On 20 June 2016, the IASB issued three amendments to IFRS 2 to eliminate diversity in practice in the classification and measurement of particular share-based payment transactions. The amendments are intended to eliminate diversity in practice in three main areas:

- The effects of vesting conditions on the measurement of a cash-settled share-based payment transaction
- The classification of a share-based payment transaction with net settlement features for withholding tax obligations
- The accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash-settled to equity-settled.

**Vesting conditions when measuring cash-settled share-based payment transactions**

IFRS 2 requires the terms and conditions of a cash-settled share-based payment transaction to be taken into account when valuing the liability. However, it has no specific guidance on whether a distinction is to be drawn between the treatment of non-vesting conditions and market conditions on one hand and that of other non-market vesting conditions on the other, as would be the case for an equity-settled transaction.

The lack of guidance has typically led to two approaches being applied in practice for cash-settled awards with non-market performance conditions:

- Analogise to the treatment of service conditions in Example 12 of the Implementation Guidance (IG) to IFRS 2, excluding the conditions from the fair value calculation, but basing the liability until vesting date on the current best estimate of the outcome of those conditions (as is the case for equity-settled share-based payments)
  
  Or

- Reflect the estimated outcome of the conditions, other than service conditions, as part of the fair value calculation
This amendment clarifies that the first of the two approaches needs to be followed for cash-settled share-based payments. In particular, it clarifies that:

- Vesting conditions (service and non-market performance conditions), upon which satisfaction of a cash-settled share-based payment transaction is conditional, are not taken into account when estimating the fair value of the cash-settled share-based payment at the measurement date. Instead, these are taken into account by adjusting the number of awards included in the measurement of the liability arising from the transaction.
- An entity recognises an amount for the goods or services received during the vesting period. That amount is measured based on the best available estimate of the number of awards that are expected to vest. The entity needs to revise the estimate if subsequent information indicates that the number of awards that are expected to vest differs from previous estimates. On the vesting date, the entity revises the estimate to equal the number of awards that have ultimately vested.
- Market and non-vesting conditions are taken into account when estimating the fair value of the cash-settled share-based payment granted. These are also taken into account when remeasuring the fair value at the end of each reporting period and at the date of settlement.
- The cumulative amount ultimately recognised for goods or services received, as consideration for the cash-settled share-based payment, is equal to the cash that is paid.

A new illustrative example, Example 12A, has also been included in the IG to IFRS 2.

**Classification of share-based payment transactions with net settlement features for withholding tax obligations**

In many jurisdictions, tax authorities levy taxes on share options and other share-based payment transactions with employees that give rise to a personal tax liability for the employee. In some cases, employers are required to withhold the tax due and to settle it with the tax authority on behalf of the employees.

This amendment only addresses the narrow situation where the net settlement arrangement is designed to meet an entity's obligation, under tax laws or regulations, to withhold a certain amount in order to meet the employee's tax obligation associated with the share-based payment. This amount is then transferred, normally in cash, to the tax authorities on the employee's behalf. To fulfil this obligation, the terms of the share-based payment arrangement may permit or require the entity to withhold the number of equity instruments that are equal to the monetary value of the employee's tax obligation from the total number of equity instruments that otherwise would have been issued to the employee upon exercise (or vesting) of the share-based payment (‘net share settlement feature’).

The IASB confirmed that under the current requirements in paragraph 34 of IFRS 2, such a transaction with net share settlement features has to be divided into an equity-settled component and a cash-settled component. Each component is then accounted for accordingly. However, in the Basis for Conclusions, the IASB noted that this could be a significant operational challenge for preparers and thus impose cost in excess of the benefit of distinguishing the two components.\(^1\) The IASB decided to add an exception to the requirements in IFRS 2 to remove the requirement to divide the transaction into two components, if certain conditions are met. Therefore, as an exception to the requirements in paragraph 34 of IFRS 2, such transactions will be classified in their entirety as equity-settled share-based payment transactions if they would have been so classified in the absence of the net share settlement feature. Paragraph 29 of IFRS 2 is applied to account for the withholding of shares to fund the payment to the tax authority in respect of the employee's tax obligation associated with the share-based payment. Therefore, the payment made will be accounted for as a

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\(^1\) IFRS 2.BC255J.
deduction from equity for the shares withheld, except to the extent that the payment exceeds the fair value at the net settlement date of the equity instruments withheld.

This exception is designed to alleviate the operational difficulties encountered by entities when they are required to divide a share-based payment transaction into an equity-settled element and a cash-settled element under the current requirements of IFRS 2. However, the IASB has clarified that the amendment only applies in the narrow situation described above where the entity has a withholding obligation under tax laws or regulations. Therefore, this amendment provides, in substance, a very specific exception.

Withholding shares to fund the payment to the tax authority could result in a significant difference between the amount paid and the amount at which the share-based payment was measured. The IASB decided to require an entity to disclose the estimated amount that it expects to transfer to the tax authority when this disclosure is necessary to inform users about the future cash-flow effects associated with the share-based payment. However, the IASB did not specify the basis for calculating such an estimate.2

A new illustrative example, Example 12B, has also been included in the IG to IFRS 2.

### How we see it

Other types of arrangements that are commonly seen in practice might appear similar, in substance, to the tax obligation covered by this amendment. For example, the terms of the share-based payment arrangement might require the counterparty to forfeit sufficient shares to meet the tax liability or the counterparty might have some choice over whether or not shares are withheld and/or directly sold in order to raise cash to settle the tax liability. However, the IASB has clarified that this amendment will not apply unless the net share settlement arrangement arises from the entity’s obligation under tax laws or regulations.

Careful analysis of net share settlement arrangements will continue to be required to determine whether part of the award should be treated as cash-settled or whether the arrangement is within the scope of this exception and, if so, whether it is appropriate to treat it as equity-settled in its entirety.

### Modifications to terms and conditions that change classification from cash-settled to equity-settled

IFRS 2 does not contain specific guidance for modifications that change the classification of share-based payment arrangements from cash settled to equity settled. Due to the lack of guidance, a number of approaches have been taken in practice to the recognition of any difference between the fair values of the cash-settled and equity-settled awards as at the date of modification. Some approaches recognise the difference immediately; others recognise any incremental value over the remaining vesting period.

With this amendment, the IASB has clarified that, if the terms and conditions of a cash-settled share-based payment transaction are modified, with the result that it becomes an equity-settled share-based payment transaction, the transaction is accounted for as an equity-settled transaction from the date of the modification.

Specifically:

- The equity-settled share-based payment transaction is measured by reference to the fair value of the equity instruments granted at the modification date and is recognised in equity, on the modification date, to the extent to which goods or services have been received.

- The liability for the cash-settled share-based payment transaction as at the modification date is derecognised on that date.
Any difference between the carrying amount of the liability derecognised and the amount recognised in equity on the modification date is recognised immediately in profit or loss. The remaining fair value of the equity instrument is recognised over the remaining vesting period of the equity-settled transaction.

The amendment also clarifies that if, as a result of the modification, the vesting period is extended or shortened, the application of its requirements must reflect the modified vesting period and that they also apply if the modification occurs after the vesting period.

The importance of this amendment is that it clarifies that any difference between the carrying amount of the liability derecognised and the amount recognised in equity on the modification date arising from such a modification should be recognised immediately in profit or loss. This means that, as well as recognising a debit for any incremental fair value, an entity will recognise an immediate credit in situations where the fair value of the modified award is lower than that of the cash-settled award as at the date of modification. In the Basis for Conclusions, the IASB noted that the recognition of any difference in fair value immediately in profit or loss for the vested portion of the award is consistent with the general measurement requirements for cash-settled share-based payment transactions. Moreover, the IASB noted that this is consistent with the requirements of IFRS 9 Financial Instruments and IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments for the extinguishment of a financial liability that has been extinguished fully or partially by the issue of equity instruments.3

A new illustrative example, Example 12C, has also been included in the IG to IFRS 2.

How we see it

Prior to the amendment, entities may only have recognised any incremental expense on modification (as would be the case for the modification of an equity-settled share-based payment transaction) and would not have recognised an immediate credit in profit or loss. Entities may also have adopted a policy of spreading any incremental value relating to the vested portion of the award over the remaining (post-modification) vesting period, rather than recognising the difference immediately as at the date of modification. In such cases, entities will need to revise their accounting policy for any modifications made following adoption of the amendment.

Effective date and transition

The amendments to IFRS 2 are effective for accounting periods beginning on or after 1 January 2018, but earlier application is permitted provided it is disclosed.

On adoption, prior periods will not be restated. More specifically:

- The amendments relating to the effects of vesting conditions on cash-settled share-based payments and the classification of share-based payments with net settlement features for withholding tax obligations apply to share-based payment transactions that are unvested, or vested but unexercised, at the date that an entity first applies the amendments and to those with a grant date on or after the date of first application of the amendment.

- The amendment relating to the modification of share-based payment transactions from cash-settled to equity-settled only applies to modifications that occur on or after the date that an entity first applies the amendments.

An entity may elect to apply the IFRS 2 amendments retrospectively, subject to the transitional provisions in paragraphs 53–59 of IFRS 2, in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, if and only if it is possible without hindsight. If an entity elects retrospective application, it must do so for all three amendments.

3 IFRS 2.BC237H.