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

1. Background

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 as follows:

- The Interpretation IFRIC 8 clarified the scope of IFRS 2 ;
- The Interpretation IFRIC 11 clarified the accounting treatment of Group and Treasury Share Transactions ;
- An amendment to IFRS 2 clarified the accounting treatment of Vesting Conditions and Cancellations;
- The IASB is currently working on a new amendment to IFRS 2 and IFRIC 11 which sets out to clarify the scope and the accounting for group transactions, while another scope issue is currently dealt with as part of the Annual improvements project.

Several of these requests for interpretation have been rejected by the IFRIC. However the IASB continues to receive frequent requests for change, some of which challenge the underlying principles of IFRS 2. Considering the number of these requests and the fact that the Standard has now been applied for four years, the IASB has decided to carry out a review of the Standard in order to clarify the accounting principles underlying IFRS 2 and to facilitate application and enhance understandability.

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 clarified the objectives and scope of the review at a meeting on 14 January 2009. The following description of the project reflects this clarification including the objectives, the scope, the organisation and an estimated timetable for the project. They may be a basis for a Memorandum of Understanding between both parties.

2. Objectives

The objective of the review project is to prepare a draft revised IFRS 2 without changing the basic principles underlying the standard. The outcome of the work should be a revised IFRS 2 that is easier to read and understand, facilitates the application of the standard in practice and enhances the comparability of reported information.

A certain number of principles have been identified on which IFRS 2 is based:

- Where under a share-based payment an entity receives an asset or a service in exchange for that payment, an asset or an expense is recognised by the entity;

- 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.

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, basis principles identifies above will not be altered.

3. Scope and issues

As explained above (see Section 1 “Background”) different interpretations and amendments have been set out to clarify or are in the process of clarifying the scope of IFRS 2. The review should therefore, as necessary, deal with any perceived need for clarification of the scope.

The CNC has already identified some issues that the redrafting of IFRS 2 should encompass. This list is not exhaustive and may be updated:

- The recognition of the expense over the vesting period;
- The accounting treatment of vesting conditions and changes to the plan;
- The accounting treatment of intra-group share-based payments in the statutory (individual, separate) accounts of group entities;
- The disclosure in the notes which is considered difficult for users to understand;
- Issues arising for unlisted entities if these issues are material.

4. Organisation

The ANC has set up a working group representative of stakeholders at the national level, which worked on the draft list of IFRS 2 underlying accounting principles that is presented in annex for discussion. The ANC will constitute as soon as possible (a) working group(s) representative of stakeholders at European and international level(s) with participants willing to get involved in this issue. Work at the European level will be organised through the EFRAG.

The ANC will work in conjunction with and consult regularly:

- European stakeholders or representative organisations (through the EFRAG) ;
- The NSS and any other stakeholders worldwide;
- Associations representing users of the financial information provided by IFRS 2;
- IASB Board and staff members.

5. Timetable

According to preliminary estimations, the following phases are tentatively identified. They will be subject to updating as the project progresses:

1. Agreement with the IASB on the global objectives and scope of the project and elaboration of the list of accounting principles as well as application issues with working group(s) already set up (currently)
2. Elaboration of a MoU with the IASB on the global objectives
3. Presentation to NSS the 8th April 2009 of the project, as defined through the signed MoU, and a draft list of accounting principles distinguishing those considered as underlying assumptions for the purposes of the project and those requiring clarification to facilitate application and enhance understandability. This list which will draw avenues for subsequent analysis and work on IFRS 2 would be discussed and could be amended with NSS inputs prior to validation. This presentation will be the opportunity to appeal to NSS interested in getting involved in the project.
4. Finalisation of the setting up of working group(s) involved in the project following the NSS meeting (April 2009).
5. Finalisation of the list of accounting principles and the application issues to be examined (June 2009)
6. Analysis of perceived needs for clarification of the standard in a principles based approach, identification of minimum mandatory application guidance relating to IFRS 2, consultation of interested parties, summary drawn up as results from answers to consultation (12 months – June 2010)
7. Drawing up a draft revised standard and related interpretations based on outcomes from analysis and consultation undertaken in phase 6. Consultation of interested parties and finalisation of the draft (12 months – June 2011)

Are NSS members interested in participating to the identification of the accounting principles underlying IFRS 2?

Are NSS members interested in participating and/or organising consultations in their jurisdictions to set up a list of application issues related to IFRS 2?

Are NSS members interested in participating and/or organising consultations in their jurisdictions with users of financial reporting to identify issues related to information provided on share-based payment transactions?

Annex: working paper for discussion - draft list of accounting principles underlying IFRS 2

NSS members are invited to provide comments and suggestions to amend/complete this draft list of accounting principles.

This draft list focuses on accounting principles underlying IFRS 2 as a priority. Most application issues have not yet been listed. As the main objective of the project is to redraft IFRS 2 applying a principles based approach, this is the first milestone to be undertaken. Clarifying accounting principles underlying IFRS 2 would normally help to apply it more easily to various cases of application issues, which may be used as a field testing in a second milestone.

IFRS 2 Review Project

Analysis of accounting principles underlying IFRS 2 (and some application issues)

Key principles

1. **If an entity receives or acquires goods or services(asset) from a third party, other than a shareholder acting in his capacity as a shareholder, settled in equity instruments or in cash for amount based on the value of equity instruments , it shall recognise them .**

   1.1. Presumption of consideration received when an entity issues equity instruments

   - When the value of the identified service is less than the fair value of the consideration given , presumption of the existence of an additional unidentifiable service (IFRIC 8)

   1.2. Presumption of a share-based payment when equity instruments are issued to an employee or regular supplier of goods or services

   - Case of retired staff and broad-based plans

   1.3. Certain conditions may determine whether services are rendered (vesting conditions)

2. **Recognition takes place even if the entity itself does not issue equity instruments or incur a liability (i.e. irrespective of who makes the payment?)**

   2.1. Presumption that a shareholder of the entity (any shareholder or only the controlling shareholder?) or another entity from the same group only makes a share-based payment to a supplier of its subsidiary in order to remunerate the supplier for services rendered to the subsidiary

   - Whether the payment is based on shares of the entity or of any other entity under common control
     (draft amendment of IFRS 2 / IFRIC 11 includes cash payments)

   2.2. In this case, the payment shall be considered as a capital contribution by the entity that receives the services in application of the Framework (payment made by the shareholder in his capacity as shareholder)

   2.3. Comments :

- The standard does not deal with payments made by the shareholder to joint ventures and associates
- This "push down" principle is specific to share-based payments
- How is this accounted for by the entity which makes the payment ?

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

3.1. If no period of service is required , the service is presumed to have already been rendered

3.2. The required service period (vesting period determined by the conditions) is presumed to be the period over which the entity receives the services and therefore recognises an expense

- Distinction between vesting /non vesting conditions => vesting conditions = service and performance conditions other than market conditions (if unrealised , lead to a retrospective elimination of the service rendered).
- Market / non market performance conditions
- Explicit / implicit conditions
- Case of "graded vesting"

3.3. The fact that certain conditions are not satisfied is accounted for as if the services had not been rendered , for others as if all the services have been rendered , others have no accounting effect
=> difference of accounting treatment according to conditions , based on which principle?

- Cancellations to be analysed
- Treatment of dismissals (cancellation or forfeiture ?)

3.4. No clear expense allocation principle laid down . In practice , a straight-line allocation .

- Interactions between the different conditions (vesting / non vesting ; market / non market)

3.5. No differences in treatment between the different types of condition for cash-settled (final adjustment to actual cash outflows)

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

4.1. IFRS 2 does not refer to the debt/equity distinction in IAS 32 (on the grounds that it is a service being measured and not a financial instrument) , without stipulating clearly the principles

- Constructive obligation to pay in cash : cash settled
- Settlement in a variable number of shares : equity settled (issue of a variable number of shares in exchange for a fixed amount)

- Contingent settlement not dealt with
- Split accounting slightly different to IAS 32

4.2. Definitions of equity and debt in IFRS 2 very concise (reference to Framework)

4.3. The designation “cash” or “equity” is determined by the nature of what the entity ultimately remits to the beneficiary

5. The asset 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)

5.1. Measurement principles different according to whether payment is in cash or in equity instruments:
- cash : measurement at the fair value of the debt
- equity : principle of measurement at the fair value of goods and services received

5.2. Exception : measurement is indirect when goods and services cannot be reliably measured :

- Indirect measurement is systematic for employees and unidentifiable services

5.3. Specific rules for determining fair value : exclusion of certain vesting conditions (service and performance other than market)

- If the fair value of the equity instruments cannot be reliably measured (in particular the time value of an option), use of the intrinsic value of the option until payment (unusual in practice)

6. Initial measurement is at the exchange date

6.1. Convention : measurement at the grant date for employees and other unidentifiable services

- Grant date is the date at which the two parties agree on the terms and conditions of the transaction
- Grant date may in certain cases be after the date when the rendering of services has commenced

7. Subsequent measurement depends on the nature of the counterpart (equity or debt)

7.1. Equity (= difference between assets and liabilities) never remeasured

- Exception where initial measurement at intrinsic value : remeasurement at end of each reporting period based on intrinsic value

7.2. Debt remeasured throughout vesting period and up until final payment

- Nature of the expense arising on remeasurement not specified in the standard

7.3. Modifications to plans : recognition as a minimum of the grant date fair value

- Recognition of additional fair value (measured at date of modification) over the residual vesting period
- Several issues linked to modifications and cancellations