Grant Thornton

Technical Accounting Alert

Amendment to AASB 2 – vesting conditions and cancellations

Background

The International Accounting Standards Board (IASB) has released its amendment to IFRS 2 Share-based Payment: Vesting Conditions and Cancellations.

The AASB released AASB 2008 – 1 which is identical to the IASB pronouncement on 7 February 2008, which amends AASB 2

It is effective for reporting periods beginning on or after 1 January 2009.

Overview

The amendment clarifies the definition of vesting conditions and the treatment of certain cancellations of share-based payments. The new rules distinguish vesting from non-vesting conditions and require the latter to be included in grant date measurement of the fair value of share-based payments. The amendment also requires that when either the entity or a counterparty can choose whether a non-vesting condition is met, failure to meet that non-vesting condition is to be treated as a cancellation.

A common example of a non-vesting condition is a share-based payment arrangement under which an employee has to provide funding during the vesting period, which is then used to exercise the options; i.e. a "Save As You Earn" (SAYE) scheme. Consequently, any such schemes operated by clients should be reviewed carefully for the impact of this amendment. Accounting systems may need to be amended to track the savings record of all employees in the scheme to ensure cancellations are identified and accounted for in accordance with this new requirement.

This amendment relates only to equity-settled share based payment arrangements.

Vesting conditions

Paragraph 19 of AASB 2 (AASB 2.19) states that a “grant of equity instruments might be conditional upon satisfying specified vesting conditions”. AASB 2, defines vesting conditions as “conditions that must be satisfied for the counterparty to become entitled to receive cash, other assets or equity instruments of the entity, under a share-based payment arrangement . . . . .” (see Appendix A of AASB 2).

Vesting conditions other than market conditions may not be considered in measuring fair value at the grant date of a share-based payment arrangement. Instead, they should be taken into account by adjusting the number of equity instruments an entity expects to issue under the share-based payment arrangement. Vesting conditions are therefore highly relevant in accounting for share-based payments.

AASB 2 has been clear that requirements for the other party (eg. the employees) to complete a specified period of service (service conditions) and requirements to meet or exceed specified performance targets and market conditions (performance conditions) are vesting conditions. However, it was silent on whether other types of condition included in share-based payment arrangements are vesting conditions. Common examples of other types of condition include requirements for employees to participate in a savings scheme and/or to acquire "matching shares". The amendment restricts vesting conditions to service conditions and performance conditions. This is consistent with paragraph BC171 of the Basis for Conclusions to AASB 2, which describes vesting conditions as those conditions that "ensure that the counterparty provides the services required to "pay" for the equity instruments issued" (emphasis added).

Non-vesting conditions

The amendment revised the definition to “conditions that determine whether the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity, under a share-based payment arrangement. Vesting conditions are either service conditions or performance conditions.”

The amendment also introduces the term “non-vesting conditions”. Non-vesting conditions are all requirements that do not represent service or performance conditions, but which have to be met in order for the counterparty to receive the share-based payment. Paragraph BC171A clarifies that the "feature that distinguishes a performance condition from a non-vesting condition is that the former has an explicit or implicit service requirement and the latter does not".

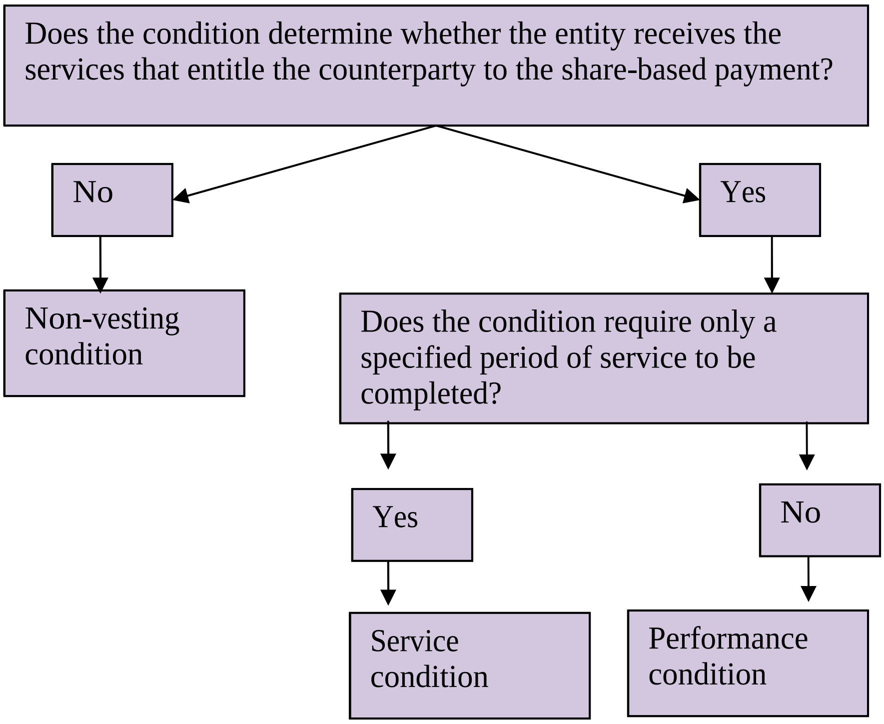
Similar to the treatment of market conditions, non-vesting conditions have to be taken into account in measuring fair value at the grant date. Accordingly, such non-vesting conditions do not affect the number of shares expected to vest for the purposes of AASB 2.20. Instead, any failure to meet the non-vesting conditions is treated as a cancellation, unless neither the entity nor the counterparty can choose whether the condition is met (see below). The definition of “vest” has been revised accordingly.

Examples of non-vesting conditions include, but are not limited to:

- share-based payment arrangements in which an employee has to provide funding during the vesting period, which is then used to exercise the options; and
- scenarios in which the entity can discontinue the share-based payment plan at its own discretion.

If neither the entity nor the counterparty can choose whether the non-vesting condition is met, e.g. a condition is linked to a commodity index target, failure to meet the condition is not treated as a cancellation. Instead it is treated in the same way as failure to meet a performance condition that is a market condition. In this case, when the condition is not met the entity continues to recognise the expense over the remainder of the vesting period in accordance with AASB 2.21. In practice, this type of non-vesting condition may not be common. However, it is important that all equity-settled share-based payment arrangements are reviewed carefully to identify both non-vesting conditions and vesting conditions.

The following table is taken from AASB 2008-1 and illustrates the treatement of vesting and non-vesting conditions.



Cancellations and settlements

The revised AASB 2 only deals with cancellations of share-based payments by the entity. The amended version of the standard now addresses cancellations by either the entity or the counterparty. When a counterparty chooses not to meet a non-vesting condition during the vesting period, this is treated as a cancellation (AASB 2.28A).

Any cancellation or settlement is accounted for as an acceleration of vesting (AASB 2.28 (a)). The amount that would otherwise have been recognised for services received over the remainder of the vesting period is expensed immediately. Any payment made by the entity on the cancellation or settlement of the grant is accounted for as a repurchase of an equity interest. This results in a deduction from equity. However, any payment that exceeds the fair value of granted equity instruments at the repurchase date are recognised as an expense (AASB 2.28 (b)).

The general treatment of cancellations is unchanged. However, AASB 2.28 (b) is extended to require the remeasurement to fair value of any liability component of the share-based payment arrangement at the date of the cancellation or settlement. Any payment made to settle the liability component shall be treated as a settlement of the liability.

Example

The following example has been added to the implementation guidance of AASB 2 to demonstrate the impact of the amendment.

IG Example 9A

Share-based payment with vesting and non-vesting conditions when the counterparty can choose whether the non-vesting condition is met

Background

An entity grants an employee the opportunity to participate in a plan in which the employee obtains share options if he agrees to save 25 per cent of his monthly salary of $400 for a three-year period. The monthly payments are made by deduction from the employee's salary. The employee may use the accumulated savings to exercise his options at the end of three years, or take a refund of his contributions at any point during the three-year period. The estimated annual expense for the share-based payment arrangement is $120.

After 18 months, the employee stops paying contributions to the plan and takes a refund of contributions paid to date of $1,800.

Application of requirements

There are three components to this plan: paid salary, salary deduction paid to the savings plan and share-based payment. The entity recognises an expense in respect of each component and a corresponding increase in liability or equity as appropriate. The requirement to pay contributions to the plan is a non-vesting condition, which the employee chooses not to meet in the second year. Therefore, in accordance with paragraphs 28(b) and 28A of AASB 2, the repayment of contributions is treated as an extinguishment of the liability and the cessation of contributions in year 2 is treated as a cancellation.

	Expense ($)	**Cash ($)**	**Liability ($)**	**Equity ($)**
Year 1				
Paid salary (75% *400*12)	3,600	(3,600)		
Salary deduction paid to the savings plan (25%400*12)	1,200		(1,200)	
Share based payment	**120**			**(120)**
TOTAL	**4,920**	**(3,600)**	**(1,200)**	**(120)**
Year 2				
Paid salary (75% *400*6) + (100% * 400*6)	4,200	(4,200)		
Salary deduction paid to the savings plan (25%*400*6)	600		(600)	
Refunds of contributions to the employee		(1,800)	1,800	
Share based payment (being acceleration of remaining expense) (120*3 – 120)	**240**			(240)
TOTAL	**5,040**	**(6,000)**	**(1,200)**	**(240)**

Effective date and transition

The amendment to AASB 2 is effective for reporting periods starting on or after 1 January 2009. Full retrospective application is required (AASB 2.62).

Early application is permitted, but must be disclosed.

Further information

For further information on any of the information included in this TA alert, please contact your local Grant Thornton Australia representative or a member of the National Audit Support team at NAS@grantthornton.com.au