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International Accounting Standards Board®

International Financial Reporting Interpretations Committee

IFRIC DRAFT INTERPRETATION D11

Changes in Contributions to Employee Share Purchase Plans

Comments to be received by 1 March 2005

IFRIC Draft Interpretation D11 *Changes in Contributions to Employee Share Purchase Plans* is published by the International Accounting Standards Board (IASB) for comment only. Comments on the draft Interpretation should be submitted in writing so as to be received by **1 March 2005**.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence. If commentators respond by fax or email, it would be helpful if they could also send a hard copy of their response by post. Comments should preferably be sent by email to: **CommentLetters@iasb.org** or addressed to:

D11 Comment Letters
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This draft Interpretation is available from www.iasb.org

INVITATION TO COMMENT

The International Accounting Standards Board's International Financial Reporting Interpretations Committee (IFRIC) invites comments on any aspect of this draft Interpretation *Changes in Contributions to Employee Share Purchase Plans*. Comments are most helpful if they indicate the specific paragraph to which they relate, contain a clear rationale and, when applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing so as to be received no later than **1 March 2005**.

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IFRIC DRAFT INTERPRETATION D11

Changes in Contributions to Employee Share Purchase Plans

IFRIC [draft] Interpretation X *Changes in Contributions to Employee Share Purchase Plans* ([draft] IFRIC X) is set out in paragraphs 1-7 and the Appendix. [Draft] IFRIC X is accompanied by a Basis for Conclusions. The scope and authority of Interpretations are set out in paragraphs 1 and 8-10 of the IFRIC *Preface*.

References

- IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- IFRS 2 *Share-based Payment*

Background

1 Under some employee share purchase plans (ESPPs), the employees regularly contribute a specified amount to the ESPP, usually by deduction from their salary. The employees' contributions are used as payment for the shares that the employees agree to buy under the plan. The 'Save-As-You-Earn' (SAYE) schemes that operate in the United Kingdom are an example of such ESPPs. The employee makes contributions into the plan over a specified period (eg three, five or seven years). At the end of the savings period, the employee decides whether to use those contributions to buy a specified number of shares, at a price that is typically set at a discount to the market price of the shares at the beginning of the savings period. The employee is not obliged to buy any shares, and is able to withdraw from the plan during or at the end of the savings period, and obtain a refund of the amounts previously paid into the plan (sometimes with interest).

Scope

2 This [draft] Interpretation applies to ESPPs within the scope of IFRS 2.

Issues

3 The issues addressed in the [draft] Interpretation are how to apply IFRS 2 to account for the following events:

(a) an employee ceases to contribute to an ESPP and, as a consequence, is no longer able to buy shares under the plan.

(b) as described in (a), except that the employee then starts to contribute to another ESPP, ie the employee changes from one ESPP to another.

Consensus

4 If an entity's employee, while remaining in the entity's employment, ceases to contribute to an ESPP and, as a consequence, is no longer able to buy shares under the plan, the entity shall account for this event as a cancellation. Therefore, in accordance with paragraph 28(a) of IFRS 2, the entity shall recognise immediately the amount that otherwise would have been recognised for services received over the remainder of the vesting period.

5 If an employee changes from one ESPP to another, the entity shall account for this event in accordance with paragraph 28(c) of IFRS 2. If the entity identifies the equity instruments granted to the employee under the new ESPP as replacements for the equity instruments granted to that employee under the original ESPP, the entity shall account for this event as a modification of the original grant of equity instruments. If the entity does not identify the new equity instruments granted under the new ESPP as replacements for the equity instruments granted under the original ESPP, the entity shall account for:

(a) the employee's cessation of participation in the original ESPP as a cancellation.

(b) the employee's commencement of participation in the new ESPP as a new grant of equity instruments.

Effective date

6 An entity shall apply this [draft] Interpretation for annual periods beginning on or after [date to be set at three months after the Interpretation is finalised].

Transition

7 An entity shall apply this [draft] Interpretation retrospectively in accordance with the requirements of IAS 8, subject to the transitional provisions of IFRS 2.

Appendix

Amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

The amendment in this [draft] appendix shall be applied for annual periods beginning on or after [date to be set at three months after the Interpretation is finalised].

A1 IFRS 1 *First-time Adoption of International Financial Reporting Standards* is amended as described below.

In paragraph 25B, the following sentence is inserted at the end of the paragraph:

> In this paragraph, references to IFRS 2 shall be read as meaning IFRS 2 as interpreted by [draft] IFRIC [X] *Changes in Contributions to Employee Share Purchase Plans*.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the draft Interpretation.

BC1 This Basis for Conclusions summarises the IFRIC's considerations in reaching its draft consensus. Individual IFRIC members gave greater weight to some factors than to others.

BC2 The issue addressed in the draft Interpretation is the accounting treatment of changes in employees' contributions to an ESPP. Specifically, the draft Interpretation addresses the effect of an employee ceasing to contribute to an ESPP, including situations in which the employee then starts to contribute to another plan, ie the employee changes from one ESPP to another. An employee might cease making contributions or change to another ESPP for various reasons. For example, if the share price has fallen to a level that is below the purchase price specified in the plan, the employee might decide against buying shares. Or the employee might have other financial commitments, and choose to cease making contributions for that reason. If a new ESPP is established, with a lower purchase price than an existing plan, the employee might choose to change to the more advantageous plan.

BC3 The IFRIC concluded that, if an employee ceases to contribute to the plan and, as a consequence, the employee is no longer able to buy shares under the plan, the entity shall account for this event as a cancellation under paragraph 28(a) of IFRS 2 *Share-based Payment*. The employee's contributions represent payment of the purchase price of the shares. By deciding to cease contributions, the employee has decided against buying the shares at the specified price, and it is this decision that leads to the cancellation of the employee's rights under the plan.*

BC4 Some might argue that the employee, rather than the entity, cancelled the employee's participation in the plan. IFRS 2 discusses cancellations in the context of cancellations by the entity, not the employee. However, it is debatable whether the employee's participation in the plan was cancelled by the entity or the employee. (The cancellation occurred as a consequence of the employee ceasing to contribute to the plan, but that potential consequence was specified by the entity when establishing the

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* As noted in paragraph 1 of the draft Interpretation, the employee might decide against buying shares at the end of the savings period. However, this event has no accounting effect (other than possibly a transfer within equity, ie from one component of equity to another), because it occurs after the employee's rights under the plan have vested.

plan.) In any event, the IFRIC concluded that the requirements of IFRS 2 relating to cancellations should be applied, irrespective of whether the entity or the employee cancelled the employee's participation in the plan.

BC5 The IFRIC also considered whether the requirement to contribute to the plan during the vesting period could be regarded as a vesting condition. If so, the cessation of employee contributions to the plan would be treated as a failure to satisfy a vesting condition under paragraphs 19 and 20 of IFRS 2.

BC6 However, the IFRIC concluded that a requirement to contribute to an ESPP is a requirement to pay the specified purchase price of the shares, and this requirement is not a vesting condition. IFRS 2 defines vesting conditions as follows:

> The 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. Vesting conditions include service conditions, which require the other party to complete a specified period of service, and performance conditions, which require specified performance targets to be met (such as a specified increase in the entity's profit over a specified period of time).

BC7 A requirement to pay the share purchase price is neither a service condition nor a performance condition. Although IFRS 2 does not explicitly limit vesting conditions to service and performance conditions, the discussion in the IFRS and its accompanying Basis for Conclusions, and in the illustrative examples in the Implementation Guidance, all relate to vesting conditions that are either service or performance conditions. The IFRIC concluded that vesting conditions do not include any conditions other than service or performance conditions.

BC8 The IFRIC also noted that treating a requirement to pay the specified purchase price as a vesting condition would undermine the requirements of IFRS 2. For example, under a typical share option plan, the employee pays the purchase price in a single amount at the time the option is exercised. If the employee does not exercise the option, the exercise price will not be paid. Treating the failure to pay the exercise price as a vesting condition would mean that the expense previously recognised for all options that expire unexercised would be reversed. This would result in exercise date accounting when the share price falls and the option is not exercised, and grant date accounting when the share price rises and the option is exercised.

BC9 Furthermore, IFRS 2 requires that if the entity cancels a grant of equity instruments during the vesting period, this must be accounted for as an acceleration of vesting. There is no reversal of the expense recognised previously and the entity is required to recognise immediately the amount that otherwise would have been recognised for services received over the remainder of the vesting period (IFRS 2, paragraph 28(a)). Although the entity might not have cancelled the entire ESPP, if an employee ceases to contribute to the plan, that employee's participation in the plan is cancelled.

BC10 The IFRIC also considered an alternative view to its own, whereby the cessation of an employee's contributions to an ESPP, without the employee changing to another plan, is not accounted for as a cancellation. Instead, the entity would continue to recognise the services received from the employee over the remainder of the vesting period. The cessation of contributions is substantially similar to a share option plan in which the employee chooses not to exercise an option, causing the option to lapse. The lapse of an unexercised option has no accounting effect (other than possibly a transfer within equity, ie from one component of equity to another). Similarly, under this alternative view, the cessation of contributions would also have no accounting effect. Hence, the entity would continue to recognise the services received from that employee over the remainder of the vesting period.

BC11 The IFRIC noted that the accounting effect of this alternative view would be similar to the treatment of a modification to the original ESPP. As noted in paragraph BC16, the IFRIC concluded that a change from one ESPP to another should be accounted for as a modification.

BC12 However, IFRS 2 specifies different accounting treatments for cancellations and modifications. When developing IFRS 2, the International Accounting Standards Board originally proposed in ED 2 *Share-based Payment* that if an entity cancels an employee share or share option grant during the vesting period, the entity should nevertheless continue to recognise services received over the remainder of the vesting period. Many respondents to ED 2 who commented on the treatment of cancellations disagreed with the proposals in ED 2. They commented that it was inappropriate to continue recognising an expense after a grant has been cancelled. After considering these comments, and given that the Board had decided to replace the units of service method proposed in ED 2 with the modified grant date method used in the US standard SFAS 123 *Accounting for Stock-Based Compensation*, the Board concluded that it should adopt the same approach as applied in SFAS 123 to cancellations.

BC13 Therefore, if the alternative view in paragraph BC10 were applied, the cancellation of an individual employee's participation in an ESPP would be accounted for in a manner that the Board had rejected for cancellations in general. It would also result in a different accounting treatment for cancellations, depending on whether the cancellation related to an individual employee (in which case the treatment described in paragraph BC10 would be applied) or to all employees participating in the plan (in which case the treatment described in paragraph BC9 would be applied). Hence, the IFRIC concluded that the alternative view in paragraph BC10 was not consistent with IFRS 2.

BC14 After considering the above points, the IFRIC concluded that if an employee ceases to contribute to an ESPP and, as a consequence, is no longer able to buy shares under the plan, this event should be accounted for as a cancellation.

BC15 The IFRIC also considered the accounting treatment of an employee ceasing to contribute to one plan and then starting to contribute to another plan. For example, an employee might change from one ESPP to another if the new ESPP provides the opportunity for the employee to buy shares at a lower purchase price than would be possible under the original ESPP. The IFRIC concluded that changing from one ESPP to another ESPP with a lower purchase price has the same economic effect as a repricing. Also, permitting the employee to change from one plan to another is analogous to the entity deciding to cancel one plan and replace it with a new plan. IFRS 2 requires repricing, and the replacement of one plan with another, to be accounted for as a modification.

BC16 The IFRIC therefore concluded that, if an employee changes from one ESPP to another, the requirements of paragraph 28(c) of IFRS 2 apply. For example, if the entity identifies the equity instruments granted to the employee under the new ESPP as replacements for the equity instruments granted to that employee under the original ESPP, the entity should account for this event as a modification of the original grant of equity instruments.

BC17 The IFRIC noted that the above conclusions are consistent with US guidance on similar issues that arise in relation to US ESPPs, ie FASB Technical Bulletin 97-1 *Accounting under Statement 123 for Certain Employee Stock Purchase Plans with a Look-Back Option.* This guidance is of interest because the modified grant date accounting method in IFRS 2 is the same as the accounting method in SFAS 123.