

Financial Reporting Bulletin

Amendment to IFRS 2 'Share-based Payment' – Vesting Conditions and Cancellations

Background

The International Accounting Standards Board (IASB) has issued an amendment to IFRS 2 'Share-based Payment', which finalise the proposals that were contained in the exposure draft of proposed amendments to that standard published in February 2006.

IFRS 2 as amended distinguishes between:

- vesting conditions, which comprise service conditions and market and non-market performance conditions. These are the conditions that determine whether or not the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments under a share-based payment scheme; and
- non-vesting conditions, which are other conditions that must be satisfied for the counterparty to become so entitled, ie they do not determine whether the entity is receiving services. Examples include a requirement to pay contributions towards the exercise price of a share-based payment such as monthly deductions from payroll in a Save-As-You-Earn (SAYE) scheme, the requirement for the entity to keep the plan open, non-compete provisions or transfer restrictions which apply after the shares have vested, and a target based on a commodity index.

The purpose of making the distinction between vesting and non-vesting conditions is so as to be able to address the accounting for non-vesting conditions, as previously IFRS 2 only considered the accounting for vesting conditions.



Requirements

As with market vesting conditions, IFRS 2 as amended requires entities to take into account all non-vesting conditions in valuing share options. It should be noted though that the fair value of grants should assume that the probability of continuation of the plan by the entity is 100 per cent, ie the fair value of share-based payment awards at the date of grant should not be reduced to allow for the possibility that the entity might withdraw the plan before the awards vest.

Again, as with market vesting conditions, an entity is required to recognise an expense irrespective of whether any non-vesting conditions are met. In consequence, where a share-based payment arrangement includes both vesting and non-vesting conditions, it is only failure to meet service conditions or non-market vesting conditions that will result in an adjustment to the cumulative expense recognised by the entity.

Where the entity or the counterparty can choose whether to meet a non-vesting condition (eg the need for the entity to continue to operate a SAYE plan, or a requirement for an employee to pay contributions towards the exercise price of a share-based payment such as monthly deductions from payroll in a SAYE scheme), any failure to meet that non-vesting condition during the vesting period must be treated as a cancellation with the immediate recognition of the total expense that would have been recognised in future periods had the non-vesting condition been satisfied.

This has particular significance in the UK for entities that operate SAYE schemes as any decision by employees to stop making monthly contributions to the savings scheme would result in an acceleration of the IFRS 2 expense that would otherwise have been recognised in future periods.

The accounting for vesting conditions (ie service, market and non-market) is not affected by the Amendment.

Effective Date

The Amendment is effective for accounting periods beginning on or after 1 January 2009 and is fully retrospective. However, in our view there will be an expectation that entities which have yet to develop a policy on the accounting for non-vesting conditions will adopt a policy that is consistent with IFRS 2 as amended. Although the Amendment has yet to be endorsed by the European Union, it is consistent with published IFRS and so may be adopted early by UK companies reporting in accordance with IFRS.

Action Required

Companies should ensure that they are aware of any non-vesting conditions which attach to share-based payment awards, and that they are aware of the changes being made to IFRS 2. In particular they should note that for awards already made:

- the fair value of options awarded in the past may need to be revised to take into account the effect of non-vesting conditions, with a consequential impact on the expense recognised in the income statement; and
- an expense should be recognised (as a prior period adjustment) in the first period IFRS 2 as amended is adopted for those situations where either the entity or counterparty failed to meet a non-vesting condition in an earlier period but was not accounted for at that time as a cancellation. In the UK, this is likely to be most relevant to entities that operate SAYE schemes.

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