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The Chair
Australian Accounting Standards Board
PO BOX 204
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West Victoria 8007

27 March 2015

Dear Ms Peach

Ernst & Young's global submission to the IASB on the Invitation to comment – Exposure Draft ED/2014/5 – *Classification and Measurement of Share-based Payment Transactions – Proposed amendments to IFRS 2* (ED)

Please find enclosed Ernst & Young's global submissions to the IASB on the above Exposure Draft.

Yours sincerely

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International Accounting Standards Board
30 Cannon Street
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24 March 2015

Dear Board members,

Invitation to comment – Exposure Draft ED/2014/5 – *Classification and Measurement of Share-based Payment Transactions – Proposed amendments to IFRS 2* (ED)

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on Exposure Draft ED/2014/5 – *Classification and Measurement of Share-based Payment Transactions (Proposed amendments to IFRS 2)* issued by the International Accounting Standards Board (IASB or Board) in November 2014.

Overall, we support the general concepts of the three amendments proposed in the ED. We note that the proposed amendments are narrowly scoped and primarily derived from the IASB and IFRS Interpretations Committee's discussions of specific fact patterns. Whilst we think that these narrow-scope amendments are improvements to IFRS 2 and assist in addressing some areas of diversity and complexity in current practice, we would like to suggest to the Board that it considers including a broader and more holistic review of the standard in the next Agenda Consultation.

Whilst we support the general concepts, we have some concerns on the detail of the amendments proposed in the ED and the main points are summarised below:

1. **Effects of vesting conditions on the measurement of a cash-settled share-based payment**
   We agree that the clarification that equity-settled awards and cash-settled awards should have the same measurement basis is helpful in eliminating an area of diversity in current practice. For this area of the proposed amendments, we do not have any major issues; our detailed comments on the wording of the proposed amendment are set out in Appendix A.

2. **Classification of share-based payment transactions with net settlement features**
   The proposed amendment is worded in such a way that it is restricted to entities which are obliged by tax laws or regulations, i.e., a <u>statutory</u> obligation, to deduct and pay an amount of withholding tax to the tax authorities in respect of an employee's tax obligation. The proposed amendment therefore scopes out entities that have a <u>contractual</u> or <u>constructive</u> obligation to employees to:
   (a) 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; and
   (b) Pay that amount in cash to the tax authorities on the employee's behalf.

The amendment is therefore narrowly worded and does not appear to apply to other arrangements that might be similar in substance and that are frequently seen in practice in many jurisdictions.

We encourage the Board to be more explicit as to whether the scope of the proposed exception to the general requirements of IFRS 2 was intended to be narrowly applied only to instances where an entity has a statutory withholding tax obligation and also to consider whether it should be broadened to cover arrangements where entities are obliged to net settle an employee's statutory tax obligation under either the tax laws or a contractual or constructive arrangement with the employee. We suggest that the Board clarifies and states this in the Basis for Conclusions to the proposed amendments. In addition, we note that the proposed amendment is similar to the exception specified under US GAAP.[1] We highlight the current simplification project being conducted by the US Financial Accounting Standards Board (FASB) on the application of this exception which could potentially result in a broadening of the exception to tax withholdings in excess of the employer's statutory withholding obligation. Because the FASB's simplification project is expected to be finished and approved in the very near term, the IASB may find it beneficial to know the outcome of this project before finalising the proposed amendment if one of the IASB's considerations in this area is possible convergence with US GAAP.

3. **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**

General comments

The proposed amendment deals only with situations where the classification of the share-based payment transaction changes from cash-settled to equity-settled. Before finalising the amendment, we urge the IASB also to address within the main body of IFRS 2 the situation where a share-based payment transaction is modified from equity-settled to cash-settled.

We also suggest that the IASB clarifies the interaction of this amendment with IAS 19 *Employee Benefits* (i.e. whether the same accounting conclusion would have resulted had the modified arrangement not been a share-based liability). An increasing number of situations are seen in practice where arrangements are modified from share-based arrangements to non share-based cash arrangements or *vice versa*. A link between the two standards to ensure consistency of approach where there is a change from a liability classification under IAS 19 to an equity classification under IFRS 2 and *vice versa* would, in our view, be a helpful part of the consideration of the underlying principles in accounting for the modification of arrangements with employees.

Specific comments on the proposed amendment

The proposed amendment requires that the difference between the carrying amount of the liability, as at modification date, and the amount recognised in equity, as at that date be recognised in profit or loss immediately. This approach potentially creates differences between the accounting treatment of modifications to equity-settled and cash-settled awards. In our view, it does not adequately differentiate between the accounting for instances where there is an incremental fair value and those where there is a reduction in fair value. We outline below some areas where we believe that additional clarification would be helpful within the context of the proposed amendment to IFRS 2.

[1] Accounting Standards Codification (ASC) 718 *Compensation—Stock Compensation*

- **Clear differentiation between accounting for a change in classification and other changes in the terms of the share-based payment arrangement**
  It is not clear from the proposed amendment and paragraph BC17 of the Basis for Conclusions, whether the change in fair value is expected to arise solely from a modification that changes the classification of a transaction from cash-settled to equity-settled (which, alone, would not necessarily be expected to change the value of an award) or whether it also relates to other modifications to the terms of the arrangement. The accounting treatment of a change in classification of the share-based payment transaction and that of other changes in the underlying value of the equity instruments should be clearly distinguished. We suggest, therefore, that the amendments clearly differentiate between these two types of changes and explicitly state the respective accounting treatments to be applied together with supporting discussion of the underlying principles in the Basis for Conclusions.

- **Clear guidance as to whether the Board intended to allow the immediate recognition of either a debit or a credit to profit or loss and the underlying basis for the approach**
  In the absence of guidance to the contrary, the proposed amendment appears to apply both to instances where there is an incremental fair value and those where there is a reduction in fair value. As noted by the Board in paragraph BC18, the immediate recognition of the difference in profit or loss differs from the accounting treatment of modifications of equity-settled awards under IFRS 2.27 and B43, but no explanation has been given as to why a modified settlement approach (more akin to equity-settled awards that are accounted for as cancelled and replaced (i.e., IFRS 2.28)), rather than a prospective spreading approach over the remaining vesting period, which is typically the approach for modification accounting in IFRS 2, has been adopted in the amendment.

  In addition, the recognition of a credit in profit or loss – whilst consistent with the cancellation or settlement of a cash-settled liability – is not consistent with the approach in IFRS 2.43 for the settlement of awards where an entity has a choice of settlement method and where it is only incremental expense that is taken to profit or loss and any credit must remain within equity.

  The proposed amendments and the Basis for Conclusions thereto do not currently explain the interaction of the proposals with the existing guidance elsewhere in the standard. Therefore, we urge the Board to clarify whether it is intended to diverge from modification accounting for equity-settled awards and from accounting for awards with a choice of settlement and, if so, to indicate clearly within the Basis for Conclusions the reasons and/or underlying principles applied.

  If it is not the Board's intention to create divergence between the respective accounting treatments of modifications to cash-settled and equity-settled awards, then we suggest an amendment to require that any reduction in the value be ignored and only an increase in value be spread over the period in which the services are provided. This will be more reflective of the compensation given in return for the receipt of services over time. Alternatively, we suggest that similar language to that used in IFRS 2.43 be included.

- **Guidance on accounting for modifications that occur during the vesting period**
  It is unclear from the proposed amendments how certain modifications should be accounted for if they occur during the vesting period. In a situation where a modification extends the vesting period and that is prima facie disadvantageous to the employee, we urge the Board to clarify the vesting period that should be used – whether it would be appropriate to recognise the modification date fair value of the equity-settled award over the original, rather than the modified, vesting period. This assumes the situation where it does not result in a lower expense being recognised.

- **Clarification on the interaction of (a) modification accounting and (b) cancellation and replacement accounting**
  Paragraph B41B of the proposed amendments appears to specify that if an entity cancels or settles a cash-settled share-based payment transaction and designates an equity-settled award as a replacement for the cancelled or settled award then the modification accounting set out in paragraph B41A applies. Unlike the situation for the cancellation and replacement of an equity-settled award where the wording of the standard (when read in the context of the Basis for Conclusions) appears to allow two differing approaches, the proposed amendment seems to rule out an accounting choice between: (a) modification accounting; and (b) cancellation accounting followed by the treatment of the replacement award as a completely new grant. Whether this diversity of treatment is intended is unclear. We would like to highlight this for the IASB to clarify if this was its intention.

A more detailed response, including some additional areas of comment, is provided in Appendix A to this document.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas on +44 (0)20 7951 3152.

Yours faithfully

Ernst & Young Global Limited

Appendix A

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?

Response:

Yes, overall we agree and support this amendment as we believe that the clarification that equity-settled awards and cash-settled awards should have the same measurement principles is helpful in eliminating an area of diversity in current practice. Furthermore, we think that the proposed amendments will reduce discrepancies between the accounting treatment of cash-settled and equity-settled awards and help to simplify the analysis where there is a choice of settlement between cash and equity.

We note that, following the amendments to the definition of 'market condition' in Appendix A to IFRS 2 as part of the *Annual Improvements to IFRSs 2010-2012 Cycle*, some of the proposed wording of paragraph 33B is perhaps superfluous (although consistent with the current wording of paragraph 21).

We note that the word 'award' has been used in the proposed amendment to replace the words 'equity instruments' in the corresponding wording in the existing paragraphs relating to equity-settled share-based payment transactions. Elsewhere in the guidance on cash-settled share-based payment transactions, IFRS 2 refers to 'share appreciation rights'. We think that the consistency of reference between 'award' and 'share appreciation right' should be specifically reviewed and also request that the precise definition / unit of account of 'award' be considered.

In addition, we suggest that the IASB explicitly clarify within the illustrative example introduced as part of the ED (IG Example 12A) that the 40% probability should not be taken into account when accounting for the liability other than as the basis of the binary assessment as to whether or not the award is expected to vest (i.e., the calculated fair value is not a probability-weighted expected value).

Paragraph BC4 of the Basis for Conclusions to the proposed amendments refers to 'some explanations'. It would be helpful if this were made a more explicit explanation of the reasons for adopting the proposed approach to the determination of an IFRS 2 fair value for cash-settled arrangements.

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?

Question 2

Response:

The wording of the first sentence of the proposed paragraph 33D indicates that the amendment is intended only to apply to entities which are obliged under tax laws or regulations to deduct and pay to the taxation authorities the withholding tax associated with an employee's tax obligation, i.e., the entity has a statutory obligation. The proposed amendment therefore scopes out entities which have a contractual or constructive obligation to employees to:

(a) 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; and

(b) pay that amount in cash to the tax authorities on the employee's behalf.

The amendment is therefore narrowly worded and does not appear to apply to other arrangements which might be similar in substance and which are frequently seen in practice in many jurisdictions. In such cases, the amendment would mean that many entities would still have to differentiate between an equity-settled portion and a cash-settled portion (for the amount relating to the contractual or constructive tax obligation).

We note that the second paragraph of the introduction on page 4 of the ED and paragraph BC15 of the Basis for Conclusions are not as explicit as paragraph 33D in respect of the requirement for the entity, rather than just the employee, to have a statutory obligation. We are concerned that the proposed wording could lead to diversity in practice in jurisdictions where it is only the employee who has a statutory obligation if entities interpret the second sentence of paragraph 33D as having a wider application than the IASB intends.

We encourage the Board to be more explicit as to whether the scope of the proposed exception to the general requirements of IFRS 2 was intended to be so narrow and whether both diversity in practice and the 'undue burden' to which paragraph BC13 refers would be reduced if the amendment were to apply both to entities obliged under tax laws and those with a contractual or constructive obligation to employees to net settle an award in respect of an employee's statutory tax obligations. We suggest that the Board clarifies and state this in the Basis for Conclusions to the proposed amendments.

If the scope of the amendment were to be broadened to also apply to instances where entities have a contractual or constructive obligation to employees to net settle in respect of the employee's statutory tax obligations, then we suggest the following revisions to the proposed amendment:

> *"33D 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, which 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 statutory tax ~~withholding~~ obligation. In such cases, if, in the absence of such a net settlement feature, the entire share-based payment transaction would have been classified as an equity-settled share-based payment, the share-based payment shall be accounted for in accordance with the requirements that apply to equity-settled share-based payment transactions in paragraphs 10–29."*

However, if the Board's intention is to limit the application of the exception to instances where the entity has a statutory tax withholding obligation to net settle under the tax laws, then entities may need further guidance as to how to distinguish precisely what the statutory obligations are and whether it is only the employer's withholding obligation, and not larger

Question 2

amounts that better reflect the employee's statutory tax obligations, that should be considered.

We note that this proposed amendment is similar to the exception specified under US GAAP.[2] We highlight the current simplification project being conducted by the US Financial Accounting Standards Board (FASB) on the application of the US GAAP exception and the possible broadening of the exception to tax withholdings in excess of the employer's statutory withholding obligation. Because the FASB's simplification project is expected to be finished and approved in the very near term, the IASB may find it beneficial to know the outcome of this project before finalising the proposed amendment if one of the IASB's considerations in this area is possible convergence with US GAAP.

Our other comments on this amendment are, as follows:

- It would be helpful if the heading above paragraph 33D were made more specific. It is not immediately clear from the reference to 'net settlement features' that the amendments are referring only to cases where an entity's statutory tax withholding obligations are deducted from the total number of equity instruments and not to other types of net settlement feature. This could be confusing. We suggest that the Board revise the title preceding paragraph 33D to make it clearer that the net settlement features and exception to the general requirements of IFRS 2 relate only to an entity's statutory tax withholding obligations.
- We suggest that the amendments to the standard make clearer the required accounting treatment for the settlement of the share-based payment when the requirements of the exception are met, i.e., that, based on paragraph BC10, the element relating to the entity's tax withholding should be treated as a repurchase of vested equity instruments (and accounted for as a deduction from equity) in accordance with paragraph 29 of IFRS 2. However, we note that if there is an obligation to net settle, whether under the tax laws or because of a contractual arrangement with the employee, it is not a discretionary repurchase. Therefore, accounting for this element of the share-based payment transaction as equity-settled under the terms of the proposed exception to IFRS 2 and then treating the repurchase from the employee in a manner similar to a treasury share transaction may seem inconsistent with the requirements of IAS 32 to classify and account for such an obligation as a liability.
- Paragraph BC12 states that view 2, which forms the basis of the proposed amendment, is based on the assumption that the entity is acting as an agent in paying cash to the taxation authorities. However, the wording of the amendment is such that the entity itself has a statutory obligation rather than just acting as the employee's agent. If the entity were just acting as agent for the employee then it is difficult, as noted above, to distinguish between the arrangements in the proposed amendment and those based on a contractual share-based payment agreement between the entity and the employee. We consider it important that the explanation in the Basis for Conclusions fully supports the amendment as drafted and if the amendment is simply designed to provide an exception to the general requirements of IFRS 2, then it be acknowledged as such.

It is unclear how paragraph BC14 fits in with the amendment as drafted. It would be helpful to expand on how it interacts with views 1 and 2, as discussed in paragraph BC10. Furthermore, we suggest that it be made more explicit in paragraph BC15 that the exception relates solely to statutory tax withholding obligations incurred by the entity if that is what the Board intended. It is also unclear in paragraph BC16 which party has the obligation and we suggest that this should also be clarified.

[2] Accounting Standards Codification (ASC) 718 *Compensation—Stock Compensation*

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?

Response:

The proposed amendment deals only with situations where the classification of the share-based payment transaction changes from cash-settled to equity-settled. Before finalising the amendment, we urge the IASB to address the following situations relating to the modification of share-based payment transactions that are not explicitly covered by existing IFRS guidance:

- Modifications from equity-settled to cash-settled. Notwithstanding the illustration in Example 9 in the Guidance on Implementing IFRS 2 (which is not part of the standard) of the addition of a cash alternative, addressing how to account for such modifications as part of the amendments to IFRS 2 would help to provide clearer guidance and improve the consistency of accounting treatment in practice;
- Modifications that change an arrangement from being within the scope of IFRS 2 to being within the scope of IAS 19 *Employee Benefits* and *vice versa*. A link between the two standards to ensure consistency of approach where there is a change from a liability classification under IAS 19 to an equity classification under IFRS 2 and *vice versa* would be a helpful part of the consideration of the underlying principles in accounting for the modification of arrangements with employees. This may be particularly relevant because, even though the underlying principles of both IAS 19 and IFRS 2 are to recognise the expense as and when the services are received, there are differences in the application of these principles under the requirements of the two standards, e.g. in the basis of attribution of the expense to the relevant periods of services. Therefore, we encourage the Board to provide further guidance on how IAS 19 and IFRS 2 interact with each other for modifications in which arrangements may change from being within scope of IFRS 2 to within scope of IAS 19 (or *vice versa*) and to clarify the underlying principle/basis for the approach taken.

Clear differentiation between accounting for a change in classification and other changes in the terms of the share-based payment arrangement

It is not clear from the proposed amendment and paragraph BC17 of the Basis for Conclusions whether the change in fair value is expected to arise solely from a modification that changes the classification of a transaction from cash-settled to equity-settled (which alone would not necessarily be expected to change the value of an award) or whether it also relates to other modifications to the terms of the arrangement. The accounting treatment of a change in classification of the share-based payment transaction and that of other changes in the underlying value of the equity instruments should be clearly distinguished. We suggest

Question 3

that the amendments clearly differentiate between these two types of changes and explicitly state the respective accounting treatments to be applied together with supporting discussion of the underlying principles in the Basis for Conclusions.

Clear guidance as to whether the Board intended to allow the immediate recognition of either a debit or a credit to profit or loss and the underlying basis for the approach

The proposed amendment requires that the difference between the carrying amount of the liability as at modification date and the amount recognised in equity as at that date be recognised in profit or loss immediately. This approach potentially creates differences between the accounting treatment of modifications to equity-settled and cash-settled awards and, in our view, does not adequately differentiate between the accounting for instances where there is an incremental fair value and those where there is a reduction in fair value. There are two particular areas to which we draw attention:

- In the absence of guidance to the contrary, the proposed amendment appears to apply both to instances where there is incremental fair value and those where there is a reduction in fair value. As noted by the Board in paragraph BC18, the immediate recognition of the difference in profit or loss differs from the accounting treatment of modifications of equity-settled awards under IFRS 2.27 and B43, but no explanation has been given as to why a modified settlement approach (more akin to equity-settled awards that are accounted for as cancelled and replaced (i.e. IFRS 2.28)), rather than a prospective spreading approach over the remaining vesting period, has been adopted in the amendments.
- The recognition of a credit in profit or loss – whilst consistent with the cancellation or settlement of a cash-settled liability – is not consistent with the approach in IFRS 2.43 for the settlement of awards where an entity has a choice of settlement method and where it is only incremental expense that is taken to profit or loss and any credit remains within equity. We note that the fact pattern originally submitted to the IFRS Interpretations Committee related to a situation with a higher fair value rather than a reduced fair value and would like to ensure that the treatment of a reduction in fair value is fully consistent with other elements of IFRS 2.

The proposed amendments and Basis for Conclusions thereto do not currently explain the interaction of the proposals with the existing guidance elsewhere in the standard. Therefore, we urge the Board to consider if it is intended to diverge from modification accounting for equity-settled awards and from accounting for awards with a choice of settlement and, if so, to indicate clearly within the Basis for Conclusions the reasons and/or underlying principles applied.

If it is not the Board's intention to create divergence between the respective accounting treatments of modifications to cash-settled and equity-settled awards, then we suggest an amendment to require that the change in value be spread over the period in which the services are provided. This will be more reflective of the compensation given in return for the receipt of services over time. Alternatively, we suggest that similar language to that used in IFRS 2.43 be included.

Furthermore, we are concerned that if this liability settlement approach is taken, it may give rise to structuring opportunities for share-based payment arrangements if it appears that the reversal/settlement of the liability is being accounted for separately from the replacement equity transaction. For example, in a situation where an entity issues equity instruments to third parties in exchange for a cash consideration that is higher than the fair value of the equity instruments given, an entity may take the view under the liability settlement approach that a profit may be recognised on the date of the exchange.

Question 3

Clarification on the interaction of (a) modification accounting and (b) cancellation and replacement accounting

Paragraph B41B of the proposed amendments appears to specify that if an entity cancels or settles a cash-settled share-based payment transaction and designates an equity-settled award as a replacement for the cancelled or settled award, then the modification accounting set out in paragraph B41A applies. Unlike the situation for the cancellation and replacement of an equity-settled award where the wording of paragraph 28 of IFRS 2 (when read in the context of the Basis for Conclusions) appears to allow two differing approaches, the proposed amendment seems to rule out an accounting choice between (a) modification accounting and (b) cancellation accounting followed by the treatment of the replacement award as a completely new grant. Whether this diversity of treatment is intended is unclear. We would like to highlight this to the IASB to clarify if this was its intention and/or to clarify the sequence in which the requirements of paragraph 28 should be applied.

We note that the wording in paragraph B41B on the designation of an equity-settled award as a replacement award is similar to, and consistent with, that of IFRS 2.28(c). However, we suggest that the IASB considers clarifying whether the intention is for this to be an area of judgement that an entity will need to apply consistently for similar types of arrangements or whether an entity will need to formally designate the equity instruments as a replacement award at the point of modification on an individual arrangement basis.

We further note that paragraph BC19 appears to consider the concepts of modification and cancellation/replacement more interchangeably than is the case elsewhere in IFRS 2. If there is settlement of the original award, it is perhaps inconsistent to treat a portion of the replacement equity-settled award as having already been received. The terms are used more precisely in the context of accounting for changes to equity-settled awards under IFRS 2.

Guidance on accounting for modifications that occur during the vesting period

It is unclear from the proposed amendments how certain modifications of classification from cash-settled to equity-settled should be accounted for if they occur during the vesting period. We note that for modifications of equity-settled share-based payment arrangements, IFRS 2 provides the following guidance:

> *"… If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period …" [IFRS 2.B43(a)].*
>
> *"… if the entity modifies the terms or conditions … in a manner that reduces the total fair value…, or is not otherwise beneficial to the employee, the entity shall nevertheless continue to account for the services received as consideration for the equity instruments granted as if that modification had not occurred… For example … if the entity modifies the vesting conditions in a manner that is not beneficial to the employee … by increasing the vesting period …, the entity shall not take the modified vesting conditions into account …" [IFRS 2.B44].*

We would like to seek clarification as to whether it is the IASB's intention for a similar accounting treatment to be applied to modifications of cash-settled awards to equity-settled awards that occur during the vesting period. We have provided an illustrative example below which deals with a modification that includes a change of classification and a lengthening of the vesting period and seek to clarify which accounting treatment the IASB intended to result from the proposed amendments.

Question 3

- An employee is granted a cash-settled share-based payment with a vesting period of one year. The award is modified shortly before the end of year 1 so that it is equity-settled and has a further one-year vesting period from the modification date. The fair value of the equity-settled award at the modification date is CU150. The total fair value of the cash-settled liability as at the modification date is CU100 and an expense of CU100 is recognised in the period prior to modification.
- Does application of the proposed amendment result in:

  a) A credit to profit or loss of CU25 as at the modification date (liability of CU100 derecognised less CU75 (CU150 x 1/2) for the proportionate amount of the equity-settled award based on this award being approximately 50% through its total vesting period of two years) and future expense of CU75 (CU150 x 1/2) recognised over one year from the modification date

  Or

  b) An incremental expense of CU50 recognised as at the modification date in addition to the CU100 already recognised in year 1 and no additional expense after the modification date?

  The CU50 (being CU150 for the value of the equity-settled award less CU100 for the cash-settled award) would be expensed immediately because, notwithstanding the overall increase in fair value, a modification that extends the vesting period is disadvantageous to the counterparty and so not taken into account for an equity-settled award in accordance with paragraph B44(c) of IFRS 2.

We encourage the IASB to include an illustrative example in the Guidance on Implementing IFRS 2 to provide additional clarification on how the proposed amendments should be applied, i.e., whether the portion of services received as at the modification date is determined by reference to (a) the original vesting period; (b) the modified vesting period; or (c) another period such as the shorter (or greater) of the original vesting period and the modified vesting period.

Other comments

- We suggest that the proposed new paragraphs (currently labelled B41A and B41B) be located after paragraphs B42-B44, instead of after paragraph B41, because the principles and application guidance for modification accounting are contained in paragraphs B42-B44.
- We propose the following editorial amendment to paragraph B41A as outlined in the ED:

"… The equity-settled share-based payment transaction is measured at the fair value of the equity instruments granted as at ~~of~~ the modification date …"

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?

Response:

We generally agree with the proposed prospective application of the amendments and the option for entities to apply the amendments retrospectively. In addition, we support including the option for entities to early adopt the amendments.

However, we suggest that the IASB state explicitly whether the prospective application of the amendments is intended to be applied:

- To all existing and new share-based payment arrangements and modifications as at the effective date;

  Or

- Only to new share-based payment arrangements granted and modifications made on or after the effective date.

In some situations there may be practical difficulties in applying these proposed amendments to existing arrangements, for example, where there are modifications that occurred in the past. In such instances, we would see merit in applying the proposed amendments that are related to questions 1 and 2 to new share-based payment arrangements that are granted on or after the effective date. For the proposed amendments relating to question 3, we suggest that they be applicable to modifications made on or after the effective date.

Question 5
Do you have any other comments on the proposals?

Response:

We have no other comments on the proposals.