Issues Paper

AASB ED 257 (IASB ED/2014/5) *Classification and Measurement of Share-based Payment Transactions*

Introduction

1 The purpose of this paper is to form tentative views on the proposals in ED 257 *Classification and Measurement of Share-based Payment Transactions* and decide key comments to be raised in the AASB's submission on IASB ED/2014/5 *Classification and Measurement of Share-based Payment Transactions* (subject to feedback received from constituents). This paper is structured to correspond to the questions in ED/2014/5.

2 This paper is structured to correspond to the questions asked by the IASB in ED/2014/5. Due to the timing of the comment period for AASB ED 257, the issues raised in this paper do not incorporate feedback from submissions received by the AASB. Staff will raise at the February 2015 AASB meeting or out of session prior to 25 March 2015, any significant issues included in the submissions received that staff think have not already been adequately dealt with in this issues paper. .

Effects of vesting conditions on the measurement of a cash-settled share-based payment

3 Paragraph 33[1] of IFRS 2 *Share Based Payment* requires an entity to measure the liability for a cash-settled share-based payment initially and at the end of each reporting period until settled, at the fair value of the cash-settled share-based payment, taking into account the terms and conditions on which the cash-settled share-based payment was granted and the extent to which the employees have rendered service to date. However, IFRS 2 does not specifically address the impact of vesting and non-vesting conditions on the measurement of the fair value of the liability incurred in a cash-settled share-based payment transaction.

4 Consequently, the IASB proposes to clarify that accounting for the effects of vesting and non-vesting conditions on the measurement of a cash-settled share-based payment should follow the approach used for measuring equity-settled share-based payments in paragraphs 19–21A of IFRS 2 (refer to Appendix A of the Issues paper).

5 The IASB proposes to amend paragraphs 30 and 33 of IFRS 2 and add paragraphs 33A–33C to clarify the effect that vesting and/or non-vesting conditions have on the measurement of the liability (refer to pages 8 – 9 of IASB ED/2014/5). The IASB proposes that non-market vesting conditions shall not be taken into account when estimating the fair value of the cash-settled share-based payment and, instead, shall be taken into account by adjusting the number of awards expected to vest.

6 The IASB also proposes to clarify that the cumulative amount ultimately recognised for goods or services received as consideration for the cash-settled share based payment is equal to the cash paid.

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1 Paragraph 33 of IFRS 2 states that "The liability shall be measured, initially and at the end of each reporting period until settled, at the fair value of the share appreciation rights, by applying an option pricing model, taking into account the terms and conditions on which the share appreciation rights were granted, and the extent to which the employees have rendered service to date".

Question 1
The IASB proposes to clarify that accounting for the effects of vesting and non-vesting conditions on the measurement of a cash-settled share-based payment should follow the approach used for measuring equity-settled share-based payments in paragraphs 19–21A of IFRS 2. Do you agree? Why or why not?

Preliminary AASB staff views

7 AASB staff note that the 'fair value' of share-based payment transactions should be measured in accordance with the specific guidance in IFRS 2 for measuring the impact of vesting and non-vesting conditions and not in accordance with IFRS 13 *Fair Value Measurement* (paragraph 6A of IFRS 2[2]). AASB staff also note that the accounting for a cash-settled award that includes a service condition in Example 12 of the Implementation Guidance in IFRS 2 is consistent with the accounting for the effect of a vesting condition (other than a market condition) in an equity-settled award and is not consistent with the remeasurement for all the uncertainties at each reporting date.

8 Consequently, AASB staff agree with the proposals that the accounting for the effects of vesting and non-vesting conditions on the measurement of a cash-settled share-based payment should be based on the analogy of the accounting treatment for an equity-settled share-based payment transaction. AASB staff also agree with the IASB's observation that measuring the fair value of the liability incurred in a cash-settled share-based payment transaction by analogy to the guidance for equity-settled share-based payment transactions would be easier to apply in practice (paragraph BC4 of IASB ED/2014/5).

Question 1 to the Board
Does the Board agree with the preliminary AASB staff views in paragraphs 7–8 above?

Classification of share-based payment transactions with net settlement features

9 An entity may be obliged by tax laws or regulations to withhold an amount for an employee's tax obligation associated with share-based payments and transfer the amount, normally in cash, to the taxation authorities. To fulfil this obligation, the terms of some employee share-based payment arrangements permit or require the entity to deduct from the total number of equity instruments that would otherwise be issued to the employee upon exercise (or vesting) of the share-based payment, the number of equity instruments needed to equal the monetary value of the employee's tax obligation in order to meet the statutory tax withholding obligation.

10 The amendments propose an exception to the requirements in IFRS 2. The IASB proposes to specify that if the entity settles the share-based payment arrangement net by withholding a specified portion of the equity instruments to meet the statutory tax withholding obligation, then the transaction should be classified as equity-settled in its

2 Paragraph 6A in IFRS 2 states that "this IFRS uses the term 'fair value' in a way that differs in some respects from the definition of fair value in IFRS 13 Fair Value Measurement. Therefore, when applying IFRS 2 an entity measures fair value in accordance with this IFRS, not IFRS 13".

entirety, if the entire share-based payment would otherwise be classified as equity-settled if it had not included the net settlement feature.

11 The IASB considered an alternative approach (View 1 in paragraph BC10 of ED/2014/5) where each component of the share-based payment would be accounted for in a manner that is consistent with the manner of settlement. The portion withheld by the entity to pay the employee's tax would be classified as a cash-settled share-based payment transaction and the portion that the entity settles by the issue of equity instruments would be accounted for as an equity-settled share-based payment. This approach would require entities to reclassify the share-based payment between cash-settled and equity-settled whenever there were estimate changes in tax laws, including changes in tax rates. The IASB rejected this alternative approach on the basis that it would impose a significant operational challenge to entities.

Question 2
The IASB proposes to specify that a share-based payment transaction in which the entity settles the share-based payment arrangement net by withholding a specified portion of the equity instruments to meet the statutory tax withholding obligation should be classified as equity-settled in its entirety. This is required if the entire share-based payment transaction would otherwise have been classified as an equity-settled share-based payment transaction if it had not included the net settlement feature. Do you agree? Why or why not?

Preliminary AASB staff views

12 AASB staff agree with the proposed amendments as the economic substance of the relevant share-based payment transaction is that the entity settles the share based payment entirely in equity instruments and separately, yet simultaneously, repurchases a portion of those equity instruments to settle the tax obligations of the counterparty, to which paragraph 29[3] of IFRS 2 applies. AASB staff consider that the entity is acting as an agent in paying cash to the taxation authorities, because the tax obligation is the employee's obligation, consistent with View 2 in paragraph BC12 of ED/2014/5. AASB staff also acknowledge that the alternative approach considered by the IASB (View 1 in paragraph BC10(a) of ED/2014/5) would impose undue burden on entities.

Question 2 to the Board **Does the Board agree with the preliminary AASB staff views in paragraph 12 above?**

3 Paragraph 29 of IFRS 2 states that "If an entity repurchases vested equity instruments, the payment made to the employee shall be accounted for as a deduction from equity, except to the extent that the payment exceeds the fair value of the equity instruments repurchased, measured at the repurchase date. Any such excess shall be recognised as an expense".

Accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled

13 A cash-settled share-based payment may change to an equity-settled share-based payment because of modifications to the terms and conditions of the arrangement. In addition, there are transactions in which a cash-settled share-based payment is settled and replaced by a new equity-settled share-based payment. IFRS 2 does not specifically address such situations.

14 The IASB proposes to amend IFRS 2 so that:

(a) the share-based payment transaction is measured by reference to the modification-date fair value of the equity instruments granted as a result of the modification;

(b) the liability recognised in respect of the original cash-settled share-based payment is derecognised upon the modification, and the equity-settled share-based payment is recognised to the extent that the services have been rendered up to the modification date; and

(c) the difference between the carrying amount of the liability as at the modification date and the amount recognised in equity at the same date is recorded in profit or loss immediately.

Question 3
The IASB proposes to specify the accounting for modifications to the terms and conditions of a cash-settled share-based payment transaction that results in a change in its classification from cash-settled to equity-settled. The IASB proposes that these transactions should be accounted for in the following manner: (a) the share-based payment transaction is measured by reference to the modification-date fair value of the equity instruments granted as a result of the modification; (b) the liability recognised in respect of the original cash-settled share-based payment is derecognised upon the modification, and the equity-settled share-based payment is recognised to the extent that the services have been rendered up to the modification date; and (c) the difference between the carrying amount of the liability as at the modification date and the amount recognised in equity at the same date is recorded in profit or loss immediately. Do you agree? Why or why not?

Preliminary AASB staff views

15 AASB staff agree that the replacement equity-settled share-based payment transaction should be measured by reference to the modification-date fair value of the equity-settled share-based payment, because the modification-date should be viewed as the

grant date of the replacement equity-settled share-based payment in accordance with the definition of 'grant date' in IFRS 2[4].

16 AASB staff also agree that the liability recorded in respect of the original cash-settled share-based payment should be derecognised upon the modification and the equity-settled share-based payment should be recognised to the extent that service has been rendered up to the modification date; and the difference between the carrying amount of the liability as at the modification date and the amount recognised in equity as at the same date should be recorded in profit or loss immediately. This reflects the remeasurement of the liability to the settlement amount in accordance with paragraph 30[5] of IFRS 2 and is consistent with the IASB observation in paragraph BC19 of ED/2014/5 that at the original grant date of cash-settled share based payment there was a shared understanding that the entity would pay cash for services to be rendered by the counterparty. However, at the modification date, the entity and its counterparty have a new shared understanding that the entity would issue equity instruments to the counterparty.

Question 3 to the Board **Does the Board agree with AASB staff views in paragraph 15–16 above?**

Transition

Question 4
The IASB proposes prospective application of these amendments, but also proposes to permit the entity to apply the amendments retrospectively if it has the information needed to do so and this information is available without the use of hindsight. Do you agree? Why or why not?

Preliminary AASB staff views

17 AASB staff agree with the proposed transition requirements, when considering the proposed amendments collectively. This makes the transition requirements straight-forward and also enables an entity to apply the amendments applicable to it retrospectively if the entity has the information necessary to do so.

Question 4 to the Board **Does the Board agree with AASB staff views in paragraph 17 above?**

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4 Definition of grant date in Appendix A of IFRS 2: "The date at which the entity and another party (including an employee) agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date the entity confers on the counterparty the right to cash, other assets, or equity instruments of the entity, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained".

5 Paragraph 30 of IFRS 2 states that "For cash-settled share-based payment transactions, the entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity shall remeasure the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognised in profit or loss for the period".

Appendix A

Paragraphs 19 – 21A of IFRS 2 *Share Based Payment*

Treatment of vesting conditions

19A A grant of equity instruments might be conditional upon satisfying specified vesting conditions. For example, a grant of shares or share options to an employee is typically conditional on the employee remaining in the entity's employ for a specified period of time. There might be performance conditions that must be satisfied, such as the entity achieving a specified growth in profit or a specified increase in the entity's share price. Vesting conditions, other than market conditions, shall not be taken into account when estimating the fair value of the shares or share options at the measurement date. Instead, vesting conditions shall be taken into account by adjusting the number of equity instruments included in the measurement of the transaction amount so that, ultimately, the amount recognised for goods or services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. Hence, on a cumulative basis, no amount is recognised for goods or services received if the equity instruments granted do not vest because of failure to satisfy a vesting condition, for example, the counterparty fails to complete a specified service period, or a performance condition is not satisfied, subject to the requirements of paragraph 21.

20 To apply the requirements of paragraph 19, the entity shall recognise an amount for the goods or services received during the vesting period based on the best available estimate of the number of equity instruments expected to vest and shall revise that estimate, if necessary, if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates. On vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested, subject to the requirements of paragraph 21.

21 Market conditions, such as a target share price upon which vesting (or exercisability) is conditioned, shall be taken into account when estimating the fair value of the equity instruments granted. Therefore, for grants of equity instruments with market conditions, the entity shall recognise the goods or services received from a counterparty who satisfies all other vesting conditions (e.g. services received from an employee who remains in service for the specified period of service), irrespective of whether that market condition is satisfied.

Treatment of non-vesting conditions

21A Similarly, an entity shall take into account all non-vesting conditions when estimating the fair value of the equity instruments granted. Therefore, for grants of equity instruments with non-vesting conditions, the entity shall recognise the goods or services received from a counterparty that satisfies all vesting conditions that are not market conditions (e.g. services received from an employee who remains in service for the specified period of service), irrespective of whether those non-vesting conditions are satisfied.