two different things. Financial reporting should report the latter, not the former—compafre a contract to acquire goods where the price is expressed in a foreign currency.

It may be also noted that once the terms of the contract are fixed at "grant date", they are not changed afterwards whatever changes in the fair value of the instruments granted are, which may be understood as the parties still agreeing on the initial terms of the contract, unless the contract is subsequently modified or cancelled. Effects of modifications or cancellations will be analysed further specifically. Therefore, in the absence of modification or cancellation of the contract, the fair value at "grant date" may be considered as a good surrogate measure of the fair value of the services rendered.

It is at "vesting date" that the employee becomes entitled to receive the equity instruments. It may therefore seem appropriate to measure the transaction at that date. However, services are rendered by the employee over a period of time and not specifically - and certainly not entirely only - at the vesting date. Therefore, mirroring equity interests are also granted over a period of time, as noted by the Board in IFRS 2 BC 101. Measuring these equity interests at "vesting date" would be contrary to the principle of not revaluing equity instruments (IFRS 2 BC 103).

Commentaire : This problem, of course, goes away if the view is taken that what exists before the vesting date is a liability, not an equity instrument.

An employee finally exercises his rights to remuneration at "exercise date". However, the "exercise date" occurs after the exchange date or period which is complete on vesting. Moreover, "exercise date" measurement would also require re-measurement of the equity instruments.

Accounting principle 7

Subsequent measurement of share-based payment transactions reflects the nature of the related reference items (debt or equity) according to the general principles of accounting for exchange transactions.

General case

For cash-settled transactions, where the reference item is a liability, the latter is re-measured at each reporting date to reflect changes in the fair value of the related equity instruments according to the terms of the contract.

For equity-settled transactions the fair value of the instrument used to measure the transaction is not re-measured subsequent to the grant date.

Rationale

The general accounting principles in the IFRS framework is that a liability is re-measured to reflect the current related obligation to pay cash in the future if this obligation changes in accordance with some index (in this case the fair value of equity instruments), whereas equity instruments are not subsequently re-measured.

Comment

Although the liability representing a cash-settled share-based transaction shall be subsequently re-measured, one should take into consideration arguments developed in order to justify the use of the "grant date" for equity-settled share-based transactions. In particular, the statement that it is unlikely that subsequent changes in the fair value of an equity instrument to be issued could be considered as highly correlated with changes in the fair value of services rendered should also be applied to subsequent changes in the fair value of liabilities which are indexed on an equity instrument. In order to be consistent with the grant date approach to measurement of equity-settled share-based transactions, changes in the fair value of a liability representing a cash-settled share-based transaction should not affect the fair value of services rendered. Instead these fair value changes should rather

be recognised as financial expense or income (not as an operational expense or income).

Commentaire : I very strongly agree. The same treatment should be accorded to equity-settled share based payments between initial recognition (which should be on service date) and vesting date.

The application of this presentation approach for cash-settled share-based transactions would have the merit of making recognition of operational expenses related to share-based payment transactions comparable whether they are settled in cash or in equity instruments.

Q.1. Do you have comments on the statements, rationales and comments developed when analysing these Accounting principles?

Q.2. Do you consider that other aspects, rationales or comments could be examined?

3. **Analysis of key accounting issues**

3.1. Identification of possible main accounting objectives

The analysis of how to apply the key accounting principles underlying IFRS 2 raises the issue of what the standard is setting out to portray. Once this objective has been determined, the key recognition and measurement principles should reflect a common accounting approach in line and consistent with this main objective.

The ANC working group noted two possible main accounting objectives that could be assigned to IFRS 2:

1. **To represent assets acquired by or services rendered** to the reporting entity as part of a share-based payment transaction irrespective of whether there is an identifiable payment made by the entity (or by a entity's shareholder or another entity of the group).
2. **To represent share-based payments** made by the reporting entity (or by a entity's shareholder or another entity of the group) irrespective of whether there is an identifiable service rendered to the entity.

These two objectives focus respectively on the two different facets of the exchange and may lead to different representations of the transaction.

Supprimé : payments to

For example, if we consider equity-settled schemes for employees including a vesting period, which are common transactions, services may be rendered by employees in the expectation of remuneration without ever actually giving rise to a payment e.g. if any of the conditions of payment are not satisfied. In a transaction with a 3 year vesting period an employee may leave after 2 years and 11 months and therefore not meet the payment condition. If we consider only the objective of representing the payment of the transaction, in this case nothing will be recognized because the vesting condition has not been satisfied.

Nevertheless, the employee may be perceived as having "performed" during his period of employment in the expectation of remuneration. He will have been present for the greater part of the vesting period and may therefore have substantially rendered the required services. If we consider the objective of representing services rendered by the employee, it would appear logical to

recognize as an expense the fair value of services rendered before the employee's departure.

This question has been analysed in particular in IFRS 2 BC 207 to 213 and the conclusions were that the objective of the standard should be to account for the services subsequently received, rather than the cost of the equity instruments issued (in the case of a equity-settled share-based payment transaction). However, there is an issue as to whether services should be recognized even when there is no payment, considering the two following aspects:

- Payment will be made only if all the service and performance conditions included in the initial contract agreed on by both parties at "grant date" are completely fulfilled; therefore, it may be considered that services rendered are closely linked to the fulfilment of these conditions; if these conditions are not completely fulfilled, one may consider that the related services have not been rendered; analysing services rendered in such a way could justify a focus on representing the payment of share-based payment transactions as the materialization of the rendering of the related services;
- Even if one may consider that services have been partially rendered, the absence of payment may be interpreted as these services being rendered for free; therefore these services should not be recognized in the accounts as they would be measured for nil; one may question the consistency of such an interpretation with the accounting principle that equity instruments issued should not be re-measured; it might be argued that it is the services that are measured, not the instruments, and that the instruments have finally not been issued.

Current provisions of IFRS 2 may be confusing in this respect, as they may be interpreted as a mix of both approaches. For example, the recognition of services rendered is cancelled retrospectively when an employee does not fulfil service or non-market performance conditions. This accounting treatment may appear as aiming to represent the payment (through the kind of approach chosen in terms of measurement method determined at "grant date"), although it could be argued that the employee has at least partially rendered required services. The measurement principle applied to cash-settled share-based payment transactions appears consistent with the objective of representing the payment rather than the value of services rendered, especially as no distinction between the measurement of services rendered and fair value changes of the liability due to changes in the fair value of the equity instrument used as an index is required.

On the other hand, cancellation of share-based payment agreements by the employer does not result in the recognition of services rendered being cancelled retrospectively (their recognition is even accelerated), which does not appear consistent with the payment approach. Moreover, it is a core principle of IFRS 2 that an entity shall recognize services as they are received in a share-based payment transaction (see Accounting principle 1 above).

It therefore appears that a clarification of the accounting objectives of IFRS 2 is necessary.

In order to make IFRS 2 appear more principles based, one should make a clear choice between these two objectives and approaches and develop detailed provisions of the standard consistently. In particular, recognition and measurement principles should reflect the chosen objective and approach. As noted above, this includes clarification of how the notion of service rendered is understood.

The ANC working group preliminary analysis is that the objective of representing services rendered may imply:

1. A definition of services rendered that is proportional to employee's presence.
2. A measurement method taking into account all contractual conditions other than service conditions.
3. An interpretation of the effect of resignations, dismissals, cancellations such that services rendered prior to these events would be recognized and not eliminated retrospectively.

The ANC working group further analysed that the objective of representing the payment of the transaction by the entity (or an entity's shareholder or another entity of the same group) may imply:

1. A definition of service rendered that includes presence of the employee at the vesting date.
2. A measurement method not taking into account contractual conditions that could call into question the payment.
3. An interpretation of the effect of resignations, dismissals, cancellations taking account the effect of these events on payment, such that where no payment is to take place all expenditure in respect of services rendered is eliminated retrospectively.

Q.3. Do you agree that the accounting objectives of IFRS 2 require clarification?

Commentaire : Yes

Q.4. Do you think that the primary accounting objective of IFRS 2 should be to :

1. represent services rendered to the reporting entity, or

2. represent the payment of share-based payment transactions?

Commentaire : There is a false distinction here—and in IFRS 2. The view that the accounting should reflect the services rendered means that the number (and value) of equity instruments issued is irrelevant, which cannot be right. The payment view is equated with vesting date accounting—which means no expense is recognised if nothing vests. Neither conclusion is satisfactory.

3.2. Definition of the notion of services rendered

When applying the objective of representing services rendered it is necessary to consider what is meant by "service". Does the service consist of completing the required vesting period in full and being present on the vesting date? Or could it be that service implies service or performance over a period of time irrespective of whether the employee is still there on the vesting date? There would appear to be at least two possible interpretations of what is meant by service.

The ANC working group identified two possible definitions of the notion of service rendered:

1. Services are supposed to be rendered regularly on an accrual basis and are supposed to be proportional to the employee's presence; this definition seems consistent with the objective of representing service rendered and could facilitate the achievement of this objective;
2. Services are rendered if service (and performance) conditions are fully completed, which implies that they are rendered if the employee is present at the end of a vesting period, if any; this definition seems consistent with the objective of representing payment of share-based payment transactions.

The ANC working group also considered examining a third definition of services rendered that would be considered as an additional element not based on the sole presence of the employee during or at the end of a vesting period. This service would consist in an expected additional performance to be rendered during the presence of the employee and linked with productivity, quality of the work performed or other kind of motivation.

The ANC working group thought that such a definition would help in building a conceptual basis for the current provisions in IFRS 2 that result in applying a different accounting treatment when vesting/non vesting conditions are fulfilled or not, as well as when forfeiture/cancellation occurs. Such an approach would explain these different treatments by referring to the respective initiative and responsibility of the employees or employers in not respecting the conditions or terms of the initial contract agreed at "grant date". When the breach of the contract is at the initiative of the employee, it would justify the retrospective cancellation of recognized services on the grounds that this initiative evidenced a lack of motivation or performance from the employee, that could be supposed to exist since the beginning of the vesting period. On the contrary, a breach at the initiative of the employer could justify not cancelling the recognition of services retrospectively on the grounds that this event does not prevent the employee from performing the expected service at least until the date of the breach.

Having said that, the ANC working group acknowledged that this approach may result in various application difficulties similar to those currently experienced. This creates difficulties in differentiating vesting and non vesting conditions, in particular non-market performance conditions where fulfilment could be under the control of the employee and market conditions that would be beyond his control. There would also be difficulties in making the distinction between events resulting in breach of the contract at the employee's or the employer's initiative . For example, some resignations may be caused by employers whereas some redundancies may be at the employee's demand. Trying to solve these issues may imply developing rules based approaches that would not be in line with the objective of the review project.

Therefore, the ANC working group concluded that this third definition could not be applied in a principles-based approach and would not be explored further.

Q.5. Do you agree that the definition of what is meant by service is an issue?

Commentaire : Yes

Q.6. Which definition of service do you find appropriate in the above example: presence at the vesting date or presence and implicitly performance during the vesting period?

Commentaire : Performance during the vesting period—ie when services are rendered. But this does not mean that changes between initial recognition and vesting date can be ignored.

3.3. Possible recognition and measurement methods

The working group considered which methods would be appropriate considering the above discussion on the main accounting objectives and on the definition of services rendered. Most of the measurement approaches have already been analysed and discussed in the BCs of IFRS 2.

The grant date method

The ANC working group analysed this method although it does not seem to comply with either the main accounting objectives nor the definition of services rendered discussed above. However, as the other analysed methods derive from this one, the ANC saw an interest in examining it as a preliminary step.

Description

The primary objective of this method is to account for the value of services expected to be rendered in exchange for rights granted (subject to conditions) to employees. It is based on the assumption that the value of services expected to be rendered is equivalent to the value of the rights granted under conditions.

Under this method all contractual terms and conditions are included in the grant date value of the instrument. The total transaction cost is determined at grant date.

If the service has been rendered at grant date, then the corresponding expenditure is recognized in full at that date. Where the service has not been rendered at grant date, the total transaction cost is expensed over a period of time e.g. the vesting period.

There is no subsequent adjustment to the transaction cost to take into account actual outcomes.

Assessment

The grant date method reflects the view that the transaction is a conditional grant of rights to equity instruments to employees in exchange for expected services that takes place at the grant date.

As the fair value measurement of the transaction includes the expected impact of all terms and conditions of the contract, it is not affected by actual outcomes relating to the realisation of the various agreed conditions. As a result, it will recognize the services rendered and the corresponding share-based payments as they were initially expected without any adjustment to effective realization.

It is not therefore compatible with the view that the cost of the transaction should reflect the fair value of instruments that actually vest or rights actually exercised by employees. This implies that recognition of the cost of the transaction recognized through this method will not meet the objective of representing the share-based payment effectively made. It is also not compatible with the view that the cost of the transaction recognized in expense should meet the objective of representing the services effectively rendered as it does not take into account actual outcomes for service conditions.

Another difficulty relating to this method lies in the measurement of the various conditions at the grant date. Can the grant date measurement of all these conditions be considered reliable? It could, however, be argued that what is important is that the two parties have agreed on the terms of the exchange and not whether those terms are actually corroborated by actual outcomes.

Subject to the preceding remarks, this method simplifies the accounting for share-based payment transactions, once the initial measurement is made. However, it could be said that neither of the two possible main accounting objectives identified above can therefore be fully reached through that method because it does not take into account actual outcomes.

Modified grant date method adopted in IFRS 2

Description

As under the grant date method, the objective is to measure the fair value of services rendered by reference to the agreement between the parties at the grant date.

Under the modified grant date method, all the terms and conditions of the transaction other than service conditions and non-market performance conditions are included in the grant date fair value of the instruments. An expense is recognized on the basis of the number of instruments expected to vest i.e. service and non-market performance conditions are taken into account in the assessment of the number of instruments expected to vest. The number of instruments expected to vest will reflect the estimated rate of forfeiture.

No expenditure is recognized on a cumulative basis where a service or a non-market performance condition is not met.

Assessment

The fair value measurement at the grant date is easier to assess in this approach compared to the grant date method, as service and non-market performance conditions are reputed to be the most difficult ones to include in the estimate of the fair value.

Although the modified grant date method sets out to represent services received it does not take into account services rendered proportionally by employees (see debate on the definition of services rendered in 3.2 above) i.e. a service is only recognized to the extent a vesting condition is fully satisfied. Therefore, this method as it is currently applied in case of forfeiture does not seem to be compatible with the definition of services rendered on an accrual basis proportionally to the presence of the employees during the vesting period. In this respect it differs from the unit of service method described below. It will also not represent the share-based payments effectively made, as market conditions are included in the initial fair value measurement. This means that the effective realization of these market conditions will not adjust the recognition process subsequently if realization differs from expectations.

Non-market performance conditions are treated in the same way as service conditions i.e. they are taken into account in estimating the number of instruments to vest. They are considered to be like service conditions because an employee can influence their outcome. This assumption is debatable. The example given in the table in the Guidance for Implementation of IFRS 2 is a "Target based on a successful initial public offering with a specific service requirement". In the case of this example and more generally, it is debatable to what extent the outcome of such performance conditions can actually influenced by the employee. In which case, it might seem more appropriate to include such conditions in the fair value of the instrument as for market-based performance conditions. Assessing which performance conditions are under the control of the employees – and to which extent – is anyway a difficult and judgmental exercise.

Units of service method

Description

The objective of this method is to represent services actually rendered by employees.

It is based on the assumption that there is a balanced agreement at the grant date such that the fair value of services expected to be received is equivalent to the fair value of equity instruments expected to be issued.

According to this method, a fair value per unit of service is determined by dividing the grant date fair value of the equity instruments to be issued, allowing for all vesting conditions and adjusted for the expected rate of forfeiture, by the number of units of service expected to be received.

The actual number of units of service received is measured at the fair value per unit of service.

Under this method there is no reversal of the expenditure for services effectively received e.g. in the case of forfeiture.

Assessment

This method arguably provides a faithful representation of services effectively received by an entity. It seems compatible with the main accounting objective to represent services rendered and with the definition of services rendered on an accrual basis proportionally to the presence of the employee during the vesting period.

However, the notion of services received is open to interpretation (see 3.2 above). For example, where an employee is present at the vesting date but a performance condition has not been met, has the employee rendered the required services? The IASB took the position in ED 2 that services had been rendered and that the corresponding expenditure should be recognized, although this position was not shared by many commentators.

This method was not finally adopted by the Board for practical reasons rather than reasons of principle. These reasons include the difficulties of estimating the grant date fair value of certain non-market performance conditions and the need to track individual employees where all employees do not have identical rights under a scheme.

A variant of the unit of service method excluding performance conditions which have to be performed directly by the employee from the grant date fair value might also be considered.. This implies that these performance conditions are under the control of the employee and their achievement is representative of the achievement of the service expected from the employee. The distinction between these performance conditions and other conditions may be difficult to assess.

Another question would be how to assess if and to which extent these performance condition are met. By analogy with the definition of service as rendered on an accrual and proportional basis, the performance conditions could be considered as partially met using a proportional measurement method. However, it may be difficult and judgmental to determine which kind of measurement process could be applied.

The ANC working group has not analysed if and how some performance conditions could be excluded from the initial fair value measurement at grant date.

Payment method

Description

The objective of this method is to represent the payment of the instruments that effectively vest.

Under this method, the fair value of the instruments excludes the effect of all the payment conditions and expenditure is recognized on the basis of the number of instruments expected to vest. An adjustment is made to take into account the actual number of instruments that vest.

As a consequence, where an entity has provided for expenditure for which the payment conditions are not ultimately satisfied, the expenditure will be reversed.

Assessment

This method focuses on the representation of payment of share-based transactions that actually vest to an entity rather than on the representation of services rendered to the entity. It does not take into account whether employee's rights are actually exercised. Therefore, it is compatible with the main accounting objective to represent payment of share-based payment transactions that actually vest and with the definition of services that requires the complete fulfilment of the vesting conditions.

By definition, services rendered that do not give rise to payment are not recognized. Therefore, this method is not compatible with the main accounting objective to represent services rendered and with the definition of services rendered on an accrual basis.

Q.7. Which of the modified grant date method currently applied in IFRS2 and the Unit of Services method provides the most relevant representation of services rendered by employees?

Commentaire : The Unit of Service method seems the most promising of those presented.

Q.8. If, as under the grant date method, it is assumed that the terms of an equity-based transaction are agreed and the value of services to be received fixed at grant date (), is it relevant to consider the outcome of vesting conditions or other future events in accounting for the transaction?

Commentaire : I find it difficult to comment on a method that seems to be based on reflecting what the parties think will happen, rather than what actually transapires.

Q.9. Do you agree that the payment method adequately fulfils the main accounting objective of representation of payments of share-based payment transactions that actually vest?

Commentaire : It portrays the cost of those transactions that vest, but does not successfully convery the cost of those that do not.

Supprimé :

3.4. Modifications and cancellations

The above discussions generally assume that the initial plan, as agreed at the grant date, will reach its term unchanged. However, for different reasons such as a change in market conditions affecting the value of the rights granted to employees, it may be considered appropriate to modify or cancel the initial plan. Modifications and cancellations are often similar in substance, for example where cancellations lead to the introduction of a new plan with modified conditions. Therefore, these situations should be analysed by focusing on all changes that appear interlinked and their global impact rather than on individual changes.

Modifications

An entity might modify the terms or conditions under which equity instruments were granted to employees during the life of the plan e.g. options may be re-priced to take account of changing market conditions. In this case, the re-pricing may be analysed as an increased benefit for the employee to the extent the resulting share-based payment is worth more than if it had not been re-priced.

As noted above, the analysis of the situation should include all changes that appear to be interlinked. For example, a cancellation occurring at the same time as the initiation of a new agreement that in fact replace the previous one cancelled should be analysed as a modification.

Under the assumption that the initial fair value of the instruments reflected the services to be rendered at the grant date, it appears logical that the re-pricing of an option that effectively leads to a revaluation of the instruments would also lead to a revaluation of services still to be rendered as from the date of modification.

The ANC working group considers that the current accounting treatment in IFRS 2 that relates to modifications resulting in increasing the fair value of the considerations given to employees at the date of the modification appears appropriate and in line with the accounting principles underlying IFRS 2.

IFRS 2 does not however require a symmetrical treatment for modifications that give rise to a decrease in the fair value of the instrument granted. The Board gives no principles-based justification for this position. It is however stated that an entity should not be able to avoid recognizing at least the agreed grant date fair value of remuneration.

So far the ANC working group has not found a principles-based justification for the difference of treatment of positive and negative modifications.

It noted that applying a symmetrical treatment may have accounting consequences that may appear counter-intuitive in some circumstances. For example, if the fair value of equity instruments granted in a share-based payment transaction subsequently rise sharply, e.g. from 10 to 100, and the modification results in a reduction of their fair value from 100 to 50, the negative change at the date of the modification (minus 50) would result in the services recognized as rendered on the remaining vesting period being negative or even the global amount of services recognized (or value of the payment in equity instrument effectively vest) becoming negative.

It also noted that in the opposite case where the fair value of equity instruments granted subsequently decreases to a point that makes the employees agree on a modification that results in the equity instrument being further reduced to nil with no reasonable expectation of recovery, this modification will have the same effect as a cancellation without the obligation to apply the same accounting treatment.

The ANC working group will continue to carefully analyse these situations in order to determine the accounting principles that would address them appropriately.

Cancellations

Under the requirements of IFRS 2, when an entity cancels a share or share option grant during the vesting period, it is required to recognize the outstanding amount of remuneration expense immediately as though vesting had been accelerated by the cancellation.

It should be noted that the failure to meet a non-vesting condition by a counterparty which can choose not to meet that condition is also treated as a cancellation.

The arguments in favour of maintaining the expense in spite of cancellation given by the Board (see BC 233) are that:

1. An employer would not be able to avoid giving compensation to employees or implementing a replacement plan
2. The treatment should be consistent with that of a modification

The ANC working group noted that where a replacement plan was introduced this was equivalent in substance to a modification rather than a termination of the plan.

However, if the plan was cancelled and compensation given, it may be considered that the compensation replaced the plan remuneration, possibly for a different amount. In this case it may be appear logical to reverse or stop recognising the plan remuneration expense and replace it by the compensation expense, depending which accounting approach is applied. However, concerns expressed in IFRS 2 BC 232 that such accounting treatment may allow an asymmetrical treatment of changes in equity instruments' prices (recognition of the effect of fair value decrease whereas fair value increase will not be recognized) have to be noted.

The working group had difficulty in finding a principles-based rationale for the requirements of IFRS 2 related to cancellation. The principle of immediate accelerated vesting is a possible interpretation of the cancellation event among others. The ANC working group has not yet identified reasons to favour this interpretation compared to other ones and will continue its analysis in this respect.

It noted that the current provisions would not appear to be compatible with a faithful representation of services rendered. On the other hand, immediate vesting did not correspond to a representation of expected cost or payment.

Q.10. What principles-based rationale do you see for explaining the treatment of cancellations and negative modifications?

Commentaire : I share the puzzlement of the ANC working group.

Q.11. Is the approach adopted consistent with the main accounting objectives of the standard?

4. The way forward

The ANC working group is issuing this paper ahead of the NSS meeting of September 2009 with a view to obtaining NSS's reactions to the questions raised in the paper, both at that meeting and up until a deadline which we fix for the 15th of October 2009.

In the meantime, the working group will continue to address issues requiring further research and in particular the issue of Modifications and Cancellations.

The ANC working group will incorporate NSS input through October 2009 with a view to developing a comprehensive consistent principles-based approach ahead of the NSS meeting in spring 2010.