In this newsletter:

1. IASB publishes exposure draft on improvements project 2010-12 cycle
2. IFRS/HKFRS quiz: share-based payments
3. Contacts

IASB publishes exposure draft on improvements project 2010-12 cycle

What is the issue?
The IASB has published an exposure draft for the 2010-12 cycle of the annual improvements project, with amendments that would affect ten standards.

The proposed amendments affect IFRS 2, IFRS 3, IFRS 8, IAS 1, IAS 7, IAS 12, IAS 16, IAS 24 and IAS 36. They are expected to apply for annual periods beginning on or after 1 January 2014 except for the amendment to IFRS 3, which applies to business combinations on or after 1 January 2015.

The Board is asking for comments on the transition provisions and the effective date of each proposed amendment, for the first time. The deadline for comments is 5 September 2012.

The following is a summary of the proposed amendments.

IFRS 2, ‘Share-based payment’
The amendment clarifies the definition of ‘vesting conditions’ as either a ‘performance condition’ or a ‘service condition’ and separately defines those terms. A performance condition requires a specified period of service and specified performance targets to be met while the services are being performed. A service condition requires a specified period of service to be completed but does not include a performance target.

IFRS 3, ‘Business combinations’
The amendment clarifies that contingent consideration that meets the definition of a financial instrument is classified either as equity or a financial liability in accordance with IAS 32. The reference to other IFRSs is removed. The amendment further clarifies that contingent consideration that is classified as a financial liability is subsequently measured at fair value, with changes in fair value being presented in profit or loss or in other comprehensive income, depending on the requirements of IFRS 9. The amendment includes consequential amendments to IFRS 9.
IFRS 8, ‘Operating segments’
There are two amendments to IFRS 8:
• Entities are required to disclose the factors used to identify
  the reportable segments when operating segments have been
  aggregated.
• The Board has clarified that the reconciliation of a segment’s
  assets to the entity’s assets is only required when details of
  segment assets are reported to the chief operating decision-
  maker.

IFRS 13, ‘Fair value measurement’
The amendment to the Basis for Conclusions to IFRS 13 clarifies
that the Board did not intend the changes made to IFRS 9 and
IAS 39 by IFRS 13 to remove the ability of entities to measure
short-term receivables and payables without discounting when
the effect of discounting is not material.

IAS 1, ‘Presentation of financial statements’
The amendment clarifies that a liability is classified as non-
current if the entity expects, and has the discretion, to re-
finance or roll over an obligation for at least 12 months after the
reporting period under an existing loan facility with the same
lender on the same or similar terms.

IAS 7, ‘Statement of cash flows’
The amendment clarifies that the classification of capitalised
interest follows the classification of the asset to which the interest
payments were capitalised.

IAS 12, ‘Income taxes’
The amendment clarifies how an entity recognises deferred tax
assets for unrealised losses.

If tax law restricts the use of tax losses to income of a certain
type, the entity assesses whether it expects sufficient taxable
income of that type to recognise a deferred tax asset.

Taxable profit against which an entity assesses a deferred
tax asset for recognition is the amount before reversal of any
deductible temporary differences. A tax-planning opportunity is
an action that creates or increases taxable profit.

Examples are included in the ED to illustrate these clarifications.

IAS 16, ‘Property, plant and equipment’, and
IAS 38, ‘Intangible assets’
The amendment clarifies how the accumulated depreciation
should be calculated at the date of valuation when the revaluation
model is applied.

IAS 24, ‘Related party disclosures’
The amendment extends the definition of ‘related party’ to
include entities that provide management services to the
reporting entity. Disclosure is required of amounts charged as an
expense for management services provided by such entities.

IAS 36, ‘Impairment of assets’
The amendment clarifies that the disclosures required when
there has been a material impairment loss or reversal in the
period are the same whether the recoverable amount has been
estimated using ‘value in use’ or ‘fair value less costs of disposal’.

Am I affected?
The proposed amendments are seemingly minor changes.
However, if you are affected, the impact could be significant.

What do I need to do?
Please read the proposed amendments in their entirety to
determine the impact to you and consider commenting on the
proposed amendments.
Identifying share-based payments is not as straightforward as you might expect. It is broader than simply giving shares or share options to employees. IFRS/HKFRS 2 was issued in 2004, but some entities still struggle with its application. You need to understand the basics if you are going to account for them properly. The following questions help you to assess your knowledge.

**Q1: Assess the following statements on the scope of IFRS/HKFRS 2 as ‘true’ or ‘false’:**

a. A transaction with an employee in his/her capacity as a shareholder of the entity is not a share-based payment transaction in the scope of IFRS/HKFRS 2.

b. A share-based payment transaction may be settled by another group entity (or a shareholder of any group entity) on behalf of the entity receiving or acquiring the goods and services. However, a written agreement between all the parties involved is needed for the transaction to be in the scope of IFRS/HKFRS 2.

c. Management has to identify the goods or services received in order to account for the issue of shares as a share-based payment transaction under IFRS/HKFRS 2.

d. A transaction is in the scope of IFRS/HKFRS 2 if an entity acquires services by incurring a liability to transfer cash to the supplier of those services for amounts that are based on the value of equity instruments of the entity.

**Q2: How you classify a share-based payment has an impact on how you measure it. What are the possible classifications for share-based payment transactions under IFRS/HKFRS 2?**

a. Share-settled, share option-settled, cash-settled.

b. Equity-settled, cash-settled, share-based payment transactions with a settlement choice.

c. Entity-settled, group-settled.

d. Vested, not-vested.

**Q3: When should you recognise the expense for an equity-settled share-based payment transaction that requires service from an employee to earn the award?**

a. When the parties have a shared understanding of the arrangement.

b. During the period when the services are received.

c. At the end of the required service period.

d. When the shares are provided to the employee or when the options are exercised by the employee.

**Q4: The grant date is important for measuring equity-settled share-based payment transactions because it is the measurement date. On 15 March 2010, the entity explained the key terms, including vesting conditions of its new equity-settled share-based payment plan. The awards vest on 15 March 2012. The remuneration committee approved the plan only upon vesting. When is the grant date?**

a. 15 March 2010.

b. 15 March 2012.

**Q5: The vesting period is the period during which all the vesting conditions in a share-based payment arrangement are satisfied (and during which the expense is recognised). How long is the vesting period if management grants equity-settled share options to its employees that are forfeited if the employees leave within two years, and can be exercised between three years and five years after the grant date?**

a. It is an equity-settled share-based payment, therefore it vests immediately.

b. Two years.

c. Three years.

d. Five years.

**Q6: An entity grants 1,000 equity-settled share options to its employees on 1 January 2011. The options vest over two years: half at the end of the first year and half at the end of the second year. This is often referred to as ‘tranchd’ or ‘graded’ vesting. How much should management charge to profit or loss in the first year if all the awards are expected to vest? The fair value of the options on 1 January 2011 (grant date) is C10.**

a. Zero (the awards are not yet vested).

b. 500 x C10 = C5,000.

c. (500 + 250) x C10 = C7,500.

**Q7: How should management account for a share-based payment where the counterparty may choose the settlement method?**

a. As a compound instrument. The value of the debt instrument is established first, and the equity component is measured at the difference between that amount and the value of the entire instrument.

b. It depends on the entity’s past practice. If its past practice is cash settlement, it should recognise a liability; otherwise, the award is classified as equity.

c. The entity cannot avoid the cash payment, so the entire award is presented as a liability.
Q8: How should management account for the cancellation of an equity-settled share-based payment during the vesting period?

a. It reclassifies the previously accumulated entries within equity.

b. No reclassification is necessary, and no further entries are required.

c. The cancellation is an acceleration of vesting, and the amount that would otherwise have been recognised over the remainder of the vesting period is recognised in profit or loss immediately.

Q9: One year after granting unvested shares to the employees, management increases the vesting period from three to six years. This is a modification to the award that is not beneficial to the employee (requiring the employees to work longer to earn the award). Assume that there are no changes in other assumptions. How much expense should be charged to profit or loss in year two if the charge in year one was C100?

a. C50 because the vesting period has doubled, so the annual charge is halved.

b. C100 because the modification is non-beneficial, so management should continue to account for the original grant as if the modification had not occurred.

c. \((C300-C100)/5=C40\) because the remaining charge should be spread over the remaining vesting period.

d. Zero because the cumulative charge at the end of year two should be C100 \((=C300/6 \times 2)\), so no expense should be charged in year two.

Q10: How should a share-based payment be classified in a subsidiary’s separate financial statements if the parent company grants its own shares to the employees of the subsidiary, and the subsidiary has no obligation to settle the award?

a. The share-based transaction is not recorded in the separate financial statements because it is granted by the parent, and there is no need for classification at the subsidiary’s level.

b. Equity-settled, as the subsidiary has no obligation to settle in cash.

c. Cash-settled if the subsidiary expects to reimburse the parent.

d. Cash-settled, as the parents grants its own (and not the subsidiary’s) shares.

Answers

Question 1: A and D – IFRS/HKFRS 2 paragraphs 2-6 define the scope of the standard and refer specifically to (a) and (d). The statements in (b) and (c) are false. Under (b), there is no need for a written three-party agreement if the share-based transaction is settled by another group entity. Under (c), other circumstances might indicate that goods or services have been (or will be) received even in the absence of specifically identifiable goods or services.

Question 2: B – IFRS/HKFRS 2 distinguishes between equity-settled and cash-settled share-based payment transactions and also identifies a third category of share-based payment transactions with a settlement choice. This last one can be further split into two subgroups, depending on which party has the settlement choice. Getting the classification right is key because it drives the measurement of the award.

Question 3: B – IFRS/HKFRS 2 requires the expense to be recognised when the services are provided.

Question 4: B – IFRS/HKFRS 2 states that having a shared understanding of the terms of the share-based payment transaction is not sufficient to have a grant date. If the transaction is subject to an approval process, the grant date is the date when the approval is obtained. Even though the award does not have a grant date until vesting is confirmed, an expense should be recognised over the two-year service period because the employees are working in expectation of receiving the award.

Question 5: B – The share-based payment has a two-year service vesting condition (that is, the employee has to remain in the employment of the entity for two years). The vesting period is therefore two years, and the related expense will be recognised during this period. The limitation on when the option can be exercised is a post-vesting restriction, which affects the value of the award but not the vesting period.

Question 6: C – IFRS/HKFRS 2 requires the expense to be calculated separately for each tranche over the vesting period for that tranche. That will result in the expense being front-loaded. The answer is C500 x 10 for the first tranche plus C250 x 10 for the second tranche.

Question 7: A – It is a compound instrument. The entity's past practice, referred to in answer (b), should be considered if the entity not the counterparty has the settlement choice.

Question 8: C – The recognition of the charge is accelerated if an award is cancelled.

Question 9: B – The entity should continue to account for the original grant as if the modification had not occurred when a modification is not beneficial.

Question 10: B – The subsidiary should account for the award as an equity-settled share-based payment because it has no obligation to settle the award.
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