IFRS 2: Share-based Payment Awards with Variable Vesting Periods

Extract, IFRS® Discussion Group Report on the Meeting – May 19, 2022

Share-based payments are commonly subject to one or more specified conditions. For example, 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.

Paragraph 21 of IFRS 2 *Share-based Payment* states, "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 services received from a counterparty (who satisfies all other vesting conditions) are recognized, irrespective of whether the market conditions are satisfied. Some examples of market conditions include:

(a) the entity must achieve a minimum share price by a specified date;

(b) the entity must achieve a total shareholder return target; or

(c) the entity's share price must outperform a share price index.

Where the length of the vesting period could vary, depending on when a performance condition is satisfied, paragraph 15(b) of IFRS 2 states that "the entity shall estimate the length of the expected vesting period at grant date, based on the most likely outcome of the performance condition. If the performance condition is a *market condition*, the estimate of the length of the expected vesting period shall be consistent with the assumptions used in estimating the fair value of the options granted; and it should not be subsequently revised."

The Group considered the pattern of expense recognition for a share-based payment scenario where a market condition is met earlier than expected.

Fact Pattern

- On January 1, 20X5, an employee receives a share-based payment award that vests if Entity A's share price hits a market performance condition ("target") either by December 31, 20X5 ("Date 1"), or by December 31, 20X6 ("Date 2").
- The employee could receive from zero to 100 per cent of the award depending on how much of the target is met. This means that:

    (a) the award has the potential to be 100 per cent vested on Date 1 if the full target is met on that date;

    (b) if the award does not fully vest on Date 1, the employee can earn any remaining amount on Date 2; and

    (c) the employee forfeits any amount not vested by Date 2.

Source: www.frascanada.ca/archive-meeting-reports

- Assume that Entity A initially estimated that zero per cent of the award would be earned on Date 1 and 100 per cent of the award would be earned on Date 2. However, on Date 1, Entity A meets the full target. Hence, 100 per cent of the award is vested on Date 1.

Issue: Should Entity A accelerate the expense recognition when the target is met on Date 1, or should the company continue to recognize the expense over the estimated two-year vesting period?

View A – Expense recognition should be accelerated

Proponents of this view think that accelerating the recognition of the expense is consistent with the requirements in IFRS 2 to recognize expenses over an option's vesting period. This would reflect the fact that Entity A has received all the services to which it is entitled in exchange for the awards at the point that the market condition is met. Proponents of this view think that it would be inappropriate to consider any services to be received for an award after it has vested.

View B – Expense recognition should not be accelerated

Proponents of this view think that IFRS 2 specifically prohibits revision of the vesting period when a performance condition is met earlier than estimated. Therefore, Entity A should not accelerate the expense recognition, even though it might better reflect the economics of the share-based payment award.

The Group's Discussion

Several Group members indicated there is diversity in practice in how entities interpret the guidance in IFRS 2 on accounting for share-based payment awards with variable vesting periods when a market condition is met earlier than initially estimated.

Most Group members agree with View A that the expense should be accelerated in these situations. They think accelerating expense recognition results in more useful information for financial statement users and is more in line with the overall guidance in IFRS 2 to recognize an expense as vesting conditions are met. One Group member pointed out that accelerating the expense recognition is not a change in the initial estimate, but rather a reflection of the fact that the vesting condition was met. As such, they question whether accelerating the expense recognition conflicts with the requirements in paragraph 15(b) of IFRS 2, which only states that the estimate of the length of the expected vesting period should not be revised.

Some Group members agreed with View B in that the expense should not be accelerated. They noted that IFRS 2 specifically prohibits revision of the vesting period when a market condition is met earlier than estimated.

One Group member noted that entities should consider disclosing their accounting policy regarding this issue if these types of arrangements are material.

Overall, the Group's discussion raised awareness of how entities might interpret the guidance in IFRS 2 on accounting for share-based payment awards with variable vesting periods when a market condition is met earlier than initially estimated. The Group recommended the AcSB discuss this issue and determine what, if any, further action is required.